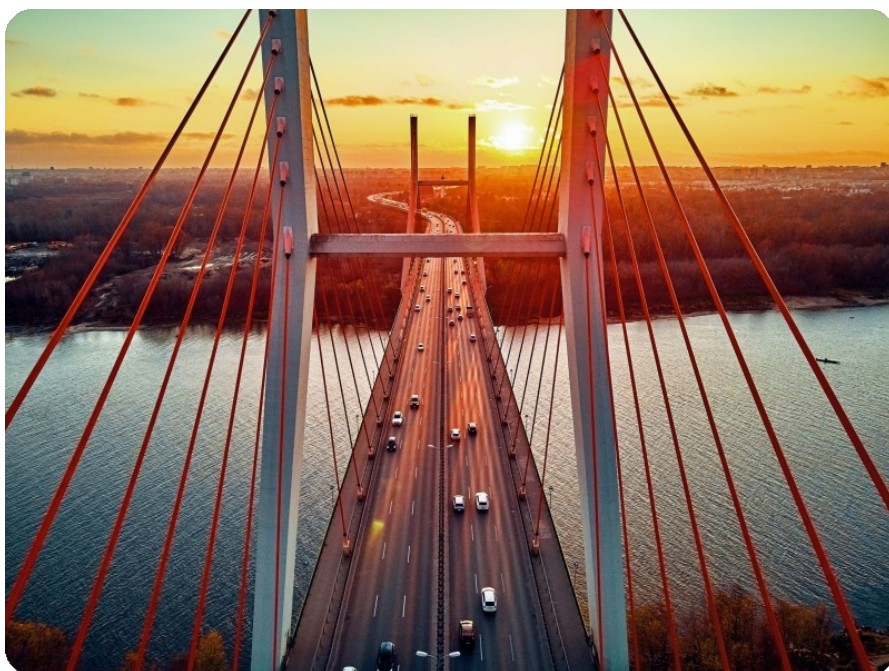


Report | 26 June 2024

Directional Economics Summer 2024

Update: Nearshoring trends in Central and Eastern Europe

The feature article in our Directional Economics update examines nearshoring prospects for Central and Eastern Europe. The region's strategic location, low cost base, and skilled workforce make it a focal point for corporate direct investment plans. As usual, we also share our latest macro and market forecasts for the region



Executive summary

The economies of Central and Eastern Europe (CEE) are largely in recovery mode. At the heart of the story has been the disinflation process and rising real wages which have fired up consumption. In some cases, real wage growth is the highest in two decades and some countries are witnessing the first rise in real wages in over three years. We expect these trends to continue driving the rebound in CEE growth rates well into 2025. However, the investment story is far more mixed – and partially linked to political cycles.

On the subject of investment, our main article focuses on 'nearshoring'. While inward FDI

has been a feature of the region since 1990 and accelerated after EU accession, nearshoring has become a more compelling theme after recent supply chain disruptions. Our team believe CEE's strategic location, skilled labour force, low costs, strong infrastructure, and proactive government policies make a strong case for multi-nationals to further explore nearshoring opportunities.

Of course, there are challenges. Surveys suggest that the lack of tax law predictability is one of the main concerns as is the tightness of labour markets. Yet the benefits of EU accession have been tangible across the region and countries such as Poland, the Czech Republic and Hungary have attracted substantial investments in the high-tech and auto sectors, while Romania is now starting to specialise in IT.

We also look at Turkey – which has seen nearly US\$200bn of FDI investments between 2002 and 2023. That FDI has slowed since 2017, but some more orthodox policymaking will allow attention to again be drawn to Turkey's strategic access to Europe, Asia and Africa. In a world of expensive labour, Turkey's low-cost base looks very attractive.

Turning back to CEE economies, one of the main themes is whether disinflation has run its course and if there is any more room for rate cuts. The region went into recent crises with tight labour markets. Low unemployment rates and strong wage growth are now questioning whether core inflation can fall much further.

Within CEE4 we are starting to see divergences develop. Poland and Hungary look done with easing for 2024 but could resume next Spring/Summer when a little more disinflation and a changing of the guard at the National Bank of Hungary could help those countries respectively.

The Czech Republic and Romania are running on slightly different cycles. The Czech National Bank has scope to cut rates further this year, while Romania should only start its easing cycle in August. And these two countries are at opposite ends of the spectrum when it comes to fiscal policy. Unlike the rest of the CEE4, Prague is not under the European Commission's excessive deficit procedure, which was recently imposed on Hungary and Poland. Romania will again look to the kindness of investors and try to deliver back-loaded fiscal consolidation. Based on the reformed fiscal surveillance in the EU, the required fiscal adjustment across the region is expected to be relatively gradual in the medium term.

The subject of fiscal consolidation invariably brings us to the political cycle. Romania sees Presidential and Parliamentary elections later this year. And ahead of Parliamentary elections in 2026, Hungary will be looking to put money to work – a key reason we forecast Hungary to have the highest CEE4 growth rate next year.

Turkish markets should see less volatility since significant elections are not held until

2028. Investors are certainly warming to the more orthodox tight fiscal and monetary policy being employed in Ankara. While Turkish growth may slow, the welcome rebalancing of the economy should continue the bullish re-appraisal of Turkish assets.

Our team also share their latest forecasts for Ukraine, the other Balkans and the CIS.

As usual, this publication showcases ING Research's unique footprint and local expertise across the CEE region. We hope you enjoy reading it.

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