2014 CEE-4 Governments' Financing Needs

Special Report

Financing Needs Likely to Be Covered Smoothly

Moderate Borrowing Needs: Fitch Ratings expects the gross public borrowing requirement (GPBR) of the larger eastern-central European sovereigns of Poland, the Czech Republic, Hungary and Romania to reach EUR78.5bn in 2014 (9.5% of estimated aggregate GDP), down from EUR96bn in 2013 (12.4% of aggregate GDP). This compares favourably with an expected GPBR for the eurozone of 15.1%. However, as in previous years, there is some dispersion within the CEE-4, with Hungary having relatively larger financing needs.

Favourable Financing Conditions: In late 2013 and early 2014 financing conditions in the external markets were favourable for all CEE-4 sovereigns. Poland, Hungary and Romania all took advantage of this to issue Eurobonds. The Polish government has stated that it intends to fulfil half of its borrowing requirement for 2014 by end-January.

Recovery Aids Fiscal Discipline: An improving macroeconomic picture should facilitate budget goals. Fitch forecasts that all CEE-4 countries will run budget deficits in line with commitments undertaken at the EU level. For Hungary, the Czech Republic and Romania, this means a general government deficit below 3% of GDP. The agency expects Poland to make progress towards exiting the Excessive Deficit Procedure in 2015, notwithstanding distortions from the expected transfer of pension assets to the public sector in 2014.

Less Vulnerable to Turbulence: Moderate budget financing and debt redemption needs should help CEE-4 countries withstand market turbulence from the gradual withdrawal of US extraordinary monetary stimulus. The current-account balances of all CEE-4 countries have improved markedly since the crisis, and substantial buffers are in place. Poland and Romania benefit from multilateral financing arrangements (a flexible credit line from the IMF in Poland's case and a precautionary stand-by arrangement with the IMF and EU in Romania's).

Risks from Non-Resident Positions: Non-resident investors feature strongly in Hungary and Poland, where they hold half of government securities. The share is set to rise in Poland once the reform of open pension funds is completed, which could carry additional risks. Non-resident shares are lower in the Czech Republic and Romania, although they have risen in the latter.

Multilateral Repayments for Some: The medium- and long-term debt redemption profiles of Romania and Hungary will continue to be affected by the repayment of loans from multilateral institutions. In August 2013 Hungary prepaid a loan from the IMF, which reduces its future repayment burden.

Politics Pose Residual Risks: Several countries in the region face a busy electoral calendar in 2014 but Fitch does not expect the results to bring significant changes in economic policy. Nevertheless, there is a risk that political uncertainty could damage investor sentiment towards CEE-4, particularly if it coincides with periods of financial market turbulence or instability.

Related Research

European Government Borrowing in 2014 (December 2013)
Global Economic Outlook (December 2013)
2014 Outlook: Global Sovereigns (December 2013)

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Moderate Financing Needs, Favourable Market Access

Fitch projects that the CEE-4 countries of Poland, Hungary, the Czech Republic and Romania will need to borrow EUR78.5bn in 2014 to finance planned central budget deficits and debt redemptions (defined as gross public borrowing requirement, or GPBR). This is equivalent to 9.5% of aggregate projected GDP in 2014, considerably lower than 15.1% for the eurozone as a whole and down from 12.4% in 2013.

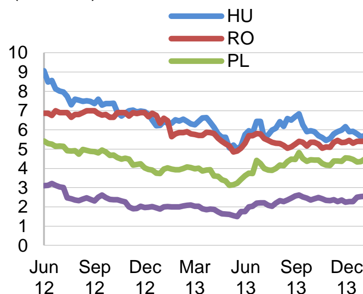
Poland, Romania and the Czech Republic have GPBRs of 10% of GDP or less. As in previous years, Hungary's requirement is higher, at 18.3%. This is less than the (realised) borrowing in 2013, which was equivalent to 30% of GDP, driven by larger-than-planned issuance of domestic (including retail) securities both in euros and Hungarian forints (HUF). The proceeds went towards bond buy-backs, the takeover of local government debt, and the prepayment of an IMF loan[1].

Figure 1
Central Government Gross Borrowing for 2014

(EURbn)	Central gov't deficit (1)	MLT redemptions (2)	ST debt stock (end-2013) (3)	Gross borrowing requirement (1)+(2)+(3)	GBR (% of GDP)	Financing to date (% of GBR)
Poland	13.3	18.6	0.0	31.9	7.5	>50
Hungary	3.3	9.2	6.4	18.9	18.3	8
Czech Rep	4.1	6.1	4.5	14.7	10.0	-
Romania	3.1	7.8	2.2	13.2	8.9	17
CEE-4	23.8	39.9	13.1	78.5	9.5	-

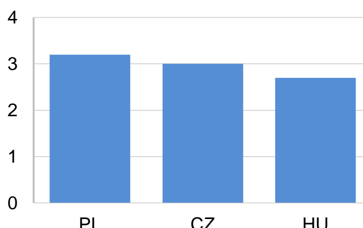
Source: National debt agencies and Fitch

Figure 2
10-year Bond Yields
(LCU, %)



Source: Datastream

Figure 3
External Bond Redemptions in 2014
(EURbn)



Note: Romania has no external bond redemptions in 2014
Source: National debt agencies

CEE-4 countries (including more vulnerable Hungary) have benefited from favourable financing conditions on domestic and international financial markets over the last 18 months. Long-term bond yields have come down or been stable at low levels. Moderate instability in the wake of Fed "taper talk" in May-June 2013 proved to be short-lived. Positive investor sentiment has continued in early 2014 so that eurozone peripherals such as Ireland and Portugal have been able to issue long-dated paper.

Hungary, Poland and Romania have taken advantage of benign financing conditions to issue euro and US dollar bonds recently. In November Hungary issued USD2bn in 10-year bonds, allowing it to pre-finance part of the estimated USD7.2bn in foreign-exchange redemptions in 2014. In January Poland placed EUR2bn and USD2bn in 10-year bonds, which alongside strong Polish zloty issuance allowed the government to finance over half its GPBR before the end of January. Romania placed USD2bn in 10- and 30-year bonds. Romania has also expanded the size of its global medium-term notes (GMTN) programme to EUR15bn from EUR8bn.

Medium-and long-term (MLT) debt redemption profiles should remain manageable. Fitch calculates that external bond redemptions represent 53% of total MLT redemptions in the Czech Republic; 29% in Hungary; 33% in Romania; and 20% in Poland. Romania and Hungary must also repay previous multilateral financial assistance (EU in both cases, IMF in the case of Romania) in 2014. In Hungary's case, this amounts to EUR2bn, whereas in Romania's case it is EUR1.2bn[2].

CEE-4 governments plan to run moderate deficits in 2014. Fitch expects the Czech Republic, Hungary and Romania to post GGDs below 3% of GDP, in keeping with commitments undertaken with the EU and the IMF in Romania's case. In Poland, the picture is blurred on the one hand by fiscal slippage that caused the 2013 GGD to be revised to an estimated 4.6% of

Related Criteria

Sovereign Rating Methodology (August 2012)

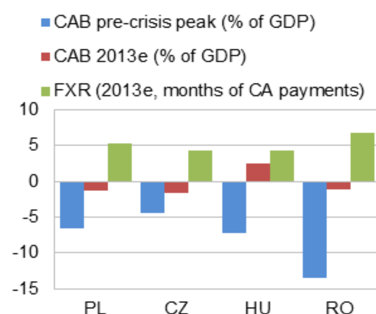
[1] EUR2.9bn in total (EUR2.1bn by the sovereign and the balance by the National Bank of Hungary).

[2] EUR4.6bn once the portion owed by the National Bank of Romania is taken into account.

GDP from an initial goal of 3.2%[3]; and on the other by the transfer of pension assets[4] expected to take place in February 2014. Nevertheless, improving macroeconomic conditions should facilitate the attainment of fiscal goals.

With the exception of Hungary, where the gross general government debt (GGGD) was an estimated 81% of GDP in 2013, debt burdens are moderate. In 2013 GGGD amounted to an estimated 58% of GDP in Poland; 49% in the Czech Republic; and 38% in Romania, all well below the EU average. The reform of Poland's pension system is expected to bring about a reduction in GGGD of about eight percentage points from an estimated 57.6%, given that it will entail the cancellation of government securities currently held by open pension funds (OFEs).

Figure 4
External Indicators



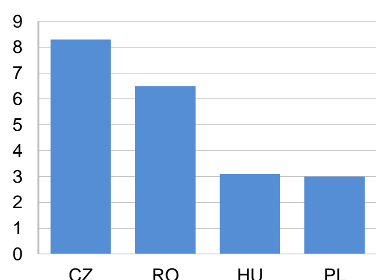
Source: Fitch

Risks Remain but Buffers Are in Place

Fitch assesses CEE-4 financing plans as realistic but risks exist. Although the agency's baseline is that the start of the reduction in US T-Bond purchases by the Fed (known as tapering) will have a more muted impact on emerging markets (EMs) than witnessed in mid-2013[5], instances of greater market volatility cannot be ruled out. The CEE-4 were less affected than other global EMs in mid-2013, but there is a tail risk that their financing plans could be affected by another bout of turbulence.

Such risks could be amplified by political or policy uncertainty. All CEE-4 countries face European parliamentary elections in the spring. In addition, Hungary faces a national parliamentary election in the spring and local elections in the autumn, and Romania a presidential election towards the end of the year. Local elections will be held in the autumn in Poland, a prelude to a busy electoral cycle (presidential followed by parliamentary) in 2015. The Czech Republic held a parliamentary election in October 2013, and a new government based on a coalition between parties with partly differing policy priorities was recently formed.

Figure 5
Government Deposits
(with all banks, % of GDP, latest)



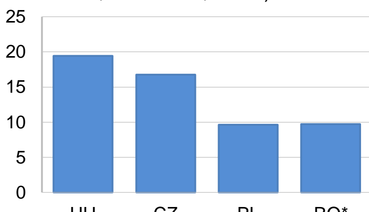
Source: Fitch and National authorities

Fitch's baseline scenario for each of the CEE-4 countries is that they will keep to existing fiscal targets. However, changes in political leadership or priorities, brought about by growth underperformance for example, could lead to fiscal slippage, and in turn a loss of investor confidence.

Non-resident (NR) investors hold large portions of the stock of local currency-denominated government securities in CEE-4. This is particularly the case in Hungary and Poland, where the NR share at end-November 2013 was 40% and 33%, respectively. The share is lower in Romania and particularly the Czech Republic. However, in Romania it rose markedly to 22% at end-October compared with 5.6% in September 2012. Fitch does not expect large changes in NR holdings in the near term. However, a more pronounced outflow from EMs (not Fitch's current baseline) could prompt an exit from CEE-4 positions by NR investors.

There are several buffers that mitigate these risks. CEE-4 countries have either reduced drastically their current-account deficits since their pre-crisis peaks, or have turned them into a surplus in Hungary's case. Foreign-exchange reserves (FXRs) meet or exceed international standards of adequacy. The Czech National Bank's foreign-exchange intervention policy since November 2013, aimed at weakening the Czech koruna (CZK), has bolstered FXR. Romania's precautionary Stand-by Agreement with the IMF and EU, valid until September 2015, would make available EUR4bn (11% of end-2013 FXR). Poland's flexible credit line, valid until January 2015, is worth approximately USD34bn, with the potential to add around 32% to existing FXRs.

Figure 6
Bank Liquidity
(deposits at central bank plus holdings of central bank securities, % of GDP, latest)



"Reserve money (sum of banks' vault cash, current account and currency in circulation
Source: Fitch and National authorities

[3] The upward revision in the deficit led to the extension of the deadline for exiting the EU's Excessive Deficit Procedure to 2014 initially, and subsequently to 2015.

[4] The Polish government estimates that as a result of the transfer and subsequent cancellation of treasury securities hitherto held by open pension funds (OFEs), savings on public debt service could reach 0.3% of GDP. The Polish constitutional court is expected to rule on certain aspects of the reform sometime in 2014.

[5] See *2014 Outlook: Global Sovereigns*, 12 December 2013

Governments can also draw on deposits at the central bank and commercial banks. CEE-4 banking sectors have ample liquidity that could be deployed if other sources of government financing dry up. The National Bank or Romania decided to cut the minimum reserve requirements on domestic- and foreign currency-denominated MFI liabilities to 12% and 18% (from 15% and 20%, respectively) in January 2014. However, these continue to provide an important liquidity cushion.

Better Risk Perceptions Than for Other EMs

Market perceptions of CEE-4 sovereign risk, as captured by the CDS-implied rating calculated on a continuous basis by Fitch Solutions, either improved or were stable in 2013. Figure 7 shows the gap between the Foreign-Currency Issuer Default Rating (FC IDR) and its CDS-implied counterpart. Financial markets appear to have a much stronger perception of CEE-4 sovereign creditworthiness now than a year ago, with the exception of Romania. Spread tightening has been particularly apparent in Poland and Czech Republic. These trends compare favourably with other large emerging markets, where perceptions of sovereign creditworthiness have deteriorated from a year ago.

Figure 7
Sovereign Ratings

Country	FC IDR	CDS-implied (Jan 14)	Notch gap (Jan 14)	Notch gap (Jan 13)
Czech Rep	A+	AA	+2	0
Hungary	BB+	BB	-1	-2
Poland	A−	A+	+2	-3
Romania	BBB−	BB+	-1	-1
Memo				
Brazil	BBB	BB+	-2	0
Turkey	BBB−	BBB−	0	+1
Indonesia	BBB−	BBB−	0	+1
Mexico	BBB+	BBB	-1	0

Source: Fitch, Fitch solutions

All CEE-4 countries are on a Stable Outlook. This, together with Fitch's assessment of GBRs, would suggest that, all other things being equal, CEE-4 sovereign ratings are unlikely to change in 2014.

Background

Fitch defines gross borrowing as net borrowing plus redemptions on medium- and long-term debt plus the stock of short-term debt at the end of the previous year, which will need to be rolled over at least once during the current year. To estimate the net borrowing need, Fitch has taken (where available) budgeted central government deficits, added below-the-line borrowing requirements and assumed no change in governments' cash balances (ie, no pre-funding of future expenditure). Medium- and long-term redemptions and end-2013 short-term debt include marketable securities (ie, T-bills, notes and bonds), as well as loans due from multilateral institutions like the IMF, for example. This differs from the methodology used to calculate the GBR of eurozone countries, where only marketable securities were taken into account.

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