

CEE and the new proposed EU budget

We don't see the new EU budget proposal as CEE negative. In particular, we see a high bar for the 'rule of law' clause as it must first be first unanimously agreed. The PLN weakness seems particularly exaggerated



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The new EU budget proposal has been particularly in focus for CEE investors given the anticipated introduction of the 'rule of law' clause, which would limit the payment of cohesion funds to those CEE countries which the EU deems to be in breach of the clause - Poland and Hungary come to mind.

This has been seen by many investors as a downside risk to selected CEE country outlooks, but we foresee a very high bar for countries to lose access to the cohesion funds. This is because:

- For the new budget for the period between 2021-2027 to be put in place and the introduction of the 'rule of law' clause, it must be unanimously agreed by all EU member states.
- If the budget is vetoed (by any single country) and there is no agreement on a new permanent budget in the coming quarters/years, the EU budget for 2020 will be extended to 2021 - the first year of the new budgetary period. While it may be possible to

adjust the budget for inflation, this adjustment would only affect the size, but would not affect the geographical split. Such an outcome would not be a negative for CEE countries as the status quo would remain.

- We have a hard time seeing how the EU would stop the payment of funds to one country while keeping the payments to other countries flowing under the current rules. The experience of the Article 7 investigation into the Polish judicial system and the eventual need for a unanimous agreement is a point in case.

Crucially the bar is very high for all member states to agree to this 'rule of law' proposal, particularly because Poland and Hungary will appreciate that to reverse any punitive measures, the EU will require a qualified majority vote, given the proposed reverse qualified majority voting.

In effect, the burden would shift from a unanimous agreement to put punitive measures in place, as per Article 7, to a qualified majority to prevent them from being imposed. Poland and Hungary will be well aware of this shift, meaning that the passage of the 'rule of law' clause seems less likely in the current form in our view.

Hence, we believe this issue does not pose a material risk to PLN and HUF outlooks at this point and, in particular, some of the recent PLN weakness seems exaggerated.

[Read our first thoughts on the EU's budget plans for wider implications here](#)

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