Central and Eastern Europe is standing at a critical juncture on its economic path that may determine whether the region continues to outperform its western peers or is confined to economic doldrums. Policymakers need to stop a wave of foreign cash leaving the region, help the banking sector overcome the fallout of the Greek crisis and bolster pan-European efforts to diminish reliance on Russian energy. They have to decide whether supplying cheap labor to western manufacturers should remain the foundation of growth or whether they can steer the local economies towards a more value-added model. Decisions are being taken against the backdrop of financial strain from an ageing population and pressures stemming from the Ukraine crisis.

Top policy makers gave crucial insight on the future of the region’s energy policy, banking sector and the politics of migration at the Reuters Eastern Europe Investment. Reuters clients had a chance to learn about Hungarian interest rate prospects in unusually forthcoming remarks from deputy central bank governor Marton Nagy, Eurobond issuance plans in Romania as well as fiscal policy targets planned by opposition parties in Bucharest and Warsaw who may be on the brink of winning power. In Slovenia, which finds itself at the heart of the European migration crisis, Prime Minister Miro Cerar issued a stark warning to the European Union that its very existence may be at risk.
EU’s very existence at stake in migrant crisis, Slovenia warns

BY MARJA NOVAK
LJUBLJANA, SEPTEMBER 22, 2015

Europe’s migrant crisis may imperil the very existence of the European Union unless a long-term solution is found, Slovenian Prime Minister Miro Cerar said on Tuesday as his country struggles to cope with a wave of refugees.

Speaking on the eve of a crunch summit of EU leaders, Cerar told the Reuters Eastern Europe Investment Summit that a full deal on how to address the influx was unlikely this week, and might take another “few weeks or more”.

EU and euro zone member Slovenia, a former Yugoslav republic of 2 million people, has seen some 3,000 migrants cross its border with Croatia since last week, and is braced for many more.

“If we fail to find the right solution in the long term, the migrant crisis could truly threaten the existence of the European Union. But I am not a pessimist, I believe that we will find joint measures,” Cerar said in an interview in Ljubljana.

Cerar will join the leaders of the other 27 members of the EU at a summit in Brussels on Wednesday dedicated to tackling the arrival of hundreds of thousands of migrants.
Romania plans benchmark Eurobond before year-end

BY LUIZA ILIE
BUCHAREST, SEPTEMBER 24, 2015

Romania plans to sell a benchmark Eurobond of 1-1.5 billion euros ($1.69 billion) before year-end and could tap a World Bank credit line to meet its 2015 foreign issuance target, its deputy treasury director said on Thursday.

The finance ministry aims to borrow 2 billion euros overseas this year but has yet to raise any funds in foreign markets, largely because of volatility stemming from Greece’s debt problems and worries about Chinese economic growth.

“We are at that stage where we are monitoring market conditions so as to choose the right moment to issue,” deputy treasury director Diana Popescu told Reuters at the Eastern Europe Investment Summit. “In the following period we plan to issue a benchmark Eurobond of 1 to 1.5 billion euros.”

Popescu said the ministry may consider a potential second issue if conditions improve significantly, but that it also has the option of taking up to 750 million euros in World Bank development loans.

She added: “It is not a pressure as the treasury’s hard currency buffer currently covers more than four months of funding needs.”

Romania is rated an investment grade Baa3 by Moody’s and BBB- by Fitch Ratings and S&P.

Foreigners currently hold 17.1 percent of Romania’s outstanding domestic debt, compared with 20-21 percent throughout 2014.

Popescu said the Federal Reserve’s decision to postpone a landmark rise in U.S. interest rates would help demand for local debt while Romania also benefits from its budget surplus, low public debt to GDP ratio and buoyant stock market.

“The biggest risk factors for Romanian domestic debt yields and demand are external conditions, and the funding is depending very much on the size of next year’s budget deficit,” she added.

Earlier this month Romania approved a 4 percentage point cut in value-added tax, to 20 percent from 2016, postponing several other cuts by one year to avoid a fiscal blowout.

Popescu said the current 2016 budget deficit estimate stood at 1.9-2 percent of GDP, meaning foreign issuance next year is likely to total 2-2.5 billion euros.

But a planned overhaul of public sector wages could push the deficit to 2.9 percent, just below the European Union’s 3 percent of GDP ceiling, in debt managers’ worst-case scenario. Earlier, Romania’s fiscal watchdog had also identified the planned wage rises as a risk to the deficit.

“There are absolutely no expectations of this scenario or going above this level because it would put us in the EU’s excessive deficit procedure,” Popescu said.

But “in the unlikely worst-case scenario of a 2.9 percent deficit in 2016, we would need to change the maturity structure of domestic debt issues and the amount we sell on international markets.”

The most pessimistic scenario would mean that 60 percent of domestic debt issues would have medium and long term maturities instead of the envisioned 70 percent, with the remaining 40 percent at short-term maturities. Foreign debt issuance in 2016 would meanwhile rise to up to 4 billion euros.

Even then, public debt would not go above 41 percent of GDP, Popescu said, a fraction of other EU states’ debt ratios.
Romanian opposition may bring forward tax cuts if government falls

Romania’s main opposition will stick to the government’s tax-cutting program if it succeeds in toppling Prime Minister Victor Ponta’s coalition and may even accelerate some of its measures, its leader said on Monday.

National Liberal Party (PNL) leader Alina Gorghiu plans to present a no-confidence motion in parliament at the end of September to unseat Ponta, who faces trial after being indicted on corruption charges last week.

She ruled out a coalition with Ponta’s Social Democrats, saying she planned a minority government, with former justice minister Catalin Predoiu as premier.

A general election is due at the end of 2016 and her remarks suggest investors could expect some degree of continuity in fiscal policy.

Gorghiu also wants Romania to negotiate a new aid deal with the International Monetary Fund, the European Commission and the World Bank when the existing agreement expires in September.

“I would see, if the motion passes, a minority PNL government with a PNL prime minister,” Gorghiu, co-president of the center-right party, said at the Reuters Eastern Europe Investment Summit.

Parliament voted through tax cuts this year in a program known as the Fiscal Code, but watered them down after the fiscal council and the central bank among others criticized them as profligate.

“The fiscal code remains as it has been discussed with the PSD and the other parties during consultations. It emerged as a political consensus ... and its main attribute was to offer stability to the business environment,” Gorghiu said.

Some measures including lowering levies on dividends and fuel, and scrapping a tax on special buildings, were postponed to 2017. But the cuts “could become reality earlier if economic figures would show this thing is possible,” Gorghiu said.

Editing by Matthias Williams/Ruth Pitchford
Bulgaria is ready to finalise a deal to build a gas link to neighbouring Greece but is waiting for the new government in Athens to move ahead with the project, Bulgaria’s Deputy Energy Minister Nikolay Nikolov said on Wednesday.

Bulgaria wants to build the link as part of its efforts to wean it off near total dependence on Russian gas and turn itself into a regional energy hub.

But the 182 km (113 mile) project has repeatedly fallen behind schedule since it was first conceived in 2009 after a gas price spat between Ukraine and Russia.

It aims to tap gas from Azerbaijan, and can also carry gas from Greece’s liquefied natural gas (LNG) terminal. Recent delays mean the project will finish at the end of 2018, against an earlier target of mid-2018, Nikolov said.

Bulgaria’s state energy holding BEH has a 50 percent stake with the rest held by Greek state gas operator DEPA and Italy’s Edison (EDN.MI). It will pump up to 5 billion cubic meters (bcm) of gas per year.

“What we are expecting to happen is the final investment, which we have to sign,” Nikolov said at the Reuters Eastern Europe Investment Summit, referring to the final investment decision (FID) for the deal.

“If you ask us, we can sign it tomorrow. So it actually depends on our Greek col-
leagues and given that the new government is in place as of today, we are expecting as soon as possible for them to sign the FID and therefore start the project."

His government is in talks with the European Commission to help fund the link. Brussels has committed 45 million euros ($50 million) thus far, and Bulgaria hopes for more.

“At the end of the day, the grant will actually improve the viability of the project, its rate of return, which is something of a concern to our partners,” Nikolov said.

He added that a planned link with Romania should be finished by next year, after the government issued a new tender to build a part of the link that goes underneath the Danube river, which had been abandoned by previous contractors.

POWER REFORMS

Nikolov also promised to implement reforms to deregulate the Bulgarian power market, including by launching a power exchange and freeing up energy prices, by March next year.

The reforms should help ease the 3.7 billion leva ($2.1 billion) debt burden of state power provider NEK.

Once NEK’s finances have stabilised, Bulgaria could take a “political decision” on whether to float some state-held energy assets on the Sofia bourse in 2017, including the state energy holding BEH, Nikolov said.

Despite a recent downgrade by global ratings agency Fitch, Nikolov said BEH’s bid to raise up to 650 million euros, either through a loan or bridge-to-bond financing, has already attracted the interest of some large banks. He hopes BEH will have secured the funds by end-November.

Nikolov does not expect gas supply disruptions this winter that could have resulted from tensions between Russia and Ukraine, saying Bulgaria was building up gas reserves.

Poland’s opposition pledges to keep 3 pct deficit cap

REPORTING BY PAWEL SOBCZAK, ADRIAN KRAJEWSKI, PAWEL FLORKIEWICZ AND AGNIESZKA BARTECZKO
WARSAW, SEPTEMBER 24, 2015

Poland’s main opposition party, which leads in polls ahead of an October election, will keep the fiscal deficit under the European Union’s ceiling of 3 percent of gross domestic product if it wins power, an influential lawmaker said on Thursday.

“Our budget policy will remain within these safe limits, and we will not breach the magic level,” Pawel Szalamacha, the conservative Law and Justice party’s (PiS) main economic policy experts, told the Reuters Eastern Europe Investment Summit.

Poland exited the EU’s excessive deficit procedure, a sin-bin for countries running deficits in excess of 3 percent of output, earlier this year.

Last month, rating agency Standard & Poor’s said Poland would lose its positive outlook on its credit rating if it fell back into the procedure or breached budget spending safeguards written into Polish law.

Szalamacha said exiting the excessive deficit procedure was “an achievement that one cannot disregard” but that Poland’s spending rules may have to be modified or temporarily loosened if they conflict with PiS priorities such as policies encouraging people to have children.

“The spending rule will have to be adjusted accordingly if we need money to finance the implementation of our policy priorities,” Szalamacha said.

If it wins the October election, PiS says it will hike public spending by 2.3 percent of GDP, which it mostly wants to finance with better tax collection and new levies.

The party is considering some form of a bank tax, either on assets -- which it says would raise more than 5 billion zlotys (1.18 billion euros) -- or financial transactions, which PiS estimates would bring in some 1.7 billion zlotys.

Szalamacha said he would prefer to tax assets but with a limit on the levy for lenders who agreed to participate in a scheme to help borrowers struggling with costly Swiss franc mortgages -- one of the party’s key election promises.

“We should try to link the two so that any hypothetical bank losses stemming from the mortgage issue could be divested from the banking tax,” Szalamacha, who was deputy treasury minister in a previous PiS government, said.

Some half a million Poles have seen a sharp rise in the costs of servicing mortgages denominated in the Swiss currency after the franc soared to a record high against the zloty.

As the election nears, all the major political parties have proposed relief measures for borrowers, with banks seen bearing almost all of the costs.

PiS is also considering a levy on supermarkets. Szalamacha said he favoured a revenues tax, with the rate growing depending on a retailer’s income.

He also said dividend policies at Poland’s state-run companies, which include Europe’s second-largest copper producer KGHM KGH.WAs well as power producers and chemical groups, should be related to their investment plans.

“The dividend policy should be formulated within a few years’ time frame in all the state-run companies and correlated with their investment policies,” Szalamacha said.
Bad loans in Bulgaria have peaked, says Unicredit Bulbank executive

Bad loans at Bulgarian banks have already peaked apart from a possible one-off spike once the troubles of failed Corpbank are cataloged, the chief executive of major lender Unicredit Bulbank said on Monday.

Non-performing loans surged after the global financial crisis punctured a real estate and construction boom in Bulgaria’s fledgling economy. They stood at 16.9 percent in 2013.

Levon Hampartzoumian told the Reuters Eastern Europe Investment Summit that a significant part of Bulgaria’s bad loans were well collateralized and getting value out of them was a matter of time.

He also said bad loans at his bank, part of Unicredit Group (CRDI.MI) were at a manageable level and that it would not look to sell on its non-performing loan portfolio.

“I believe the peak of non-performing (loans) is behind us. You may see some non-performing spikes because of Corporate Commercial Bank’s one-off effect on the system, but generally judging also from our non-performing portfolio, I think the worst is behind us,” he said.

A full audit at Corporate Commercial Bank 6C9.BB is expected next month after the central bank seized control over Bulgaria’s fourth-largest lender and shut its operations. An initial audit showed a lack of information on many of its loans.

The banking crisis has raised concerns about the quality of banking supervision in Bulgaria, the European Union’s poorest state.

Hampartzoumian joined calls by Bulgarian politicians for the country to join Europe’s Single Supervisory Mechanism (SSM) and allow European control over its banks to restore trust in the system.

Bulgaria would be the first country outside the 18-nation euro zone to join the...
Czech electricity producer CEZ (CEZP.PR) will consider bidding for lignite power plants in Germany put up for sale by Sweden’s Vattenfall VATN.UL earlier on Tuesday, its chief financial officer told Reuters.

State-owned Vattenfall, which is under pressure from the Swedish government to get out of its profitable lignite power business in Germany because it is heavily polluting, said it would sell its German lignite plants.

“We are definitely ready to look at the assets,” Chief Financial Officer Martin Novak said at the Reuters East European Investment Summit in Prague.

The plants could be operated profitably for years to come despite current low electricity prices, which have deterred investors from building new power capacity, he said.

“The logic is very simple,” Novak said. “Yes, it makes no sense to build anything new (with power prices) at 30 euros per megawatt hour anymore but it does make sense to buy something, discounting it with cash flow.

“Which means if something is for sale you will be able probably to obtain it cheaper than building it from scratch today.”

“And yes, lignite plants might be something that one day will not be used for power generation any more but it will take a few decades.”

However, he said there were risks from potential regulatory shifts that must be weighed up in any acquisition.

CEZ, Europe’s seventh-biggest utility with a market capitalization of 10.3 billion euros ($11.5 bln), has maintained strong cash flow and lower debt than many of its peers.

The company has been looking at expansion opportunities as others are forced to sell.

Novak said he expected financial institutions might compete for the Vattenfall power plants in addition to energy companies.

Vattenfall said it would also sell 10 hydro power plants together with the lignite power stations. Novak said the inclusion of hydro assets could be a good balancing point for a heavy-carbon lignite portfolio.

EU’s very existence at stake in migrant crisis, Slovenia warns

BY JAN LOPATKA, JASON HOVET AND MICHAEL KAHN
PRAGUE, SEPTEMBER 22, 2015

Czech electricity producer CEZ’s logo is seen on the company’s headquarters in Prague March 17, 2013. REUTERS/DAVID W CERNY

SSM, set up in response to the global financial and euro zone debt crises.

“This to some extent will ... restore confidence, knowing that it is not just a local supervision but something overseen by European authorities,” he said.

The banking crisis has also put renewed scrutiny on the investment climate in Bulgaria. Ratings agency Standard & Poor’s downgraded Bulgaria’s credit rating in June and the country has struggled to revive economic growth and foreign investment.

The economy is expected to grow by 1.5 percent this year, after expanding by 0.9 percent in 2013.

Hampartzoumian said he hoped a stable government after an Oct. 5 election would boost growth, which could also boost bank lending to businesses.

The election will be Bulgaria’s third in two years. A Socialist-led government, whose one year in office was overshadowed by anti-graft protests, floods and a banking crisis, resigned in July.

“If after the election ... we have the opportunity to have a more stable political constellation, this creates conditions for higher growth of the economy,” Hampartzoumian said.

The center-right GERB party is tipped to win the election but may fall short of an outright majority, raising the risk of further political and economic instability.

The recovery will also depend on growth in the euro zone, a major export destination.

Hampartzoumian said Bulgaria’s economic growth of around 1 percent was not enough to boost business appetite, but that Bulbank, part of Unicredit group (CRDI.MI), was ready to boost lending if the economy picked up.

For now the bank plans to keep lending next year in line to levels in 2013 and this year. The bank’s credits grew by 3 percent for the first eight months to 9.53 billion levs, after 2.5 percent growth in 2013.

By Jan Lopatka, Jason Hovet and Michael Kahn
Prague, September 22, 2015

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Editing by Ruth Pitchford

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Editing by Susan Fenton
The National Bank of Hungary could cement its base rate at a record low 1.35 percent NBHI level until at least the third quarter of 2017 or beyond, helped by low inflation and compressing risk premiums, a deputy governor told Reuters.

On Tuesday the bank, which had brought down rates from a mid-2012 peak of 7 percent in two easing cycles, left the benchmark on hold but struck a dovish tone and cut its inflation forecasts for both this year and next.

That led some economists to believe it might trim borrowing costs further.

But Marton Nagy, who took office last month, quashed any such expectations in an interview at the Reuters Eastern Europe Investment Summit, adding that Hungary could keep the base rate low for longer than most market participants now project.

“The period of rate cuts is over,” he said on Wednesday, when asked about prospects of any further rate easing. “The Monetary Council is now focused on bringing down the longer end of the yield curve.

“The market believes that at the end of the second quarter (of 2017) it will be no longer possible to keep rates unchanged, that they will need to rise,” Nagy said. “We believe that rates can be maintained until the third quarter of 2017.”

He said the benchmark could stay unchanged even longer, “as long as possible,” but uncertainty over economic conditions over that kind of time frame did not allow for such a commitment.

Nagy said the central bank’s wiggle room was bolstered by low inflation, which the bank expects to approach its 3 percent policy target in the second half of 2017, as well as declining risk premiums on Hungary’s “junk”-rated government debt.

Local debt yields have fallen in the past months, driven by reforms to the central bank’s main policy instrument, which aims to squeeze liquidity out of central bank facilities and into government papers to curb financing costs across the economy.

The central bank announced in June it would replace its two-week policy instrument with a three-month deposit from September.

Banks will now be limited in how much they can put in two-week deposits, while tying it up over three months may be too long. As a result they are likely to be more inclined to invest in tradeable government securities.

Hungary sold three-month bills at an average yield of 0.38 percent on Tuesday and its yield curve is below those of investment-grade rated regional peers Poland and Romania up to the three-year tenor.

Nagy said the task was now to bring down longer yields and an additional 600 to 700 billion forints in demand from local banks for government debt due to the liquidity reforms could help facilitate that objective.

“For me it is more important to bring down longer yields,” Nagy said. “It is much more important that loose monetary conditions also manifest in those maturities because this is essential for investments as well as the state.”

“We can build a big room for maneuver there and stimulate the economy, because inflation allows this,” he said.

Nagy said the rate cuts and liquidity reforms have curbed the government’s debt financing costs by about 300 billion forints ($1.1 billion) this year, or about one percent of economic output. He said these costs may fall further still.

Nagy said the wiggle room provided by compressing risk premia could ensure that Hungary can eschew or postpone rate hikes once the U.S. Federal Reserve or European Central Bank starts tightening.

“We are building up that room for maneuver,” he said.

Editing by Ruth Pitchford

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Tomislav Ćorić
President of HDZ Committee on Finance
Croatia

Petia Dimitrova
Chief Executive Officer and Chairperson of the Management Board
Postbank

Ionut Dumitru
Chairman
Fiscal Council, Romania

Alina-Stefania Gorghiu
Co-President
Romania’s National Liberal Party

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