S&P Global
Ratings

EMEA Utilities 2024 Outlook: Eastern Europe

Eastern Europe | Higher Yields Will Weaken Credit Metrics And Liquidity

This article is an update from our previous report published in January 2023 and is part of a series covering Southern Europe, Benelux, the U.K., and Germany.

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Key Takeaways

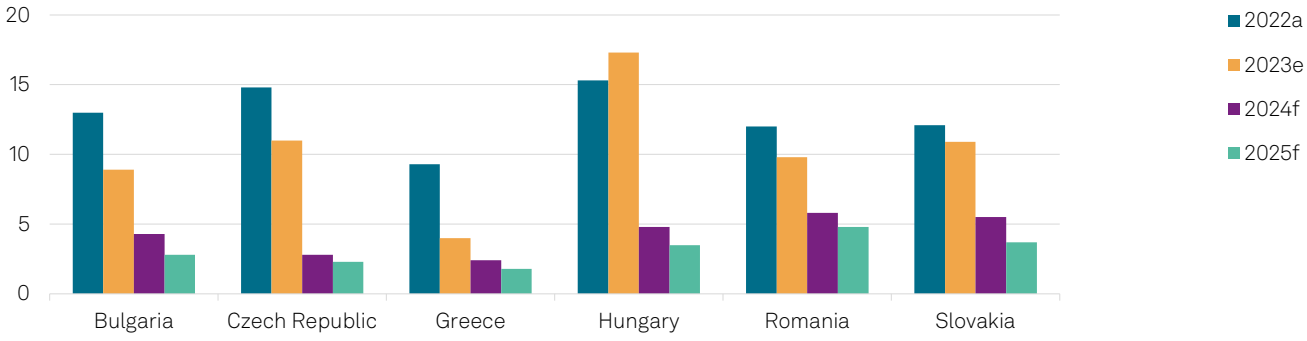
- After two years of high inflation, 2024 should mark a return to 1%-3% consumer price index (CPI) growth rates. Timely cost recovery will be critical for regulated utilities, while high power prices will continue to bolster the credit performance of unregulated activities.
- We think affordability challenges are more acute in Eastern Europe as the average GDP per capita is significantly lower than in Western Europe. Governments could reintroduce windfall taxes (even partially) in 2024, as we expect power prices to remain high until 2025.
- Moreover, as we see some regulation as less credit-supportive than in Western Europe, longer-than-average inflation and rising cost pass-through could dent the performance of Eastern European regulated networks in the short term.
- We project that high long-term yields will persist in 2024, after the abrupt increase in 2023, which should lower utility companies' asset-retirement burdens. Nuclear accounts for the dominant share of power generation in the larger Eastern European economies. Higher yields could also raise the cost of financing for Eastern European utilities, which are lower rated than Western peers.
- Liquidity will be key, as companies might delay their refinancing plans to seek lower yields in a volatile environment.
- Currency pressures may arise, notably in Hungary. Although certain sovereigns are now on a negative outlook, we do not expect these to directly pressure our ratings on utilities.

How we think utilities in Eastern Europe will fare

For regulated networks, passing through higher costs will be critical. After record-high inflation in 2022 and 2023, CPI growth should slow to 1%-3% in 2024. For regulated energy and water networks, high inflation--even if it translates into higher remuneration in the long term--could dent profits in the short term. This is notably the case for Bulgarian electricity, Hungarian and Slovakian energy networks, and Latvian gas storage since the time lag for their cost recovery exceeds a year.

Chart 1

Consumer price index growth rates of some Eastern European countries and Greece until 2025



a--Actual. e--Expected. f--Forecast. Source: S&P Global Ratings.

Chart 2

Most Eastern European regulatory frameworks are skewed toward a strong/adequate and adequate assessment

	Less credit supportive	Somewhat credit supportive	Quite credit supportive	Very credit supportive

Country	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Slovakia	Croatia	Georgia	Greece	Romania	Bulgaria	Malta
Activity	Electricity and gas	Electricity and gas	Electricity and gas	Electricity and gas	Electricity and gas	Electricity and gas	Electricity and gas	Electricity and water	Electricity	Electricity and gas	Electricity	Electricity
Sovereign rating*	AA (AA-)	AA-	BBB-	A+	A+	A+	BBB+	BB	BBB-	BBB-	BBB	A-
Sovereign outlook	Stable	Negative	Stable	Negative	Negative	Stable	Positive	Stable	Stable	Stable	Positive	Stable
Country risk	[3] Intermediate	[3] Intermediate	[4] Moderately high	[3] Intermediate	[3] Intermediate	[3] Intermediate	[4] Moderately high	[4] Moderately high	[4] Moderately high	[4] Moderately high	[4] Moderately high	[3] Intermediate
Regulatory advantage	Strong	Strong/ Adequate	Strong/ Adequate	Strong/ Adequate	Strong/ Adequate	Strong/ Adequate	Adequate	Adequate	Adequate	Adequate	Adequate/ Weak	Weak
Regulatory stability												
Regulator's independence												
Tariff setting												
Financial stability												

*Sovereign long-term local currency rating. Foreign currency rating in parentheses where applicable. Source: S&P Global Ratings.

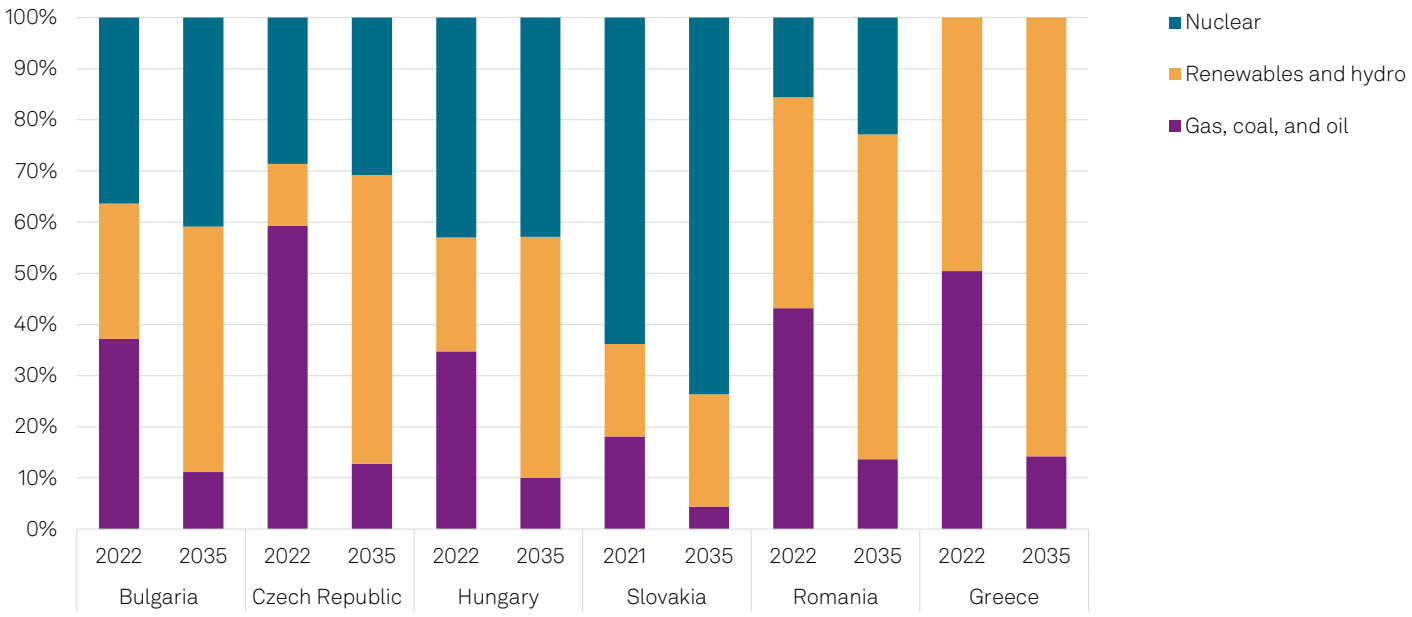
Sustained high commodity prices rather than overall inflation will boost unregulated power generation. Despite declining from the record highs of 2022, commodity prices will continue to remain well above pre-pandemic levels in 2024-2025. This will keep power prices high in the same period, supporting merchant power generators' revenue on recently hedged and unhedged production.

Affordability concerns remain high but should not significantly impact Eastern European utilities' credit quality in 2024. After two years of extraordinary measures to curb the effect of high power prices on final customers, 2024 should see most of the price caps removed as power prices remain high but lower than the extremely high levels seen in 2022 and at the beginning of 2023. That said, governments could still introduce price caps should prices increase further, for example, for limited periods. Moreover, as some Eastern European countries are undergoing the liberalization of the retail market (for example, Bulgaria), high power prices will be directly transferred to final customers, potentially further increasing public sensitivity to the topic.

Eastern European utilities depend more on nuclear for the electricity mix than in Western Europe overall, while higher-for-longer real interest rates translate into smaller asset-retirement burdens. This is due to discount rates on asset-retirement obligations and, secondarily, employee-benefit liabilities increasing more than inflation, even as dedicated asset values reduce. We also note the electricity mix is skewed toward nuclear in key Eastern European countries such as Bulgaria, Czech Republic, Hungary, and Slovakia (see chart 3). This is expected to reduce S&P Global Ratings-adjusted debt for Energeticky a prumyslovy holding, a.s. (EPH) and CEZ a.s., among others. Higher yields will also translate into potentially higher costs of financing for Eastern European utilities, given that they are generally rated lower than their Western peers.

Chart 3

Eastern European generation mix is skewed toward nuclear, Greece mostly hydro and thermal



Source: S&P Global Commodity Insights.

Related Research

- Croatia Gas And Electricity Regulatory Frameworks: Somewhat Supportive, Oct. 12, 2023
- Eastern European Utilities' Regulatory Frameworks Are Varied, But Most Are Adequate To Strong, Sept. 18, 2023
- Europe's Utilities Face A Power Price Cliff From 2026, June 22, 2023
- Bulgarian Electricity Framework: Not Very Supportive, May 30, 2023
- Georgian Electricity Framework For Distribution System Operators: Somewhat Supportive, March 27, 2023
- Georgian Water Regulatory Framework: Somewhat Supportive, Feb. 17, 2023
- Eastern European Utilities Handbook 2023, Jan.5, 2023

Areas to watch

Risks are to the downside but still manageable. In 2024, we expect fixed-cost power generators and network operators with supportive or mostly supportive regulatory frameworks to continue to improve their earnings performance. While the former will benefit from increasing profits thanks to low productions costs, the latter should efficiently pass-through increasing costs to final customers. We expect companies with production shortfalls to continue to suffer from earnings or liquidity events (absent government interventions).

Liquidity management will be key in a volatile market. We expect high yields to persist in 2024, following the abrupt increase in 2023. The higher cost of interest immediately but temporarily weakens credit metrics, depressing adjusted funds from operations. The effect on liquidity might persist for longer. In 2024, financial markets are likely to remain highly volatile, as central banks might start to lower their policy rates. This could directly impact the liquidity of Central and Eastern European (CEE) utilities, which may look to postpone bond refinancings to capitalize on better market conditions, with most having an adequate or less than adequate liquidity assessment. As a mitigant, we note CEE utilities have so far shown good access to financial markets even in volatile conditions, thanks to guarantees (Energo-Pro with the guarantee from the U.S. Development Finance Corporation and Zagrebacki Holding from the city of Zagreb) or at high refinancing costs (with the $300 million five-year bond issued with a 11% coupon by Energo-Pro in November 2023).

Cost inflation will continue to strain operating margins. This could hit unregulated utilities exposed to renewables, or regulated utilities with limited cost pass-through ability, especially under less-supportive regulation. For unregulated utilities, we see this as a minor concern compared with Western Europe, given the slower pace of the energy transition in Eastern Europe.

Unregulated power generators exposed to coal-fired generation will require longer-term capacity markets to support their earnings profile. Given that we expect power prices to remain above pre-pandemic levels at least until 2025, a decrease of power prices from 2026 will depend on the pace of renewables installation and phaseout of conventional (coal and gas) fired generation. While in Western Europe these should start significantly affecting power prices from as early as 2026-2027, a slower energy transition (see chart 3) and less favorable conditions for renewables in Eastern Europe might lead to higher-for-longer prices. At the same time, S&P Global Commodity Insights expects carbon dioxide prices to continue to increase toward €100 per ton in 2030 from about €70 per ton today. Amid declining power prices, this will strain the spread for conventional power generators. Coal plants might become unprofitable toward the end of the decade should power prices in Eastern Europe decline at the same pace as in Western Europe, absent capacity markets. This will be a key factor for EPH and CEZ.