EMERGING EUROPE UPDATE

9th Jan. 2012

CAPITAL ECONOMICS

Little good news for industry over the New Year

- **A raft of data released over the past week paints a mixed picture for the Emerging Europe's industrial sector. But even though production held up relatively well in the last months of 2011, weak survey data suggest it is on track to slow markedly in the coming months.**
- **The worst news has come from the region's previous best performers.** In Turkey, industrial production contracted by 2.5% in November from the previous month (in seasonally adjusted terms), while the fall in the manufacturing PMI in December suggests production may contract further.
- **The steepest fall in the PMI came in Russia,** where the index came in at 51.6 in December, down from 52.6 in November, on the back of a sharp drop in the new export orders component. The bleak outlook for external demand will continue to put pressure on the already slowing industrial sector. (See Chart 1.) What's more, in theory, the uncompetitive industrial sector could suffer from the recently secured WTO membership in the short-term. But the bulk of the change to the tariff system is set to be implemented over a prolonged period, meaning that any short-term effects will be limited.
- **Meanwhile, PMI data continue to point towards a sharp slowdown in Polish industry.** Admittedly, while the PMI fell to 48.8, its lowest level in over two years, industrial production surprised on the upside once again growing by 8.8% y/y in November. Nevertheless, the monthly data are volatile and the PMI is consistent with industrial output expanding by around 5% y/y in December. (See Chart 2.)
- **However, a big surprise came from the region's most open economies.** Czech industrial growth picked up in November to 5.1% y/y (well above the consensus 0.5% y/y). Likewise, in Hungary industry grew by 3.5% y/y in November, an improvement from 3.0% y/y in October. Meanwhile, **PMI data suggest that production may have accelerated further in December**. In the Czech Republic, the headline index rose to 49.2 from 48.6 in November, while in Hungary it increased to 48.5 from November's 47.8.
- **But the good news should be taken with a pinch of salt.** First, the PMIs are still below the 50 level in both countries, the level which, in theory at least, separates expansion from contraction. And second, industrial production in Germany, the main trading partner for both economies, continues to slow sharply (production fell 0.6% in monthly terms in November). **As external demand weakens, it looks like the downward trend in industrial production growth is set to return in both countries.**
- **More worryingly, the region's industry appears to have been propped up by external demand.** Indeed, the export orders PMI component performed relatively well in December (except in Russia). But with export growth set to slow sharply this year on the back of the looming recession in the euro-zone, it looks like Emerging Europe's industry is set to slow further.
- **All in all, over the past couple of months the relatively strong growth in industrial production has been inconsistent with the weakening PMIs data in most countries in the region. This all suggests that, with external demand set to slow further, the region's industrial sector is in for a tough year.**

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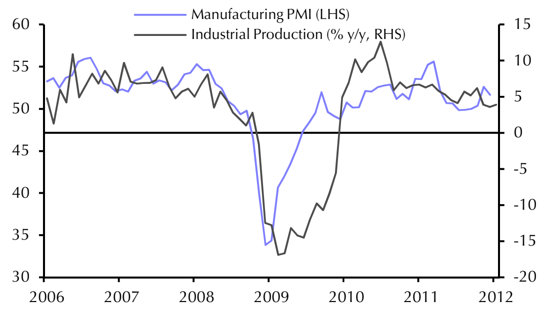
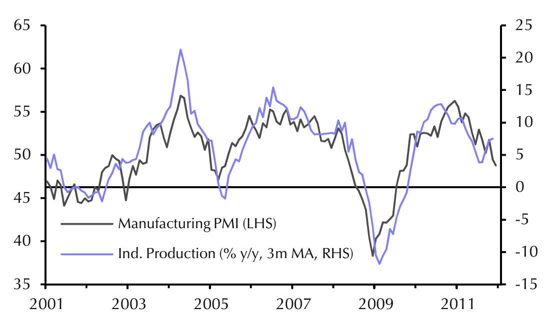
1. Russia Manufacturing PMI & Industrial Production



Sources –Thomson Datastream, Markit

2. Polish Manufacturing PMI & Industrial Production



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