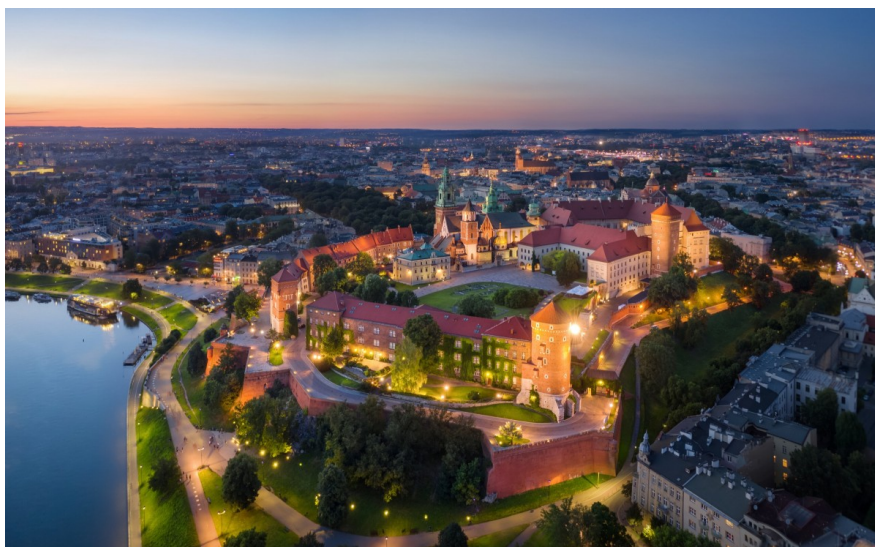


## CEEMEA FX Outlook 2024: Same region yet so different

Next year offers an optimistic outlook for the region, but the risks from this year are being carried over into next, and there are some new ones, too. We are bullish but the region is in a precarious position. Falling rate differentials and less attractive carry will have to be offset by a weaker US dollar and a strong economic recovery for FX to stay on track



Source: Shutterstock

For next year, the markets are full of optimism with the prospect of a better tomorrow but there are still many unresolved issues and risks

### Optimistic outlook but many risks remain

The central and eastern European region has been hit by a number of negative shocks in the past year due to geopolitical issues but is now probably out of the woods. For next year, the markets are optimistic but there are still many unresolved issues and risks. So the glass half full could become half empty very quickly and we should be vigilant despite our bullish outlook on FX.

On the macro side, this year we have seen optimistic expectations and subsequent disappointment. Most of the time, economies in the region have teetered on the edge of recession, or GDP growth estimates have been revised significantly downwards. Still, most currencies eventually found their way to stronger levels supported by high interest rates and a current

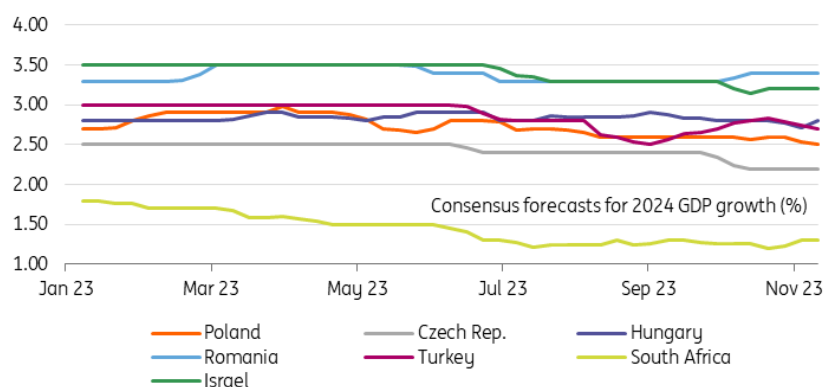
account recovery. For next year, on paper, the economy is expected to recover across the board but the end of this year already shows that the outlook is not as positive as it may seem. The market consensus for economic growth next year is already slowly deteriorating and unless we see a recovery in the major European economies, this trend will continue. So recovery is still our baseline but the risks are more to the downside. Moreover, geographic location means that risks from this year carry over into next, and new ones are opening up given the tensions in the Middle East. Commodity and energy prices will thus continue to play a key role for both central banks and FX.

In the CEE4 space, FX will be driven by balancing falling interest rate differentials against a higher EUR/USD. The cutting cycle has started in Hungary and Poland and it is only a matter of time before it starts in the Czech Republic and Romania. Financial markets have largely priced in most of the easing but we still see room to move further in this direction. Meanwhile, global central banks remain at the peak of their cycles, and rate cutting is not yet on the table. Interest rate differentials have already shrunk significantly and the trend here is clearly negative for local currencies. FX carry is thus becoming less and less of a benefit for CEE FX and can no longer rely on this to the same extent. On the other hand, despite the risks, we expect an economic recovery, a current account surplus across the board and a higher EUR/USD at 1.15 by the end of next year. This should drive CEE FX to stronger levels in our base case scenario, overcoming the negative impact of the interest rate differential. However, based on the risks we mentioned, it is clear that it will be a bumpy road.

Elsewhere, investors are turning a little more optimistic on Turkey as the Erdogan administration embraces more conventional policy. Here, the Central Bank of Turkey (CBT) should take the policy rate up to 40% by year-end and regulatory reforms are now placing more emphasis on the policy rate - hence increasing upside risks to the terminal rate. We expect the CBT to allow a further steady decline in the lira in 2024 - but probably not quite as much as the 30% priced in by the current forwards. South Africa's rand may continue to stay soft ahead of key elections next May. Weak growth may prompt the ANC-led government to increase spending and bring South Africa's fiscal problems back to the fore.

Military activity in both Ukraine and Israel has taken its toll on both the hryvnia and the shekel. On the former, we suspect the National Bank of Ukraine might struggle to hold the hryvnia stronger in the face of a large current account deficit. The Bank of Israel, however, has access to larger FX reserves and the shekel has a strong balance of payments position. Having allocated a large proportion of FX reserves to support the shekel, we suspect USD/ILS can sustain its recent move below 4.00 - especially if the dollar turns lower through 2024.

## Optimism about the recovery next year is gradually declining



Source: Macrobond, ING

## EUR/PLN: Mixed to positive on the zloty


	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/PLN	4.40	Neutral	4.41	4.43	4.45	4.43	4.40

**Our short- and medium-term outlook** on the zloty is mixed to positive. Our concern is that PLN has already significantly appreciated in real terms since late 2021, as Poland has seen substantially higher inflation than its trade partners. BIS estimates suggest the zloty has gained over 10%. In normal circumstances, this would likely result in a nominal depreciation of the zloty (i.e. higher EUR/PLN). However, there are a few important positives and 'low hanging fruit' that the new government could unlock to revive GDP (FDI, EU funds, private investments). Also, foreign investors are heavily underweight in local government bonds (foreign holding at 14% vs 28% in other CEEs on average) and we expect that to change. Moreover, Poland should likely soon receive payments from the Recovery Fund, as the coalition that won the October general elections aims to significantly improve relations with the EU and obtain access to the Recovery and Resilience Fund (even if a likely lengthy formation of a new government delays the advances).

**Moreover, the rate outlook is PLN-positive.** In our view, the National Bank of Poland (NBP) has ended the easing cycle. Investors have trimmed expectations for additional rate cuts, but in our view, they are still excessive. This should provide some support, given wide expectations for core central bank policy easing next year.

**However, we expect some policy actions to trim further PLN gains.** Polish exports remain profitable above 4.30-40. It was the previous Civic Platform government that started to convert EU funds in the NBP to prevent excessive PLN gains. It is very likely it will continue with this process to shelter the economy, as long as the NBP cooperates. At the same time, we expect Poland's current account to worsen a bit. Domestic demand is rebounding, led by consumption and the adoption of EU funds. This should reinvigorate imports. At the same time, economic activity in the euro area remains soft, with still limited signs of recovery. Hence a rebound in exports is likely to be delayed.

## EUR/HUF: We continue to forecast a stronger forint


	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/HUF	376.00	Mildly Bearish 	375.00	368.00	365.00	370.00	370.00

**The EU deal is a potential catalyst:** History shows that we have been here before. As of the end of 2022, the European Commission (EC) and Hungary achieved a compromise, providing grounds for optimism and improving the fortunes of the forint. However, one year has passed and a positive outcome to the rule-of-law dispute is yet to be seen. The moment of truth is near, yet progress remains painfully slow as the EC has once again posed questions to the Hungarian government about the judicial reforms, halting the net 90-day evaluation period for a second time. With the clock paused, having ticked down to just under 10 days, our viewpoint remains unchanged. There is no “plan B” in place for either side, hence we anticipate a partial agreement between Budapest and Brussels towards the end of November or early December. Such an agreement would release a significant portion of the Cohesion Fund (EUR13bn), providing a substantial and permanent uplift to the forint.

**The dawn of an old-new era:** We expect the National Bank of Hungary to continue to lower the policy rate and the interest rate corridor as disinflation continues early next year. We wouldn't be surprised to see the Monetary Council maintain the recent pace of easing (75bp), keeping ex-post real interest rates above 350bp, and then slowing the pace in a way that helps maintain a 200bp positive ex-post real interest rate. Given our inflation forecast, which sees inflation hovering around 5% in 2024, we see the policy rate reaching 7% around the summer and then remaining on hold until the end of the year. If our monetary policy and inflation views prove accurate, this setup will lead to the region's highest positive real rate and carry, ultimately aiding the forint's appreciation.

**Blessing in disguise:** The collapse in domestic demand led to a slowdown in economic activity in the first half of this year, which rapidly reduced the need for imports. In addition, as energy prices were significantly lower than a year earlier, the pressure on the external balance from the import side continued to ease. These factors have led to persistent trade surpluses, while the current account (CA) was also in surplus already in the second quarter. With assistance from the export sector, we foresee a modest CA surplus this year. The 2024 CA balance appears even more promising (approximately 1% of GDP), with energy contracts being renewed at reduced rates and new capacities aiding exports, along with a sluggish rebound in domestic demand. Consequently, the natural flow of hard currency helps maintain the stability of the forint.

## EUR/CZK: Weak economy but responsible policy

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/CZK	24.46	Mildly Bearish 	24.70	24.50	24.50	24.00	23.75

**Czech National Bank (CNB) plays it safe but rate cuts are inevitable:** Despite expectations, the central bank did not cut rates in November, delaying the start of the cutting cycle. The current discussion is whether the board just wants confirmation of the previous dovish numbers and the December meeting will be the right moment or whether the board wants to see more and we will have to wait until the beginning of next year. At the moment, we lean towards the second option. But the conclusion is that the start of a cutting cycle is inevitable. Even though the vast majority of policy easing has already been priced in, the CNB move itself will still cause some pain to the CZK. Thus, in the short term, we see the CNB's move as a reason for a weaker CZK, but it should not be a game changer given that the market needs just a little time to finish the job the CNB intends to start.

**The economy is weak and the recovery is delayed:** The Czech economy has been teetering on the brink of recession for the past six quarters and the outlook does not appear to be positive either. Household consumption has been falling for almost two years in a row and industrial production has been declining across sectors, with the exception of the automotive sector. Overall, the Czech Republic is the only economy in the EU that has not reached pre-Covid levels, and is the true weak man of Europe. The outlook is also not very optimistic. The consensus for next year is currently 2.2% for GDP growth, while the CNB revised the outlook down to 1.2% in a new forecast. We are leaning more towards the CNB numbers and expect the coming months to be disappointing for the market as well, which will also hinder the CZK recovery.

**Responsible policy should be rewarded by markets later:** On the positive side, the Czech Republic runs policy responsibly. Monetary policy is still restrictive and fiscal policy could see significant consolidation next year, while elsewhere in the region we can see the opposite approach. On the one hand, this is one of the reasons for the weak economy; on the other, the Czech Republic will be one of the first countries, perhaps globally, to hit the central bank's inflation target early next year. We thus believe that the market will not punish the Czech Republic for the lack of economic growth and will reward it with higher demand for CZK assets later next year when the results of the work become apparent.

## EUR/RON: Limited flexibility to persist in election year

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/RON	4.97	Neutral	4.98	5.02	5.03	5.03	5.05

**Super electoral year ahead:** Romania is experiencing a somewhat unusually long period of eventless politics, with the grand socialist-liberal coalition apparently working smoothly. Nevertheless, the super electoral cycle of 2024 might stir the waters a bit, as both coalition parties seem more likely to go into elections separately. Despite that, we might have more noise than facts, as the electoral campaign has clear potential to generate negative headlines throughout the year. Traditionally, the National Bank of Romania (NBR) has been a touch reluctant to intervene in the market around political turmoil, but given the still fragile disinflationary trend and the leu's proximity to all-time lows, it might feel more emboldened to limit excessive fluctuations.

**EU fund inflows boosting FX reserves:** Due mainly to solid EU funds inflows and also to another year of robust external issuance, the NBR's FX reserves have increased from EUR46.6bn (excluding gold) at the end of 2022 to EUR58.1bn as of October 2023. Given that for 2024 and beyond, the pace of EU funds inflows is likely to be well north of EUR10bn per year, the NBR is likely to see its nominal FX reserves continuing to pile up while staying broadly constant in relative terms (e.g. by IMF's ARA metrics). This should consolidate the market's confidence in the NBR's ability to emphasise the "managed" part of its "managed floating" regime.

**Official easing to begin in the second quarter of 2024:** The background for 2024 should, in principle, mean that the central bank will remain cautious – leading to the likely scenario of the NBR being the last central bank in the CEE4 to begin its rate-cutting cycle. A pre-requisite for a first cut might be for inflation to go below the key rate, which is likely to happen by the end of the first quarter of 2024. However, historically high excess liquidity in the interbank market is already generating the outcome of conventional policy easing through its visible impact on market rates. From overnight to the one-year tenor, rates are closer now to the 6.00% deposit facility rather than the 7.00% key rate, with the benchmark index for loans granted to consumers printing even well below the deposit facility at times. Therefore, we tend to think that the impact of a rate-cutting cycle might be transferred more to the long end of the curve (above the five-year tenor), which might tend to price in a full cutting cycle once it starts and lead to a flatter yield curve.

## EUR/RSD: As tightly managed as ever

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
EUR/RSD	117.20	Neutral	117.22	117.21	117.20	117.22	117.23


**Geopolitics gets complicated and hinders EU accession:** Far from saying “we told you so”, the reality for Serbia is that its strategic geopolitical ambivalence comes at a cost, which in this case is an almost de-facto freeze of its European Union accession negotiations, underway for a decade already. Whether it is about Kosovo, the free trade agreement signed with China or the refusal to rally behind EU sanctions on Russia, there are plenty of reasons to be cautious on Serbia’s prospective advance towards the EU. To date, the country opened 22 out of 35 negotiation chapters, with only two in principle closed. The early elections called for 17 December 2023 are likely to result in another SNS-led government, though the opposition’s chances look much better this time compared to previous elections.

**National Bank of Serbia (NBS) will remain FX-centered:** Faced with consistent inflows, mainly FDI-related, the NBS continued to intervene in the FX market by buying almost EUR3.4bn over the first nine months of 2023, thus boosting its FX reserves to a record EUR24.2bn. The stability of the EUR/RSD rate seems to remain the NBS’s main focus and 2024 will look no different. If anything, the relative stickiness of headline inflation could tilt the balance towards a mild appreciation stance for the dinar, though the magnitude is likely to be extremely limited by any metric. On the other hand, the relatively high FX pass-through of the exchange rate into inflation will likely cap the upside potential of the pair to near its present levels of around 117.20.

**IMF to continue acting as a stability anchor:** The EUR2.4bn Stand-By Arrangement (SBA) signed with the IMF in late 2022 is likely to be turned into a precautionary agreement as the authorities consider they have sufficient buffers in case of new shocks. The SBA has been working smoothly, with the country drawing around half of the total amount by October 2023. The new arrangement is facilitated by an overachievement on the current account and fiscal side which are expected to narrow this year towards -2.5% of GDP and below 3.0% of GDP, respectively, and remain below 3.0% of GDP in 2024.



## USD/UAH: Hryvnia strength probably will not last

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/UAH	36.35	Bullish 	37.00	37.00	39.00	39.00	39.00

**NBU shifts the FX regime:** Since the National Bank of Ukraine (NBU) decided to shift the hryvnia regime, the currency has appreciated against fundamentals. This also came against wide market expectations. To keep the currency appreciating, the NBU has had to increase FX intervention to an all-time high (over USD\$3bn in October, more than at the peak of the Russian aggression), and has possibly been even more aggressive in November. This drove USD/UAH from 37 to 36.

**Hryvnia strength unlikely to last:** Unfortunately, this is unlikely to last. Ukraine has a significant current account deficit, and it is unlikely to phase out for years. The NBU may continue to try to counter that via FX intervention, but despite foreign aid, FX reserves have been falling for four months straight.

**Long-term prospects of the hryvnia are fundamentally negative:** The Russian aggression is unlikely to end anytime soon (some analysts pinpoint the US presidential elections as pivotal). The damage to the Ukrainian economy, sadly will likely only intensify. That is why we expect the NBU to allow some hryvnia weakening in the long run, but possibly no sooner than the conflict ends.



## USD/KZT: Supported near-term, thereafter less certain


	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/KZT	464.00	Neutral	465.00	460.00	460.00	465.00	470.00

**Pick-up of imports lowers the role of oil.** USD/KZT is trading around 460, the middle of the range of 440-480 in the first 10 months of 2023. This 4% fluctuation is much narrower than Brent's 18% volatility around \$85/bbl seen during this period. This can be explained by the normalisation of the current account following the abnormal surplus of 2022. As of August 2023, 12-month rolling import growth reached 27% year-on-year led by Chinese manufacturing products (amid large capex), while exports stagnated in volume terms. As a result, the current account could see a \$4bn deficit this year and is likely to remain negative in 2024-25, unless oil exports shoot up.

**Transparent private capital inflow is narrow.** The weakness in the current account should be offset by the capital inflow. Indeed, as of mid-2023, the current account deficit of US\$2.4bn (4Q rolling sum) is overwhelmingly offset by the net private (banks, companies and households) capital inflow of US\$13bn. However, the quality and sustainability of the inflow are under question, as two-thirds of this inflow falls under 'errors and omissions', which became large and positive in the third quarter of 2022 following the Russia-related geopolitical turmoil. The transparent and sustainable capital inflows are much more modest, providing much smaller support to the local FX market.

**State FX sales may increase shortly but will decline later.** FX sales out of the oil fund to finance budget expenditures is the final and crucial variable for the tenge. The KZT's weakness in 2022 and early 2023 corresponded to a decline in the state oil fund's (NFRK) FX sales from \$10bn in 2021 (90% of transfers) to \$5bn in 2022 (43%). In the first 10 months of 2023, FX sales picked up to \$7.6bn, and the conversion rate (85%) still suggests some room for further recovery in the near term. At the same time, the planned reduction of NFRK transfers by KZT200bn (c.US\$0.6bn per year) in 2024-26 due to stricter fiscal rules suggests lower support to the tenge in the longer run, unless higher local borrowing amid elevated real rates attracts more foreign portfolio investors.

## USD/TRY: Managed TRY depreciation

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/TRY	28.62	Bullish 	30.00	33.30	35.50	37.00	38.00

### The Central Bank of Turkey (CBT) remains hawkish implying upside risks to the rate


**outlook.** With five consecutive hikes since the elections, the CBT increased the policy rate to 35%, while repeating its signal for further tightening steps to achieve disinflation. The underlying inflation trend started to improve in October, in line with the CBT's expectation. As the bank also pledged that the policy rate will be determined in a way that will create monetary and financial conditions necessary to ensure a decline in the underlying trend of inflation, we should not rule out the possibility of a deceleration in the pace of hikes at the upcoming Monetary Policy Committee meeting. Accordingly, we expect the terminal policy rate to be 40%, with two more 250bp hikes in November and December, with risks to the upside.

### Steps to unwind banking sector regulation to make the policy rate the main monetary tool

**again.** Following the signal of additional macro-prudential measures at the October MPC and thanks to the progress on the monetary tightening process, with high enough rates to control lending and support de-dollarisation, the CBT has taken significant steps to reinforce rate hikes in recent days. These moves and their impact on deposit and lending rates will be important in tightening financial conditions and controlling domestic demand. Given that the macro-prudential framework has been in a process of gradual simplification based on an impact analysis, we will likely see further simplification of the existing micro- and macro-prudential framework with ongoing efforts to return to orthodoxy.

**High budget deficit target despite disinflation efforts.** In the government's new Medium Term Plan, the budget deficit forecast for 2023 was revised to 6.4% of GDP on the back of earthquake-related reconstruction works and heavy pre-election spending, though the latest budget data indicates a deficit of less than 3% currently. This suggests that a very large deficit may be recorded in the remainder of this year. Additionally, the fiscal stance is likely to remain accommodative in 2024 with another wide deficit at 6.4% of GDP, though excluding earthquake-related spending, the target is below the 3% threshold. Given this backdrop, the fiscal outlook for next year is not fully helping the CBT in the disinflation process. We expect further lira weakness in 2024, but not as much as priced in by the forwards.

## USD/ZAR: Fiscal risks ahead of May elections


	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/ZAR	18.36	Mildly Bearish 	18.75	18.75	18.50	18.00	18.00

**First half challenges:** It looks as though it could be a difficult couple of quarters for the rand. Slowing global growth as the US converges lower on the Rest of the World will not be good news for industrial commodity prices – some of South Africa's key exports. This will come at a time when domestic growth remains weak. The South African Reserve Bank (SARB) is forecasting very tepid growth of around 1% in 2024 and 2025, which will do little to alleviate South Africa's 33% unemployment rate. That weak growth may spark some ANC fiscal giveaways before the general election scheduled in May. The ANC faces one of the stiffest races here in 30 years and higher public sector wages may bring fiscal concerns back to the fore. Like Brazil, fiscal accounts have often been one of South Africa's weaknesses.

**SARB set for now:** The SARB was a little late to hike and also may be a little later to cut if the rand comes under pressure over coming quarters. Inflation has been slightly better behaved in South Africa than in the rest of the world, but the SARB was very close to one further hike in September and may not be in a position to cut until much deeper into 2024. That will keep the policy rate around 8.25% and real rates quite attractive around the 3% area – providing some welcome support to the rand. On the external side, the current account deficit is expected to widen a little further to the 2.0/2.5% of GDP area. This is not quite as bad as the 5%+ deficit seen a decade ago, but a long way from the 4% surplus seen in early 2021.

**Our thesis:** We expect the rand to be stronger by the end of 2024 as global growth starts to pick up and the dollar turns lower. Before then, however, the elections and weak growth will probably prevent a major bullish re-assessment of the rand's outlook. Indeed, before then there could be further challenges to portfolio flows into South Africa. We note that from June next year, India will be included in the JPM GBI-EM local currency government bond index. South Africa currently has quite a large 8.7% weight in that index. India's inclusion stands to squeeze out investment in South Africa and prove another headwind to the rand.

## USD/ILS: Counting the cost of war

	Spot	Year ahead bias	4Q23	1Q24	2Q24	3Q24	4Q24
USD/ILS	3.81	Bearish 	3.90	3.80	3.70	3.60	3.50

**The impact on GDP:** Large uncertainty remains over the path of Israel's economy and financial markets after the horrendous events of 7 October. For reference, Israel's economy contracted 10% at the start of the pandemic and some are suggesting that a six-month conflict could trigger the same kind of contraction. Clearly, Israeli authorities will be doing all they can to stabilise growth, including aggressive fiscal spending. Some banks have forecast early Bank of Israel (BoI) rate cuts and money markets have shifted to pricing in 125bp over the next 12 months. For the time being, however, it looks as though the Bank of Israel is prioritising shekel stability and will thus prefer to avoid large rate cuts at this time.

**The shekel support plan:** In the immediate aftermath of the attack, the BoI announced a financial support package, including \$30bn in FX intervention, \$15bn in USD/ILS swaps and a repo programme. In October, the BoI sold \$8.2bn in FX intervention and has managed to drive USD/ILS back below 4.00. Currently, the BoI's FX reserves are around 37% of GDP and would have to fall by around another \$35bn to get back to the 30% of GDP level that persisted between 2010 and 2020. We do not see FX reserve adequacy being an issue for Israel, which could probably count on a Fed dollar swap line if a much larger intervention meant that FX reserves were falling quickly.

**The shekel outlook:** In prior years we have been very bullish on the shekel, which tends to lead currencies during periods of a dollar bear trend. Typically, Israel also produced large current account surpluses to support the shekel. How quickly the Israeli economy adjusts to this new war footing remains to be seen, but it seems unlikely USD/ILS will be pressing the lows near 3.10/3.20 again in 2024. As we had mentioned previously in FX Talking publications, the BoI had also estimated that the shekel contained a 10% risk premium pre-war due to the tension over constitutional reforms. What happens to Israeli politics from here of course remains uncertain too, but until a clearer outcome emerges in the region, that risk premium likely remains in the shekel.

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