Economic & Financial Analysis

EM Economics & Strategy

Directional Economics CEEMEA: Shifting tides

24 June 2024

- Armenia
- Azerbaijan
- Bulgaria
- Croatia
- Czech Republic
- Hungary
- Kazakhstan
- Poland
- Romania
- Serbia
- Turkey
- Ukraine
- Uzbekistan

CEEMEA Economics and Strategy Team

Follow us
@ING_Economics

Contents

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

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
david.havrlant@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ing.com.tr

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

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

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

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

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

Péter Virovácz
Senior Economist, Hungary
péter.virovácz@ing.com

James Wilson
Emerging Markets Sovereign Debt Strategist
james.wilson@ing,com

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 pro-active 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.

Chris Turner, Global Head of Markets and Regional Head of Research, UK & CEE

Country summaries: CEE4

Czech Republic

The Czech economy is on a gradual recovery path from a recession in the previous year, with household consumption representing the main growth driver. The disinflationary process remains intact, as both the headline and core inflation softened. Despite the hesitant recovery, the labour market remains relatively tight paving the way for a continued upbeat nominal wage growth. With inflation back within the CNB's tolerance band, the renewed real wage growth lends support to household budgets and is set to propel consumer spending in the quarters ahead. The fiscal consolidation package will keep fiscal impact in a neutral or restrictive mode. The true laggard is investment, which has dropped back to levels observed in 2018. The monetary easing has gained pace, but future inflationary pressures driven by upbeat wages suggest more caution ahead.

Hungary

Hungary is finally on the road to sustainable recovery. While some clouds remain on the horizon, rays of light are breaking through. Economic activity in 2024 should continue to be supported by net exports on a low import bill and improving consumption. The next two years of forecast strong GDP growth are driven by new export capacity and possible fiscal stimulus ahead of the 2026 elections. If wondering where the room for this will come from, well, on a relative basis, the Hungarian budget does not look too bad. Moreover, everything appears rosy on the financing side, so confidence should remain there. The biggest caveat could be inflation, with a strong labour market, high real wage growth, election spending and monetary easing over the coming years. For the rest of 2024, we are relatively positive on Hungarian assets, although the upcoming challenges make us more cautious and bearish for 2025-26.

Poland

In 2024 Poland should be among growth leaders in the EU but, in the current cycle, GDP growth should peak at 3-4% instead of the 5-6% to date. Labour costs in Poland outpaced productivity, so core inflation may stay sticky in 2024-25. In addition, unwinding of anti-inflation shields should temporarily lift CPI to 5-6% at the turn of 2024-25 and bring support to the NBP's rhetoric that is strongly calling against monetary easing this year. The NBP favours a strong PLN, which matches many NBP governor objectives. We see a short and shallow easing cycle starting in 2Q25. This should provide support for the zloty at an uncertain time of carry trade unwinding and approaching US elections.

Romania

While growth is picking up on the back of sharply reviving consumption and still-strong investment, Romania is heading towards an even worse situation on the fiscal front. Co-financing of investments, debatable tax collection improvements, military spending and a rigid expenditure structure all play a role. This environment sets the stage for a very cautious easing cycle from the central bank, as well as for a push from officials towards a slow-paced deficit reduction in their negotiations with the European Commission (EC), relying heavily on the "Romania needs investments" card. On this note, we think that the government will use the same strategy as before – minimal improvements that tick the EC's boxes but satisfy local political pressures. The good news is that productive investments are now also flowing in.

Country summaries: Other Central & Eastern Europe

Bulgaria

With political instability back in the headlines, the country's prospects of joining the Eurozone on 1 January 2025 have faded. To make matters worse, the outcome of the recent election (the sixth in three years) did not bring a clear path to a stable government either. That is not to say that the criteria fulfilment for euro adoption is in bad shape. On the contrary, a little more progress on inflation and completion of the Euro Adoption Act blueprint by the end of summer would clear out the main issues. And, technically, despite rivalries, the Western-oriented parties dominated the last elections. While the EC could ignore small inflation differences, a delay is probable if the political situation isn't resolved. Ultimately, even with all criteria in check, inter-institutional cooperation needs to be smooth early on in the euro adoption process. Without a quick solution, 1 January 2026 is looking more realistic.

Croatia

Following Parliament's approval on 17 May, a new government coalition was formed between the ruling conservatives and right-wing nationalists. The base case is that PM Plenković will continue to lead with a pro-EU agenda and that policy continuity will prevail. On the macro side of things, both growth and inflation have good prospects this year, albeit with some upside risks at play for the latter. The upshot is that recent public wage reform and the disbursement of the fourth RRF tranche will continue to stimulate consumption and investment ahead. What's more, better-than-expected wage growth in the euro area is set to benefit the prospect of tourist arrivals this summer, likely easing the pressures posed by the country's shift towards an increasingly premium destination.

Serbia

While the macroeconomic situation continues its vigorous progress, Serbia's positioning on the international stage does not look to be in sync with its EU accession goal, at least not at this stage. Relations with Kosovo remain tense, with no clear resolution in sight. Not normalising might be enough to jeopardise the accession process. Serbia's declared 'shared future' with China and the free trade agreement starting in July this year could be somewhat beneficial for economic growth but adds geopolitical complications. This trade agreement will build on already strong Chinese FDI assets in Serbia, with these having almost tripled in 2023. Considering macroeconomic factors, the country has been performing well (with solid growth, small imbalances and cooling inflation) and an upgrade to investment grade this year seems within reach.

Turkey

As Turkey has shifted towards policy normalisation there has been a notable uptick in investor interest and engagement. Following the local elections, volatility has declined, net FX reserves started to recover and the de-dollarization trend resumed with messaging from the CBT and the government that tight monetary and fiscal policies would continue. These clear policy indications have reduced the volatility in the markets. Accordingly, after the Fitch upgrade in March, S&P also upgraded Turkey's ratings at the beginning of May. Moody's, currently grading Turkey two notches below the Fitch and S&P ratings and having a regular assessment in July, could also hike, in our view. Policy predictability and durability, as well as progress on a broader structural reform agenda are key for the sustainability of the current performance.

Ukraine

The hryvnia was hit hard in recent weeks, reflecting both unfavourable EM global sentiment, as well as persistent woes caused by Russian aggression and the gradual relaxation of the NBU policy (50bp rate cut in June). We expect the global factors to prove temporary, as a huge trimming of carry trade positions has already happened. Local woes are likely to continue though. The persistent current account deficit still calls for medium- and long-term depreciation of the hryvnia. The NBU increased FX interventions in May, but it proved insufficient to shore up the currency given both the global sentiment and NBU June policy easing. The central bank is less focused on defending the hryvnia since CPI slowed to just above 3% YoY (from over 25% in late 2022).

Country summaries: CIS

Armenia

Despite the challenges related to domestic and foreign policy, the Armenian economy and markets are showing continued strength, leading to an improvement in the near-term view. Higher-than-expected foreign trade contributes to above-average GDP growth rates which, due to weakening domestic demand, does not translate into higher inflationary pressure for now. This allows some room for a lower key rate. The dram has also shown strength, as a stronger-than-expected trade balance is mitigating the effect of moderating remittances inflows.

Factors to watch for the longer run would be how the government navigates the complicated international relations in the region and whether the economy manages to convert the post-2022 financial windfalls into sustainable domestic growth drivers.

Azerbaijan

Azerbaijan is showing signs of recovery in economic growth after a trough in 2023, mostly thanks to sectors other than oil & gas. Commodity-driven growth has also stopped being a drag. Closer trade ties with the EU (and formerly with Russia) support positive expectations in Azerbaijan's gas sector and in other areas, including for airlines. Lower domestic price pressures, though temporary, create some scope for monetary easing. Fiscal policy, though generally focused on maintaining a budget surplus, is showing signs of becoming more growth-supportive. This is amid more generous spending on social support, defence and state administration, reflecting the geopolitical realities in the region. As always, tensions with Armenia, which appear muted for now, remain a risk factor.

Kazakhstan

Kazakhstan's economic growth momentum is now somewhat weaker as the country is between investment projects, is recovering from the consequences of the floods, and must restrain oil production somewhat due to OPEC+ commitments. For 2025-26 we are more optimistic - growth should be supported by new oilfield development and strong non-oil trends, financed by both the banking sector and the budget. Rates still have significant downside, but higher services inflation is a watch factor.
For the near-term, KZT might be at an inflection point as it may start to lose support from state FX interventions soon. The sovereign oil fund, which has been actively selling FX YTD, may now have to limit its outlays for the budget in order to comply with tightening fiscal rules. We retain our view on long-term KZT depreciation.

Uzbekistan

Economic activity in Uzbekistan appears well supported, especially on the corporate side, aided by the country's widening foreign relations and by a more generous domestic fiscal policy focusing on corporate capex and social support. Room for monetary easing compared to CIS peers is limited this year, following the household utilities tariff-induced spike in CPI.

Some stabilisation in the foreign trade deficit has become evident in 2024 – thanks to wider export geography – and this should be seen as a watch factor for the FX market. All else being equal this should reduce the pace of UZS depreciation in coming years. The financial flow picture is also important, as increasing public foreign debt has been the only reliable source of capital inflows to date.

ING main macroeconomic and financial forecasts

Real GDP (% YoY)

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Armenia	9.2	6.5	7.0	5.5	4.5	7.1	5.0
Azerbaijan	4.0	5.0	2.5	1.5	1.7	3.3	2.5
Bulgaria	1.8	2.5	2.8	3.1	3.4	2.6	3.3
Croatia	3.9	3.0	4.3	2.6	2.6	3.5	2.7
Czech Republic	0.2	0.5	1.8	1.8	2.1	1.1	2.2
Hungary	1.1	2.3	2.2	3.1	3.2	2.2	3.8
Kazakhstan	3.7	4.3	4.5	3.5	5.4	4.0	5.5
Poland	2.0	3.0	3.1	3.9	3.2	3.0	3.5
Romania	0.1	2.8	3.4	4.1	4.2	2.8	3.0
Serbia	4.7	4.2	3.5	3.6	3.6	4.0	3.8
Turkey	5.7	3.1	1.9	0.8	0.9	2.7	3.5
Ukraine	3.1	3.5	1.5	3.7	2.5	3.0	4.0
Uzbekistan	6.2	5.5	5.7	4.5	4.0	5.5	5.7
Eurozone*	1.3	1.2	1.4	1.4	1.4	0.8	1.4
US*	1.3	2.5	1.5	0.4	1.1	2.4	1.4

*% QoQ annualised

Source: National sources, Bloomberg, ING estimates

Exchange rate (quarterly is eop, annual is avg)

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
USD/AMD	393	390	395	405	409	398	413
USD/AZN	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/BGN	1.96	1.96	1.96	1.96	1.96	1.96	1.96
EUR/HRK	7.5345	7.5345	7.5345	7.5345	7.5345	7.5345	7.5345
EUR/CZK	25.27	24.65	24.55	24.50	24.45	24.74	24.38
EUR/HUF	395.8	395.0	388.0	385.0	395.0	389.3	399.6
USD/KZT	447	465	470	475	470	463	478
EUR/PLN	4.30	4.28	4.23	4.25	4.26	4.27	4.28
EUR/RON	4.98	4.98	4.98	5.02	5.02	4.98	5.03
EUR/RSD	108.5	108.43	106.45	106.44	106.41	117.11	116.95
USD/TRY	32.35	32.55	34.06	37.00	39.17	33.26	41.15
USD/UAH	39.2	40.5	41.0	41.5	41.7	40.6	42.0
USD/UZS	12,615	12,640	12,740	12,840	12,936	12,593	13,033
EUR/USD	1.08	1.08	1.10	1.10	1.10	1.10	1.10

*Quarterly data is eop, annual is average

Source: National sources, Bloomberg, ING estimates

CPI (%YoY, quarterly is eop except for US/EZ avg, annual is avg)

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Armenia	-1.2	0.7	-0.2	2.2	4.1	0.1	3.6
Azerbaijan	3.1	0.4	1.8	3.1	3.5	1.2	3.8
Bulgaria	3.0	2.4	2.0	3.0	2.9	2.6	3.4
Croatia	4.1	2.6	2.1	2.6	2.6	2.9	2.6
Czech Republic	2.0	2.6	2.3	2.8	2.9	2.5	2.4
Hungary	3.6	4.1	3.6	5.5	4.4	4.1	4.4
Kazakhstan	9.1	8.4	8.0	7.9	7.5	8.5	7.5
Poland	2.0	2.5	4.6	4.7	5.7	3.5	4.3
Romania	6.6	4.7	3.9	4.2	3.4	5.2	4.0
Serbia	5.0	4.1	4.1	4.0	4.4	4.6	4.4
Turkey	68.5	72.2	46.1	41.8	31.8	56.9	27.8
Ukraine	3.2	3.3	5.0	7.0	9.0	4.6	7.1
Uzbekistan	8.0	11.3	11.7	12.0	12.6	10.5	9.6
Eurozone	2.6	2.5	2.3	2.3	2.1	2.4	2.1
US	3.2	3.4	3.1	2.8	2.3	3.1	2.0

Source: National sources, Bloomberg, ING estimates

Central Bank rate (%, eop)

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Armenia	8.50	8.00	7.50	7.00	6.75	7.00	6.50
Azerbaijan	7.50	7.25	7.00	7.00	7.00	7.00	7.00
Bulgaria	3.80	3.78	3.75	3.70	3.65	3.70	3.50
Croatia	4.00	3.75	3.50	3.25	3.00	3.25	2.50
Czech Republic	5.75	5.00	4.75	4.50	4.25	4.50	3.75
Hungary	8.25	7.00	7.00	7.00	6.75	7.00	5.25
Kazakhstan	14.75	14.50	14.00	13.00	12.50	13.00	11.00
Poland	5.75	5.75	5.75	5.75	5.75	5.75	5.00
Romania	7.00	7.00	6.75	6.50	6.50	6.50	5.75
Serbia	6.50	6.25	6.00	6.00	5.75	6.00	5.00
Turkey	50.00	50.00	50.00	45.00	37.50	45.00	27.50
Ukraine	14.5	13.0	13.0	14.0	15.0	14.0	12.0
Uzbekistan	14.00	14.00	14.00	14.00	14.00	14.00	13.00
Eurozone	4.00	3.75	3.50	3.25	3.00	3.25	2.50
US	5.50	5.50	5.25	4.75	4.25	4.75	4.00

*Upper level of 25bp range; [1] Refi Rate

Source: Bloomberg, ING estimates

10yr local yield (%, quarterly is eop, annual is avg)

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Armenia	9.7	n/a	n/a	n/a	n/a	n/a	n/a
Azerbaijan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Bulgaria	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Croatia	3.35	3.30	3.30	3.30	3.25	3.30	3.20
Czech Republic	4.00	4.20	4.20	4.15	4.10	4.14	4.11
Hungary	6.65	6.90	7.00	6.90	7.15	6.79	7.18
Kazakhstan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Poland	5.43	5.75	5.60	5.42	5.20	5.62	5.09
Romania	6.55	6.75	6.60	6.50	6.40	6.60	6.20
Serbia	6.20	6.00	6.00	5.80	5.80	5.80	5.50
Turkey	26.82	27.94	25.70	22.17	20.41	26.22	19.22
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Uzbekistan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	2.30	2.60	2.50	2.40	2.50	2.40	2.80
US	4.25	4.75	4.25	4.00	4.25	4.00	5.00

Source: National sources, Bloomberg, ING estimates

3m local rate (%, quarterly is eop, annual is avg)

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Armenia	9.0	n/a	n/a	n/a	n/a	n/a	n/a
Azerbaijan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Bulgaria	3.20	3.10	3.00	2.80	2.70	2.90	2.60
Croatia	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Czech Republic	5.61	5.10	4.85	4.60	4.35	5.04	3.98
Hungary	7.83	6.87	7.00	7.00	6.65	7.39	6.07
Kazakhstan	13.7	14.2	13.7	12.7	12.2	13.8	11.2
Poland	5.88	5.85	5.85	5.90	5.87	5.87	5.60
Romania	6.05	6.03	5.80	5.60	5.45	5.94	5.33
Serbia	5.70	5.65	5.45	5.20	5.00	5.20	4.20
Turkey	50.58	48.50	47.32	42.19	38.58	46.27	34.61
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Uzbekistan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	3.90	3.70	3.40	3.20	2.90	3.20	2.60
US	5.40	5.40	5.20	4.70	4.20	4.70	4.00

Source: National sources, Bloomberg, ING estimates

Nearshoring trends in Central and Eastern Europe

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ing.com.tr

The term nearshoring is associated with the relocation of business operations to geographically closer countries. Increasing operational efficiency and improving supply chains is most often the underlying reason behind this move. The breakout of the Covid-19 pandemic in 2020 and the geopolitical tensions that began in 2022 has brought the term back to the fore. Given this background, some variations of the term became popular as well, namely friendshoring and reshoring. While there are important differences between them (ie, friendshoring is driven mainly by political alliances and risk mitigation, nearshoring by geographical proximity and logistical effectiveness, while reshoring simply means bringing back the business to the home country), we will use the term nearshoring in a wider sense, sometimes covering the meaning of the other two terms as well. Moreover, from a flow perspective it is rather difficult to differentiate between investments driven by a nearshoring purpose and 'regular' foreign direct investments, hence the terms are likely to overlap.

Why CEE?

Offering a blend of strategic advantages, Central and Eastern Europe (CEE) is naturally positioned as a prime destination for nearshoring. The most obvious benefit is, of course, the proximity to Western Europe, but the list of strategic advantages extends to competitive labour costs, skilled workforce, good infrastructure and, where it is the case, EU membership offering a solid policy anchor.

Fig 1 CEE nearshoring regions in our focus

Source: ING, Cushman & Wakefield

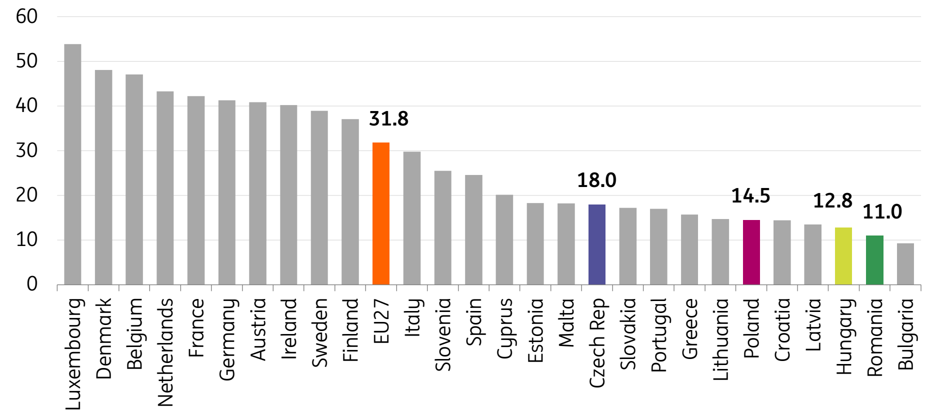
Beneficial strategic location and connectivity

CEE's geographic position provides an incentive for companies looking to streamline their supply chains. This corroborates well with the region's improved infrastructure, including extensive motorway networks and rail connections which supports efficient logistics and transportation. For instance, since 2004 when Poland, Hungary and the Czech Republic joined the EU, the length of motorways in the CEE4 region (which includes Romania as well) has more than tripled. It is worth noting that not all countries have progressed at the same pace. Poland, Hungary and the Czech Republic have particularly benefitted from earlier infrastructure developments, while Romania (which joined the EU in 2007) has been a laggard by a wide margin in this respect and has only recently started to progress towards the completion of its motorway network.

Cost advantages

Despite rapidly catching up with Western Europe in terms of incomes, labour costs in CEE are still substantially lower and remain a strong argument for businesses to consider the region when deciding to relocate production. On average, labour costs in CEE are about a third of those in Western Europe, making the region comparable with other cost-effective locations, such as China. Lower operational and regulatory costs also help to embellish the cost advantage argument, though the labour market tightness remains a significant issue when it comes to attracting new employees.

Fig 2 Hourly labour costs across the European Union (€ per hour, 2023)

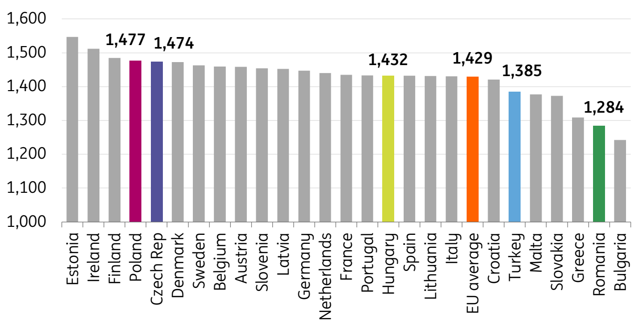


Source: Eurostat

Skilled workforce

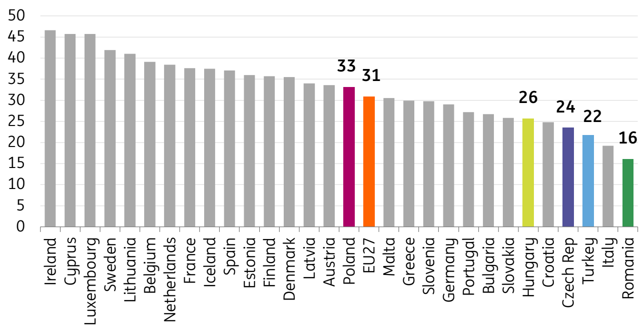
The CEE region can still claim to have an educated workforce, with a significant proportion of graduates in STEM (Science, Technology, Engineering and Mathematics) fields. In particular, countries like Poland and the Czech Republic are known for their strong educational systems, reflected in the latest PISA scores as well. Corroborating PISA scores with the number of tertiary education graduates says something, in our view, about the degree of sophistication that can be expected for a country's manufacturing base and investment prospects.

Fig 3 Total PISA scores (2022)



Source: OECD

Fig 4 Population with tertiary education (% of total, 2023)



Source: Eurostat

Business environment

The business climate in CEE is generally perceived as friendly, with supportive government policies, tax incentives and very dynamic private sectors. For example, Poland provided €95m in state aid for LG Energy Solution's expansion of its battery factory, underscoring the role of the government in fostering direct investments.

Industry Focus and what we've seen so far

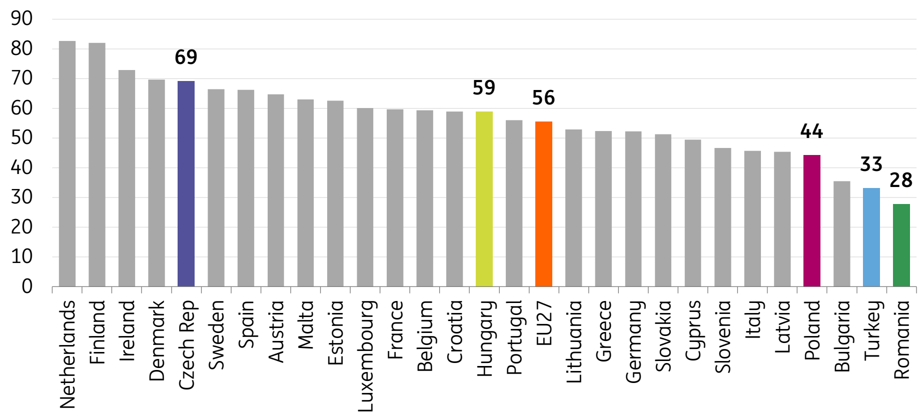
IT sector

The IT sector has become a significant beneficiary of nearshoring, driven by the region's competitive labour costs proposition and good educational systems. Countries such as Poland, Romania and Bulgaria boast a significant number of ICT graduates. Several multinational companies have recognised CEE's potential and established IT operations in the region. Intel's US$4.6bn investment (with potential for expansion) is the largest greenfield investment in Poland. It creates opportunities for building a new industry and higher technological advancement of Polish production and exports. Intel's Polish plant will create a unique supply chain with its silicon wafer factory in Ireland and its factory under construction in Germany. Google has been expanding its cloud computing data centre in Poland's capital city Warsaw following an almost €2bn investment, Microsoft announced the expansion of its digital hub in Romania focused on cloud solutions, AI and cybersecurity – a €300m investment, while Oracle has set up a development centre in Romania's capital, Bucharest. IBM runs a large development centre in Brno, in the Czech Republic, while SAP has a global service centre in Budapest, Hungary.

Governments have played a vital role in incentivising the presence of these large multinationals by offering tax breaks, grants for capital investment and subsidies for R&D activities. Infrastructure investments in technology parks and high-speed internet have also been part of the public proposition that governments have made to these companies. CEE remains well positioned to continue attracting IT investments, either due to nearshoring or 'regular' foreign investments.

Balancing the large numbers of ICT graduates and the relatively young and dynamic workforce active in the sector, the picture looks quite different when assessing the digital skills of the overall population of the region. Poland and Romania perform particularly poorly, suggesting a certain degree of polarisation of the workforce and, to some extent, of the society overall when it comes to using the new technologies. This outcome is largely a result of poor performance among older cohorts.

Fig 5 Individuals with basic or above basic overall digital skills (as a % of total population, 2023)



Source: Eurostat

Manufacturing

The manufacturing sector is arguably the most relevant driver of nearshoring in CEE. The region has a longstanding industrial tradition and a robust industrial base which, coupled with modern infrastructure and lower labour costs, makes a strong business proposition for manufacturing operations. High-tech manufacturing in the areas of automotive and electronics has seen robust growth in recent years.

Automotive industry

The automotive industry has a strong presence and essentially forms the backbone of the industrial base throughout CEE. The region's well-developed supply chains, skilled labour and favourable macroeconomic conditions have made it attractive for carmakers and component manufacturers alike. Major production facilities are owned by Skoda in the Czech Republic, by Audi, Mercedes and BMW in Hungary, Stellantis in Poland and Ford and Renault in Romania.

It is worth noting that the electrification trend does not seem to have left the CEE region on the sidelines. Electric vehicle production will ramp up in the coming years as Skoda has invested €450m in a new plant in Mlada Boleslav, Czech Republic, while BMW has injected some €1bn in its plant in Debrecen, Hungary. Also in Hungary, the Chinese carmaker BYD is expected to open a car factory – one of its few gateways into the European EV market. Investments in EV car plants will be complemented by battery factories as well, with battery giant CATL announcing a €7.3bn investment in Debrecen – Hungary's largest greenfield Foreign Direct Investment (FDI) project on record. Meanwhile, Poland has attracted producers of batteries for EVs (LG Chem, Northvolt), producers of EVs (Mercedes-Benz), and has announced plans to establish a local brand of electric vehicle (to be confirmed by the new government), while Ford is close to starting the production of electric vehicles in Craiova, Romania.

High-tech and Electronics industry

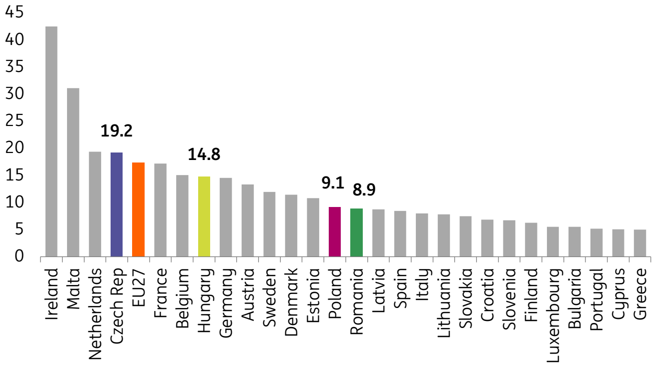
High-tech manufacturing, including electronics, is also picking up across the CEE region. LG Energy Solutions has significantly expanded its lithium-ion battery factory in Poland, supported by €95m in state aid. Similarly, Samsung has a major electronics manufacturing plant in Hungary. Romania has seen notable investments as well, such as Continental's expansion of its electronics production facility in Timisoara, while Foxconn's facility in Pardubice, Czech Republic, produces a variety of electronic components and devices for global markets. Siemens has also expanded its manufacturing capabilities in the Czech Republic, producing advanced industrial equipment and automation systems.

The success of the manufacturing sector in CEE goes beyond the location and labour costs. Countries have invested heavily in developing modern industrial parks, logistics centres and transportation networks to support manufacturing activities. Poland's Katowice Special Economic Zone and Slovakia's Zilina Industrial Park are prominent examples.

Outlook for the manufacturing sector

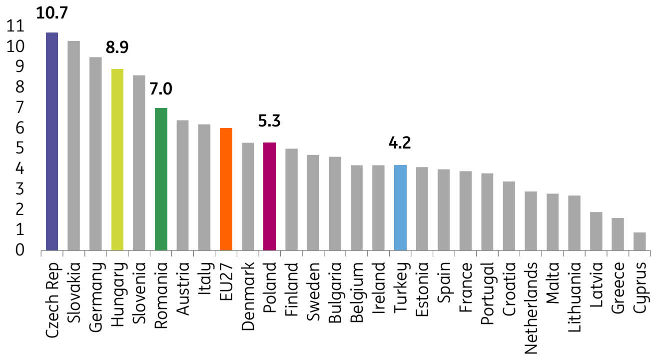
With setbacks in the region driven mostly by tight labour markets, we still see the outlook for the manufacturing sector in CEE as highly positive. The region is expected to continue attracting nearshoring investments, supported by a combination of skilled labour, competitive labour costs, robust infrastructure and proactive government policies. The shift towards electric vehicles and renewable energy solutions might pose some short-term challenges as the know-how and trained labour is not uniformly available across the region. Nonetheless, as businesses pursue diversification and a strengthening of their supply chains, the strategic location of CEE should overcome most of the short-term challenges.

Fig 6 High-tech exports (% of total, 2022)



Source: Eurostat

Fig 7 Employment in high- and medium-high technology (% of total employment, 2023)



Source: Eurostat

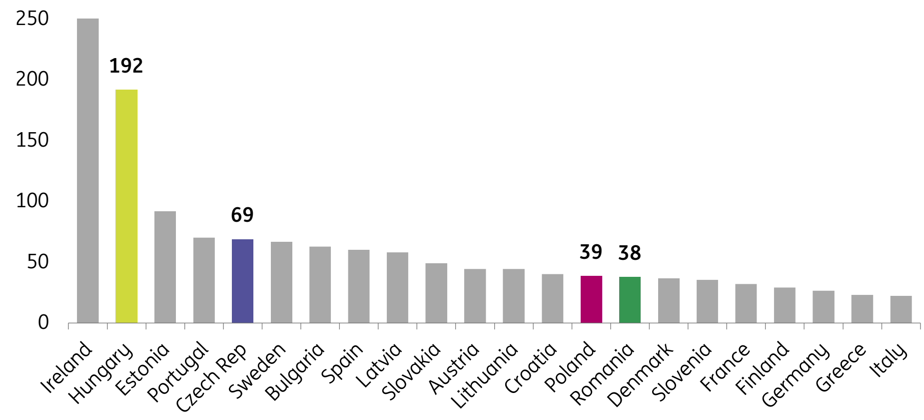
Shared Services

CEE has also become a favoured destination for shared services and Business Process Outsourcing (BPO) (when a company outsources entire business functions to be handled by another company). One of the main factors driving the growth of BPO and shared services in CEE is the availability of a multilingual and educated workforce. Many CEE countries boast a high level of proficiency in English and other European languages, a key element in providing support to global clients.

Several multinational companies have established significant shared service centres and BPO operations in CEE. For example, Deloitte has a major service centre in Rzeszow, Poland. Similarly, Accenture has expanded its operations in Bratislava, Slovakia. In Hungary, Citi operates one of its largest service centres worldwide.

Summing up, while the bulk of expansion might have already taken place, we believe that the shared services and BPO sector in CEE still has some upside potential driven by a combination of local talent, costs and government policies.

Fig 8 Inward Foreign Direct Investment (FDI) stocks (% of GDP, 2022)



Source: Eurostat, excluding Luxembourg, Cyprus and the Netherlands

Challenges and risks

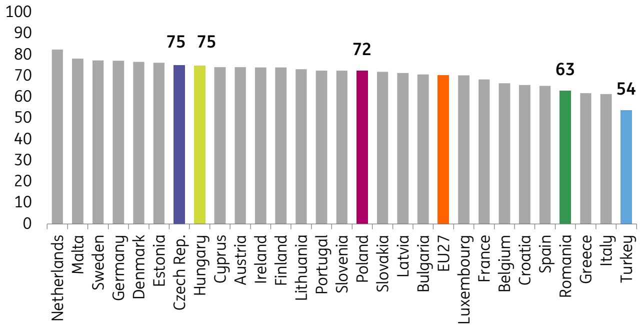
Legal and Regulatory

While CEE offers several strategic advantages, companies still face a strain of legal and regulatory challenges when setting up or expanding operations in the region. Variations in compliance requirements, regulatory frameworks and bureaucratic hurdles can pose considerable obstacles. For instance, in our recent study on Poland (written in Polish), business leaders pointed to the insufficient quality of regulation and lack of tax law predictability as the number one investment barrier in the past decade. The tax issue appears common to the region as a whole, with in addition the frequently changing tax regulations in both Romania and Hungary also creating uncertainties that add to the administrative burden for businesses. Navigating the local regulatory environment can require specialised local knowledge to ensure compliance.

Labour market tightness

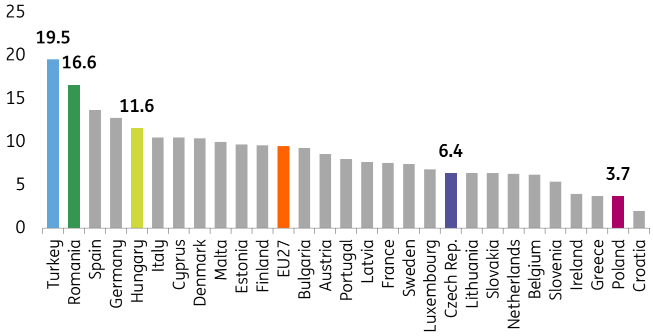
More recently, all CEE countries have started to experience labour market tightness. This is particularly visible in the IT and advanced manufacturing sectors, but also in lower-skilled sectors, such as construction and HORECA (hotels, restaurants, caffes/catering). Severe shortages have been mitigated in some countries by an influx of Ukrainian workers, with Poland likely to have integrated the largest number into the local labour market, while other countries, such as Romania, needing to import labour from Southeast Asia to keep construction sites open, a solution that is expected to be adopted by the Hungarian government as well. The situation is aggravated in Romania by a very low activity rate compared to the EU average.

Fig 9 Activity rate, ages 15-64 (% of total population, 2023)



Source: Eurostat

Fig 10 Early leavers from education and training, ages 18-24 (% of total, 2023)



Source: Eurostat

Political and economic stability

Most CEE countries have stable political environments. Nevertheless, this stability doesn't necessarily go back a long time, and a resurfacing of political turmoil is never a surprise. Almost all countries in the region have, at times, experienced softer or harsher degrees of political shifts and democratic backsliding which impact the business climate. At the same time, it does seem that the business environment in most CEE countries has built in a higher level of resilience against political uncertainty and, to some extent, seems reasonably decoupled from this source of volatility.

Government initiatives and incentives

CEE countries have actively implemented various initiatives and incentives to attract nearshoring investment.

Poland

Poland has been favouring nearshoring through a mix of financial incentives, regulatory reforms and infrastructure investments. Most often this translates into tax breaks, grants for R&D and the establishment of Special Economic Zones (SEZs). The Katowice SEZ offers significant tax exemptions and streamlined administrative procedures. As has been mentioned above, the government also provided substantial state aid to major projects, such as Intel's and LG's investments.

Czech Republic

Like Poland, the Czech Republic offers financial incentives, including investment grants, tax breaks and subsidies for R&D. A pivotal role in facilitating foreign investment is played by the CzechInvest agency. Notable initiatives include the 2019-2030 Innovation Strategy, aiming to transform the Czech Republic into an innovation leader by promoting high-tech industries and private R&D expenditures.

Hungary

The country generally offers generous tax incentives, including a flat corporate tax rate of 9.0%, one of the lowest in Europe. Hungary also provides cash grants for investment projects, particularly in high-tech and manufacturing sectors. The National Investment Promotion Agency offers assistance to foreign investors. BMW's recent decision to build an electric car plant in Debrecen offers some indication of the effectiveness of these policies.

Conclusion

As companies adapt to the new realities of global supply chains and political alliances, CEE continues to stand out as a prime destination for nearshoring due to its strategic location, still competitive cost structure, skilled workforce and government incentives. However, the CEE landscape is far from homogenous and it offers varying degrees of attractiveness from country to country.

In our view, Poland has been a frontrunner in attracting nearshoring investments and FDIs in general. Beyond its strategic location, the country offers good infrastructure and a business-friendly environment, particularly in high-tech manufacturing and IT sectors. While the Czech Republic also presents a compelling case for nearshoring due to its strong industrial base and skilled workforce, the labour market tightness and diminishing income-gap versus Western Europe might make it more difficult for newcomers to establish production facilities there.

Hungary has shown a strong performance in attracting nearshoring, particularly in the automotive and electronics sectors. Other sectors have become increasingly attractive too, as investments by companies such as TitanX Engine Cooling and Huawei's new R&D centre in Budapest highlight the country's potential.

Romania is emerging as a hotspot for IT and software development, with the size of the ITC sector nearing 8.0% of GDP, roughly double compared to the agriculture sector. On the manufacturing side, the country has not been a prime destination in the CEE4 space for large-scale investments involving hundreds or thousands of new jobs in one place but it is instead an indirect beneficiary of key investments nearby (eg, a car factory in Hungary will source most of its components from Romania). Nonetheless, the country retains a diversified industrial base and the current expansion of infrastructure investments (motorways, railways and also digital infrastructure) might reposition the country higher up the European value chain.

While the overall outlook for nearshoring in CEE is positive, there are clear differences between countries in the region. Poland and the Czech Republic currently lead in attracting high-tech manufacturing and automotive investments, while Romania is becoming a key player in the IT sector. Hungary shows promise in automotive and electronics but needs to address its labour market and (geo)political challenges.

Extending the picture to Turkey

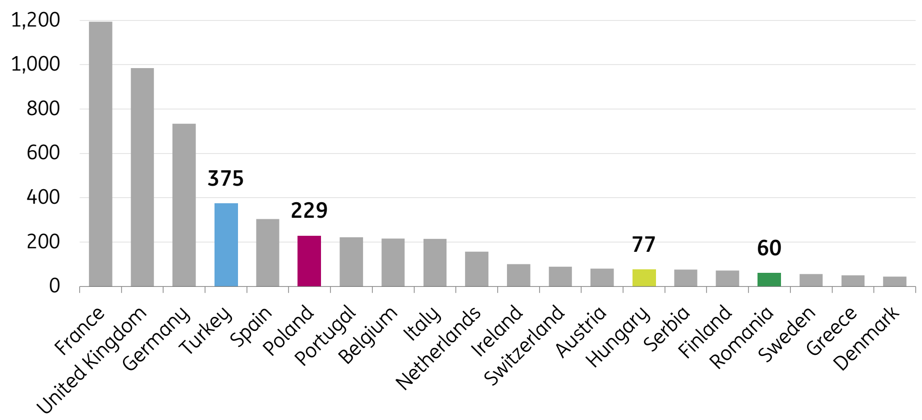
Having one of the most liberal legal regimes for FDI among OECD members, Turkey attracted close to US$190bn FDI between 2002 and 2023, mostly from Europe, representing a 72.6% share, due to: (1) its proximity to the region; (2) structural reforms carried out as part of its EU accession process in early 2000s; (3) reliance on public-private partnerships for major infrastructure projects; (4) efforts to reduce administrative procedures; (5) a strengthening of the regulatory framework, ie, greater protection of intellectual property rights. During 2002-2023, finance & insurance and manufacturing received the highest shares of investment at 30.7% and 24.2%, respectively.

However, despite its favourable demographics and strategic geographical position, FDI in Turkey has significantly weakened to US$5-7bn per year since 2017 with real estate investment by foreign companies the major driver contributing an average share of 45%

in this period. The factors weighing on the FDI flows include increasing political and geopolitical risk anticipation among investors, macroeconomic instability leading to frequent bouts of currency volatility and stagnation in the drive to reform. Given this backdrop, Turkey has lagged its CEE peers as a prime destination for nearshoring.

While normalisation in the policy framework with a shift to more conventional regulation is expected to reduce macro imbalances, it will also help recover FDI flows in an environment of intensifying efforts to reconfigure global supply chains and a trend towards cost-competitive locations for manufacturing. In fact, according to the latest issue of the EY Europe Attractiveness Survey, Turkey rose to fourth position in Europe as the most attractive Foreign Direct Investment (FDI) destination in 2023 (up from seventh in 2020).

Fig 11 Top 20 destination countries in Europe by number of FDI projects in 2023

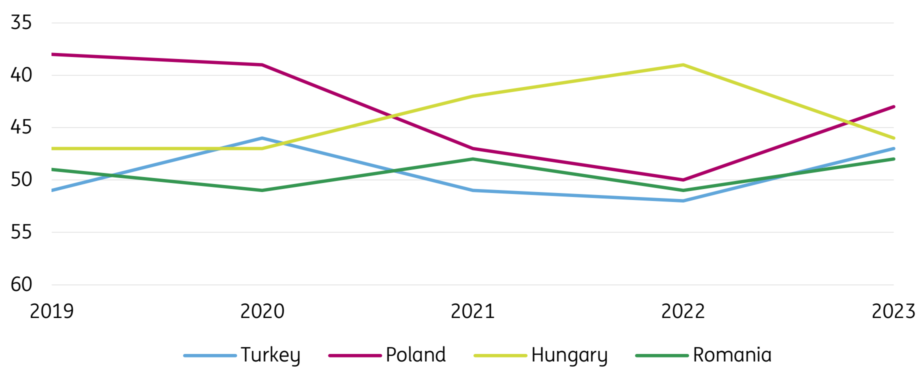


Source: EY Europe Attractiveness Survey 2023

Evidence suggests that Turkey has the potential to be a nearshoring choice along with other CEE countries for several reasons, including:

1) **Competitiveness:** According to IMD's World competitiveness ranking, Turkey and its CEE peers, Hungary, Poland, Romania, are close, with positions in the 40-50 range out of 64 countries covered. The Czech Republic ranks a much higher 18. In IMD's Digital Competition Landscape, however, Turkey stands behind the four countries, though quite close to Hungary and Romania. In addition, based on IMD's talent ranking that assesses the extent to which countries are able to develop, attract and retain talent for enterprises operating in those economies, all countries are close again (except Czech Republic).

Fig 12 Overall competitiveness ranking (rank out of 64 countries)



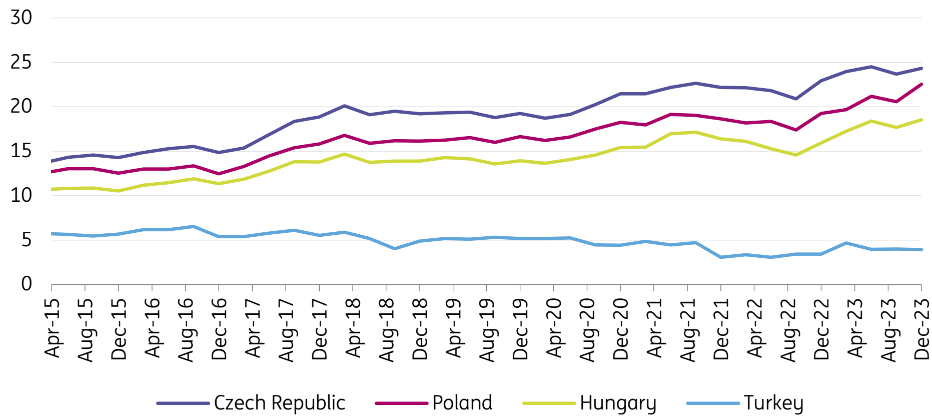
Source: IMD (International Institute for Management Development) World competitiveness

2) **Infrastructure:** Turkey has a global market access to Europe, Asia and Africa, and potential to create an efficient and cost-effective hub to major markets. While the government has put significant efforts in recent years into improving infrastructure

and connectivity, it plans to continue investments to become a regional logistics base in global trade, focusing on three themes: transit trade revenues, export-oriented infrastructure improvements and productivity growth.

3) **Costs:** In addition to favourable demographics providing a strong labour pool and a lucrative domestic market, relatively lower costs of labour can be an advantage. In many countries, wage inflation has outpaced production gains in recent years, but episodes of currency weakness have kept labour costs under control in Turkey. Between 2015 and 2023, average labour costs (US$ per hour) declined in Turkey while Poland, Hungary and the Czech Republic recorded 7% CAGR.

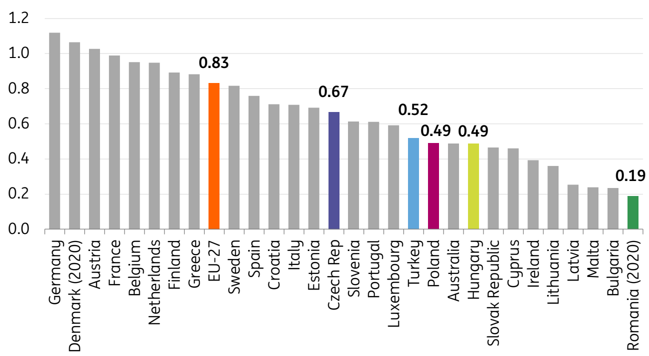
Fig 13 Average labour cost (US$/hour)



Source: businessanalytiq.com

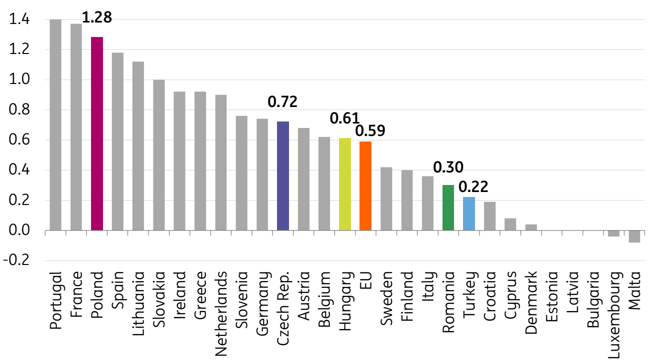
4) **Government incentives:** The Turkish government is working to attract FDI into certain sectors. In this regard, while it offers a comprehensive investment incentives programme, direct government funding and tax support for business R&D amounted to 0.23% of GDP in 2021, the highest level alongside Hungary according to OECD data. Regarding government budget allocations for R&D, on the other hand, Turkey remains behind CEE peers (except Romania) with 0.38% of GDP (see Figure 14 for the total of government budget allocations and indirect government support through tax incentives).

Fig 14 Government budgets for R&D and tax incentive support for business R&D, 2021 (% of GDP)



Source: OECD

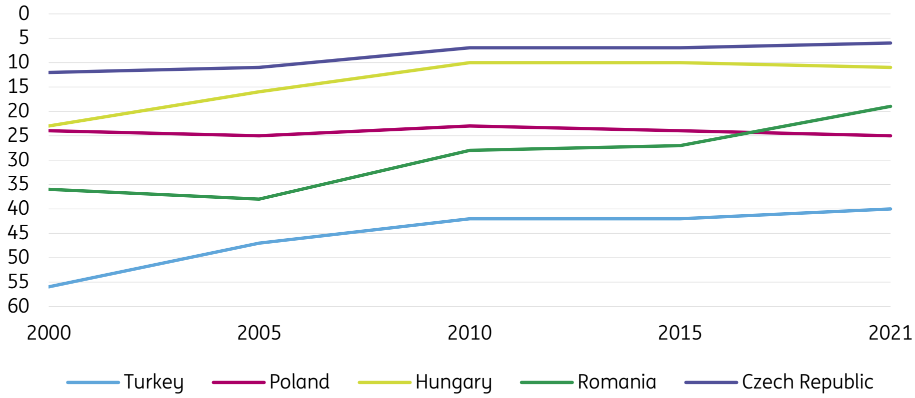
Fig 15 Tax subsidy rates on R&D expenditures, 2023



Source: OECD

5) **Economic complexity:** Turkey holds advantages in terms of its technological know-how, having an economic complexity ranking (based on the diversity and complexity of the export basket) that is better than emerging production powers, such as India and Vietnam. However, other CEE peers rank as high complexity countries with a range of sophisticated, specialised capabilities compared with Turkey (see Harvard Growth Lab's ECI Country Rankings, Figure 16).

Fig 16 Ranking in the Economic Complexity Index (ECI)



Source: Harvard Growth Lab's Country Rankings

In fact, there are signals that Turkey is starting to benefit from a globally shifting FDI landscape with increasing nearshoring opportunities. For example, IKEA has been moving production from East Asia to Turkey since 2021 in order to improve product delivery to European stores. Likewise, Benetton brought production closer to home in 2021, locating in Serbia, Croatia, Turkey, Tunisia and Egypt, with the aim of halving production in Asia from the end of 2022. Renault is investing €400m with local partners to expand its factory in Turkey to turn it into an international export hub after it closed its Russian operations following the invasion of Ukraine.

Overall, Turkey is in strong position to expand its export manufacturing, powered by competitive costs, large labour force and proximity to the EU and other markets. In particular, we believe the global pandemic and the Russian-Ukrainian war have highlighted risks and resiliency gaps that outweigh cost considerations. Nonetheless, the need for further improvement in Turkey's macro environment, elevated regional geopolitical risks, strong dependence on energy imports, and frequent changes in the legal and regulatory environment are the factors that will keep investors cautious despite the government's efforts to implement initiatives to make the country a more attractive destination for foreign investment and business operations.

CEE FX, rates and debt strategy

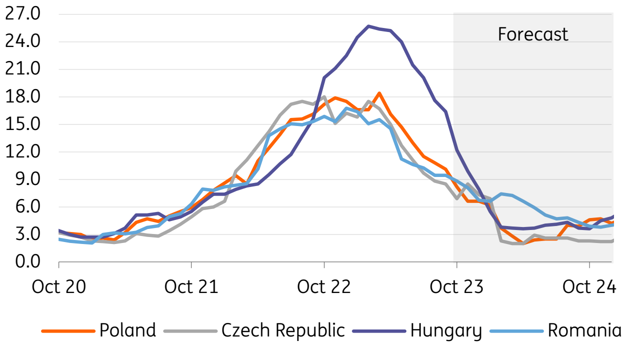
Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

The main part of the disinflation and cutting cycle is behind us and we expect the rules of the game to change in the second half of the year and the focus to shift elsewhere. Inflation is starting to pick up again but is still surprising to the downside relative to expectations. On the other hand, the economic recovery is not going as planned but at the same time wage inflation is around the corner. In addition, fiscal policy has failed to deliver consolidation which only compounds the inflation and recovery problems. This makes central bankers' jobs more complicated and we expect fine-tuning rather than activist policy with limited room for rate cuts in the Czech Republic and Romania and stable rates in Poland and Hungary.

In our outlook for this year (*Directional Economics: CEEMEA in 2024, Same path, different journeys*, 7 December), among the main issues for the CEE region we highlighted the high likelihood of over-optimism in relation to the expected economic recovery, as well as possible problems with ongoing disinflation. The reality turned out to be somewhere in between. The economy has not really recovered as the markets expected, but inflation has fallen faster and has repeatedly surprised to the downside in recent months. However, central bank interest rate cuts have been without major surprises, or somewhere in line with the expectations, and we are still waiting for first rate cuts. The first half of the year has been markedly different to last year as expected with far more focus on country specifics and local stories. And the second half of the year should continue that trend, but we think a lot of things will be different:

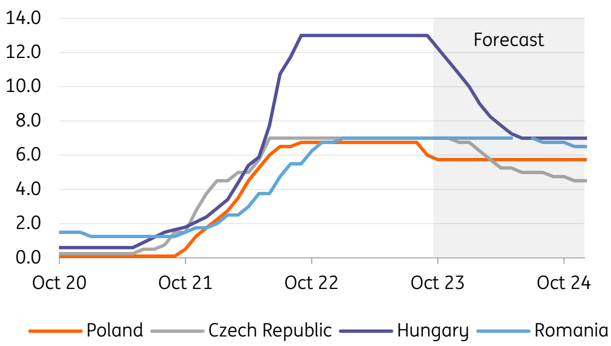
1) Headline inflation is bouncing up from its lows this year while services inflation is stuck at uncomfortable levels, meanwhile an overheated labour market is generating significant wage pressures, increasing the risk of demand inflation rebound.
2) Fiscal consolidation in the region has failed and fiscal policy in the face of uncontrolled growth in government debt is becoming a global issue, calling for markets' attention and reflection in asset prices if the situation escalates further.
3) The rate-cutting cycle is entering a later phase in CEE, while developed markets central banks are only at the beginning of their journey, complicating the next steps in the region and we expect to see fine-tuning rather than activist monetary policy in the second half.

Fig 17 Headline inflation forecast (%YoY)



Source: Macrobond, ING

Fig 18 Key policy rate forecast (%YoY)

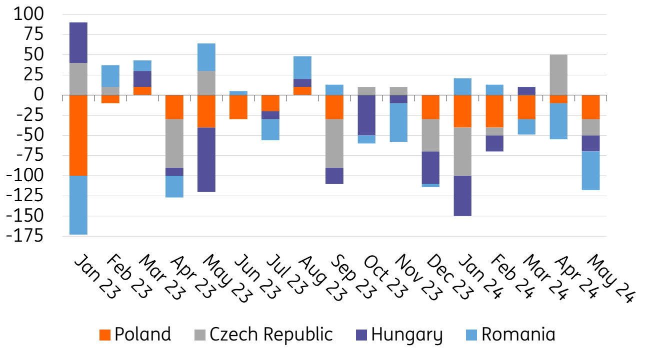


Source: Macrobond, ING

1

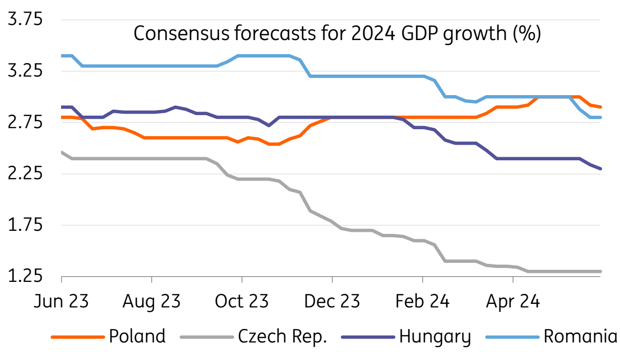
Headline inflation has essentially only surprised to the downside across the board since last September but, in most cases, it has come from non-core components or, at best, tradable items. The contribution of goods inflation has thus shrunk from dominating to almost zero across CEE, with the exception of Romania. This means that the easy part of the disinflation is over. The attention of central banks and markets is thus fully on service inflation, which in turn is proving more resilient than expected. This is where we have a problem for the second half of the year. Of course, this is not just a problem in the CEE region these days. However, as usual in recent years when it comes to inflation the CEE region is the expert in this area. As we can see in the details of the inflation prints, services inflation will be difficult to beat and, at the same time, for the second half of this year, we see demand pressures returning. The CEE economy may not be recovering as strongly as expected, but it is recovering nonetheless and we expect more later. At the same time, not much has changed in the labour market; on the contrary, wage pressures are rather surprising to the upside and are in high double-digits across most of the region. This will no doubt feed through to household demand to some extent, especially as real wage growth gathers momentum. Of course, one could still argue for a recovery in savings, but that argument may soon hit the ceiling and we will see increasing pass-through to household consumption. Headline inflation is thus certain to bounce up and the only question is by how much. At the same time, we don't expect much change on the core inflation side from current levels. So, while we may continue to see a surprise to the downside relative to expectations, it is fairly certain that inflation numbers will be higher for the rest of the year, complicating the job of the central banks. We see Poland and Hungary as the riskiest in this sense, where we expect headline growth of 150-220bp cumulatively by the end of the year. On the other hand, in the Czech Republic, inflation should remain within the central bank's tolerance band and Romania is going in the opposite direction with currently the highest inflation in the region.

Fig 19 Headline inflation surprises vs consensus (ppt)



Source: Eikon, ING

Fig 20 Optimism about recovery fades



Source: Eikon, ING

2

Fiscal consolidation across the board has been promised for this year, with the exception of Poland. After problematic years due to the Covid pandemic, war and energy crisis, there was hope for deficit reduction and government bond supply. However, at the end of the first half of this year, it is already certain that we will see none of this in most cases. Moreover, fiscal policy is taking centre stage given that inflation is no longer as much of an issue as in previous years. On a global level, we have the topic of US debt and the European Union is once again launching an EDP (Excessive Debt Procedure) in an attempt to keep debt growth in check. In addition, the European Parliament election results have generated a buzz that may further shift the focus from monetary policy to fiscal policy. In CEE, we were already pointing to upside fiscal risk in most countries at the start of the year and have revised our estimates in the direction of higher deficits in recent months. Moreover, the outlook for the next few years is not better either, given the greater impact of election cycles and a weaker-than-expected economic recovery. In June, the EC launched the EDP for all CEE countries except the Czech Republic. Romania is the only country already in this procedure, so the situation remains the same here. However, we do not see the procedure as a game changer that would force governments to tighten fiscal policy. Moreover, even the requirements set out in the RRF are not a sufficient whipping boy for decision-makers. We are therefore sceptical that we will see any changes in the current trajectory. Thus, ultimately the only stop sign here is the financial markets, which may start to punish unsustainable public finances in asset prices, especially if fiscal policy becomes a global issue. From this perspective, we see Romania and Hungary as the most risky within the CEE region. Poland, paradoxically, looks better in this context, where admittedly high deficits were already known earlier in the year and peers have worsened in the meantime. On the other hand, the Czech Republic should benefit in this environment, as it was the only country to deliver tangible consolidation.

3 The interest rate cutting cycle started in the region last year and we saw a lot of action from the CNB and NBH in the first half of the year. The NBP remains muted after the big cuts in September and October last year and the NBR is waiting for the cutting cycle to start. However, we seem to be getting into the late phase of the cutting cycle while in the developed markets' space the cutting cycle is just beginning. So, we do not expect much from central banks in the region in the second half of the year. The main reasons for this are the previously mentioned issues: (1) Inflation is bouncing up and it is uncertain quite how far we will go; (2) the economy is recovering supported by a tight labour market and anticipated household demand; and (3) fiscal policy remains significantly loose adding fuel to the recovery and inflationary pressures. Thus, for the second half of the year, we expect central banks to retreat and more likely to fine-tune depending on the global story and local inflation recovery. We do not expect any further rate cuts from the NBP and NBH this year, though NBH may be a wild card in the coming months with surprise rate cuts if conditions permit. From the NBR, we expect the cutting cycle to start in August, but overall we see room for only 2x25bp. From the CNB we expect another 3x25bp over the remainder of the year with the risk of a bit more if inflation allows.

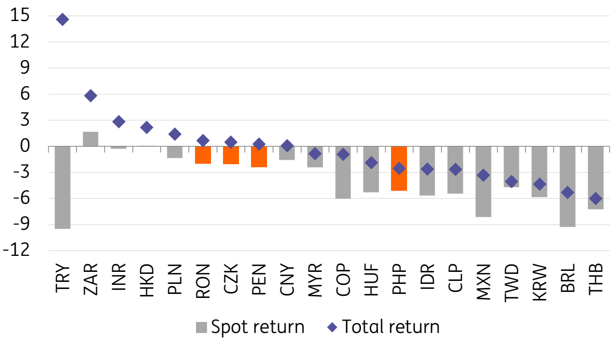
FX: More resistance to foreign pressure

CEE currencies resisted pressure from outside in the first half of the year but the recent sell-off has put them back on the starting line again, opening up attractive valuations across the region. The second half of the year is likely to see fewer rate cuts than the first and an acceleration of the economic recovery. This should support CEE FX while global central banks begin a cutting cycle, easing EM space conditions. PLN remains our favourite currency, but current valuations are also favourable for CZK and HUF.

The first half of the year proved challenging for CEE FX, however, it still proved resilient to global forces compared to the rest of the EM universe. The second half of the year could be slightly more favourable with the start of the DM central bank cutting cycle, economic recovery and a slowdown in the CEE cutting cycle. The external balance has also improved for most CEE economies with a surprisingly strong current account surplus, which should continue in some form in the months ahead. However, the carry is gone and the main driver will be the global story – in particular, how many rate cuts the Fed and ECB will deliver and where EUR/USD will be. The EM world hit the reset button in June and with the sell-off triggered by the elections in Mexico, India and South Africa and the political turmoil in France, we are back to square one in CEE with all this year's earlier gains erased. This opens up tempting valuations at the start of a period of hawkish central banks in the region.

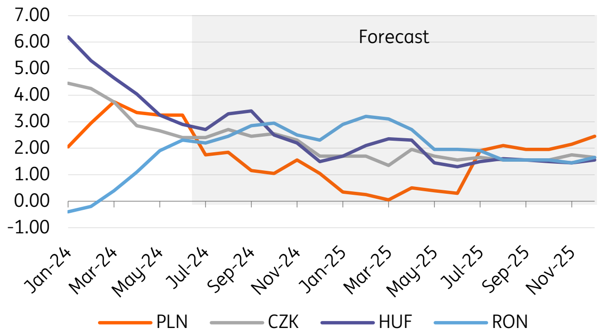
Our favourite currency remains the PLN, which in our view reflects the best of the CEE world at the moment. We believe that the NBP rates are certain to remain unchanged for some time. The economy may not be recovering as fast as we had anticipated in the first quarter, but our economists still see the potential for a catch-up in the months ahead. The current account has maintained a solid surplus since the end of last year and the wild card is the potential inflow of foreign investors into POLGBs, which currently lags behind CEE peers in this sense. In addition, its positioning since the sell-off is significantly more balanced in our view, whereas, in previous months, an overwhelming long positioning was a major concern for further gains. Thus, PLN has solid potential to return to previous levels and we are likely to see new lows in EUR/PLN, in our view.

Fig 21 FX spot and total return (YTD, %)



Source: Macrobond, ING

Fig 22 Projected real policy rate (%)



Source: Macrobond, ING

The CZK and HUF should see some gains for similar reasons, but the story we see here is more complicated. The currency should benefit from similar economic characteristics but both central banks, CNB and NBH, will be in a mode that anticipates further rate cuts. Compared to the first half of the year, however, the pace of rate cuts should slow or stop, which from a market perspective given current pricing should be more FX friendly than in previous months. The CZK is thus the best example in this case, given the fast money nature of the move recently. We believe that there is currently a reversal of positioning in the market after the CNB delivered the main part of the cutting cycle and we cannot expect any acceleration in momentum. Therefore, we only expect a stronger crown from here. EUR/HUF, on the other hand, will balance in the 385-400 range depending on inflation, the global story and NBH communication. However, any weakness will be taken as a reason for markets to unwind rate cut positions, which will again lead to FX strength. Therefore, we do not expect HUF to find a way out of this range any time soon.

Rates: Fine-tuning stage

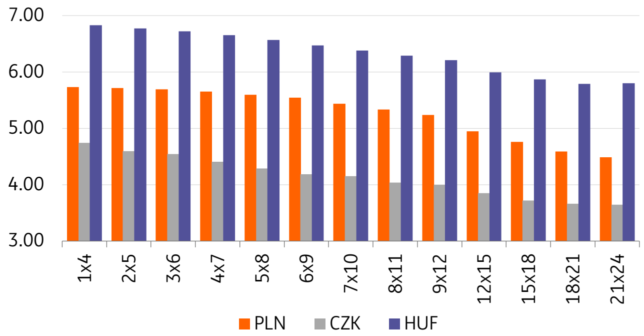
After the main phase of the rate cutting cycle in the CEE region, rates should stabilise and fine-tune any remaining rate cutting according to central banks' openness to recovering inflation. In Poland and the Czech Republic, we see the short end of the curve as fairly priced. In Poland, however, we should see more flattening of the curve given the nature of the NBP and the economy. In Hungary, we see markets underestimating the NBH change of leadership next year and believe that the whole curve has room to move lower with a flattening bias at first before steepening again later.

Given that we are entering the late phase of the cutting cycle across the region and that, in our view, inflation will only go up from this point, it seems that most of the normalisation of IRS curves is behind us. In recent months, short ends, in particular, have materially adjusted to the new reality and rate cuts thus we believe the second half of the year should bring a reduction in volatility from local sources and arguably the bigger driver may be global drivers. This could generally lead to pressure on the long end of the curve if we get more guidance on the ECB and Fed cutting cycle. While the short end seems fairly priced in most countries, the long end remains elevated, in our view, given the complicated story in the core markets.

In Poland, the market has continued to price in almost an entire one-rate cut this year and we see any rally at the ultra-short end of the curve as a pay opportunity. On the other hand, 2y looks fairly priced to us at the moment with 5y5y at almost the same level. The Polish curve seems to us to be the best case for a correction of some curve steepening from previous months. The high certainty of stable NBP rates and at the same time, admittedly, potential for rising inflation, but surprising to the downside if combined with ongoing economic recovery and loose fiscal policy, overwhelmingly due to military spending pulled from outside, should put pressure on the long end of the curve.

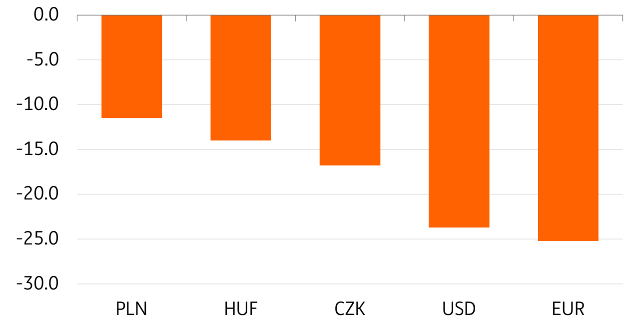
In the Czech Republic, the markets are pricing in a roughly 110bp CNB rate cut for this year, a bit more than we forecast but justified given the risks. On the other hand, the market implied path is well below the CNB forecast at the moment. Thus, if the CNB delivers a hawkish rate cut in June, the market may see some repricing to the upside. However, even looking further out, the curve is not too far from our path and the IRS market should stabilise in the range for the second half of the year.

Fig 23 FRA market



Source: Eikon, ING

Fig 24 Change since 31 May 2024 in 10y IRS



Source: Eikon, ING

In Hungary, the NBH delivered its last rate cut in June ahead of a planned pause in the second half of the year but we believe it is clear that additional rate cuts will be the name of the game for the coming months. Markets are currently pricing in a roughly 20% chance for the next meetings and 35% for the year-end meetings. In our view, the probability of rate cuts is a bit higher but it will depend on the incoming inflation data, EUR/HUF and the global story. However, the front-end of the IRS curve in our view underestimates a dovish change in the NBH board early next year.

Local currency debt: Fiscal policy disappointment and falling demand

The focus is shifting from monetary to fiscal policy and heavy issuance may be a problem in the second half of the year. Demand is gradually declining while the engine driven by rate cuts and disinflation is running out of steam. We believe fiscal consolidation or sufficiently high yield will be reasons for outperformance in the Czech Republic and Hungary. On the other hand, a lack of rate cuts and negative fiscal developments would drag down Romania.

As mentioned in the opening section of this chapter, fiscal policy is gaining momentum and mostly in a negative direction in the CEE region. This can already be seen in the issuance of sovereign bonds whereby MinFins are trying to frontload and secure financing for unclear deficits. Thus, we expect some shift from monetary to fiscal policy in the second half of the year as a factor making the difference between countries.

In Poland, although at the beginning of the year the fiscal situation looked like the worst in terms of the delta in the deficit and POLGBs issuance, thanks to developments within the region Poland now looks better. Although we expect some fiscal slippage, the picture has been stable since the beginning of the year. MinFin assumes a 5.1% GDP deficit vs our forecast of 5.5%, mainly due to weaker VAT collection. On the funding side, MinFin declares 71% coverage of all needs including cash buffer usage. According to our calculations, MinFin has covered about 66% of POLGBs YTD, the most in the CEE region.

On the negative side, auction demand has been declining since the beginning of the year (bid to cover average of 1.3 this year) and foreign investors still remain on the sidelines. POLGBs valuations don't look bad and we may see a bit less supply over the summer. However, it is clear that supply will remain very high next year. At the same time, the absence of rate cuts makes Poland less attractive, which may be exacerbated by an inflation rebound in the coming months.

The Czech Republic remains alone on the fiscal consolidation track in the region, which could be a major game changer for the second half of the year. Given the surprisingly low issuance needs, MinFin is in no great hurry to issue and has covered about 45% of CZGBs YTD, according to our calculations. Although demand decreased slightly (bid to cover average of 2.0 so far this year) it is still significantly stronger than most peers. In addition, inflation should remain within the central bank's tolerance band this year and the CNB is continuing rate cuts albeit at a slower pace. In addition, the country's fiscal position makes a difference here relative to peers and we believe CZGBs will benefit from this. However, the downside is the long positioning already built into the market.

Hungary is building a complicated story for the second half of the year with an announced pause in the cutting cycle and rising fiscal slippage. However, in detail and relative comparison, we see good value here. Although inflation has been bouncing up, inflation has surprised to the upside in only four out of seventeen cases since January last year. On the fiscal side, it can be argued that the entire deficit is made up of debt service and, from a primary deficit perspective, consolidation is taking place in a big way. At the same time, the AKK has done a good job of frontloading HGBs to cover the additional deficit and, in our view, has already covered about 60% of the YTD issuance. In addition, HGBs are enjoying high demand in auctions (bid to cover average of 2.0 so far this year). Rating agencies seem relaxed on budget revisions.

Romania is the only country in Europe that has already been in the EDP in previous years and therefore the current launch of the procedure should not be too much of a game changer. At the same time, the country is facing several elections, which bring additional fiscal risk. We recently revised our forecast for the general government deficit to 6.5% of GDP with the risk being up. MinFin covered about 46.6% of ROMGBs issuance YTD, according to our calculations, however, demand is noticeably lower than last year (bid to cover average of 1.4 so far this year). In addition, delays in EU money are creating cashflow issues in the funding plan, calling for additional issuance. The complicated situation is already reflected in ROMGBs pricing with the 10y yield returning to the 7.0% threshold. The only positive stimulus we see here comes from the possible start of the NBR cutting cycle in August. On the other hand, markets appear to have already priced in this move and likely ROMGBs gains would be limited.

Hard currency sovereign debt: Spreads grinding tighter

James Wilson, CFA
Emerging Markets Sovereign Debt Strategist
james.wilson@ing.com

With hopes of a 'soft landing' scenario in the US still intact, the macro environment should remain relatively benign for EM sovereigns, which have shown remarkable resilience to the major shocks in recent years. We see potential for steady returns given the carry on offer despite fairly tight spreads, although as ever politics remains a risk that could shake up the market.

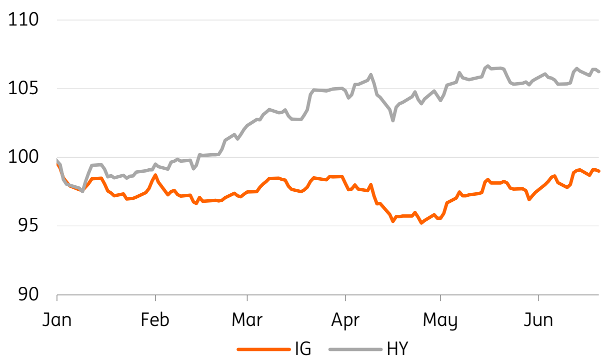
This year has seen a consistent narrative of spread tightening in EM credit, amid further signs of resilience for the asset class. Total returns are positive for EM sovereigns this year, with HY names benefitting the most from the environment of spread tightening. Performance has been more mixed for IG names, with the volatility in core rates driving swings in total returns even as spreads there also continued to squeeze towards all time tights.

10Y UST yields have generally been rangebound between 4% and 5%, with the year through to May seeing a general move higher as US data consistently beat expectations and showed signs of a major divergence with the rest of the world. More recently, UST yields have eased lower amid more optimism about the chances of rate cuts this year, while we have also seen a slight tick wider in HY spreads amid some renewed signs of market volatility.

With spreads still hovering near all-time tights for most higher quality credits, the scope for further significant compression has clearly diminished. Heading forward, we would need to see a return of inflows to EM debt funds for a potential leg lower in spreads, which so far have been absent despite the overall resilience of the asset class.

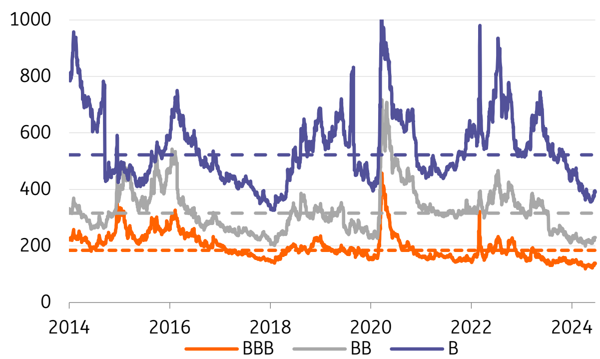
As a positive, all-in yields still look attractive for EM sovereigns, which should keep investor demand robust, including in the primary market. At the same time, the macro environment looks to be heading towards global monetary easing, while EM nations should increase their growth advantage over the developed world, which overall should be a fairly benign setup for EM sovereign credit.

Fig 25 Cumulative total returns YTD (EM USD sovereigns)



Source: ICE, Refinitiv, ING

Fig 26 EM sovereign spreads by rating (bp)



Source: ICE, Refinitiv, ING

Key themes

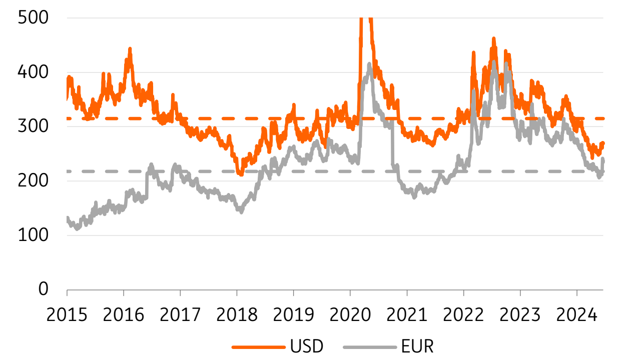
- **Waiting for the Fed.** With signs of more positive data prints out of the US recently, investor optimism is building about the potential for long-awaited Fed rate cuts by the end of the year, while the ECB has already started its cycle. An environment of modest easing by DM central banks towards more neutral territory, from restrictive, would be a positive for EM assets, as long as the US can avoid a significant slowdown.

- **Fiscal pressures in focus**. Within CEE, external metrics have recovered well from the recent shocks of Covid and the war in Ukraine, but a remaining issue for many of the larger sovereigns is difficulty in implementing fiscal consolidation. This has been a longstanding issue for Romania, while the recent move by the EU to place Hungary and Poland under the EDP further highlights the fiscal pressures on CEE, with deficits projected to remain wide in the coming years and financing needs elevated. We recently revised up our issuance expectations for Poland, Hungary and Romania for this year, and we expect further steady Eurobond issuance from all three in the next few years, in contrast to the decade prior to Covid. In this context, Serbia's fiscal performance stands out as impressive in a CEE context, as the nation pushes towards potential ratings upgrades to IG.

- **EUR paper looking attractive.** We continue to expect positive technical tailwinds for EUR EM credit from a shift towards more USD issuance for CEE. In addition, spread levels for EM EUR sovereigns look far more attractive relative to their history, when compared to the USD space.

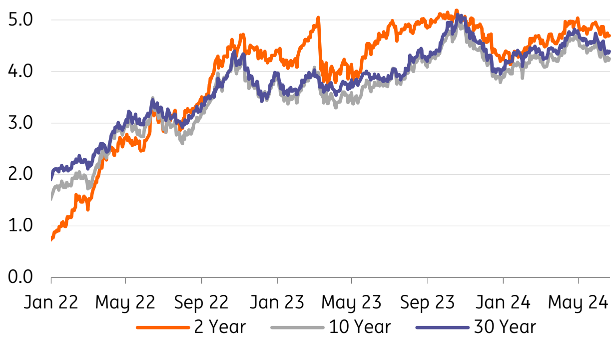
- **Politics in focus for CEE.** Recent political events have had a mixed impact on EM sovereigns, with South Africa seeing some relief after the formation of a government, while Mexico is facing uncertainty. CEE looks exposed to a range of political issues, with some spillover recently from volatility in France and more general uncertainty from the EU elections, along with potential geopolitical implications from US elections later in the year. On the domestic front, Bulgaria faces the risk of persistent uncertainty as it tries to form a new government, while Romania's elections will make fiscal reforms more difficult.

Fig 27 EM sovereign spreads by currency (bp)



Source: ICE, Refinitiv, ING; USD spreads versus USTs, EUR spread versus bunds

Fig 28 UST yields



Source: Macrobond, ING

Countries

Armenia

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	9.2	6.5	7.0	5.5	4.5	7.1	5.0
CPI (%YoY)*	-1.2	0.7	-0.2	2.2	4.1	0.1	3.6
Policy interest rate (eop, %)	8.50	8.00	7.50	7.00	6.75	7.00	6.50
3m interest rate (%)*	9.0	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (%)*	9.7	n/a	n/a	n/a	n/a	n/a	n/a
USD/AMD*	393	390	395	405	409	398	413
EUR/AMD*	425	421	435	445	450	433	454

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2029	S&P	BB-	BB-
Fiscal	Easing	Parliamentary: 2026	Moody's	Ba3	Ba3
Monetary	Tight		Fitch	BB-	BB-

*Quarterly data is eop, annual is average

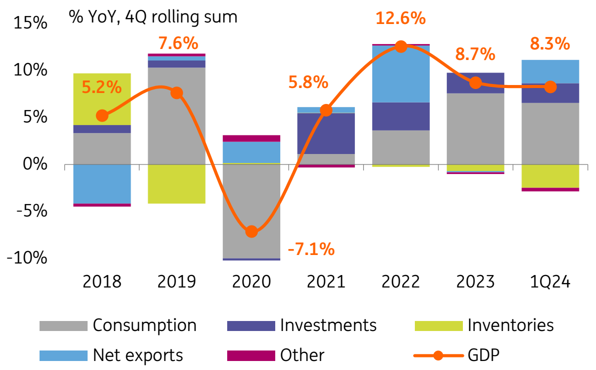
Source: National sources, ING estimates

Country strategy: Activity and FX remain strong

Despite the challenges related to domestic and foreign policy, the Armenian economy and markets are showing continued strength, leading to an improvement in the near-term view. Higher-than-expected foreign trade contributes to above-average GDP growth rates which, due to weakening domestic demand, does not translate into higher inflationary pressure for now. This allows some room for a lower key rate. The dram has also shown strength, as a stronger-than-expected trade balance is mitigating the effect of moderating remittances inflows.

Factors to watch for the longer run would be how the government navigates the complicated international relations in the region and whether the economy manages to convert the post-2022 financial windfalls into sustainable domestic growth drivers.

GDP growth composition by usage

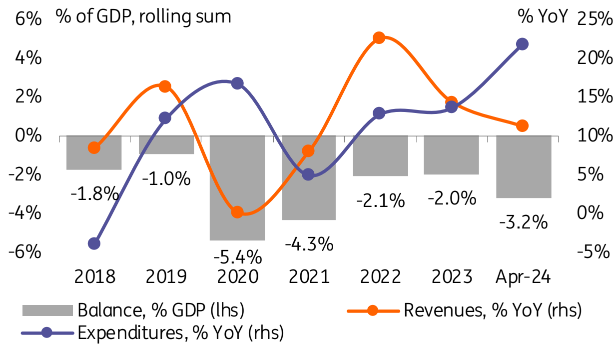


Source: National sources, CEIC, ING

Activity: Weaker domestic demand offset by higher exports

Armenian GDP growth is slowing (on a rolling 4Q sum basis) but remains elevated compared to pre-2022 levels. Standalone 1Q24 GDP posted a 9.2% YoY spike, driven by a very sharp 104% YoY growth in exports (amid a 78% YoY increase in imports). The reignited spark of foreign trade, most likely related to the politics of the region, allows us to raise our 2024 GDP expectation to 7.0-7.5%. For the longer run we note waning domestic demand, despite generally supportive fiscal policy and rapid credit expansion – the local retail loan portfolio has increased by 3ppt to 24% of GDP over the past 12 months. This weaker domestic demand explains why strong GDP growth does not preclude below-target CPI and potential key rate cuts. For 2025, we continue to see a noticeable moderation in activity, unless foreign trade continues to exceed expectations.

Key parameters of the state budget

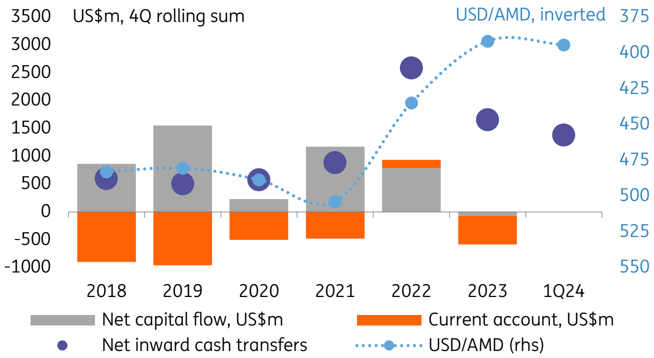


Source: National sources, CEIC, ING

Fiscal policy: Staying supportive

Having stabilised at around 2% of GDP in 2022-23, the budget deficit is now showing signs of widening. Looking at 4M24 performance, the revenue side is largely stable and is likely to remain so, as the potential weakening in consumption-related taxes could be offset by stronger taxes related to international trade and financial flows. The expenditure side is showing signs of ongoing increases, driven by higher outlays for social support, defence, and state administration and security. Together these three items account for 80% of overall spending as of now and were the primary driver of the spending increase in 2023 and 4M24. The situation around refugees from Artsakh (Nagorno Karabakh) and tension with Azerbaijan is likely to remain the watch factor for the budget balance in the coming years.

Current account, remittances and Armenian dram (AMD)



Source: National sources, CEIC, ING

AMD: Depreciation postponed, not cancelled

Despite the normalisation of the key balance of payment items to pre-2022 levels and the tensions with Azerbaijan, the Armenian dram avoided depreciation in 2023 and has even shown further appreciation in 1H24. The most recent round may have been related to regulatory changes associated with processing Russian-issued MIR bank cards as well as an improved trade balance. The rolling 12-month trade deficit narrowed to US$4.2bn as of April 2024 from US$4.7bn in October 2023. That might be a result of Armenia's greater participation in CIS-related trade flows in the region, although Russia's direct share in Armenian imports and exports did not increase. The continued decline in remittance inflows and weaker domestic demand mean that AMD depreciation risks have not evaporated, but more likely have just been postponed.

Armenia

dmitry.dolgin@ing.de

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	3.6	3.2	0.2	7.5	5.2	7.7	-7.2	5.8	12.6	8.7	7.1	5.0	4.5
Private consumption (%YoY)	1.6	-7.6	-2.1	13.7	4.9	11.5	-13.9	2.8	5.6	6.5	4.0	3.7	3.5
Government consumption (%YoY)	-1.2	4.7	-2.4	-2.1	-3.0	12.9	9.2	-6.2	-2.2	28.3	-10.0	5.0	4.0
Fixed investment (%YoY)	-2.2	2.5	-11.4	9.7	4.8	4.4	-1.5	23.6	14.0	10.1	5.0	6.0	5.0
Industrial production (%YoY)	1.5	5.2	6.5	12.3	4.2	9.0	-0.9	3.3	7.9	4.1	5.0	4.0	4.0
Unemployment rate (average, %)	17.6	18.5	18.0	17.8	19.0	18.3	18.2	15.5	13.5	12.6	12.5	12.3	12.2
Nominal GDP (AMDbn)	4,829	5,044	5,067	5,564	6,017	6,543	6,182	6,992	8,501	9,505	10,184	11,074	12,014
Nominal GDP (€bn)	8.7	9.5	9.5	10.2	10.5	12.2	11.1	11.7	18.4	22.4	23.5	24.4	25.3
Nominal GDP (US$bn)	11.6	10.6	10.5	11.5	12.5	13.6	12.6	13.9	19.5	24.2	25.6	26.8	27.8
GDP per capita (US$)	3,853	3,512	3,524	3,869	4,196	4,597	4,269	4,685	6,572	8,097	8,263	8,652	8,981
Gross domestic saving (% of GDP)	2.4	9.0	10.2	7.7	8.7	4.0	9.7	15.1	20.7	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	3.0	3.7	-1.4	1.0	2.5	1.4	1.2	7.2	8.6	2.0	0.1	3.6	3.8
CPI (year-end, %YoY)	4.6	-0.1	-1.4	2.6	1.8	0.7	3.7	7.7	8.3	-0.6	2.2	3.2	4.0
Wage rates (nominal, %YoY)	8.2	8.0	2.3	3.2	-11.4	5.6	4.0	7.4	15.3	14.7	9.0	5.0	4.0
Fiscal balance (% of GDP)													
Consolidated government balance	-1.9	-4.8	-5.5	-4.8	-1.6	-0.8	-5.1	-4.5	-2.2	-1.9	-2.5	-2.7	-3.1
Consolidated primary balance	-0.6	-3.3	-3.6	-2.6	0.7	1.6	-2.4	-2.0	0.1	0.7	0.3	0.1	-0.2
Total public debt	43.7	48.7	56.7	58.8	55.5	53.6	67.4	63.4	49.2	50.5	52.5	53.7	55.2
External balance													
Exports (US$bn)	1.7	1.6	1.9	2.4	2.7	3.4	2.7	3.3	5.7	8.5	14.0	12.6	10.1
Imports (US$bn)	3.8	2.8	2.9	3.8	4.5	5.1	4.1	4.8	7.6	10.9	15.9	14.3	11.4
Trade balance (US$bn)	-2.1	-1.2	-1.0	-1.4	-1.8	-1.7	-1.4	-1.5	-1.9	-2.4	-1.8	-1.6	-1.3
Trade balance (% of GDP)	-17.7	-11.2	-9.3	-12.2	-14.2	-12.6	-10.9	-10.8	-9.5	-10.1	-7.1	-6.1	-4.7
Current account balance (US$bn)	-0.9	-0.3	-0.1	-0.1	-0.9	-1.0	-0.5	-0.5	0.2	-0.5	-0.3	-0.8	-0.9
Current account balance (% of GDP)	-7.7	-2.7	-1.0	-1.3	-7.2	-7.1	-4.0	-3.5	0.8	-2.1	-1.3	-3.1	-3.4
Net FDI (US$bn)	0.4	0.2	0.3	0.2	0.3	0.2	0.1	0.3	0.9	0.4	0.3	0.2	0.3
Net FDI (% of GDP)	3.3	1.5	2.5	1.9	2.1	1.7	0.7	2.5	4.9	1.6	1.2	0.7	1.1
Current account balance plus FDI (% of GDP)	-4.5	-1.2	1.5	0.7	-5.1	-5.3	-3.3	-1.0	5.6	-0.5	-0.1	-2.3	-2.3
Foreign exchange reserves ex gold (US$bn)	1.5	1.8	2.2	2.3	2.3	2.8	2.6	3.2	4.1	3.6	3.7	3.8	3.9
Import cover (months of merchandise imports)	4.8	7.6	9.2	7.3	6.0	6.7	7.7	8.1	6.5	4.0	2.8	3.2	4.1
Debt indicators													
Gross external debt (US$bn)	8.5	8.9	10.0	10.5	10.9	12.4	12.9	13.8	15.3	15.5	16.0	17.0	18.0
Gross external debt (% of GDP)	73.5	84.5	94.4	91.3	87.7	90.9	102.1	99.8	78.2	63.9	62.3	63.2	64.5
Gross external debt (% of exports)	503	549	526	441	401	368	475	423	267	182	114	134	178
Lending to corporates/households (% of GDP)	41.6	38.3	40.3	42.7	46.2	49.6	60.4	51.2	44.7	48.6	49.3	50.4	51.5
Interest & exchange rates													
Central bank key rate (year-end, %)	8.50	8.75	6.25	6.00	6.00	5.50	5.25	7.75	10.75	9.25	7.00	6.50	6.50
Broad money supply (average, %YoY)	-3.5	5.2	24.8	28.9	13.2	21.5	14.8	12.8	13.4	22.1	15.0	12.0	10.0
3m interest rate (average, %)	7.50	12.09	8.56	6.11	6.02	5.83	5.44	7.10	10.00	10.75	n/a	n/a	n/a
3m interest rate spread over US$-Libor (ppt)	7.27	11.77	7.82	4.85	3.71	3.50	4.79	6.94	7.60	5.35	n/a	n/a	n/a
2yr yield (average, %)	8.93	13.30	11.15	7.68	7.04	6.80	6.17	8.22	10.62	11.05	n/a	n/a	n/a
10yr yield (average, %)	11.26	14.92	14.00	11.10	9.72	9.48	7.99	9.39	11.24	11.03	n/a	n/a	n/a
USD/AMD exchange rate (year-end)	475	484	484	484	484	480	523	480	394	405	405	421	442
USD/AMD exchange rate (average)	416	478	480	483	483	480	489	504	436	392	398	413	432
EUR/AMD exchange rate (year-end)	577	529	512	580	554	537	641	543	420	448	445	463	486
EUR/AMD exchange rate (average)	552	530	532	545	571	538	558	597	461	425	433	454	475
Brent oil price (annual average, US$/bbl)	99	54	45	55	72	64	43	71	99	82	85	80	75

Source: National sources, CEIC, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	9.3	7.4	7.7	9.2	6.5	7.0	5.5	4.5	5.7	4.3	5.5	5.0	4.0
CPI (eop, %YoY)	-0.5	0.1	-0.6	-1.2	0.7	-0.2	2.2	4.1	3.8	3.7	3.2	3.7	3.8
Central bank key rate (eop, %)	10.50	9.75	9.25	8.50	8.00	7.50	7.00	6.75	6.50	6.50	6.50	6.50	6.50
3m interest rate (eop, %)	10.94	10.36	10.27	8.95	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	10.78	10.17	10.77	9.65	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AMD exchange rate (eop)	387	396	404	393	390	395	405	409	413	417	421	426	432
EUR/AMD exchange rate (eop)	423	418	447	425	421	435	445	450	454	459	463	469	475

Source: National sources, CEIC, ING estimates

Azerbaijan

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	4.0	5.0	2.5	1.5	1.7	3.3	2.5
CPI (%YoY)*	3.1	0.4	1.8	3.1	3.5	1.2	3.8
Policy interest rate (eop, %)	7.50	7.25	7.00	7.00	7.00	7.00	7.00
3m interest rate (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AZN*	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/AZN*	1.83	1.84	1.87	1.87	1.87	1.86	1.87

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2031	S&P	BB+	BB+
Fiscal	Neutral	Parliamentary: 2024	Moody's	Ba1	Ba1
Monetary	Tight		Fitch	BB+	BB+

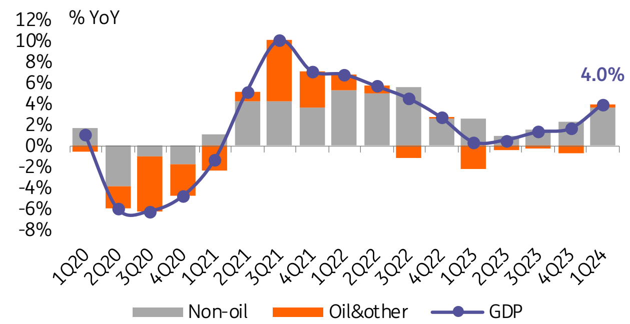
*Quarterly data is eop, annual is average

Source: National sources, ING estimates

Country strategy: On a rebound

Azerbaijan is showing signs of recovery in economic growth after a trough in 2023, mostly thanks to sectors other than oil & gas. Commodity-driven growth has also stopped being a drag. Closer trade ties with the EU (and formerly with Russia) support positive expectations in Azerbaijan's gas sector and in other areas, including for airlines. Lower domestic price pressures are seen as largely temporary, leaving little scope for monetary easing. Fiscal policy, though generally focused on maintaining a budget surplus, is showing signs of becoming more growth supportive. This is amid more generous spending on social support, defence, and state administration, reflecting the geopolitical realities in the region. As always, tensions with Armenia, which appear muted for now, remain a risk factor.

GDP and oil/non-oil contribution (%YoY, ppt)

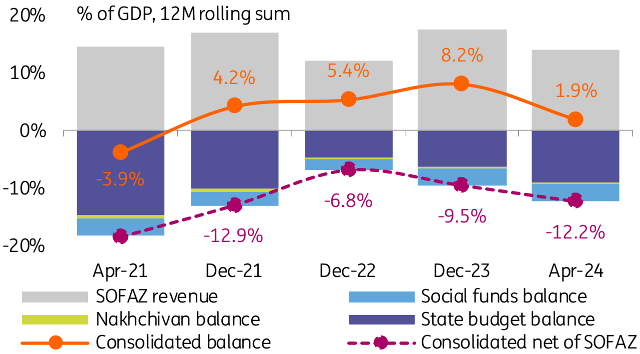


Source: National sources, CEIC, ING

Activity: Showing signs of recovery

In 2024 Azerbaijan's economy has been picking up, mostly thanks to non-oil & gas sectors. This is reflected in faster retail loan growth – to 12% of GDP (or 21% of non-oil GDP). The oil & gas part of the economy is also improving, and new gas contracts with the EU should continue to support positive expectations. Monetary policy is unlikely to provide support as current disinflation (-0.3% YoY as of May 2024 versus +2.1% YoY as of December 2024) is seen as temporary. The main reason for the drop in CPI is the food component benefitting from global food price disinflation. We therefore expect CPI to eventually return to 3-4% in the coming years, limiting the room for cuts in the key rate from the current 7.25% to 25bp.

Consolidated budget balance by components (% of GDP)

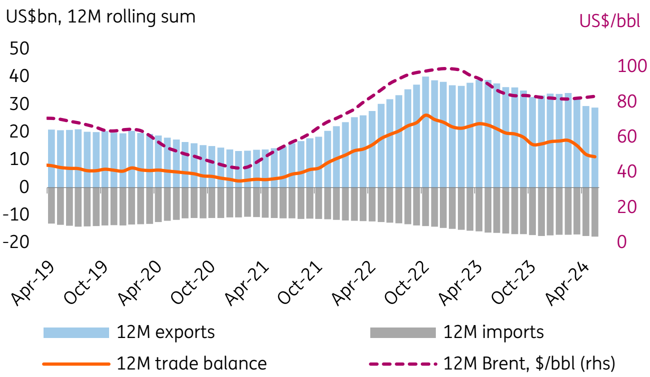


Source: National sources, CEIC, ING

Fiscal policy: Narrowing surplus is growth-supportive

In 2023 the consolidated budget posted a very wide 8.2% of GDP surplus. This was mostly thanks to higher-than-expected oil revenues, these reaching historical highs of US$0.20bn per US$1/bbl for the oil price. This year's performance is pointing to a retreat in oil revenues to US$0.17bn per US$1/bbl. Meanwhile, expenditures keep growing due to higher social support, defence and state administration (accounting for 62% of total spending and 80% of spending growth YTD), a situation similar to neighbouring Armenia amid continued tensions between the two countries. Although recent newsflow might offer a chance for de-escalation, we continue to expect a reduction in the consolidated fiscal surplus in coming years. This should be somewhat supportive for the growth story.

Trade balance composition and Brent oil price (US$/bbl)



Source: National sources, CEIC, ING

External balance: Growing vulnerability to the oil price

Expectations for Azerbaijan's trade and current account surplus remain solid, on strong exports and some moderation of import flows after some acceleration in 2022-23. In the coming years Azerbaijan is likely to benefit from higher trade of goods (including gas) and services (including airlines) with the EU, taking up a portion of the market previously occupied by Russia. Oil exports are likely to be constrained by ageing production infrastructure. Annual exports per US$1/bbl of the Brent oil price have declined from US$0.40bn in 2022-23 to US$0.35bn currently, while the current account breakeven level has increased from US$35-45/bbl in 2020-22 to US$56/bbl in 2023. This suggests potentially higher susceptibility to the risk of lower oil prices. We expect a gradual narrowing of the current account surplus in the coming years.

Azerbaijan

dmitry.dolgin@ing.de

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	2.8	1.1	-3.1	0.2	1.5	2.5	-4.2	5.6	4.7	1.1	3.3	2.5	2.8
Real oil GDP (%YoY)	-2.9	0.6	0.1	-5.3	0.5	0.4	-6.5	1.4	-2.5	-2.3	0.0	1.5	1.5
Real non-oil GDP (%YoY)	6.9	1.1	-4.4	2.7	2	4	-2.9	7.1	9.0	3.7	5.0	3.7	4.0
Investment (%YoY)	-1.7	-11.1	-21.7	2.8	-4.3	5.5	-7.3	-4.5	3.3	9.8	4.5	5.5	4.5
Industrial production (%YoY)	-0.7	2.5	-0.5	-3.5	1.5	1.8	-4.0	5.0	-1.1	-1.1	1.5	3.0	2.0
Unemployment rate (average, %)	4.9	5.0	5.0	5.0	4.9	4.9	6.4	6.4	5.8	5.6	5.5	5.5	5.5
Nominal GDP (AZNbn)	59.0	54.4	60.4	70.3	80.1	81.9	72.6	93.2	134.0	123.0	127.8	136.0	145.6
Nominal GDP (€bn)	56.6	47.8	34.2	36.2	39.9	43.0	37.4	46.3	74.7	66.9	68.8	72.7	77.8
Nominal GDP (US$bn)	75.2	53.0	37.9	40.9	47.1	48.2	42.7	54.8	78.8	72.4	75.2	80.0	85.6
GDP per capita (US$)	7,991	5,562	3,929	4,199	4,798	4,851	4,269	5,458	7,806	7,126	7,314	7,704	8,170
Gross domestic saving (% of GDP)	44	31	28	31	35	31	23	34	46	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	1.4	4.0	12.4	12.9	2.3	2.6	2.8	6.7	13.9	8.9	1.2	3.8	4.2
CPI (year-end, %YoY)	-0.2	7.6	15.7	7.9	1.6	2.3	2.6	12.0	14.4	2.1	3.1	3.5	4.8
Wage rates (nominal, %YoY)	4.6	5.0	7.0	5.7	3.0	16.6	11.4	3.4	14.7	11.2	6.2	5.3	6.7
Fiscal balance (% of GDP)													
Consolidated government balance	2.9	-5.3	0.3	-1.5	5.9	9.1	-6.5	4.2	6.0	8.2	5.1	3.3	2.2
Consolidated primary balance	4.3	-3.8	2.4	0.9	8.7	10.9	-4.4	6.3	6.5	8.6	5.6	3.8	2.6
Total public debt	8.5	18.0	20.6	22.5	18.7	17.7	21.3	26.3	17.3	18.4	18.7	19.7	21.0
External balance													
Exports (US$bn)	28.3	15.6	13.2	15.2	20.8	19.9	12.6	21.7	40.9	29.2	32.6	32.5	32.1
Imports (US$bn)	9.3	9.8	9.0	9.0	11.0	11.3	10.1	10.4	13.5	16.4	18.1	18.8	19.6
Trade balance (US$bn)	18.9	5.8	4.2	6.1	9.8	8.5	2.5	11.3	27.4	12.8	14.5	13.7	12.6
Trade balance (% of GDP)	25.2	11.0	11.1	15.0	20.9	17.7	5.9	20.6	34.7	17.7	19.3	17.1	14.7
Current account balance (US$bn)	10.4	-0.2	-1.4	1.7	6.1	4.4	-0.2	8.3	23.5	8.3	9.4	8.3	6.9
Current account balance (% of GDP)	13.9	-0.4	-3.6	4.1	12.8	9.1	-0.5	15.1	29.8	11.5	12.5	10.3	8.1
Net FDI (US$bn)	2.4	0.8	1.9	0.3	-0.8	-1.4	-0.8	-2.2	-5.1	-2.1	-2.0	-1.0	-1.0
Net FDI (% of GDP)	3.2	1.5	5.1	0.7	-1.7	-2.9	-1.8	-4.1	-6.5	-2.9	-2.7	-1.3	-1.2
Current account balance plus FDI (% of GDP)	17.1	1.1	1.5	4.9	11.1	6.2	-2.3	11.0	23.3	8.6	9.8	9.1	6.9
Foreign exchange reserves ex gold (US$bn)	15.3	7.7	7.3	7.0	6.7	7.1	7.8	8.3	10.8	13.7	14.2	14.7	15.0
Import cover (months of merchandise imports)	19.7	9.4	9.7	9.3	7.3	7.5	9.3	9.5	9.5	10.1	9.5	9.4	9.2
Debt indicators													
Gross external debt (US$bn)	12.1	13.3	14.6	15.4	16.6	16.5	16.5	15.6	15.3	16.8	17.3	17.8	18.3
Gross external debt (% of GDP)	16.1	25.2	38.6	37.8	35.2	34.3	38.6	28.5	19.4	23.2	23.0	22.2	21.3
Gross external debt (% of exports)	42.9	85.6	110.6	101.9	79.8	83.2	130.9	72.1	37.4	57.5	53.0	54.8	56.9
Lending to corporates/households (% of GDP)	31.4	40.0	27.2	16.7	16.3	18.7	20.0	18.4	15.1	19.5	19.6	19.6	19.6
Interest & exchange rates													
Central bank key rate (year-end, %)	3.50	3.00	15.00	15.00	9.75	7.50	6.25	7.25	8.25	8.00	7.00	7.00	7.50
Broad money supply (average, %YoY)	11.8	-1.3	-1.9	9.0	5.7	20.0	1.1	18.7	23.6	5.3	14.2	8.8	9.7
3m interest rate (Bakibor, average, %)	10.8	9.2	13.5	20.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
3m interest rate spread over US$-Euribor (ppt)	1,057	884	1,279	1,936	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AZN exchange rate (year-end)	0.78	1.56	1.77	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70
USD/AZN exchange rate (average)	0.78	1.02	1.60	1.72	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/AZN exchange rate (year-end)	0.96	1.70	1.90	2.04	1.95	1.91	2.08	1.93	1.81	1.88	1.87	1.87	1.87
EUR/AZN exchange rate (average)	1.04	1.14	1.77	1.94	2.01	1.90	1.94	2.01	1.79	1.84	1.86	1.87	1.87
Brent oil price (annual average, US$/bbl)	99	54	45	55	72	64	43	71	99	82	85	80	75

Source: CEIC, National sources, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	0.9	1.7	1.1	4.0	5.0	2.5	1.5	1.7	2.5	2.7	3.0	3.5	3.0
CPI (eop, %YoY)	10.6	5.1	2.1	3.1	0.4	1.8	3.1	3.5	4.1	3.9	3.5	4.8	4.1
Central bank key rate (eop, %)	9.00	9.00	8.00	7.50	7.25	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
3m interest rate (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AZN exchange rate (eop)	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/AZN exchange rate (eop)	1.85	1.80	1.88	1.83	1.84	1.87	1.87	1.87	1.87	1.87	1.87	1.87	1.87

Source: CEIC, National sources, ING estimates

Bulgaria

Valentin Tataru, Chief Economist | Stefan Posea, Economist

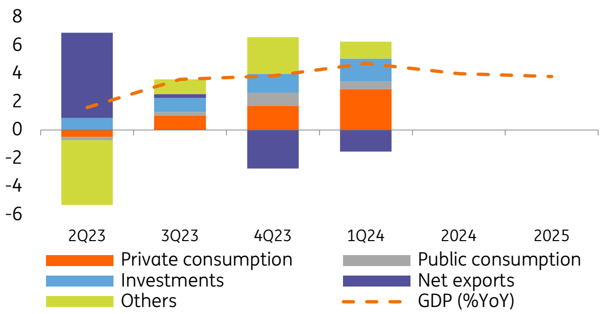
Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	1.8	2.5	2.8	3.1	3.4	2.6	3.3
CPI (%YoY)*	3.0	2.4	2.0	3.0	2.9	2.6	3.4
Base rate (eop, %)	3.80	3.78	3.75	3.70	3.65	3.70	3.50
3yr yield (%)*	3.20	3.10	3.00	2.80	2.70	2.90	2.60
USD/BGN	1.81	1.81	1.78	1.78	1.78	1.79	1.78
EUR/BGN	1.96	1.96	1.96	1.96	1.96	1.96	1.96

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2026	S&P	BBB	BBB
Fiscal	Loose	Parliamentary: 2028	Moody's	Baa1	Baa1
Monetary	Loose	Local: 2027	Fitch	BBB	BBB

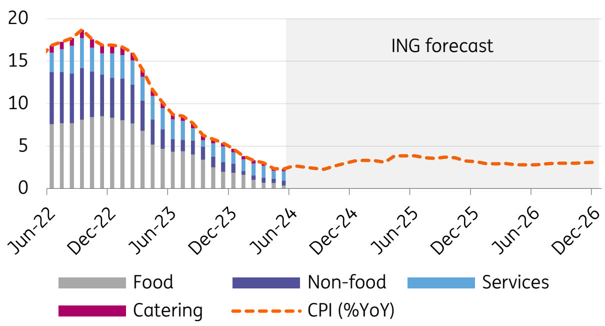
*Quarterly data is eop. annual is average
Source: National sources. ING estimates

Real GDP (%YoY) and contributions (ppt)



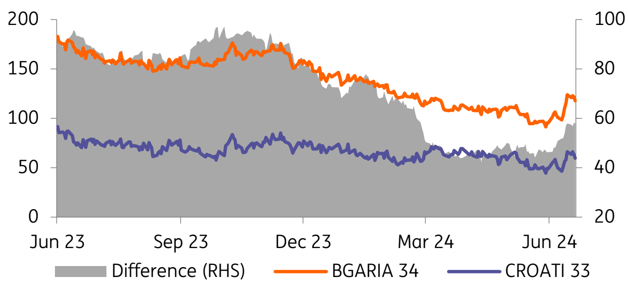
Source: NSI, ING

Inflation (%YoY) and main components (ppt)



Source: NSI, ING

BGARIA credit spreads vs CROATIA (bp)



Source: ICE, Refinitiv, ING

Country strategy: Keeping eyes on the prize

With political instability back in the headlines, the country's prospects of joining the Eurozone on 1 January 2025 have faded. To make matters worse, the outcome of the recent election (the sixth in three years) did not bring a clear path to a stable government either. That is not to say that the criteria fulfilment for euro adoption is in bad shape. On the contrary, a little more progress on inflation and completion of the Euro Adoption Act blueprint by the end of summer would clear out the main issues. And, technically, despite rivalries, the Western-oriented parties dominated the last elections. While the EC could ignore small inflation differences, a delay is probable if the political situation isn't resolved. Ultimately, even with all criteria in check, inter-institutional cooperation needs to be smooth early on in the euro adoption process. Without a quick solution, 1 January 2026 is looking more realistic.

Delayed investments to cap the gains

Our view is that activity will accelerate this year, with fixed investments and private consumption as the key growth engines. While we are less optimistic now, due to the prospects of another extended period of delayed investments and EU-money absorption, we are not gloomy either. Private consumption started the year on a strong footing and the recent real wage growth is consistent with accelerating momentum on this front. Also, we have recently become slightly more optimistic on the Eurozone prospects, to the likely benefit of exports. All in all, we pencil in growth of 2.6% this year, with mild downside risks, stemming from the limitations of an extended caretaker government.

Look out for internal demand and taxes

Inflation decelerated to 2.4% in May, almost half of December's 4.7%. While progress has been good so far, we don't think that there is room for complacency. Real wage growth is close to all-time highs and some tax changes are in full swing. More specifically on the latter, a reversal of pandemic VAT cuts will end on 30 June and 31 December, providing upward potential ahead, especially as this will catch consumers pressing the accelerator, and not the brake. That said, the longer the caretaker government remains in place, the harder it will be for public spending to boost demand, weighing eventually on firms' pricing power confidence too. We pencil in a 3.0% year-end inflation, with balanced risks.

Sovereign credit yet to price in political uncertainty

Bulgaria's euro bonds have performed well for much of this year, with spreads grinding tighter through to late May. More recently, the shift back towards political instability has had limited impact on valuations, with investors largely looking through the likely delay to planned euro entry. While we expect the medium-term thesis to remain intact (eventual euro adoption leading to rating upgrades and spread compression towards most eurozone sovereigns), further signs of a return to the cycle of snap elections and headlines around euro delays could see some weakness in performance, so we prefer Croatia at current levels.

James Wilson, EM Sovereign Strategist

Bulgaria

valentin.tataru@ing.com | tiberiu-stefan.posea@ing.com

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	0.9	3.4	3.0	2.7	2.7	4.0	-4.0	7.7	3.9	1.8	2.6	3.3	3.2
Private consumption (%YoY)	1.4	2.8	2.2	2.6	3.7	6.0	-0.6	8.5	3.8	5.4	4.2	3.8	3.0
Government consumption (%YoY)	-0.1	1.8	2.2	4.3	5.3	2.0	8.3	0.4	5.5	-0.4	1.8	3.0	2.1
Investment (%YoY)	3.5	2.7	-6.6	3.2	5.4	4.5	0.6	-8.3	6.5	3.3	4.5	6.2	6.0
Industrial production (%YoY)	2.0	2.7	2.5	4.0	0.3	0.5	-6.3	10.1	12.8	-8.2	-1.1	3.9	4.4
Unemployment rate (eop, %)	11.4	9.0	7.7	6.7	5.7	5.3	6.3	4.6	4.0	4.4	4.8	4.5	4.4
Nominal GDP (BGNbn)	84.1	89.6	95.3	102.7	109.9	120.3	120.5	139.0	167.8	183.7	193.6	206.8	219.4
Nominal GDP (€bn)	43.0	45.8	48.7	52.5	56.2	61.5	61.6	71.1	85.8	93.9	99.0	105.7	112.2
Nominal GDP (US$bn)	56.8	50.4	53.6	59.9	65.7	68.9	70.9	83.9	90.1	101.4	107.9	116.3	123.4
GDP per capita (US$)	7,900	7,100	7,600	8,500	9,400	9,900	10,300	12,200	13,200	14,900	15,900	17,100	18,100
Gross domestic saving (% of GDP)	20.4	21.9	23.9	24.1	23.7	24.2	22.3	22.9	23.6	22.0	21.5	21.3	21.9
Prices													
CPI (average %YoY)	-1.4	-0.1	-0.8	2.1	2.8	3.1	1.7	3.3	15.3	9.7	2.6	3.4	2.9
CPI (year-end %YoY)	-0.9	-0.4	0.1	2.8	2.7	3.8	0.1	7.8	16.9	4.7	3.0	3.2	3.1
Wage rates (nominal %YoY)	2.4	7.9	7.0	10.5	7.4	12.0	8.6	12.0	13.7	14.5	16.5	7.0	7.0
Fiscal balance (% of GDP)													
Consolidated government balance	-5.4	-1.9	0.3	1.6	1.7	2.1	-3.8	-3.9	-2.9	-1.9	-2.8	-2.9	-2.0
Consolidated primary balance	-4.5	-0.9	1.2	2.4	2.4	2.7	-3.3	-3.5	-2.5	-1.4	-2.3	-2.4	-1.7
Total public debt	27.0	25.9	29.1	25.1	22.1	20.0	24.6	23.9	22.6	23.1	24.8	24.6	24.3
External balance													
Exports (€bn)	22.0	22.9	23.1	26.9	27.7	29.1	27.3	34.4	47.1	43.3	44.5	46.7	49.1
Imports (€bn)	26.1	26.3	24.1	27.7	30.4	32.0	29.2	37.3	52.2	47.0	48.8	51.2	53.8
Trade balance (€bn)	-4.1	-3.5	-1.0	-0.8	-2.7	-2.9	-1.9	-2.9	-5.1	-3.7	-4.3	-4.5	-4.7
Trade balance (% of GDP)	-9.5	-7.6	-2.0	-1.5	-4.8	-4.7	-3.2	-4.1	-6.0	-3.9	-4.3	-4.3	-4.2
Current account balance (€bn)	0.5	0.0	1.5	1.7	0.5	1.1	0.0	-1.2	-1.2	-0.3	0.1	0.4	0.7
Current account balance (% of GDP)	1.2	0.0	3.1	3.3	0.9	1.9	0.0	-1.7	-1.4	-0.3	0.1	0.4	0.6
Net FDI (€bn)	0.3	2.0	0.9	1.6	1.0	1.6	3.0	1.5	2.6	3.6	3.7	3.8	4.0
Net FDI (% of GDP)	0.3	4.1	0.6	1.3	0.8	1.2	2.8	1.3	2.0	3.9	3.8	3.6	3.5
Current account balance plus FDI (% of GDP)	0.9	-4.1	2.5	2.0	0.2	0.6	-2.7	-3.0	-3.4	-4.1	-3.6	-3.2	-2.9
Foreign exchange reserves (€bn)	14.5	18.2	21.6	21.4	22.8	22.2	28.0	30.5	34.2	37.5	37.6	41.8	46.5
Import cover (months of merchandise imports)	6.7	8.3	10.8	9.3	9.0	8.3	11.5	9.8	7.9	9.6	9.2	9.8	10.4
Debt indicators													
Gross external debt (€bn)	39.3	36.7	38.1	37.7	37.2	37.7	39.3	41.2	44.2	45.4	45.9	46.8	47.7
Gross external debt (% of GDP)	91	80	78	72	66	61	64	58	52	48	46	44	43
Gross external debt (% of exports)	178	160	165	140	134	129	144	120	94	105	103	100	97
Lending to corporates/households (% of GDP)	59.2	54.8	52.0	49.8	50.4	49.6	51.5	48.3	44.9	43.8	42.9	44.3	45.7
Interest & exchange rates													
Base interest rate (year-end %)	0.02	0.01	0.00	0.00	0.00	0.00	0.00	0.00	1.30	3.60	3.70	3.50	3.30
Broad money supply (average %YoY)	1.1	8.8	7.6	7.7	8.8	9.9	10.9	10.7	13.2	8.7	8.9	9.3	9.8
3yr yield (average %)	1.59	1.03	0.36	0.08	-0.05	-0.20	0.05	-0.05	4.40	3.25	2.90	2.60	2.50
10yr yield (average %)	3.42	2.83	2.19	1.60	0.94	0.46	0.40	0.30	1.00	4.50	4.30	4.00	3.80
USD/BGN exchange rate (year-end)	1.62	1.79	1.86	1.63	1.70	1.75	1.60	1.72	1.83	1.78	1.78	1.78	1.78
USD/BGN exchange rate (average)	1.48	1.78	1.78	1.72	1.67	1.75	1.70	1.66	1.86	1.81	1.79	1.78	1.78
EUR/BGN exchange rate (year-end)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
EUR/BGN exchange rate (average)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96

Source: National sources. ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	1.9	1.5	1.8	1.8	2.5	2.8	3.1	3.4	3.1	3.2	3.2	3.2	3.2
CPI (eop. %YoY)	8.7	6.3	4.7	3.0	2.4	2.0	3.0	2.9	3.8	3.7	3.2	3.0	2.8
Base interest rate (eop. %)	2.96	3.53	3.79	3.80	3.78	3.75	3.70	3.65	3.55	3.50	3.50	3.40	3.30
3yr yield (eop. %)	3.20	3.25	3.25	3.20	3.10	3.00	2.80	2.70	2.60	2.60	2.50	2.50	2.50
USD/BGN exchange rate (eop)	1.79	1.85	1.78	1.81	1.81	1.78	1.78	1.78	1.78	1.78	1.78	1.78	1.78
EUR/BGN exchange rate (eop)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96

Source: National sources. ING estimates

Croatia

Valentin Tataru, Chief Economist | Stefan Posea, Economist

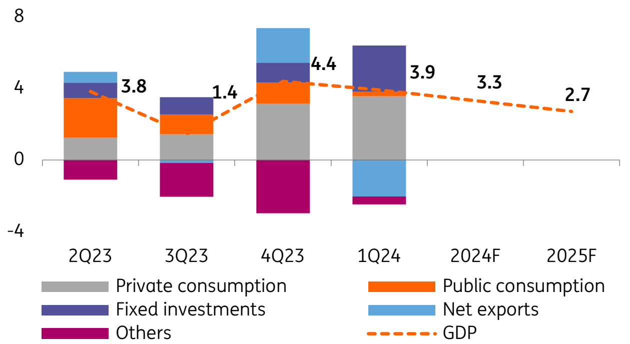
Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	3.9	3.0	4.3	2.6	2.6	3.5	2.7
HICP (%YoY)*	4.9	3.4	2.8	3.2	3.0	3.6	3.2
CPI (%YoY)	4.1	2.6	2.1	2.6	2.6	2.9	2.6
ECB depo rate (eop,%)	4.00	3.75	3.50	3.25	3.00	3.25	2.50
10yr yield (%)*	3.35	3.30	3.30	3.30	3.25	3.30	3.20

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2024	S&P	BBB+	BBB+
Fiscal	Loose	Parliamentary: 2028	Moody's	Baa2	Baa2
Monetary	Tighter	Local: 2025	Fitch	BBB+	BBB+

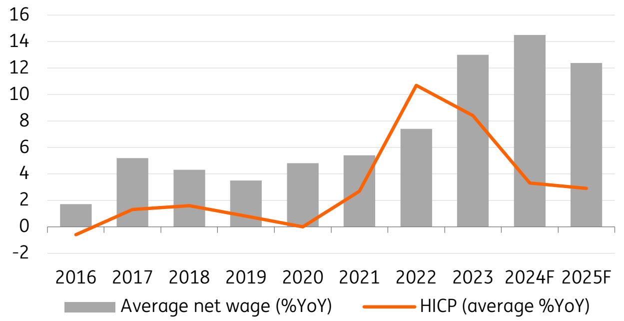
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

Real GDP (YoY%) and contributions (ppt)



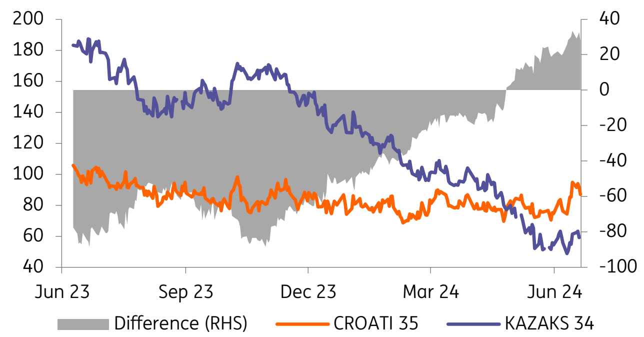
Source: Eurostat, ING

Harmonised inflation and wages (YoY)



Source: Eurostat, ING

CROATI EUR credit spreads vs KAZAKS (bp)



Source: ICE, Refinitiv, ING

Country strategy: Policy continuity in place

Following Parliament's approval on 17 May, a new government coalition was formed between the ruling conservatives and right-wing nationalists. The base case is that PM Plenković will continue to lead with a pro-EU agenda and that policy continuity will prevail. On the macro side of things, both growth and inflation have good prospects this year, albeit with some upside risks at play for the latter. The upshot is that recent public wage reform and the disbursement of the fourth RRF tranche should continue to stimulate consumption and investment ahead. What's more, better-than-expected wage growth in the euro area is set to benefit the prospect of tourist arrivals this summer, likely easing the pressures posed by the country's shift towards being an increasingly premium destination.

Growth: Good start to the year and good prospects ahead

Annual GDP growth continued on a strong footing in the first quarter of the year, following the visible acceleration from the last quarter of 2023. Private consumption and fixed investments were key positive drivers, while net exports took a toll on output. Activity is set to continue on a strong footing in the coming months too – retail sales continued to grow strongly in April, in line with the income gains brought by the recent public wage reform. In March, real net earnings per employee were up 12.7% YoY. Investments are also set for another strong year following the disbursement of the country's fifth payment request of €0.81bn on 15 April. This led Croatia to reach an RRF collection rate of 31%. All in all, we expect private consumption and investments to remain the key growth drivers and we pencil in an above consensus 3.5% growth.

Inflation: A further fall ahead but obstacles might emerge

After more than halving in December 2023 compared to December 2022, harmonised inflation reached 4.3% in May. Services remain at high levels, with the restaurants and hotels category still in double digits since April 2022 and standing out the most. We believe that inflation is set to fall further on the back of lagged effects of monetary policy tightening and base effects. That said, internal demand pressures are well-alive, especially due to the boost in public sector incomes which we expect to be felt in the months ahead. Overall, we pencil a 2024 year-end HICP of 3.2%, with risks tilted to the upside and – somewhat more important – an essentially flat inflation profile over the next couple of years.

Sovereign credit: CROATI bonds a good defensive pick

As a higher-rated and fairly low beta name, spreads of just under Z+100bp on Croatia's 10-year EUR paper offer fairly little to get excited about for EM investors. However, in the context of strong and steady fundamentals, low issuance risk, limited political risk and eurozone membership, current valuations look reasonable against peers such as Poland and Kazakhstan in the EUR space. Robust growth momentum, current account surplus and limited budget deficit stand out in the CEE context, while government debt looks set to stabilise below 60% of GDP.

James Wilson, EM Sovereign Strategist

Croatia

valentin.tataru@ing.com | tiberiu-stefan.posea@ing.com

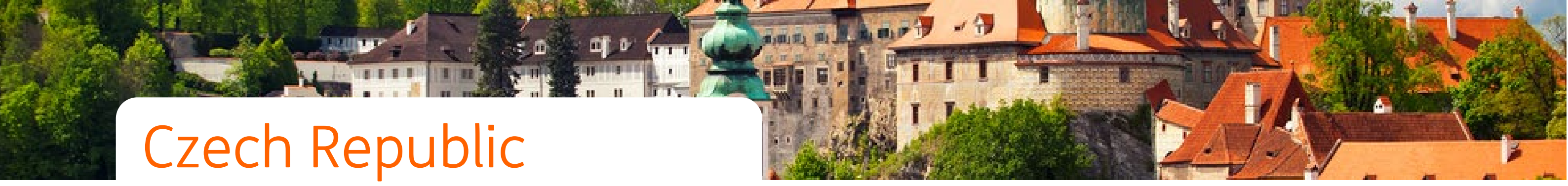
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	-0.3	2.5	3.6	3.4	3.0	3.4	-8.5	13.0	7.0	3.1	3.5	2.7	2.4
Private consumption (%YoY)	-2.5	0.4	3.2	3.2	3.4	4.1	-5.2	10.6	6.7	3.0	3.5	2.6	2.3
Government consumption (%YoY)	1.3	-0.4	1.1	2.1	2.2	2.8	3.5	3.1	2.7	6.6	5.2	2.9	2.5
Investment (%YoY)	-2.3	8.2	5.0	1.6	3.9	9.0	-5.0	6.6	0.1	4.2	5.9	4.0	3.1
Industrial production (%YoY)	1.1	2.5	4.8	1.9	-0.7	0.6	3.4	6.3	1.6	-2.0	3.1	2.8	2.6
Unemployment rate (year-end, %)	17.8	16.0	13.5	10.5	8.1	6.6	9.0	6.7	7.0	6.2	5.8	5.5	5.4
Nominal GDP (€bn)	44.8	46.0	47.6	49.9	52.4	55.3	51.0	58.9	68.4	76.5	81.6	86.6	91.2
Nominal GDP (US$bn)	59	51	52	57	61	62	59	69	72	83	89	95	100
GDP per capita (US$)	14,000	12,000	12,600	13,800	15,000	15,200	14,700	17,800	18,400	21,200	22,900	24,600	26,100
Gross domestic saving (% of GDP)	17.6	19.8	21.2	21.6	21.8	22.0	16.9	19.9	20.6	20.1	20.1	20.3	20.8
Prices													
HICP (average, %YoY)	0.2	-0.3	-0.6	1.3	1.6	0.8	0.0	2.7	10.6	8.5	3.6	3.2	3.0
HICP (year-end, %YoY)	-0.1	-0.3	0.7	1.3	1.0	1.3	-0.3	5.2	12.7	5.4	3.2	3.4	3.0
CPI (average, %YoY)	-0.2	-0.5	-1.1	1.1	1.5	0.8	0.1	2.6	10.8	8.0	2.9	2.6	2.6
CPI (year-end, %YoY)	-0.5	-0.6	0.2	1.2	0.9	1.4	-0.7	5.5	13.1	4.5	2.6	2.5	2.5
Wage rates (net, %YoY)	0.3	-3.4	2.5	5.3	4.3	3.5	4.7	5.4	7.3	13.0	14.5	12.4	10.0
Fiscal balance (% of GDP)													
Consolidated government balance	-5.2	-3.5	-1.0	0.6	-0.1	0.2	-7.2	-2.5	0.1	-0.7	-2.2	-2.1	-2.0
Consolidated primary balance	-1.8	-0.1	2.0	3.3	2.2	2.4	-5.3	-1.0	1.5	1.0	-1.0	-1.0	-1.1
Total public debt	83.4	82.8	79.1	76.0	72.6	70.4	86.1	77.5	67.8	63.0	59.9	58.9	58.3
External balance													
Exports (€bn)	10.4	11.5	12.3	14.0	14.5	15.2	14.9	18.4	24.1	22.9	23.8	24.8	25.8
Imports (€bn)	17.1	18.5	19.7	21.9	23.7	25.0	22.9	28.4	41.9	39.6	41.3	43.0	44.8
Trade balance (€bn)	-6.8	-7.0	-7.4	-7.9	-9.2	-9.8	-8.0	-10.0	-17.8	-16.7	-17.4	-18.2	-19.0
Trade balance (% of GDP)	-15.1	-15.1	-15.5	-15.8	-17.6	-17.7	-15.7	-17.0	-26.0	-21.8	-21.4	-21.0	-20.9
Current account balance (€bn)	0.2	1.6	1.1	1.8	0.9	1.6	-0.5	0.6	-1.9	0.8	0.8	0.8	1.0
Current account balance (% of GDP)	0.4	3.5	2.3	3.6	1.7	2.9	-1.5	1.0	-2.8	1.0	1.0	0.9	1.1
Net FDI (€bn)	0.7	0.2	2.0	1.1	0.8	3.4	0.7	3.0	3.7	1.5	1.5	1.5	1.6
Net FDI (% of GDP)	1.5	0.4	4.2	2.2	1.6	6.2	1.4	5.1	5.3	1.9	1.8	1.8	1.7
Current account balance plus FDI (% of GDP)	-1.1	3.1	-1.9	1.4	0.1	-3.4	-2.9	-4.1	-8.1	-0.9	-0.9	-0.9	-0.6
Foreign exchange reserves ex gold (€bn)	12.7	13.7	13.5	15.7	17.4	18.6	18.9	25.0	27.9	28.8	29.5	30.1	30.3
Import cover (months of merchandise imports)	8.9	8.9	8.2	8.6	8.8	8.9	9.9	10.6	8.0	8.7	8.6	8.4	8.1
Debt indicators													
Gross external debt (€bn)	49.5	48.6	45.1	43.9	42.8	40.6	41.3	47.2	49.8	56.9	65.0	67.0	70.6
Gross external debt (% of GDP)	110.6	105.8	94.6	88.0	81.7	73.4	81.0	80.2	72.8	74.4	79.7	77.4	77.4
Gross external debt (% of exports)	478	422	366	313	294	267	277	257	206	248	273	270	274
Lending to corporates/households (% of GDP)	69.2	65.2	60.3	56.5	54.7	53.3	61.0	53.8	51.0	49.1	50.8	50.2	50.4
Interest & exchange rates													
Central bank rate (ECB deposit, year-end, %)	-0.20	-0.30	-0.40	-0.40	-0.40	-0.50	-0.50	-0.50	2.00	4.00	3.25	2.50	2.50
3yr yield (year-end, %)	3.15	2.60	1.70	1.20	0.70	0.15	0.15	0.10	3.00	2.95	3.15	3.00	2.85
10yr yield (year-end, %)	4.00	3.90	3.00	2.50	2.40	0.60	0.65	0.85	4.00	3.30	3.30	3.20	3.10
EUR/USD (average)	1.32	1.10	1.10	1.14	1.17	1.12	1.15	1.18	1.05	1.08	1.09	1.10	1.10
EUR/USD (end-period)	1.21	1.09	1.05	1.20	1.15	1.12	1.22	1.14	1.07	1.10	1.10	1.10	1.10

Source: National sources, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	3.8	1.4	4.4	3.9	3.0	4.3	2.6	2.6	2.5	2.7	2.9	2.7	2.6
HICP (eop, %)	8.3	7.4	5.4	4.9	3.4	2.8	3.2	3.0	3.1	3.1	3.4	3.5	3.4
CPI (eop, %YoY)	7.6	6.7	4.5	4.1	2.6	2.1	2.6	2.6	2.6	2.5	2.5	2.8	3.1
Central bank rate (ECB deposit, eop, %)	3.50	4.00	4.00	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50	2.50	2.50
10yr yield (eop, %)	3.80	3.50	3.40	3.35	3.30	3.30	3.30	3.25	3.20	3.20	3.20	3.20	3.10

Source: National sources, ING estimates



Czech Republic

David Havrlant, Chief Economist, Czech Republic

Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	0.2	0.5	1.8	1.8	2.1	1.1	2.2
CPI (%YoY)*	2.0	2.6	2.3	2.8	2.9	2.5	2.4
Policy interest rate (%)	5.75	5.00	4.75	4.50	4.25	4.50	3.75
3m interest rate (%)*	5.61	5.10	4.85	4.60	4.35	5.04	3.98
10yr yield (%)*	4.00	4.20	4.20	4.15	4.10	4.14	4.11
USD/CZK*	23.42	22.85	22.75	22.75	22.71	22.94	22.64
EUR/CZK*	25.27	24.65	24.55	24.50	24.45	24.74	24.38

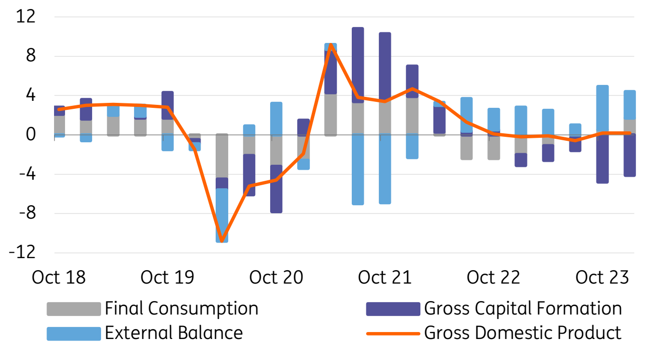
Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2028	S&P	AA-	AA
Fiscal	Tighter	Parliamentary: 2025	Moody's	Aa3	Aa3
Monetary	Looser	Local: 2024	Fitch	AA-	AA-

*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

Country strategy: Gradual rebound amid tamed inflation

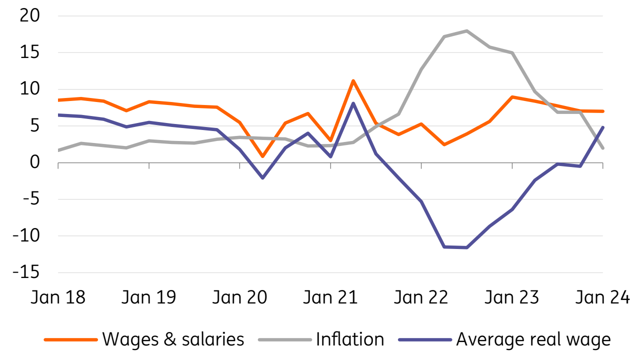
The Czech economy is on a gradual recovery path from a recession in the previous year, with household consumption representing the main growth driver. The disinflationary process remains intact, as both headline and core inflation softened. Despite the hesitant recovery, the labour market remains relatively tight, paving the way for continued upbeat nominal wage growth. With inflation back within the CNB's tolerance band, the renewed real wage growth lends support to household budgets and is set to propel consumer spending in the quarters ahead. The fiscal consolidation package will keep fiscal impact in a neutral or restrictive mode. The true laggard is investment, which has dropped back to levels observed in 2018. The monetary easing has gained pace, but future inflationary pressures driven by upbeat wages suggest more caution ahead.

Investment is a drag (%, ppt YoY)



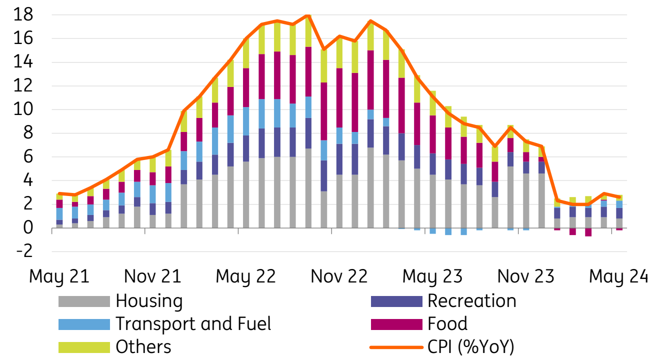
Source: CZSO, Macrobond, ING

Real wages returned to growth (%YoY)



Source: CZSO, Macrobond, ING

Inflation within the CNB tolerance band (%, ppt YoY)



Source: CZSO, Macrobond, ING

Renewed real wage growth supports household spending

Real GDP growth remained intact at 0.2% YoY in 1Q24, driven by a pickup in household consumption and solid foreign demand. This reflects the renewed real wage growth on the one hand and the economic rebound of the main eurozone trading partners on the other. Both are set to support economic performance in the coming quarters, with the Czech economy likely to expand by 1.1% this year and 2.2% the next, in our view.

By contrast, investment recorded a strong negative contribution on account of both changes in inventories and fixed capital formation. The latter seems a particularly pressing issue, as it puts a lid on medium-term economic recovery. The drop is, to some extent, linked to an end in the EU-funds drawdown period, with the onset of the new funding not fully overlapping due to administrative delays. Still, the weakness in fixed investment points to some fragility in the current economic rebound. We also see such a weakness as a symptom of structural issues that prevent the country's full economic potential from being reached. The anaemic investment is likely to contribute to the decision function of the CNB bank board.

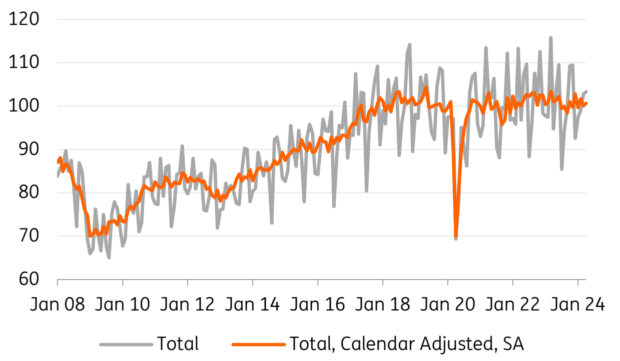
The quickening in household consumption reflected the positive effect of renewed real wage growth at 4.8% in 1Q24 which brought a welcome relief to household budgetary constraints. The real wage growth returned to positive territory after nine quarters of decline, with real purchasing power shedding 18% peak to trough in the previous years. Indeed, April's buoyant retail sales growth of 5.3% YoY in real terms looks like a healthy consumption effort from the household side. Average growth in the pre-pandemic years of 2016-2019 reached some 4.8%, showing that the current level of spending is on track to provide solid support to a cyclical rebound.

Headline inflation is within the upper bound of the CNB's tolerance band, with the disinflationary process remaining well intact for core inflation. Consumer prices increased by 2.6% YoY in May with housing and services being the main drivers of the price increase. Given the upbeat nominal wage growth and solid household spending, we expect some price pressures to build up in the second half of the year, with overall inflation reaching 2.5% this year and 2.4% the next. Still, the monetary policy conditions are somewhat restrictive, paving the way to a gradual reduction in the policy rate, in our view.

Czech Republic

david.havrlant@ing.com

Industry has not expanded since 2018 (Index)

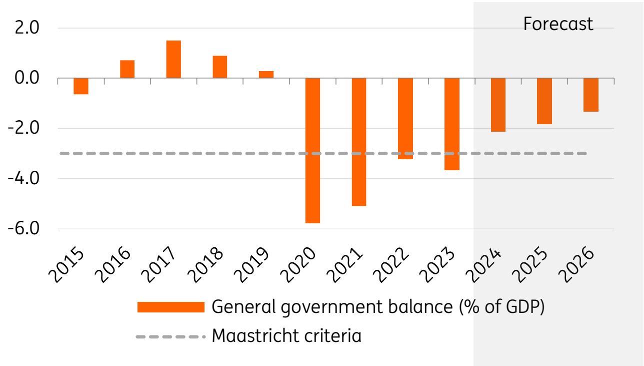


Source: CZSO, Macrobond

Industrial production still not on a solid footing

The subdued investment corresponds to the lack of an upward trend in industrial production. Considering the seasonally adjusted index, industrial production is currently only hovering around levels reached in 2018. By contrast, a solid recovery of an industry-driven economy would require a more trend-based comeback of industrial strength, such as that observed in 2013-17. At the same time, average wages in the industrials sector added a buoyant 10% from a year earlier, contributing to a potential build-up of future price pressure. The good news though is continued growth in new orders, with orders from abroad taking the lead. Solid export performance points to a positive outlook for the net export contribution to real GDP in 2Q24, with foreign demand expected to support a rebound and the current account balance.

Fiscal stance to remain restrictive (% of GDP)

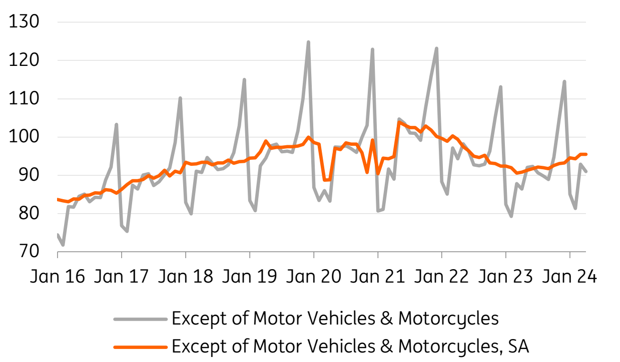


Source: MinFin, ING

Consolidation of public finances set to continue

The fiscal consolidation effort is picking up steam and is likely to continue in the coming years. The general government balance is expected to improve to 2.1% of GDP this year and remain well above the Maastricht threshold thereafter. That said, with the parliamentary elections next year, the appetite for spending might still increase. At the same time, the scope to boost the budget is limited by law and any excessive spending would mean some violation. We do not expect that any party would go in that direction, as the Czech public perceives public finances as a sensitive topic. Public debt is likely to increase to 45.8% this year on the back of only mild economic recovery and is expected to decrease thereafter.

Retail sales grow out of the woods (Index)

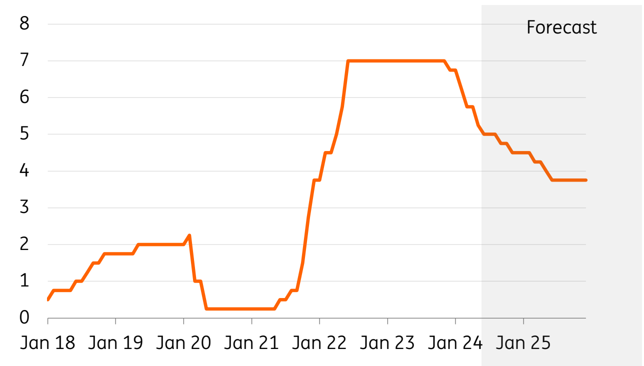


Source: CZSO, Macrobond

Household spending lifts the economy

Private consumption came in stronger than the CNB's expectations in 1Q24, with fundamentals pointing to a continued willingness of consumers to open their wallets in the quarters ahead. Retail sales annual growth remained above 5% in real terms, a dynamic historically observed during a solid economic expansion. The seasonally adjusted index shows that the bottom in purchases was left behind in 2023, while pre-pandemic levels have not been reached yet. The buoyant nominal and real wage growth provides an important relief to household budgets that can keep consumers at what they do best. Lofty demand can, however, set the ground for future inflationary pressures should the supply side not be able to keep pace. Import prices already returned to annual growth.

Policy rate set to decline (%)



Source: CNB, Macrobond, ING

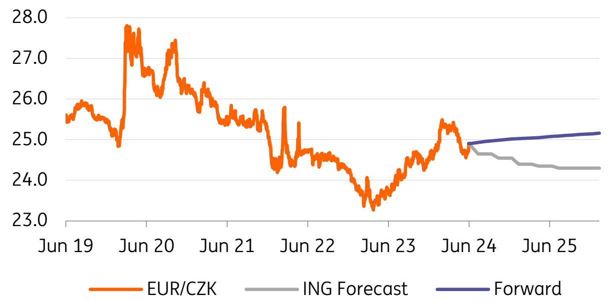
Monetary policy easing to be more gradual

We see the inflationary hotspots of the past being extinguished, with disinflationary process remaining intact, which paves the way to further easing in the monetary policy stance. However, some potential centres of future upward pressures to consumer prices are emerging, such as a lofty nominal wage growth and a pickup in household demand. This side asks for a more cautious approach to keep consumer inflation within the tolerance band of the central bank. We expect the policy rate to descend to 4.50% at the end of this year with 3.75% being the terminal rate for 2025.

Czech Republic

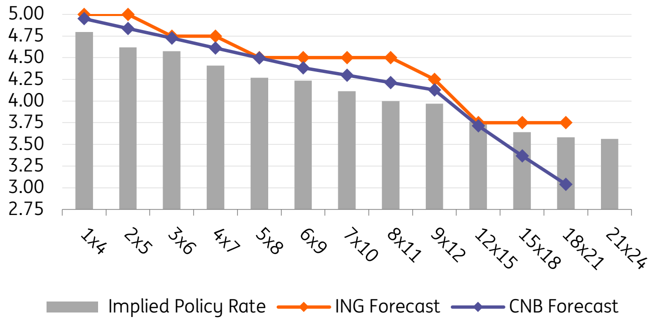
Strategy

FX – spot vs forward and INGF



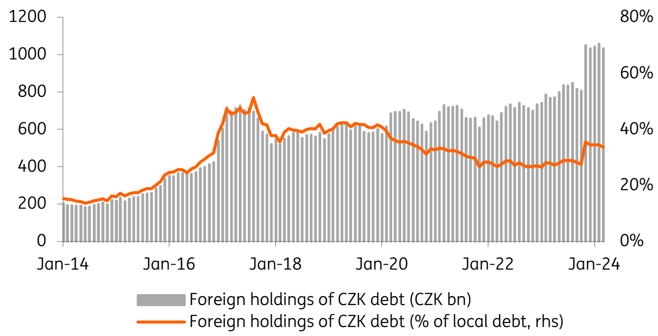
Source: Eikon, ING

Market expectations



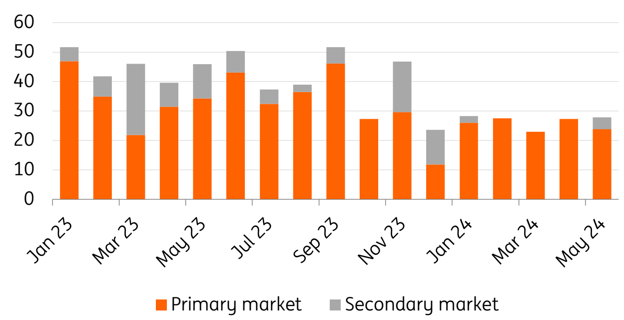
Source: Eikon, ING

Foreign holdings of CZGB (%)



Source: Macrobond, ING

CZGBs issuance (CZKbn)



Source: MinFin, ING

FX strategy

In our view, the Czech koruna this year is a fully fast money trade driven by the CNB's cutting cycle. While between the February central bank meeting and April the markets were reckoning on the central bank making faster rate cuts and the interest rate differential compressing, since May the market has been moving from short to long CZK positions.

The slowdown in the pace of rate cutting is a reason for the market to close short positions and instead look at healthy CZK fundamentals. Among CEE peers, the Czech economy is the only one surprising with a relatively more rapid recovery given the lowest expectations in the region, and the current account is maintaining a solid surplus. Moreover, having by far the lowest general government deficit among peers should be a benefit for the CZK in the second half of this year, when market attention is likely to shift to fiscal policy.

We therefore expect the CZK to strengthen further in the second half, but still expect the CNB to be the main driver here. However, the market is already pricing in a terminal rate near 3.50% and is expecting more cuts than our and the CNB's forecasts indicate over the one-year horizon. Therefore, we see greater potential for CZK gains here after pricing adjustments.

In the short term, the June CNB meeting, where a 50bp rate cut remains a risk, may be the last good chance for Long CZK at weaker levels. Indeed, we already know that the central bank will slow the pace of rate cuts and we may even see a pause or end to the cutting cycle this year, which will keep the CZK stronger later.

Fixed Income strategy

The IRS market has moved from one extreme in February to a strong sell-off and an unwind heavy receiving position in April, and only in recent weeks has it been looking for equilibrium levels that are more sustainable. However, the CZK market remains a place where the market is will be happy to receive rates despite the painful April. Markets have again moved below the CNB forecast with the prospect of more rate cuts. In our view, the June central bank meeting is the last time the CNB can deliver more than 25bp and so it makes sense for us to pay the lows in the very front-end if the market overreacts with a view of more rate cuts later. However, in our view, the belly and long-end curves still have some potential to go lower with the 5y5y around 4.0% at the moment.

We see more value in CZGBs with 10y above 4%, which may be a crucial level for investors. In addition, ASW are again relatively wider and the tightening trend has slowed down. Valuations are thus attractive, in our view, and the supply side is the best within CEE peers. The supply of CZGBs is the only paper within the region that has fallen significantly and we anticipate lower supply for the rest of the year. Added to this, the summer months may be quieter on the MinFin side. And if global attention shifts to fiscal policy and the debt problem in Europe and the US, the Czech Republic should benefit from this as the only country that has avoided the EDP procedure within the CEE peers.

Czech Republic

david.havrlant@ing.com

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	2.3	5.4	2.5	5.2	3.2	3.0	-5.5	3.6	2.4	-0.3	1.1	2.2	2.6
Private consumption (%YoY)	1.4	3.9	3.7	3.9	3.3	2.6	-7.4	4.1	-0.8	-3.2	2.2	3.1	3.6
Government consumption (%YoY)	1.0	1.8	2.5	1.8	3.9	2.5	4.2	1.4	0.3	3.5	1.8	1.4	1.6
Investment (%YoY)	3.3	9.7	-3.0	4.9	10.0	5.9	-6.0	0.8	3.0	4.0	-1.2	2.8	3.4
Industrial production (%YoY)	9.1	2.2	0.9	7.5	3.6	0.9	-6.2	10.7	15.9	4.4	0.8	2.6	3.2
Unemployment rate (year-end, %)	6.1	5.0	4.0	2.9	2.2	2.0	2.6	2.8	2.2	2.6	2.8	2.8	2.6
Nominal GDP (CZKbn)	4,346	4,625	4,797	5,111	5,411	5,791	5,709	6,109	6,787	7,344	7,784	8,216	8,652
Nominal GDP (€bn)	158	170	177	194	211	226	216	238	276	306	314.4	336.2	355.6
Nominal GDP (US$bn)	209	188	196	219	249	253	246	282	291	331	339.3	362.7	383.9
GDP per capita (US$)	19,903	17,834	18,583	20,641	23,427	23,669	23,002	26,338	27,183	30,890	31,230	31,917	32,683
Gross domestic saving (% of GDP)	26.7	28.5	28.0	29.1	28.5	28.7	28.5	29.5	29.2	31.5	31.8	31.6	31.2
Prices													
CPI (average, %YoY)	0.4	0.3	0.7	2.5	2.1	2.8	3.2	3.8	15.1	10.7	2.5	2.4	2.3
CPI (year-end, %YoY)	0.1	0.1	2.0	2.4	2.0	3.2	2.3	6.6	15.8	6.9	2.5	2.0	2.3
Wage rates (nominal, %YoY)	2.9	3.2	4.4	6.8	8.1	7.9	4.6	5.8	5.3	7.5	7.8	6.2	5.8
Fiscal balance (% of GDP)													
Consolidated government balance	-2.1	-0.6	0.7	1.5	0.9	0.3	-5.8	-5.1	-3.2	-3.7	-2.1	-1.8	-1.3
Consolidated primary balance	-0.6	0.4	1.6	2.2	1.6	1.0	-5.0	-4.3	-2.0	-1.9	-0.9	-0.6	-0.1
Total public debt	41.9	39.7	36.6	34.2	32.1	30.0	37.7	42.0	44.2	44.0	45.8	46.2	46.2
External balance													
Exports (€bn)	127.6	136.7	143.7	158.7	168.9	171.1	152.5	168.0	188.1	198.4	196.2	204.7	213.9
Imports (€bn)	117.3	126.6	131.2	143.5	155.8	157.9	140.6	164.2	182.3	185.7	183.4	191.2	199.4
Trade balance (€bn)	10.3	10.1	12.5	15.2	13.1	13.2	11.9	3.8	5.9	12.8	12.8	13.5	14.5
Trade balance (% of GDP)	6.5	6.0	7.0	7.8	6.2	5.8	5.5	1.6	2.1	4.2	4.3	4.4	4.6
Current account balance (€bn)	0.3	0.8	3.2	3.0	0.9	0.7	4.3	-6.6	-13.5	1.2	0.3	0.4	0.5
Current account balance (% of GDP)	0.2	0.4	1.8	1.5	0.4	0.3	2.0	-2.8	-4.9	0.4	0.1	0.2	0.3
Net FDI (€bn)	-2.9	1.8	-6.9	-1.7	-2.0	-5.3	-5.6	-1.1	-3.4	-0.7	-2.8	-2.4	-2.2
Net FDI (% of GDP)	-1.9	1.1	-3.9	-0.9	-0.9	-2.4	-2.6	-0.5	-1.2	-0.2	-0.8	-0.7	-0.6
Current account balance plus FDI (% of GDP)	-1.7	1.5	-2.1	0.7	-0.5	-2.0	-0.6	-3.2	-6.1	0.2	-0.7	-0.5	-0.3
Foreign exchange reserves ex gold (€bn)	45.2	58.7	81.3	119.7	124.9	132.0	134.4	148.6	128.9	138.3	140.2	142.4	144.6
Import cover (months of merchandise imports)	4.6	4.5	5.5	7.6	10.2	9.9	10.2	11.6	10.6	7.3	8.9	9.2	9.6
Debt indicators													
Gross external debt (€bn)	106	115	129	171	172	173	165	182	186	187	190	194	200
Gross external debt (% of GDP)	67.4	68.1	73.0	88.1	81.3	76.5	76.3	76.3	67.4	61.1	60.4	58.0	56.6
Gross external debt (% of exports)	83.3	84.4	90.1	107.8	101.6	100.8	108.0	108.2	99.1	94.2	96.8	95.2	94.0
Lending to corporates/households (% of GDP)	49.4	48.4	48.5	49.9	49.8	50.3	49.8	53.4	52.6	49.3	46.2	46.8	47.6
Interest & exchange rates													
Central bank key rate (year-end, %)	0.05	0.05	0.05	0.05	0.50	1.75	2.00	0.25	3.75	7.00	4.50	3.75	3.75
Broad money supply (average, %YoY)	5.1	7.3	9.1	11.7	6.6	6.3	9.0	9.6	6.4	9.0	8.1	8.6	8.8
3m interest rate (Pribor, average, %)	0.46	0.36	0.31	0.29	0.41	1.27	2.12	0.86	1.13	6.20	4.60	3.85	3.85
3m interest rate spread over Euribor (ppt)	25	38	57	62	73	163	255	141	78	277	96	108	135
2yr yield (average, %)	0.31	0.18	-0.06	-0.31	-0.20	1.06	1.57	0.59	1.60	5.45	4.40	3.80	3.90
10yr yield (average, %)	2.11	1.56	0.70	0.44	1.06	2.02	1.61	1.18	1.97	4.40	4.15	4.15	4.15
USD/CZK exchange rate (year-end)	19.89	22.86	24.87	25.70	21.29	22.43	22.69	21.47	21.88	22.56	22.75	22.61	22.52
USD/CZK exchange rate (average)	20.76	24.58	24.43	23.37	21.73	22.93	23.21	21.68	23.35	22.20	22.94	22.65	22.54
EUR/CZK exchange rate (year-end)	27.34	27.66	27.02	27.02	25.51	25.72	25.42	26.24	24.89	24.70	24.52	24.36	24.30
EUR/CZK exchange rate (average)	27.53	27.28	27.03	26.33	25.64	25.67	26.44	25.65	24.57	24.01	24.74	24.38	24.25

Source: National sources, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	-0.1	-0.6	0.2	0.2	0.5	1.8	1.8	2.1	2.2	2.3	2.4	2.5	2.6
CPI (eop, %YoY)	11.1	8.0	7.6	2.1	2.8	2.6	2.5	3.0	2.4	2.1	2.0	2.2	2.3
Central bank key rate (eop, %)	7.00	7.00	6.75	5.75	5.00	4.75	4.50	4.25	3.75	3.75	3.75	3.75	3.75
3m interest rate (eop, %)	7.13	7.10	6.77	5.61	5.10	4.85	4.60	4.35	3.85	3.85	3.85	3.85	3.85
10yr yield (eop, %)	4.28	4.75	3.74	4.00	4.20	4.20	4.15	4.10	4.10	4.10	4.15	4.15	4.15
USD/CZK exchange rate (eop)	21.77	23.10	22.36	23.42	22.85	22.75	22.75	22.71	22.66	22.61	22.61	22.57	22.52
EUR/CZK exchange rate (eop)	23.76	24.45	24.70	25.27	24.65	24.55	24.55	24.50	24.45	24.40	24.40	24.35	24.30

Source: National sources, ING estimates

Hungary

Péter Virovácz, Chief Economist, Hungary

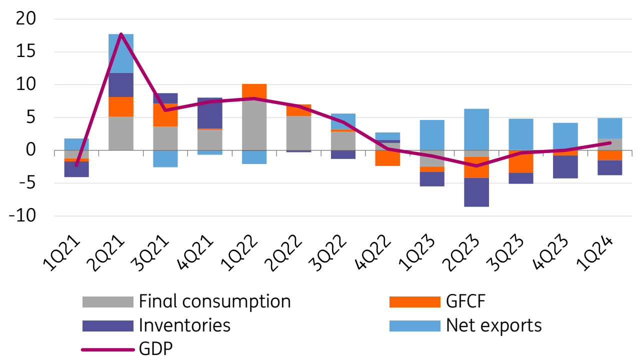
Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	1.1	2.3	2.2	3.1	3.2	2.2	3.8
CPI (%YoY)*	3.6	4.1	3.6	5.5	4.4	4.1	4.4
Policy interest rate (eop, %)	8.25	7.00	7.00	7.00	6.75	7.00	5.25
3m interest rate (%)*	7.83	6.87	7.00	7.00	6.65	7.39	6.07
10yr yield (%)*	6.65	6.90	7.00	6.90	7.15	6.79	7.18
USD/HUF*	366.5	365.7	352.7	350.0	359.1	357.2	363.3
EUR/HUF*	395.8	395.0	388.0	385.0	395.0	389.3	399.6

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2027	S&P	BBB-	BBB-
Fiscal	Tighter	Parliamentary: 2026	Moody's	Baa2	Baa2
Monetary	Looser	Local: 2029	Fitch	BBB	BBB

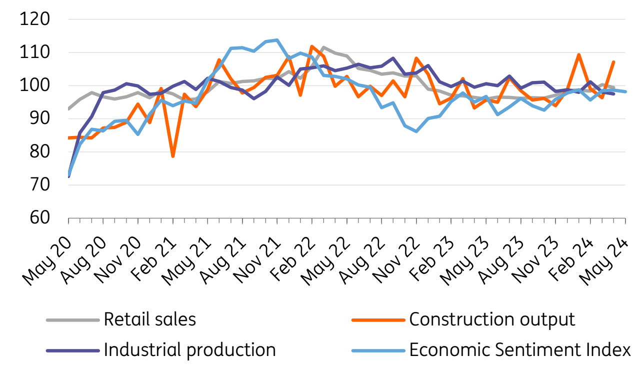
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

Contribution to YoY GDP growth (ppt)



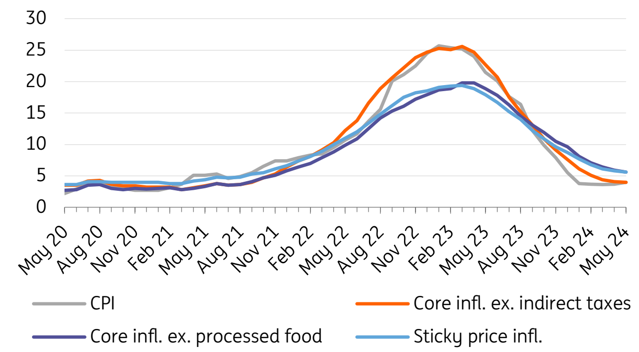
Source: Hungarian Central Statistical Office

Key activity indicators (swda; 2015 = 100%)



Source: Eurostat, Hungarian Central Statistical Office

Headline and underlying measures of inflation (%YoY)



Source: National Bank of Hungary

Country strategy: A sense of fragile optimism

Hungary is finally on the road to sustainable recovery. While some clouds remain on the horizon, rays of light are breaking through. Economic activity in 2024 should continue to be supported by net exports on a low import bill and improving consumption. The next two years of forecast strong GDP growth are driven by new export capacity and possible fiscal stimulus ahead of the 2026 elections. If wondering where the room for this will come from, well, on a relative basis, the Hungarian budget does not look too bad. Moreover, everything appears rosy on the financing side, so confidence should remain there. The biggest caveat could be inflation, with a strong labour market, high real wage growth, election spending and monetary easing over the coming years. For the rest of 2024, we are relatively positive on Hungarian assets, although the upcoming challenges make us more cautious and bearish for 2025-26.

Macro digest

In the first quarter of 2024, the Hungarian economy has once again emerged from stagnation, and we believe that this time the recovery will be sustainable. We stick to our call for full-year GDP growth of 2.2%, but we've changed the composition of growth in light of the recent surprises. So far, the recovery in consumption hasn't been too pronounced, as the precautionary motive hasn't diminished too much. This is reflected in the gross household savings rate of 21.7%, which is 8ppt higher than the EU average. At the same time, the pre-election political narrative of an escalation of the war in Ukraine is likely to have dampened consumer confidence and contributed to gloomier expectations. For the rest of the year, we still expect consumption to accelerate, supported by the realistic possibility of fiscal stimulus as the government prepares for the 2026 elections.

The inflow of EU funds and a significant drop in interest rates didn't turn the tide, as investment activity contracted in 1Q24. Order books remain rather weak, while companies are reluctant to invest for fear of impending tax-change austerity measures. As a result, the lack of investment activity lowers the import bill, while subdued industrial export orders imply declining imports as well. This, together with lower energy costs, can explain the resilience of the trade balance at a time when exports are clearly struggling. We expect this pattern to largely persist, which leads us to revise our outlook for net exports, as we now expect a positive contribution in 2024 as a whole.

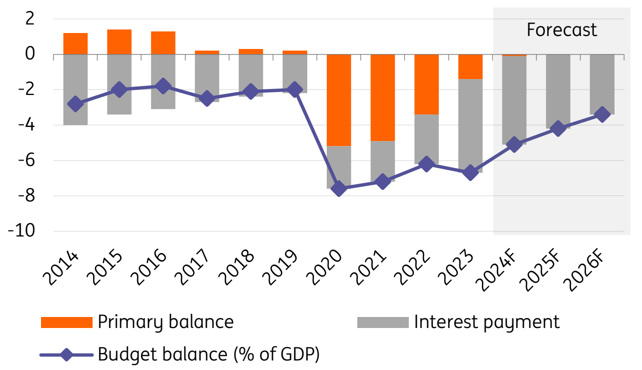
Our view is that some form of pro-consumption fiscal stimulus will be announced as the 2026 election approaches, but the biggest question is the timing and size. We believe some measures could be announced as early as late-2024 or early-2025, which underpins our higher budget deficit forecasts than the government's current plan. At the same time, we expect fiscal measures to boost consumption, leading us to forecast accelerating full-year GDP growth of 3.8% and 4.4% in 2025 and 2026, respectively.

The era of rapid disinflation is over and headline inflation is expected to pick up in the coming months. A more pronounced base effect driven reflation will begin in October, leading to a year-end inflation rate of 5.5% according to our calculations. As the repricing frequency of companies has increased since the pandemic, any pro-inflationary fiscal measures, whether stimulus or austerity, could be quickly passed on to consumers. Looking at the full-year forecast, we see inflation averaging 4.1% this year and rising to around 4.4% in 2025, with a downward sloping inflation profile next year. We expect price stability to be restored towards the end of 2025, but we believe that the evolution of fiscal policy may also play an important role in this.

Hungary

peter.virovacz@ing.com

Budget and structural balance of general government (%)

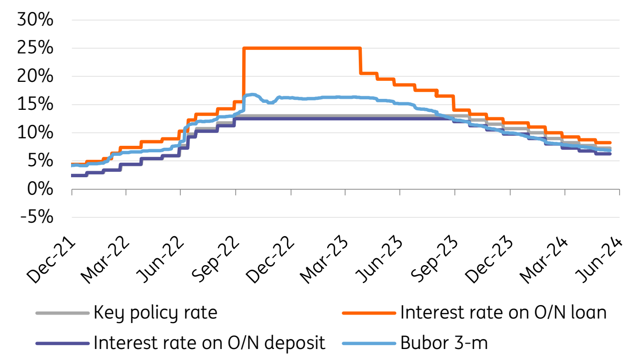


Source: AMECO, ING estimates

Dust off the old consumption-boosting playbook

The ESA-based deficit target for 2024 has been raised to 4.5% of GDP but, based on our technical projection, we still see a maximum slippage risk of around 0.5ppt. Naturally, this could be reduced by improving VAT receipts while keeping the expenditure side as tight as before. However, as we approach the 2026 general election cycle, there is a risk of pro-consumption fiscal stimulus, which we believe will also affect the 2024 budget. As a result, we expect this year's deficit to be 5.1% of GDP, while next year's could be reduced to 4.2%. From a financing perspective, this would be entirely feasible, as appetite for Hungarian retail and FX bonds remains strong, while the bid-to-cover ratio for HGBs is the highest in CEE. However, the tolerance level of the rating agencies will be strongly challenged.

Benchmark policy rate and interest rate corridor

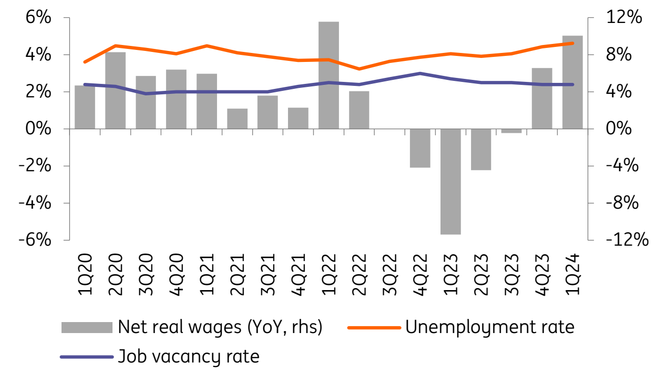


Source: National Bank of Hungary

Rates on hold for the rest of 2024; a dovish shift in 2025

After easing by 11ppt, the National Bank of Hungary (NBH) entered a new stage following the June rate cut. The forward guidance was as hawkish as possible, pointing to a pause in easing being a live option from now on. Thus, we maintain our long-held view that 7.00% will be the terminal rate for 2024. We believe we will see a sustained pause aimed at maintaining a positive real interest rate environment and keeping some risk premium over regional rates supporting HUF assets. As for next year, we expect a dovish shift within the NBH leadership, as a new governor will be sworn in by March 2025, while three other members of the Monetary Council will also be replaced. We believe the new leadership is likely to have a slightly more pro-growth agenda.

Unemployment, job vacancy rate and wage growth

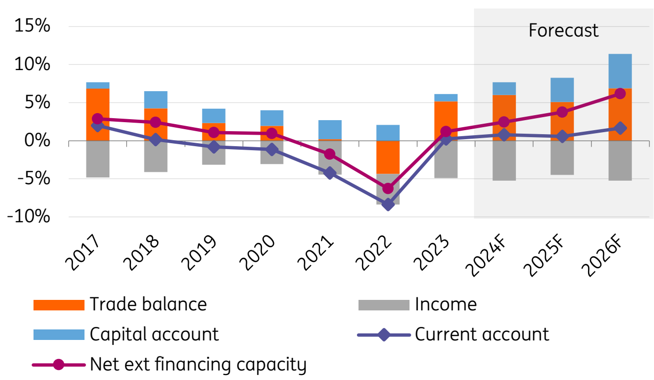


Source: Hungarian Central Statistical Office, ING estimates

Tight labour market poses a risk to services inflation

The labour market has remained remarkably stable despite several quarters of generally poor economic activity. In our view, a structural labour shortage may be one reason behind the resilience. Against this backdrop, we're beginning to see challenges in labour absorptive capacity as the economy begins to rely on imported workers to grow the labour force. Simultaneously, the tight labour market entails a long-term inflation risk, especially for services. In this regard, as the pace of wage growth in the first quarter came in higher than various surveys had indicated, this has led us to revise our forecasts, as we now see average wage growth of 11.5% and 9.8% in 2024 and 2025, respectively. In our view, this strong positive real wage impulse will ultimately boost consumption.

Structure of the current account (% of GDP)



Source: National Bank of Hungary, ING estimates

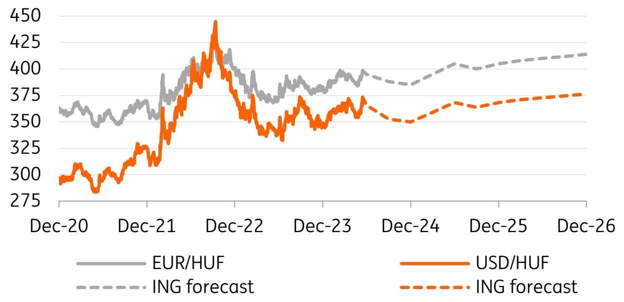
External balances are expected to remain resilient in 2024

The trade balance remained resilient despite the weak industrial performance, which led to a flattening of the export side. However, still subdued domestic demand and lower energy prices have contributed to a lower import bill. As a result, the trade balance has maintained large surpluses since the beginning of the year, and we now expect the current account (CA) to end 2024 with a surplus of 0.8% of GDP. Looking ahead, we see an erosion of the surplus as consumption and investment activity is expected to pick up. Overall, we see a significant increase in exports because of the new export capacities that will be completed in 2025-26. Though this will also increase the need for imports, as these new export capacities will have a very high share of intermediate imports (at c.85%).

Hungary

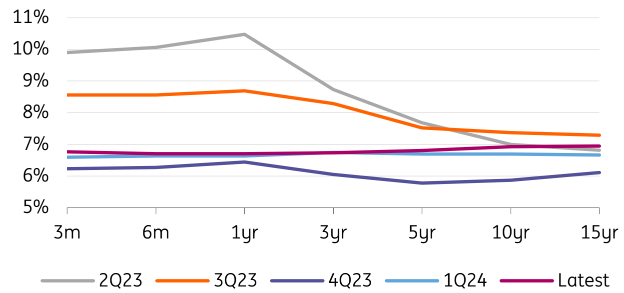
Strategy

FX – spot and INGF



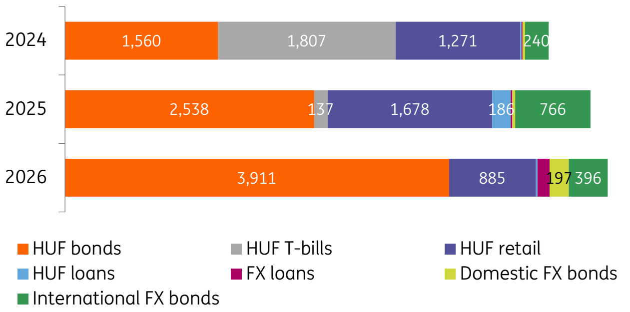
Source: National Bank of Hungary, ING estimates

Local curve (%)



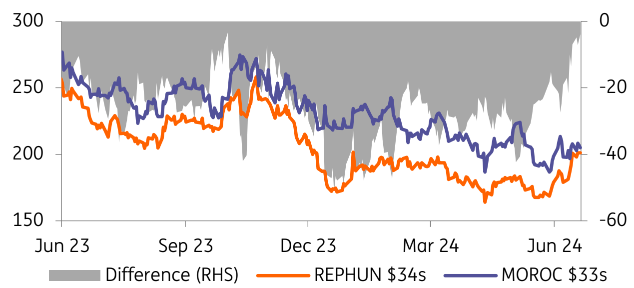
Source: Government Debt Management Agency

Public debt redemption profile (end-March 2024, HUFbn)



Source: Government Debt Management Agency

REPHUN vs MOROC USD credit spreads (bp)



Source: Refinitiv, ING

FX strategy *(with Frantisek Taborsky, EMEA FX & FI Strategist)*

EUR/HUF moved into the 395-400 range in the early days of June. While part of the story is being written at a global level, the underperformance of the forint has been quite telling. Hungary has so far dodged the rating agency downgrade bullet, but investors remain nervous as the risk of fiscal loosening increases following the local and EP election results. The main reason for this is that, for the first time in a long time, a strong opposition has emerged on the political landscape to challenge the ruling party coalition in the 2026 parliamentary elections.

With market instability on the rise, we think the NBH tried to turn the tables on the HUF with its hawkish cut in June. The latest forward guidance points to the possibility of a (series of) pause(s) in the easing of monetary policy in the coming months. Such an outcome would be in line with our long-standing view of rates being on hold for the remainder of 2024. We expect this stance to be broken only under the new leadership of the Monetary Council in Spring 2025.

NBH policy will thus continue to be a key factor for EUR/HUF. Although we do not expect a rate cut in the second half of the year, markets keep pricing in some probability. This should limit HUF appreciation if global and inflationary conditions allow the central bank to ease further. Thus, in both scenarios, we do not think EUR/HUF can go far and expect more range trading in the 385-400 area, depending on the factors mentioned. From this perspective, we believe current EUR/HUF levels could go lower.

Fixed income strategy *(with Frantisek Taborsky, EMEA FX & FI Strategist and James Wilson, EM Sovereign Strategist)*

For the second half of the year, the market is pricing in a roughly 20% to 35% chance of rate cuts for each meeting with a higher probability for one at year-end. However, looking further out, we still believe the market is underestimating the dovish shift of the NBH with the board change next year. Therefore, we see room for the entire curve to go lower with a steepening bias. On the HGBs side, AKK has pre-funded roughly 60% of this year's issuance and we see a strong position on the demand side as well with the strongest auctions within the region in recent weeks and a stable foreigners base unlike CEE peers. Thus, despite the complicated story, we like HGBs that offer attractive yield and high beta, open to a global cutting story.

On the Eurobond side, despite the pressure on fiscals, Hungary looks to be in a comfortable position in terms of issuance after strong frontloading of supply. We expect further FX issuance this year to come only from Samurai and Panda bonds (outside of potential small taps in EUR or USD) and any slack on the back of fiscal slippage to be taken up by local issuance. While headline noise around the EU funds situation may return towards the end of the year given time pressure on unlocking RRF funds, we see scope in the near term for decent performance, with valuations becoming more attractive. We like the belly of the USD curve, with REPHUN now trading almost flat to lower-rated Morocco

Hungary

peter.virovacz@ing.com

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	4.2	3.7	2.2	4.3	5.4	4.9	-4.5	7.1	4.6	-0.9	2.2	3.8	4.4
Private consumption (%YoY)	2.5	3.7	4.8	4.7	4.8	5.1	-1.3	4.8	7.1	-2.2	3.2	5.1	6.1
Government consumption (%YoY)	8.9	1.3	0.5	3.8	4.3	9.5	4.2	2.5	0.8	-1.5	-0.6	4.9	1.5
Investment (%YoY)	12.2	4.9	-10.6	19.7	16.3	12.8	-7.1	5.7	1.4	-7.4	-3.5	9.3	8.4
Industrial production (%YoY)	7.7	7.4	0.9	4.6	3.5	5.6	-6.0	9.5	6.1	-5.5	-2.9	3.1	6.2
Unemployment rate (year-end, %)	6.9	5.7	4.1	3.5	3.3	2.9	4.2	3.8	3.8	4.2	4.2	3.8	3.7
Nominal GDP (HUFbn)	32,805	34,965	36,207	39,275	43,387	47,674	48,444	55,205	65,952	74,992	80,080	87,703	95,694
Nominal GDP (€bn)	106	113	116	127	136	147	138	154	169	196	206	219	234
Nominal GDP (US$bn)	140	124	128	145	159	164	159	182	177	212	224	241	257
GDP per capita (US$)	14,299	12,711	13,109	14,630	16,423	16,787	16,135	18,746	18,253	22,089	23,377	25,195	26,839
Gross domestic saving (% of GDP)	24.5	25.3	25.7	24.7	26.7	27.4	26.2	26.6	25.4	25.9	26.2	26.7	27.1
Prices													
CPI (average, %YoY)	-0.2	-0.1	0.4	2.4	2.8	3.4	3.3	5.1	14.5	17.6	4.1	4.4	3.3
CPI (year-end, %YoY)	-0.9	0.9	1.8	2.1	2.7	4.0	2.7	7.4	24.5	5.5	5.5	3.7	3.0
Wage rates (nominal, %YoY)	3.0	4.3	6.2	12.9	11.3	11.3	9.8	8.9	17.4	14.2	11.5	9.8	7.5
Fiscal balance (% of GDP)													
Consolidated government balance	-2.8	-2.0	-1.8	-2.5	-2.1	-2.0	-7.6	-7.2	-6.2	-6.7	-5.1	-4.2	-3.4
Consolidated primary balance	1.2	1.4	1.3	0.2	0.3	0.2	-5.2	-4.9	-3.4	-2.0	-0.1	0.0	0.0
Total public debt	76.5	75.8	74.9	72.1	69.1	65.3	79.3	76.7	74.1	73.5	74.7	72.9	69.3
External balance													
Exports (€bn)	84.5	90.5	93.0	100.7	104.9	109.1	105.0	119.2	142.5	149.2	145.2	153.5	168.3
Imports (€bn)	78.2	81.9	83.3	92.6	99.3	104.8	99.4	117.6	151.7	140.0	134.3	145.5	158.7
Trade balance (€bn)	6.3	8.6	9.7	8.1	5.5	4.3	5.6	1.6	-9.1	9.2	10.9	8.0	9.6
Trade balance (% of GDP)	5.9	7.6	8.4	6.4	4.1	3.0	4.1	1.1	-5.4	4.7	5.3	3.6	4.1
Current account balance (€bn)	1.3	2.6	5.2	2.5	0.2	-1.2	-1.6	-6.6	-14.1	0.4	1.6	1.2	3.9
Current account balance (% of GDP)	1.2	2.3	4.5	2.0	0.2	-0.8	-1.1	-4.3	-8.4	0.2	0.8	0.5	1.7
Net FDI (€bn)	5.1	2.3	3.9	5.1	5.6	3.1	4.6	6.7	8.6	5.4	9.4	7.8	5.0
Net FDI (% of GDP)	4.8	2.0	3.3	4.0	4.1	2.1	3.4	4.4	5.1	2.7	4.5	3.5	2.1
Current account balance plus FDI (% of GDP)	6.0	4.4	7.8	6.0	4.2	1.3	2.2	0.1	-3.3	3.0	5.3	4.1	3.8
Foreign exchange reserves ex gold (€bn)	33.7	30.0	24.0	22.6	25.8	26.5	31.8	30.8	30.8	30.1	31.5	34.0	36.0
Import cover (months of merchandise imports)	5.2	4.4	3.5	2.9	3.1	3.0	3.8	3.1	2.4	2.6	2.8	2.8	2.7
Debt indicators													
Gross external debt (€bn)	87.6	82.4	78.4	75.1	75.4	77.1	82.6	95.7	109.3	125.0	132.8	136.6	136.0
Gross external debt (% of GDP)	82	73	67	59	55	53	60	62	65	64	65	62	58
Gross external debt (% of exports)	104	91	84	75	72	71	79	80	77	84	91	89	81
Lending to corporates/households (% of GDP)	41.1	33.8	32.2	31.3	31.3	32.3	36.1	35.7	33.3	30.3	29.4	28.6	28.2
Interest & exchange rates													
Central bank key rate (year-end, %)	2.10	1.35	0.90	0.90	0.90	0.90	0.60	2.40	13.00	10.75	7.00	5.25	4.50
Broad money supply (average, %YoY)	4.1	4.7	4.6	9.6	13.9	7.5	14.5	17.4	16.3	1.1	8.6	11.6	9.9
3m interest rate (Bubor, average, %)	2.41	1.61	0.99	0.15	0.12	0.19	0.69	1.45	9.96	14.30	7.39	6.07	4.81
3m interest rate spread over Euribor(ppt)	220	163	125	48	44	55	112	200	961	1087	375	330	231
3yr yield (average, %)	3.5	2.1	1.5	0.9	1.3	0.8	1.0	2.0	8.5	9.0	6.8	6.5	5.9
10yr yield (average, %)	4.8	3.4	3.1	3.0	3.0	2.5	2.2	3.1	7.6	7.5	6.8	7.2	7.0
USD/HUF exchange rate (year-end)	260.2	287.3	296.2	258.5	279.6	295.1	299.3	323.7	374.1	348.0	350.0	368.2	376.4
USD/HUF exchange rate (average)	233.8	281.7	283.1	271.2	272.5	290.5	305.4	303.8	372.7	353.7	357.2	363.3	372.5
EUR/HUF exchange rate (year-end)	314.9	313.1	311.0	310.1	321.5	330.5	365.1	369.0	400.3	382.8	385.0	405.0	414.0
EUR/HUF exchange rate (average)	308.7	309.9	311.5	309.2	318.9	325.4	351.2	358.5	391.3	382.0	389.3	399.6	409.8

Source: National sources, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	-2.4	-0.4	0.0	1.1	2.3	2.2	3.1	3.2	3.3	3.9	4.8	4.6	4.8
CPI (eop, %YoY)	20.1	12.2	5.5	3.6	4.1	3.6	5.5	4.4	4.7	4.2	3.7	3.5	3.3
Central bank key rate (eop, %)	13.00	13.00	10.75	8.25	7.00	7.00	7.00	6.75	6.00	5.75	5.25	5.00	4.75
3m interest rate (eop, %)	15.17	12.27	9.96	7.83	6.87	7.00	7.00	6.65	5.95	5.75	5.25	5.00	4.75
10yr yield (eop, %)	6.94	7.30	5.81	6.65	6.90	7.00	6.90	7.15	7.15	7.25	7.25	7.10	7.00
USD/HUF exchange rate (eop)	340.5	369.1	348.0	366.5	365.7	352.7	350.0	359.1	368.2	363.6	368.2	370.9	372.7
EUR/HUF exchange rate (eop)	371.1	391.3	382.8	395.8	395.0	388.0	385.0	395.0	405.0	400.0	405.0	408.0	410.0

Source: National sources, ING estimates

Kazakhstan

Dmitry Dolgin, Chief Economist, CIS

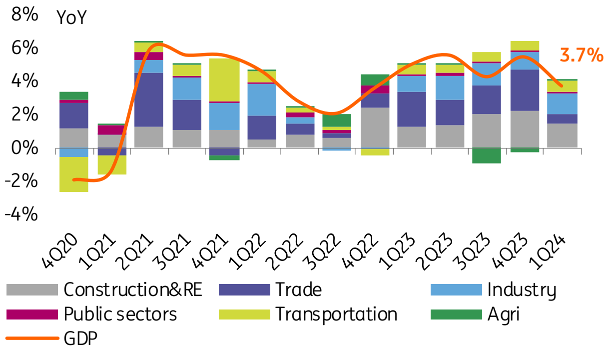
Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	3.7	4.3	4.5	3.5	5.4	4.0	5.5
CPI (%YoY)*	9.1	8.4	8.0	7.9	7.5	8.5	7.5
Policy interest rate (%)	14.75	14.50	14.00	13.00	12.50	13.00	11.00
3m interest rate (%)*	13.7	14.2	13.7	12.7	12.2	13.8	11.2
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT*	447	465	470	475	470	463	478
EUR/KZT*	483	502	517	523	517	504	526

Macro trend		Political cycle	Ratings	FC	LC
Activity	-	Presidential: 2029	S&P	BBB-	BBB-
Fiscal	Easing	Parliamentary: 2028	Moody's	Baa2	Baa2
Monetary	Tight	Local: 2028	Fitch	BBB	BBB

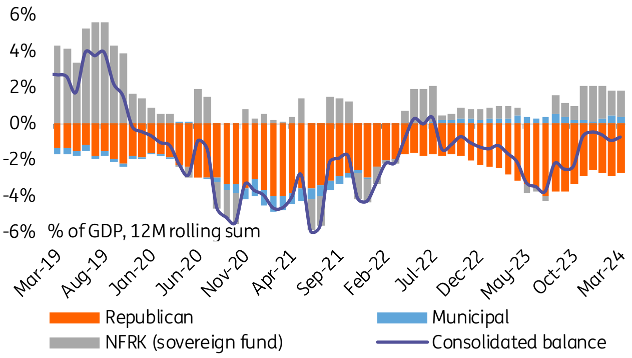
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

GDP growth and major contributors (%YoY)



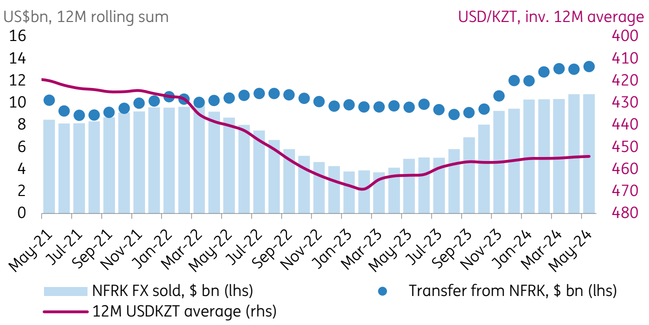
Source: National sources, CEIC, ING

Consolidated budget balance by components



Source: National sources, CEIC, ING

Key parameters of state FX interventions (US$bn)



Source: National sources, CEIC, ING

Country strategy: Expecting weaker growth and KZT

Kazakhstan's economic growth momentum is now somewhat weaker as the country is between investment projects, is recovering from the consequences of the floods, and must restrain oil production somewhat due to OPEC+ commitments. For 2025-26 we are more optimistic – growth should be supported by new oilfield development and strong non-oil trends, financed by both the banking sector and the budget. Rates still have significant downside, but higher services inflation is a watch factor.

For the near-term, KZT might be at an inflection point as it may be starting to lose support from state FX interventions. The sovereign oil fund, which has been actively selling FX YTD, may now have to limit its outlays for the budget in order to comply with tightening fiscal rules. We retain our view on long-term KZT depreciation.

Activity: Temporary slowdown

After healthy 5.1% GDP growth in 2023, activity in 2024 has been negatively affected by the lapse of some large investment projects as well as by the negative effect of recent floods on agricultural and other non-oil output. The oil sector is likely to remain under pressure for the rest of the year, compensating for above-quota production earlier. Longer run output should be supported by Tengiz. Consumer spending appears well supported by income fundamentals and continued lending growth. We expect GDP to slow to 4% this year, with subsequent recovery in 2025. Inflation (at 8.5% YoY as of May) has been on a downward path since early 2023, and the scope for any cut in the key rate (currently at 14.50%) remains significant. Higher services inflation combined with the effect of recent floods may limit any rate cuts.

Fiscal policy: Consolidation challenged

Having narrowed to 0.5% of GDP in 2023 thanks to NFRK (sovereign fund) investment income, the consolidated budget deficit is again widening. The revenue side appears solid, with oil revenue per US$1/bbl of Brent price improving from US$0.17bn in 2023 to US$0.20bn currently, and likely to increase over the next couple of years. Non-oil revenue collection is being supported by stricter administration. Expenditure growth (19% YoY) is outpacing revenues (up 10% YoY) due to sticky social and investment spending, higher interest expense and emergency support related to the floods. The deficit is especially noticeable at the Republican level, leading to higher state borrowing. The fiscal rule prescribes slower expenditure growth and lower disbursement of oil savings out of NFRK and this approach is facing challenges in 2024. We see the fiscal breakeven Brent price approaching US$100/bbl this year.

FX market: State support to KZT may be reduced

Even though Kazakhstan's trade balance is off its 2022 highs, and the current account is back to a normal deficit of around US$8bn on a 4Q rolling sum basis, the tenge has been strong until mid-May, outperforming its main trade partner currencies and oil. We believe that FX sales by the government have been the main support factor for this. In 5M24 NFRK sold US$4.3bn of FX versus US$2.9bn in 5M23. As a result, almost 80% of the annual transfer plan of KZT3.6tr had been fulfilled by 5M24. Although we do not assume that extra spending needs will lead to an increase in planned annual NFRK outlays, the intensity of FX sales should eventually decline in 2024-25, within the constraints of the tighter fiscal rule. This should lead to lower state support for the KZT and allow further depreciation from current levels.

Kazakhstan

dmitry.dolgin@ing.de

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	4.2	1.2	1.1	4.1	4.1	4.5	-2.5	4.3	3.2	5.1	4.0	5.5	4.5
Private consumption (%YoY)	1.1	1.8	1.2	1.5	6.1	6.1	-3.7	6.3	4.0	4.5	4.5	4.0	3.5
Government consumption (%YoY)	9.8	2.4	2.3	2.1	-14.1	15.5	12.8	-2.4	4.3	10.3	3.0	6.0	4.5
Investment (%YoY)	4.4	4.2	3.0	4.5	5.4	13.8	-0.2	2.6	3.8	20.7	3.0	6.0	4.5
Industrial production (%YoY)	0.3	-1.6	-1.1	7.3	4.4	-4.1	-0.5	3.6	1.1	4.3	4.0	5.5	4.3
Unemployment rate (average, %)	5.0	5.0	5.0	4.9	4.9	4.8	4.8	4.0	4.9	4.7	4.7	4.6	4.6
Nominal GDP (KZTbn)	39,676	40,884	46,971	54,379	61,820	69,533	70,649	83,952	103,766	120,561	133,355	151,144	168,523
Nominal GDP (€bn)	167	166	124	148	152	162	150	167	214	244	320	351	378
Nominal GDP (US$bn)	221	184	137	167	179	182	171	197	225	264	294	320	343
GDP per capita (US$)	12,807	10,511	7,715	9,248	9,813	9,813	9,122	10,371	11,477	13,277	14,625	15,741	16,743
Gross domestic saving (% of GDP)	41	35	34	37	40	39	34	37	40	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	6.7	6.6	14.7	7.4	6.0	5.2	6.8	8.0	14.9	14.8	8.5	7.5	6.7
CPI (year-end, %YoY)	7.4	13.6	8.5	7.1	5.3	5.4	7.5	8.4	20.3	9.8	7.9	6.9	6.5
Wage rates (nominal, %YoY)	10.9	4.1	13.4	5.5	7.9	14.8	14.0	17.5	23.1	24.1	11.7	11.2	10.5
Fiscal balance (% of GDP)													
Consolidated government balance	6.1	9.6	-4.4	-4.1	2.6	-0.4	-3.7	-4.3	-1.3	-0.5	-0.8	-0.9	-1.0
Consolidated primary balance	6.7	10.3	-3.3	-3.2	3.6	0.5	-2.6	-3.1	0.0	1.1	0.8	0.8	0.9
Total public debt	14.3	22.1	24.3	24.8	24.9	23.7	29.2	26.2	24.4	22.5	23.1	23.4	23.7
External balance													
Exports (US$bn)	70.1	41.6	37.0	49.5	59.0	59.5	44.1	65.8	85.6	79.9	81.1	82.7	84.2
Imports (US$bn)	42.5	33.9	26.6	31.0	35.0	41.1	38.1	41.6	50.6	59.7	60.9	62.7	64.6
Trade balance (US$bn)	27.7	7.7	10.5	18.5	24.0	18.4	6.0	24.2	35.0	20.2	20.2	20.0	19.6
Trade balance (% of GDP)	12.5	4.2	7.6	11.1	13.4	10.1	3.5	12.3	15.5	7.6	6.9	6.3	5.7
Current account balance (US$bn)	-2.9	-10.0	-7.0	-3.4	-1.8	-7.0	-11.0	-2.7	7.1	-8.7	-7.9	-7.6	-7.6
Current account balance (% of GDP)	-1.3	-5.4	-5.1	-2.1	-1.0	-3.9	-6.4	-1.4	3.1	-3.3	-2.7	-2.4	-2.2
Net FDI (US$bn)	4.7	3.3	13.7	3.8	5.0	5.9	5.9	1.9	8.1	2.3	4.0	2.0	2.0
Net FDI (% of GDP)	2.1	1.8	10.0	2.3	2.8	3.3	3.4	1.0	3.6	0.9	1.4	0.6	0.6
Current account balance plus FDI (% of GDP)	0.8	-3.6	4.9	0.2	1.8	-0.6	-3.0	-0.4	6.7	-2.4	-1.3	-1.7	-1.6
Foreign exchange reserves ex gold (US$bn)	29.2	27.9	29.7	31.0	30.9	29.0	35.6	34.4	35.1	35.9	37.9	38.9	39.9
Import cover (months of merchandise imports)	8.3	9.9	13.4	12.0	10.6	8.5	11.2	9.9	8.3	7.2	7.5	7.4	7.4
Debt indicators													
Gross external debt (US$bn)	157	153	164	167	160	160	164	164	161	163	168	173	178
Gross external debt (% of GDP)	71	83	119	100	89	88	96	83	71	62	57	54	52
Gross external debt (% of exports)	224	367	442	339	272	268	372	249	188	204	70	65	61
Lending to corporates/households (% of GDP)	31.4	31.0	27.1	23.4	21.2	19.9	20.7	22.0	23.9	24.7	25.2	25.2	25.2
Interest & exchange rates													
Central bank key rate (year-end, %)	5.50	16.00	12.00	10.25	9.25	9.25	9.00	9.75	16.75	15.75	13.00	11.00	10.00
Broad money supply (average, %YoY)	-8.2	8.0	46.2	7.5	7.1	11.0	19.2	24.1	18.0	16.8	13.8	8.8	3.8
3m interest rate (TONIA, average, %)	7.1	10.4	15.5	11.8	10.3	10.2	10.8	8.9	15.5	16.5	13.8	11.2	10.7
3m interest rate spread over US$-Euribor (ppt)	6.90	10.08	14.76	10.49	7.94	7.87	10.10	8.70	13.05	11.06	8.4	7.0	6.7
2yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT exchange rate (year-end)	182	339	333	332	384	381	421	432	463	455	475	490	500
USD/KZT exchange rate (average)	179	222	342	326	345	383	413	426	460	456	463	478	492
EUR/KZT exchange rate (year-end)	222	371	352	398	439	427	516	488	493	502	523	539	550
EUR/KZT exchange rate (average)	238	246	379	368	407	429	471	504	485	493	504	526	541
Brent oil price (annual average, US$/bbl)	99	54	45	55	72	64	43	71	99	82	85	80	75

Source: CEIC, National sources, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	5.6	4.3	5.4	3.7	4.3	4.5	3.5	5.4	5.5	5.3	5.7	4.0	3.8
CPI (eop, %YoY)	14.6	11.8	9.8	9.1	8.4	8.0	7.9	7.5	7.8	7.3	6.9	6.8	6.7
Central bank key rate (eop, %)	16.75	16.50	15.75	14.75	14.50	14.00	13.00	12.50	12.00	11.50	11.00	10.75	10.50
3m interest rate (eop, %)	14.89	16.80	14.68	13.70	14.20	13.70	12.70	12.20	11.70	11.20	10.70	10.45	10.20
10yr yield (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT exchange rate (eop)	451	478	456	447	465	470	475	470	475	480	490	485	490
EUR/KZT exchange rate (eop)	492	506	502	483	502	517	523	517	523	528	539	534	539

Source: CEIC, National sources, ING estimates

Poland

Rafał Benecki, Chief Economist, Poland

Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	2.0	3.0	3.1	3.9	3.2	3.0	3.5
CPI (%YoY)*	2.0	2.5	4.6	4.7	5.7	3.5	4.3
Policy interest rate (eop, %)	5.75	5.75	5.75	5.75	5.75	5.75	5.00
3m interest rate (%)*	5.88	5.85	5.85	5.90	5.87	5.87	5.60
10yr yield (%)*	5.43	5.75	5.60	5.42	5.20	5.62	5.09
USD/PLN*	3.99	3.97	3.85	3.86	3.87	3.92	3.89
EUR/PLN*	4.30	4.28	4.23	4.25	4.26	4.27	4.28

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2025	S&P	A-	A
Fiscal	Loose	Parliamentary: 2027	Moody's	A2	A2
Monetary	Restrictive	Local: 2028	Fitch	A-	A-

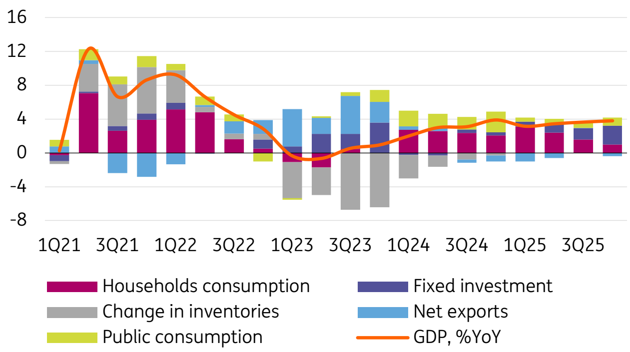
*Quarterly data is eop, annual is avg

Source: National sources, ING estimates

Country strategy: CEE growth leader at the crossroads

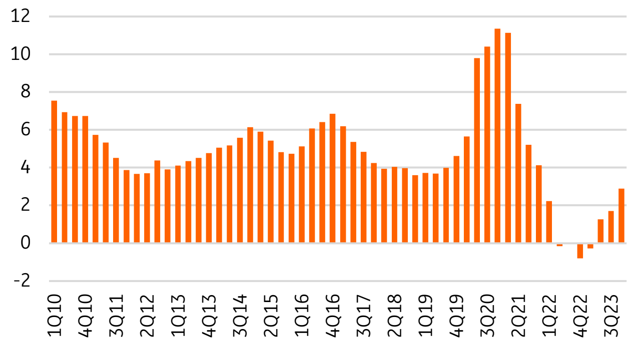
In 2024 Poland should be among growth leaders in the EU but, in the current cycle, GDP growth should peak at 3-4% instead of the 5-6% to date. Labour costs in Poland outpaced productivity, so core inflation may stay sticky in 2024-25. In addition, unwinding of anti-inflation shields should temporarily lift CPI to 5-6% at the turn of 2024-25 and bring support to the NBP's rhetoric that is strongly calling against monetary easing this year. The NBP favours a strong PLN, which matches many governor objectives. We see a short and shallow easing cycle starting in 2Q25. This should provide support for the zloty at an uncertain time of carry trade unwinding and approaching US elections.

GDP composition (%YoY)



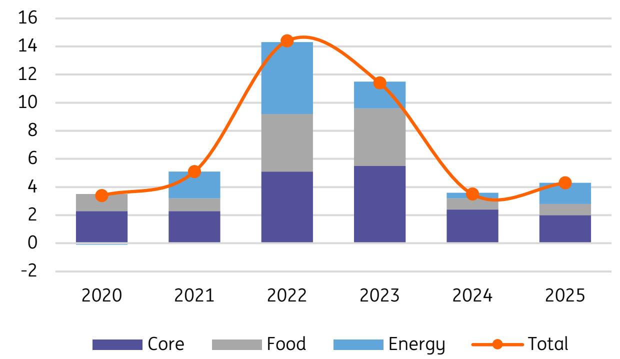
Source: Polish Statistical Office, ING forecast

Household savings rate, last four quarters (1Y rolling, %)



Source: Eurostat, ING

CPI inflation (%YoY)



Source: Polish Statistical Office, ING

Consumption-led recovery and delayed monetary easing

2024 is expected to be marked by a rebound in households' consumption as lower inflation, double-digit wages growth and generous valorisation of social benefits support households' finances. Real disposable income is set to expand at its highest pace in two decades in 2024. At the same time, fixed investment is expected to be subdued this year as public sector outlays ease amid the transition between EU financial prospects and morbidly low private outlays. We expect economic growth in 2024 of 3% on the back of buoyant consumption and stagnant investment. The rebound in consumption is somewhat restrained by savings rebuilding, but 1Q24 data suggests that the pace of real disposable income growth leaves room for both higher savings and stronger consumer spending. The beginning of the year also brought poor fixed investment (down by 1.8% YoY in 1Q24) and a continued drag from destocking, which is projected to gradually come to an end in 2024. In 2025, GDP growth is forecast to accelerate to 3.5% as projects from the EU 2021-27 financial framework and Recovery and Resilience funds should build momentum also in private outlays.

Rapid disinflation linked to the abating energy shock and PLN firming has come to an end (CPI hit a local low of 2.0%YoY in March) and consumer inflation started trending upwards again. Higher VAT (from 0% to the prevailing 5% rate since April) on food and normalisation of energy prices for households will lift headline inflation towards c.4-5%YoY at the end of 2024 despite a maximum price on electricity and the absence of capacity fees in electricity bills in 2H24. We forecast that CPI inflation may reach nearly 6%YoY in March 2025 before declining for the reminder of the year.

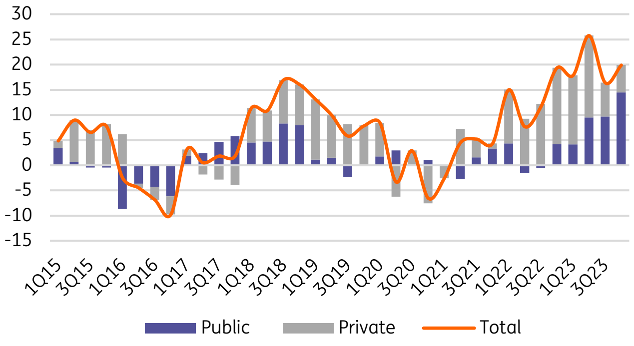
The main mid-term inflation challenges are linked to tight labour market and robust wages growth that put upward pressure on labour-intensive services prices. Since services account for roughly 50% of core prices, core inflation is expected to hover around 4% by the end of 2024 and above 3% in 2025 still well above the CPI target.

We see limited room for monetary policy easing in 2024, due to the temporary surge in energy prices that boosts headline CPI, but more importantly persistently high core inflation amid high inflation of services, the economic rebound helping companies to rebuild margins and high fiscal imbalance. In our view, the NBP rates should remain unchanged this year and a short easing cycle may start in 2Q25 (total 75bp cuts in 2025) after the peak in headline inflation. Since mid-term inflation outlook is not particularly favourable (sticky high core inflation and strong reliance of imported low inflation), we see scope for policy easing as moderate, and target a rate of 5.00%.

Poland

rafal.benecki@ing.pl

Fixed investment (nominal) (%YoY)

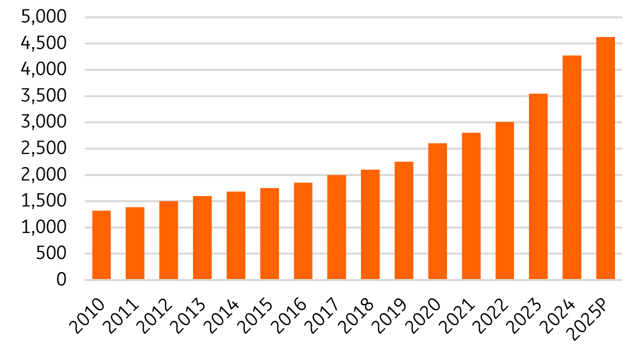


Source: Eurostat

Public investment shaped by EU money flows

The beginning of 2024 brought a serious slowdown in investment activity with 1Q24 seeing a slide to 1.8% YoY after 15.8%YoY in 4Q23 when two-thirds of growth was driven by public outlays before the end of the 2014-20 EU perspective. The beginning of the new EU budget usually brings a visible slowdown in EU funds absorption. Also, private businesses propensity to invest was hit by the previous government's institutional deterioration, as well as the stop and go policy when it came to access to the EU Recovery & Resilience Fund (RRF). The conflict with the EC was resolved only after the Autumn 2023 elections, but we expect poor public investment and moderate private outlays in 2024 as many businesses await new grants. In 2025, investment activity should be boosted as RRF and cohesion funds kick in, with risk of overheating in 2026 due to limited space for extending the RRF deadline.

Minimum wage (PLN monthly)

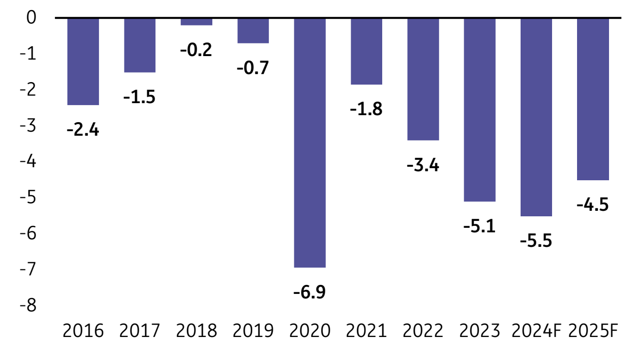


Source: ING

Tight labour market to keep inflation pressure high

Poland's unemployment is among the lowest in the EU (LFS measure 3%) and the scarcity of labour is putting upward pressure on wages, which in 2024 are set to expand at a double-digit rate for the third year in a row. On the top of that, authorities have pursued sharp increases in the minimum wage over recent years. Currently some 3m employees receive minimum wage vs 0.5m a few years ago and minimum wage in Poland is higher than in Portugal (nearly €1,000 a month). Buoyant growth of wages is already a challenge for businesses reliant on low cost, while more advanced employees still appreciate a high quality of labour as an attractive reward. High cost of labour is currently at the forefront of barriers to growth in business surveys. Price increases in labour-intensive services are to keep core inflation sticky above the NBP CPI target of 2.5% (+/- 1%).

General government balance (% of GDP)

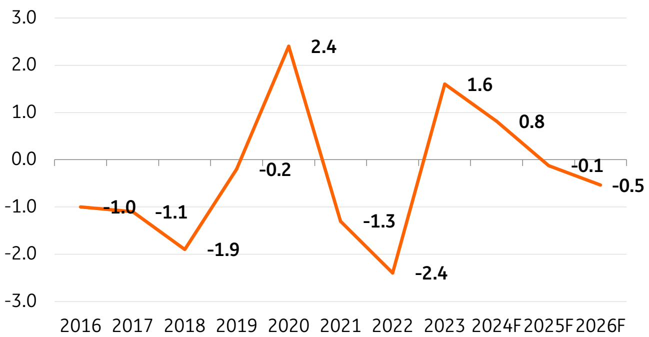


Source: Eurostat, ING forecast

Fiscal consolidation expected to be slow

With continued high military spending, generous indexation of social benefits (pensions, child benefits) and wage hikes in the public sector (30% for teachers, 20% for civil servants), the general government spending is expected to remain above 5% of GDP in 2024. The EU has proposed imposing the excessive deficit procedure on Poland, but the expected consolidation path is not to be particularly ambitious amid high war-related spending (defence, aid for refugees). We project the excessive deficit correction to be slow and public debt to trend to 60% of GDP, which should eventually force authorities to propose slow fiscal adjustment (0.5% of GDP yearly). Military spending should remain high on the agenda with utmost priority, so social spending growth may be forced to slow somewhat to make room for defence and energy transformation expenditure.

Current account balance (% of GDP)



Source: NBP, ING forecast

Poland's solid external position to deteriorate gradually

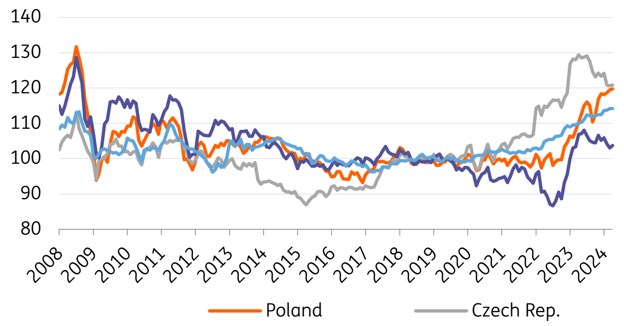
As the energy commodity shock faded away in late-2022 and over the course of 2023, Poland's external position improved significantly. In 2023, the current account reached a surplus of 1.6% of GDP from a deficit of 2.4% of GDP in 2022. Provided global energy commodity prices remain broadly stable, the current account balance is set to deteriorate gradually on the back of recovering domestic demand and with a stagnant German economy. In 2024, Poland's GDP is expected to be consumption-led, and supported by investment growth in 2025-26.

We project Poland's external CA position to moderate from 0.8% of GDP surplus this year to small deficits over 2025-26. Higher spending on military equipment may push imports up, while exports will be constrained by slow growth in Germany and PLN appreciation.

Poland

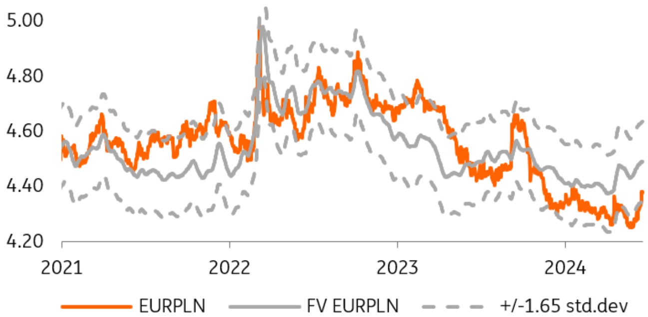
Strategy

CEE FX performance since 2018 (%)



An increase represents appreciation of CEE currency
Source: Macrobond

ING relative value €/PLN model



Source: Macrobond, ING estimates

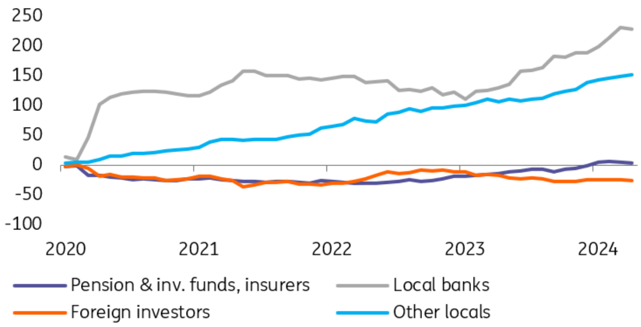
FX strategy

The zloty was hit by the recent wave of carry trade unwinding. Domestic fundamentals call for renewed PLN gains as soon as the global EM sentiment improves, though. We still eye €/PLN below 4.30 in the coming months, but 4Q24 brings another risk for CEE with the US elections. Persistently high core inflation in Poland leaves limited room for NBP monetary easing this year, in contrast to the ECB. Moreover, Poland maintains a current account surplus (1.5% of GDP on a 12-month rolling basis). On the top of that, after the summer, Poland is to receive another tranche of RRF funding, likely to at least partially be converted into PLN via the market (total flow PLN100bn net this year). We also hope for some limited foreign inflows towards POLGBs, but rather at the turn of 2024-25

Our relative value €/PLN model (gauging the rate against other market variables, such as swaps) suggests that the zloty is no longer overvalued against the euro (see the chart on the left). And this is despite the market still pricing some NBP easing in 2024 and 70bp cuts next year.

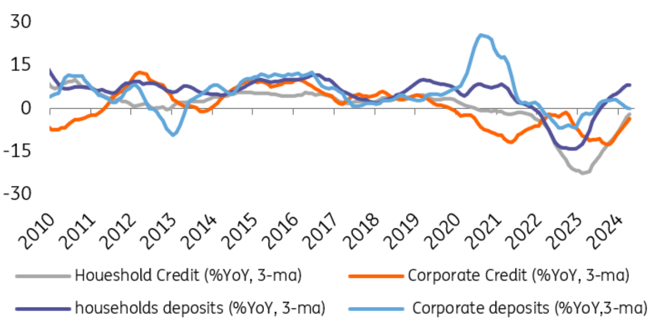
We are cautious on PLN prospects in 4Q24 and early 2025. US presidential elections may spark another wave of EM risk aversion, this time concentrated on CEE currencies, particularly the zloty. A softer US stance on Russia might affect the propensity of foreigners to invest in the CEE region. Moreover, domestic investors may also again move towards foreign assets. We are yet to see how many long PLN positions have been unwound during the latest EM selloff phase. But betting on a €/PLN decline was one of most crowded positions in 1H24. Any €/PLN move towards 4.20 could prove temporary.

POLGBs' holder structure (PLNbn change since 2019)



Source: Ministry of Finance

Credit and deposit growth in Polish banks



Source: National bank of Poland

Fixed income strategy

We expect asset swap tightening on the long end to be the major trend for POLGBs in 2H24. Historically (both in Poland and other CEE peers), inflows of EU funds resulted in a surge in banking sector liquidity. With EU funding unfrozen, some PLN100bn net could arrive both this and next year. Given still limited demand for credit (and an overall slow start to EU-backed projects), this should force local buyers to extend POLGB holdings as liabilities continue swelling, in order to avoid the asset tax (see the loan and deposit activity in the Polish banking sector chart on the left). Other local buyers should extend holdings as well, as banks may decrease deposit rates to limit balance sheet expansion.

Available data suggests that foreign investors failed to meaningfully increase POLGB holdings in 1H24, preferring, for example, LatAm. The recent wave of carry trade unwinding hit these positions particularly strongly. As such, we anticipate at least some foreign inflow to POLGBs, as a means to at least diversify.

The market is still pricing some NBP easing this year, as well as further cuts in 2025. High wages, elevated core inflation and gradual unwinding of anti-inflation shields support the NBP's rhetoric, strongly suggesting no monetary easing this year. We see some downside risk to 1Q25 CPI peak, due to a possible energy tariff cut. We expect 75bp in cuts for 2025, in line with market pricing now, but downside risk to CPI in 1Q25 may temporarily deepen easing expectations.

Poland

rafal.benecki@ing.pl

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	3.8	4.4	3.0	5.1	5.9	4.5	-2.0	6.9	5.6	0.2	3.0	3.5	3.8
Private consumption (%YoY)	3.4	3.8	3.6	6.3	4.4	3.5	-3.6	6.2	5.4	-1.0	4.3	3.5	3.9
Government consumption (%YoY)	4.0	2.4	2.0	2.7	3.5	6.5	4.9	5.0	0.5	2.8	10.1	3.6	3.0
Investment (%YoY)	11.7	6.9	-7.6	1.6	12.6	6.2	-2.3	1.2	2.7	13.1	0.4	7.7	9.1
Industrial production (%YoY)	4.1	6.0	3.6	6.2	5.4	5.1	-1.9	14.7	9.3	-2.1	2.7	4.3	4.9
Unemployment rate (year-end, %)	11.4	9.7	8.2	6.6	5.8	5.2	6.8	5.8	5.2	5.1	4.8	4.6	4.4
Nominal GDP (PLNbn)	1,700	1,799	1,853	1,983	2,127	2,289	2,338	2,631	3,075	3,410	3,648	3,959	4,235
Nominal GDP (€bn)	406	430	425	466	499	532	526	576	653	751	854	925	978
Nominal GDP (US$bn)	539	477	470	525	589	596	600	681	677	812	931	1,018	1,075
GDP per capita (US$)	14,005	12,405	12,231	13,661	15,320	15,528	15,631	17,850	17,902	21,527	24,739	27,122	28,709
Gross domestic saving (% of GDP)	21.4	23.1	23.2	22.9	23.5	24.2	24.4	25.1	23.9	24.1	22.3	22.7	22.7
Prices													
CPI (average, %YoY)	0.0	-0.9	-0.6	2.0	1.6	2.3	3.4	5.1	14.4	11.4	3.5	4.3	3.2
CPI (year-end, %YoY)	-1.0	-0.5	0.8	2.1	1.1	3.4	2.4	8.6	16.6	6.2	4.7	2.8	3.7
Wage rates (nominal, %YoY)	3.8	3.5	4.1	5.6	7.1	6.6	4.8	8.6	13.0	11.9	12.0	7.5	6.5
Fiscal balance (% of GDP)													
Consolidated government balance	-3.7	-2.6	-2.4	-1.5	-0.2	-0.7	-6.9	-1.8	-3.4	-5.1	-5.5	-4.5	-3.8
Consolidated primary balance	-1.7	-0.8	-0.7	0.1	1.2	0.6	-5.6	-0.7	-1.9	-3.0	-3.4	-2.3	-1.9
Total public debt	51.4	51.3	54.5	50.8	48.7	45.7	57.2	53.6	49.2	49.6	54.9	56.9	58.8
External balance													
Exports (€bn)	152.8	164.0	169.2	191.2	205.2	220.3	220.5	263.6	322.1	334.2	353.5	372.9	387.6
Imports (€bn)	160.7	166.2	170.6	196.0	216.4	224.7	213.6	271.3	346.3	328.0	352.5	382.4	404.2
Trade balance (€bn)	-7.9	-2.1	-1.3	-4.8	-11.3	-4.4	7.0	-7.7	-24.3	6.2	1.0	-9.5	-16.6
Trade balance (% of GDP)	-1.9	-0.5	-0.3	-1.0	-2.3	-0.8	1.3	-1.3	-3.7	0.8	0.1	-1.1	-1.7
Current account balance (€bn)	-11.7	-5.5	-4.3	-5.3	-9.6	-1.2	12.8	-7.4	-15.7	11.8	6.6	-2.6	-6.8
Current account balance (% of GDP)	-2.9	-1.3	-1.0	-1.1	-1.9	-0.2	2.4	-1.3	-2.4	1.6	0.8	-0.3	-0.7
Net FDI (€bn)	10.3	9.5	3.3	7.0	14.2	10.9	12.5	22.0	23.9	16.6	27.1	29.4	31.1
Net FDI (% of GDP)	2.5	2.2	0.8	1.5	2.8	2.0	2.4	3.8	3.6	2.2	3.3	3.3	3.2
Current account balance plus FDI (% of GDP)	-0.3	1.0	-0.2	0.4	0.9	1.8	4.8	2.5	1.3	3.8	4.2	3.0	2.5
Foreign exchange reserves (€bn)	82.6	86.9	108.1	94.6	102.3	114.5	125.6	146.6	156.5	175.4	191.9	209.4	227.9
Import cover (months of merchandise imports)	6.2	6.3	7.6	5.8	5.7	6.1	7.1	6.5	5.4	6.4	6.5	6.6	6.8
Debt indicators													
Gross external debt (€bn)	293.9	304.0	321.4	319.8	317.3	316.7	307.4	323.3	347.6	386.4	412.7	442.0	470.3
Gross external debt (% of GDP)	72.4	70.7	75.6	68.7	63.6	59.5	58.4	56.2	53.0	51.3	50.9	50.2	48.1
Gross external debt (% of exports)	192.3	185.3	189.9	167.3	154.7	143.8	139.4	122.7	107.9	115.6	116.7	118.5	121.3
Lending to corporates & households (% of GDP)	56.7	57.2	58.1	56.2	56.3	55.0	54.0	50.5	43.8	39.5	38.2	36.7	35.9
Interest & exchange rates													
Central bank key rate (year-end, %)	4.26	4.26	4.42	4.17	4.30	4.26	4.61	4.60	4.69	4.35	5.75	5.00	5.00
Broad money supply (average, %YoY)	6.1	8.2	10.1	6.9	6.3	9.6	13.6	11.9	7.8	7.1	7.6	8.2	7.8
3m interest rate (WIBOR, average, %)	2.51	1.75	1.70	1.73	1.71	1.72	0.66	0.55	6.04	6.53	5.87	5.60	5.20
3m interest rate spread over EURIBOR (ppt)	230	177	196	206	203	208	109	110	569	310	223	283	270
2yr yield (average, %)	2.48	1.73	1.66	1.89	1.59	1.57	0.53	0.83	6.33	5.67	5.12	4.85	4.80
10yr yield (average, %)	3.52	2.71	3.05	3.44	3.22	2.38	1.52	1.95	6.11	5.83	5.62	5.09	5.04
USD/PLN exchange rate (year-end)	3.51	3.90	4.18	3.48	3.76	3.80	3.76	4.06	4.40	3.94	3.92	3.91	3.95
USD/PLN exchange rate (average)	3.15	3.77	3.94	3.78	3.61	3.84	3.90	3.86	4.46	4.20	3.92	3.89	3.94
EUR/PLN exchange rate (year-end)	4.26	4.26	4.42	4.17	4.30	4.26	4.61	4.60	4.69	4.35	4.25	4.30	4.35
EUR/PLN exchange rate (average)	4.19	4.18	4.36	4.26	4.26	4.30	4.44	4.57	4.69	4.54	4.27	4.28	4.33

Source: National sources, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	-0.6	0.5	1.0	2.0	3.0	3.1	3.9	3.2	3.5	3.7	3.8	4.1	3.4
CPI (eop, %YoY)	11.5	8.2	5.2	2.0	2.5	4.6	4.7	5.7	5.2	3.3	2.8	2.8	3.0
Central bank key rate (eop, %)	6.75	6.00	5.75	5.75	5.75	5.75	5.75	5.75	5.50	5.25	5.00	5.00	5.00
3m interest rate (eop, %)	6.90	5.77	5.88	5.88	5.85	5.85	5.90	5.87	5.70	5.37	5.20	5.20	5.20
10yr yield (eop, %)	5.78	5.91	5.20	5.43	5.75	5.60	5.42	5.20	5.10	5.00	4.93	5.00	5.15
USD/PLN exchange rate (eop)	4.11	4.37	3.94	3.99	3.97	3.85	3.86	3.87	3.88	3.90	3.91	3.93	3.94
EUR/PLN exchange rate (eop)	4.45	4.64	4.35	4.30	4.28	4.23	4.25	4.26	4.27	4.29	4.30	4.32	4.33

Source: National sources, ING estimates

Romania

Valentin Tataru, Chief Economist | Stefan Posea, Economist

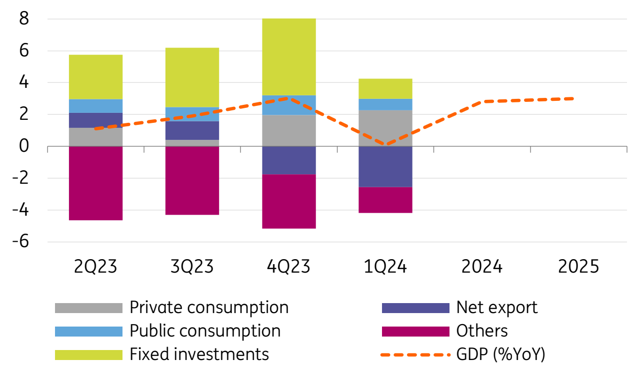
Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	0.1	2.8	3.4	4.1	4.2	2.8	3.0
CPI (%YoY)*	6.6	4.7	3.9	4.2	3.4	5.2	4.0
Policy interest rate (eop, %)	7.00	7.00	6.75	6.50	6.50	6.50	5.75
3m interest rate (%)*	6.05	6.03	5.80	5.60	5.45	5.94	5.33
10yr yield (%)*	6.55	6.75	6.60	6.50	6.40	6.60	6.20
USD/RON*	4.61	4.61	4.53	4.56	4.56	4.57	4.57
EUR/RON*	4.98	4.98	4.98	5.02	5.02	4.98	5.03

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: Sep 2024	S&P	BBB-	BBB-
Fiscal	Loose	Parliament: Dec 2024	Moody's	Baa3	Baa3
Monetary	Neutral	Local: 2028	Fitch	BBB-	BBB-

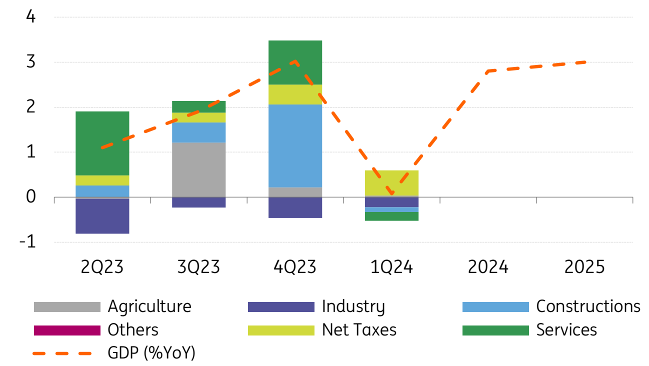
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

GDP (YoY%) and components (ppt)



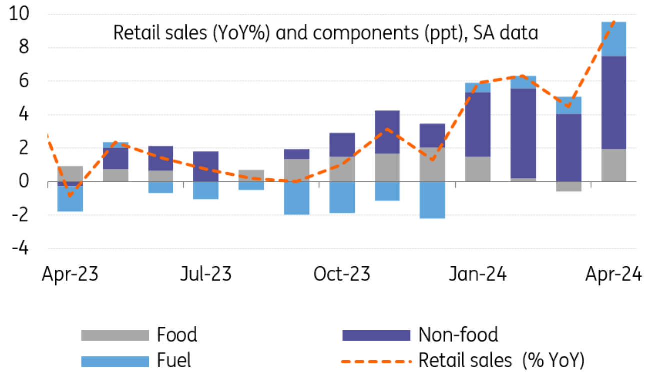
Source: NIS, ING estimates

Supply side GDP (YoY%) and components (ppt)



Source: NIS, ING estimates

Retail sales: Living in the moment(um)



Source: NIS, ING

Country strategy: Investments to sweeten fiscal excuses

While growth is picking up on the back of sharply reviving consumption and still-strong investment, Romania is heading towards an even worse situation on the fiscal front. Co-financing of investments, debatable tax collection improvements, military spending and a rigid expenditure structure all play a role. This environment sets the stage for a very cautious easing cycle from the central bank, as well as for a push from officials towards a slow-paced deficit reduction in their negotiations with the European Commission (EC), relying heavily on the "Romania needs investments" card. On this note, we think that the government will use the same strategy as before - minimal improvements that tick the EC's boxes but satisfy local political pressures. The good news is that productive investments are now also flowing in.

Growth prospects remain good

Annual growth slowed sharply to 0.1% in the first quarter, held back by weak net exports and inventories. Positives came from stronger private consumption and investment remaining robust. These are currently Romania's two main growth engines, and we expect both to perform well this year. We think that consumption will continue to receive solid support from credit activity and respectable real income growth, while investment will continue to post robust growth rates as public infrastructure projects are in full swing. External demand should provide more support from the slight improvement that we forecast for the European economy overall, ultimately turning more supportive for local industrial exports.

On the supply side, we expect civil engineering projects and most other activities related to public investment to continue to outperform the rest of the economy and add a one-sided boost to the construction sector. Industrial activity has started to show some signs of life, in line with German activity, making it likely that Romanian industrial exports will see a small boost in the second semester. Our view is that it will take time for the German export-driven business model to shrug off structural weakness caused by a halt to affordable inputs from Russia and by a declining Chinese market. Apart from all-important EU funds inflows, we expect domestic demand to be the main value-added generator for Romania's economy in the medium term.

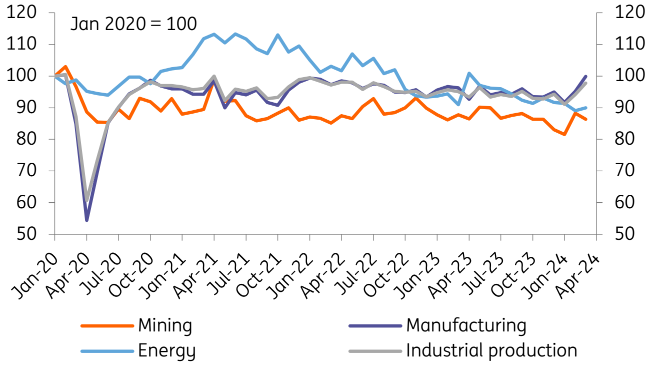
On the monetary policy front, the National Bank of Romania kept rates on hold at its last meeting and our base case is that it will continue to do so until August, when we expect the first 25bp cut. We pencil in the next cut too, also of 25bp, in November, followed by three more rate cuts next year, taking the policy rate to 5.75%. Overall, risks for the rates path seem tilted to the upside as long as the combination of strong consumption, high wage growth and fiscal slippages persists. All three have limited room for cooling this year. Excess interbank liquidity is likely to persist. While the delay in the absorption of the third NRRP tranche might put some downward pressure on liquidity, above-plan FX issuance from the MinFin is likely to compensate.

On EUR/RON, we continue to see no significant moves ahead. Still-sticky inflation, especially on services, as well as strong consumption and the stubborn fiscal deficit make it unlikely that rising FX volatility will be a topic of discussion into 2H24.

Romania

valentin.tataru@ing.com | tiberiu-stefan.posea@ing.com

Industry still below pre-pandemic levels

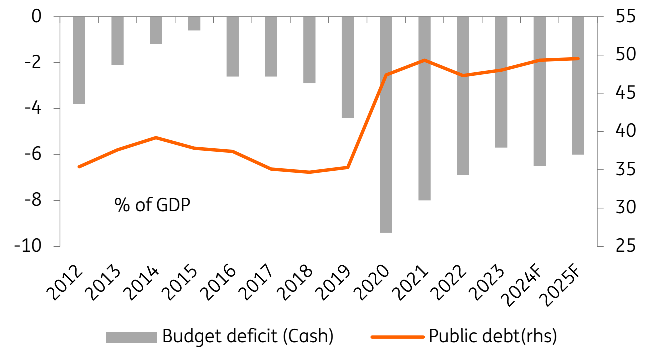


Source: NSI, ING

Showing mild improvement but still far from recovery

Industrial production continues its soft patch though some better German data recently gives some hope for a bottoming-out for local industry. After four months of 2024, output was only 0.3% higher than the previous year but with some clear signs of acceleration. Steady gains in manufacturing (80% of the index) have led the advance. Our view is that the cyclical bottoming out in German activity will not automatically be followed by a strong recovery, at least as long as Germany's structural weaknesses persist. Latest confidence indicators confirm a small increase in order-books, together with a decrease in inventories and a cautious view on production expectations. This suggests limited business confidence beyond the short term.

Getting out of EDP is a long-term project

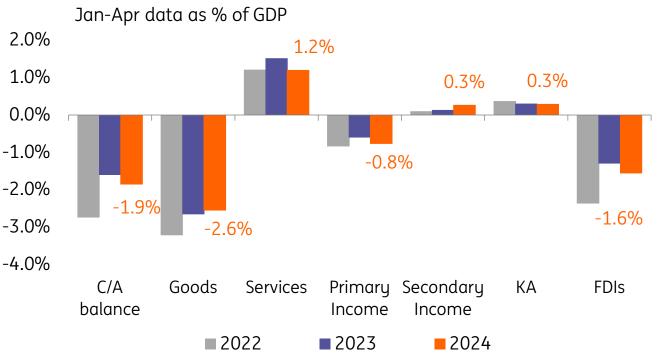


Source: MFin, ING estimates

Slippages make headlines

As of April, the deficit reached 3.43% of GDP (official target: 5.0%). Capital spending has been the main culprit, apparently on postponed expenditure from 2023 and on a defence buildup. We think that the deficit will reach 6.5% this year, with upside risks remaining. Overall, we expect the deficit reduction plan that officials must send to the EC this year to use the maximum timeframe of seven years and aim to backload any large reductions as far as possible into the future. Key factors to watch are whether the new leadership of the EC will be as lenient with Romania as the previous one and whether the recent push of Poland to exclude military expenditures from the metrics will be taken into consideration. In any case, fiscal improvements are likely to be only marginal, while still satisfying the minimum requirements of the EC.

Last year's gains coming under pressure

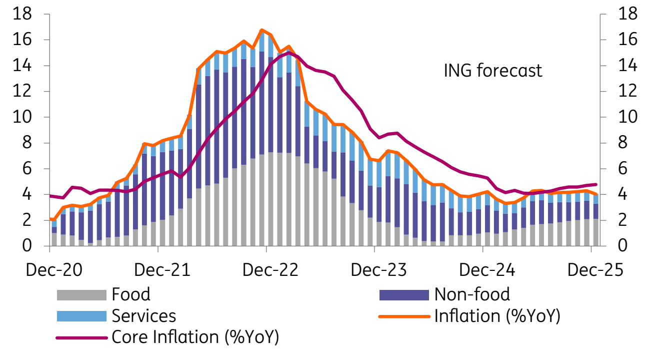


Source: NBR, ING estimates

Strong consumption again fuel imports

Better terms of trade curbed the current account deficit to -7.0% of GDP in 2023, from -9.3% the year before. We think that further major improvements are unlikely in 2024. If anything, risks are tilted to the upside. On the one hand, stronger-than-expected private consumption and big delays in fiscal consolidation (with risks for even a -7.0% of GDP budget deficit) mean that upward pressures on the current account deficit are set to prevail. We are now slightly less pessimistic on Eurozone growth prospects, which should benefit exports. With internal demand set to outpace external demand by a margin, Romania's twin deficits problem has no end in sight yet, especially as we expect the stimulative fiscal deficit to continue.

Inflation (YoY%) and main components (ppt)



Source: NIS, ING estimates

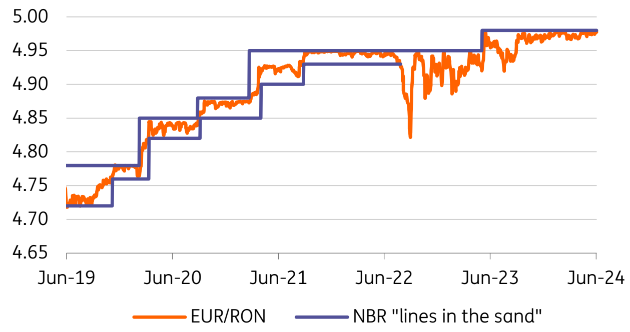
Progress on inflation: Not bad but also not great

Romanian inflation inched down to 5.1% in May. So far this year price increases have decelerated visibly on the food items front – the only category to have returned to the target range. Services inflation has remained stubbornly double-digit, fuelled by still-high wage growth. Non-food inflation has picked up since the beginning of the year, in line with strong non-food items retail demand. We think that consumer demand is set to remain strong in the coming months, allowing firms to remain confident in their pricing power as they plan for next year's likely increase in the tax burden. We are revising down our 4.8% year-end forecast to 4.2%, on energy price effects. For 2025 we keep to our 4.1% forecast.

Romania

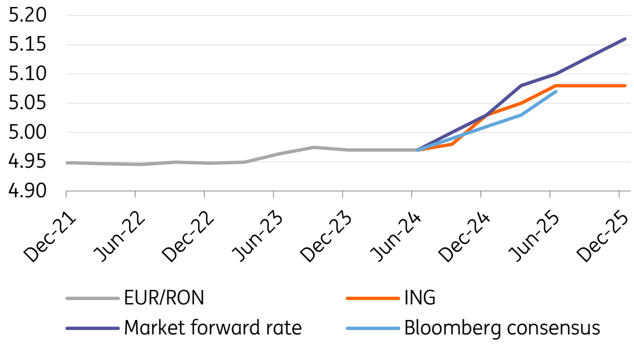
Strategy

Veritable managed floating



Source: NBR, ING estimates

FX – spot vs forward and INGF



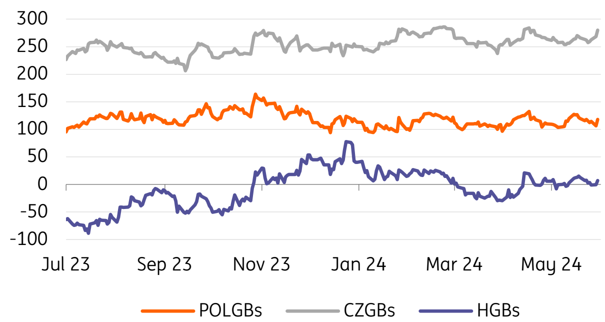
Source: NBR, Bloomberg, ING estimates

FX strategy *(with Frantisek Taborsky, EMEA FX & FI Strategist)*

EUR/RON remains in a very narrow range of 4.960-4.975 and nothing is likely to change in the near term for the rest of the year. Volatility has fallen to the freezing point. Moreover, the central bank doesn't seem to need much effort to maintain such a narrow range with FX reserves rising to all-time highs. At the same time, banking sector excess liquidity has stabilised at around slightly below RON50bn, pushing the ROBOR lower still and creating unintended monetary policy easing. This allows the NBR to remain on the hawkish side for longer, as the last central bank within the CEE peers not to start a cutting cycle.

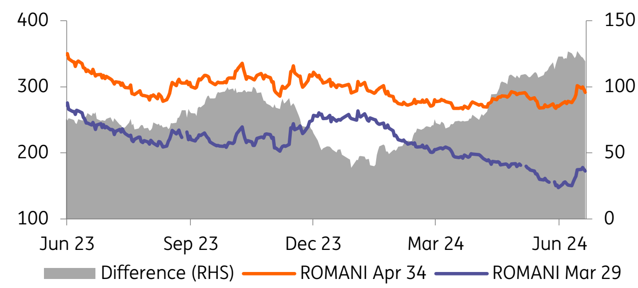
The RON picture may become clearer at the turn of the year, when we know the outcome of the election, fiscal policy and probably see the first rate cuts in the meantime. Only then could the NBR's attention shift to FX and current account issues, allowing some depreciation.

10y ROMGBs spreads vs CEE3 (bp)



Source: Refinitiv, ING

ROMANI €34 vs €29 spread (bp)



Source: Refinitiv, ING

Fixed income strategy *(with Frantisek Taborsky, EMEA FX & FI Strategist and James Wilson, EM Sovereign Strategist)*

Fiscal slippage and possible rate cuts will be the main drivers of ROMGBs in 2H24. MinFin covered about 47% of the issuance needed to cover the 6.5% of GDP fiscal deficit, according to our calculations. This is sufficient at the moment but cautionary given falling auction demand and fiscal risk. Moreover, positioning remains very heavily long from last year and the 10y yield is back close to 7%. So the main game changer here may be the start of a cutting cycle to give ROMGBs some momentum. On the other hand, the markets seem to have started adjusting after the first NBR live meeting in May and roughly one rate cut is already priced in FX implieds. Therefore, we are rather negative on ROMGBs here compared to CEE peers.

Persistent twin deficits that look unlikely to improve significantly in the near term remain the key headwind for Romanian sovereign credit, in turn feeding our expectations for further consistent Eurobond issuance in the coming years. With the potential for more supply later in the year on the back of fiscal slippage and the sticky structural vulnerabilities, significant spread tightening from the wide end of the BBB tier looks unlikely. However, we do find the steepness of the 5s-10s EUR curve attractive in terms of potential carry and roll-down.

Romania

valentin.tataru@ing.com

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	4.1	3.2	2.9	8.2	6.0	3.9	-3.7	5.7	4.1	2.1	2.8	3.0	3.0
Private consumption (%YoY)	3.5	5.8	6.4	11.7	9.4	3.3	-3.9	7.5	5.8	2.9	3.6	2.9	3.0
Government consumption (%YoY)	0.0	1.3	-9.5	11.5	-0.8	6.4	2.0	0.4	-3.3	5.9	4.5	1.6	1.7
Investment (%YoY)	5.4	7.7	-2.2	5.5	0.0	12.6	1.1	2.9	5.9	12.0	5.9	6.2	6.9
Industrial production (%YoY)	6.2	2.7	3.1	8.6	5.0	-2.6	-9.2	6.5	0.9	-2.5	2.1	2.4	2.8
Unemployment rate (year-end, %)	6.8	6.8	5.9	5.7	4.2	3.9	5.0	5.6	5.6	5.6	5.4	5.3	5.1
Nominal GDP (RONbn)	669	713	752	852	959	1,064	1,056	1,182	1,401	1,606	1,734	1,855	1,983
Nominal GDP (€bn)	150	160	167	186	206	224	218	240	283	324	348	369	390
Nominal GDP (US$bn)	199	176	184	213	241	251	249	283	297	350	380	406	429
GDP per capita (US$)	10,000	8,900	9,400	10,800	12,400	12,900	12,900	14,800	15,600	18,400	20,000	21,400	22,700
Gross domestic saving (% of GDP)	24.6	24.7	22.7	21.4	20.0	20.2	20.2	20.6	20.4	20.9	21.0	21.0	21.0
Prices													
CPI (average, %YoY)	1.1	-0.6	-1.6	1.3	4.6	3.8	2.6	5.1	13.8	10.5	5.2	4.0	3.9
CPI (year-end, %YoY)	0.8	-0.9	-0.5	3.3	3.3	4.0	2.1	8.2	16.4	6.6	4.2	4.1	3.6
Wage rates (nominal, %YoY)	5.2	8.3	13.0	14.2	13.1	14.9	6.7	7.1	12.2	15.4	12.0	7.0	6.0
Fiscal balance (% of GDP)													
Consolidated government balance	-1.2	-0.5	-2.5	-2.5	-2.8	-4.3	-9.3	-7.2	-6.3	-6.6	-6.5	-6.0	-6.0
Consolidated primary balance	0.6	1.0	-1.1	-1.4	-1.9	-3.2	-7.9	-5.7	-4.8	-4.6	-4.9	-4.5	-4.0
Total public debt	39.1	37.7	37.8	35.3	34.4	35.1	46.7	48.5	47.5	48.8	49.9	50.7	51.5
External balance													
Exports (€bn)	52.5	54.6	57.4	62.6	67.7	69.0	62.2	74.7	91.9	93.1	100.5	107.6	115.1
Imports (€bn)	58.5	63.0	67.4	75.6	82.8	86.3	80.6	98.4	126.0	122.0	130.6	138.4	146.7
Trade balance (€bn)	-6.1	-8.4	-10.0	-13.0	-15.1	-17.3	-18.4	-23.7	-34.1	-28.9	-30.0	-30.8	-31.6
Trade balance (% of GDP)	-4.0	-5.2	-6.0	-7.0	-7.3	-7.7	-8.4	-9.9	-12.0	-8.9	-8.6	-8.4	-8.1
Current account balance (€bn)	-0.4	-1.3	-2.7	-5.8	-9.5	-10.9	-10.9	-17.4	-26.0	-22.6	-24.5	-26.0	-26.0
Current account balance (% of GDP)	-0.3	-0.8	-1.6	-3.1	-4.6	-4.9	-5.0	-7.3	-9.2	-7.0	-7.0	-7.0	-6.7
Net FDI (€bn)	2.7	2.9	4.8	4.8	4.9	4.8	2.9	8.8	8.8	6.6	8.1	8.7	9.2
Net FDI (% of GDP)	1.8	1.8	2.9	2.6	2.4	2.1	1.3	3.7	3.1	2.0	2.3	2.3	2.4
Current account balance plus FDI (% of GDP)	1.5	1.0	1.3	-0.5	-2.2	-2.7	-3.7	-3.6	-6.1	-5.0	-4.7	-4.7	-4.3
Foreign exchange reserves ex gold (€bn)	32.2	32.2	33.0	32.3	31.8	31.7	36.2	37.1	43.2	56.4	62.0	66.9	71.0
Import cover (months of merchandise imports)	6.6	6.1	5.9	5.1	4.6	4.4	5.4	4.5	4.1	5.5	5.7	5.8	5.8
Debt indicators													
Gross external debt (€bn)	97.2	94.7	94.3	97.4	99.8	109.8	126.8	136.6	143.9	170.0	183.6	196.5	210.0
Gross external debt (% of GDP)	65	59	56	52	48	49	58	57	51	53	53	53	54
Gross external debt (% of exports)	185	173	164	155	147	159	204	183	157	183	183	183	182
Lending to corporates/households (% of GDP)	31.0	29.9	28.5	26.5	25.4	24.5	25.7	26.5	24.7	23.2	24.1	24.7	25.4
Interest & exchange rates													
Central bank key rate (year-end, %)	4.00	2.75	1.75	1.75	1.75	2.50	1.50	1.75	6.75	7.00	6.50	5.75	4.75
Broad money supply (average, %YoY)	4.1	6.8	7.8	11.4	8.8	10.9	15.3	15.8	6.8	10.7	12.9	10.2	8.0
3m interest rate (Robor average, %)	2.54	1.40	0.89	1.15	2.80	3.15	2.38	1.82	6.19	6.62	5.94	5.33	4.79
3m interest rate spread over Euribor (ppt)	2.3	1.4	1.2	1.5	3.1	3.5	2.8	2.4	5.8	3.2	2.7	2.7	2.2
3yr yield (average, %)	3.3	1.9	1.5	1.9	3.7	3.7	3.3	2.9	7.2	6.5	6.3	5.7	5.2
10yr yield (average, %)	4.6	3.5	3.3	3.9	4.7	4.5	3.9	4.0	7.6	6.9	6.6	6.2	5.7
USD/RON exchange rate (year-end)	3.70	4.15	4.32	3.88	4.06	4.27	3.97	4.34	4.62	4.53	4.56	4.62	4.67
USD/RON exchange rate (average)	3.37	4.04	4.08	4.01	3.98	4.24	4.24	4.18	4.71	4.59	4.57	4.57	4.63
EUR/RON exchange rate (year-end)	4.48	4.52	4.54	4.66	4.66	4.78	4.87	4.95	4.94	4.98	5.02	5.08	5.14
EUR/RON exchange rate (average)	4.44	4.45	4.49	4.57	4.65	4.75	4.84	4.93	4.95	4.96	4.98	5.03	5.09

Source: National sources, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	1.1	1.9	3.0	0.1	2.8	3.4	4.1	4.2	3.0	2.3	3.0	3.2	3.0
CPI (eop, %YoY)	10.3	8.8	6.6	6.6	4.7	3.9	4.2	3.4	4.3	4.2	4.0	4.1	4.0
Central bank key rate (eop, %)	7.00	7.00	7.00	7.00	7.00	6.75	6.50	6.50	6.25	6.00	5.75	5.50	5.25
3m interest rate (eop, %)	6.54	6.40	6.22	6.05	6.03	5.80	5.60	5.45	5.20	5.05	4.95	4.75	4.50
10yr yield (eop, %)	6.76	6.95	6.40	6.55	6.75	6.60	6.50	6.40	6.20	6.00	5.90	5.70	5.60
USD/RON exchange rate (eop)	4.54	4.69	4.52	4.61	4.61	4.53	4.56	4.56	4.56	4.62	4.62	4.62	4.64
EUR/RON exchange rate (eop)	4.95	4.97	4.97	4.98	4.98	4.98	5.02	5.02	5.02	5.08	5.08	5.08	5.10

Source: National sources, ING estimates

Serbia

Valentin Tataru, Chief Economist | Stefan Posea, Economist

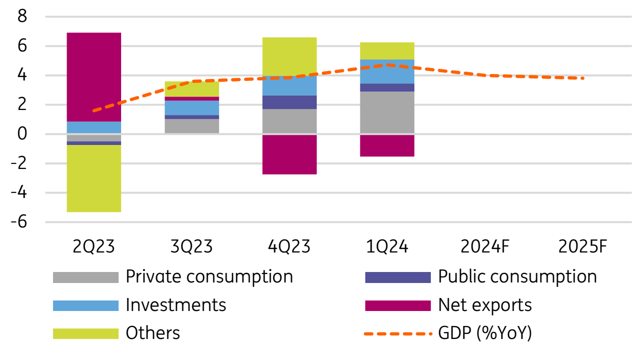
Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	4.7	4.2	3.5	3.6	3.6	4.0	3.8
CPI (%YoY)*	5.0	4.1	4.1	4.0	4.4	4.6	4.4
Policy interest rate (eop, %)	6.50	6.25	6.00	6.00	5.75	6.00	5.00
3m interest rate (eop, %)	5.70	5.65	5.45	5.20	5.00	5.20	4.20
10yr yield (eop, %)	6.20	6.00	6.00	5.80	5.80	5.80	5.50
USD/RSD (avg, ann)	117.2	117.10	117.09	117.08	117.05	107.4	106.4
EUR/RSD (avg, ann)	108.5	108.43	106.45	106.44	106.41	117.11	116.95

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2027	S&P	BB+	BB+
Fiscal	Neutral	Parliamentary: 2027	Moody's	Ba2	Ba2
Monetary	Restrictive	Local: 2028	Fitch	BB+	BB+

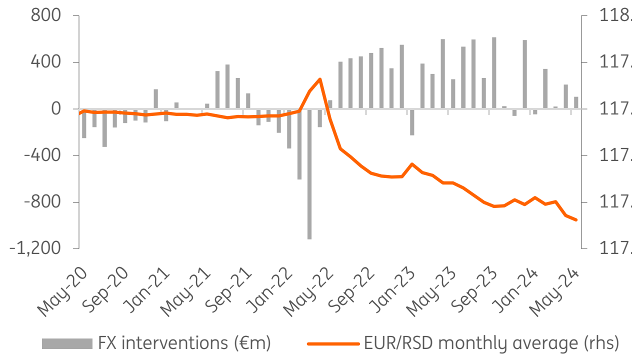
Source: National sources, ING estimates

Real GDP (%YoY) and contributions (ppt)



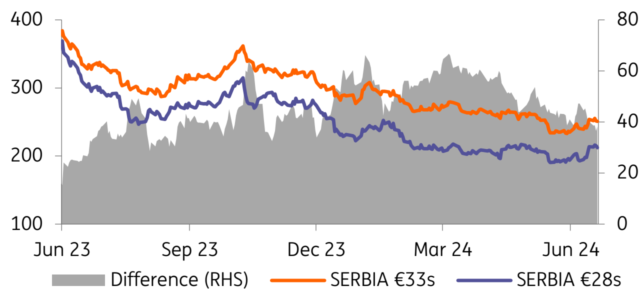
Source: NSI, ING

FX stability remains the main policy tool



Source: NBS, ING

SERBIA EUR credit - 33s vs 28s (bp)



Source: ICE, Refinitiv, ING

Country strategy: Play with the East, hope for the West

While the macroeconomic situation continues its vigorous progress, Serbia's positioning on the international stage does not look to be in sync with its EU accession goal, at least not at this stage. Relations with Kosovo remain tense, with no clear resolution in sight. Not normalising might be enough to jeopardise the accession process. Serbia's declared 'shared future' with China and the free trade agreement starting in July this year could be somewhat beneficial for economic growth but adds geopolitical complications. This trade agreement will build on already strong Chinese FDI assets in Serbia, with these having almost tripled in 2023. Considering macroeconomic factors, the country has been performing well (with solid growth, small imbalances and cooling inflation) and an upgrade to investment grade this year seems within reach.

Growth spells anything but trouble

After stabilising at lower but still decent 2.5% annual growth in 2023, activity started 2024 on a strong footing. Private and public consumption, as well as investments, continued their upward momentum and grew strongly. Import growth, on the other hand, visibly outpaced exports as consumption pressures rebounded fast after last year's slump. Overall, the 4.7% growth recorded over the quarter sets the stage for a healthy acceleration this year, for which we pencil in a 4.0% expansion. Private consumption is set to re-emerge as the key growth driver this year. Key to this contribution will be wages – which have seen double-digit growth rates since November 2021 – as well as lower interest rates.

Inflation set to moderate and FX stability to persist

Price pressures fell to 4.5% in May, approaching the upper bound of the target range. The central bank began its policy easing cycle in June (cutting from 6.5% to 6.25%), following the ECB but taking the lead over its CEE peers. Our view is that demand pressures stemming from solid growth and income rises will continue to keep inflation in the vicinity of the upper target range over the medium term and will limit the easing potential of the NBS. We expect the policy rate to end this year at 6.00% and at 5.00% in 2025. On FX, we continue to see stability ahead. The Bank of Serbia bought €635m net in January-May, muting dinar appreciation pressures stemming from strong FDI inflows (€1.3bn in 1Q24), which are set to continue.

Macro strength driving investor optimism

Continued progress on the macro front looks to be outweighing any political concerns for investors in Serbia at the moment, with many looking towards potential upgrades to IG. Fiscal metrics stand out as positive relative to most in CEE, while strong FDI continues to support the external picture. While relations with Kosovo remain tense, for now at least there are limited signs pointing towards escalation, which should be enough to keep demand robust for Serbia's external bonds. We believe valuations look more attractive in the USD curve, relative to EUR. In the EUR space, longer-dated maturities are trading well inside Romania, while shorter dated bonds such as the €28s could compress towards IG peers if upgrade hopes come to fruition.

James Wilson, EM Sovereign Strategist

Serbia

valentin.tataru@ing.com | tiberiu-stefan.posea@ing.com

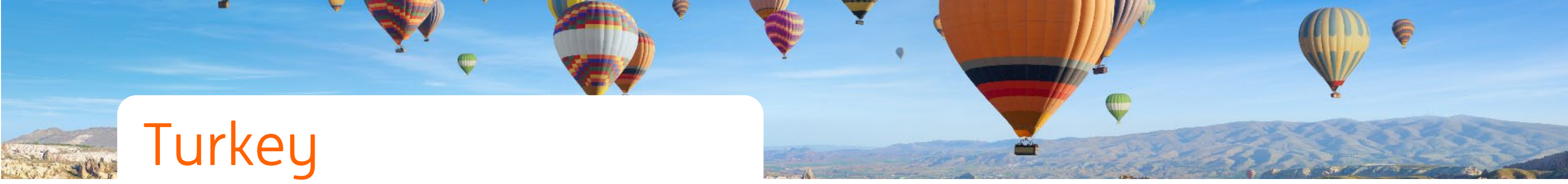
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	-1.6	1.8	3.3	2.1	4.5	4.3	-0.9	7.7	2.5	2.5	4.0	3.8	3.6
Private consumption (%YoY)	-0.1	-0.6	1.9	2.2	3.1	3.7	-1.9	7.8	4.0	0.8	3.1	2.9	2.8
Government consumption (%YoY)	0.9	-3.7	0.0	2.9	3.7	1.9	2.8	4.1	0.4	0.3	1.6	0.9	1.5
Investment (%YoY)	-3.4	6.2	5.1	6.6	17.5	17.2	-1.9	15.7	1.9	3.9	5.2	4.8	4.4
Industrial production (%YoY)	-7.3	7.3	5.2	3.9	1.3	0.3	0.4	6.4	1.6	2.4	4.9	3.2	3.0
Unemployment rate (average, %)	20.6	18.9	16.4	14.5	13.7	11.2	9.7	11.1	9.5	9.4	9.1	8.8	8.5
Nominal GDP (RSDbn)	4,161	4,315	4,528	4,761	5,073	5,422	5,504	6,272	7,098	8,150	8,805	9,501	10,242
Nominal GDP (€bn)	34.4	35.5	36.7	40.2	42.9	46.1	46.8	53.3	60.5	69.6	75.2	81.2	87.6
Nominal GDP (US$bn)	47.3	50.8	50.8	43.5	45.4	51.5	53.8	62.9	63.4	75.1	82.0	89.3	96.3
GDP per capita (US$)	6,700	7,200	7,300	6,200	6,500	7,500	7,800	9,300	9,500	11,300	12,400	13,700	14,800
Gross domestic saving (% of GDP)	8.4	11.6	13.3	13.0	14.0	15.2	15.9	17.2	15.5	16.9	16.8	16.7	16.6
Prices													
CPI (average, %YoY)	2.1	1.4	1.1	3.1	2.0	1.9	1.6	4.1	11.9	12.5	4.6	4.4	4.3
CPI (year-end, %YoY)	1.8	1.6	1.5	3.0	2.0	1.9	1.3	7.9	15.1	7.6	4.0	4.5	4.2
Wage rates (nominal, %YoY)	1.4	-0.2	3.7	4.0	3.7	10.6	9.4	9.6	13.8	14.8	12.0	10.0	8.8
Fiscal balance (% of GDP)													
Consolidated government balance	-6.2	-3.5	-1.2	1.1	0.6	-0.2	-8.0	-4.1	-3.2	-2.2	-2.2	-1.5	-1.5
Consolidated primary balance	-3.5	-0.4	1.7	3.6	2.8	1.8	-6.1	-2.5	-1.8	-0.5	-0.7	-0.1	-0.2
Total public debt	67.5	71.2	68.7	58.6	54.4	52.8	60.0	57.1	55.6	52.3	51.4	49.9	49.1
External balance													
Exports (€bn)	11.2	12.0	13.5	15.1	16.4	17.7	17.1	21.9	27.6	28.6	29.7	30.8	31.9
Imports (€bn)	15.2	16.1	17.1	19.5	22.1	24.1	23.1	28.9	39.0	36.9	39.8	43.0	46.5
Trade balance (€bn)	-4.0	-4.0	-3.6	-4.4	-5.7	-6.4	-5.9	-7.1	-11.4	-8.2	-10.1	-12.2	-14.5
Trade balance (% of GDP)	-11.7	-11.4	-9.9	-11.0	-13.2	-13.9	-12.7	-13.3	-18.9	-11.8	-13.5	-15.1	-16.6
Current account balance (€bn)	-2.0	-1.2	-1.1	-2.1	-2.1	-3.2	-1.9	-2.3	-4.2	-1.8	-2.5	-2.7	-2.7
Current account balance (% of GDP)	-5.8	-3.5	-2.9	-5.1	-4.8	-6.9	-4.1	-4.2	-6.9	-2.6	-3.3	-3.3	-3.1
Net FDI (€bn)	1.2	1.8	1.9	2.4	3.2	3.6	2.9	3.7	4.3	4.2	4.4	4.5	4.7
Net FDI (% of GDP)	3.6	5.1	5.2	6.0	7.4	7.7	6.3	6.9	7.2	6.0	5.8	5.6	5.3
Current account balance plus FDI (% of GDP)	-2.2	1.6	2.2	0.9	2.5	0.8	2.2	2.6	0.3	3.4	2.5	2.2	2.2
Foreign exchange reserves ex gold (€bn)	9.9	10.4	10.2	10.0	11.3	13.4	13.5	16.5	19.4	24.9	26.0	27.9	30.0
Import cover (months of merchandise imports)	7.8	7.7	7.2	6.1	6.1	6.7	7.0	6.8	6.0	8.1	7.8	7.8	7.7
Debt indicators													
Gross external debt (€bn)	25.7	26.2	26.5	25.5	26.7	28.3	30.8	36.5	41.9	45.4	46.5	47.7	48.9
Gross external debt (% of GDP)	74.7	73.9	72.2	63.5	62.1	61.3	65.8	68.4	69.2	65.3	61.9	58.7	55.8
Gross external debt (% of exports)	230	218	197	169	163	160	180	167	152	159	157	155	153
Lending to corporates/households (% of GDP)	40.8	40.6	40.9	40.3	41.4	42.0	45.5	43.4	40.3	35.8	37.1	38.4	39.7
Interest & exchange rates													
Central bank key rate (year-end, %)	8.00	4.50	4.00	3.50	3.00	2.25	1.00	1.00	5.00	6.50	6.00	5.00	4.50
Broad money supply (average, %YoY)	7.6	6.6	11.6	3.6	14.5	8.4	18.1	13.3	6.9	12.7	12.0	8.0	10.0
3m interest rate (Belibor, year-end, %)	9.85	3.83	3.47	3.12	3.03	1.64	0.90	0.94	4.95	5.70	5.20	4.20	3.70
3m interest rate spread over Euribor (ppt)	9.7	3.9	3.8	3.4	3.3	2.0	1.3	1.5	4.5	2.3	2.0	1.6	1.1
3yr yield (year-end, %)	n/a	n/a	n/a	n/a	n/a	3.2	2.1	2.4	6.0	5.8	5.2	4.9	4.7
10yr yield (year-end, %)	n/a	n/a	n/a	n/a	4.8	4.0	3.1	3.6	7.0	6.3	5.8	5.5	5.5
USD/RSD exchange rate (year-end)	86.2	83.1	99.5	111.2	117.1	105.0	96.4	103.1	109.6	106.5	106.4	106.4	106.3
USD/RSD exchange rate (average)	88.0	84.9	89.1	109.4	111.8	105.2	102.3	99.6	111.9	108.6	107.4	106.4	106.3
EUR/RSD exchange rate (year-end)	121.0	121.6	123.5	118.5	118.2	117.6	117.6	117.6	117.3	117.2	117.05	117.00	116.90
EUR/RSD exchange rate (average)	117.4	120.8	123.2	121.3	118.3	117.8	117.6	117.6	117.5	117.3	117.11	117.03	116.95

Source: National sources, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	1.6	3.6	3.8	4.7	4.2	3.5	3.6	3.6	3.7	3.8	3.8	3.7	3.7
CPI (eop, %YoY)	13.7	10.2	7.6	5.0	4.1	4.1	4.0	4.4	4.3	4.4	4.5	4.1	4.0
Central bank key rate (eop, %)	6.50	6.50	6.50	6.50	6.25	6.00	6.00	5.75	5.50	5.25	5.00	4.75	4.50
3m interest rate (eop, %)	5.70	5.70	5.70	5.70	5.65	5.45	5.20	5.00	4.75	4.40	4.20	4.00	3.75
10yr yield (eop, %)	6.80	6.50	6.30	6.20	6.00	6.00	5.80	5.80	5.50	5.50	5.50	5.50	5.50
USD/RSD exchange rate (eop)	117.27	117.20	117.17	117.19	117.10	117.09	117.08	117.05	117.03	117.00	116.90	116.95	116.95
EUR/RSD exchange rate (eop)	107.59	110.57	106.52	108.51	108.43	106.45	106.44	106.41	106.39	106.36	106.27	106.32	106.32

Source: National sources, ING estimates



Turkey

Muhammet Mercan, Chief Economist, Turkey

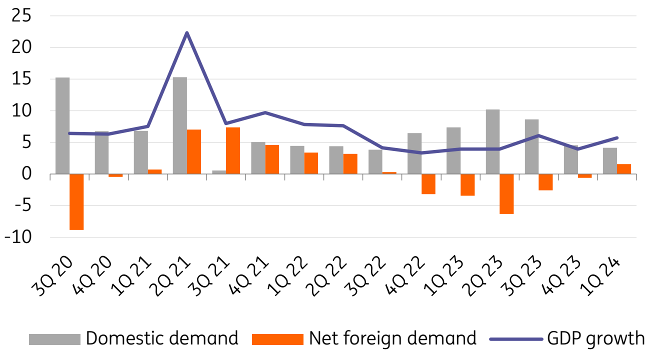
Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	5.7	3.1	1.9	0.8	0.9	2.7	3.5
CPI (%YoY)*	68.5	72.2	46.1	41.8	31.8	56.9	27.8
Policy interest rate (eop, %)	50.00	50.00	50.00	45.00	37.50	45.00	27.50
3m interest rate (%)*	50.58	48.50	47.32	42.19	38.58	46.27	34.61
10yr yield (%)*	26.82	27.94	25.70	22.17	20.41	26.22	19.22
USD/TRY*	32.35	32.55	34.06	37.00	39.17	33.26	41.15
EUR/TRY*	34.92	35.15	37.46	40.70	43.09	36.26	45.26

Macro trend		Political cycle	Ratings	FC	LC
Activity	-	Presidential: May 2028	S&P	B+	B+
Fiscal	Loose	Parliamentary: May 2028	Moody's	B3	B3
Monetary	Tight	Local: March 2029	Fitch	B+	B+

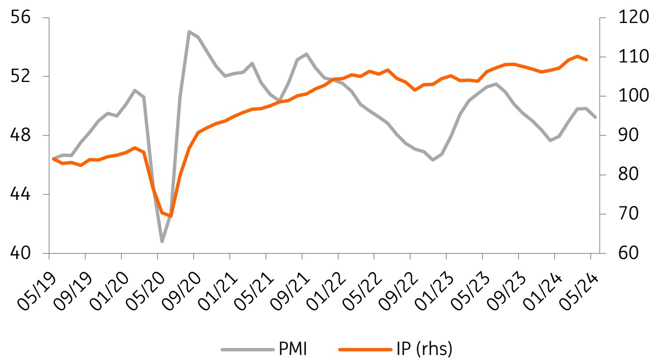
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

GDP growth (%YoY)



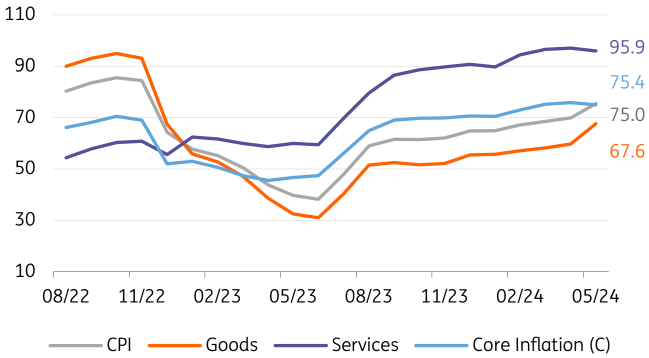
Source: TurkStat, ING

PMI & IP (seas. adj., 3m-ma, %YoY)



Source: ICI, TurkStat, ING

Inflation (%YoY)



Source: TurkStat, ING

Country strategy: Growing interest for Turkish assets

As Turkey has shifted towards policy normalisation there has been a notable uptick in investor interest and engagement. Following the local elections, volatility has declined, net FX reserves started to recover and the de-dollarization trend resumed with messaging from the CBT and the government that tight monetary and fiscal policies would continue. These clear policy indications have reduced the volatility in the markets. Accordingly, after the Fitch upgrade in March, S&P also upgraded Turkey's ratings at the beginning of May. Moody's, currently grading Turkey two notches below the Fitch and S&P ratings and having a regular assessment in July, could also hike, in our view. Policy predictability and durability, as well as progress on a broader structural reform agenda are key for the sustainability of the current performance.

Macro digest

1Q24 GDP growth turned out to be 5.7% on year-on-year basis, aligned with market consensus, with still strong domestic demand and a positive contribution from net exports. This translates into a quarter-on-quarter growth rate at 2.4% after seasonal adjustments, showing a momentum gain in comparison to a relatively modest reading in 4Q at 1.0%. Accelerating sequential performance is attributable to investments and government spending turning positive after a negative reading a quarter ago and the supportive impact of net exports despite a contractionary effect of inventory build-up and moderation in private consumption. The data reveals that economic activity was stronger in the first quarter due to wage hikes and fiscal stimulus. However, following the surge in loan demand in the run-up to the local elections, the CBT has introduced policy actions, including an unexpected rate hike in March, to control both TRY and FX lending growth and sterilise the excess liquidity. Banking sector data shows that these actions led to a slowdown in credit growth, including a sharp decline in consumer credit card spending, and further deceleration is likely following the recently imposed cap on FX loans. Given this backdrop, while early indicators for 2Q24 point to some weakening in activity, which is still moderate so far, growth is expected to lose significant momentum with tightening financial conditions, slowing real wage growth and leading to a likely increase in the unemployment rate, in our view.

Annual CPI inflation reached its cyclical peak in May at 75.4% with across-the-board price increases in both food and non-food groups in addition to a one-off effect from the energy sector. The seasonally adjusted headline inched up in May thanks to the goods group, while services, after the peak in January, is on a gradually improving trend. Confirming the challenges of disinflation, the underlying trend is still significantly high with the CBT seeing a decline in the seasonally adjusted monthly inflation to around 2.5% on average in 3Q24, and slightly below 1.5% in 4Q24. For the remainder of this year, annual inflation is expected to drop rapidly with the large base and is likely to fall within the CBT's forecast range (34-42%) at end-2024, close to the upper band, in our view. Whether: (1) the stability in the Lira continues; (2) the electricity and natural gas price subsidies provided to consumers remain in place; and (3) the government avoids inflationary tax adjustments will be key determinants for the pace of disinflation, while the deterioration in pricing behaviour and the rigidity in services inflation are challenges for the period ahead. We expect the CBT to maintain a tight stance with the policy rate at 50% in the near term, while keeping the funding cost and ON repo rate high via liquidity policy, and could move with two rate cuts to 45% by end-2024, conditional on inflation and inflation expectations.

Turkey

muhammet.mercan@ing.com.tr

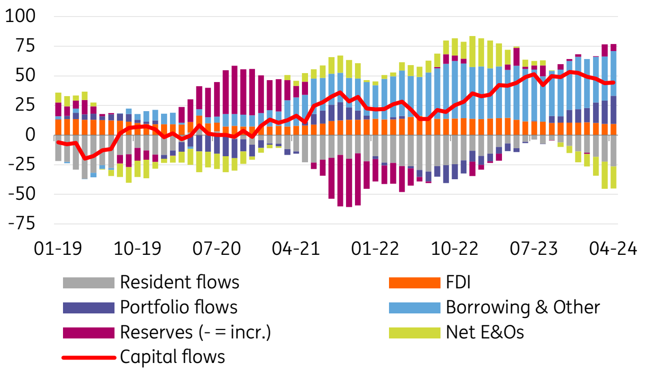
Unemployment vs NPLs (%)

Source: TurkStat, BRSA, ING

Unemployment at lowest level in more than a decade

The unemployment rate (seasonally adjusted) stood at 8.5% in April, the lowest since late-2012, with a slight decline from 8.6% a month ago. The composite measure of labour underutilisation (the sum of time-related underemployment, unemployment and potential labour force) was below 20% before the pandemic and is above 27%, at the latest, implying underlying strains. Given that activity will lose steam over the rest of 2024, unemployment is expected to rise from these levels. Asset quality metrics continue to remain strong reflecting inflationary trends and tight credit conditions, while NPL ratios are still at all-time lows across different categories. However, higher rates and tighter conditions mean NPL formation is now gradually picking up. This is particularly visible on the retail side with a gradual increase in NPL ratios year-to-date.

Breakdown of C/A financing (12m-rolling, US$bn)

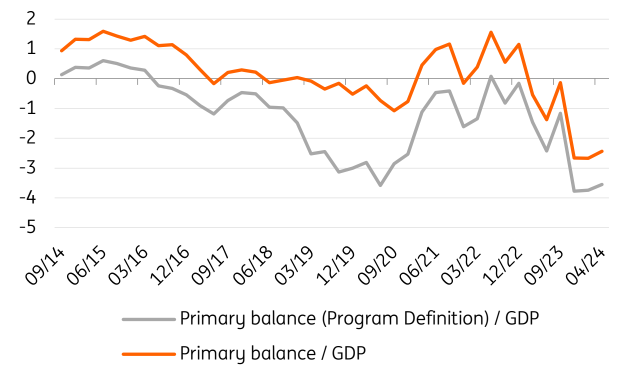


Source: CBT, ING

Capital flows accelerating since local elections

12-month cumulative exports and imports have been almost flat for the past three months. This implies that exports do not seem to have been affected by the appreciation of the TRY. On the other hand, the downward trend in imports has stagnated after February. In the short term, exports are expected to be impacted by external demand conditions, while imports are likely to continue to decline slightly in seasonally adjusted terms with the policy tightening. Accordingly, the envisaged impact of the policy tightening on the balancing of demand factors is likely to be supportive for the external outlook. On the capital account, one of the major challenges for policymakers is that the financing need arising from the current account deficit was not met through normal channels. Recent data show re-acceleration in inflows.

Primary balance (12m-rolling, % of GDP)

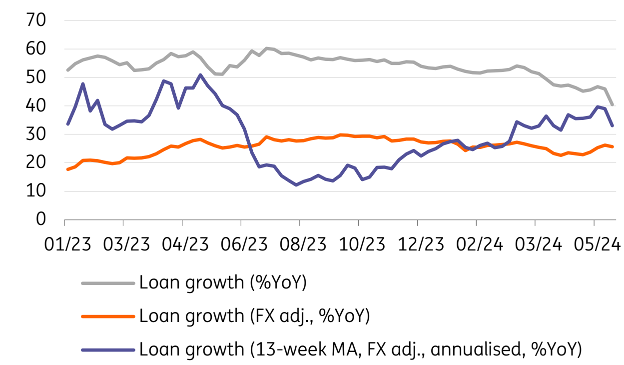


Source: Ministry of Treasury and Finance, ING

Signals of fiscal tightening

The budget deficit for the past 12 months to April stood at 5.3% of GDP, while the current pace implies a wider deficit in the period ahead. Accordingly, MinFin's Mehmet Şimşek recently announced a package of measures, which include cutting purchases of goods and services and investment spending to control widening in the budget deficit and help disinflation, measures that amount to a saving of TRY100bn (c.0.3% of GDP). This was followed by another set of measures to raise TRY200bn new revenues (c.0.6% of GDP) without increasing tax rates, including a prepaid tax system for certain professions, reducing the share of indirect taxes in general tax revenues and adjustments to ensure tax fairness. The government targets a budget deficit-to-GDP ratio this year close to the level realised in 2023 (5.2%) or lower vs the 6.4% target in the Medium-Term Plan.

Banking sector volume expansion



Source: BRSA, ING

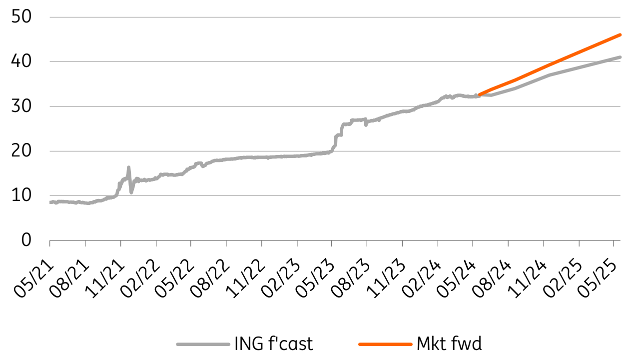
Lending likely to decelerate further

Given the CBT's measures to directly restrict TRY-denominated loans and the excessive increase in loan interest rates, the rate of lending growth slowed significantly. We expect the deceleration to continue given the recent tightening moves after the May MPC. The sharp slowdown in lending growth increases challenges for corporates especially for SMEs in accessing financing and could have a negative impact on the production side rather than curbing demand. The CBT's high interest rate and tight liquidity policy support deposit rates and de-dollarisation. Accordingly, with the breakdown of the exchange rate depreciation expectations, the downward trend in the sum of FX deposits and the FX-protected deposits (KKM), which are indicators of dollarisation, has resumed. The pace of decline in the KKM has also gained momentum lately.

Turkey

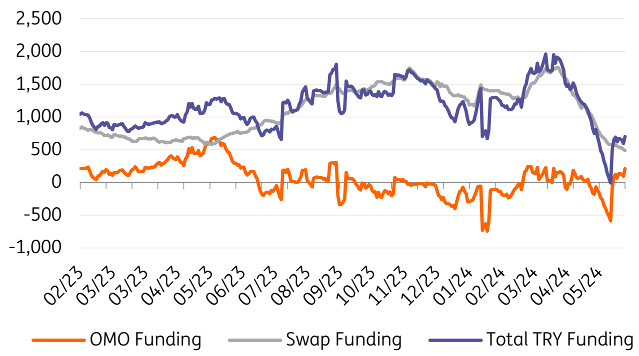
Strategy

FX – spot vs forward and INGF



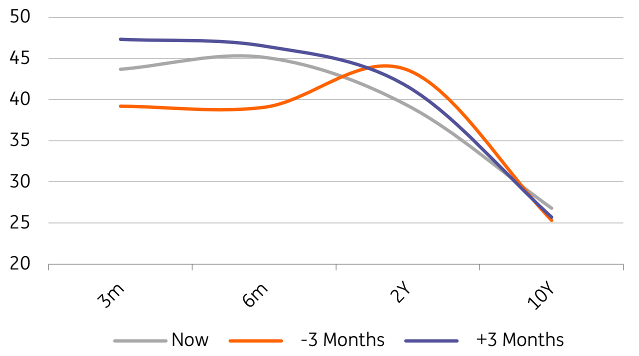
Source: Bloomberg, ING estimates

CBT funding (TRYbn)



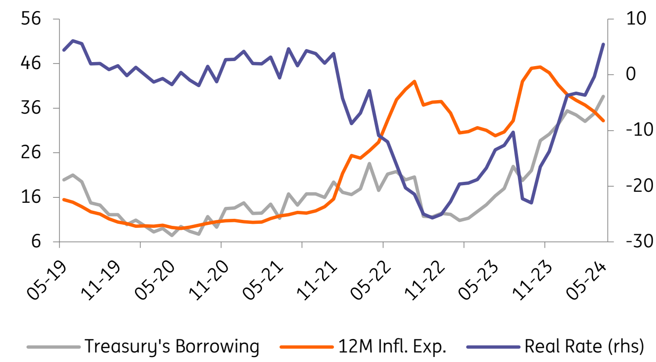
Source: CBT, ING Bank

Yield curve (%)



Source: Bloomberg, ING estimates

Real interest rate (%)



Source: Treasury, CBT, ING Bank

FX strategy

Given the clear CBT message, still leaving the door open for further hikes if required by the inflation outlook in addition to the recent rate and non-rate tightening, foreign interest in the lira is on the rise since the local elections. TRY has strengthened on the back of increasing FX supply with accelerating inflow of foreign portfolio investments, firms' orientation towards FX loans, residents' partial reduction of their FX deposits and the partial return of FX and gold that had been out of the system before the elections. All in all, with the breakdown of the exchange rate depreciation expectations, the downward trend in the FX deposits (including FX protected deposits), has resumed, while gold imports are also falling. These indicate return of the de-dollarization in the economy. The CBT has been preventing the decline in exchange rates with its strong FX purchases reaching US$75bn until early June after the local elections, while net reserve position (excluding swaps) improved by a significant margin from -US$65bn at end-March to positive territory. The currency will likely remain supported in the period ahead, making a significant contribution to the slowdown in the inflation trend. There is a large potential of inflows with improving risk premium that is supporting foreign investors' appetite and leading to a recovery in stock of portfolio investments from very low levels in addition to feeding into locals' desire for external borrowing with tightening spreads. While increasing upside pressure on the currency further given significantly high ex-ante real policy currently, the flow outlook can add to the CBT's challenges going forward.

Fixed Income strategy

While the CBT thinks that services inflation is sticky and the domestic economy remains resilient as of May, it has remained sensitive to the inflation outlook, emphasising that it is highly attentive to inflation risks. Accordingly, the bank retains a strong tightening bias and seems to be ready to hike further. Based on May inflation at 75.4%, the ex-post real policy rate remains negative, while the ex-ante real policy rate is around 18% (vs 12M inflation expectations at 31.8%). Despite the improvement in the macro-financial outlook, Treasury borrowing rates remain quite high given the monetary tightening and the easing of bank obligations to purchase government securities. On the supply side, there are increasing efforts to control the budget deficit, while MinFin's Mehmet Şimşek signalled a likely increase in Treasury borrowing beyond its needs to help the CBT in sterilisation of the liquidity. The domestic debt rollover rate stood at 142.5% in May, while it is 104.4% on a year-to-date basis due to very low borrowing at 56.9% despite heavy redemptions in April. Foreign flows to bonds have been continuously positive since the last week of March, exceeding US$9bn on a cumulative basis, while domestic banks' offshore FX swaps have picked up in this period by more than US$16bn, though the second half of May showed some moderation. Given this backdrop, the share of foreign investors in the domestic debt stock is on the rise from around 2% in March to high single digits in May. It seems borrowing rates have reached a peak recently, while foreign appetite remains key for the evolution of bond yields ahead.

Turkey

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	4.9	6.1	3.3	7.5	3.0	0.8	1.9	11.4	5.5	4.5	2.7	3.5	4.0
Private consumption (%YoY)	3.1	5.3	3.8	5.9	0.7	1.5	3.2	15.4	18.9	12.8	3.7	3.5	3.7
Government consumption (%YoY)	3.1	3.9	9.5	5.0	5.9	3.9	2.2	3.0	4.2	5.2	2.1	3.0	1.4
Investment (%YoY)	4.9	9.3	2.2	8.3	0.1	-12.5	7.3	7.2	1.3	8.9	0.7	1.3	3.1
Industrial production (%YoY)	5.7	5.8	3.4	9.0	1.3	-0.5	1.6	17.5	5.7	0.9	2.8	3.3	3.7
Unemployment rate (year-end, %)	9.9	10.3	10.9	10.9	10.9	13.7	13.1	12.0	10.5	9.4	9.9	10.9	10.7
Nominal GDP (TRYbn)	2,055	2,351	2,627	3,134	3,761	4,318	5,049	7,256	15,012	26,276	43,475	57,593	70,802
Nominal GDP (€bn)	681	707	779	763	664	677	623	671	849	1,004	1,199	1,272	1,362
Nominal GDP (US$bn)	937	856	867	861	775	761	712	788	900	1,085	1,307	1,400	1,498
GDP per capita (US$)	12,178	11,085	10,964	10,696	9,792	9,213	8,536	9,369	10,589	12,712	15,226	16,125	19,612
Gross domestic saving (% of GDP)	24.9	25.2	26.0	26.0	26.8	25.8	26.4	30.5	30.0	26.9	30.1	31.1	30.4
Prices													
CPI (average, %YoY)	8.9	7.7	7.8	11.1	16.3	15.2	12.3	19.6	72.3	53.9	56.9	27.8	20.0
CPI (year-end, %YoY)	8.2	8.8	8.5	11.9	20.3	11.8	14.6	36.1	64.3	64.8	41.8	23.8	17.5
Wage rates (nominal, %YoY)	15.6	18.3	20.7	13.4	15.9	18.3	6.8	39.7	88.2	130.4	63.8	31.2	22.4
Fiscal balance (% of GDP)													
Consolidated government balance	-1.1	-1.0	-1.1	-1.5	-1.9	-2.8	-3.4	-2.6	-0.9	-5.2	-5.5	-2.9	-2.4
Consolidated primary balance	1.3	1.3	0.8	0.3	0.0	-0.5	-0.8	-0.2	1.1	-2.7	-2.2	0.6	2.0
Total public debt	28.3	27.2	27.7	27.8	29.9	32.4	39.4	40.4	30.8	29.5	30.8	29.6	27.9
External balance													
Exports (US$bn)	173.3	154.9	152.6	169.2	178.9	182.2	168.4	224.7	253.4	250.8	268.9	286.6	300.7
Imports (US$bn)	239.9	203.9	192.6	227.8	219.7	199.0	206.3	254.0	343.0	337.7	337.0	354.4	366.0
Trade balance (US$bn)	-66.6	-49.0	-39.9	-58.6	-40.8	-16.8	-37.9	-29.3	-89.6	-86.9	-68.1	-67.8	-65.3
Trade balance (% of GDP)	-7.1	-5.7	-4.6	-6.8	-5.3	-2.2	-5.3	-3.7	-10.0	-8.0	-5.2	-4.8	-4.4
Current account balance (US$bn)	-38.8	-27.3	-26.8	-40.6	-20.7	6.8	-35.5	-7.2	-49.1	-45.0	-26.4	-24.0	-22.6
Current account balance (% of GDP)	-4.1	-3.2	-3.1	-4.7	-2.7	0.9	-5.0	-0.9	-5.5	-4.1	-2.0	-1.7	-1.5
Net FDI (US$bn)	13.3	19.3	13.9	11.1	13.0	9.3	7.8	13.3	13.7	10.6	10.5	13.3	16.0
Net FDI (% of GDP)	1.4	2.3	1.6	1.3	1.7	1.2	1.1	1.7	1.5	1.0	0.8	1.0	1.1
Current account balance plus FDI (% of GDP)	-2.7	-0.9	-1.5	-3.4	-1.0	2.1	-3.9	0.8	-3.9	-3.2	-1.2	-0.8	-0.4
Foreign exchange reserves ex gold (US$bn)	106.3	95.7	92.1	84.1	72.0	81.2	50.0	72.6	82.9	92.8	94.7	104.9	117.5
Import cover (months of merchandise imports)	5.3	5.6	5.7	4.4	3.9	4.9	2.9	3.4	2.9	3.3	3.4	3.6	3.9
Debt indicators													
Gross external debt (US$bn)	416.5	402.9	406.3	451.2	426.4	414.4	428.5	436.4	458.0	499.9	515.8	526.5	533.1
Gross external debt (% of GDP)	44	47	47	52	55	54	60	55	51	46	39	38	36
Gross external debt (% of exports)	240	260	266	267	238	227	254	194	181	199	192	184	177
Lending to corporates/households (% of GDP)	60.2	63.1	65.9	66.8	63.6	61.4	70.7	67.4	50.4	44.2	36.2	34.0	33.4
Interest & exchange rates													
Central bank key rate (year-end, %)	8.25	7.50	8.00	8.00	24.00	12.00	17.00	14.00	9.00	42.50	45.00	27.50	20.00
Broad money supply (average, %YoY)	11.9	17.1	18.3	15.7	19.1	26.1	36.0	53.6	60.7	66.5	66.5	33.5	23.9
3m interest rate (TRLibor, average, %)	8.6	9.9	8.9	11.6	19.1	18.8	11.0	18.0	15.7	20.5	46.3	34.6	20.6
3m interest rate spread over US$-Libor(ppt)	837	960	812	1,029	1,671	1,684	1,071	1,794	1,225	1,523	4,109	3,056	1,655
2yr yield (average, %)	9.2	9.8	9.7	11.8	18.9	17.2	11.9	18.5	19.2	21.1	42.4	30.6	22.6
10yr yield (average, %)	9.3	9.4	10.1	11.0	15.8	15.5	12.7	18.2	17.6	18.4	26.2	19.2	16.3
USD/TRY exchange rate (year-end)	2.32	2.92	3.53	3.79	5.29	5.95	7.43	13.32	18.69	29.48	37.00	44.00	50.00
USD/TRY exchange rate (average)	2.19	2.75	3.03	3.64	4.85	5.67	7.09	9.20	16.68	24.22	33.26	41.15	47.25
EUR/TRY exchange rate (year-end)	2.81	3.17	3.70	4.55	6.05	6.67	9.08	15.14	20.00	32.54	40.70	48.40	55.00
EUR/TRY exchange rate (average)	3.02	3.33	3.37	4.11	5.66	6.37	8.11	10.81	17.68	26.17	36.26	45.26	51.98
Brent oil price (annual average, US$/bbl)	99.35	52.08	43.31	54.13	71.17	64.72	41.80	71.25	99.25	82.25	85.50	80.25	75.00

Source: National sources, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	3.9	6.1	4.0	5.7	3.1	1.9	0.8	0.9	3.1	4.4	5.2	4.3	4.2
CPI (eop, %YoY)	38.2	61.5	64.8	68.5	72.2	46.1	41.8	31.8	27.2	25.1	23.8	22.1	20.1
Central bank key rate (eop, %)	15.00	30.00	42.50	50.00	50.00	50.00	45.00	37.50	32.50	30.00	27.50	25.00	22.50
3m interest rate (eop, %)	12.58	22.82	38.61	50.58	48.50	47.32	42.19	38.58	34.11	30.94	28.60	25.45	22.95
10yr yield (eop, %)	16.79	27.15	25.06	26.82	27.94	25.70	22.17	20.41	19.75	18.45	17.15	16.76	16.41
USD/TRY exchange rate (eop)	26.05	27.37	29.48	32.35	32.55	34.06	37.00	39.17	41.03	42.63	44.00	45.50	47.00
EUR/TRY exchange rate (eop)	28.43	28.95	32.54	34.92	35.15	37.46	40.70	43.09	45.14	46.89	48.40	50.05	51.70

Source: National sources, ING estimates

Ukraine

Leszek Kąsek, Senior Economist, Poland

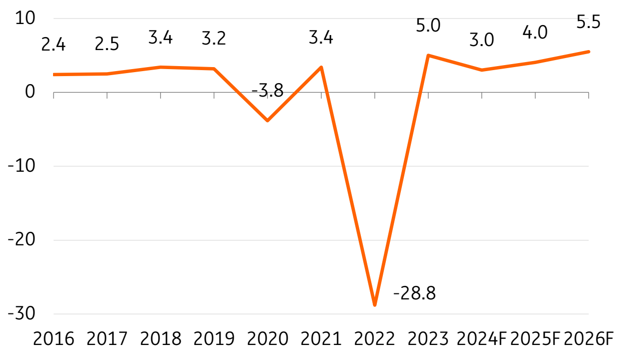
Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	3.1	3.5	1.5	3.7	2.5	3.0	4.0
CPI (%YoY)*	3.2	3.3	5.0	7.0	9.0	4.6	7.1
Policy interest rate (eop, %)	14.5	13.0	13.0	14.0	15.0	14.0	12.0
USD/UAH*	39.2	40.5	41.0	41.5	41.7	40.6	42.0
EUR/UAH*	42.4	43.7	45.1	45.7	45.9	45.8	46.2

Macro trend		Political cycle	Ratings	FC	LC
Activity	–	General elections	S&P	CC	CCC+
Fiscal	Neutral	postponed until the end	Moody's	Ca	Ca
Monetary	Neutral	of martial law	Fitch	CC	CCC-

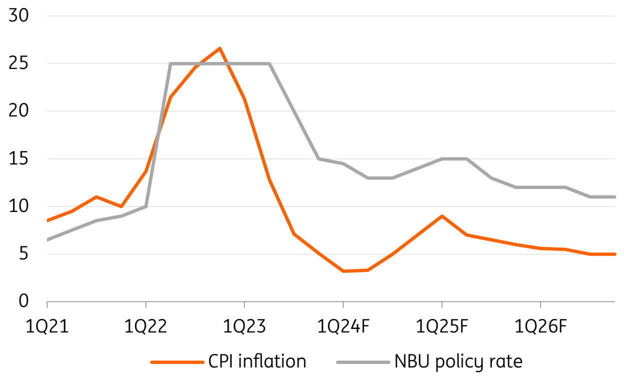
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

GDP growth (%)



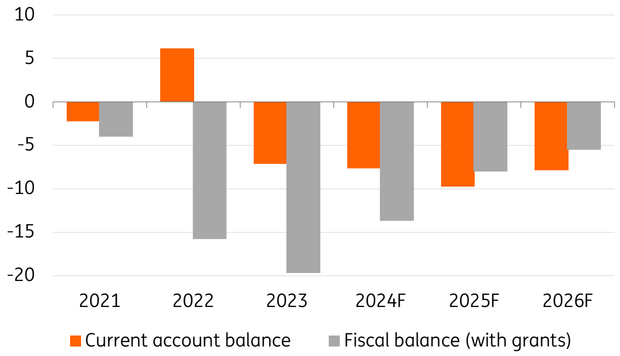
Source: NSI, ING

Inflation and NBU policy rate (%)



Source: NBU, ING

Fiscal and external current account balance (% of GDP)



Source: NBU, IMF, ING

Country strategy: Hryvnia remains at risk

The hryvnia has been hit hard in recent weeks, reflecting both unfavourable EM global sentiment, as well as persistent woes caused by Russian hostility and the gradual relaxation of the NBU policy (50bp rate cut in June). We expect the global factors to prove temporary, as a huge trimming of carry trade positions has already happened. Local woes are likely to continue though. The persistent current account deficit still calls for medium- and long-term depreciation of the hryvnia. The NBU increased FX interventions in May, but this was insufficient to shore up the currency given both the global sentiment and NBU June policy easing. The central bank is less focused on defending the hryvnia since CPI slowed to just above 3% YoY (from over 25% in late-2022).

Wartime economy is growing but losses are huge

The Russian war in Ukraine continues and the prospect of it ending in the near future remains low. Around 18% of Ukraine's territory is currently occupied, half of this (Crimea) already annexed in 2014, and over six million Ukrainians remain refugees abroad. As of end-2023, the total costs of reconstruction and recovery in Ukraine was estimated at US$486bn over the next decade, up from US$411bn a year before.

In 2023, the economy grew by 5% after a severe 29% decline in 2022. It is operating on a wartime footing with half of the budget spent on defence. Growth is expected to slow to 3% this year due to energy and trade disruptions and uncertainty on the timing and quantity of external aid, and to recover gradually over the following two years.

Sharp disinflation enabled NBU rate cut but to go up again

As the FX market and financial sector remained broadly stable during the war, the reversal of the global supply chain, energy and food price shocks led to sharp disinflation in 2023 and in the first half of this year. CPI inflation fell from nearly 27%YoY in late-2022 to 5.1% in December 2023 and just 3.3% in May 2024. Food prices moderated significantly on the back of good harvests and lower global commodity prices. Sharp disinflation and favourable projections allowed the National Bank of Ukraine to cut its key policy rate from 25% in late-2022 to 15% in late-2023, and further to 13% in mid-June this year. However, as inflation is projected to pick up later in 2024, the NBU is expected to adjust rates and remain higher for some time, before resuming interest rate cuts in 2H25.

Access to foreign aid and its timing adds to uncertainty.

Ukraine has largely covered the huge fiscal and external imbalances caused by the war by foreign grants and loans, including from international institutions. Securing continued foreign aid has proven politically challenging in 2024 though. According to the NBU, foreign financial assistance will gradually decline from US$43bn in 2023, to US$38bn in 2024, and then US$25bn and US$12.6bn in 2025-26. In 2023, the fiscal balance including grants is estimated at nearly 20% of GDP. It is projected to moderate to about 14% of GDP in 2024 and decline further in the medium term. The external current account deficit is set to widen to around 8% of GDP in 2024 from 7% of GDP in 2023, and is expected to remain large in subsequent years as domestic demand translates into higher imports.

Ukraine

leszek.kasek@ing.pl

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	-6.6	-9.8	2.4	2.5	3.4	3.2	-3.8	3.4	-28.8	5.0	3.0	4.0	5.5
Private consumption (%YoY)	-8.3	-20.7	2.1	7.7	8.8	10.9	1.7	6.9	-28.8	5.0	3.1	5.0	6.1
Government consumption (%YoY)	1.1	1.7	-0.5	2.4	0.2	-13.6	-0.7	0.8	31.4	18.0	20.0	10.0	7.0
Investment (%YoY)	-24.0	-9.2	20.4	18.8	14.3	11.7	-21.3	9.1	-33.9	4.0	3.0	7.0	10.5
Industrial production (%YoY)	-10.1	`	2.8	0.4	3.0	-0.5	-4.0	3.5	-42.8	5.0	4.0	5.0	7.0
Unemployment rate (year-end, %)	10.6	9.5	9.7	9.9	9.3	8.5	9.0	9.8	24.5	19.1	14.5	13.5	12.0
Nominal GDP (UAHbn)	1,587	1,989	2,385	2,983	3,561	3,975	4,090	4,742	4,205	5,028	5,519	6,252	7,060
Nominal GDP (€bn)	101	82	84	99	111	137	133	147	123	127	121	135	150
Nominal GDP (US$bn)	133	91	93	112	131	154	152	174	130	137	131	149	165
GDP per capita (US$)	3,100	2,117	2,200	2,600	3,050	3,600	3,400	4,200	3,700	3,900	4,500	5,100	5,100
Gross national saving (% of GDP)	9.9	13.3	14.8	12.3	15.3	12.2	12.2	12.8	17.6	10.8	12.0	11.3	12.5
Prices													
CPI (average, %YoY)	12.1	48.5	14.9	14.5	11.0	7.9	3.0	9.8	21.6	11.6	4.6	7.1	5.5
CPI (year-end, %YoY)	24.9	43.3	12.4	13.7	9.8	4.1	5.0	10.0	26.6	5.1	7.0	6.0	5.0
Wage rates (nominal, %YoY)	6.1	21.1	23.3	37.0	24.8	18.4	10.4	20.9	5.9	17.5	15.0	13.0	11.0
Fiscal balance (% of GDP)													
Consolidated government balance	-4.5	-1.6	-2.3	-1.4	-2.0	-2.2	-5.9	-4.0	-15.8	-19.7	-13.7	-8.0	-5.5
Consolidated primary balance	-1.5	2.8	1.9	2.4	1.2	1.0	-3.0	-1.1	-12.6	-15.8	-8.2	-2.8	-2.4
Total public debt	69.4	79.0	80.9	71.8	60.9	50.2	60.4	48.9	78.5	82.9	94.1	96.9	97.3
External balance													
Exports (US$bn)	50.6	35.4	33.6	39.7	43.3	46.1	45.1	63.1	40.9	34.7	40.0	42.0	46.2
Imports ((US$bn)	57.7	38.9	40.5	49.4	56.1	60.4	52.0	69.8	55.6	65.0	68.9	75.1	82.6
Trade balance (US$bn)	-7.1	-3.5	-6.9	-9.7	-12.7	-14.3	-6.9	-6.7	-14.7	-30.3	-28.9	-33.1	-36.4
Trade balance (% of GDP)	-5.4	-3.8	-7.4	-8.6	-9.7	-9.3	-4.5	-3.9	-11.3	-22.0	-22.0	-22.2	-22.0
Current account balance (US$bn)	-0.3	0.4	-3.8	-3.7	-4.5	-4.1	5.3	-3.9	8.0	-9.8	-10.4	-14.5	-13.0
Current account balance (% of GDP)	-0.2	0.4	-4.1	-3.3	-3.4	-2.7	3.5	-2.2	6.2	-7.1	-7.9	-9.7	-7.9
Net FDI (US$bn)	0.3	3.0	3.3	3.6	4.4	-5.2	0.1	6.6	0.1	2.6	1.6	3.5	5.0
Net FDI (% of GDP)	0.2	3.3	3.5	3.2	3.4	-3.4	0.1	3.8	0.1	1.9	1.2	2.4	3.0
Current account balance plus FDI (% of GDP)	0.0	3.7	-0.5	-0.1	0.0	-6.0	3.6	1.6	6.2	-5.2	-6.7	-7.4	-4.8
Foreign exchange reserves (US$bn)	10.0	13.2	15.3	18.9	17.7	25.3	29.1	30.9	28.5	40.5	43.0	44.5	40.0
Import cover (months of merchandise imports)	2.1	4.1	4.5	4.6	3.8	5.0	6.7	5.3	6.2	7.5	7.5	7.1	5.8
Debt indicators													
Gross external debt (US$bn)	125.3	117.7	112.5	115.5	114.7	121.7	125.7	117.3	113.4	127.2	128.2	135.5	142.0
Gross external debt (% of GDP)	94.1	129.5	120.6	103.0	87.7	79.0	82.9	67.5	87.5	92.5	97.6	91.0	85.9
Gross external debt (% of exports)	247.9	332.3	335.2	290.9	264.6	264.0	278.4	185.9	277.3	366.6	320.5	322.5	307.3
Lending to corporates/households (% of GDP)	62.4	48.4	41.3	33.7	29.8	24.5	23.1	21.6	23.6	18.2	18.2	20.1	21.1
Interest & exchange rates													
Central bank key rate (year-end, %)	14.0	22.0	14.0	14.5	18.0	13.5	6.0	9.0	25.0	15.0	14.0	12.0	11.0
Broad money supply (average, %YoY)	5.3	3.9	10.9	9.6	5.7	12.6	28.6	12.0	20.8	23.0	13.0	10.0	10.0
2yr yield (average, %)	17.9	18.9	19.4	15.7	17.8	17.2	13.0	12.5	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UAH exchange rate (year-end)	15.8	24.0	27.2	28.1	27.7	23.7	28.3	27.3	36.6	38.0	41.5	42.0	43.0
USD/UAH exchange rate (average)	11.9	21.9	25.6	26.6	27.2	25.8	27.0	27.3	32.4	36.6	40.6	42.0	42.7
EUR/UAH exchange rate (year-end)	19.2	26.2	28.4	33.5	31.7	26.4	34.7	30.9	39.0	42.2	45.7	46.2	47.3
EUR/UAH exchange rate (average)	15.7	24.3	28.3	30.0	32.1	28.9	30.8	32.3	34.1	39.5	45.8	46.2	47.0

Source: National sources, IMF, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	19.2	9.6	4.7	3.1	3.5	1.5	3.7	2.5	4.0	5.0	5.5	5.0	5.4
CPI (eop, %YoY)	12.8	7.1	5.1	3.2	3.3	5.0	7.0	9.0	7.0	6.5	6.0	5.6	5.5
Central bank key rate (eop, %)	25.0	20.0	15.0	14.5	13.0	13.0	14.0	15.0	15.0	13.0	12.0	12.0	12.0
USD/UAH exchange rate (eop)	36.6	36.6	38.0	39.2	40.5	41.0	41.5	41.7	42.0	42.0	42.3	42.5	42.6
EUR/UAH exchange rate (eop)	40.0	38.6	42.2	42.4	43.7	45.1	45.7	45.9	46.2	46.2	46.5	46.8	46.9

Source: NBU, Ukrstat, Macrobond, ING estimates

Uzbekistan

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2024F	2025F
Real GDP (%YoY)	6.2	5.5	5.7	4.5	4.0	5.5	5.7
CPI (%YoY)*	8.0	11.3	11.7	12.0	12.6	10.5	9.6
Policy interest rate (eop, %)	14.00	14.00	14.00	14.00	14.00	14.00	13.00
USD/UZS*	12,615	12,640	12,740	12,840	12,936	12,593	13,033
EUR/UZS*	13,611	13,651	14,014	14,124	14,230	13,727	14,336

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2030	S&P	BB-	BB-
Fiscal	Easing	Parliamentary: 2025	Moody's	Ba3	Ba3
Monetary	Neutral	Local: n/a	Fitch	BB-	BB-

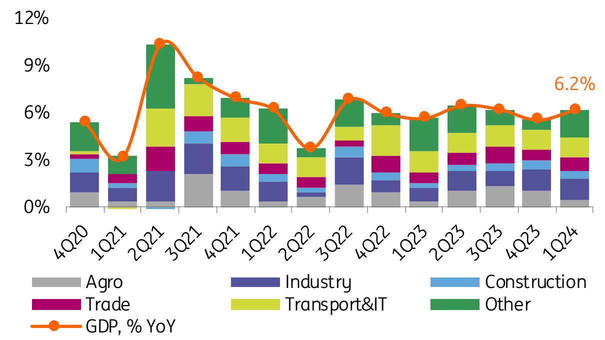
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

Country strategy: Shifting foreign trade flows in focus

Economic activity in Uzbekistan appears well supported, especially on the corporate side, aided by the country's widening foreign relations and by a more generous domestic fiscal policy focusing on corporate capex and social support. Room for monetary easing compared to CIS peers is limited this year, following the household utilities tariff-induced spike in CPI.

Some stabilisation in the foreign trade deficit has become evident in 2024 – thanks to wider export geography – and this should be seen as a watch factor for the FX market. All else being equal this should reduce the pace of UZS depreciation in coming years. The financial flow picture is also important, as increasing public foreign debt has been the only reliable source of capital inflows to date.

GDP growth by sectors

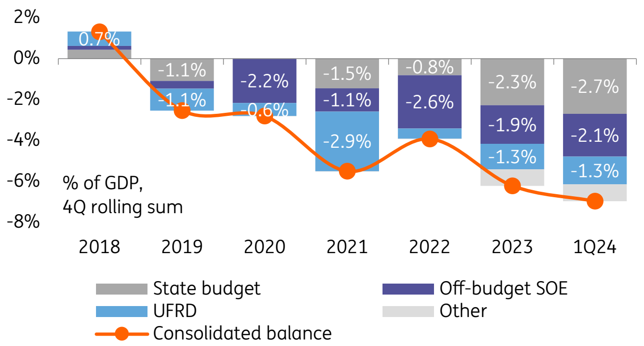


Source: National sources, CEIC, ING

Activity: Favouring corporate activity

Uzbekistan's economy continues to post high growth rates amid ongoing reforms and expanding economic cooperation in the region, including with China, Turkey and post-Soviet countries. 1Q24 GDP growth reached 6.2% YoY with a diversified base, and we expect 5%+ growth rates to persist in the coming years. Consumption growth may face a hiccup in 2024 due to the recent spike in the household utilities tariff that has already led to a spike in CPI, from 8.8% YoY in December 2023 to 10.6% YoY in May 2024. YE CPI is expected to be 10-12% YoY. This should temporarily hamper real income growth and prevent the NBU from proceeding with the easing cycle from the current key rate of 14.00% any time soon. The fiscal policy stance appears supportive for growth.

Consolidated budget balance by components (% GDP)

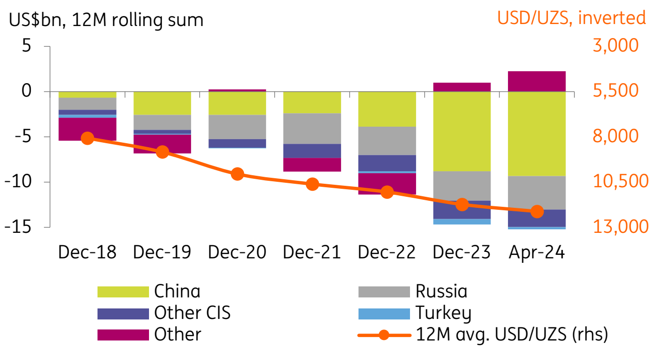


Source: National sources, CEIC, ING

Fiscal policy: Ongoing generosity

In 2023, Uzbekistan's consolidated budget deficit widened significantly to 6.2% of GDP, exceeding our expectations and confirming the temporary nature of the 2022 narrowing. Expenditures, having increased materially in 2022 to 36.4% of GDP, are proving to be sticky and reflect the high share of social support and off-budget investments involved. The higher income support allocated to households amid the utilities tariff hike and continued investment programmes suggests that a material fall in spending is unlikely in the near-term. Without a similar dynamic on the revenue side, the overall deficit is likely to remain elevated in coming years. This will need to be financed by state savings in UFRD and by higher public debt, potentially expanding the creditor base.

Balance of goods and services trade by geography (US$bn)



Source: National sources, CEIC, ING

External balance: Stabilisation not excluded

Recent balance of payments developments reflect both the country's domestic capex agenda and growing foreign trade relations in the post-Soviet region. Preliminary data for 4M24 shows a continued widening trade deficit with China due to machinery imports, but recently offset by higher exports to smaller trade partners (and a stable direct trade deficit with Russia). As a result, the overall merchandise and services deficit has stopped widening, which may be a positive sign for UZS, especially if accompanied by more active capital inflows from the public and private sectors. We expect UZS depreciation vs USD to slow from 9% in 2023 to 2-4% pa in 2024-26.

Uzbekistan

dmitry.dolgin@ing.de

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	6.9	7.2	5.9	4.4	5.5	6.0	2.0	7.4	5.7	6.0	5.5	5.7	5.5
Private consumption (%YoY)	8.7	11.9	8.3	4.2	7.0	5.6	0.3	11.7	11.1	6.1	6.0	6.0	5.5
Government consumption (%YoY)	8.4	6.7	2.7	1.5	4.8	5.7	1.4	3.1	3.5	1.4	3.0	2.0	3.0
Gross capital formation (%YoY)	9.8	9.4	4.1	19.4	29.9	38.1	-4.4	2.9	0.2	22.1	7.0	8.0	7.0
Industrial production (%YoY)	4.5	5.3	5.4	5.2	10.8	6.6	0.7	8.8	5.2	6.0	5.0	5.5	5.0
Unemployment rate (average, %)	5.2	5.2	5.2	5.4	9.3	9.1	11.1	9.8	8.9	8.4	8.0	7.5	7.3
Nominal GDP (UZStn)	187	221	255	317	427	533	606	738	897	1,067	1,243	1,440	1,633
Nominal GDP (€bn)	60.9	77.6	77.9	54.1	44.6	53.8	52.7	58.8	77.1	84.0	90.6	100.4	111.1
Nominal GDP (US$bn)	80.9	86.2	86.2	61.9	52.5	60.1	60.2	69.6	81.2	90.9	98.7	110.5	122.3
GDP per capita (US$)	2,628	2,754	2,705	1,917	1,604	1,795	1,759	1,993	2,276	2,496	2,638	2,898	3,149
Gross domestic saving (% of GDP)	23.4	21.5	19.6	23.2	24.6	24.3	25.0	23.6	21.3	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	9.3	8.8	8.1	13.9	17.5	14.5	12.9	10.8	11.4	10.0	10.5	9.6	7.5
CPI (year-end, %YoY)	10.4	7.6	9.8	18.8	14.3	15.2	11.2	10.0	12.3	8.8	12.0	7.8	7.0
Wage rates (nominal, %YoY)	n/a	n/a	n/a	n/a	25.0	27.5	15.0	20.3	20.8	17.2	19.5	15.6	13.5
Fiscal balance (% of GDP)													
Consolidated government balance	1.9	-0.3	0.7	1.2	1.3	-2.5	-2.8	-5.5	-3.9	-6.2	-6.6	-5.8	-5.1
Consolidated primary balance	1.9	-0.3	0.7	1.3	1.4	-2.2	-2.3	-4.8	-3.2	-5.5	-5.9	-5.0	-4.3
Total public debt	6.1	10.0	8.2	19.4	19.4	28.3	37.1	35.3	33.9	36.3	38.5	40.5	42.2
External balance													
Exports (US$bn)	10.6	9.5	8.6	10.2	11.4	13.9	12.8	14.1	17.1	19.4	22.7	24.3	25.5
Imports (US$bn)	13.5	11.6	11.0	12.4	18.3	21.2	19.0	22.9	28.3	34.5	36.9	38.0	38.4
Trade balance (US$bn)	-3.0	-2.1	-2.4	-2.2	-6.9	-7.3	-6.2	-8.8	-11.2	-15.1	-14.2	-13.7	-12.8
Trade balance (% of GDP)	-3.7	-2.4	-2.8	-3.6	-13.0	-12.1	-10.3	-12.6	-13.8	-16.6	-14.4	-12.4	-10.5
Current account balance (US$bn)	2.1	0.9	0.2	1.5	-3.6	-3.4	-3.0	-4.9	-0.6	-7.8	-6.2	-5.7	-4.8
Current account balance (% of GDP)	2.6	1.0	0.2	2.4	-6.8	-5.6	-5.0	-7.0	-0.8	-8.6	-6.2	-5.1	-4.0
Net FDI (US$bn)	0.8	1.0	1.7	1.8	0.6	2.3	1.7	2.3	2.6	2.2	2.4	2.6	2.9
Net FDI (% of GDP)	1.0	1.2	1.9	2.9	1.2	3.8	2.9	3.3	3.2	2.4	2.4	2.4	2.4
Current account balance plus FDI (% of GDP)	3.6	2.2	2.2	5.3	-5.6	-1.8	-2.2	-3.8	2.4	-6.2	-3.8	-2.8	-1.6
Foreign exchange reserves ex gold (US$bn)	24.1	24.3	26.4	28.1	27.1	29.2	34.9	35.1	35.8	34.6	34.1	34.6	35.1
Import cover (months of merchandise imports)	21.4	25.2	28.7	27.2	17.8	16.5	22.0	18.4	15.2	12.0	11.1	10.9	11.0
Debt indicators													
Gross external debt (US$bn)	11.6	13.4	14.6	15.6	17.1	24.3	33.3	43.4	51.9	61.0	68.0	73.0	78.0
Gross external debt (% of GDP)	14.3	15.6	17.0	25.1	32.3	40.3	55.3	62.4	64.0	67.1	68.8	66.0	63.8
Gross external debt (% of exports)	109.9	141.3	169.2	153.3	150.0	174.6	259.7	307.2	303.5	313.9	299.1	300.1	305.4
Lending to corporates/households (% of GDP)	n/a	n/a	20.6	34.8	39.2	38.9	45.2	43.7	43.0	42.7	43.1	43.9	44.7
Interest & exchange rates													
Central bank key rate (year-end, %)	10.00	9.00	9.00	14.00	16.00	16.00	14.00	14.00	15.00	14.00	14.00	13.00	12.00
Broad money supply (average, %YoY)	15.7	24.3	23.5	40.2	14.1	13.9	17.7	29.7	30.2	12.2	17.5	13.5	12.5
3m interest rate (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
3m interest rate spread over US$-Euribor (ppt)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UZS exchange rate (year-end)	2,422	2,791	3,225	8,120	8,404	9,506	10,466	10,818	11,229	12,346	12,840	13,225	13,490
USD/UZS exchange rate (average)	2,310	2,569	2,965	5,126	8,133	8,861	10,055	10,614	11,046	11,733	12,593	13,033	13,358
EUR/UZS exchange rate (year-end)	2,931	3,030	3,393	9,745	9,563	10,657	12,787	12,303	12,022	13,648	14,124	14,548	14,839
EUR/UZS exchange rate (average)	3,066	2,851	3,280	5,869	9,573	9,895	11,493	12,548	11,627	12,693	13,727	14,336	14,693
Brent oil price (annual average, US$/bbl)	99	54	45	55	72	64	43	71	99	82	85	80	75

Source: National sources, CEIC, ING estimates

Quarterly forecasts

	2Q23	3Q23	4Q23	1Q24	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F
Real GDP (%YoY)	6.5	6.2	5.6	6.2	5.5	5.7	4.5	4.0	5.5	6.5	6.7	6.5	6.0
CPI (eop, %YoY)	9.0	9.2	8.8	8.0	11.3	11.7	12.0	12.6	8.6	7.8	7.8	7.9	7.5
Central bank key rate (eop, %)	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	13.50	13.00	12.75	12.50
3m interest rate (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UZS exchange rate (eop)	11,490	12,184	12,346	12,615	12,640	12,740	12,840	12,936	13,033	13,129	13,225	13,292	13,358
EUR/UZS exchange rate (eop)	12,540	12,897	13,648	13,611	13,651	14,014	14,124	14,230	14,336	14,442	14,548	14,621	14,693

Source: National sources, CEIC, ING estimates

Disclaimer