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Directional Economics CEEMEA: Why beating the middle-income trap isn't enough

The countries of Central and Eastern Europe are quite rightly celebrated as having beaten the middle-income trap and evolved into high-income economies. Yet there is more work to be done. To converge on the income levels enjoyed by some of the core EU economies, the region can no longer mainly rely on cheap labour and an export-led growth model



Executive summary

In this Autumn edition of Directional Economics, our Senior Economist in Poland, Michał Rubaszek and colleagues present a must-read article on this subject – looking at key development trends in Poland, Hungary, the Czech Republic, Romania and Turkey.

These countries must avoid the mistakes made by Southern Europe a decade ago – where income gains were largely fuelled by debt and a construction boom. Today that region is further away from core EU income levels than it was in 2012.

Fortunately, our CEE countries in question have enjoyed income growth fuelled by FDI rather than debt. And the improvements in the quality of local institutions (which

does matter for prosperity as just recognised by the Nobel committee), plus a well-educated labour force have delivered solid income gains.

To converge on core EU income levels, however, the CEE will need to do more. The priority, we identify, should be to focus on enhancing the productivity of scarce labour resources via innovation, automation and AI solutions, while assuring access to clean and affordable energy.

This can be done on the one hand through financial deepening, where an underleveraged region can better develop banking and capital markets to help innovative and productive companies grow. It can also be done by the CEE countries twisting their decarbonisation challenge into an opportunity for productive investment-led growth. Please let us know what you think of our conclusions.

In terms of the outlook for the region, it is fair to say that growth has disappointed this year. The seizing up of the German industrial engine has certainly not helped, but it really has been the more cautious consumer and the higher savings rates that have weighed on domestic demand.

At the same time, investment trends have been poor. Unlocking domestic demand is going to be the key challenge for 2025 and, in general, our economists expect growth rates to improve and certainly outperform a stagnant eurozone next year.

Helping these trends should be central banks delivering the final 50-100bp of their easing cycles, but also governments keeping fiscal policy looser than they should as the electoral calendar intensifies. Important elections in the region are seen every quarter for the next eighteen months.

Crucial to those investment trends for EU countries will be the ability to continue absorbing EU Cohesion funds and Recovery and Resilience Facility transfers. Here, Poland is preparing for a strong rise in public investments in 2025-26. Croatia and Romania are active users of EU money, while any improvement on access to EU funds by Hungary would be a positive surprise. In Ukraine, the war will continue to affect investment and severe energy deficits this coming winter will weigh on the economy.

Beyond the CEE4 and Ukraine, we expect Turkish authorities to stay the course with their disinflation policy. However, fiscal rather than monetary policy may have to do the heavy lifting now. And in the CIS space, fiscal policy is becoming easier and leading to upward revisions in CPI and policy rate trajectories.

As always, please take a look at our new set of quarterly and multi-year forecasts across the region, plus detailed analysis of the FX, rates, local and hard currency debt space.

Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Michal Rubaszek

Senior Economist, Poland
michal.rubaszek@ing.pl

Rafal Benecki

Chief Economist, Poland
rafal.benecki@ing.pl

Adam Antoniak

Senior Economist, Poland
adam.antoniak@ing.pl

Dmitry Dolgin

Chief Economist, CIS
dmitry.dolgin@ing.de

David Havrlant

Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Leszek Kasek

Senior Economist, Poland
leszek.kasek@ing.pl

Muhammet Mercan

Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Stefan Posea

Economist, Romania
tiberiu-stefan.posea@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

Peter Virovacz

Chief Economist, Hungary

peter.virovacz@ing.com

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

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