

Emerging Europe: Political Risk On The Rise

August 2017



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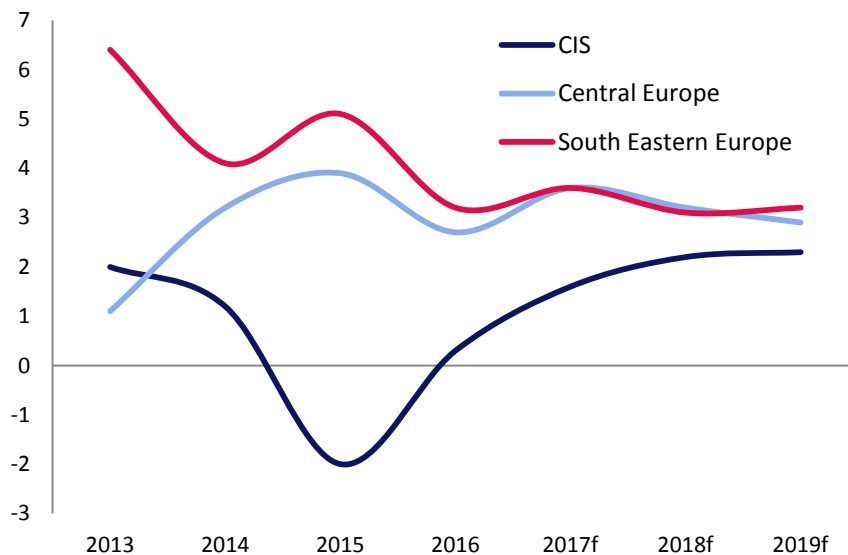
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Emerging Europe: Political Risk On The Rise

- Rising political risk in major emerging European markets will weigh on growth and investor sentiment to varying degrees.
- Poland and Hungary are currently subject to EU infringement proceedings, although severely punitive actions remain unlikely at this stage. Political tensions and populist government policymaking can nevertheless negatively impact growth and FDI flows.
- An increasingly authoritarian political environment in Turkey will weigh on long-term growth potential.
- Elevated tensions between Russia and the West will limit the former's recovery, with negative knock-on effects for Ukraine.

Stable Growth Outlooks...

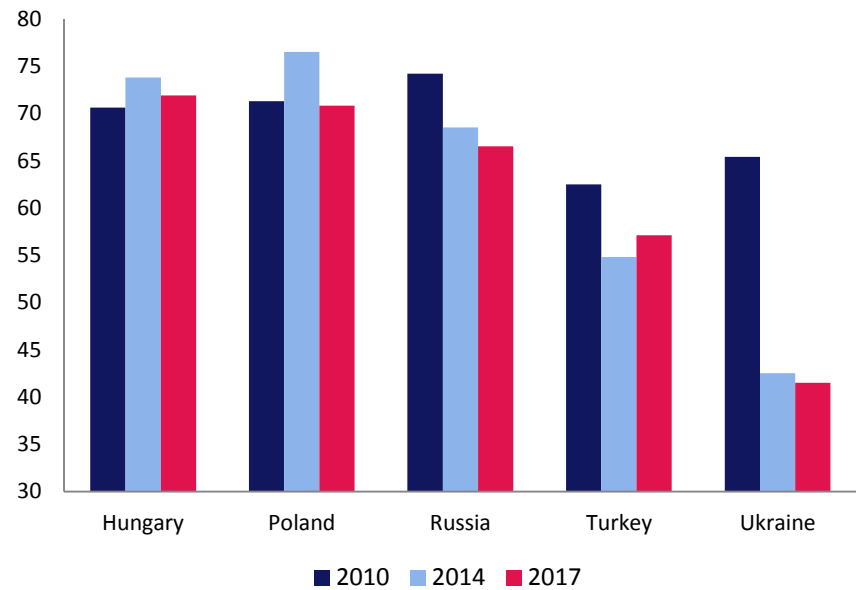
Real GDP, % chg y-o-y



f = BMI forecast. Source: Eurostat, National Sources, BMI

..But Political Risk Mounting

BMI Short-Term Political Risk Index



Note 100 is the best score available, 0 the worst. Source: BMI

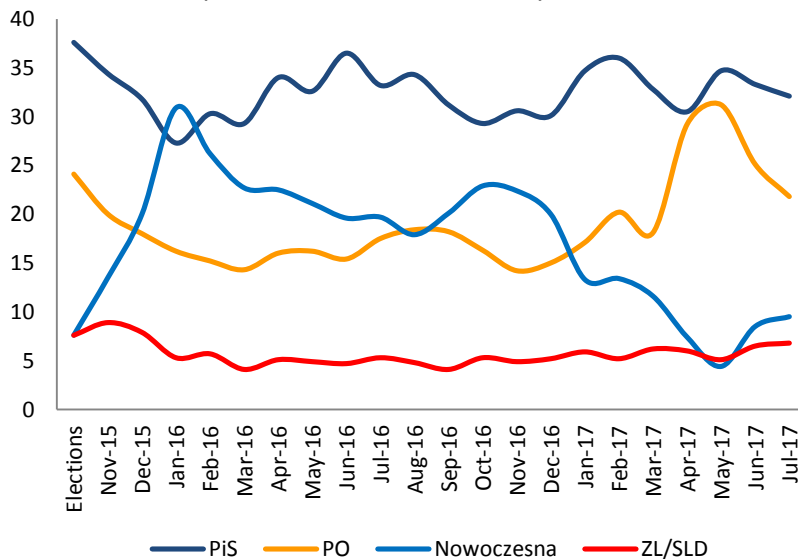
Poland

Punitive EU Action A Rising Threat

- Tensions between Poland and the EU will remain high as the former continues to breach EU laws in an effort to centralise power.
- The ruling PiS party remains popular and is unlikely to rescind controversial policies, including efforts to politicise judiciary.
- The EU launched infringement procedures in July and has warned it may activate Article 7 of the the Lisbon treaty (“nuclear” option) revoking voting rights, but would require a unanimous vote from EU member states which Hungary has pledged to block.
- A politicised judiciary and divergence from EU governance norms will nonetheless be red flags for investors.

PiS Yet To Take A Beating In Polls

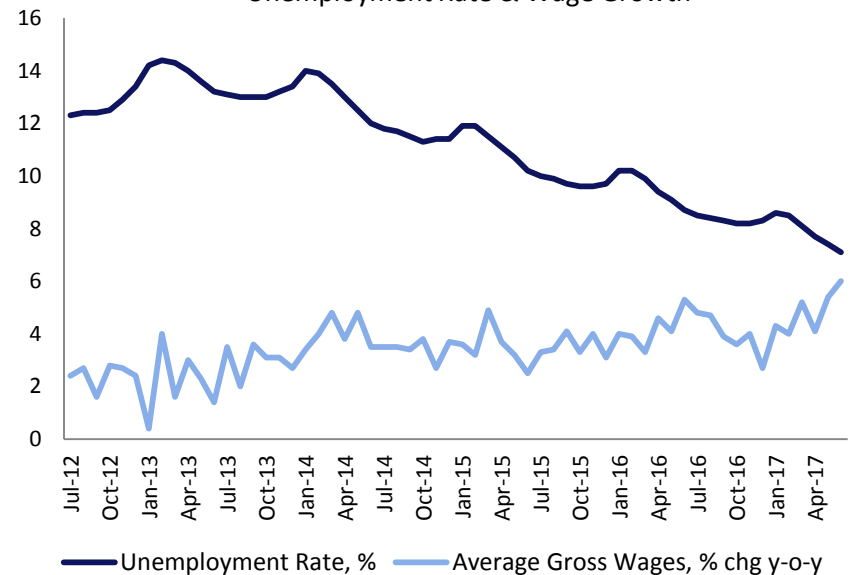
Opinion Poll For Parliamentary Election, %



Source: Ibris, BMI

Labour Market Supporting PiS Popularity

Unemployment Rate & Wage Growth



Source: Bloomberg, BMI

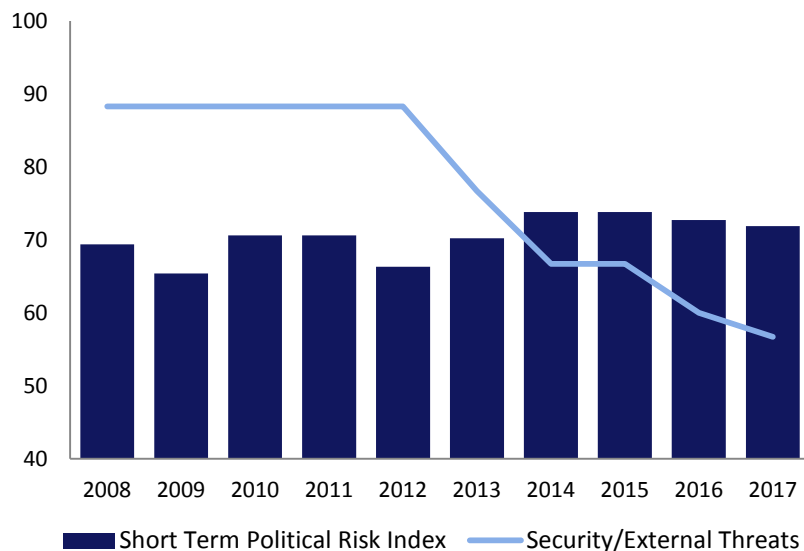
Hungary

Prime Minister Orban In The EU's Crosshairs

- Prime Minister Orban has taken an increasingly populist and nationalist stance, eroding democratic principles and the rule of law.
- Erratic government policymaking is cited as major concern for foreign investors, and will limit FDI inflows.
- EU infringement proceedings against Hungary's asylum and higher education policies fit into the trend of rising political risk, although the ruling Fidesz party remains very popular and is unlikely to cede to EU demands.
- Hungary is heavily reliant on EU structural funding, although the EU has limited ability or willingness to restrict these at this time.

EU Relations Weighing On Risk Outlook

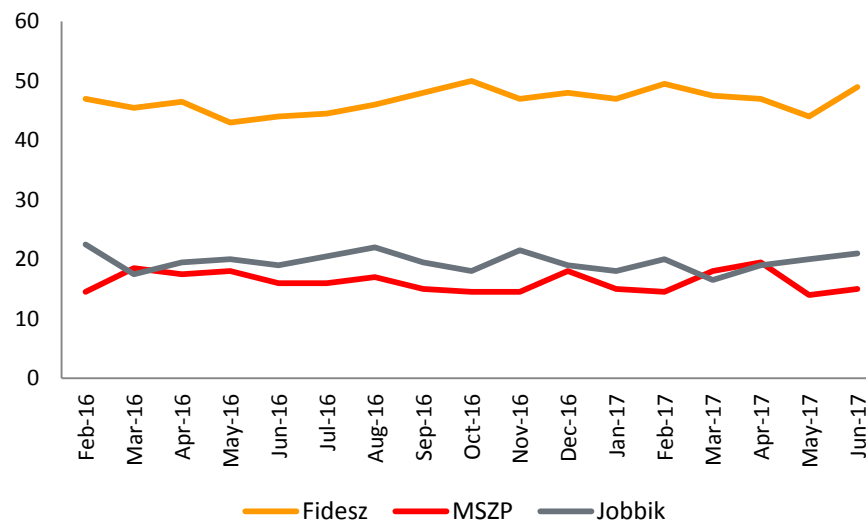
BMI Short Term Political Risk Index



Source: BMI. Note 100 being the best score available, 0 the worst

Orban Still Heavy Favourite

Voting Intentions At 2018 Election, % of respondents



Source: Bloomberg, BMI

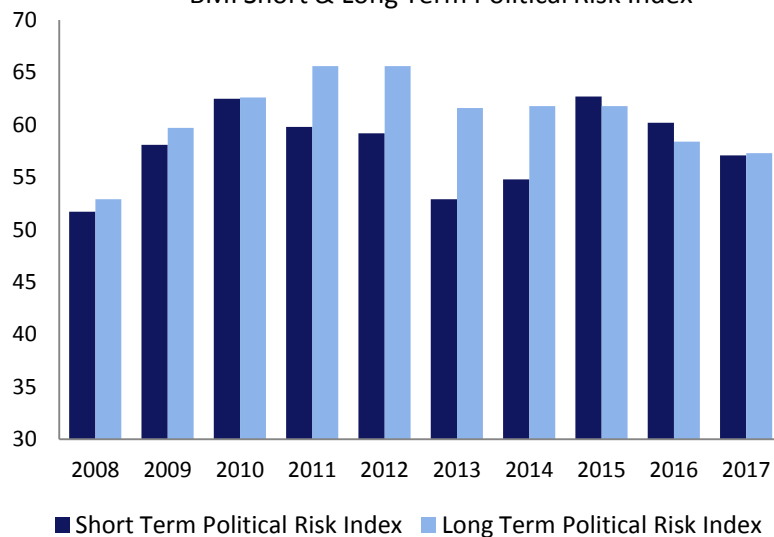
Turkey

State Of Emergency Extension To Accelerate Authoritarian Slide

- The April 2017 referendum enforcing an executive presidency, as well as the ongoing state of emergency following the July 2016 coup attempt, will see Turkey continue to move in an authoritarian direction.
- President Erdogan will use the extensive powers granted to him to suppress opposition in the public and private sectors.
- The structural reform outlook and business environment have suffered, weighing on long-term growth potential.
- EU-Turkey relations will remain icy, and a permanent cessation of accession talks cannot be ruled out.

Political Outlook Deteriorating

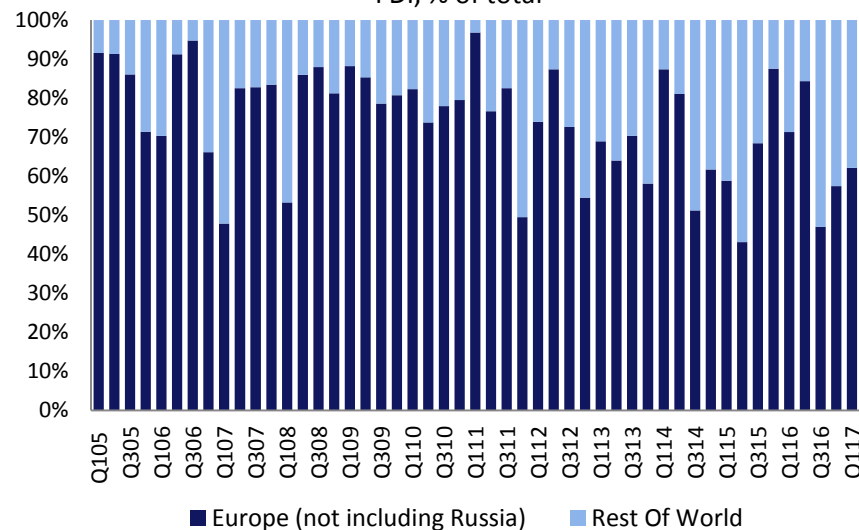
BMI Short & Long Term Political Risk Index



Note 100 being the best score available, 0 the worst. Source: BMI

Europe A Vital Source Of FDI

FDI, % of total



Source: CBRT, BMI

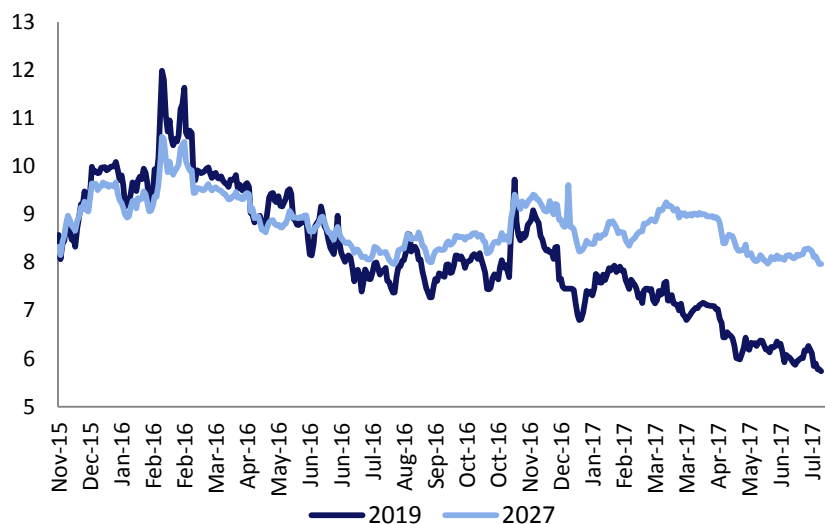
Ukraine

Uncertainty Over Structural Reform Outlook Prominent

- Sluggish structural reform implementation and heightened security risks will keep political risk in Ukraine elevated.
- The separatist conflict in the Donbas has escalated, with negative implications for political stability and growth potential.
- Key structural reform measures are being delayed, putting IMF support and the timely dispersal of funding at risk.
- While the macro backdrop has improved markedly in recent years, stability cannot yet be assured without external support.
- Our core view remains that the government will serve its full-term until 2019, although risks of a snap election have risen.

Investors Remain Sanguine For Now

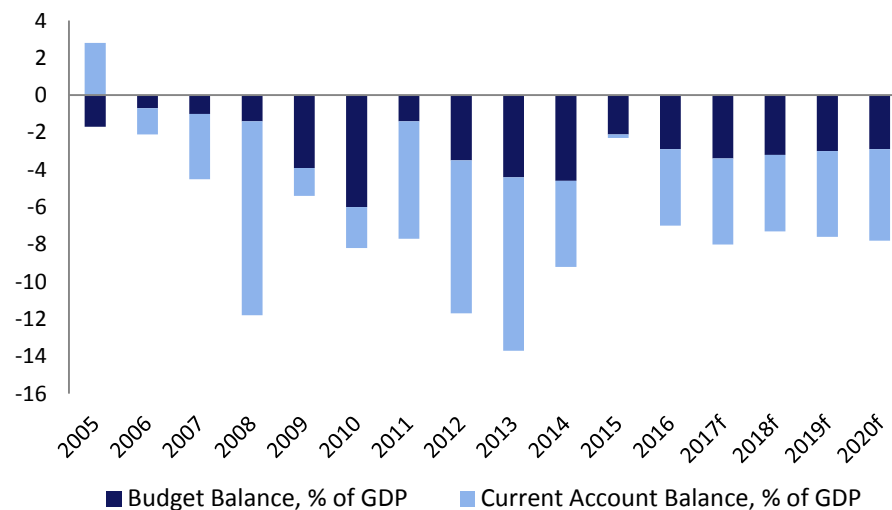
Government USD Eurobond Yields, %



Source: Bloomberg, BMI

External Financing Needs Remain Large

Budget And Current Account Balance, % of GDP



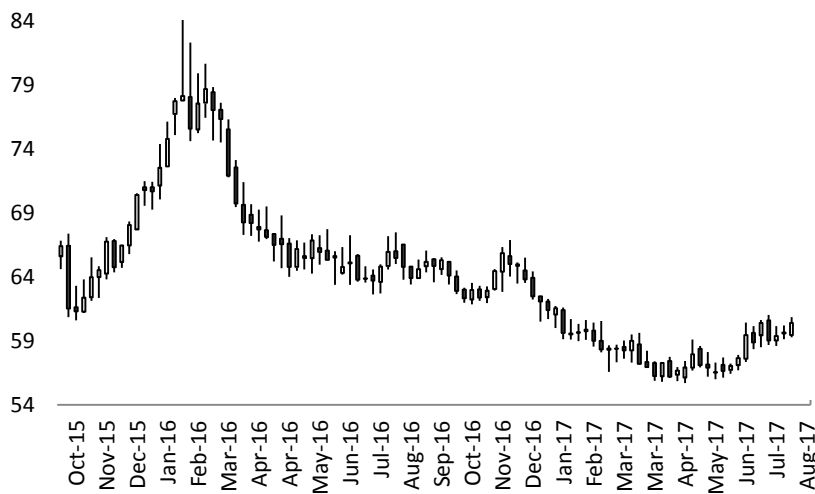
f = BMI forecast. Source: Bloomberg, BMI

Russia

Risks Rising From West-Russia Relations

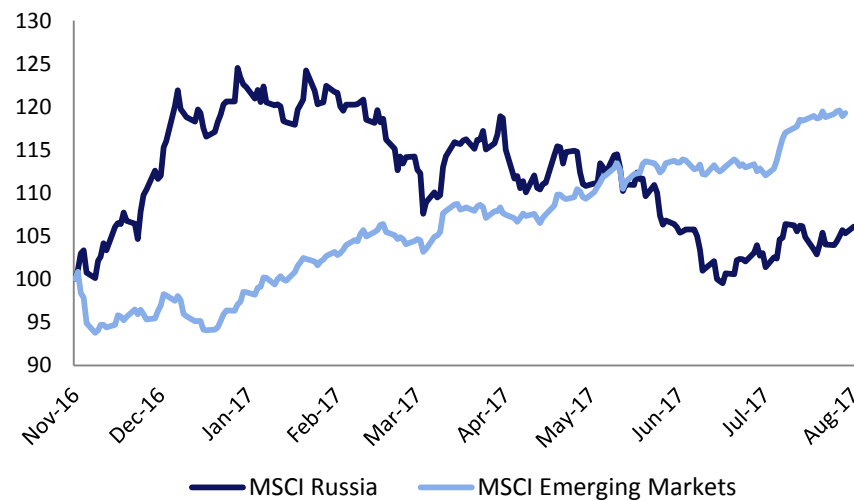
- There is little chance of a near-term rapprochement between Russia and the West following the extension and expansion of both EU and US sanctions in recent months, limiting the prospects for economic integration and Russia's recovery.
- Russian election interference has further inflamed tensions, while the conflict in eastern Ukraine shows few signs of abating.
- New US legislation will raise economic headwinds by increasing the number of targeted sectors and tightening sanctions on energy.
- Russia's growing frustrations with the sanctions regime could prompt it to behave more aggressively in terms of foreign policy.

Tensions Help Put An End To Appreciation
Exchange Rate, RUB/USD



Source: Bloomberg, BMI

Optimism Following Trump Has Quickly Faded
MSCI Indices, Normalised to 7 November 2016 = 100



Source: Bloomberg, BMI

BMI vs Consensus Forecasts

| Country | 2017 Real GDP Growth, % | | |
|----------------|-------------------------|---------------------|----------------------|
| | BMI | Bloomberg Consensus | Consensus Last Month |
| Austria | 2.0 | 1.9 | 1.8 |
| Azerbaijan | 0.2 | 0.3 | 0.3 |
| Belarus | 0.1 | 0.3 | 0.3 |
| Belgium | 1.6 | 1.7 | 1.6 |
| Croatia | 2.9 | 2.7 | 2.9 |
| Czech Republic | 2.9 | 2.7 | 2.7 |
| Denmark | 2.0 | 1.6 | 1.6 |
| Eurozone | 1.8 | 2.0 | 1.9 |
| Finland | 2.8 | 1.5 | 1.5 |
| France | 1.4 | 1.5 | 1.4 |
| Germany | 1.8 | 1.9 | 1.8 |
| Greece | 0.8 | 1.0 | 0.8 |
| Hungary | 3.5 | 3.5 | 3.5 |
| Ireland | 4.0 | 3.9 | 4.0 |
| Italy | 1.1 | 1.2 | 1.2 |
| Kazakhstan | 3.0 | 2.8 | 2.6 |
| Luxembourg | 3.3 | 3.5 | 3.4 |
| Netherlands | 2.0 | 2.2 | 2.2 |
| Norway | 1.6 | 1.7 | 1.6 |
| Poland | 4.1 | 3.8 | 3.8 |
| Portugal | 2.3 | 2.5 | 2.5 |
| Romania | 4.6 | 4.2 | 4.1 |
| Russia | 1.2 | 1.4 | 1.3 |
| Slovakia | 3.1 | 3.2 | 3.2 |
| Spain | 3.0 | 2.9 | 2.8 |
| Sweden | 2.8 | 2.6 | 2.6 |
| Switzerland | 1.6 | 1.4 | 1.4 |
| Turkey | 3.5 | 3.9 | 3.7 |
| Ukraine | 2.0 | 2.0 | 2.0 |
| United Kingdom | 1.5 | 1.6 | 1.6 |

| Currency | End 2017 Exchange Rate | | |
|----------|------------------------|---------------------|----------------------|
| | BMI | Bloomberg Consensus | Consensus Last Month |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| AZN/USD | 1.75 | - | - |
| BYR/USD | 2.12 | - | - |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| HRK/USD | 6.77 | - | - |
| CZK/EUR | 26.10 | 26.00 | 26.05 |
| DKK/USD | 6.77 | 6.71 | 6.77 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| HUF/EUR | 310.00 | 310.00 | 310.00 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| KZT/USD | 330.00 | 315.00 | 310.00 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| NOK/USD | 8.57 | 8.04 | 8.27 |
| PLN/EUR | 4.20 | 4.20 | 4.20 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| RON/EUR | 4.56 | 4.53 | 4.54 |
| RUB/USD | 59.50 | 60.00 | 59.35 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| USD/EUR | 1.10 | 1.15 | 1.12 |
| SEK/USD | 8.64 | 8.29 | 8.53 |
| CHF/USD | 1.00 | 0.97 | 0.98 |
| TRY/USD | 3.60 | 3.65 | 3.65 |
| UAH/USD | 28.00 | 27.50 | 28.00 |
| USD/GBP | 1.27 | 1.29 | 1.27 |

BMI vs Consensus Forecasts

| Country | 2017 Average Inflation, % | | |
|-------------|---------------------------|---------------------|----------------------|
| | BMI | Bloomberg Consensus | Consensus Last Month |
| Austria | 1.7 | 1.9 | 1.9 |
| Azerbaijan | 12.0 | 12.0 | 12.0 |
| Belarus | 10.3 | 10.0 | 10.0 |
| Belgium | 2.0 | 2.1 | 2.2 |
| Croatia | 1.1 | 1.2 | 1.3 |
| Czech | 2.4 | 2.3 | 2.3 |
| Denmark | 1.1 | 1.2 | 1.2 |
| Eurozone | 1.5 | 1.5 | 1.6 |
| Finland | 1.2 | 1.0 | 1.1 |
| France | 1.0 | 1.2 | 1.3 |
| Germany | 1.6 | 1.7 | 1.7 |
| Greece | 0.7 | 1.2 | 1.1 |
| Hungary | 2.2 | 2.5 | 2.5 |
| Ireland | 0.8 | 0.7 | 0.7 |
| Italy | 1.0 | 1.4 | 1.4 |
| Kazakhstan | 7.8 | 7.5 | 7.4 |
| Luxembourg | 1.7 | 2.0 | 2.0 |
| Netherlands | 1.2 | 1.4 | 1.4 |
| Norway | 2.2 | 2.0 | 2.1 |
| Poland | 1.5 | 2.0 | 2.0 |
| Portugal | 1.1 | 1.5 | 1.5 |
| Romania | 1.4 | 1.3 | 1.2 |
| Russia | 4.3 | 4.3 | 4.2 |
| Slovakia | 1.5 | 1.4 | 1.4 |
| Spain | 1.3 | 1.9 | 2.1 |
| Sweden | 1.6 | 1.7 | 1.7 |
| Switzerland | 0.8 | 0.5 | 0.5 |
| Turkey | 9.3 | 10.6 | 10.6 |
| Ukraine | 12.2 | 12.2 | 12.1 |
| UK | 2.6 | 2.7 | 2.7 |

| Country | End-2017 Policy Interest Rate, % | | |
|-------------|----------------------------------|---------------------|----------------------|
| | BMI | Bloomberg Consensus | Consensus Last Month |
| Austria | 0.00 | 0.00 | 0.00 |
| Azerbaijan | 15.00 | - | - |
| Belarus | 20.00 | - | - |
| Belgium | 0.00 | 0.00 | 0.00 |
| Croatia | 3.00 | 2.90 | 2.85 |
| Czech | 0.25 | 0.25 | 0.25 |
| Denmark | 0.00 | -0.65 | -0.65 |
| Eurozone | 0.00 | 0.00 | 0.00 |
| Finland | 0.00 | 0.00 | 0.00 |
| France | 0.00 | 0.00 | 0.00 |
| Germany | 0.00 | 0.00 | 0.00 |
| Greece | 0.00 | 0.00 | 0.00 |
| Hungary | 0.90 | 0.85 | 0.85 |
| Ireland | 0.00 | 0.00 | 0.00 |
| Italy | 0.00 | 0.00 | 0.00 |
| Kazakhstan | 9.50 | - | - |
| Luxembourg | 0.00 | 0.00 | 0.00 |
| Netherlands | 0.00 | 0.00 | 0.00 |
| Norway | 0.50 | 0.50 | 0.50 |
| Poland | 1.50 | 1.50 | 1.50 |
| Portugal | 0.00 | 0.00 | 0.00 |
| Romania | 1.75 | 1.85 | 1.90 |
| Russia | 8.25 | 8.25 | 8.15 |
| Slovakia | 0.00 | 0.00 | 0.00 |
| Spain | 0.00 | 0.00 | 0.00 |
| Sweden | -0.50 | -0.50 | -0.50 |
| Switzerland | -0.75 | -0.75 | -0.75 |
| Turkey | 8.00 | 8.40 | 8.25 |
| Ukraine | 11.50 | 10.45 | 10.40 |
| UK | 0.25 | 0.30 | 0.30 |

Emerging Europe Data Pack

