

Europe Macroeconomic Update:

War, Recession & Other Things

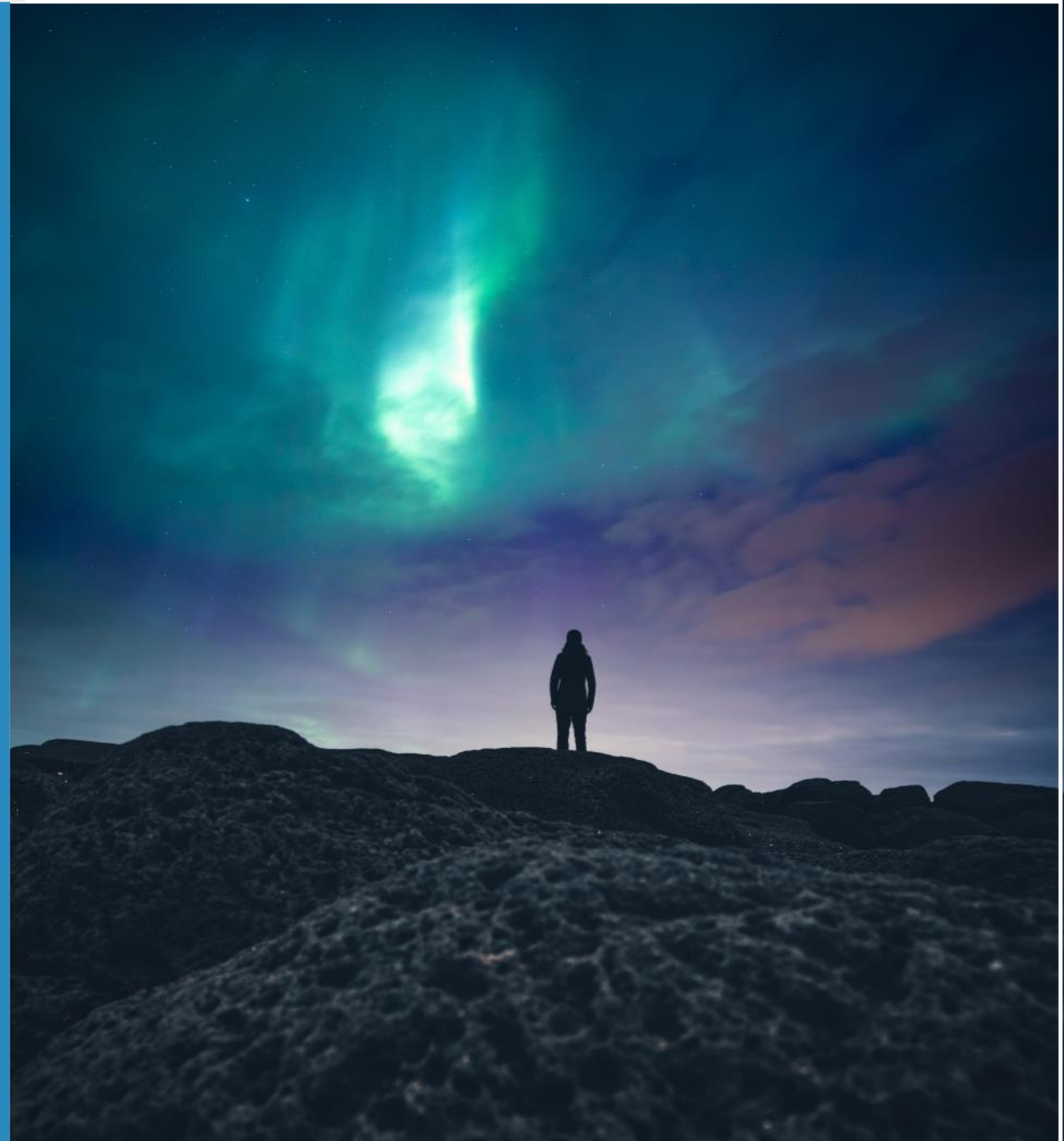
Wednesday, 19th October 2022

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Contents

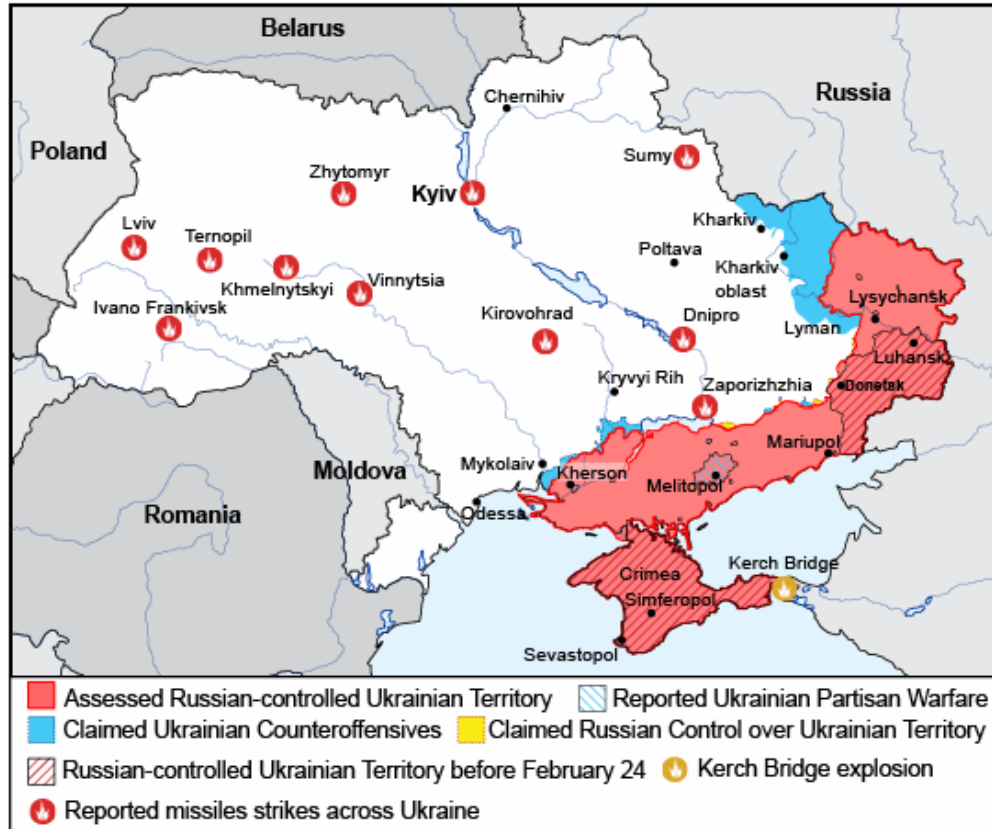
- Russia-Ukraine: New Dynamics In The War
- Eurozone Recession Outlook
- CEE Economic Outlook
- In Focus: Poland And Hungary
- Turkey Outlook
- Q&A



War In Ukraine Ramps Up A Gear Following Kharkiv Counteroffensive

Russia Retaliates After Kerch Bridge Explosion

Ukraine - Map of Territorial Control, Recent Strikes & Explosions



Note: Adapted From Data By The Institute For The Study Of War (ISW). Source: ISW, Fitch Solutions

Key Dates

September 6: Kharkiv Counteroffensive begins

September 15: US announces USD600mn aid package for Ukraine including HIMARS missiles

September 20: Russian State Duma introduces law banning voluntary surrender and tightening punishments for military sabotage and disobedience; Donetsk and Luhansk People's Republics, Kherson and Zaporizhzhia regions announce referenda on their secession to the Russian Federation; EU approves EUR5bn in macrofinancial aid to Ukraine

September 21: President Putin announces partial mobilisation

September 23-27: Voting in referenda

September 28: Nord Stream I pipeline damaged; US announces USD1.1bn aid to Ukraine

October 4: US announces a further USD625mn in aid to Ukraine

October 8: Russia's Kerch Bridge is bombed, temporarily halting traffic

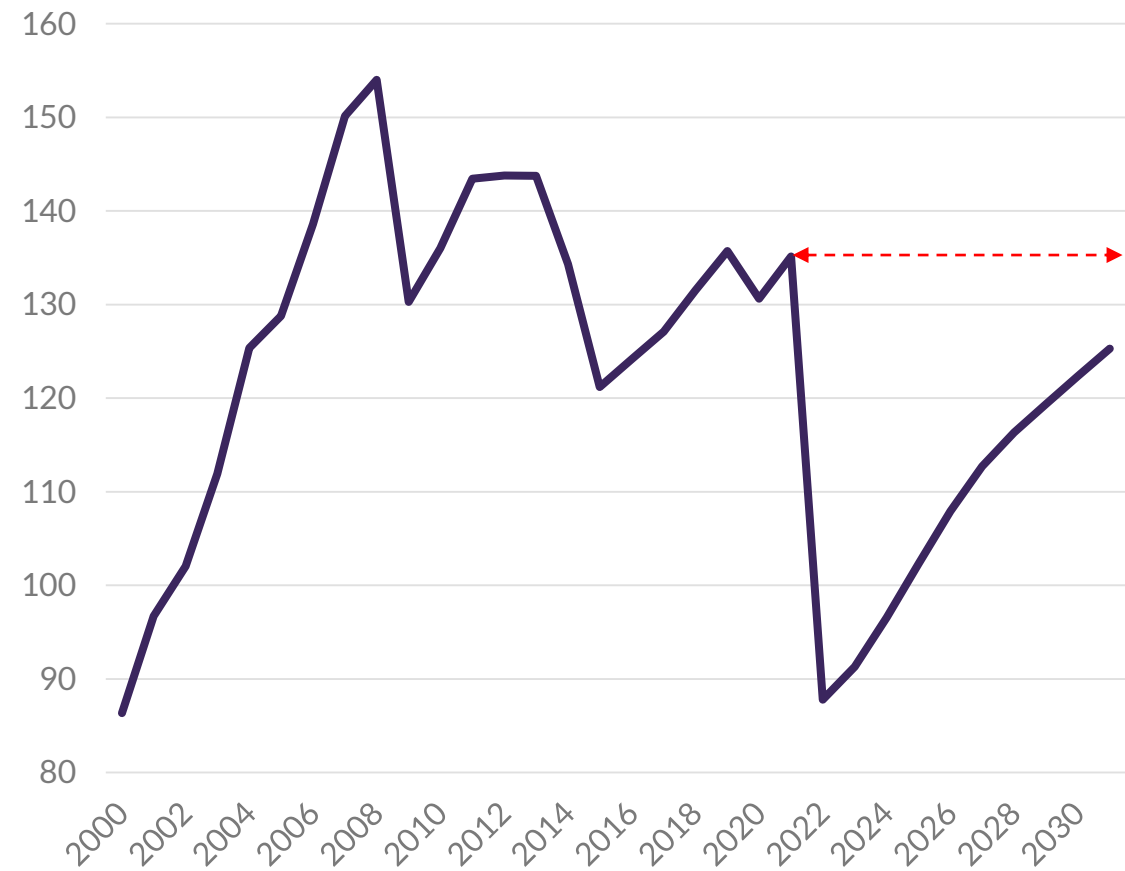
October 9: Russia appoints General Sergei Surovikin as the new commander of its forces in Ukraine.

October 10: Russia launches retaliatory strikes on civilian targets; Belarusian president Aleksandr Lukashenko announces formation of a joint unit with Russia

War To Continue For Foreseeable Future, Weighing On Growth

No Return To Pre-War GDP In Sight For Ukraine

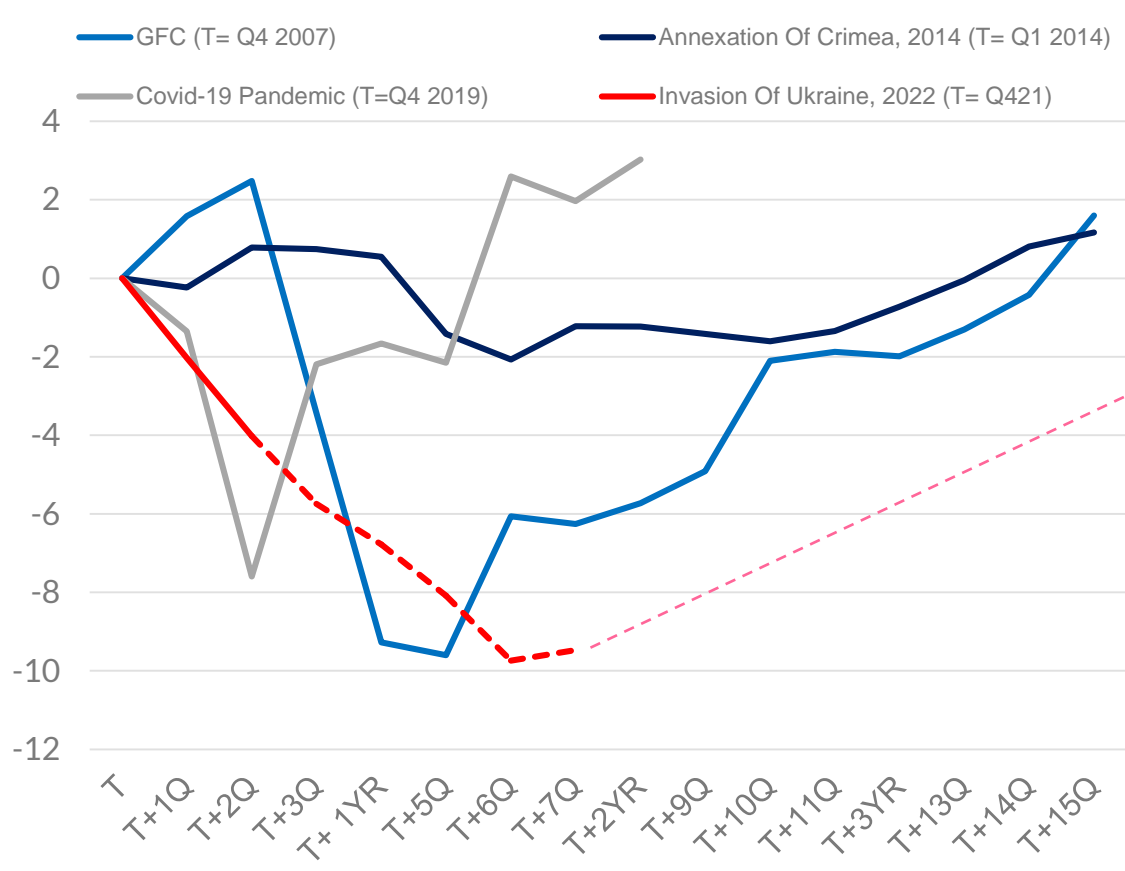
Ukraine – Real GDP, USDbn



f = forecast. Source: State Statistics Committee of Ukraine, Fitch Solutions

Sanctions To Russia Hit Gradually Before Slow Recovery

Russia - Real GDP, SA RUB Quarters since pre-crisis peak (T)

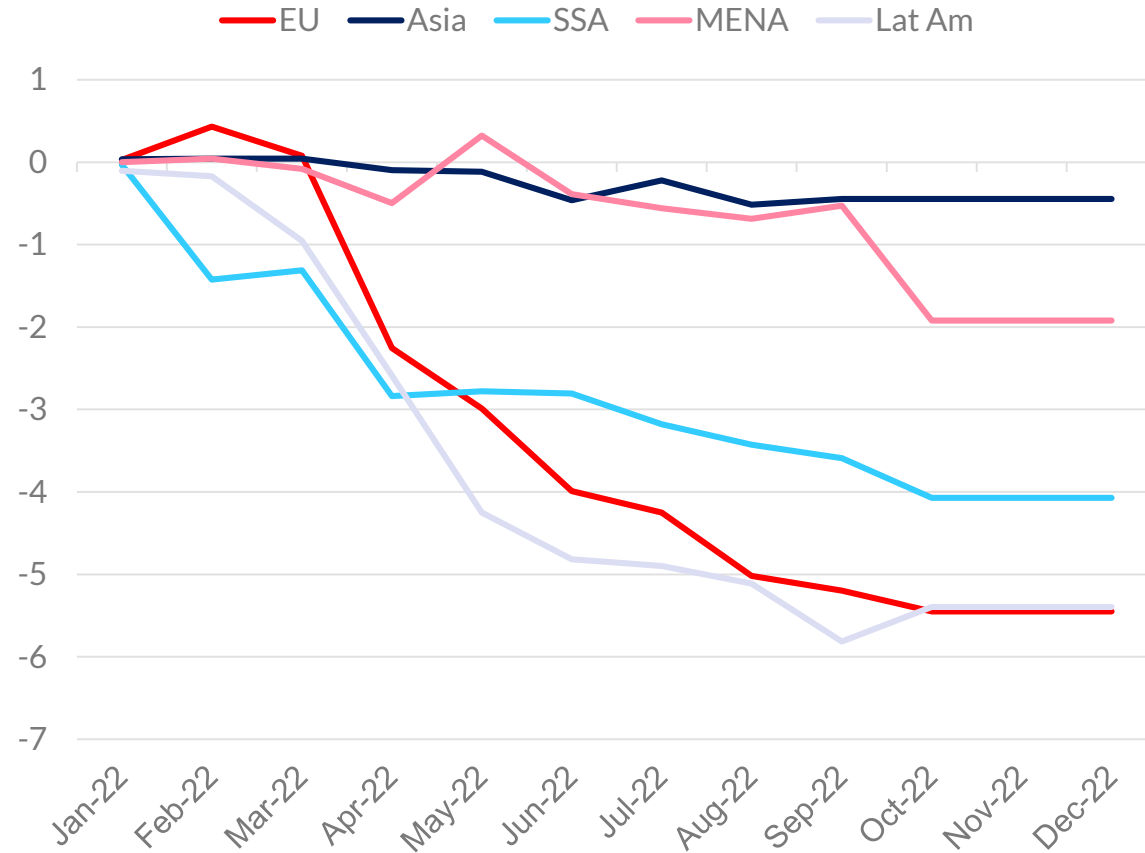


Note: Dotted red line denotes FS forecasts. Source: Rosstat, Fitch Solutions

Pervasive Political Uncertainty In Europe Following Invasion

Political Stability In Europe Deteriorates From High Base

Global – Short-term Political Risk Indices By Region, % chg from Dec-21



Source: Fitch Solutions

- The war in Ukraine has placed extensive political, economic and humanitarian pressure on European policymakers.
- This will have a destabilising effect with uncertain and unpredictable results.
- Particular flashpoints:
 1. UK: Governance Issues
 2. CEE: Governance/institutional Integrity Issues
 3. Turkey: Policy/Institutional Integrity Issues
- Heightened risk of protests across region amid cost of living crisis
- New geopolitical environment to change approach of governments in Europe?



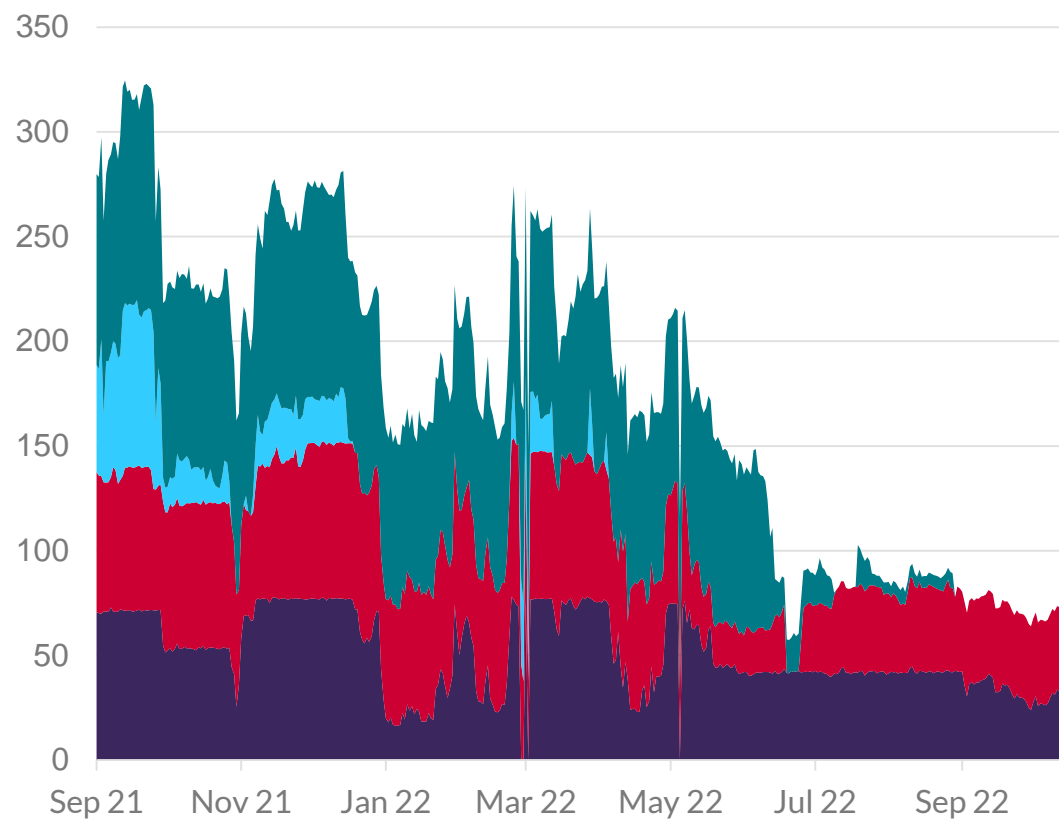
Outlook For The Eurozone

Russia Throttles Natural Gas Supply, Pushing Prices Higher

Flows At 25% Of Normal Level...

EU – Russian Gas Exports By Pipeline, mcm per day

Turkstream Ukraine Yamal NS1



Source: Bloomberg, Fitch Solutions

.... Have Seen Natural Gas Prices Soar

EU – Dutch TTF Month Ahead Contract, EUR per MWh

Dutch TTF 2015-2019 Average

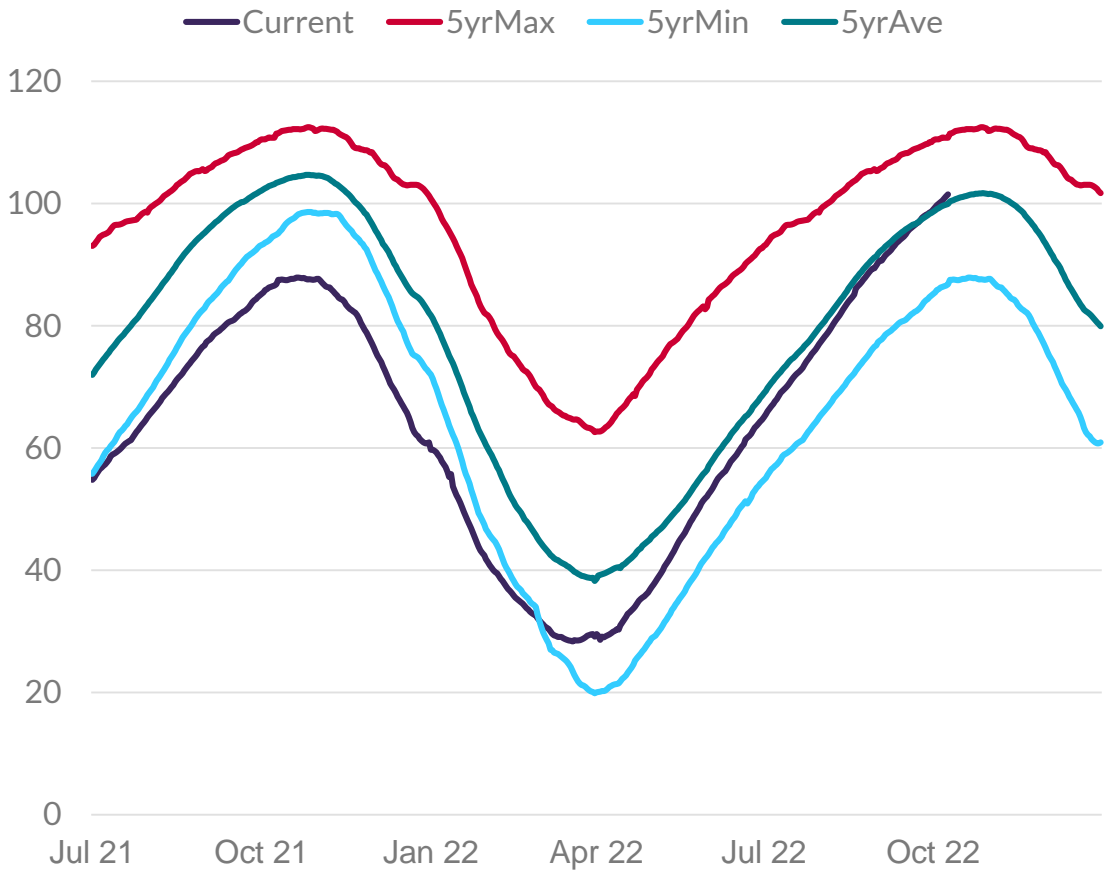


Source: Bloomberg, Fitch Solutions

For Europe This Means Prolonged Energy Insecurity

Gas Storage Levels Built Up This Year...

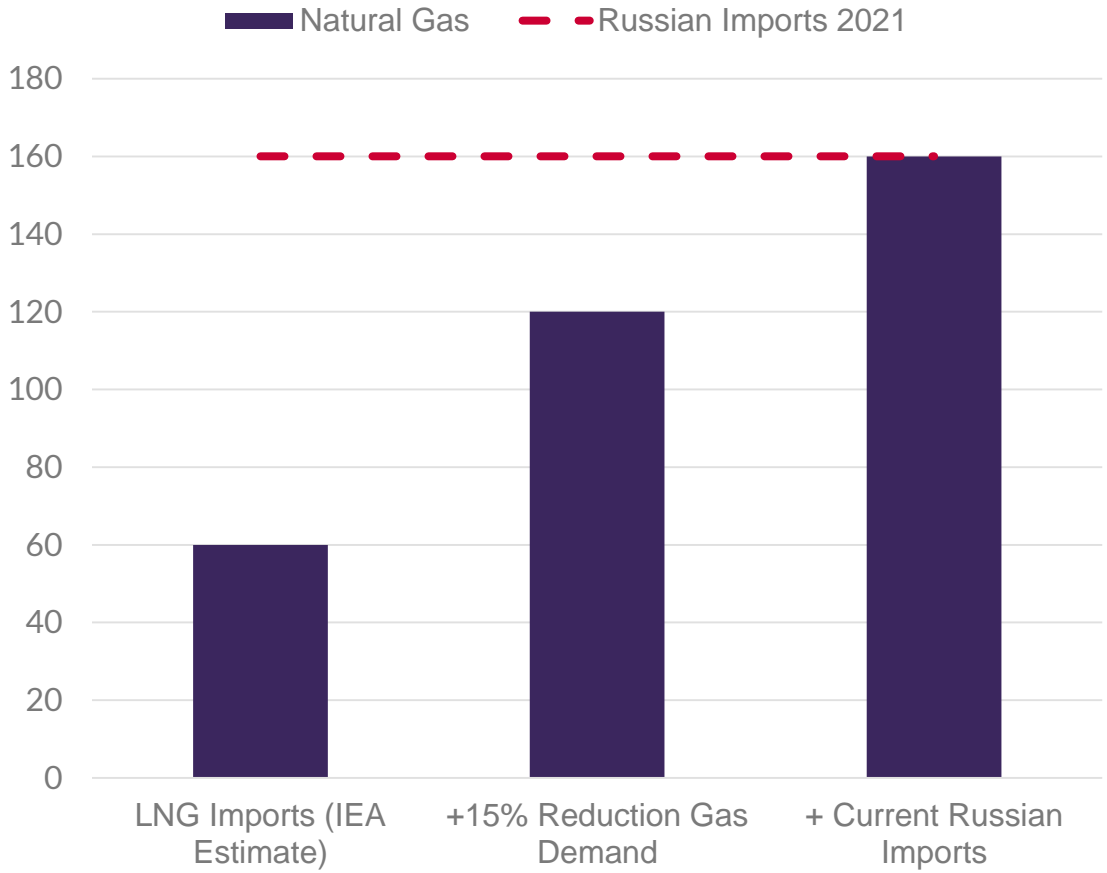
EU - Gas Storage Levels, bcm



Source: GIEE, Fitch Solutions

.... But Europe Will Remain Vulnerable In 2023

EU – Natural Gas Consumption And Imports, bcm

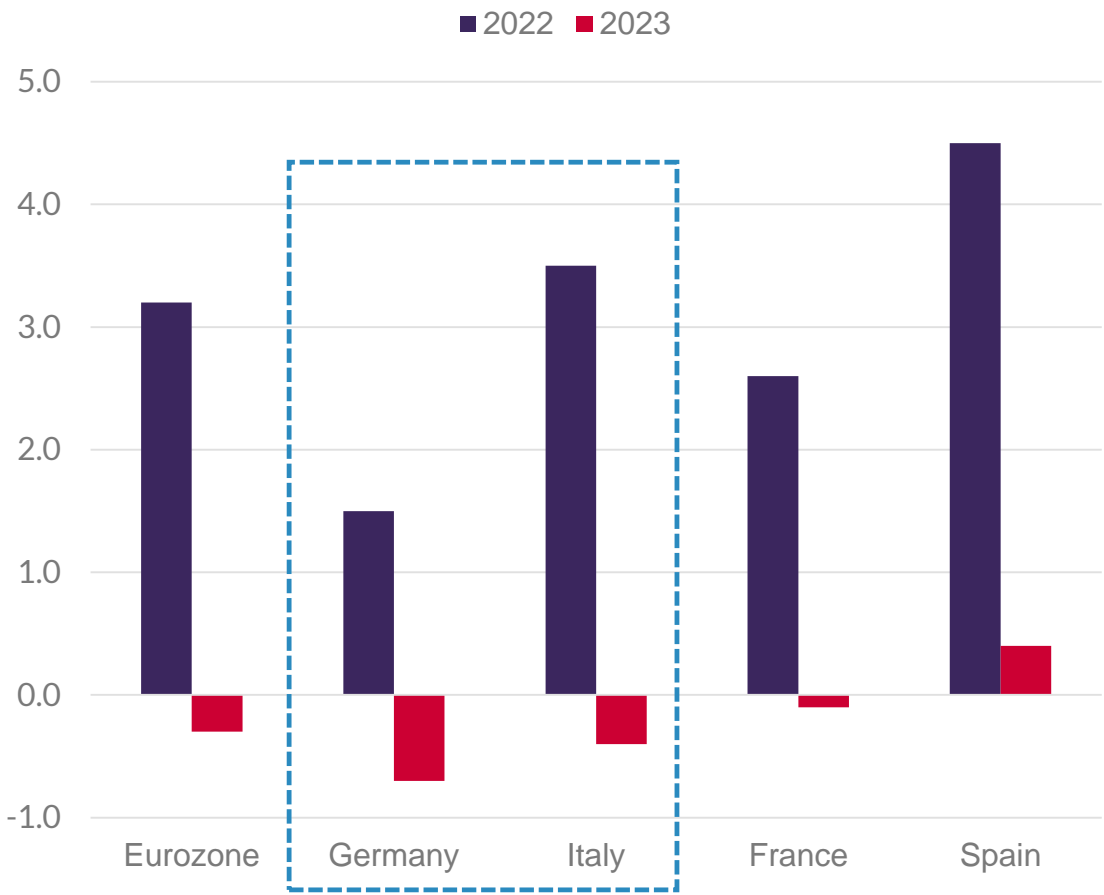


Source: Eurostat, IEA, Fitch Solutions

Eurozone Will Fall Into Recession, Recovery Will Be Slow

Germany And Italy Set To Underperform

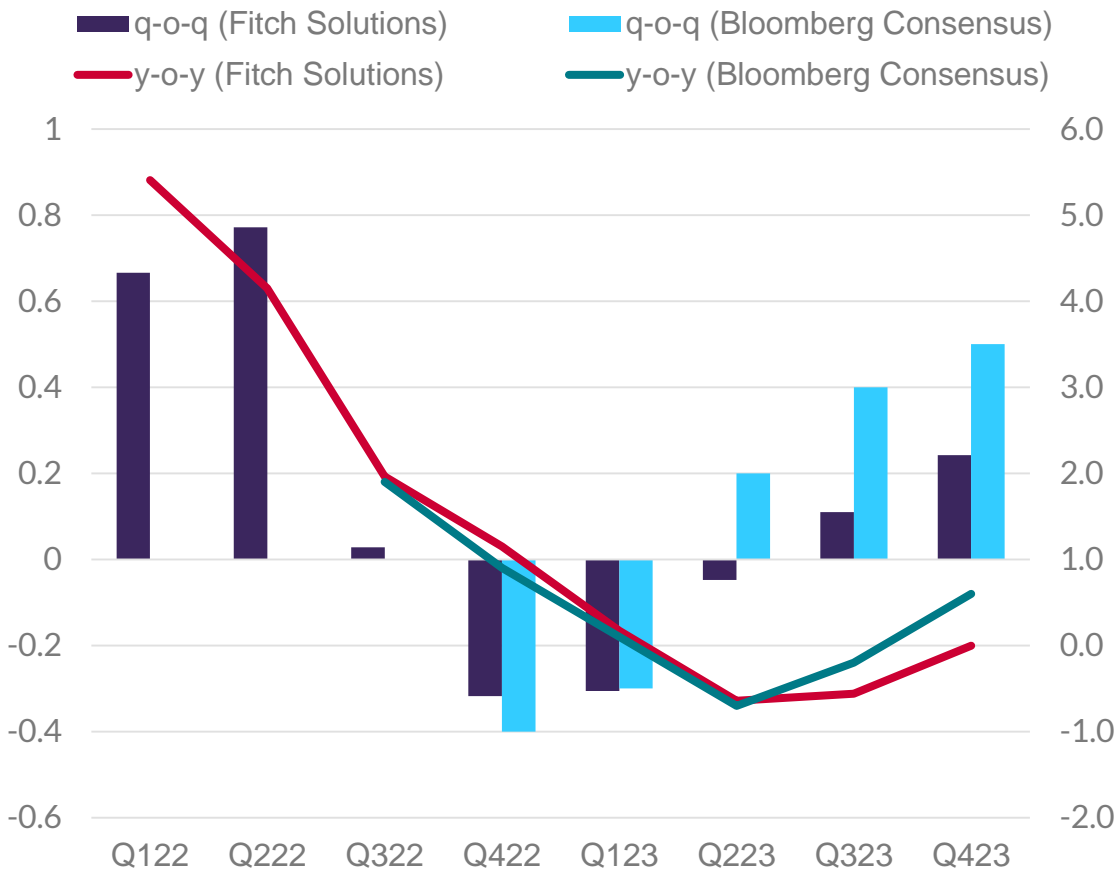
Eurozone- Real GDP Growth, % chg y-o-y



Source: Eurostat, Fitch Solutions

Recession In The Eurozone Over Winter Months

Eurozone- Real GDP Growth, % chg y-o-y



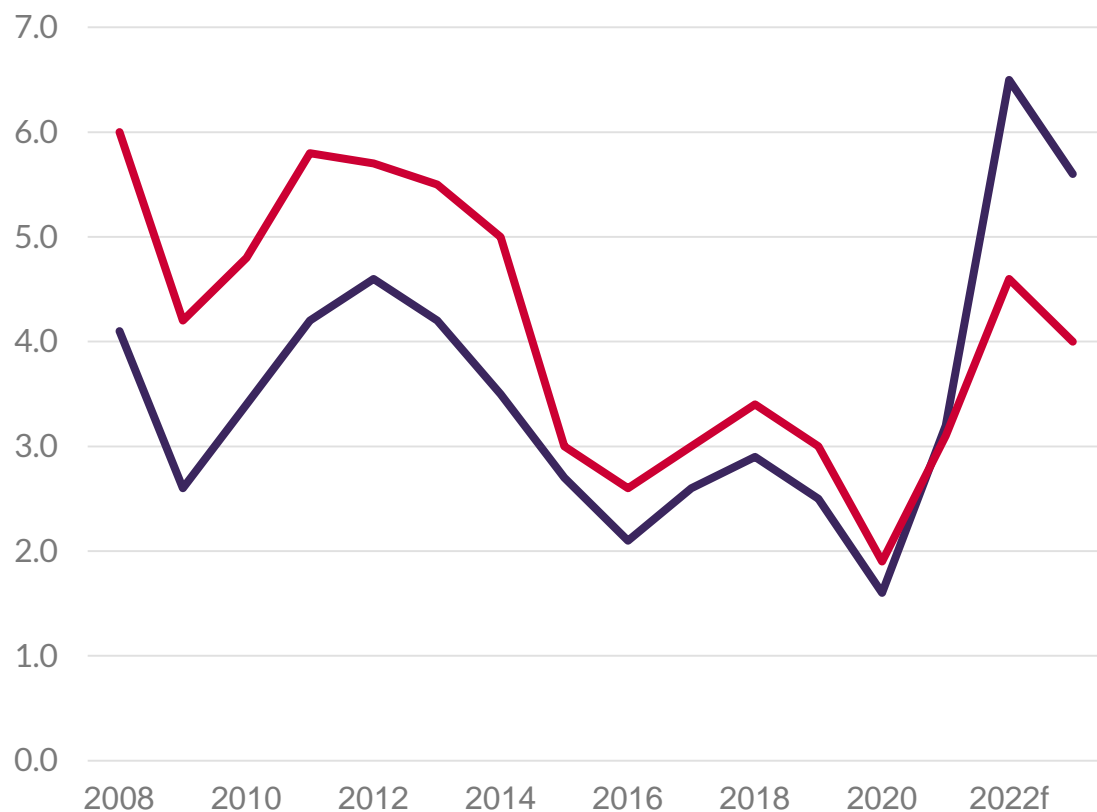
Source: Eurostat, IEA, Fitch Solutions

Cost Of Living And Competitiveness Issues Mounting

A Long Road Back To Normal In Europe

US & Europe – Oil & Gas Consumption, % of GDP

— Eurozone — US

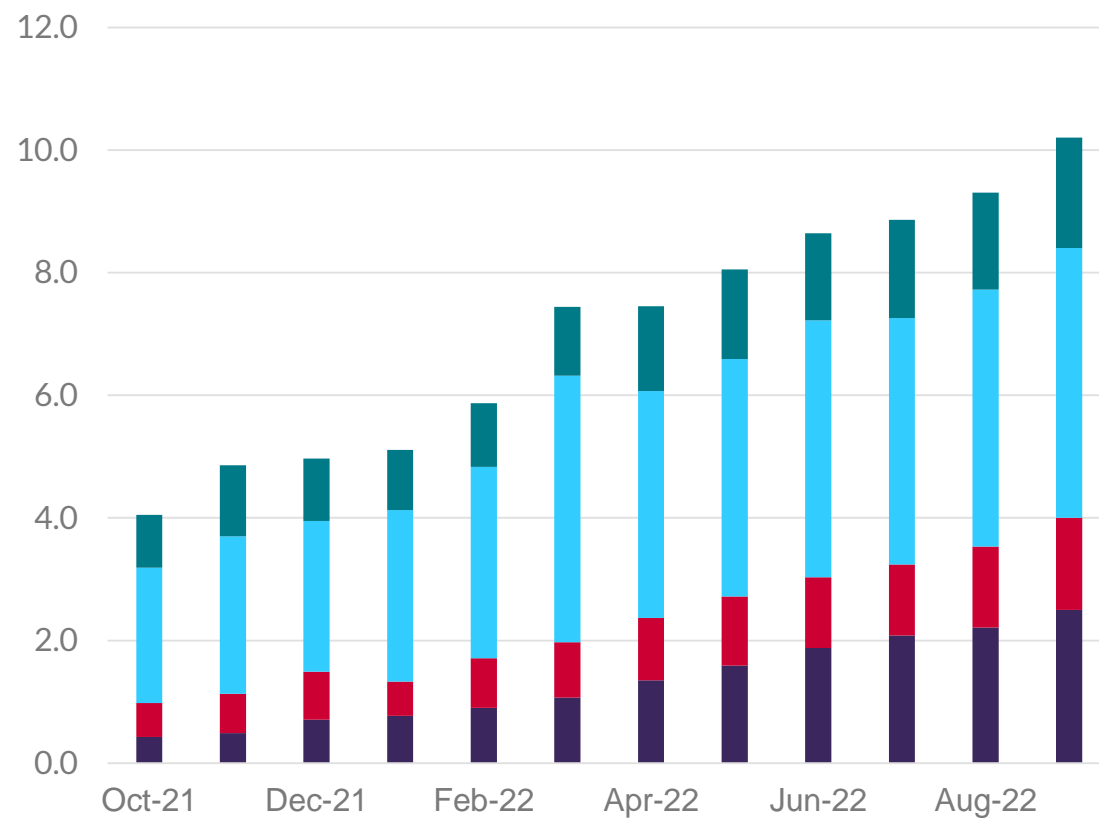


Source: National Sources, Fitch Solutions

Inflationary Pressures Weighing On Purchasing Power

Eurozone – Contribution To Headline Inflation, pp

■ Food ■ Non-Energy Industrial Goods ■ Energy ■ Services

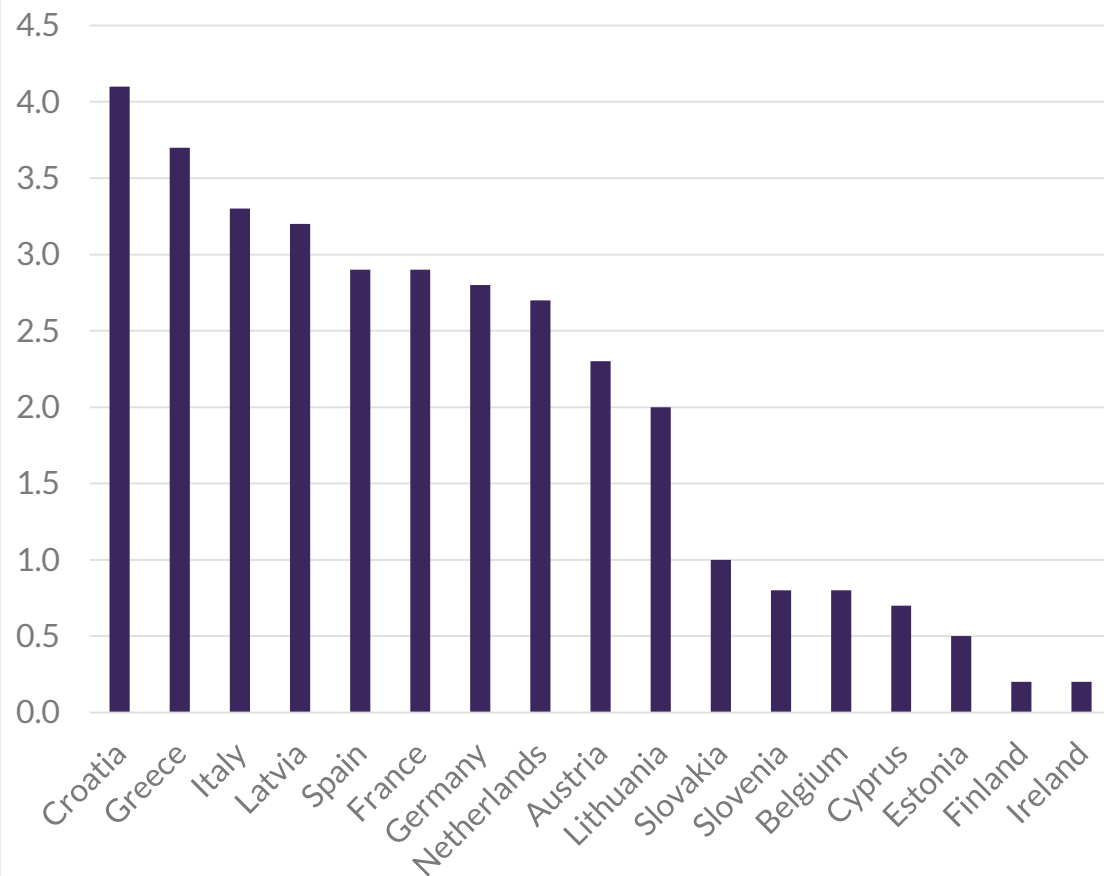


Source: Eurostat, Fitch Solutions

Fiscal Taps Loosened, But Rising Bond Yields May Create Issues

Governments Attempt To Mitigate Energy Crisis Impact...

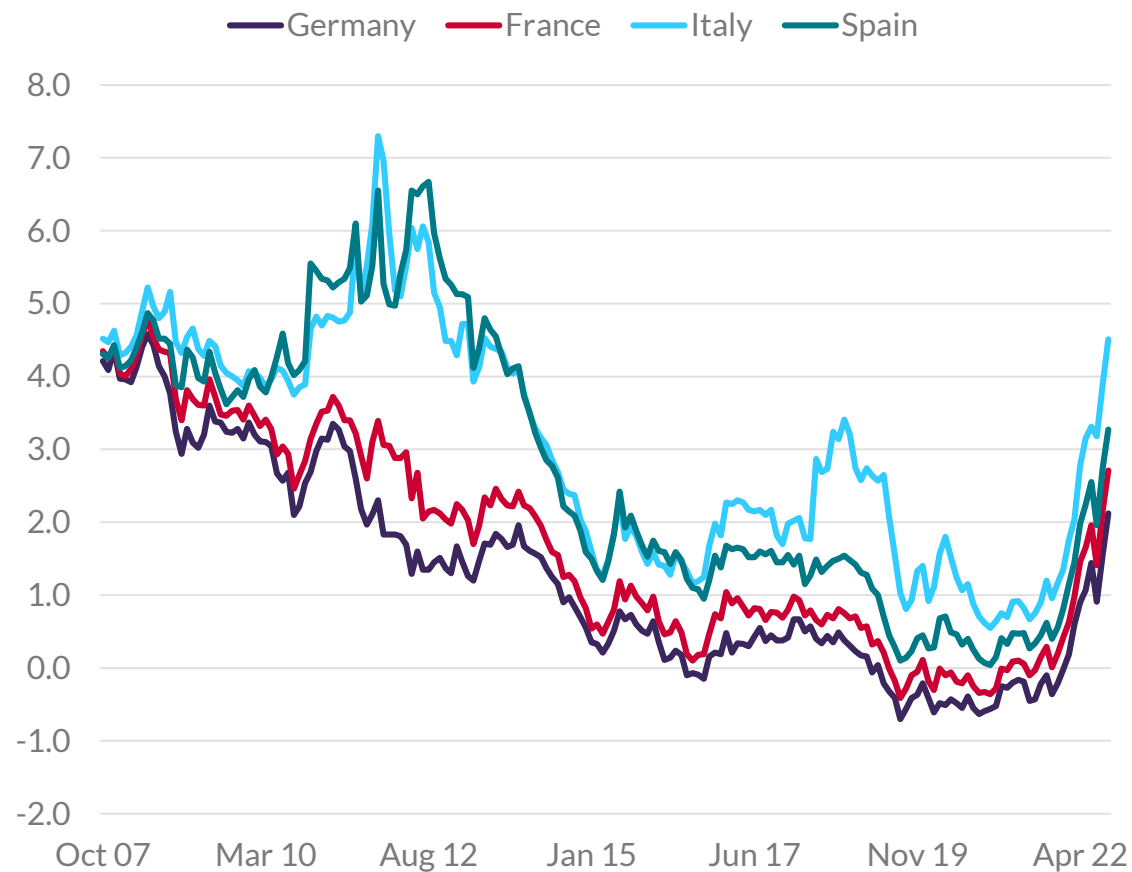
Eurozone-Allocated Funds To Shield Private Sector, % of GDP



Source: Bruegel, Fitch Solutions

....But Bond Market Growing Restless

Eurozone-10-Year Government Bond Yields, %

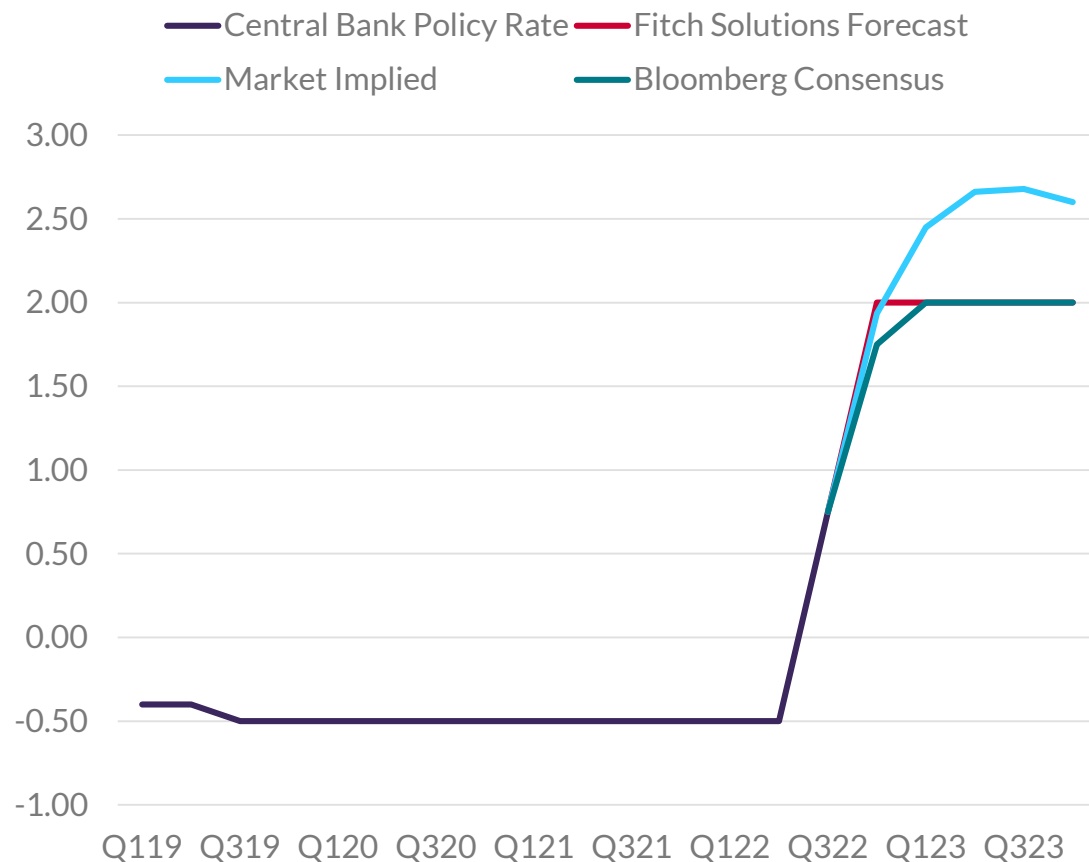


Source: Macrobond, Fitch Solutions

Meanwhile Monetary Policy Will Offer Limited Reprieve

ECB Will Be Pressured To Hike Into Recession

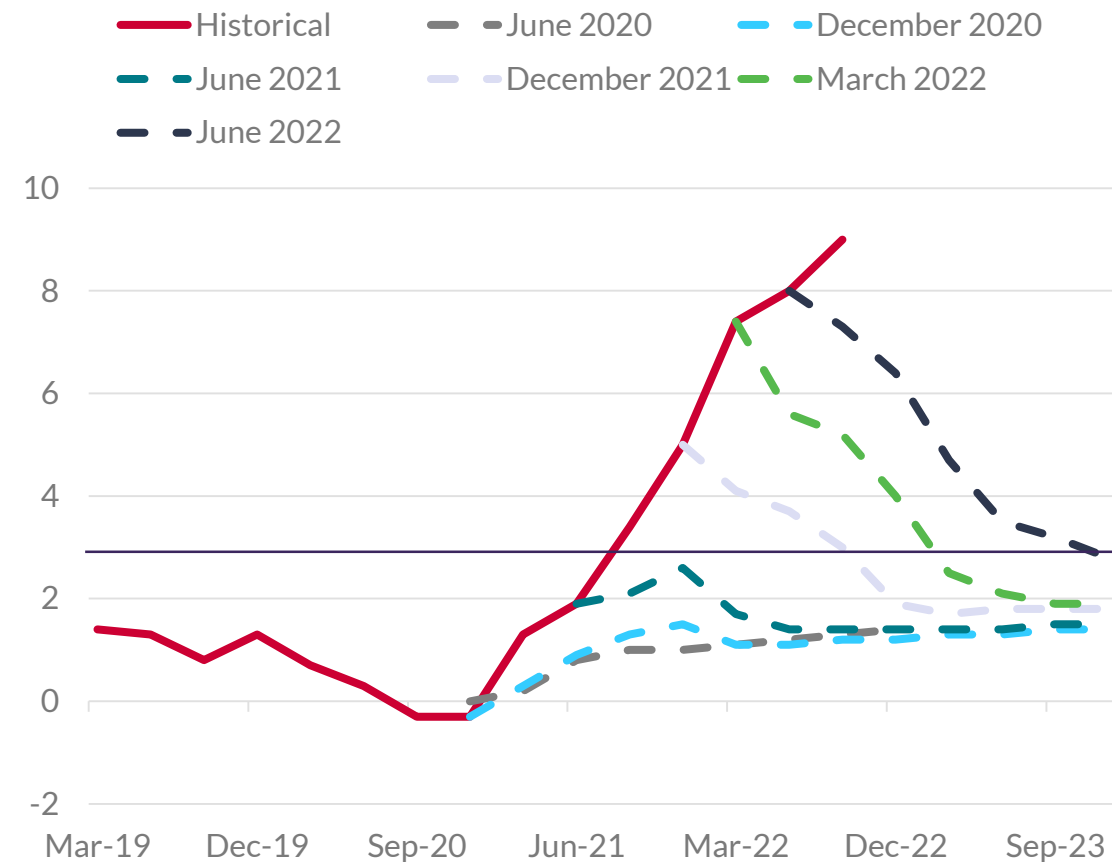
Eurozone - Central Bank Policy Rate, %



Source: Bloomberg, Fitch Solutions

Inflation Forecasting Has Been A Challenge

Eurozone – HICP Inflation & ECB Forecast Profile, % chg y-o-y

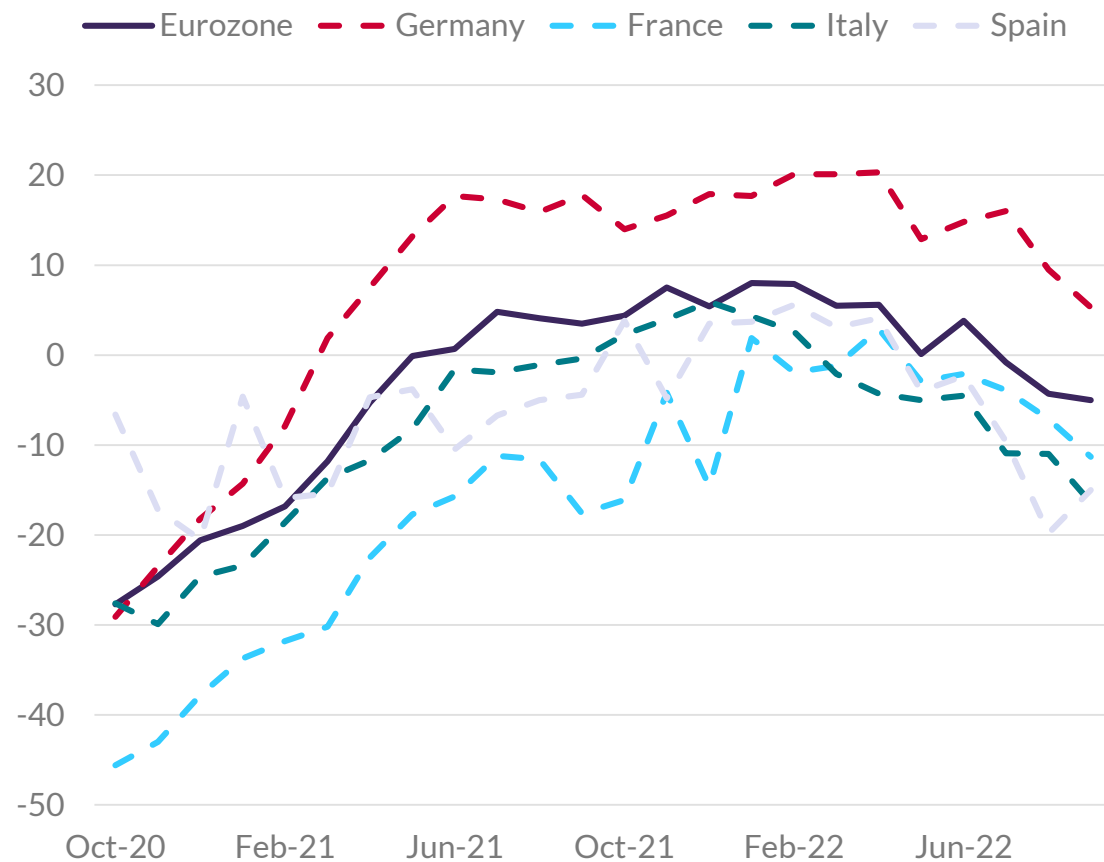


Source: ECB, Eurostat, Fitch Solutions

Weak External Backdrop To Add To The Eurozone's Problems

Backlog Of Export Orders Quickly Being Run Down...

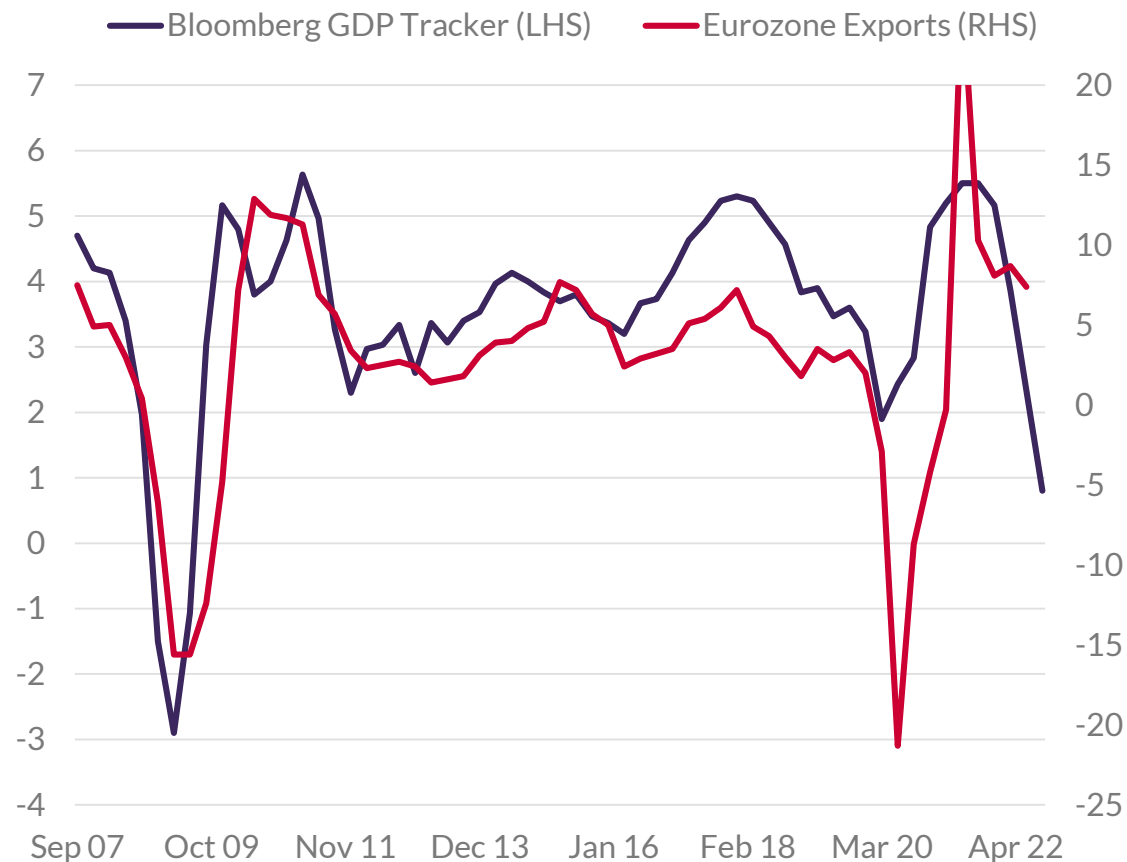
Eurozone – Assessment Of Export Orders, balance of responses



Source: Bloomberg, Fitch Solutions

....With Limited Prospects For A Meaningful Rebound

Eurozone - Global GDP Tracker, index & Eurozone Quarterly Exports, % chg y-o-y



Source: Bloomberg, Eurostat, Fitch Solutions

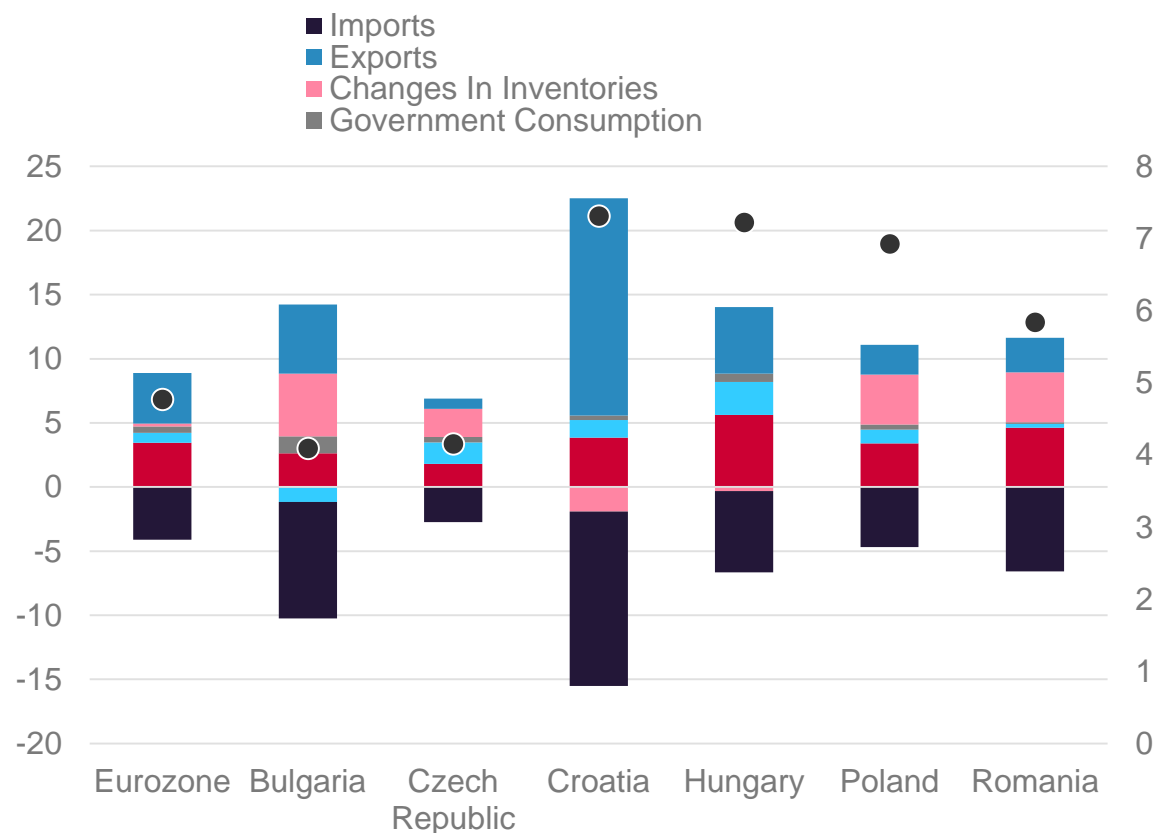


Outlook For Central & Eastern Europe

Growth Set To Sharply Lose Momentum

Post-Pandemic Demand Has Supported Annual Growth...

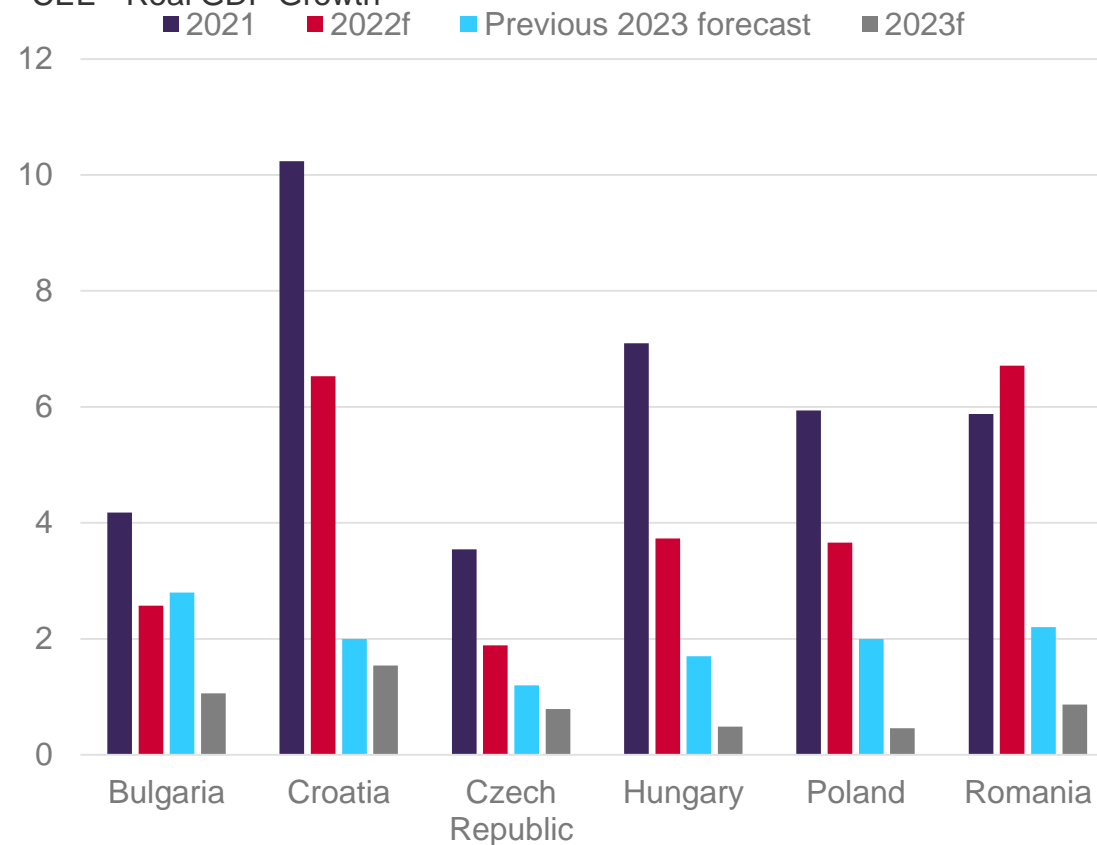
CEE - H122 Real GDP Growth & Component Contributions, Percentage Points



Source: Eurostat, Fitch Solutions

...But Regional Growth Outlook Has Deteriorated

CEE - Real GDP Growth

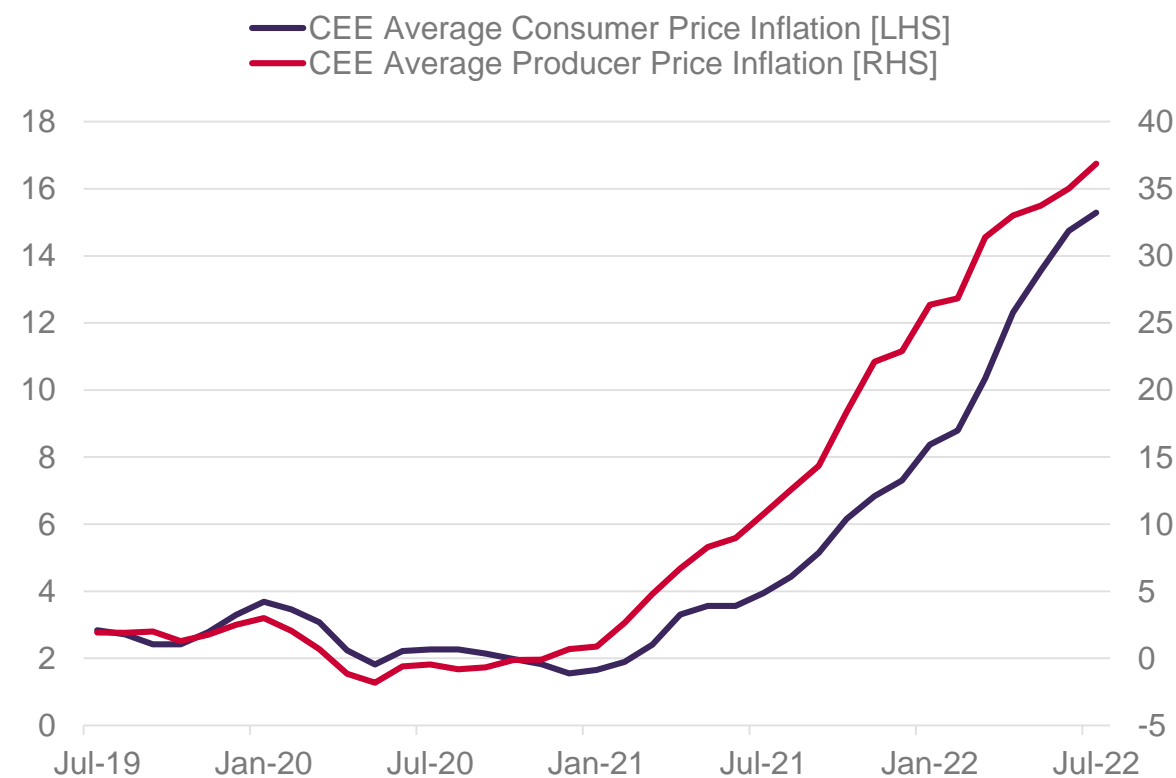


f = Fitch Solutions forecast. Source: Eurostat, Fitch Solutions

Energy Prices And Higher Interest Rates Will Constrain Growth

High Energy Prices Weighing On Purchasing Power And Capital Formation

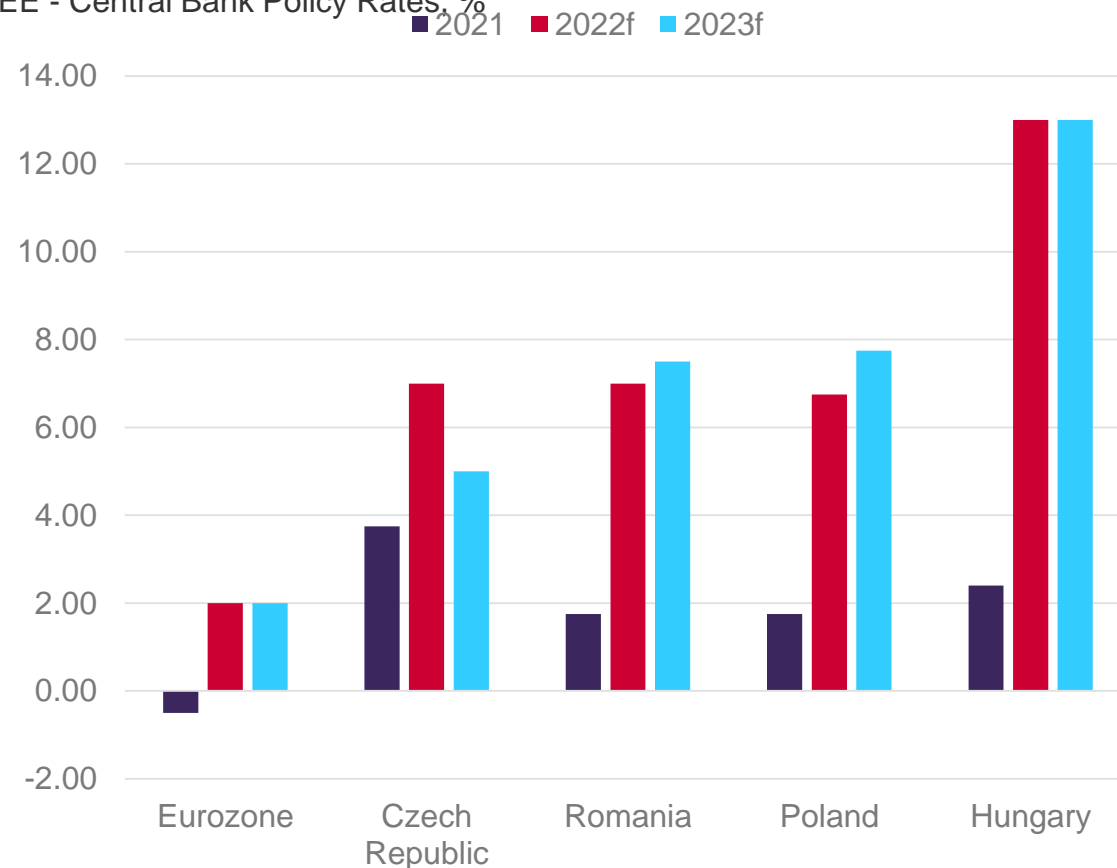
CEE - Consumer & Producer Price Inflation, % y-o-y



Source: Eurostat, Fitch Solutions

Tighter Financial Conditions Will Further Hamper Demand

CEE - Central Bank Policy Rates, %

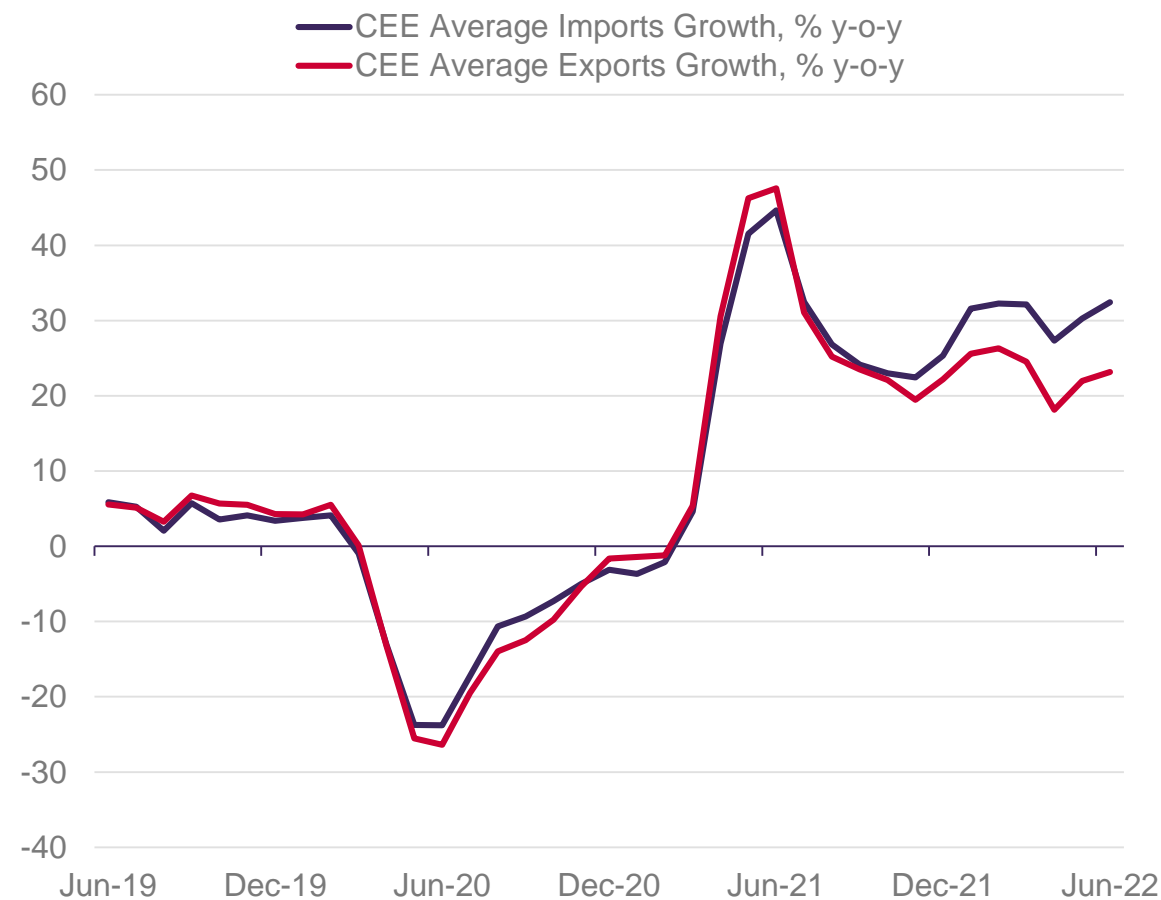


f = Fitch Solutions forecast. Source: Eurostat, Fitch Solutions

External And Fiscal Balances Under Pressure

Import Bills Rising Sharply While Exports Face Headwinds

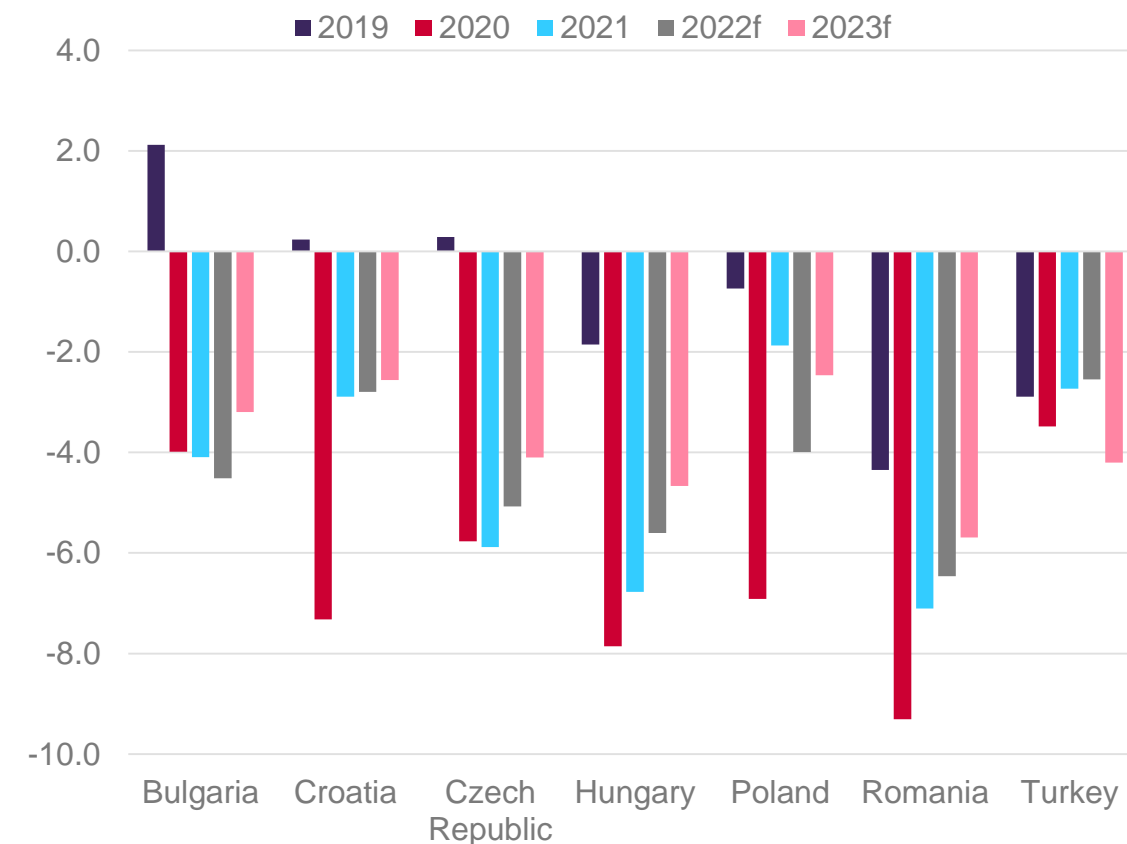
CEE - Trade Flow Growth, 3-Month Moving Averages



Source: Eurostat, Fitch Solutions

Support Measures For Households And Firms Keeping Budget Deficits Wide

CEE - Budget Balance, % Of GDP

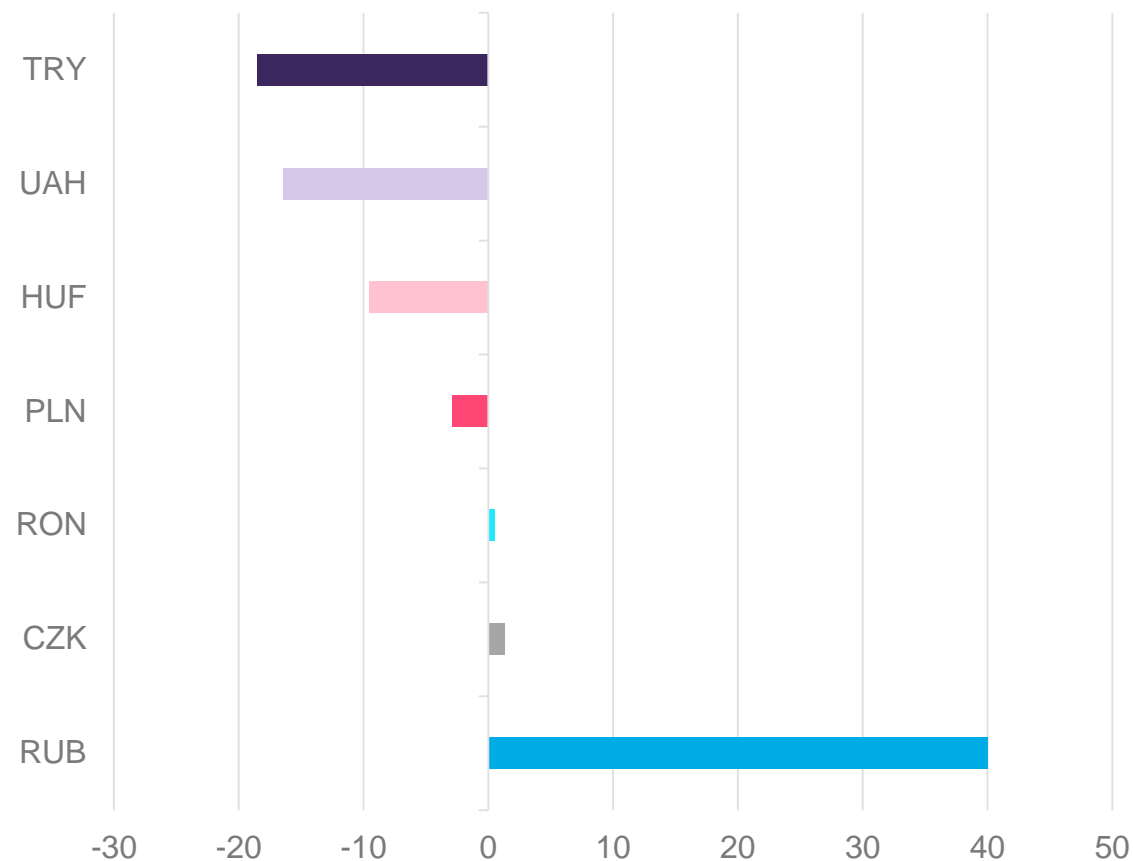


f = Fitch Solutions forecast. Source: Eurostat, Fitch Solutions

Eastern Europe FX Outlook Darkens

Political Stability In Europe Deteriorates From High Base

Eastern Europe – Year-To-Date Spot Returns Vs. Euro, %



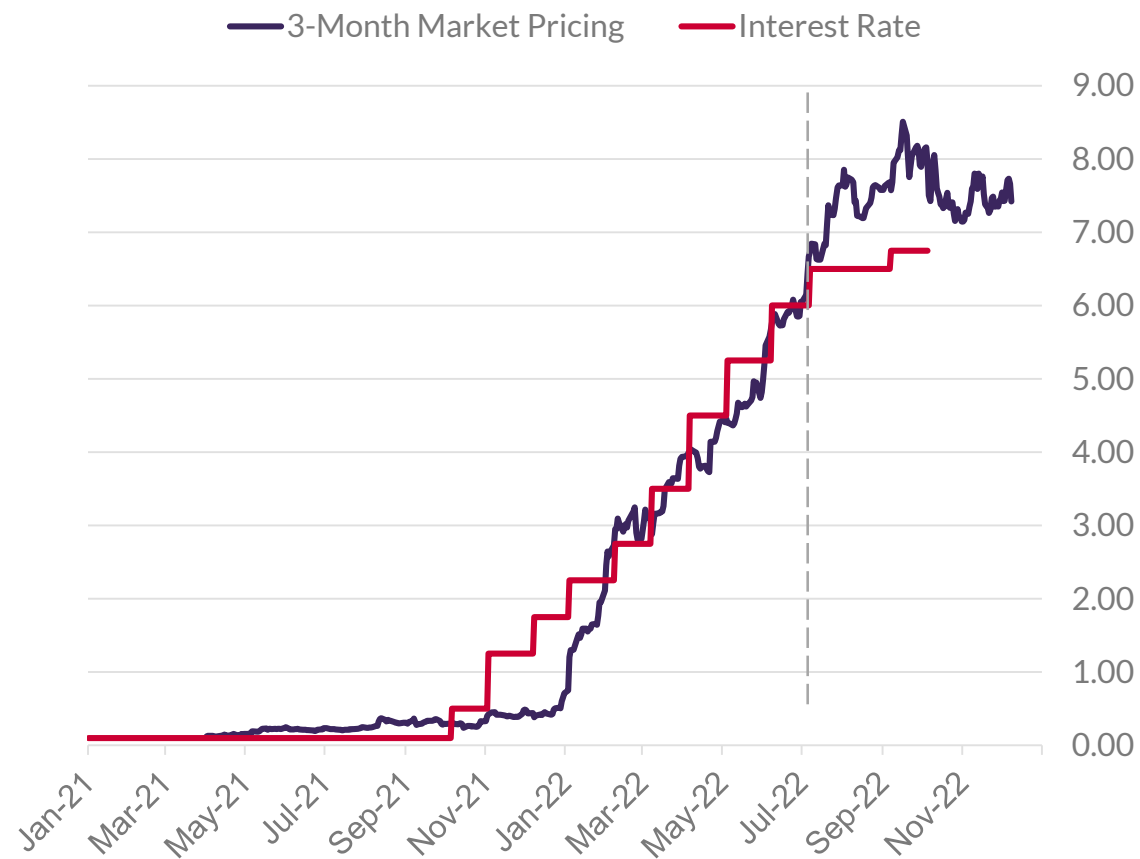
Source: Bloomberg, Fitch Solutions

- Mixed currency performance year-to-date in CEE
- **Weakness in coming quarters driven by:**
 - **High inflation prints will continue to drive currency weakness.** The region is particularly exposed to imported price inflation with reliance on hydrocarbons, mostly imported from Russia.
 - **Narrowing interest rate differentials with developed markets** will trigger further outflows.
 - **Geopolitical uncertainties will continue** to distort the outlook for emerging European currencies as the conflict in Ukraine is set to continue in 2023.

PLN: EU Tensions Pose Downside But Monetary Policy Is Main Driver

Slowing Hikes Surprise Markets More Than EU Clash

Poland – Historical Interest Rate & 3-Month Forward Rate, %



Source: Bloomberg, Fitch Solutions

Drivers Of PLN

- Year-to-date PLN/EUR Ave = PLN4.68/EUR
- July 1- October 18 PLN/EUR Ave = PLN4.75/EUR
- NBP's hiking cycle disappoints market expectations amid surging inflation.

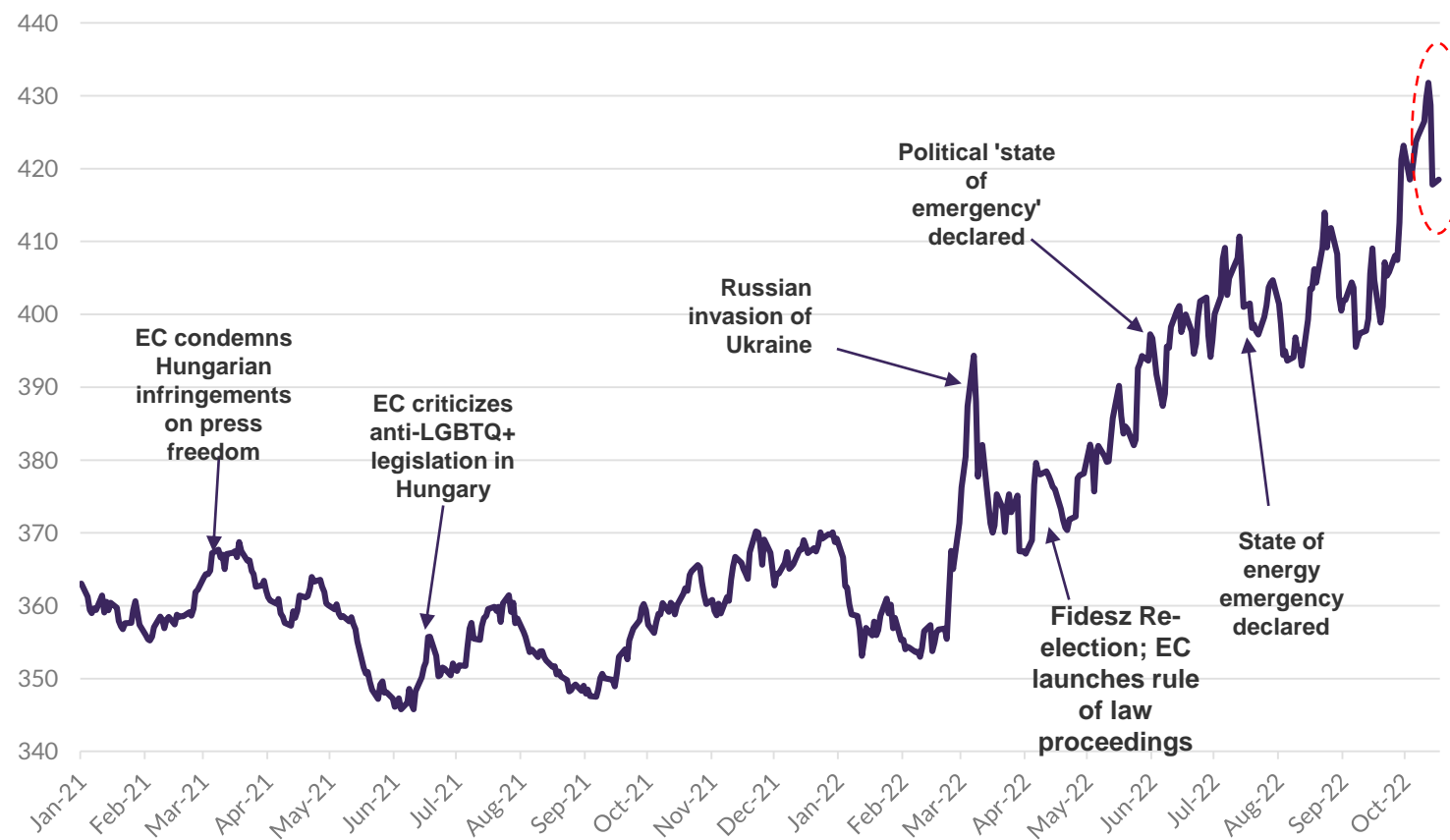
Risks To Outlook

- EUR 75bn of EU cohesion funds targeted.
- Progress expected.
- EUR36bn of RRF pandemic relief funding also at risk
- Required reform politically difficult but we expect a deal
- Risks pose downside to PLN as dispersal of both packages priced
- Muted PLN reaction to news of cohesion fund risks, -0.1%

HUF: Outlook Remains Bearish

Political Risk Major Driver Of Forint Weakness

Hungary – Exchange Rate, HUF/EUR, daily & Selected Political Events



Source: Bloomberg, Fitch Solutions

Headwinds

- EU disputes
- High Inflation
- Worsening consumption and external outlook
- Energy security threats
- Fractious politics under Fidesz
- Fiscal and external account troubles

Tailwind

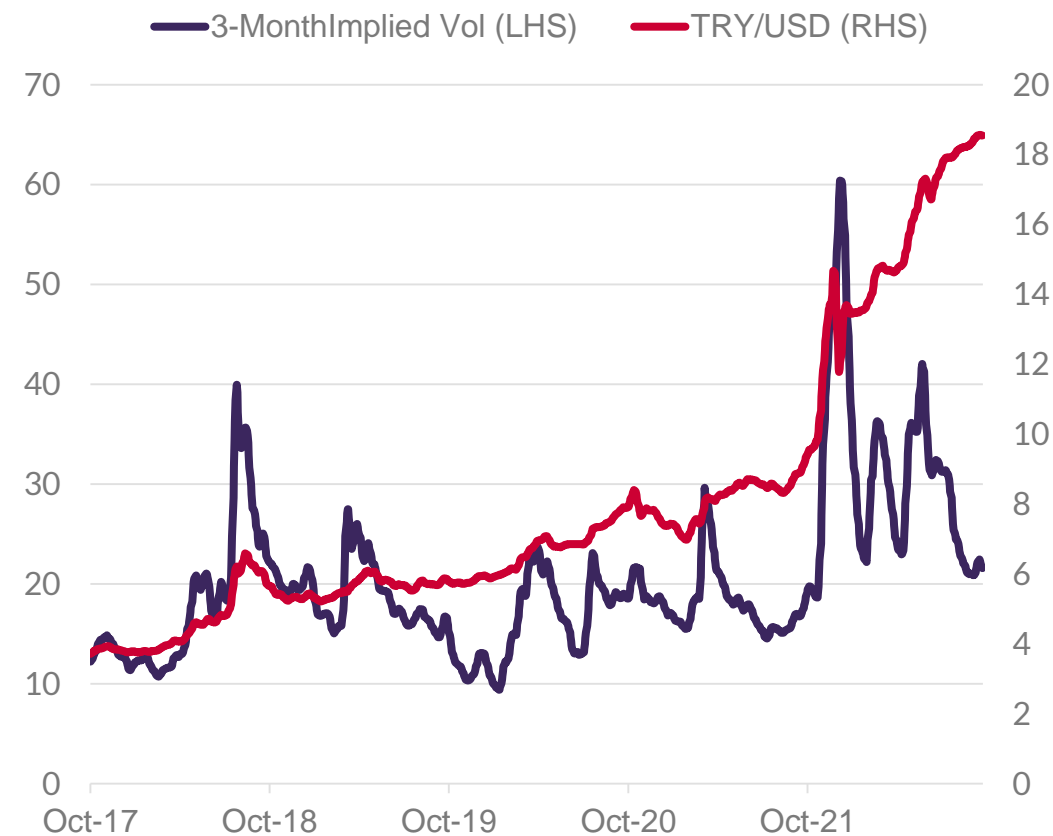
- 18.00% new policy rate

Outlook For Turkey

Turkish Lira Set For Further Weakness

Capital Controls Have Anchored TRY/USD...

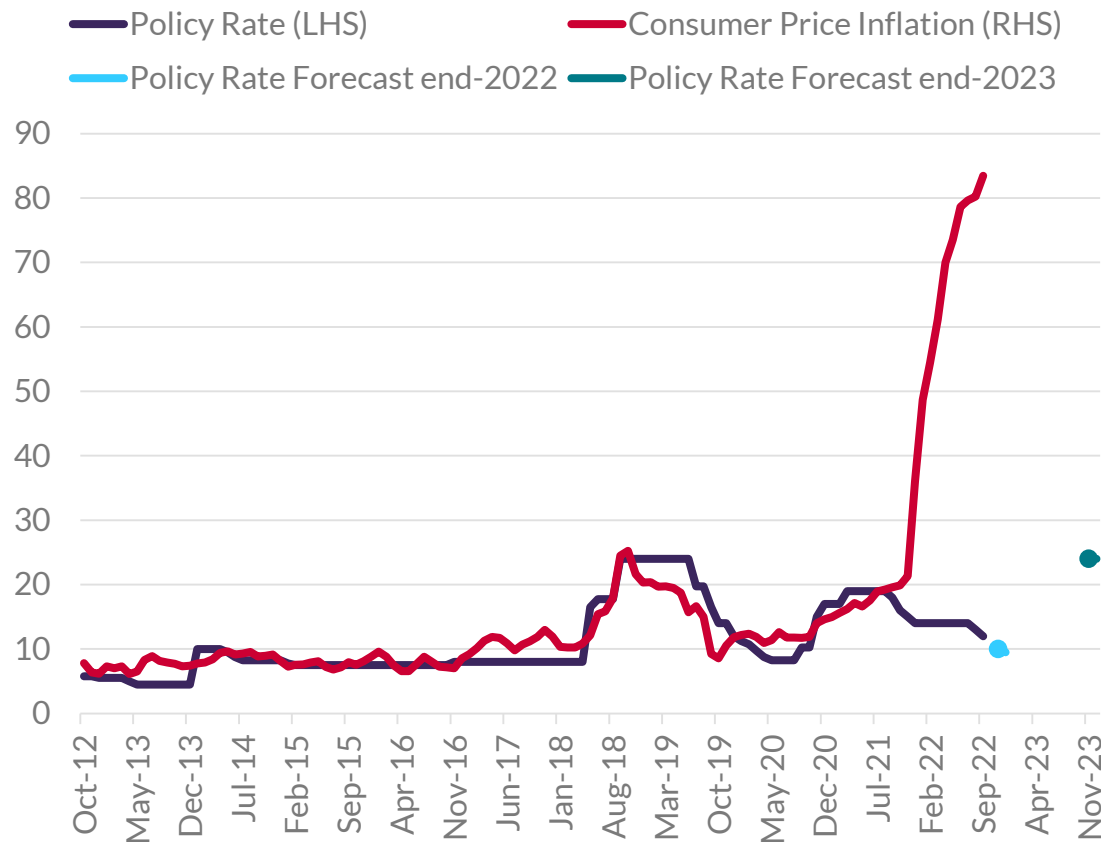
Turkey - 3-Month Implied Volatility Index VS Exchange Rate, TRY/USD



Source: Bloomberg, Fitch Solutions

...But Further Rate Cuts Likely Ahead Of Elections

Turkey - Policy Rate, % Vs Consumer Price Inflation, % chg y-o-y

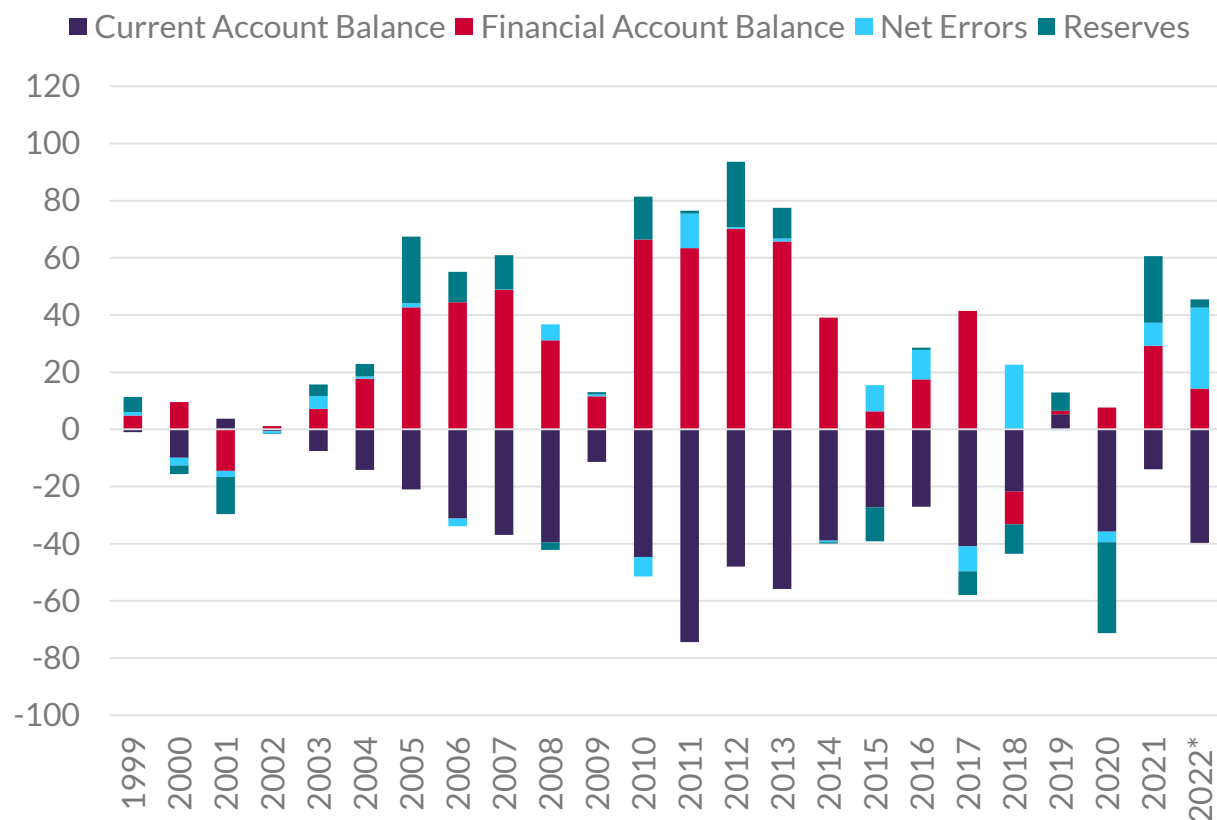


Source: Bloomberg, Fitch Solutions

A Risky Gamble With Russian Funds

Net Errors Funding Turkey's Current Account

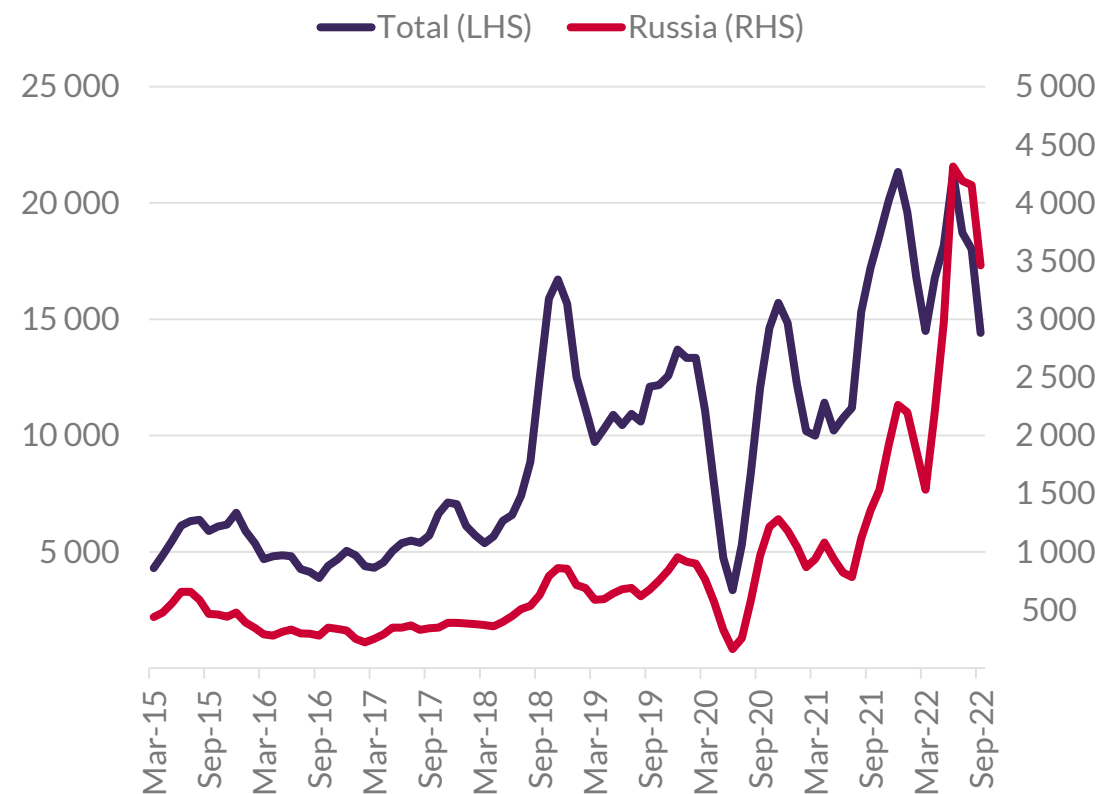
Turkey - Balance Of Payments, USD bn



Source: CBRT, Fitch Solutions

Russian's Piling Into Turkish Real Estate

Turkey- Number Of House Purchases By Foreigners

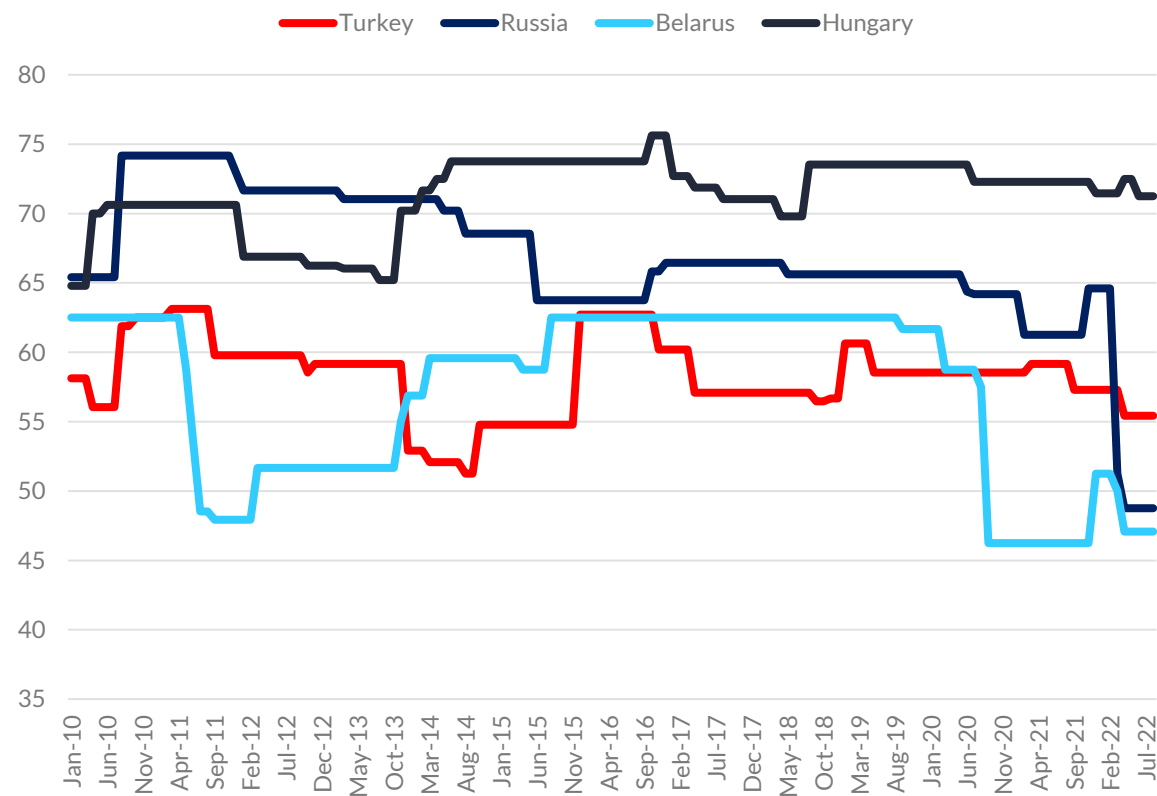


Source: Turkstat, Fitch Solutions

Headwinds To Growth Mounting As Erdoğan Loses Ground

Election Uncertainty To Raise Political Risks...

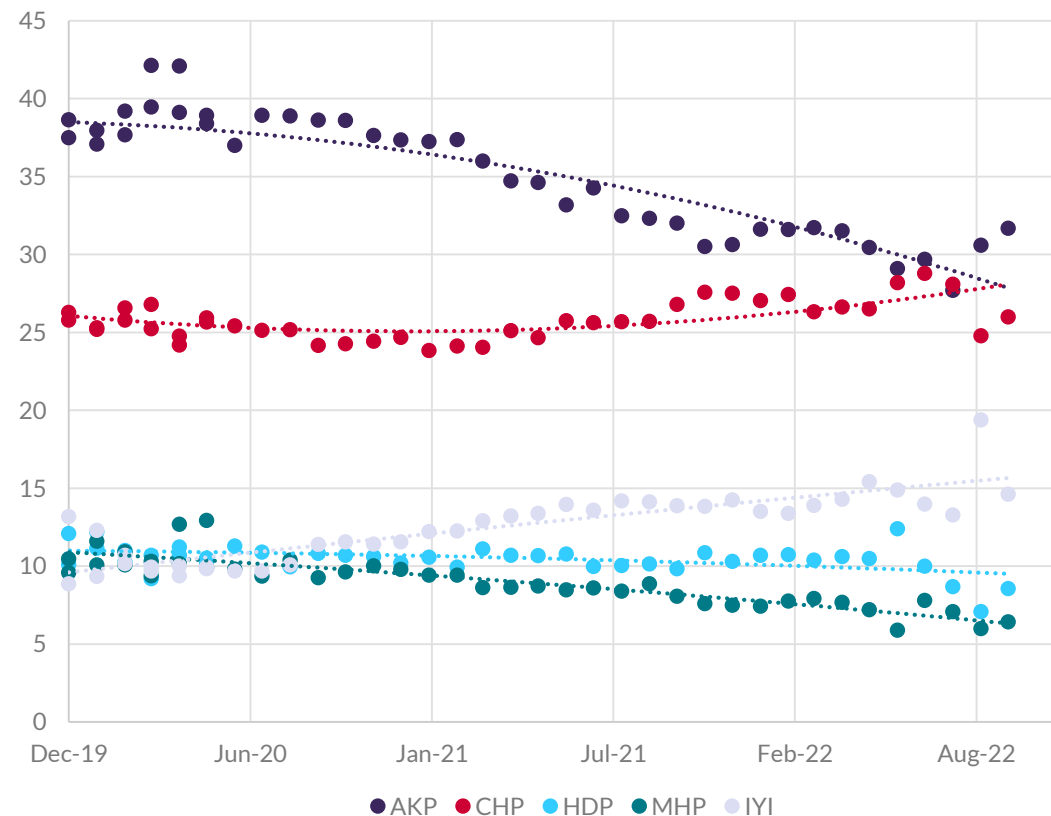
Selected Markets - Short-Term Political Risk Index, Score Out Of 100



Source: Fitch Solutions

...AKP's Fortunes Fading

Turkey - % of Total Surveyed



Source: Various Media Sources, Fitch Solutions



Q&A



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