Outlook for selected CESEE countries:

Steady growth in CESEE-6[1], deep recession in Russia[2,3]

Annual economic growth in the CESEE-6 region will settle at about 3% from 2015 to 2017, thus continuing the moderate expansion observed in 2014. This outlook corresponds to an annual improvement of less than ½ percentage point over the October 2014 projections and is in line with the improved external environment outlook. Improving external conditions imply strong export growth, but import growth will also be robust, pushing the contribution of net exports close to or slightly below zero. Domestic demand will thus continue to be the main growth driver. In 2015, all countries in the region are expected to post positive GDP growth, with Poland remaining the growth engine and Croatia being at the bottom of the league. The economic expansion will, however, remain too weak to speed up the convergence process. Given steady growth in 2016 and 2017, the region's growth advantage over the euro area average will even decline from 1.4 percentage points in 2015 to about 1 percentage point in 2016 and 2017.

Following almost flat growth in 2014, the Russian economy is contracting in 2015 on account of the oil price slump. We forecast Russian GDP to decrease by over 4% in 2015. Private investment will remain plagued by uncertainty, which is reinforced by ongoing geopolitical conflict and Western sanctions related to the

Table 1

GDP and import projections for 2015 to 2017

	GDP				Imports			
	Eurostat/ Rosstat	OeNB/BOFIT forecasts			Eurostat/ Rosstat	OeNB/BOFIT forecasts		
	2014	2015	2016	2017	2014	2015	2016	2017
	Year-on-year growth in %							
CESEE-6	2.8	2.9	2.9	3.0	8.5	7.2	7.5	7.6
Bulgaria	1.5	1.6	1.8	2.1	4.8	4.5	5.7	5.8
Croatia	–0.4	0.4	1.1	2.2	3.1	1.9	2.8	2.6
Czech Republic	2.0	2.7	2.4	2.5	9.6	8.5	8.8	8.6
Hungary	3.6	2.9	2.0	2.3	10.0	7.9	7.7	7.9
Poland	3.3	3.4	3.5	3.5	8.4	6.8	7.4	7.4
Romania	2.8	2.7	2.9	3.1	7.9	7.5	7.8	8.0
Russia	0.6	–4.4	–1.8	0.5	–7.0	–20.0	–4.0	3.0

Source: OeNB-BOFIT April 2015 forecast, Eurostat, Rosstat.

Note: CESEE-6 = Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania; 2014 figures based on seasonally adjusted data.

[1] *CESEE-6: Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania.*

[2] *Compiled by Julia Wörz with input from Stephan Barisitz, Markus Eller, Florian Huber, Mathias Lahnsteiner, Isabella Moder, Thomas Reininger and Zoltan Walko.*

[3] *Cut-off date for data underlying this outlook: April 2, 2015. The projections for the CESEE-6 countries were prepared by the OeNB, those for Russia were prepared by the Bank of Finland in cooperation with the OeNB. All projections are based on the assumption of a gradual recovery in the euro area in line with the March 2015 ECB staff macroeconomic projections for the euro area. This implies real annual GDP growth in the euro area of 1.5% in 2015, 1.9% in 2016, 2.1% in 2017 and a gradual increase of the oil price over the projection horizon in line with the upward sloping oil price futures curve. We assume no further escalation of the Ukraine-Russia conflict, but also no settlement and hence a prolongation of the current sanctions over the entire projection horizon.*

crisis in Ukraine. Private consumption will be curbed by high inflation. Imports will continue to decline sharply – by an estimated 20% – due to shrinking domestic demand, the weak ruble and falling export proceeds. In 2016 and 2017, a moderate recovery in oil prices will help revive export revenues and cause the contraction of the economy to fade.

1 CESEE-6: growth remains broadly based but too moderate to accelerate catching-up

For 2015, we expect all elements of the currently fairly growth-friendly environment to remain intact.[4] Low inflation – even deflation in Bulgaria in the last 18 months and more recently also in Hungary – will provide leeway for continued monetary policy accommodation. Low energy prices help purchasing power to remain high. Moreover, some countries have taken policy measures to support domestic demand further. Also, we expect no headwinds from the fiscal side, except for Croatia. Here consolidation needs remain considerable, as reflected in our projection of a decline in public consumption over the entire forecast horizon. Nevertheless, the Croatian government has lowered income taxes recently to boost consumption. No substantial fiscal tightening is in the offing for Bulgaria, either, despite the repayment of insured deposits following the failure of Corporate Commercial Bank. The recovery in CESEE-6 labor markets will also continue, supported by policy measures in some countries. In January 2015, wages hikes took place in the Czech Republic (public sector wages) and in Romania (minimum wage). We expect employment to keep rising and the gradual decline in unemployment rates to continue.

Contribution of domestic demand remains stable

The contribution of domestic demand remains stable in all countries throughout 2015–2017 with the exception of Hungary. Here, the contribution will recede in 2016 and 2017, as the central bank's Funding for Growth Scheme (FGS) programs expire and one-off factors supporting households in the conversion of foreign currency loans disappear; other reasons include the generally lower investment rates following exceptionally high levels in 2014 and 2015. Overall, GDP growth in CESEE-6 will be driven essentially by domestic demand from the private sector, whereas public consumption growth will fall short of private consumption growth over the entire forecast horizon.

Private consumption growth in the CESEE-6 countries will accelerate in 2015 and settle at slightly above 3% in 2016 and 2017. The two outliers are Romania (where private consumption will moderate, having increased by as much as 5.4% in 2014) and Croatia (where private consumption growth will increase most among the countries in the area but reach only 2% in 2017). Overall, the contribution of private consumption to GDP growth will remain steady or increase slightly over the projection horizon. As mentioned above, public consumption will not substantially add to GDP growth even as consolidation pressures have eased. In Croatia, it will even show a slightly negative growth contribution because of the excessive deficit procedure.

Investment growth is softening on a high level

Given an exceptionally strong expansion of gross fixed capital formation (GFCF) in 2014 as a result of overlapping fund disbursements under two EU multiannual fiscal frameworks, we expect investment growth to decelerate in

[4] *See "Developments in selected CESEE countries" in this issue.*

2015. With the EU funding overlap ending in 2015, EU-cofunded investment activities are slowing down, without sufficient replacement by (purely) private investment projects. Nevertheless, gross fixed capital formation will remain strong at almost 5% on average amid sound financing conditions for firms (especially in Poland), rising domestic and external demand, and improved fiscal positions in most countries. Hungary and Croatia are the only countries where these factors are less pronounced or not in place. Hence, we do not expect to see any notable growth in private investments in those two countries, where gross fixed capital formation will continue to rely mostly on EU-cofunded projects. In Croatia, following six years of shrinking GFCF, the trough in gross fixed capital formation growth was reached in 2014. With still negative growth rates in 2015, we expect fixed investment growth to regain positive territory in 2016. In all CESEE-6 countries, gross fixed capital formation will expand in 2016 and 2017, receiving a slight push from increased EU fund utilization in many countries.

For the CESEE-6, euro area recovery provides increasingly favorable external conditions over the entire projection horizon. By driving up euro area demand for CESEE goods and services, the ECB's asset purchase programs will boost CESEE-6 export performance. In contrast, the potential effects on capital flows to the CESEE-6 region arising from quantitative easing in the euro area – such as appreciation pressures, lower interest rates or higher yields in the region – are likely to broadly offset each other.

Taking a small dip in 2015 to around 6% – partly compensating for extremely high export growth in 2014 and partly reflecting country-specific factors such as expiring expansionary effects from increased car production capacities in Hungary – export growth of the CESEE-6 countries will rise to almost 7% in 2017. In view of our external assumption on euro area growth, these rates represent a rather moderate expansion of export activity in the region, but they are in line with our assumption on euro area import demand and also reflect a slight deterioration in price competitiveness due to developments of relative wages and exchange rates. Given differing exchange rate regimes, especially the latter effect will vary between individual countries.

Strong import demand erodes positive growth contribution of net exports

However, in line with strong domestic demand and the strong import-export nexus especially in the more open CESEE-6 economies, import growth will also be strong, rising marginally from 7.2% in 2015 to 7.6% in 2017. As a result, the net contribution of external demand will hover around zero. Only Croatia, where domestic demand is lagging behind, will see a clear, positive contribution of 0.6 percentage points to 1 percentage point. In Bulgaria and Romania, the growth contribution of net exports will be negative, at about –1 percentage point in all years covered by the projection.

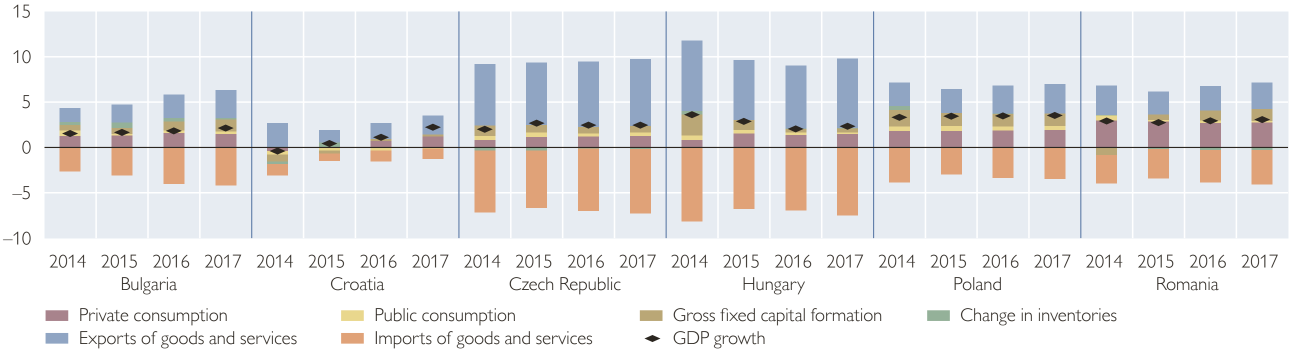
Risks to growth remain on the downside

The two major downward risks are linked to the recovery in the euro area (which constitutes a significant element of our baseline projection) and to the Russia-Ukraine conflict. Regarding the first risk, weaker than expected growth in the euro area – which may result from smaller or delayed effects of the ECB's quantitative easing measures, additional fiscal consolidation needs or even new sovereign debt market tensions – would dampen external demand and hence growth in the CESEE-6 region. A second downside risk stems from an escalation of the conflict in Eastern Ukraine. In February, a ceasefire was agreed in Minsk as a first step of a broader conflict settlement package. After a serious breach of the

Chart 1

GDP and GDP components, projections for 2015 to 2016

Percentage points; GDP growth: year-on-year in %



Source: OeNB.

ceasefire in the first days, fighting lessened noticeably but violations continued to be reported. In our baseline scenario, we assume these violations to become more seldom over time, so that the conflict would become frozen. Yet the risk of a further escalation remains elevated pending full implementation of the Minsk agreement. While the current situation has not shown a large negative impact on growth in the CESEE-6 region so far, a substantial widening of the conflict could have a major impact.

In contrast, we consider the downward risk emanating from monetary policy tightening in the U.S.A. to be rather contained for the CESEE-6 countries given moderate previous capital inflows during the period of loose U.S. monetary policy, rather sound fundamentals compared to other emerging countries and simultaneous quantitative easing by the ECB, which would remain the dominant factor in shaping the external environment. Risks arising from unexpected oil price developments are broadly balanced.

Overall, upside risks to growth in the CESEE-6 countries are small and relate to a stronger than projected recovery in the euro area that might materialize thanks to structural reforms and the effects of the European Commission's investment plan for Europe. The full implementation of the Minsk agreement and the subsequent lifting of sanctions against Russia before the end of the forecast horizon would also push growth beyond our baseline projection through increased exports, predominantly for Poland. However, this is unlikely to happen soon in our view, as many obstacles remain.

2 Projections for Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania

Bulgaria: gradual revival of domestic demand, yet no economic takeoff

While Bulgaria managed to avoid a pronounced slowdown in economic activity despite last year's failure of Corporate Commercial Bank (CCB) – one of the largest domestically owned banks – there are no signs of a significant acceleration of growth beyond 2% until 2017. In 2014, domestic demand reemerged as a positive growth driver, while net exports contributed negatively. We expect this pattern to persist over the whole forecast horizon.

The clarification of CCB's status and the repayment of insured deposits starting in December 2014 strengthened economic confidence, with both private and public consumption gaining momentum in the second half of 2014. At the same time, the labor market has continued to stabilize on the back of declining unemployment and rising employment rates. Moreover, a marked improvement in capacity utilization is indicative of a turning investment cycle. Based on these recent developments, we expect that domestic demand will steadily gain pace and gradually push GDP growth from 1.6% in 2015 to slightly above 2% in 2017. The only exception is public consumption, which is expected to widen only modestly in the near future, given that the leeway for fiscal easing has shrunk as a result of the government's CCB-related interventions in 2014. Instead, fiscal prudence will be required to bring the budget deficit back below the domestic target of 2% of GDP and to rebuild fiscal buffers.

A stronger takeoff of domestic demand during the forecast horizon is currently not a realistic scenario given that the Bulgarian economy is potentially constrained by deflation and political uncertainty. Declining energy prices have been the main reason for consumer price deflation in Bulgaria since August 2013. Although electricity tariffs were raised in the second half of 2014, the marked decline in international oil prices in 2014 will most likely result in continuing deflation this year.

In line with our external assumptions, we expect exports to accelerate gradually over the forecast horizon. Monetary easing in the euro area and the resulting depreciation of Bulgaria's anchor currency should stimulate exports. Yet import growth will most probably outpace export growth, reflecting resurging domestic demand and only moderate FDI inflows in recent years.

Croatia: slow recovery, domestic demand to pick up from 2016 onward

After six years of recession, we expect 2015 to finally mark the turning point for the Croatian economy, with slight GDP growth at 0.4%. Private consumption will stagnate despite the stimulus stemming from the income tax reform, as it continues to be held back by weak labor market conditions and high household indebtedness. In line with ongoing consolidation efforts under the excessive deficit procedure public consumption will pose the largest drag on growth; however, some fiscal slippage may occur in the second half of 2015 in light of the upcoming parliamentary elections (due in February 2016 at the latest). No recovery is expected for investments, but their negative impact on growth should be eased by positive stock changes after three years of destocking. The only positive contribution will stem from net exports, as the recovery of the euro area will boost exports and imports will still be subdued due to stagnant private consumption.

For 2016, we expect a broader recovery with a growth rate of 1.1% due to rebounding domestic demand and another year of positive stimulus from net exports. Private consumption should finally recover on the back of improving labor market conditions and higher credit growth. Public consumption, however, will still be constrained by consolidation efforts. Given improved utilization of EU funds, we expect investment growth to turn positive for the first time since 2008. Looking ahead, we forecast an acceleration of growth to 2.2% for 2017 as domestic demand will strengthen further, driven by higher private consumption and investments and easing public consolidation pressures. Although imports will pick up in line with domestic demand, we expect a positive contribution of net exports due to an ongoing rise in external demand.

This country forecast is subject to some additional downside risks beyond those affecting the CESEE-6 region as a whole. The impact of austerity measures could be stronger than anticipated and drag public consumption down more strongly than expected. Also, the pickup in investments from 2016 onward could be hampered if problems in utilizing the EU funds occur (e.g. because of domestic cofinancing constraints).

Czech Republic: settling on a broad-based growth path

For the Czech Republic, we forecast GDP to grow by 2.7% in 2015, followed by slightly lower growth rates of around 2.5% in both 2016 and 2017. The somewhat stronger performance in 2015 is based on external developments, most notably the low level of the oil price, which is expected to boost GDP growth by an additional 0.2% in 2015. Again, we expect domestic demand to be the main driver of economic growth, with its contribution rising from around 2% in 2015 to almost 3% in 2017.

Government consumption is expected to increase by 2.2% in 2015, based on the pro-growth fiscal policy mix of the new government, and to fall to slightly lower levels in 2016 and 2017. Meanwhile, private consumption is projected to rise by 2.5% in 2015 to around 2.7% in 2017. This slight upward trend is based on tax cuts, increasingly supportive labor market conditions, comparatively low energy prices and moderate real wage growth. Higher capacity utilization and increasing foreign direct investment inflows will support investment activities. Gross fixed capital formation will expand by more than 3% in 2015 and more moderately in 2016 and 2017. This is again supportive of our view that the current recovery might be broadly based as it is driven by a sustained increase in private consumption and investments rather than a single growth driver.

Recently, low commodity prices have exhibited downward pressure on inflation, urging the Czech National Bank (CNB) to extend its exchange rate interventions to the end of 2016. In addition, the CNB communicated that it might move the exchange rate commitment to a weaker level to avoid a slump in domestic demand, if necessary. Assuming that the CNB will keep the exchange rate cap at the current level in view of recent inflation figures, this translates into export growth rates of around 8.5% in 2015 and 2016, which are expected to recede somewhat to 8% in 2017. The positive development in exports is mainly supported by positive trends in traditional export markets and products, most notably the automotive industry.

Hungary: currently strong but decelerating growth

Following a strong expansion by 3.6% year on year in 2014, we expect GDP growth in Hungary to decelerate to around 3% in 2015. The major factor behind the slowdown of growth should be a substantially smaller expansion of investment activity than in 2014. Investment activity is expected to continue to benefit from the following factors: the low interest rate environment, rising and relatively high capacity utilization rates in industry, improved business sentiment, the extension of the central bank's Funding for Growth Scheme (FGS) along with the launch of an additional scheme (FGS+) under which the central bank not only provides liquidity but also temporarily assumes part of the credit losses of banks, thus substantially broadening the base of potential borrowers. However, considering the high level of investment activity in 2014, which was also promoted by residual EU funds from the 2007–2013 programming period, we expect a marked deceleration in investment growth in 2015. Assuming that the FGS schemes will end by mid-2016, we expect a further slowdown in 2016–2017, albeit with an upside forecast risk, as nonsubsidized bank lending might have picked up by that time.

We expect private consumption to receive a boost in 2015 from the reduction of households' debt service payments and debt burden following the settlement of foreign currency loan contracts (i.e. retroactive compensation by banks for exchange rate margins on foreign currency loans and for unilateral hikes in interest rates and fees) and their conversion into forint loans. Consumption growth is expected to decelerate somewhat in 2016 as this one-off factor tapers out. Nevertheless, solid real wage growth, employment gains and the improved financial position of households should keep consumption growth at close to 3% in 2016–2017. Public consumption growth will continue to be determined by the government's intention to keep the budget deficit below 3% and state debt on a decreasing path. Consequently, public consumption growth will lag overall GDP growth by a considerable margin.

We expect the contribution of net real exports to remain small over the whole forecast horizon. Exports are projected to expand by 7% to 7.4% annually, which should slightly be exceeded by import growth on the back of strong domestic demand. As the latter slows down by 2017, we expect the contribution to turn from slightly negative to slightly positive.

Poland: growth robust to geopolitical tensions

In Poland, economic growth will accelerate slightly to 3.4% in 2015, after 3.3% in 2014. The dampening effect on exports arising from the Russia-Ukraine conflict coupled with a recession in both countries will be partly offset by higher growth in the euro area and, in particular, higher German import growth. Thus, we forecast export growth for 2015 as a whole to fall only slightly short of last year's robust rate of expansion. Corporate fixed investment growth, which enjoyed a strong, nearly double-digit rebound effect last year after stagnating in 2013 and contracting in 2012, will suffer from this base effect, the temporary dampening of export growth and the instability of foreign demand coupled with uncertainty related to the Russian-Ukrainian crisis. Although investment will thus consist mainly in replacement and renovation, its growth will be supported by recently strengthened private consumption demand and the favorable financing situation. The latter results from a strong liquidity position of the corporate sector, easing supply-side constraints and disbursements of EU funds under the 2007–2013 financial framework still available in 2015. The latter factor will also underpin public investment. A higher number of building permits and starts of dwellings – which are likely to have been enhanced by a targeted government program – signals a further acceleration of housing investment. Total fixed investment growth will decelerate to the still robust rate of 6.8%. Private consumption growth will continue at a stable solid rate, as households' disposable income will rise: The improved position and substantial profitability of the corporate sector will underpin further wage and employment growth, while the increase of social benefits for low-income households achieved by adjusting both the pension indexation scheme and tax deductions for families with children will further enhance disposable incomes. While deflation will increase real income additionally, it may motivate some households to postpone larger consumption purchases. Public consumption growth will be contained by the continued partial freeze of public wages to advance fiscal consolidation. Overall, while exports remain the single most important component of total final demand growth, the contribution of total domestic demand will remain larger than that of exports. As a result of lower investment growth and due to the fact that the demand for imported intermediate products is usually higher in the initial stages of recovery (like in 2014), we forecast import growth to clearly decelerate in 2015, but to remain robust and to still outpace export growth. This will translate into a less negative contribution of net exports to GDP growth in 2015 than in the previous year.

In 2016, we forecast GDP growth to accelerate moderately to 3.5%, driven by a higher contribution of export growth, which will materialize thanks to stronger foreign (in particular German) demand and despite probable currency appreciation. By contrast, the contribution of total domestic demand will slightly decline, as we expect lower fixed investment growth (in particular due to a drop of public investment after the window for disbursements under the EU 2007–2013 financial framework will have closed) and lower public consumption growth (assuming renewed efforts directed at countercyclical fiscal consolidation after the elections in 2015). As a result of higher export growth, import growth will accelerate as well, but – given the slightly weaker expansion of domestic demand – to a lesser extent than exports. Still, the contribution of net exports to GDP growth will remain marginally negative.

Romania: strengthening domestic demand keeps growth at around 3%

Following a weak performance in the first half of 2014, Romania's GDP growth surprised on the upside thereafter, bringing full-year growth to 2.8%. In the period 2015–2017, we expect GDP growth to remain at about 3% with a rising tendency (from 2.7% in 2015 to 3.1% in 2017). The decline in oil prices and the recession in Russia only have a marginal impact on the Romanian economy. Fiscal adjustment is largely completed, as the European Commission projects the structural budget deficit to decline by only 0.1% in 2015 before increasing by the same extent in 2016.

As regards private consumption, Romania's sound export performance in recent years already translated into considerable private sector wage growth (in nominal and real terms). A further increase of the minimum wage in January 2015 affecting approximately 20% of employees already gave a further boost to real disposable income and will support private consumption. Moreover, the unemployment rate trended downward and consumer confidence improved markedly. We also see room for a recovery of private and public GFCF over the forecast horizon for the following reasons: improving economic sentiment, a higher degree of macroeconomic stability (e.g. due to low inflation and small fiscal and current account deficits), lower borrowing costs, tax changes already implemented (e.g. tax exemption for reinvested profits), higher spending on public investments budgeted for 2015, as well as ongoing efforts to improve the absorption of EU funds.

Exports are forecast to maintain their positive momentum in line with our external assumptions. Yet, weak (and most recently negative) GFCF growth and low FDI inflows in recent years have constrained the buildup of additional export capacities. Therefore, export growth rates will turn out somewhat lower than in 2013 and 2014. As recovering domestic demand will increase import demand, net exports will contribute negatively to overall growth.

3 Russia: recession and sharp import contraction

The decline of Russian export prices caused by the plunge in oil prices in late 2014 pushed the country's economic growth into negative territory: In the first months of 2015, GDP started to contract (even year on year). Without transient factors – such as a strong uptick in defense spending and consumers rushing to spend rubles as the currency's value dropped – the economy would have contracted already in 2014.

For 2015, we forecast Russian GDP to decline by 4.4%. As global economic growth and trade will pick up and oil prices are projected to rise again, the Russian economy will show a better performance in 2016 but continue on a slight downward trend (–1.8%), before slowly recovering in 2017 (+0.5%).

This forecast assumes oil prices to average at slightly over 55 USD/barrel in 2015, i.e. almost 45 USD/barrel below the 2014 average, before they will rebound to about 65 USD/barrel in 2016–2017 on average. The impact of the adjustment is profound, since energy exports account for almost one-fifth of Russia's GDP. Moreover, the Ukraine crisis, sanctions, countersanctions and control measures imposed by the authorities on business and trade have increased uncertainty about Russia. The sanctions are assumed to remain unchanged and the geopolitical tensions to persist for a rather long period. Fiscal policy is expected to remain relatively tight: In contrast to the crisis of 2008/09, government spending is set to decline in real terms.

High uncertainty undermines private investment

Given these factors, high uncertainty (including possibilities for fresh sanctions) will continue to undermine private investment in 2015 and 2016. The relatively high interest rates will probably also put a strain on business prospects. Investments of state enterprises – campaigns to boost them have been toned down by the authorities – and large projects financed by the state and state-owned banks are likely to generate only a relatively modest impact. Public funding has been diverted to support corporate efforts to repay foreign debt. As the recession hits, firms will also cut inventories further. The drop of capital formation is expected to flatten toward the end of the forecast period. Private consumption will be held back by rapid, though gradually slowing inflation. Thus, consumption will decrease markedly in 2015, and also slightly in 2016. Given slim growth prospects for wages and pensions, it will take time for private consumption to recover. Public consumption will remain constrained amid pressures on state finances. In December 2014, President Putin called for reducing federal budget expenditure in 2015–2017 in real terms – except for defense and internal security spending.

Russian imports are expected to shrink by one-fifth following the acceleration of the fall of the ruble in late 2014 and given the country's expected economic contraction in 2015 as well as the loss of export proceeds triggered by the oil price setback. The import decline will level off after 2015 as the economic contraction eases and the ruble's real exchange rate strengthens again, since inflation will likely remain much higher in Russia than in its trading partner countries. In the absence of new shocks that would fuel capital outflows, the Russian currency's nominal exchange rate is expected to remain fairly stable. After 2016, imports are likely to rebound somewhat on the back of recovering export income. While exports will benefit from the upswing of world trade and the moderate rise of oil prices, they are likely to expand very slowly for structural reasons. Over the longer term, given the persistently rough business climate and the dismal outlook for private investment, the foundations of economic growth appear to be eroding.

Risks to the Russia forecast are high and mostly on the downside

The risks to this forecast relate particularly to elevated uncertainties about both internal and external factors. One major external risk factor is a lower or higher oil price than assumed in our baseline scenario. In any case, such unexpected price changes would have immediate substantial effects on the ruble, export income, state revenues and import spending. Further, a long-lasting solution to the Ukraine conflict poses a considerable upside risk to our Russia forecast, but we attach a very low probability to this risk. In contrast, an intensification of the Ukraine crisis or additional sanctions against Russia would further weaken corporate incentives to invest.

With respect to internal factors, domestic policies might cause business sentiment to deteriorate beyond expectations; ongoing capital flight could lead to a further depreciation of the ruble and increased inflation, curbing consumption and imports beyond expectations. On the upside, rather than containing investment and consumption, domestic policies – in particular fiscal policy – could turn out to be more supportive in the short run than envisaged in our baseline scenario.