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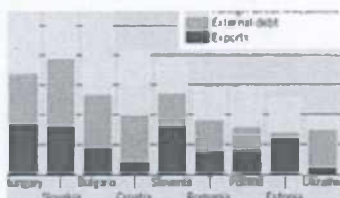
# Slowdown in west hits eastern states

By Neil Buckley, East European Editor

The shiny Eurocable factory in rolling hills north of Zagreb is just the kind of manufacturing plant central and east European countries have been striving to build in recent years.

The Croatian cable maker exports 80 per cent of its production, mostly to the European Union. But as the eurozone's economy slows, Eurocable is having to slice profit margins to the bone to retain orders – especially in its most prized market, Germany. "We're working a lot and not earning sufficiently," says Drazen Matiegka, managing president.

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The eurozone market is all the more important because Croatia and its Balkan neighbours have scarcely begun to recover from the 2008-09 financial crisis. "Croatia is dead, the region is dead," says Mr Matiegka.

With economists warning that the eurozone's debt crisis could even push it back into recession, 2012 growth forecasts are being sharply reduced for the former socialist economies further east. Many of them rely heavily on the single currency area as export destination and financing source.

Investors are getting jittery. With important exceptions such as Poland, "emerging" Europe was collectively the region hardest hit by the last crisis. Half a dozen countries needed International Monetary Fund bail-outs, though sovereign defaults were avoided.

The European Bank for Reconstruction and Development, set up to support the region's post-communist transition – and which played a key crisis response role in 2008 – last week cut its growth outlook for Europe's eastern portion for next year. For central Europe and the Baltic states, it halved the 2012 forecast to 1.7 per cent, from 3.4 per cent three months earlier. For south-east Europe, including Romania, Bulgaria and former Yugoslav states, the EBRD hacked its forecast from an earlier 3.7 per cent to 1.6 per cent now.

The EBRD's forecasts were much weaker than the IMF's a month earlier – though the spread of market forecasts is unusually wide, reflecting uncertainty over when the eurozone crisis might be contained.

Some countries are also cautioning against excessive gloom.

Poland, the only EU economy to avoid recession in 2009, is confident it can be resilient again. It has relatively healthy banks and a bigger domestic market than export-reliant neighbours such as Slovakia. Recent industrial output and retail sales figures have been buoyant.

Hungary admits it is more vulnerable to a slowdown further west. But the government is so far sticking to a 1.5 per cent growth forecast for next year, three times the EBRD's estimate. "We have to see whether there will be any significant and meaningful solution to the euro crisis," says Tamas Fellegi, national development minister. "We still think that if there is no significant deterioration of the situation, this might be a realistic figure."

Austria's Erste Group, a big east European lender, published a study this month concluding that the region was "better prepared for the new storm". The gaping current account deficits and reliance on short-term external financing, which poleaxed central European countries when credit flows dried up after the collapse of Lehman Brothers, had been closed or greatly reduced, the bank said.

The EBRD agrees that the region is better placed to withstand a Lehman-sized shock. But it warns that any shock could be more powerful this time, if the eurozone crisis spreads to bigger economies such as Italy and threatens west European banks that dominate banking in emerging Europe.

If national governments start having to rescue banks, it says they might restrict banks' support for eastern subsidiaries, resulting in a "large contraction of credit ... with potentially severe consequences for output".

Erik Berglof, EBRD chief economist, says careful policy co-ordination is needed in any moves to recapitalise banks. He is calling for a "second Vienna Initiative", referring to a 2009 programme that ensured banks did not pull out of emerging Europe.

For now, some companies in the region report little sign of a slowdown. At its €1bn ($1.4bn) car plant in Zilina, Slovakia, South Korea's Kia is ramping up production – hiring 1,000 workers and planning to add a third shift by the first quarter of next year. "At the moment we are not able to fulfil customer demand," the group says.

*Additional reporting by Neil MacDonald in Belgrade and Jan Cienski in Warsaw*

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