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Directional Economics: CEEMEA in 2024

7 December 2023

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Summary

Same path, different journeys. 2024 should be the year in which many economies in Central and Eastern Europe, and Central Asia attempt to normalise their economies – be that through a return to growth, lower interest rates and/or better fiscal positions. The journey to that destination, however, will look very different depending on the government and central bankers in charge.

When it comes to growth, most of the region, except Turkey, should witness higher growth rates next year. The aggressive rate hiking cycles that many in the region undertook starting in 2021 have served their purpose in turning the tide on inflation. Lower inflation will deliver some welcome real wage growth and private consumption will be a crucial driver of activity across the region next year.

The degree to which lower inflation will allow monetary easing to support growth will look very different across the region. Disinflation seems most advanced in the Czech Republic, allowing a 300-400bp easing cycle. We forecast a similar magnitude of rate cuts in Hungary, though from a much higher level. Romania has been struggling with stickier inflation but may still cut rates by 150bp. Poland is the outlier here, where the central bank may well keep rates at 5.75% given the highest upside risk for GDP in the region and the structural opportunities that the new ruling camp may utilise to speed up the economy. Also, Poland has already surprised with 100bp of recent easing.

Part of the differentiation in monetary policy may well be driven by the fiscal position. The Czech Republic stands out here in its plans for fiscal consolidation, while both Poland and Romania look set to keep fiscal policy loose – good for short-term growth, bad for inflation. Nonetheless, 2024 growth rates in CEE4 are all expected in the 1.4-3.0% region – substantially better than the 0.3% our team are forecasting for Eurozone growth.

Expect politics to remain very much in focus too. Both Poland and Hungary will be keen to secure funds from the EU next year – with Hungary's need more pressing. We take an optimistic view on the release of funds here, but will be keeping a close watch on the headlines. European parliamentary elections in June will also be very much in focus – with the outcome having some important implications for foreign aid to Ukraine. Romania has a presidential election next year and we see local elections in Turkey too.

Talking of Turkey, policymakers have been impressing by their return to policy orthodoxy. A continuation of this policy – including restrictive monetary policy for the majority of 2024 – could well see a turn in the inflation profile by year end. This could see the continued re-assessment of Turkish asset markets by foreign investors.

Elsewhere, we highlight Bulgaria's continued pursuit of euro entry in 2025, we evaluate Croatia's year in the eurozone and also extend our coverage across the CIS space.

In terms of our feature articles, we take a fascinating look into the theme of 'Carbon and Commodities' across the region. Poland and the Czech Republic are spending as much as 1% of GDP in securing carbon emission allowances – an expenditure that is hitting their external accounts. And Hungary, Romania and Turkey remain very exposed to natural gas prices. We conclude it has never been a better and more urgent time to scale up investments in energy transition.

As always, this Directional Economics showcases ING's global reach with our local team of experts in the CEE region. Please reach out to them with any questions.

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

Country summaries: CEE4

Czech Republic

The Czech economy has been on the verge of recession all year and any recovery next year will be fragile. Elsewhere, however, the picture is more optimistic. The labour market remains strong and wage growth should gradually slow. Inflation has fallen significantly this year and should be near the inflation target early next year, the first country in the CEE region to achieve this. Fiscal policy continues to consolidate and we expect to see a significant reduction in the government deficit over the next two years. Despite the tempting inflation profile, the central bank wants to stay on the safe side for as long as possible and to delay the start of the cutting cycle. However, a first rate cut looks inevitable despite the high level of uncertainty and we expect this move in February. The CZK is expected to weaken over the remainder of 2023 and in the first quarter of 2024. We expect it to strengthen again later.

Hungary

The good news is that Hungary has put the worst behind it and is on the road to recovery. The bad news is that we expect this road to be bumpy, as our GDP growth forecast of 3% in 2024 is based on the following positive assumptions: We see an agreement with the EU before the end of 2023, a potential boost to investment next year. While we see the positive real wage growth supporting the gradual improvement in consumption in 2024, we expect Hungary to avoid a strong reflation, although the risk is clearly there. New export capacities should help maintain a balanced growth structure, leading to a wider current account surplus. The inflow of EU funds will relieve a heavy burden on the budget, which can continue to consolidate. Improving external and internal balances, reduced financing needs and the highest positive real interest rates in the region lead us to be constructive on Hungarian assets next year.

Poland

The October general elections brought a fundamental shift for both the economy and financial markets. For years foreign investors have avoided Polish bonds and equity. We see few 'low hanging fruit' that the new government can utilise to restore a stronger, more balanced growth. The main aim is to unlock private investment and facilitate inflows of foreign capital, both FDI and portfolio. In tandem with EU money inflows, this is particularly positive for the zloty, possibly pushing €/PLN to lower levels. Main risks for POLGBs include record 2024 borrowing needs (7.5% of GDP), but MinFin has multiple funding options to avoid yield spikes (abundant local savings, FCL, cash buffer). The MPC has shifted to a neutral bias and should hold rates flat until end-2024. We see short end pricing easing too much, tighter asset swaps across the curve and stable long yields, particularly given the attractive 300bp spread over Bunds.

Romania

While visibly slowing, the economy remains in the expansion zone on increased infrastructure investments boosted by reasonably good EU funds absorption. On the downside, the fiscal consolidation story is a bit derailed, as the country will not get even close to the -3.0% of GDP budget deficit target over the next couple of years. The government has already increased the tax burden on the private sector in a context of weaker economic activity – and most likely this is just a preview of a bigger fiscal reform coming next year after elections. All in all, we think that the deficit reduction pace will test to the maximum the EU's tolerance level and the provisions of the Excessive Deficit Procedure, but that the country will eventually deliver the bare minimum needed to keep EU funds flowing.

Country summaries: Other Central & Eastern Europe

Bulgaria

After a long period of political instability, which delayed reforms and EU Funds absorption, the country has been improving the pace of its reforms under what it looks like a broad political willingness to join the eurozone in 2025. While the amendment to the central bank law is still due, the bills passed in recent months are currently paving the way for the common currency goal. Though admittedly starting from a low base, the country's progress has been notable, to say the least – the World Justice Project shows that Bulgaria topped the EU rankings in rule of law progress in 2023, recording growth in all areas except regulatory enforcement. This also bodes well for the country's bid to join the Schengen area and provides further political stability support.

Croatia

Growth remained robust in 1H23, which is likely to continue in the quarters ahead, supported by EU-funded investments, domestic demand and the positive momentum from the country's Schengen and eurozone ascension. What's more, quasi-balanced budgets could push the public debt ratio below the dreaded 60% of GDP over the next couple of years and bring a rating upgrade. That said, in the short term, merchandise trade could be a drag on activity as demand from key trading partners is likely to deteriorate more than most expect and the recently imposed border controls due to illegal migration issues brings new trade frictions. While not in sight yet, a flattening of tourism revenues could be envisaged for 2024 as the country's repositioning as a more premium destination overlaps an at best sluggish consumer demand abroad.

Serbia

While annual growth has regained pace, political and social stability has been less rosy in the second half of 2023 so far. Key risk factors include any further complications in relations with Kosovo and snap elections due on 17 December amid internal discontent and EU demands. The country's commitment to EU sanctions on Russia is still in question. All in all, the path towards EU integration is currently somewhat rocky. On the other hand, the country's finances have been better than expected and the 2023 fiscal deficit projection has been revised from -3.3% to -2.8% of GDP. In 2024, the government expects a further reduction to -2.2% and plans to allocate 6.8% of GDP to capital investments, primarily infrastructure. Together with recent historic highs for FDI inflows, this bodes well for GDP and positive feedback loops ahead.

Turkey

Since the elections there has been a shift to more orthodoxy with: (1) strong rate hikes and quantitative tightening in monetary policy: the CBT's focus has shifted to anchoring inflation expectations and achieving disinflation, while signalling further tightening steps. In this environment deposit and lending rates have moved up, with quantitative and selective credit tightening moves reinforcing rate hikes and supporting the plan to unwind the FX-protected deposit scheme. FX reserves have increased markedly since the presidential run-off; (2) efforts to reduce the budget deficit; and (3) moves to gradually unwind regulations that have contributed to a challenging operating environment for banks. We have seen a significant improvement in sentiment. Sustaining this momentum and further reducing risk premia will require ongoing efforts to move to full orthodoxy.

Country summaries: CIS

Armenia

Armenia is maintaining a solid economic growth rate in 2023, but the credit- and remittances-fuelled services boom is unlikely to persist, while the industrial output is already underperforming. Some support may come from the fiscal side, as expenditures are showing signs of acceleration, while social and military spending (50% of total) will have to remain elevated for the time being, given the external risks in the region and the need to accommodate the recent arrival of up to 120,000 refugees from Nagorno-Karabakh. Monetary policy may also ease, but the likely recovery of CPI from current near-zero to 4-5% in 2024 should limit the scope.

Following the rally, the dram is now vulnerable to depreciation risks due to normalisation of trade, services, remittances and capital flows amid persisting foreign policy risks.

Azerbaijan

Having regained control of the breakaway Nagorno-Karabakh, Azerbaijan is likely to use fiscal policy more actively to reignite the waning economic growth momentum. The non-fuel sectors are likely to be supported by expanding retail lending, higher state investments and still elevated military spending amid continued tensions with Armenia. The fuel sector is likely to benefit from closer gas ties with EU. Despite some narrowing of the fiscal and current account surpluses in the coming 2-3 years, Azerbaijan's financial position appears solid.

The main watch factor, including for AZ-EU trade, for the near term is the development of the Azeri-Armenian relationship, namely Azerbaijan's desire to have a land bridge to its exclave Nakhichevan over Armenian territory.

Kazakhstan

Despite some slowdown in 3Q23, Kazakhstan is on track to post c.4.5-5.0% GDP growth in 2023 provided there are no material disruptions in the oil sector, while the disinflation continues and allows further easing in the monetary policy. Meanwhile, the fiscal policy seems to be back in easing mode given the appetite for more social and investment spending. That should also support growth but might create inflationary risks if overdone.

Wider budget deficit amid the announced tightening in the fiscal rule means that less oil revenues can be used to finance current expenditures. All else being equal, it means a higher borrowing requirement and lower support to the tenge from the state capital flows, unless more non-residents participate in bond placements.

Ukraine

NBU policy since September has been a surprise. The bank has freed the hryvnia exchange rate but has increased the scale of interventions to drive US$/UAH lower. Half of this move lower has already corrected, but we expect further hryvnia losses. Ukraine maintains a significant current account deficit, and this is unlikely to end for some years. The NBU might continue to try to counter this via FX intervention but, despite foreign aid, FX reserves have been falling. Long-term prospects for the hryvnia are fundamentally negative. Russian aggression is unlikely to end any time soon. The damage to the Ukrainian economy will likely only intensify and we expect the NBU to allow some hryvnia weakening in the long run, but probably not before the conflict ends.

Uzbekistan

Uzbekistan is managing to sustain a high GDP growth rate with a high degree of diversification, however, on the financing side, this growth appears to be increasingly reliant on domestic credit and fiscal easing. Meanwhile, the room for monetary easing appears limited given the elevated CPI growth and expectations of higher inflation following the expected household tariff liberalisation in 2024.

The prospects for the soum remain an open question. From a balance of payments perspective, the current account is under pressure of growing imports from China, while private capital is in net outflow for the second year in a row. Meanwhile, being the worst performing CIS4 FX to date amid positive real rates and prospects of more state foreign borrowing, we do not exclude some relief in the depreciation pressure on UZS in the coming couple of quarters.

ING main macroeconomic and financial forecasts

Real GDP (% YoY)

	3Q23	4Q23F	1Q24F	2Q24F	2023F	2024F
Armenia	7.4	3.3	2.0	4.5	8.0	4.5
Azerbaijan	1.3	0.0	4.0	2.5	0.6	2.5
Bulgaria	1.7	1.8	2.2	2.5	1.9	2.9
Croatia	3.5	3.5	2.8	2.4	3.1	2.6
Czech Republic	-0.6	-0.1	0.4	1.0	-0.4	1.4
Hungary	-0.4	1.5	2.4	3.5	-0.6	3.0
Kazakhstan	3.7	4.5	3.5	3.0	4.7	4.0
Poland	0.5	2.0	2.2	3.4	0.4	3.0
Romania	0.2	0.9	2.8	1.9	1.5	2.8
Serbia	3.5	3.3	3.8	3.2	2.3	3.2
Turkey	5.9	3.1	4.4	3.0	4.2	2.5
Ukraine	7.5	4.0	3.5	3.5	4.5	3.5
Uzbekistan	6.1	8.0	7.0	5.7	6.3	5.5
Eurozone*	-0.3	-0.2	-0.1	0.6	0.5	0.3
US*	5.2	1.9	0.0	-2.1	2.5	0.5

*% QoQ annualised

Source: National sources, Bloomberg, ING estimates

Exchange rate (quarterly is eop, annual is avg)

	3Q23	4Q23F	1Q24F	2Q24F	2023F	2024F
USD/AMD	396	415	422	430	396	430
USD/AZN	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
EUR/HRK	-	-	-	-	-	
EUR/CZK	24.42	24.70	24.50	24.50	24.07	24.19
EUR/HUF	391.30	375.00	368.00	365.00	381.10	368.60
USD/KZT	478	460	460	460	455	463
EUR/PLN	4.64	4.36	4.33	4.25	4.54	4.25
EUR/RON	4.70	4.65	4.61	4.58	4.96	5.02
EUR/RSD	117.20	117.19	117.19	117.18	117.20	117.20
USD/TRY	27.37	30.00	33.31	35.52	24.29	35.35
USD/UAH	36.60	37.00	37.50	38.00	36.70	38.40
USD/UZS	12,184	12,352	12,507	12,661	11,791	12,661
EUR/USD	1.07	1.07	1.08	1.10	1.08	1.11

*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)

	3Q23	4Q23F	1Q24F	2Q24F	2023F	2024F
Armenia	0.1	1.2	2.8	5.8	2.3	4.3
Azerbaijan	5.1	2.8	6.6	3.3	9.1	5.0
Bulgaria	6.3	5.1	3.8	4.2	9.7	4.0
Croatia	6.7	5.0	4.3	2.9	8.1	3.1
Czech Republic	8.1	7.9	2.6	2.4	10.9	2.4
Hungary	12.2	6.1	4.1	5.3	17.8	5.1
Kazakhstan	11.8	9.8	8.9	8.6	14.8	8.4
Poland	8.2	6.8	4.9	5.0	11.6	5.8
Romania	8.1	7.4	7.4	6.2	10.7	6.0
Serbia	10.2	7.6	5.6	4.5	12.5	5.0
Turkey	61.5	66.9	67.1	71.4	54.1	56.7
Ukraine	7.1	5.5	6.0	8.0	11.7	8.1
Uzbekistan	8.8	8.7	8.2	11.6	9.7	10.4
Eurozone	5.0	3.7	3.1	3.0	5.9	2.8
US	3.6	3.2	2.8	2.5	4.1	2.2

Source: National sources, Bloomberg, ING estimates

Central Bank rate (%, eop)

	3Q23	4Q23F	1Q24F	2Q24F	2023F	2024F
Armenia	9.75	9.00	8.50	8.00	9.00	7.75
Azerbaijan	9.00	8.50	8.00	8.00	8.50	8.00
Bulgaria	3.53	3.60	3.60	3.55	3.60	3.50
Croatia	4.50	4.50	4.50	4.50	4.50	3.75
Czech Republic	7.00	7.00	6.25	5.00	7.00	4.00
Hungary	13.00	10.75	8.75	7.50	10.75	7.00
Kazakhstan	16.50	15.75	14.75	13.75	15.75	11.75
Poland	6.00	5.75	5.75	5.75	5.75	5.75
Romania	7.00	7.00	7.00	6.75	7.00	5.50
Serbia	6.50	6.50	6.50	5.75	6.50	5.50
Turkey	30.00	42.50	45.00	45.00	42.50	40.00
Ukraine	20.00	15.00	15.00	15.00	22.40	15.00
Uzbekistan	14.00	14.00	14.00	14.00	14.00	14.00
Eurozone	4.50	4.50	4.50	4.25	4.50	3.75
US	5.50	5.50	5.50	5.00	5.50	4.00

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

Source: Bloomberg, ING estimates

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

	3Q23	4Q23F	1Q24F	2Q24F	2023F	2024F
Armenia	10.2	n/a	n/a	n/a	n/a	n/a
Azerbaijan	n/a	n/a	n/a	n/a	n/a	n/a
Bulgaria	4.50	4.50	4.30	4.20	4.50	4.30
Croatia	4.00	3.80	3.80	3.90	3.80	3.90
Czech Republic	4.85	4.55	4.45	4.20	4.61	4.21
Hungary	7.37	6.80	6.60	6.50	7.66	6.62
Kazakhstan	n/a	n/a	n/a	n/a	n/a	n/a
Poland	5.91	5.40	5.60	5.65	5.95	5.73
Romania	7.15	7.00	7.10	7.00	6.90	6.70
Serbia	6.30	6.30	6.20	6.00	6.30	5.80
Turkey	27.15	28.34	27.78	26.69	18.92	26.89
Ukraine	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
Eurozone	2.84	2.50	2.40	2.30	2.30	2.40
US	4.57	4.50	4.25	4.00	3.81	3.75

Source: National sources, Bloomberg, ING estimates

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

	3Q23	4Q23F	1Q24F	2Q24F	2023F	2024F
Armenia	10.40	n/a	n/a	n/a	n/a	n/a
Azerbaijan	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
Croatia	n/a	n/a	n/a	n/a	n/a	n/a
Czech Republic	7.10	7.05	6.30	5.05	7.12	4.86
Hungary	12.27	9.90	8.25	7.15	14.21	7.43
Kazakhstan	16.80	15.50	14.50	13.50	15.90	13.50
Poland	5.77	5.80	5.80	5.85	6.50	5.85
Romania	6.50	6.25	6.00	5.70	6.60	5.70
Serbia	5.60	5.70	5.60	5.40	5.60	4.70
Turkey	40.16	44.64	44.07	43.14	19.39	42.74
Ukraine	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
Eurozone	3.95	4.00	3.90	3.70	3.54	2.85
US	5.41	5.40	5.40	4.90	4.65	3.25

Source: National sources, Bloomberg, ING estimates

Carbon and commodities

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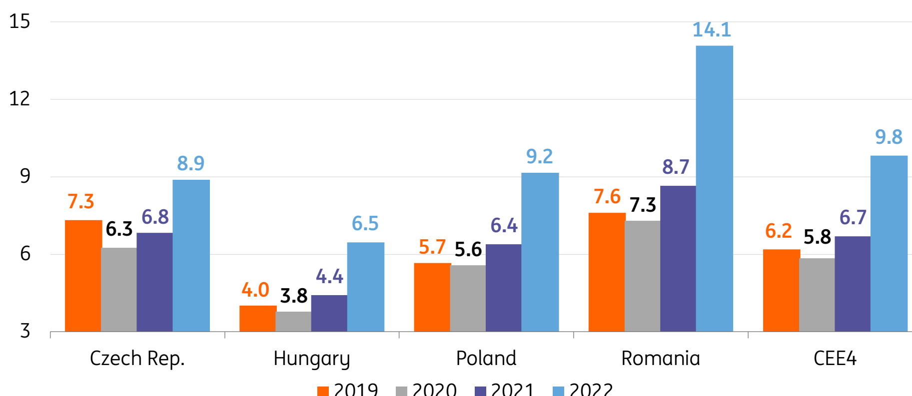
What diverging energy prices mean for the CEE region

- **CEE countries face significant cost pressure, though from different energy sources.** Countries across the CEE region are highly exposed to high and volatile energy and carbon prices. This exposure varies dependent on the structural characteristics of each country. Coal remains king in Poland and is also important in the Czech Republic, while Hungary, Romania and Turkey rely to a greater extent on natural gas in their electricity production.
- **The macro implications of these structural differences in energy mix are real, especially for Poland and the Czech Republic.** They have a significant shortfall of up to 1% of GDP in their carbon emission allowances (EUAs), which impacts their balance of payments (by over €4bn in Poland and €2bn in the Czech Republic in 2022). These amounts weigh on FX fundamentals. For Hungary, Romania and Turkey, our analysis suggests that dependence on natural gas in 2022 equated to a disproportionate impact on both PPI and HICP inflation. But the return to a normal relative price relationship between coal and natural gas in late-2023, driven by high and - most probably - rising EUA carbon prices, leaves Poland and the Czech Republic's competitiveness at risk. These high and recurrent operational costs in electricity production have serious implications for external and fiscal balances.
- **As an escape strategy, CEE countries need to accelerate investments in clean power supply and electricity grids to protect competitiveness.** Acceleration of energy investments is critical in light of heavy operational costs, associated with burning (imported) fossil fuels, and an ambitious EU climate policy. This is especially true for Poland and the Czech Republic. High carbon-intensity may also provoke an adverse chain reaction at the corporate level due to ESG risks. This is reflected in the requirements of leading blue-chip companies searching for a reduction of carbon content of final products or services in the entire supply chain. This is relevant for all CEE countries and Turkey, also because of the phasing-in of CBAM (Carbon Border Adjustment Mechanism), the EU's carbon border tax.
- **EU money and sustainable financing from the private sector can catalyse scaling up of energy investments.** EU grants and preferential loans, both from the Resilience and Recovery Fund (RRF), available through to 2026, and traditional cohesion policy funds from the 2021-27 budget, together with sustainable financing from private sources can enable significant energy investments. Because of high capital costs and long investment lead times in the energy sector, public money may crowd-in private financing, both bank lending and capital market instruments, such as green bonds.
- **Adequate action by boosting power system investments will pave the net zero path to other sectors through electrification.** Decarbonisation of CEE power systems – by scaling up to state-of-the art through existing technologies, such as photovoltaic, wind or nuclear, including small modular reactors (SMRs) – will largely pave the path to net zero by 2050 in other sectors, through electrification. This is critical for decarbonisation of transport, buildings and many industries.
- **Is there a pilot flying with us?** CEE countries need ambitious and robust long-term energy strategies as part of their development agendas. Such strategies could be directly reflected in corporate strategies and investment plans of incumbent power producers and grid operators, largely SOEs. These would also define a scope and financing options for companies and households interested in investments in own energy sources and energy efficiency. We believe it is high time for the CEE region to focus more on becoming Europe's factory in clean energy manufacturing.

In this article, we look to assess how volatile energy prices and high emission costs affect the outlooks of CEE countries.

Energy is an important input to the consumption and production of any modern economy. For example, over 2019-21, the value of energy sector output averaged 4% of GDP in Hungary, 6% in Poland, 7% in the Czech Republic and 8% in Romania (Figure 1). In 2022, these shares increased significantly following large swings in fossil fuel and carbon prices. For each of these countries, the sizeable changes observed in the energy sector had a substantial impact on inflation, output, current account and budget balance.

Fig 1 Share of gross output in the energy sector to GDP (%)

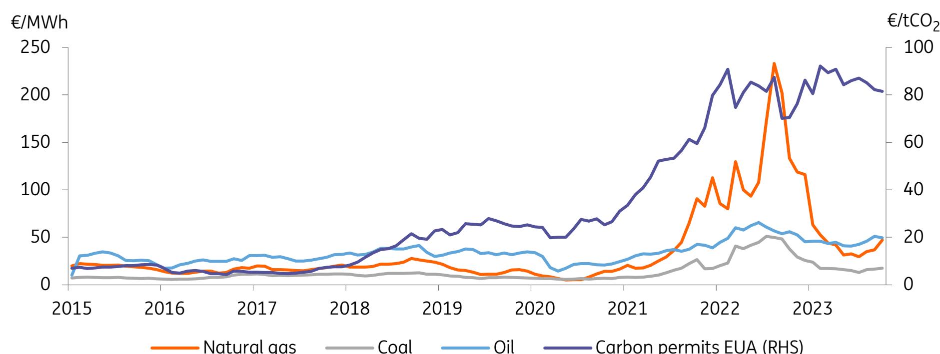


Output of energy sector is approximated by nominal value of production in NACE D sector (electricity, gas, steam and air conditioning supply).
Source: ING, Eurostat

Energy prices

Fossil fuel prices have been very volatile since the beginning of the 2020s. During the Covid lockdowns, the price of major fossil fuels reached multi-year lows. In EUR/MWh terms, at the end of April 2020 these stood at €14.4 (Brent oil), €5.9 (coal ARA) and €6.6 (natural gas TTF). The post-Covid reopening and rebound of demand as of mid-2021 and the Russian invasion of Ukraine in February 2022 pushed these prices to record high levels. The most spectacular price increase was observed for natural gas, which peaked on 25 August 2022 at €311/MWh. On that day the Brent oil price was six times lower than natural gas at €51/MWh. Subsequently, due to a mild 2022/23 winter and global arbitrage on the LNG market, natural gas prices returned to lower levels. Since April 2023, the situation has normalised and previous relationships between prices have been restored – highest for crude oil and lowest for coal (Figure 2).

Fig 2 Price of fossil fuels and EU Allowances (EUA) carbon permits, since 2015



Natural gas price is proxied by TTF quotation, coal by ARA and oil by Brent. Brent prices are converted from US$/bbl to €/MWh using spot USD/EUR rate and conversion factor of 1.7MWh/boe. ARA prices are converted from US$/tonne to €/MWh using conversion factor of 7.0MWh/tonne, which equates to the assumption that the energy content of 1kg of coal is 6000kcal.
Source: Macrobond

Carbon prices on the EU ETS market

In recent years, carbon prices in the EU have increased to levels that strongly affect the costs of energy production. In the European Union the cost of emissions is mostly set by the Emissions Trading System (ETS), which covers around 45% of all EU greenhouse gas emissions. Energy producers are obliged to purchase an ETS allowance (EUA) for each tonne of CO_2 emitted. This means that EUA prices are an important component of electricity generation costs for power plants based on fossil fuels. Recently, this cost has become relatively high as the EUA price almost quadrupled from €25 in December 2019 to €89 in October 2023. Importantly, we believe that this price increase should be perceived as permanent, rather than related to transitory factors, for instance demand or sentiment fluctuations. ETS prices are expected to rise even further with the introduction of the EU's decarbonisation policy (Fit55); according to October's '*EU ETS Market Outlook*' by BloombergNEF, the forecast is €93 per tonne of CO_2 in 2024, €98 in 2025, and €149 in 2030.

Literature review

Discussion of the effects of higher emission costs on the economy presented in academic literature is ambiguous. Simulations with the ECB NAWM model extended for the energy sector[1] indicate that a permanent increase of spot energy prices or carbon tax in the euro area would entail a transitory rise in inflation and a lasting, albeit moderate, decline in GDP. The analysis also indicates that the economic effects of a carbon tax depend on the monetary and fiscal policy response. In turn, empirical papers, which estimate the response of the economy to higher energy and carbon taxes using historical data, find almost no evidence for a negative impact of these taxes on employment and GDP[2], or indicate that energy and carbon taxes might limit economic activity[3]. These studies also indicate that high carbon prices create incentives for green innovation.

Structural energy characteristics of CEE countries

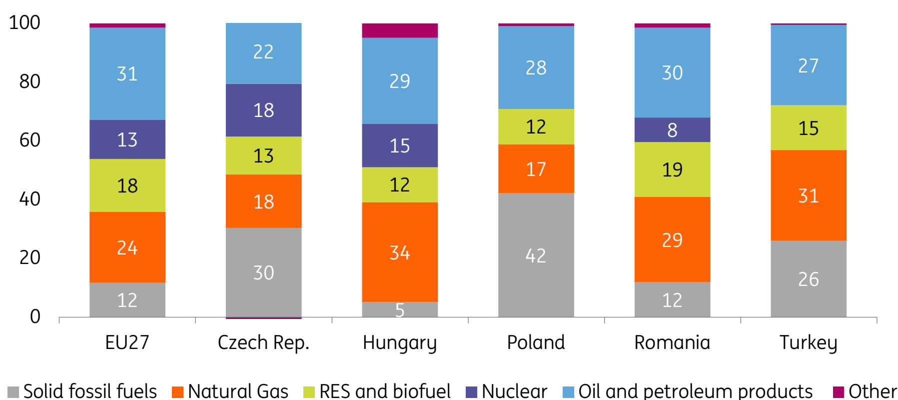
Dependence on fossil fuels varies across CEE countries, which leads to energy mix differences. Figure 3 illustrates that Poland and, to a lesser extent, the Czech Republic, are very reliant on highly CO_2-emitting coal. For that reason, the economies of these two countries are likely to be relatively strongly affected by changes in spot energy prices and EU carbon allowance. Turkey is also dependent on coal but is not subject to EU ETS. In the future, with the implementation of the EU Carbon Border Adjustment Mechanism (CBAM), this dependence on coal might affect the price competitiveness of Turkish products on the EU market. With regards natural gas prices, they are relatively important for Hungary, Turkey and Romania. Figure 3 illustrates that Hungary and Romania are more advanced in their decarbonisation process than the remaining CEE countries. We also note that all countries are reliant on oil and petroleum as part of their total energy supply.

[1] Günter C., Matija L., Romanos P., 2023. Macroeconomic effects of carbon transition policies: an assessment based on the ECB's New Area-Wide Model with a disaggregated energy sector, ECB WP 2819.

[2] Metcalf G., Stock J., 2023. The Macroeconomic Impact of Europe's Carbon Taxes. American Economic Journal: Macroeconomics, 15 (3): 265-86.

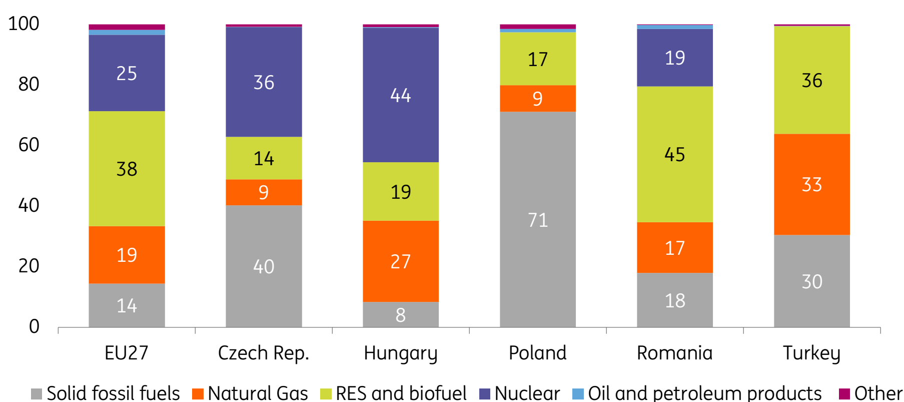
[3] Diego Känzig, 2023. The Unequal Economic Consequences of Carbon Pricing, NBER Working Papers 31221

Fig 3 Total energy supply mix, as of 2021 (%)



Source: Eurostat

Fig 4 Electricity generation mix, as of 2021 (%)



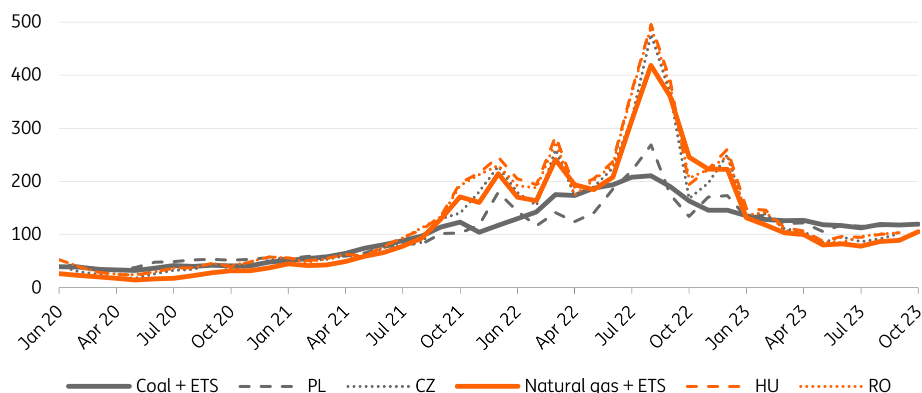
Source: Eurostat

Impact on wholesale electricity prices

Energy mix differences lead to wholesale electricity prices divergences. In the merit order system, ie, a mechanism that rebalances the demand and supply of energy within each EU economy, the last plant qualified in the auction is that with the highest marginal cost. As a result, the most expensive energy provider determines the price of electricity for all power plants involved. Figure 5 shows that in Poland the wholesale electricity price is predominantly driven by the price of burning coal, including the cost of carbon emissions. For Hungary and Romania, it is given by the marginal cost of burning natural gas.

This energy mix was favourable for Poland in 2022, ie, when abnormally high natural gas prices prevailed for a few months and moved well above those for coal. However, when natural gas prices decreased, the highly emissive coal together with currently high EU carbon allowance drove wholesale electricity prices in Poland to a higher level than in most EU countries. With the expected high and increasing level of EU carbon allowance this situation is likely to persist or even worsen, which is likely to weigh on the mid-term outlook for Polish economic competitiveness.

Fig 5 Marginal cost of electricity production and electricity prices (€/MWh)



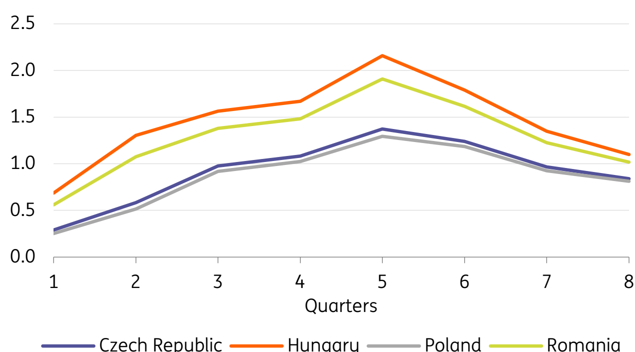
Marginal cost of producing electricity is calculated with TTF and ARA prices and the efficiency of natural gas and coal based power plants at 60% and 38%, respectively.
Source: ING, Bloomberg, https://ember-climate.org

Impact on producer and consumer prices

The differences in the energy mix also cause a CEE economies divergence in response to energy commodity shocks. Based on 2015-23 data for CEE4, we estimate a panel regression to assess the inflation response to a 10% increase in natural gas prices[4]. In general, we find that the reaction of inflation is more pronounced to this kind of disturbance in Hungary and Romania than in the Czech Republic and Poland (Figures 6 and 7). In a broader perspective, this means that in an environment of volatile natural gas price economic dynamics, CEE countries might become less synchronised.

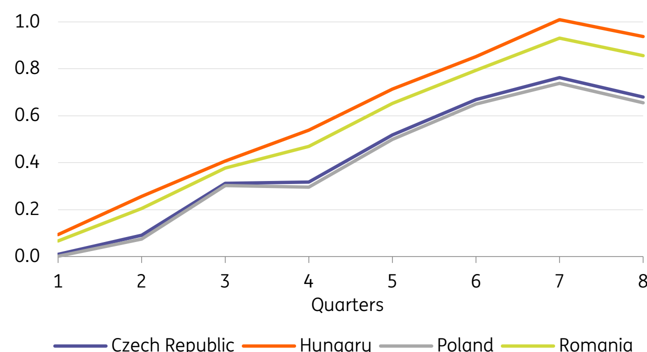
The response to a 10% natural gas price shock

Fig 6 PPI (%YoY)



Response of annual inflation to 10% increase of natural gas prices
Source: ING

Fig 7 HICP (%YoY)



Response of annual inflation to 10% increase of natural gas prices
Source: ING

Impact on fiscal and external positions

Energy mix and carbon prices are also important for budget revenues and current account developments. Figure 8 shows that in 2022 verified emissions, which are subject to the EU ETS, were the highest in Poland and amounted to 184.1 million tonnes of CO_2 (requiring redemption of 184.1 million EUAs). Given that 42.5 million EUAs were freely allocated to industries other than power, the remaining part of emissions had to be covered by redeeming 141.6 million EUAs. Multiplying this number by the average price of EUA at €81 per tonne of CO_2 leads to the conclusion that the market value of carbon emission in Poland amounted to about €11.5bn (1.8% of GDP).

[4] The specification of the regression is $y_{i,t+h} - y_{i,t-1} = \alpha_i + (\beta_h + \gamma_h TES_t^{NG})\Delta p_t^{NG} + \gamma_h z_{i,t-1} + \epsilon_t$, where y stands for the variable of interest (PPI or CPI), p^{NG} is natural gas price, TES^{NG} is the share of natural gas in the total energy supply mix and z stands for control variable.

Emitting industries acquire EU carbon allowances in three ways: freely (mainly heavy industries), through their country's auctions (mainly power), or purchases abroad. In Poland, in 2022 about a quarter of required EUAs was allocated freely. About a third of the cost to industries was made up of government revenues (€5.0bn in 2022), via auctioned allowances[5]. The remaining part to cover verified emissions had to be purchased abroad on the EU-wide carbon market. This can be tracked by looking at balance on acquisition of nonfinancial assets of the capital account of the balance of payments (€4.2bn in 2022). This amount does not match perfectly with the EUAs balance, as companies could also use certificates bought in advance and kept as a financial asset in earlier years.

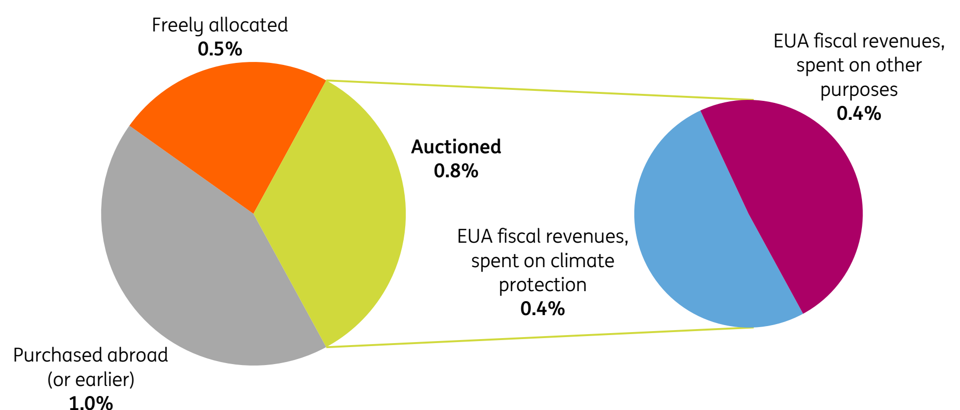
Figure 8 shows that emissions were also relatively high in the Czech Republic, with a significant balance of payment effect amounting to a deficit of almost €2bn. In the case of Hungary and Romania, emissions were much lower and represented neither a significant component of budget revenues nor balance of payments.

Fig 8 EU ETS system allotments for CEE4 in 2022

	Czech Republic	Hungary	Poland	Romania
Verified emissions (millions of EUAs)	**57**	**15.6**	**184.1**	**28.2**
Total allocated allowances	24	14.3	105.4	20.1
Freely allocated	15.6	8.5	42.5	14
Auctioned or sold	8.4	5.9	62.9	6.1
Balance, millions of EUAs	**-33.1**	**-1.2**	**-78.8**	**-8.1**
Balance, value as % of GDP	-1.0	-0.1	-1.0	-0.2
Balance on acquisition of nonfinancial assets (€bn)	**-2.0**	**-0.05**	**-4.2**	**0.1**
BoP Balance on acquisition of nonfinancial assets (% of GDP)	-0.7	0.0	-0.6	0.0
EUA budget revenues (€bn)	**0.7**	**0.5**	**5.0**	**0.5**
EUA budget revenues (% of GDP)	0.20	0.30	0.80	0.20
Share of EUA revenues spent on climate and energy in 2022 (%)	**27**	**50**	**51**	**57**
GDP at market prices in 2022 (€bn)	276.2	168.9	654.6	285.9

Balance on acquisition of nonfinancial assets is a position of the Capital Account in the Balance of Payments Statistics that covers trade in EUAs.
Source: European Environment Agency, Eurostat, European Commission (EU Climate Action Progress Report 2023), ING

Fig 9 Poland's allocation and use of EU ETS allowances (EUAs) in 2022 (% of GDP)



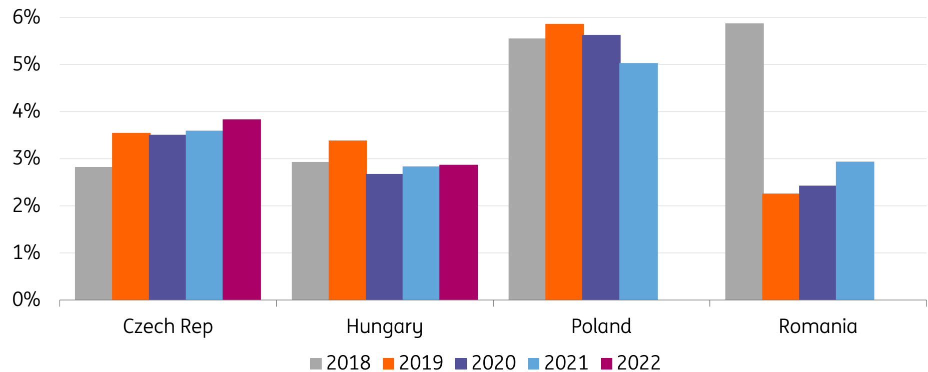
Source: ING based on EU data

Permanently high emission costs and volatile energy commodity prices constitute an incentive to accelerate energy transition and scale up investments in power generation and electricity grids. The different stages of energy transition implies that the scale of these investments is expected to be heterogeneous across CEE countries, as has been already observed in recent years (Figure 10). These investments will require substantial mobilisation of domestic and foreign savings, including EU grants from the cohesion policy and the Resilience and Recovery Facility, and preferential EU loans.

[5] From 2013, Poland's commissioned EEX stock exchange in Leipzig, Germany, for auctioning its EUAs on the primary market.

Moreover, investment needs in the energy transition will be enhanced by the rising role of corporate ESG factors in international trade and investments. Controlling carbon content in the entire production chain may force CEE companies to go green to meet the standards of their trading partners. Otherwise, they risk dropping from the supply chain (see more in our Think report).

Fig 10 Share of investment in energy sector in total investments



The energy sector is proxied by NACE D section: 'Electricity, gas, steam and air conditioning supply'
Source: Eurostat

Conclusions

1) **High and volatile energy and carbon prices** exert a significant impact on macroeconomic variables in CEE countries. On the one hand, in recent quarters they drove up inflation, dampened GDP growth and affected fiscal and external balances. On the other hand, they encourage green investments to enhance resilience today, and benefit from stable (and relatively lower) energy prices in the future.

2) Due to **different structural characteristics of CEE countries**, Poland and the Czech Republic are more exposed to coal and carbon price developments, while Hungary, Romania, and Turkey are more exposed to shifts in natural gas prices. Natural gas prices rose sharply in 2022 following the Russian invasion of Ukraine. There were significant increases of electricity generation in coal-fired power plants in Poland and the Czech Republic in 2021-22, which allowed for increased electricity exports.

3) The **situation on energy markets normalised in 2023**, as relative prices of natural gas and coal, combined with EUA costs, returned to long-term levels in mid-2023. As a result, wholesale electricity prices are again more influenced by highly emissive coal-fired power plants than by gas-fired power units, not to mention renewables, for which variable costs are negligible. If this normal relationship persists, higher wholesale electricity prices will put Poland and the Czech Republic's competitiveness at risk, relative to their CEE peers or other EU countries.

4) In addition to increased spot prices of energy for the economy in 2021-22, **Poland and the Czech Republic were short of ETS carbon allowances**. In 2022, this shortage amounted to around 0.6% of GDP equivalent per year, at an average EUA price of €81. This gap between verified emissions and received **EU carbon allowances** (for free or from auctions) for each country was reflected in their capital accounts or balance of payments. It is not a trivial amount and constitutes an exchange rate fundamental. In Poland, only a half of the fiscal revenues from EUA actions (an equivalent of 0.8% of GDP in 2022) were spent on climate protection, while the other half was not earmarked and added to overall public revenues.

5) This **shortage of EU carbon allowances is to persist** for about a decade if not longer, as lead investment times are long for zero-carbon energy projects, especially for those with higher capacity utilisation coefficients but very high upfront capital

requirements, such as offshore wind (an option for Poland and Turkey) or nuclear power (an option for all CEE countries). In the moderately green transition scenario for Poland through to 2030, carbon intensity of the electricity system is projected to decline by one-third - from above 700kg CO_2 equivalent per MWh in 2021 to around 450kg CO_2 equivalent per MWh in 2030. On the same time horizon, however, EUA prices are projected to double to €150 by 2030, compared to late-November levels of around €75.

6) **Acceleration of investments in green energy and grids is an obvious exit strategy** from elevated operational costs of power units based on fossil fuels. This is true in particular for Poland and the Czech Republic, but other CEE countries and Turkey are also to benefit from investment programmes in cost-competitive green energy installations. They are aimed to secure affordable and less volatile energy supply from renewable domestic sources, rather than imported fossil fuels.

7) **Advances in greening power sectors are critical for the decarbonisation of other sectors**, through electrification in transport, building and many industries. For power, a transition towards carbon neutrality is to be largely achieved by scaling up the already existing technologies for electricity generation and storage. The pursuit towards electrification is set to provoke a demand-side response in other economic sectors, and purchases of electric vehicles, heat pumps or other electric equipment. Some industrial sectors (eg, steel, aluminium, fertilizers) are more difficult to decarbonise, and adequate technologies are either nascent or even not-existing.

8) **Fortunately, EU members could benefit from various EU grants and preferential loans**, already budgeted through to 2030. As pointed out in our Think article, Romania and the Czech Republic already benefit from active access to RRF funds for green transition, while Poland's upcoming government is about to unlock them soon. The green transition in Hungary also hinges on EU financial support, while prospects still look distant. Also, Turkey is to benefit from cooperation with the EU and managing risks associated with the gradual phase-in of the EU's carbon border tax, CBAM. All CEE countries are to face also qualitative ESG requirements from their trading partners, all struggling to reduce emissions across the entire supply chain.

Poland

High time to accelerate energy investments using all EU funding available

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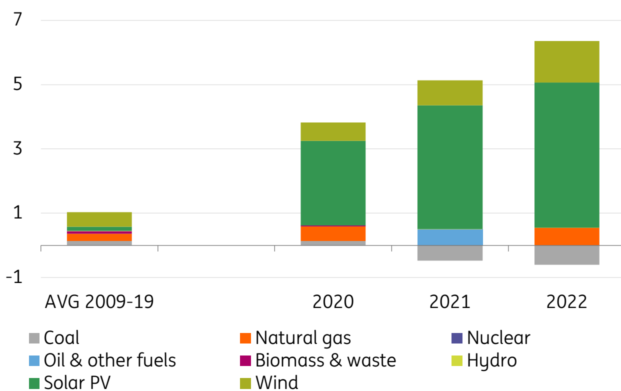
Poland needs to promptly accelerate energy investments otherwise the country will lose competitiveness due to the high price of carbon allowances (EUAs) combined with the highest emissions of electricity generation in the CEE, resulting from its structural characteristics. Poland remains a coal-based power supply outlier in the EU, and since 2021 it has borne huge costs of carbon permits purchased abroad at almost 1% of GDP annually. In recent years, the EUA futures price has remained high at €70-100/per tonne of CO_2 equivalent and is to trend up to about €150 through to 2030, in line with a gradual reduction of EUA supply within the EU's ambitious 2030 climate targets.

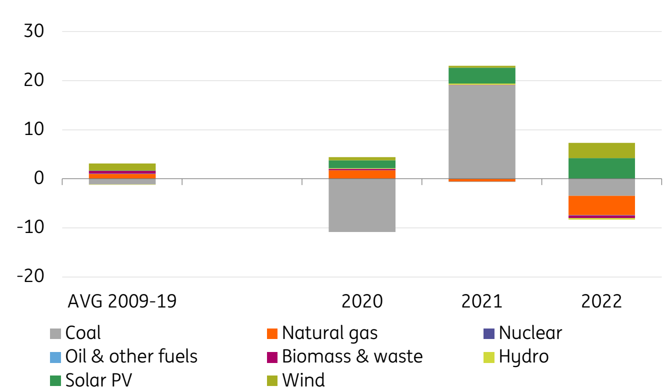
The expansion of solar energy over the past three years is impressive (5 GW+ new PVs in 2022) but barely changes the electricity production mix, which reflects decades of underinvestment. There is limited space to connect new PV capacities to the electricity grids, especially low-voltage distribution grids, assuming there is no technological breakthrough in large scale energy storage. The current power mix largely reflects decades of underinvestment, in particular in the 2010s when the yearly change in power capacity amounted to around 1 GW only. Also, because of low utilisation factors of PVs in Poland of about 10%, with unfavourable sun conditions and curtailment of this source in grid management, a rapid increase of PV capacity does not equate to a significant rise in green electricity generation.

Fig 11 Poland: **Annual change in installed power capacity, by source (GW)**



Source: BNEF

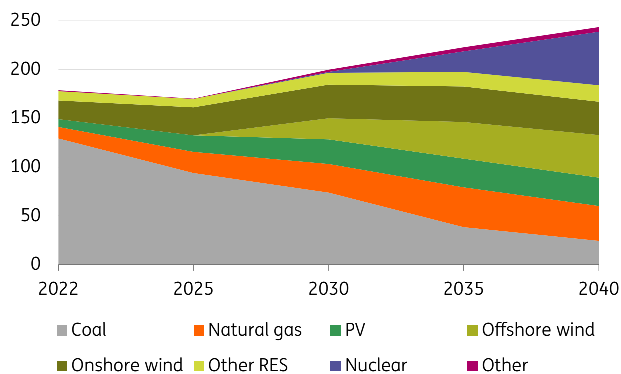
Fig 12 Poland: **Annual change in power generation, by source (TWh)**



Source: BNEF

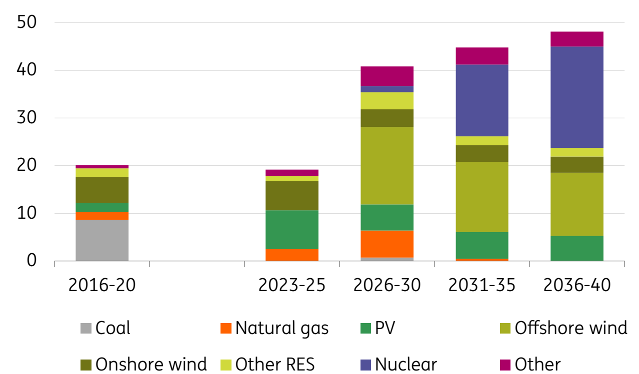
Both power generation and electricity grids require a sizeable investment boost. To reduce carbon intensity, Poland needs to swiftly deploy mature technologies at large scale, such as nuclear or offshore wind, which are novel in the Polish context. These two technologies constitute about two-thirds of Poland's planned power investments, which as a whole are to double from around 0.7% of GDP annually in the early-2020s to 1.3% of GDP by the mid-2020s and stay at this elevated level through to the 2040s. In addition to new power plants, investment in electricity grids needs to be scaled up (from about 0.5% of GDP to 1% of GDP) to allow for a higher share of intermittent RES sources in the system. Intermittent RES sources became price competitive to coal- and gas-fired units, but cannot be connected to the grid in its current structure (see our Think report). A cleaner power system and electrification is key to decarbonisation of the other parts of the economy, including transport (EVs), industry and buildings (heat pumps and other equipment). The electrification of these sectors will entail higher demand for electricity.

Fig 13 Poland: Projected annual power generation, by source (TWh)



Source: ING estimates based on Ministry of Climate (June 2023) and Poland's Energy Policy 2040 (February 2021)

Fig 14 Poland: Projected annual power investments (2020, PLNbn)



Source: ING estimates based on Ministry of Climate (June 2023) and Poland's Energy Policy 2040 (February 2021)

Energy investments through to 2030 could be substantially funded from EU grants and preferential loans, including the RRF. Energy-related grants and loans constitute the majority of Poland's €60bn Recovery and Resilience Fund (RRF) envelope, consisting of about €25bn in grants and €35bn in loans. These allocations reflect the adjustments linked to the REPowerEU chapter in the RRF (additional €2.5bn grants in Poland's National Recovery Plan) and the late summer request by the Polish government to the EC to triple the initial amount of preferential RRF loans from €12bn to €35bn, justified by additional investments associated with REPowerEU reforms and investments.

In addition to RRF, Poland could also finance its energy-related investments from other EU funds in this decade. In its report of late-2022, the Polish Electricity Association estimated that Poland could also use around a quarter of new cohesion policy funds 2021-27 (almost €20bn out of €75bn in total) on energy investment projects. There are also other EU funds supporting energy transition, such as the Just Transition Fund (with Poland's allocation of almost €4bn) or the Modernisation Fund (with Poland's allocation estimated at €7bn). Assuming that 60% of Poland's RRF is devoted to energy, from all these funds taken together, Poland could tap into around €46bn in EU grants and an additional €30bn in EU loans.

The availability of EU financing could also crowd in private sector investments in energy efficiency and clean energy. Our analysis indicates that against a backdrop of high and volatile energy prices many companies opt for a 'wait and see' approach in energy investments (energy efficiency and own energy sources) due to expectations on the availability of EU funding and favourable grid regulations. This green transition agenda is also shaped by global ESG megatrends and large companies requiring subcontractors to reduce their carbon footprint across the entire supply chain. This should also support Poland's progress in sustainable finance, both via bank lending and capital market instruments, such as green bonds. In September, Poland's energy champion Orlen secured €3.6bn via a 23-year loan from a consortium of 25 Polish and foreign financial institutions to build an offshore wind farm in the Baltic Sea.

Both cost and opportunity incentives make an acceleration of energy investment a plausible scenario for Poland. Significant cost pressure is exerted by high and volatile energy and carbon prices. In turn, the availability of EU funds and sustainable financing create a unique opportunity to modernise Poland's power system and advance decarbonisation of other sectors in Poland's economy. Otherwise, the country could lose competitiveness, not only through the quantitative channel but also through qualitative ESG factors.

Czech Republic

Nuclear and solar is the way to go

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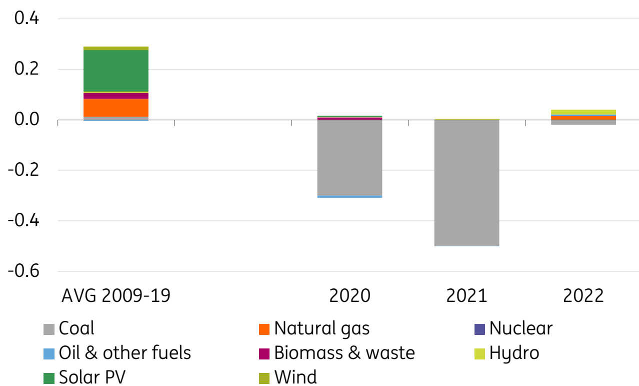
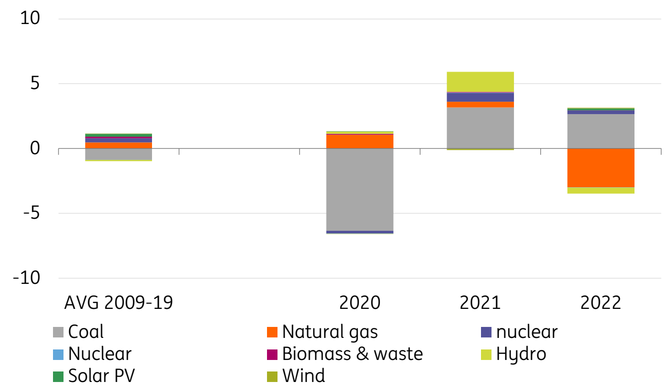
The Czech Republic currently relies on two main sources of electricity generation: coal (40%) and nuclear (36%). Other sources play less important roles in the energy mix: natural gas (9%) and RES (renewable energy sources) and biofuels (14%). Within the latter, about half are biofuel-based sources, thus pure RES forms a negligible part of the overall picture. Over the past seven years, the share of RES and biofuels has increased by 3.2ppt, mainly due to the increase in the share of biofuel use. The Czech Republic is a fully self-sufficient electricity producer, and net exports made up about 14% of total production.

Fig 15 Czech Republic: Annual change in installed power capacity (GW)



Source: ING estimates based on Ministry of Climate (June 2023), and Poland's Energy Policy 2040 (February 2021).

Fig 16 Czech Republic: Annual change in power generation, by source (TWh)



Source: ING estimates based on Ministry of Climate (June 2023), and Poland's Energy Policy 2040 (February 2021).

The Czech government recently approved an update of the country's energy plan to 2030, in which domestic electricity consumption is expected to increase by around 10%. The plan also sees a significant decline in the share of coal in the energy mix, to be offset by an increase in renewables and nuclear sources. In the short term, the government's main objective is to end its dependence on coal and gas imports from 'unreliable' countries to ensure the country's energy security, even at the cost of reducing surplus production or electricity imports from EU countries. In the long term, the government plans to continue the expansion of solar and nuclear sources, given that wind power plants are perceived by the government as unsuitable for Czech weather conditions. By 2030, the government plans to increase the share of RES to 30% and nuclear power to 40%. The power capacity installed in solar is expected to rise from the current 2.1 GW to 10.1 GW. Over the same period, coal capacity should drop from 9.4 GW to 3.0 GW.

We see two main projects that will drive the development of the energy sector in the Czech Republic in the coming years: expansion of nuclear power plants and a second solar energy boom. The Czech Republic has two nuclear power plants (Temelin and Dukovany). For several years the government has been discussing the expansion of both plants, but only the recent energy crisis has pushed the government to take concrete action. In October, the government approved the expansion of the Dukovany nuclear power plant (+2 GW), essentially doubling its total capacity. This should be a major pillar in the plan to achieve a 40% share of nuclear power in the electricity mix. The government is currently evaluating bids from three potential suppliers (the US, France and South Korea).

However, this is a long-term story given that the expansion of the Dukovany nuclear power plant is due to be completed in 2036 and full operation is not due to start until 2038. For now, in late-2024, the contract with the contractor is expected to be signed, but experience suggests that we may see further delays in the process.

In the nuclear space, the government will also focus on developing small modular reactors (SMRs). These should require lower capital expenditure, not only in total, but also per unit of installed capacity. State-owned CEZ, the biggest energy supplier in the country, plans to select a supplier as early as next year for the first SMR to be installed at the nuclear power plant Temelin and connected to the grid between 2032 and 2035.

A number of domestic and foreign factors are constraining Czech investments in the development of nuclear power. However, these plans enjoy broad political and public support in the country. The pressure of time should also help accelerate the work, as the older nuclear units are due to be decommissioned while coal-fired plants have already been shut down.

The second challenge is to sustain the nascent solar boom. This sector has been stagnant in the Czech Republic for many years and lags far behind other EU countries. One reason for this outcome is related to the poor government policy during the first solar boom of 2005-10. However, in 2022, six times more capacity was installed than in the previous year, kicking off a second boom. The challenge for the government now is to maintain and support high domestic demand and to effectively employ the allocated EU money.

In the Czech Republic, photovoltaics have a marginal share in the energy mix. In 2021, solar power plants accounted for 3.4% of generation. This year, the share has already risen to 3.8%. With the power capacity installed in solar expected to rise from the current 2.1 GW to 10.1 GW by 2030, annual electricity production could exceed the output of one unit of the Temelin nuclear power plant. However, sufficient capacity for the transmission and distribution system needs to be built. To ensure grid stability and flexibility, it is also necessary to build battery storage facilities for energy storage, which the country currently lacks. The future of the solar business lies in further development of photovoltaics due to an amendment to the Energy Act, which has been in the legislative process since September. It will simplify the conditions for new solar power plants, or renewables in general. In addition, it will no longer be necessary to apply for a building permit to install solar panels with a maximum output of 50kW, which should simplify the permitting procedure.

In terms of financing, the government estimates that the energy mix transformation will require investment of CZK500bn (6.8% of GDP) in energy and CZK350bn (4.7% of GDP) in industry by 2030. The main source of funding by 2030 is expected to be the sale of ETS (electric thermal storage), which, depending on the market price, should bring CZK450-600bn to funds set up by the government for this purpose, the EU budget (about CZK180bn) and the RRF funds (about CZK110bn).

Hungary

Energy transition depends on access to EU funds

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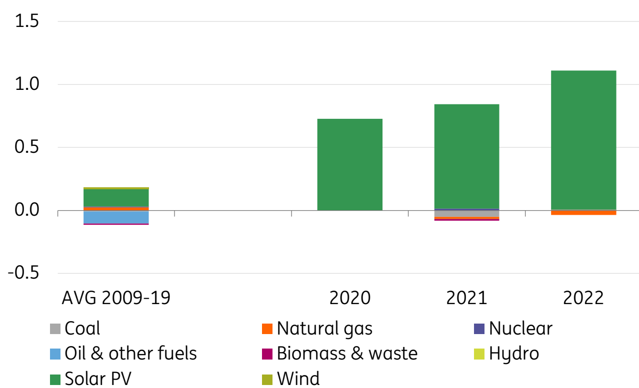
With thanks to Dávid Szőnyi

Last year's surge in energy prices had dire consequences both for the real economy and for policymakers in Hungary. Businesses saw their energy-related costs soar, while the government was forced to change its Overhead Protection Scheme as the fiscal burden grew. In the end, inflation soared, while the country's internal and external balances posted record deficits. This programme is one of the pillars of the government's economic policy and provides households with a wide range of energy products (natural gas, electricity, district heating, water and waste management) at very low, fixed prices. On the other hand, the general budget bears the burden of the price difference between the administered and the market prices, as energy is distributed through a system of state-owned companies. As energy prices rose, the fiscal burden increased and the government made an adjustment by introducing a two-tier price system. The change resulted in natural gas marginal prices seven times higher and electricity marginal prices twice as high as the base price, but ultimately the fiscal burden eased. As energy prices soared, inflation followed suit, while fiscal and external balances posted record deficits.

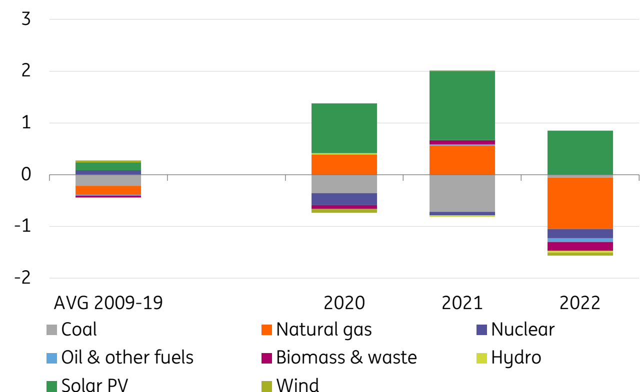
There is no doubt that the Hungarian economy is particularly sensitive to energy shocks, which makes the transition to renewable energy sources and further diversification very important priorities. However, the cost of this transition is huge, while the budget is not in particularly good shape. In the period up to 2035, the overall energy-sector related investment needs are expected to amount to HUF5,670bn (around 7.6% of GDP) as estimated by the government in the National Energy and Climate Plan (NECP). In our view, the only realistic option to meet the commitments outlined in the NECP is to gain access to EU funds, for which the picture has recently been rather cloudy.

Fig 17 Hungary: Annual change in installed power capacity (GW)



Source: ING estimates based on Ministry of Climate (June 2023), and Poland's Energy Policy 2040 (February 2021).

Fig 18 Hungary: Annual change in power generation, by source (TWh)



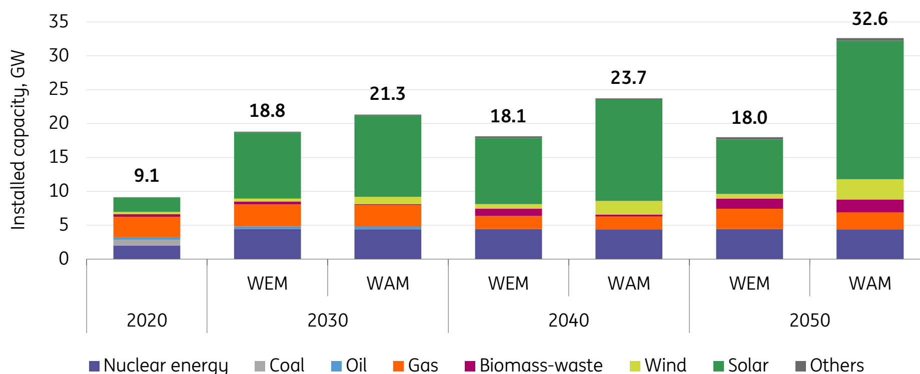
Source: ING estimates based on Ministry of Climate (June 2023), and Poland's Energy Policy 2040 (February 2021).

The government aims to ensure that the majority of Hungary's electricity production comes from two sources: nuclear and renewable energy, mainly solar power plants. In recent years, there has been an impressive increase in the installed capacity of solar power plants, as shown in Figure 17. So far, this has been partially driven by government subsidies, but we expect that last year's energy shock will further accelerate progress. The government's original Overhead Protection Scheme, which provided energy to households at a very low price, meant that there was no incentive for households to opt for more energy-efficient solutions. However, as the government made some changes to the scheme in 2022, resulting in significantly higher electricity prices, this has contributed to the increase in new capacity. The current solar generation capacity in

2023 is about 5.0 GW. The government aimed to increase this to 6.0 GW by 2030, but Hungary will attain this goal by 2025 if recent trends continue. We estimate that the solar capacity will reach 12.0 GW by 2030. Consequently, electricity generation will largely depend on PV and nuclear energy by the end of the decade.

Currently almost half of Hungary's electricity generation comes from carbon-neutral nuclear power. This is the main reason the government is very committed to maintaining the share of nuclear energy in the energy mix, as evidenced by the investment in the Paks II nuclear plant (two units) and the recently passed law to further extend the operating hours of the existing units of the Paks I nuclear power plant. In total, the installed capacity of six units could reach 4.4 GW, which would contribute to the further expansion of carbon neutral sources in the energy mix. However, there are concerns about the feasibility of building Paks II and maintaining Paks I, mainly because of the reliance on Russian technology (Rosatom is the contractor).

Fig 19 Hungary: Evolution of installed electricity generation capacity in the WEM and WAM scenarios (GW)



WEM refers to a scenario in which electricity generation is managed with **existing** measures, while WAM refers to a scenario in which **additional** measures are taken (ie, additional investments).
Source: ING based on Hungary's National Energy and Climate Plan

The cost of energy transition is much higher than the general budget alone can afford. According to the NECP, there are two pathways to implement the energy transition, the first relies on existing measures (WEM – with existing measures), while the second relies on making new investments (WAM – with additional measures). If the WEM scenario were to be implemented, electricity generation capacity is expected to peak in 2030, and slowly decrease thereafter. However, if the WAM approach were to be taken, then electricity generation capacity is expected to moderately increase from 2030 to 2040, and significantly increase up until 2050 as new investments are made. In this regard, the investment costs for the period up to 2035 amount to HUF5,670bn, while for the period between 2036 and 2050, the price tag would be a staggering HUF33,000bn.

The EU ETS fiscal revenue from auctions in 2022 was around HUF182bn, of which only 50% was spent on climate- and energy-related objectives. Although ETS revenues are expected to increase each year, the total investment costs of the NECP would be much higher. In this context, the expected minimum HUF4,200bn to spend on energy projects from the Cohesion Fund, RRF and REPowerEU would be essential to finance the transition. The EU and Hungary's partnership agreement states that the funds will be used to enhance the energy efficiency of public and private buildings, support eco-friendly mobility and boost energy production through renewable sources. Losing these funds would seriously harm the Hungarian economy, especially in the area of energy transition, which looks pretty much a 'mission impossible' without the EU funds.

Romania

Romania advances its energy transition, supported by EU funds

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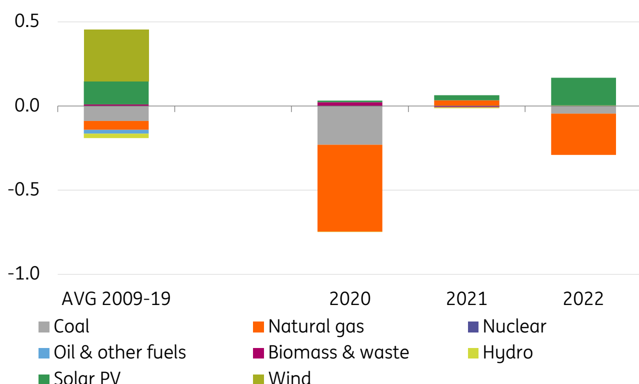
Romania has adhered to EU climate action commitments and was seen from the outset as adhering to EU climate goals. Compared to 1990 levels, Romania has a reduction target for its greenhouse gas (GHG) emissions of 78% by 2030 and 100% by 2050, in line with the European Union's carbon neutrality objective. As of 2019, the country had achieved 79% of its 2030 reduction target and official estimates point to a 94% achievement rate by 2025.

Various sectorial targets have been set in order to meet the 2030 and 2050 objectives. Among others, the energy sector is set to reduce its GHG emissions by 87% in 2030 and 99% in 2050 (compared to 1990), mainly through the gradual closure of coal plants and building new renewable energy source (RES) capacities. The transport sector is projected to decrease its emissions by 41% in 2030 and by 82% in 2050 as the national auto park shifts to electrification, while the industry sector should reduce its GHG emissions by 77% in 2030 and 89% in 2050 as RES-based electricity will replace the use of fossil fuels.

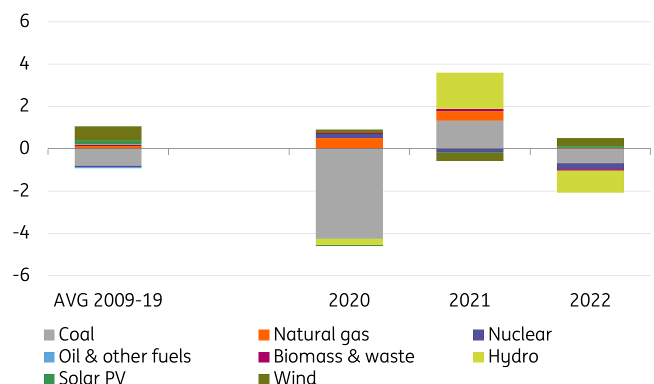
Progress in the energy mix has been notable, with Romania aiming to reach a minimum of 34% of RES in its gross final energy consumption by 2030 and 56% by 2050. Official projections show that by 2025 the share will amount to 32%, with the main contribution set to come from new wind and solar energy capacities. On a longer run (by 2050), the country aims for an 8% reduction in primary energy consumption compared to 2020 levels.

Fig 20 Romania: Annual change in installed power capacity (GW)



Source: ING estimates based on Ministry of Climate (June 2023) and Poland's Energy Policy 2040 (February 2021)

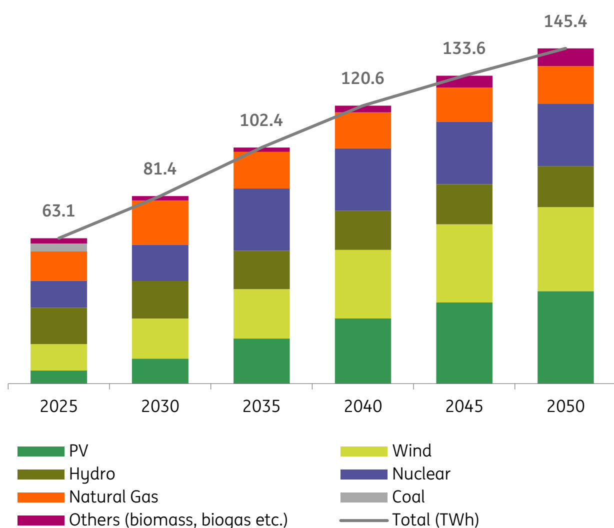
Fig 21 Romania: Annual change in power generation, by source (TWh)



Source: ING estimates based on Ministry of Climate (June 2023) and Poland's Energy Policy 2040 (February 2021)

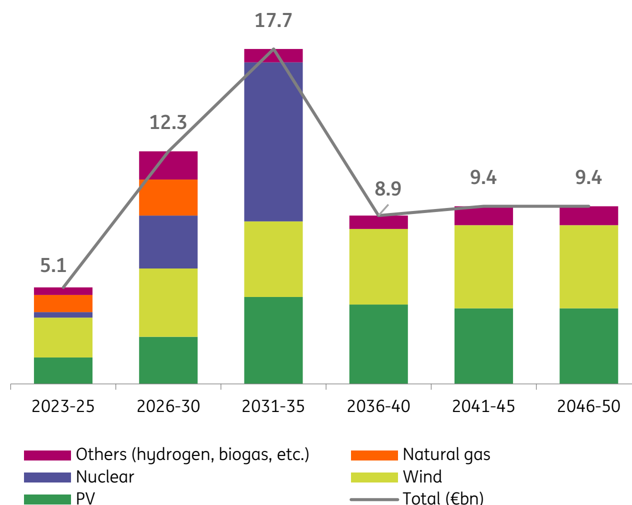
In terms of energy security, Romania has been making the domestic energy supply a priority, aiming to keep electricity imports below 5.0%. For electricity generation, the goal is to increase installed capacity to 30.4 GW by 2030, mainly through the expansion of capacity from renewable sources. In particular, wind and solar energy are expected to thrive on the back of obvious geographical advantages, with robust winds in the south-eastern part of the territory and generally plentiful sunshine across the country. On the latter, the prosumers have spectacularly increased their installed capacity from virtually zero less than two years ago to over 1 GW in mid-2023 and most likely towards 2.5 GW by the end of 2024. By 2050, the total installed capacity should reach 62.7 GW with the share of RES amounting to 88%.

Fig 22 Romania: Projection of electricity generation by technology (TWh)



Source: Romania National Energy and Climate Plan.

Fig 23 Romania: Investment needs in electricity generation (€bn)



Source: Romania National Energy and Climate Plan.

REPowerEU comes at the right time. In mid-November, Romania's updated NRRP was approved by the European Commission. Following a better-than-expected economic performance in 2021, Romania suffered a downward revision of its allocated NRRP grants, amounting to €2.1bn (from €14.2bn to €12.1bn). As a result, the country had to amend its plan to accommodate the new amount, while also adding an additional chapter – REPowerEU, with a total budget of around €1.4bn. Romania's proposal for the REPowerEU chapter consists of two legislative reforms and six investment objectives. However, given the proposed value of each investment, there are essentially two main objectives:

- Increasing the production of green energy (over €600m allocation), which in practice is likely to chiefly mean subsidies for solar panels installation.
- Increasing the energy efficiency of residential buildings (over €500m allocation), which will probably boil down to a mix of solar panel installation (apparently targeted at more vulnerable segments of the population) and thermal insulation of buildings aiming at a minimum 30% improved energy efficiency.

Overall, the main investment objectives proposed by Romania are largely in line with the country's National Energy and Climate Plan which envisages a sharp rise in the installed capacity of solar panels corroborated with progressive investments in storage capacities.

Turkey

Challenges prevail while cooperation with the EU is required to help green transformation

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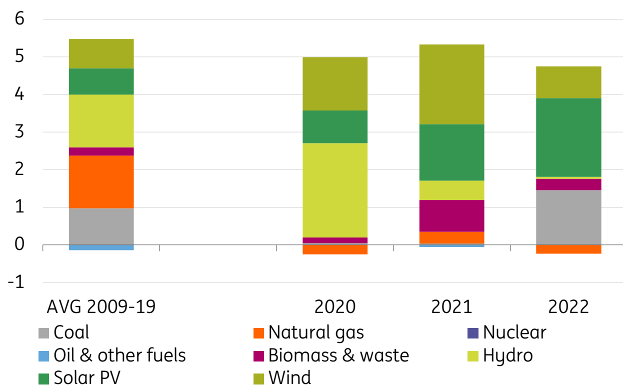
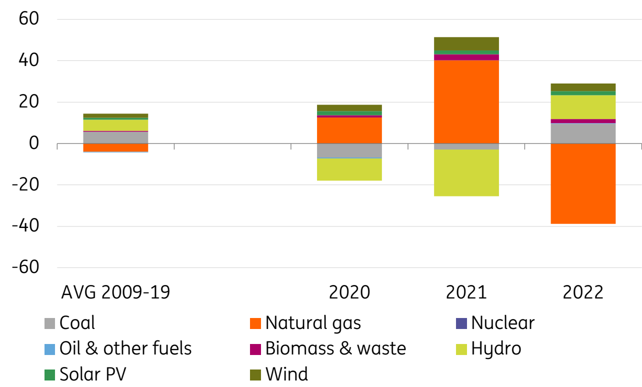
Turkey was among the first signatories of the Paris Agreement in 2015. However, its ratification and commitment to net zero emissions by 2053 took until 2021 because the country was categorised as a developed country in the annex to the Agreement. This categorisation was required to meet specific emissions reduction targets but meant there was no benefit from the financial support provided for developing countries. Nonetheless, renewable energy investments, which are among the most important components of green growth and decarbonisation, have been on Turkey's agenda for a long time. According to the World Bank, the country has increased its installed renewable energy capacity by 245% over the past 16 years, ranking it sixth in Europe (and thirteenth in the world) by installed wind and solar power capacity.

Fig 24 Turkey: Annual change in installed power capacity (GW)



Source: ING estimates based on Ministry of Climate (June 2023) and Poland's Energy Policy 2040 (February 2021)

Fig 25 Turkey: Annual change in power generation, by source (TWh)



Source: ING estimates based on Ministry of Climate (June 2023) and Poland's Energy Policy 2040 (February 2021)

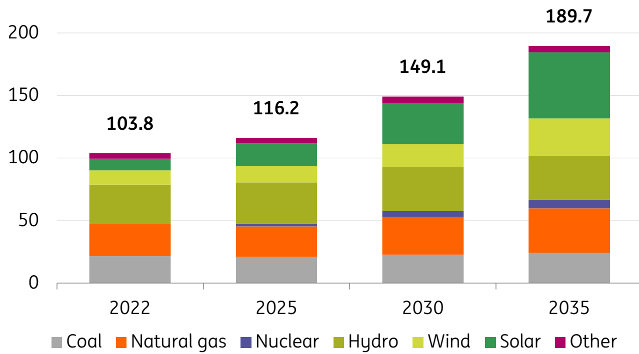
Through to 2035, Turkey plans to expand its power capacity installed by over 80%. While 70% of the total installed power commissioned over the past five years was related to renewable resources, Turkey's national energy plan announced in 2022 (covering the period up to 2035 based on Turkey's 2053 Net Zero Emission Target) envisages a rapid increase in the share of renewable energy sources to 64.6% by 2035. Within this plan, the total installed capacity of nuclear power plants in the system will reach 7.2 GW, equating to a 3.8% share in the total.

According to the Energy and Natural Resources Ministry, the projects encompassing renewable energy, nuclear energy, natural gas-oil exploration, natural gas-oil and electricity infrastructure and interconnection projects is likely to require investment of US$200bn until 2035. Turkey has been quite successful in mobilising and deploying finance, primarily for mitigation climate action, investing more than US$35bn in energy (based on GDP data) between 2015 and 2022 with the private sector having a share of more than 60%. In this period, Turkey utilised US$15.4bn of climate finance from the Multilateral Development Banks. After a decline between 2017 and 2020, there has been an acceleration in this kind of financing.

When considered alongside the change in Turkey's current account balance, this financing with respect to the balance of payments has been volatile but has a significant share. In recent years, there have been growing green/sustainable bond issuances by Turkish players. Accordingly, total stock of environmental, social and

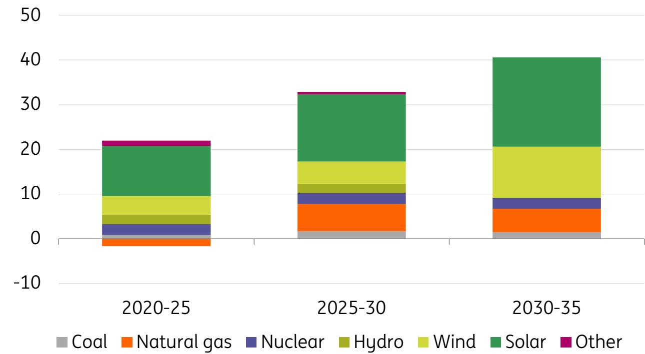
governance debt securities issued abroad reached US$9.8bn (locally issued stock TRY4.4bn, translating into c.US$150m) with banks owning the largest share at 54%. Of the external stock, the Treasury's first green eurobond issuance, completed in early 2023 with US$2.5bn borrowing, is a good example of access to a new financing universe. We expect Turkey to continue to benefit from growing public and private investment flows into low carbon, clean energy initiatives.

Fig 26 Turkey: Installed capacity by source since 2022 (GW)



Source: Ministry of Energy and Natural Resources

Fig 27 Turkey: New installed capacity commissioned in five-year periods from 2020 (GW)



Source: Ministry of Energy and Natural Resources

Adapting to the EU Green Deal is crucial for minimising the potential costs impact on exports. Implementation of the EU's Green Deal will have an impact on the EU's trade relations with its non-EU partners, including Turkey. This means that there will be the imposition of additional financial burdens on Turkey. As of 2022, approximately 41% of Turkey's total exports were made to EU countries, while the five exporting sectors that will be subject to carbon tax in 2026 have EU exports at €11.6bn, with an 11.9% share in total exports to the region. A study[6] in 2020 estimated the total carbon cost of Turkish exports to be €1.1bn, or €1.8bn, depending on the €30 or €50 unit price of European Union Allowance.

[6] A.E. Yeldan, S. Acar, A.A. Aşıcı, and B. Ünüvar, "The New Climate Regime through the Lens of Economic Indicators," TUSIAD, 21 September 2020, https://tusiad.org/tr/yayinlar/raporlar/item/10633-ekonomik-gostergeler-merceginden-yeni-i-klim-rejimi-raporu

Countries

Armenia

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	7.4	3.3	2.0	4.5	6.5	8.0	4.5
CPI (%YoY)*	0.1	1.2	2.8	5.8	4.9	2.3	4.3
Policy interest rate (eop, %)	9.75	9.00	8.50	8.00	7.75	9.00	7.75
3m interest rate (%)*	10.4	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (%)*	10.2	n/a	n/a	n/a	n/a	n/a	n/a
USD/AMD*	396	415	422	430	437	396	430
EUR/AMD*	418	444	456	472	489	428	477

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2027	S&P	BB-	BB-
Fiscal	Neutral	Parliamentary: 2026	Moody's	Ba3	Ba3
Monetary	Easing	Local: n/a	Fitch	BB-	BB-

*Quarterly data is eop, annual is average

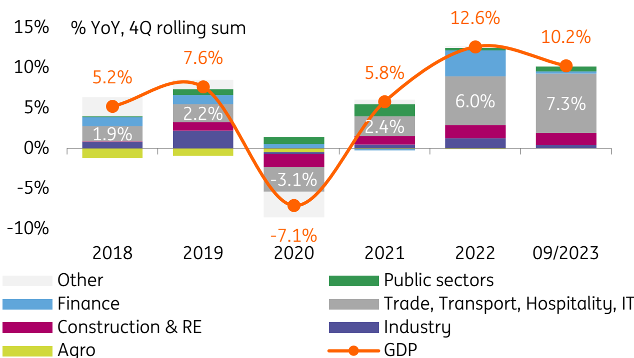
Source: National sources, ING estimates

Country strategy: Momentum still there, but risks ahead

Armenia is maintaining a solid economic growth rate in 2023, but the credit- and remittances-fuelled services boom is unlikely to persist, while the industrial output is already underperforming. Some support may come from the fiscal side, as expenditures are showing signs of acceleration, while social and military spending (50% of total) will have to remain elevated for the time being, given the external risks in the region and the need to accommodate the recent arrival of up to 120,000 refugees from Nagorno-Karabakh. Monetary policy may also ease, but the likely recovery of CPI from current near-zero to 4-5% in 2024 should limit the scope.

Following the rally, the dram is now vulnerable to depreciation risks due to normalisation of trade, services, remittances and capital flows amid persisting foreign policy risks.

GDP growth composition by sectors

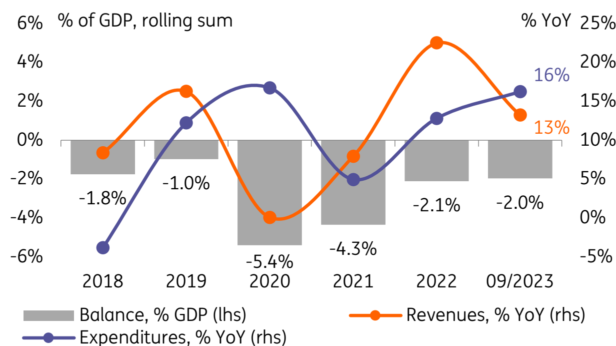


Source: National sources, CEIC, ING

Activity: Momentum is waning after peaking in 2022

Having peaked at 12.6% YoY in 2022, GDP growth has been decelerating and is likely to reach 8% this year. Domestic activity is becoming increasingly reliant on consumer and IT services, which are supported by the presence of highly skilled immigrants from the neighbouring countries, but the lack of diversification and industrial underperformance is a risk. Consumption is currently supported by 25-30% YoY growth in retail lending, but the portfolio is already large at 22% of GDP suggesting limited room for further expansion. From the monetary policy side, the extreme slowdown of CPI to close to zero levels creates room for a key rate cut from current 9.5% to 7.5-8.0% in a year (but probably not lower given the likely rebound in the CPI on higher global food prices and weaker FX), but the transmission into activity is unlikely to be strong. The value added from the financial sector dropped 15.8% YoY in 3Q23.

Key parameters of the state budget

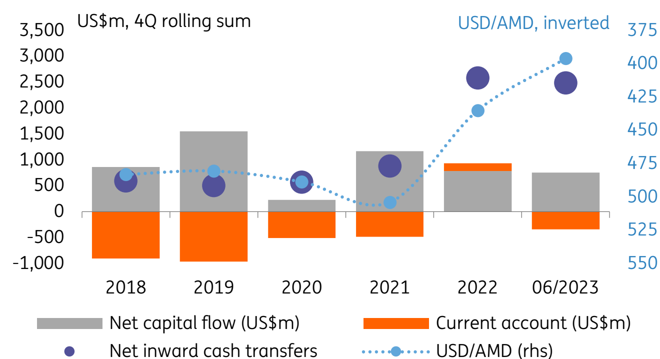


Source: National sources, CEIC, ING

Fiscal policy is leaning towards easing

The economically successful 2022 allowed a narrowing of the fiscal deficit to 2.1% of GDP. However, year-to-date, expenditure growth has picked up from 13% YoY to 16% YoY, currently outperforming revenues, keeping the deficit at 2.0% of GDP, and leading to its likely further widening. The continued military risks and the need to accommodate 100,000-120,000 refugees from Nagorno-Karabakh suggest that military and social spending (13% of GDP worth of spending, or 50% of total spending) are unlikely to shrink. Meanwhile, the revenue side should moderate along with normalisation of domestic activity. We see the fiscal deficit widening to 2.5-3.0% of GDP in the coming years, requiring the government to intensify local and foreign borrowing and suggesting an upside to the public debt, currently at around 50% of GDP.

Current account, remittances, and Armenian Dram (AMD)



Source: National sources, CEIC, ING

Risks of AMD correction are growing

Following the 25% rally vs USD between early 2022 and September 2023, the Armenian dram is in a vulnerable position, confirmed by the Karabakh-induced 4% sell-off in September-November. Even though the national currency has managed to stabilise, the risks of further depreciation persist. First, the current account is back to deficit on 52-57% YoY growth in imports of goods and services amid moderation of exports. Second, remittances inflow is also moderating as the immigrants from the neighbouring countries are settling in. Third, the nervousness around persisting Azerbaijan-Armenia tensions and Armenia distancing from Russia may negatively affect resident capital flows. Lastly, even despite the recent sell-off, the dram is still significantly stronger than other CIS FX. We expect 5-7% pa depreciation vs USD in 2024-25.

Armenia

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	3.3	3.6	3.2	0.2	7.5	5.2	7.7	-7.2	5.8	12.6	8.0	4.5	4.0
Private consumption (%YoY)	2.3	1.2	-6.0	-2.1	11.6	3.8	11.7	-10.9	1.3	5.6	6.0	5.0	4.0
Government consumption (%YoY)	7.6	-1.2	4.7	-2.4	-2.1	-3.0	12.9	9.2	-6.2	6.3	7.0	6.0	5.0
Fixed investment (%YoY)	-7.0	-2.2	2.5	-11.4	9.7	4.8	4.4	-1.5	23.6	9.0	12.0	6.0	5.0
Industrial production (%YoY)	6.3	1.5	5.2	6.5	12.3	4.2	9.0	-0.9	3.3	7.9	1.5	4.0	5.0
Unemployment rate (average, %)	16.2	17.6	18.5	18.0	17.8	19.0	18.3	18.2	15.5	13.0	12.5	12.7	13.0
Nominal GDP (AMDbn)	4,556	4,829	5,044	5,067	5,564	6,017	6,543	6,182	6,992	8,501	9,388	10,236	11,137
Nominal GDP (€bn)	8.4	8.7	9.5	9.5	10.2	10.5	12.2	11.1	11.7	18.4	22.0	21.5	21.5
Nominal GDP (US$bn)	11.1	11.6	10.6	10.5	11.5	12.5	13.6	12.6	13.9	19.5	23.7	23.8	24.5
GDP per capita (US$)	3,680	3,853	3,512	3,524	3,869	4,196	4,597	4,269	4,685	6,572	7,648	7,687	7,893
Gross domestic saving (% of GDP)	1.3	2.4	9.0	10.2	7.7	8.7	4.0	9.7	12.2	16.3	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	5.8	3.0	3.7	-1.4	1.0	2.5	1.4	1.2	7.2	8.6	2.3	4.3	4.6
CPI (year-end, %YoY)	5.6	4.6	-0.1	-1.4	2.6	1.8	0.7	3.7	7.7	8.3	1.2	5.3	4.4
Wage rates (nominal, %YoY)	6.0	8.2	8.0	2.3	3.2	-11.4	5.6	4.0	7.4	15.3	14.0	9.0	7.0
Fiscal balance (% of GDP)													
Consolidated government balance	-1.5	-1.9	-4.8	-5.5	-4.8	-1.6	-0.8	-5.1	-4.5	-2.2	-2.6	-3.0	-3.3
Consolidated primary balance	-0.5	-0.6	-3.3	-3.6	-2.6	0.7	1.6	-2.4	-2.0	0.1	-0.2	-0.5	-0.7
Total public debt	40.8	43.7	48.7	56.7	58.8	55.5	53.6	67.4	63.4	49.2	48.8	50.7	52.6
External balance													
Exports (US$bn)	1.6	1.7	1.6	1.9	2.4	2.7	3.4	2.7	3.3	5.7	8.0	8.2	8.7
Imports (US$bn)	3.8	3.8	2.8	2.9	3.8	4.5	5.1	4.1	4.8	7.6	10.2	10.5	10.5
Trade balance (US$bn)	-2.2	-2.1	-1.2	-1.0	-1.4	-1.8	-1.7	-1.4	-1.5	-1.9	-2.2	-2.3	-1.9
Trade balance (% of GDP)	-19.7	-17.7	-11.2	-9.3	-12.2	-14.2	-12.6	-10.9	-10.8	-9.5	-9.4	-9.6	-7.7
Current account balance (US$bn)	-0.8	-0.9	-0.3	-0.1	-0.1	-0.9	-1.0	-0.5	-0.5	0.2	-0.6	-0.9	-0.9
Current account balance (% of GDP)	-7.3	-7.7	-2.7	-1.0	-1.3	-7.2	-7.1	-4.0	-3.5	0.8	-2.5	-3.7	-3.8
Net FDI (US$bn)	0.3	0.4	0.2	0.3	0.2	0.3	0.2	0.1	0.3	0.9	0.4	0.3	0.2
Net FDI (% of GDP)	2.8	3.3	1.5	2.5	1.9	2.1	1.7	0.7	2.5	4.9	1.7	1.3	0.8
Current account balance plus FDI (% of GDP)	-4.5	-4.5	-1.2	1.5	0.7	-5.1	-5.3	-3.3	-1.0	5.6	-0.8	-2.4	-2.9
Gross international reserves (US$bn)	2.3	1.5	1.8	2.2	2.3	2.3	2.8	2.6	3.2	4.1	3.6	3.2	3.0
Import cover (months of merchandise imports)	7.1	4.8	7.6	9.2	7.3	6.0	6.7	7.7	8.1	6.5	4.2	3.7	3.4
Debt indicators													
Gross external debt (US$bn)	8.7	8.5	8.9	10.0	10.5	10.9	12.4	12.9	13.8	15.3	16.0	16.5	17.5
Gross external debt (% of GDP)	78.5	73.5	84.5	94.4	91.3	87.7	90.9	102.1	99.8	78.2	67.3	69.1	71.3
Gross external debt (% of exports)	534	503	549	526	441	401	368	475	423	267	199	200	202
Lending to corporates/households (% of GDP)	37.0	41.6	38.3	40.3	42.7	46.2	49.6	60.4	51.2	44.7	46.3	46.7	47.6
Interest & exchange rates													
Central bank key rate (year-end, %)	7.75	8.50	8.75	6.25	6.00	6.00	5.50	5.25	7.75	10.75	9.00	7.75	7.00
Money supply (%YoY)	14.9	-3.5	5.2	24.8	28.9	13.2	21.5	14.8	12.8	13.4	20.0	15.0	12.0
3m interest rate (average, %)	n/a	7.50	12.09	8.56	6.11	6.02	5.83	5.44	7.10	10.00	n/a	n/a	n/a
3m interest rate spread over US$-Libor (ppt)	n/a	7.25	11.76	7.76	4.82	3.67	3.54	4.84	6.90	7.45	n/a	n/a	n/a
2yr yield (average, %)	n/a	8.93	13.30	11.15	7.68	7.04	6.80	6.17	8.22	10.62	n/a	n/a	n/a
10yr yield (average, %)	n/a	11.26	14.92	14.00	11.10	9.72	9.48	7.99	9.39	11.24	n/a	n/a	n/a
USD/AMD exchange rate (year-end)	406	475	484	484	484	484	480	523	480	394	415	444	466
USD/AMD exchange rate (average)	410	416	478	480	483	483	480	489	504	436	396	430	455
EUR/AMD exchange rate (year-end)	560	577	529	512	580	554	537	641	543	420	444	511	522
EUR/AMD exchange rate (average)	544	552	530	532	545	571	538	558	597	461	428	477	519
Brent oil price (annual average, US$/bbl)	109	99	54	45	55	72	64	43	71	99	84	90	80

Source: National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	12.7	12.1	9.1	7.4	3.3	2.0	4.5	6.5	5.0	3.5	3.5	4.5	4.5
CPI (eop, %YoY)	8.3	5.4	-0.5	0.1	1.2	2.8	5.8	4.9	5.0	4.8	4.7	4.4	4.4
Central bank key rate (eop, %)	10.75	10.75	10.50	9.75	9.00	8.50	8.00	7.75	7.75	7.50	7.25	7.00	7.00
3m interest rate (eop, %)	11.23	11.02	10.94	10.36	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	11.99	11.75	10.78	10.17	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AMD exchange rate (eop)	394	388	387	396	415	422	430	437	444	450	455	461	466
EUR/AMD exchange rate (eop)	420	422	423	418	444	456	472	489	511	517	519	521	522

Source: National sources, ING estimates

Azerbaijan

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	1.3	0.0	4.0	2.5	2.0	0.6	2.5
CPI (%YoY)*	5.1	2.8	6.6	3.3	5.5	9.1	5.0
Policy interest rate (eop, %)	9.00	8.50	8.00	8.00	8.00	8.50	8.00
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*	1.80	1.82	1.84	1.87	1.90	1.83	1.88

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2025	S&P	BB+	BB+
Fiscal	Easing	Parliamentary: 2025	Moody's	Ba1	Ba1
Monetary	Neutral	Local: 2024	Fitch	BB+	BB+

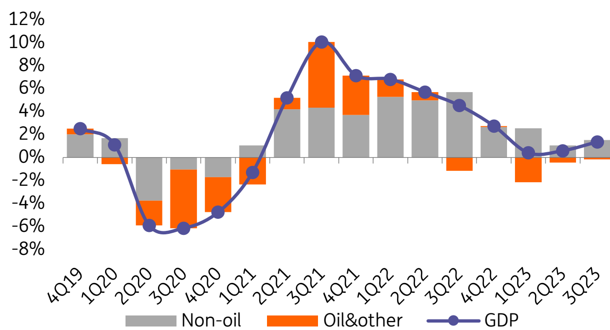
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

Country strategy: Foreign policy in focus

Having regained control of the breakaway Nagorno-Karabakh, Azerbaijan is likely to use fiscal policy more actively to reignite the waning economic growth momentum. The non-fuel sectors are likely to be supported by expanding retail lending, higher state investments and still elevated military spending amid continued tensions with Armenia. The fuel sector is likely to benefit from closer gas ties with EU. Despite some narrowing of the fiscal and current account surpluses in the coming 2-3 years, Azerbaijan's financial position appears solid.

The main watch factor, including for AZ-EU trade, for the near term is the development of the Azeri-Armenian relationship, namely Azerbaijan's desire to have a land bridge to its exclave Nakhichevan over Armenian territory.

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

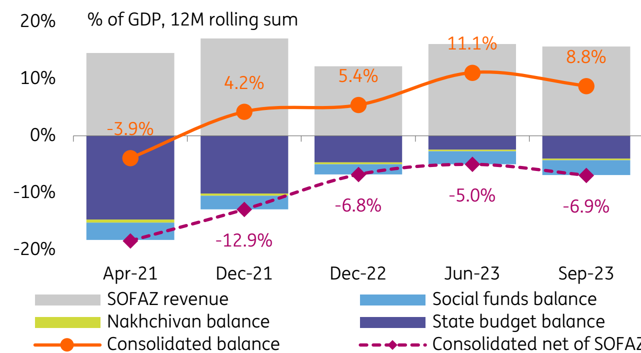


Source: National sources, CEIC, ING

Activity under pressure from unstable oil sector

Having picked up to 1.3% YoY in 3Q23 on stronger industrial output, Azerbaijani GDP declined 2.4% YoY in October given a 10.8% YoY drop in oil GDP, worsening the outlook for the full-year GDP. Oil extraction, the key contributor, remains volatile, and the main hope for a sustainable GDP recovery is related to non-oil sector performance. Growing gas supplies to the EU are also likely to provide support. In terms of financing, retail lending has shown signs of expansion from a stable 8-9% of GDP previously to 11% as of September, providing support to consumption. From a policy perspective, the scope for monetary easing seems limited given that the current slowdown in CPI is related mostly to the base effect rather than a reflection of material declines in fundamental inflationary pressures. Lastly, the fiscal policy, though generally prudent, is showing signs of easing.

Consolidated budget balance by components (% of GDP)

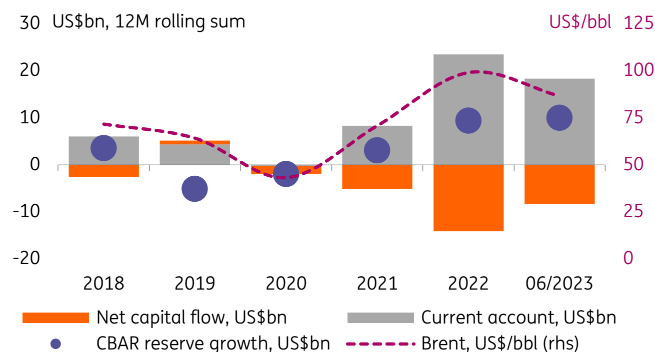


Source: National sources, CEIC, ING

Fiscal policy at an inflection point

Having seen a material widening in the consolidated budget surplus to 11% of GDP as of mid-2023, amid strong oil and non-oil revenues, it has narrowed to around 9% in September due to a pickup in expenditures by 2ppt of GDP since mid-year and 4ppt since the beginning of the year. The key drivers were higher social support, defence and investment spending, together accounting for two-thirds of the overall spending. The latter two are likely to remain elevated given continued tensions with Armenia (now over the potential land corridor to the Nakhichevan exclave) and the planned investments into the recently reintegrated Nagorno-Karabakh. We see Azerbaijan's consolidated surplus narrowing to 4-5% of GDP in 2023-24, which is still comfortable and does not create any additional need for borrowing.

Balance of payments composition (US$bn) and Brent (US$/bbl)



Source: National sources, CEIC, ING

Current account is heading back to normal

Despite the growing role of gas, Azerbaijan's balance of payments remains largely driven by oil exports, which are stable in volumes. The value of exports has dropped from US$38bn in 2022 to US$35bn (12m rolling basis) as of September 2023, while imports increased from US$15bn to US$17bn, respectively. As a result, the current account surplus shrank from US$24bn in 2022 to US$18bn (4Q sum) as of mid-2023 and is likely to narrow further to US$14bn by the year end. Going forward, we expect the maturing oil production to be gradually offset by higher gas output in exports, allowing yearly fuel exports to be maintained at around US$0.4bn per US$1/bbl of Brent price with a gradual increase in imports. Nevertheless, given our house view on oil, Azerbaijan should retain large surpluses in 2024-25, keeping the current USD/AZN 1.70 peg secure.

Azerbaijan

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	5.8	2.8	1.1	-3.1	0.2	1.5	2.5	-4.2	5.6	4.6	0.6	2.5	2.7
Real oil GDP (%YoY)	0.9	-2.9	0.6	0.1	-5.3	0.5	0.4	-6.5	1.4	-2.7	-2.5	0.7	1.5
Real non-oil GDP (%YoY)	9.9	6.9	1.1	-4.4	2.7	2	4	-2.9	7.1	9.0	2.7	3.7	3.5
Investment (%YoY)	15.1	-1.7	-11.1	-21.7	2.8	-4.3	5.5	-7.3	-4.5	5.5	15.0	3.0	5.0
Industrial production (%YoY)	1.8	-0.7	2.5	-0.5	-3.5	1.5	1.8	-4.0	5.0	-1.1	-2.0	1.7	3.0
Unemployment rate (average, %)	5.0	4.9	5.0	5.0	5.0	4.9	4.9	6.4	6.4	5.8	5.5	5.5	5.4
Nominal GDP (AZNbn)	58.2	59.0	54.4	60.4	70.3	80.1	81.9	72.6	93.2	133.8	137.6	144.6	156.8
Nominal GDP (€bn)	55.8	56.6	47.8	34.2	36.2	39.9	43.0	37.4	46.3	74.6	75.4	77.1	82.1
Nominal GDP (US$bn)	74.2	75.2	53.0	37.9	40.9	47.1	48.2	42.7	54.8	78.7	81.1	85.1	92.2
GDP per capita (US$)	7,977	7,991	5,562	3,929	4,199	4,798	4,851	4,269	5,458	7,798	7,926	8,237	8,846
Gross domestic saving (% of GDP)	48	44	31	28	31	35	31	23	34	46	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	2.4	1.4	4.0	12.4	12.9	2.3	2.6	2.8	6.7	13.9	9.1	5.0	5.6
CPI (year-end, %YoY)	3.5	-0.2	7.6	15.7	7.9	1.6	2.3	2.6	12.0	14.4	2.8	6.6	4.7
Wage rates (nominal, %YoY)	6.7	4.6	5.0	7.0	5.7	3.0	16.6	11.4	3.4	14.7	10.1	6.0	6.6
Fiscal balance (% of GDP)													
Consolidated government balance	1.8	2.9	-5.3	0.3	-1.5	5.9	9.1	-6.5	4.2	5.4	5.0	4.0	1.4
Consolidated primary balance	3.2	4.3	-3.8	2.4	0.9	8.7	10.9	-4.4	6.3	5.9	5.4	4.4	1.9
Total public debt	6.2	8.5	18.0	20.6	22.5	18.7	17.7	21.3	26.3	17.3	21.4	21.9	21.4
External balance													
Exports (US$bn)	31.8	28.3	15.6	13.2	15.2	20.8	19.9	12.6	21.7	40.9	34.2	37.0	34.2
Imports (US$bn)	11.2	9.3	9.8	9.0	9.0	11.0	11.3	10.1	10.4	13.5	15.9	16.8	17.0
Trade balance (US$bn)	20.6	18.9	5.8	4.2	6.1	9.8	8.5	2.5	11.3	27.4	18.2	20.2	17.2
Trade balance (% of GDP)	27.8	25.2	11.0	11.1	15.0	20.9	17.7	5.9	20.6	34.8	22.5	23.8	18.6
Current account balance (US$bn)	12.3	10.4	-0.2	-1.4	1.7	6.1	4.4	-0.2	8.3	23.5	14.4	15.3	12.5
Current account balance (% of GDP)	16.6	13.9	-0.4	-3.6	4.1	12.8	9.1	-0.5	15.1	29.8	17.7	17.9	13.5
Net FDI (US$bn)	1.1	2.4	0.8	1.9	0.3	-0.8	-1.4	-0.8	-2.2	-5.1	-3.0	-2.0	-1.0
Net FDI (% of GDP)	1.5	3.2	1.5	5.1	0.7	-1.7	-2.9	-1.8	-4.1	-6.5	-3.7	-2.4	-1.1
Current account balance plus FDI (% of GDP)	18.1	17.1	1.1	1.5	4.9	11.1	6.2	-2.3	11.0	23.3	14.0	15.6	12.5
Gross international reserves (US$bn)	14.2	13.8	5.0	4.0	5.3	5.6	6.3	6.4	7.1	9.0	10.0	11.0	12.0
Import cover (months of merchandise imports)	15.2	17.7	6.2	5.3	7.1	6.2	6.6	7.6	8.1	8.0	7.5	7.9	8.5
Debt indicators													
Gross external debt (US$bn)	10.6	12.1	13.3	14.6	15.3	16.2	15.8	15.8	14.6	15.0	14.5	14.5	14.5
Gross external debt (% of GDP)	14.3	16.1	25.1	38.5	37.4	34.4	32.9	37.0	26.7	19.1	17.9	17.0	15.7
Gross external debt (% of exports)	33.3	42.8	85.5	110.4	101.0	78.0	79.7	125.6	67.5	36.7	42.5	39.2	42.4
Lending to corporates/households (% of GDP)	26.5	31.4	40.0	27.2	16.7	16.3	18.7	20.0	18.4	15.1	18.5	18.9	18.9
Interest & exchange rates													
Central bank key rate (year-end, %)	4.75	3.50	3.00	15.00	15.00	9.75	7.50	6.25	7.25	8.25	8.50	8.00	7.00
Broad money supply (M3, %YoY)	15.0	11.8	-1.3	-1.9	9.0	5.7	20.0	1.1	18.7	23.6	7.0	10.0	11.0
3m interest rate (Bakibor, average, %)	9.7	10.8	9.2	13.5	20.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
3m interest rate spread over US$-Euribor (ppt)	944	1,055	883	1,274	1,933	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	0.78	1.56	1.77	1.70	1.70	1.70	1.70	1.70	1.70	1.7	1.7	1.7
USD/AZN exchange rate (average)	0.78	0.78	1.02	1.60	1.72	1.70	1.70	1.70	1.70	1.70	1.7	1.7	1.7
EUR/AZN exchange rate (year-end)	1.08	0.96	1.70	1.90	2.04	1.95	1.91	2.08	1.93	1.81	1.8	2.0	1.9
EUR/AZN exchange rate (average)	1.04	1.04	1.14	1.77	1.94	2.01	1.90	1.94	2.01	1.79	1.8	1.9	1.9
Brent oil price (annual average, US$/bbl)	109	99	54	45	55	72	64	43	71	99	84	90	80

Source: CEIC, National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	3.1	0.6	0.4	1.3	0.0	4.0	2.5	2.0	1.5	2.5	2.7	2.7	2.9
CPI (eop, %YoY)	14.4	13.6	10.6	5.1	2.8	6.6	3.3	5.5	6.6	4.7	5.7	5.3	4.7
Central bank key rate (eop, %)	8.25	8.75	9.00	9.00	8.50	8.00	8.00	8.00	8.00	7.75	7.50	7.25	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)	1.81	1.85	1.85	1.80	1.82	1.84	1.87	1.90	1.96	1.96	1.94	1.92	1.90

Source: CEIC, National sources, ING estimates

Bulgaria

Valentin Tataru, Chief Economist | Stefan Posea, Economist

Forecast summary

	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	1.7	1.8	2.2	2.5	3.1	1.9	2.9
CPI (%YoY)*	6.3	5.1	3.8	4.2	3.6	9.7	4.0
Base rate (eop,%)	3.53	3.60	3.60	3.55	3.50	3.60	3.50
10yr yield (%)	4.50	4.50	4.30	4.20	4.25	4.50	4.30
USD/BGN	1.85	1.83	1.81	1.78	1.75	1.75	1.67
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: 2027	Moody's	Baa1	Baa1
Monetary	Loose	Local: 2027	Fitch	BBB	BBB

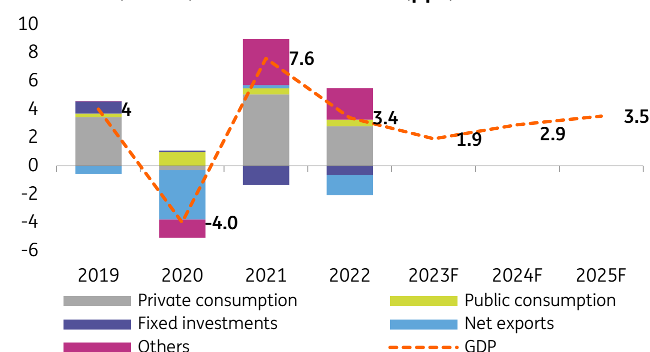
*Quarterly data is eop. annual is average

Source: National sources. ING estimates

Country strategy: Visible improvement, eurozone in sight

After a long period of political instability, which delayed reforms and EU Funds absorption, the country has been improving the pace of its reforms under what it looks like a broad political willingness to join the eurozone in 2025. While the amendment to the central bank law is still due, the bills passed in recent months are currently paving the way for the common currency goal. Though admittedly starting from a low base, the country's progress has been notable, to say the least – the World Justice Project shows that Bulgaria topped the EU rankings in rule of law progress in 2023, recording growth in all areas except regulatory enforcement. This also bodes well for the country's bid to join the Schengen area and provides further political stability support.

Real GDP (%YoY) and contributions (ppt)

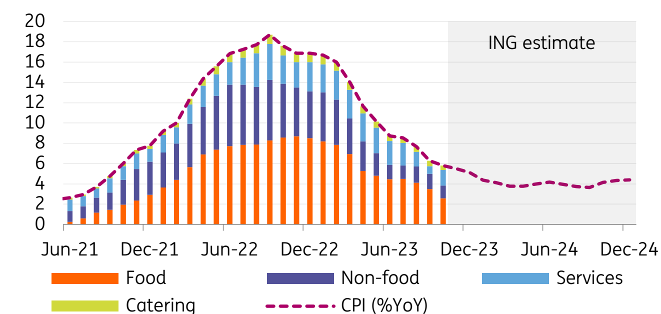


Source: NSI, ING

Growth should pick up next year

We expect improvements in private consumption and government spending to accelerate GDP growth towards the pre-pandemic growth trend. Firstly, real wages started to gain meaningful advances in the real positive territory as of March this year, and while private consumption could find some support from this starting 4Q23, we think the bulk of the positive impact will be felt in 2024. Moreover, 2H23 developments are paving the way for a reversal of the public spending downturn seen in 1H23, when the government coalition was finally formed. That said, we expect some headwinds too, stemming mainly from external demand as our below-consensus growth forecasts for Bulgaria's key EU trading partners is likely to feed into a stagnation of exports.

Inflation (%YoY) and main components (ppt)

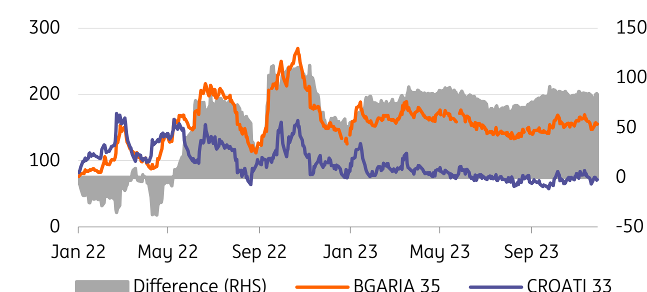


Source: NSI, ING

Inflation is falling but is still too high for the eurozone

CPI inflation continued to ease throughout 2023, reaching 5.8% in October. Despite visible progress towards lower price pressures on the back of lower energy prices and cooling demand to an extent, we think that strong wage advances will continue to keep inflation firm enough next year, leading to an end-of-period 2024 inflation rate of 4.4% - a situation under which the inflation criterion for joining the eurozone is unlikely to be met. Overall, we think that the substantial progress with the aforementioned reforms could serve as a strong enough reason for the EU to be, in the end, lenient towards this price pressure criterion, conditional on the authorities' commitment to fix the issue in due time.

BGARIA 2035 vs CROATI 2033 spreads (bp)



Source: Refinitiv, ING

Eurozone entry the key for BGARIA credit

Despite the inflation struggles, Bulgaria's ruling coalition is broadly moving towards adoption of the euro, with political will among the ruling parties clearly high. Over the coming years, this should act as a positive catalyst for Bulgaria, given reduced credit risk perception and technical tailwinds that come with euro adoption. We saw CROATI sovereign spreads tighten by around 100bp relative to BGARIA across the latter part of 2022 (on the back of Croatia's confirmation of Eurozone entry and Bulgaria's delay) and could see this dynamic reverse as Bulgaria makes progress towards the euro.

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Bulgaria

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	-0.5	0.9	3.4	3.0	2.7	2.7	4.0	-4.0	7.7	3.9	1.9	2.9	3.5
Private consumption (%YoY)	-3.9	1.4	2.8	2.2	2.6	3.7	6.0	-0.6	8.5	3.8	2.2	3.8	4.0
Government consumption (%YoY)	0.7	-0.1	1.8	2.2	4.3	5.3	2.0	8.3	0.4	5.5	-1.1	2.1	3.0
Investment (%YoY)	0.5	3.5	2.7	-6.6	3.2	5.4	4.5	0.6	-8.3	6.5	6.0	2.8	4.0
Industrial production (%YoY)	0.1	2.0	2.7	2.5	4.0	0.3	0.5	-6.3	10.1	12.8	-5.0	0.9	2.2
Unemployment rate (average, %YoY)	14.2	11.4	9.0	7.7	6.7	5.7	5.3	6.3	4.6	4.1	4.9	4.5	4.2
Nominal GDP (BGNbn)	82.3	84.1	89.6	95.3	102.7	109.9	120.3	120.5	139.0	167.8	186.2	197.3	208.1
Nominal GDP (€bn)	42.1	43.0	45.8	48.7	52.5	56.2	61.5	61.6	71.1	85.8	95.2	100.9	106.4
Nominal GDP (US$bn)	56.0	56.8	50.4	53.6	59.9	65.7	68.9	70.9	83.9	90.1	106.6	118.0	122.4
GDP per capita (US$)	7,700	7,900	7,100	7,600	8,500	9,400	9,900	10,300	12,200	13,200	15,700	17,400	18,000
Gross domestic saving (% of GDP)	20.4	20.4	21.9	23.9	24.1	23.7	24.2	22.3	22.9	23.6	22.8	22.4	22.2
Prices													
CPI (average %YoY)	0.9	-1.4	-0.1	-0.8	2.1	2.8	3.1	1.7	3.3	15.3	9.7	4.0	4.2
CPI (year-end %YoY)	-1.6	-0.9	-0.4	0.1	2.8	2.7	3.8	0.1	7.8	16.9	5.1	4.4	4.3
Wage rates (nominal %YoY)	8.6	2.4	7.9	7.0	10.5	7.4	12.0	8.6	12.0	13.7	14.0	8.0	7.0
Fiscal balance (% of GDP)													
Consolidated government balance	-0.7	-5.4	-1.9	0.3	1.6	1.7	2.1	-3.8	-4.0	-2.9	-2.8	-2.8	-2.0
Consolidated primary balance	0.0	-4.5	-0.9	1.2	2.4	2.4	2.7	-3.3	-3.5	-2.5	-2.6	-2.5	-2.0
Total public debt	17.0	27.0	25.9	29.1	25.1	22.1	20.0	24.5	23.9	22.9	26.5	26.0	25.5
External balance													
Exports (€bn)	22.3	22.0	22.9	23.1	26.9	27.7	29.1	27.3	34.4	45.9	43.0	48.6	51.0
Imports (€bn)	25.8	26.1	26.3	24.1	27.7	30.4	32.0	29.2	37.3	50.8	49.0	54.9	57.6
Trade balance (€bn)	-3.6	-4.1	-3.5	-1.0	-0.8	-2.7	-2.9	-1.9	-2.9	-4.9	-6.0	-6.3	-6.6
Trade balance (% of GDP)	-8.5	-9.5	-7.6	-2.0	-1.5	-4.8	-4.7	-3.2	-4.1	-5.7	-6.3	-6.2	-6.2
Current account balance (€bn)	0.5	0.5	0.0	1.5	1.7	0.5	1.1	0.0	-1.2	-1.2	0.5	0.1	0.1
Current account balance (% of GDP)	1.3	1.2	0.0	3.1	3.3	0.9	1.9	0.0	-1.7	-1.4	0.5	0.1	0.1
Net FDI (€bn)	1.4	0.3	2.0	0.9	1.6	1.0	1.6	3.0	1.5	2.6	3.5	3.6	3.7
Net FDI (% of GDP)	-3.0	-0.3	-4.1	-0.6	-1.3	-0.8	-1.2	-2.8	-1.3	-2.0	-3.7	-3.6	-3.5
Current account balance plus FDI (% of GDP)	-1.7	0.9	-4.1	2.5	2.0	0.2	0.6	-2.7	-3.0	-3.4	-3.1	-3.5	-3.4
Foreign exchange reserves (€bn)	14.4	16.5	20.3	23.9	23.7	25.1	24.8	30.9	34.6	38.4	40.4	44.1	47.9
Import cover (months of merchandise imports)	6.7	7.6	9.2	11.9	10.2	9.9	9.3	12.7	11.1	9.1	9.9	9.6	10.0
Debt indicators													
Gross external debt (€bn)	36.9	39.3	36.7	38.1	37.7	37.2	37.7	39.3	41.2	44.4	44.8	45.3	46.2
Gross external debt (% of GDP)	88	91	80	78	72	66	61	64	58	52	47	45	43
Gross external debt (% of exports)	166	178	160	165	140	134	129	144	120	97	104	93	91
Lending to corporates/households (% of GDP)	65.5	58.8	54.4	51.5	49.4	49.8	48.9	51.0	47.9	44.5	45.3	46.7	48.3
Interest & exchange rates													
Base interest rate (year-end %)	0.02	0.02	0.01	0.00	0.00	0.00	0.00	0.00	0.00	1.30	3.60	3.50	3.25
Broad money supply (average %YoY)	8.9	1.1	8.8	7.6	7.7	8.8	9.9	10.9	10.7	13.2	6.0	8.0	8.4
3yr yield (average %)	1.50	1.59	1.03	0.36	0.08	-0.05	-0.20	0.05	-0.05	2.50	3.00	2.80	2.50
10yr yield (average %)	3.54	3.42	2.83	2.19	1.60	0.94	0.46	0.40	0.30	1.00	4.50	4.30	4.00
USD/BGN exchange rate (year-end)	1.43	1.62	1.79	1.86	1.63	1.70	1.75	1.60	1.72	1.83	1.66	1.70	1.70
USD/BGN exchange rate (average)	1.47	1.48	1.78	1.78	1.72	1.67	1.75	1.70	1.66	1.86	1.75	1.67	1.70
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

	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	2.7	2.4	2.0	1.7	1.8	2.2	2.5	3.1	3.6	3.6	3.6	3.4	3.2
CPI (eop. %YoY)	16.9	14.0	8.7	6.3	5.1	3.8	4.2	3.6	4.4	4.2	4.2	4.2	4.3
Base interest rate (eop. %)	1.30	2.17	2.96	3.53	3.60	3.60	3.55	3.50	3.50	3.50	3.25	3.25	3.25
10yr yield (eop. %)	4.30	4.20	4.40	4.50	4.50	4.30	4.20	4.25	4.30	4.10	4.00	4.10	4.00
USD/BGN exchange rate (eop)	1.83	1.80	1.79	1.85	1.83	1.81	1.78	1.75	1.70	1.70	1.72	1.73	1.75
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

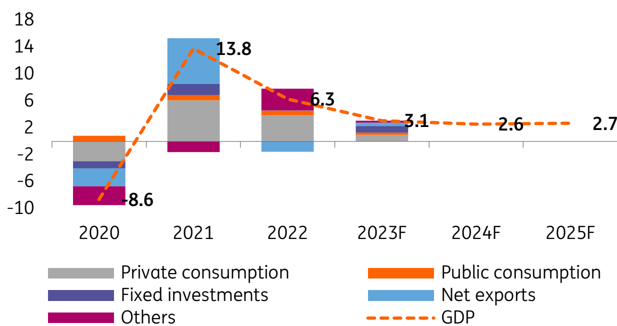
Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	3.5	3.5	2.8	2.4	2.6	3.1	2.6
HICP (%YoY)*	7.6	5.7	4.9	3.3	2.8	8.8	3.7
CPI (%YoY)	6.7	5.0	4.3	2.9	2.4	8.1	3.1
Key interest rate (eop, %)**	4.50	4.50	4.50	4.50	4.25	4.50	3.75
10yr yield (%)*	4.00	3.80	3.80	3.90	3.95	3.80	3.90

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

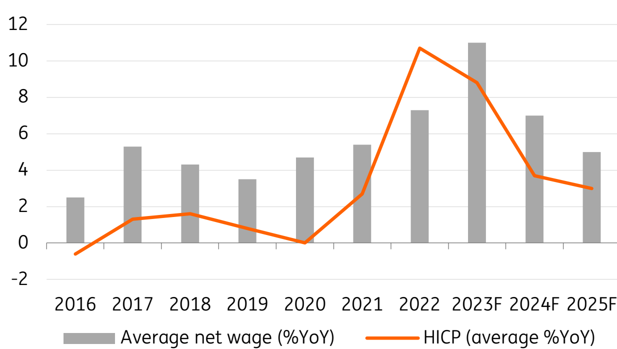
*Quarterly data is eop, annual is average; **ECB rate starting 1 January 2023
Source: National sources, ING estimates

Real GDP (YoY%) and contributions (ppt)



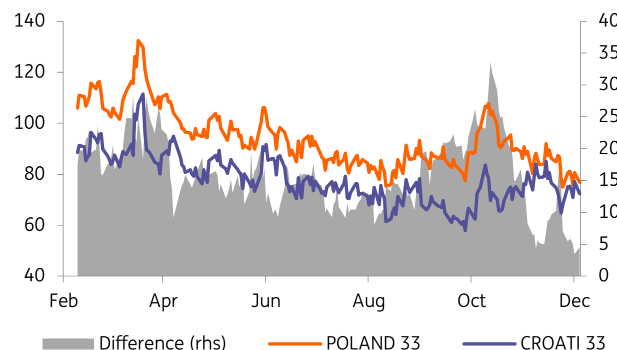
Source: Croatian Statistical Office, ING

Harmonised inflation and wages (YoY)



Source: Eurostat, ING

CROATI EUR credit spreads vs POLAND (bp)



Source: Refinitiv, ING

Country strategy: In good shape despite headwinds

Growth remained robust in 1H23, which is likely to continue in the quarters ahead, supported by EU-funded investments, domestic demand and the positive momentum from the country's Schengen and eurozone ascension. What's more, quasi-balanced budgets could push the public debt ratio below the dreaded 60% of GDP over the next couple of years and bring a rating upgrade. That said, in the short term, merchandise trade could be a drag on activity as demand from key trading partners is likely to deteriorate more than most expect and the recently imposed border controls due to illegal migration issues brings new trade frictions. While not in sight yet, a flattening of tourism revenues could be envisaged for 2024 as the country's repositioning as a more premium destination overlaps an at best sluggish consumer demand abroad.

Growth is back to its pre-pandemic trend

Deteriorations in industry and agriculture will have weighed on this year's activity. That said, the boost experienced by the financial industry due to euro adoption and a significantly stronger real estate sector are providing support. Furthermore, the consumer sector improved, supported by real wage growth, which is likely to continue in the quarters ahead. Coupled with a strong tourist season, we think that, all in all, activity will remain in good shape, and we pencil in an above-consensus growth of 3.1% in 2023 and 2.6% in 2024. We expect the moderation in 2024 to be driven by a flattening in private consumption and investment while the outlook for external demand remains foggy at best.

Inflation dips markedly but wage hikes pose risks

After peaking at 13.0% last year, the harmonised index of consumer prices (HICP) went down to 6.7% in October. Lower price pressures for energy, food and transport items were the key drivers. Producer price inflation has also slowed markedly and has remained at low levels since May. Admittedly, core inflation proved stickier – with an average of around 0.8ppt above the headline since the beginning of 2Q23. We expect this to continue in 4Q23 and only moderate slightly for 1Q24, as wage growth remains strong and unemployment remains low. In the short term, the government's latest aid package - worth €460m running until March 2024 and targeting electricity and food prices – is likely to offset most upside pressures. We expect HICP to end 2023 at 5.7% and 2024 at 3.0%.

CROATI bonds a defensive play

The government revised its 2023 budget deficit target to -0.3% of GDP (initial estimate: -2.3%), supported by better-than-anticipated revenues. In this context, we still anticipate small negative fiscal balances though – as phasing out the energy support measures will overlap increased social spending. A gradual move lower in debt ratios would improve a key weakness of the nation's credit profile.

In the context of very strong fundamentals and Eurozone membership, Croatia's euro bonds should retain strong investor demand in the coming years, despite relatively low credit spreads even compared to higher-rated Poland.

James Wilson, EM Sovereign Strategist

Croatia

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	-0.4	-0.4	2.5	3.6	3.4	2.8	3.4	-8.6	13.8	6.3	3.1	2.6	2.7
Private consumption (%YoY)	-1.6	-2.5	0.4	3.2	3.2	3.4	4.1	-5.2	10.6	6.7	2.3	2.0	2.0
Government consumption (%YoY)	0.6	1.3	-0.4	1.1	2.1	2.2	2.8	3.5	3.0	2.7	1.3	1.4	0.5
Investment (%YoY)	1.0	-2.3	8.2	5.0	1.6	3.9	9.0	-5.0	6.6	0.1	3.5	2.6	2.3
Industrial production (%YoY)	-1.5	1.1	2.5	4.8	1.9	-0.7	0.6	3.4	6.3	1.6	-2.0	2.2	2.0
Unemployment rate (year-end, %)	18.4	17.8	16.0	13.5	10.5	8.1	6.6	9.0	6.7	7.0	6.2	5.8	5.5
Nominal GDP (€bn)	44.8	44.7	45.8	47.4	49.6	52.1	54.9	50.6	58.4	66.9	76.3	81.0	85.0
Nominal GDP (US$bn)	60	59	50	52	57	61	61	58	69	70	85	95	98
GDP per capita (US$)	14,000	13,900	12,000	12,500	13,700	14,900	15,100	14,500	17,700	18,000	21,900	24,300	25,700
Gross domestic saving (% of GDP)	16.3	17.4	19.5	20.8	21.3	21.3	21.5	16.2	19.3	20.1	20.0	19.8	19.7
Prices													
HICP (average, %YoY)	2.3	0.2	-0.3	-0.6	1.3	1.6	0.8	0.0	2.7	10.7	8.8	3.7	3.1
HICP (year-end, %YoY)	0.5	-0.1	-0.3	0.7	1.3	1.0	1.3	-0.3	5.2	12.7	5.7	3.0	3.0
CPI (average, %YoY)	2.2	-0.2	-0.5	-1.1	1.1	1.5	0.8	0.1	2.6	10.8	8.1	3.1	2.7
CPI (year-end, %YoY)	0.3	-0.5	-0.6	0.2	1.2	0.9	1.4	-0.7	5.5	13.1	5.0	2.5	2.6
Wage rates (net nominal, %YoY)	-0.8	0.3	-3.4	2.5	5.3	4.3	3.5	4.7	5.4	7.3	11.0	7.0	5.0
Fiscal balance (% of GDP)													
Consolidated government balance	-5.5	-5.2	-3.5	-1.0	0.6	-0.1	0.2	-7.3	-2.5	0.4	-0.3	-1.2	-1.0
Consolidated primary balance	-2.5	-1.8	-0.1	2.0	3.3	2.2	2.4	-5.3	-1.0	1.5	1.0	-0.5	-0.5
Total public debt	80.1	83.8	83.2	79.7	76.5	73.2	71.0	87.0	78.4	68.4	62.0	60.2	58.2
External balance													
Exports (€bn)	9.6	10.4	11.5	12.3	14.0	14.5	15.2	14.9	18.4	24.1	22.9	23.8	24.8
Imports (€bn)	16.5	17.1	18.5	19.7	21.9	23.7	25.0	22.9	28.4	41.9	36.0	37.5	39.1
Trade balance (€bn)	-6.9	-6.8	-7.0	-7.4	-7.9	-9.2	-9.8	-8.0	-10.0	-17.8	-13.1	-13.7	-14.3
Trade balance (% of GDP)	-15.5	-15.1	-15.2	-15.6	-15.9	-17.7	-17.8	-15.8	-17.2	-26.5	-17.2	-16.9	-16.8
Current account balance (€bn)	-0.4	0.2	1.6	1.1	1.8	0.9	1.6	-0.3	1.0	-1.1	0.5	0.3	0.3
Current account balance (% of GDP)	-0.9	0.4	3.5	2.3	3.6	1.7	2.9	-1.5	1.8	-1.6	0.7	0.4	0.4
Net FDI (€bn)	-0.7	-0.7	-0.2	-2.0	-1.1	-0.8	-3.4	-0.7	-3.0	-3.7	-1.8	-1.8	-1.9
Net FDI (% of GDP)	-1.6	-1.5	-0.4	-4.2	-2.3	-1.6	-6.3	-1.5	-5.2	-5.5	-2.3	-2.2	-2.2
Current account balance plus FDI (% of GDP)	-2.5	-1.1	3.1	-1.9	1.4	0.1	-3.4	-3.0	-3.4	-7.0	-1.7	-1.9	-1.8
Foreign exchange reserves ex gold (€bn)	12.9	12.7	13.7	13.5	15.7	17.4	18.6	18.9	25.0	27.9	29.0	33.3	34.4
Import cover (months of merchandise imports)	9.4	8.9	8.9	8.2	8.6	8.8	8.9	9.9	10.6	8.0	9.7	10.6	10.6
Debt indicators													
Gross external debt (€bn)	48.7	49.5	48.6	45.1	43.9	42.8	40.6	41.3	47.2	49.8	57.6	57.0	56.0
Gross external debt (% of GDP)	108.6	110.8	106.2	95.0	88.5	82.2	73.9	81.6	80.8	74.4	75.5	70.4	65.9
Gross external debt (% of exports)	507	478	422	366	313	294	267	277	257	206	251	239	226
Lending to corporates/households (% of GDP)	70.0	69.2	65.2	60.3	56.5	54.7	53.3	61.0	54.5	52.3	54.0	55.4	56.9
Interest & exchange rates													
Central bank key rate (year-end,%)*	6.00	6.00	6.00	6.00	3.00	3.00	3.00	3.00	3.00	3.00	4.50	3.75	3.25
3yr yield (average, %)	n/a	4.00	4.10	3.50	2.60	1.80	0.70	0.50	0.15	1.60	3.20	3.40	3.20
10yr yield (average, %)	6.10	5.00	4.30	3.60	3.10	2.90	2.30	1.15	1.00	4.00	3.80	3.90	3.80
EUR/USD (average)	1.33	1.32	1.10	1.10	1.14	1.17	1.12	1.15	1.18	1.05	1.12	1.17	1.15
EUR/USD (end-period)	1.37	1.21	1.09	1.05	1.20	1.15	1.12	1.22	1.14	1.07	1.18	1.15	1.15

Source: National sources, ING estimates
*ECB key rate starting 1 January 2023

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	3.5	2.8	2.7	3.5	3.5	2.8	2.4	2.6	2.8	2.7	2.7	2.6	2.6
HICP (eop, %)	12.9	10.9	8.6	7.6	5.7	4.9	3.3	2.8	3.0	3.0	3.1	3.2	3.4
CPI (eop, %YoY)	13.1	10.7	7.6	6.7	5.0	4.3	2.9	2.4	2.5	2.8	2.7	2.7	2.6
Central bank key rate (eop, %)*	3.00	2.50	4.00	4.50	4.50	4.50	4.50	4.25	3.75	3.50	3.50	3.25	3.25
10yr yield (eop, %)	3.90	3.80	3.70	4.00	3.80	3.80	3.90	3.95	3.90	3.90	3.85	3.80	3.80

Source: National sources, ING estimates
*ECB key rate starting 1 January 2023

Czech Republic

Frantisek Taborsky EMEA FX & FI Strategist

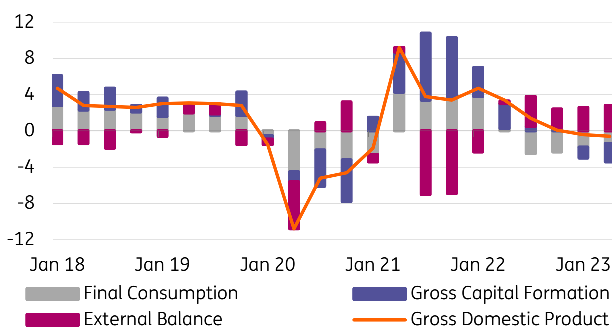
Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	-0.6	-0.1	0.4	1.0	1.8	-0.4	1.4
CPI (%YoY)*	8.1	7.9	2.6	2.4	2.3	10.9	2.4
Policy interest rate (%)	7.00	7.00	6.25	5.00	4.00	7.00	4.00
3m interest rate (%)*	7.10	7.05	6.30	5.05	4.05	7.12	4.86
10yr yield (%)*	4.85	4.55	4.45	4.20	4.05	4.61	4.21
USD/CZK*	23.10	23.10	22.70	22.25	21.45	22.29	21.79
EUR/CZK*	24.42	24.70	24.50	24.50	24.00	24.07	24.19

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

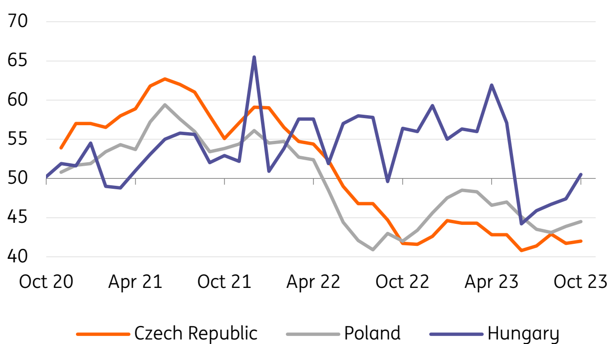
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

Real GDP growth structure (ppt of YoY growth, SA adj)



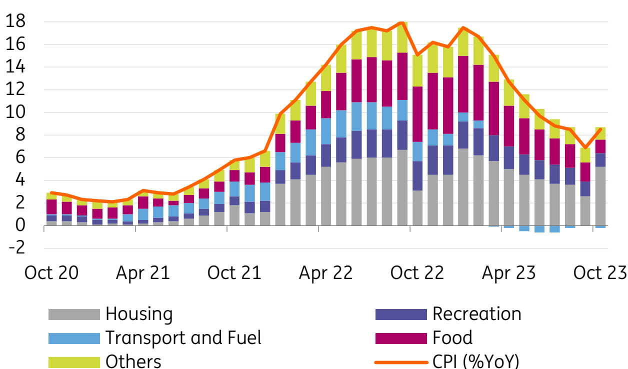
Source: CZSO, ING

Czech PMI underperforming the region



Source: Macrobond, ING

Structure of inflation (ppt)



Source: CZSO, ING

Country strategy: Right policy but a weak economy

The Czech economy has been on the verge of recession all year and any recovery next year will be fragile. Elsewhere, however, the picture is more optimistic. The labour market remains strong and wage growth should gradually slow. Inflation has fallen significantly this year and should be near the inflation target early next year, the first country in the CEE region to achieve this. Fiscal policy continues to consolidate and we expect to see a significant reduction in the government deficit over the next two years. Despite the tempting inflation profile, the central bank wants to stay on the safe side for as long as possible and to delay the start of the cutting cycle. However, a first rate cut looks inevitable despite the high level of uncertainty and we expect this move in February. The CZK is expected to weaken over the remainder of 2023 and in the first quarter of 2024. We expect it to strengthen again later.

Economy on the brink of recession but otherwise all good

The economy has been teetering on the edge of recession all year, dragged down mainly by falling household demand. Household consumption has been declining quarter-on-quarter since 4Q21, according to the national accounts, and even monthly retail sales data does not indicate any change. It is not hard to find reasons for this, notably the decline in real wages over the same period. At the same time, industry also shows a decline across the board, with the exception of automotive. Investment is also falling and foreign demand remains the main driver of the economy. Looking ahead, it seems that the recovery will not be easy and is again being postponed. We estimate this year's GDP growth at -0.4%, while next year we should see a slight recovery to 1.4%. Early next year real wage growth should return to positive levels after nine quarters, something that should support domestic demand.

For wages, not much has changed in the tightest labour market in Europe this year and we don't expect much next year either. The unemployment rate has been fluctuating around 2-3%, at 2.6% in 3Q on average. Detailed numbers occasionally show signs of easing, but we think this is more noise in the numbers than a change in trend. Unemployment remains almost unchanged and the government asserts that it is trying to simplify the process of hiring employees from abroad - but we are a long way from seeing any result in the numbers. Wage growth is gradually slowing, heading towards 6-7% at the end of this year and in 2024.

Inflation has quickly fallen from this year's peak of 18% YoY to 6.9% YoY in September. The base effect of government measures from last year was a factor in October, pushing YoY inflation back up to 8.5%. In November and December, we think it will fall back to just above 7% and January should be in the 2-4% YoY range, again mainly due to the base effect. The base effect is the main problem for inflation currently. Looking at monthly momentum, consumer prices stopped rising earlier this year. Core inflation may prove to be more persistent but still shouldn't be far off 3% next year. Downside surprises have been particularly apparent in this area in recent months and this should be enough for headline inflation to be near 2% next year.

Czech Republic

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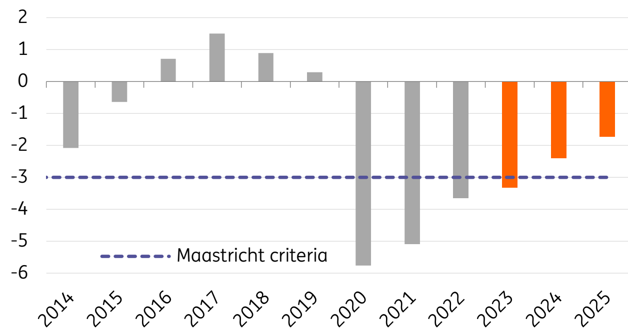
General government balance (% of GDP)

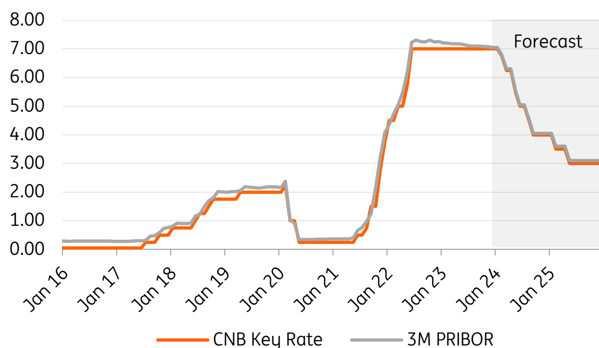


Source: MinFin, ING

Consolidation of public finances continues

Earlier this year the government announced a public finances consolidation effort and so far is on track to deliver this. This year's state budget is on track to meet its target, despite the challenges of the year, and the risk is that the deficit will be below MinFin expectations at the end of the year. Next year's consolidation package is already fully approved and the state budget proposal is in the final round of the legislative process. We expect a general government deficit at 3.3% of GDP this year and 2.4% next year. Public debt should stabilise at 46% of GDP. Moody's has responded to the consolidation efforts by upgrading its outlook from negative to stable Aa3. We expect Fitch to do the same next year.

CNB rate and PRIBOR (%)

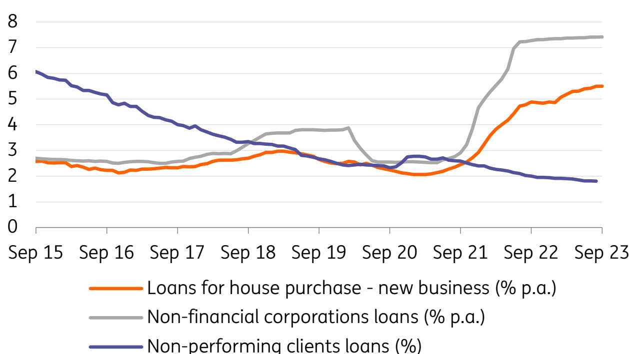


Source: Macrobond, ING

Central bank confirms its hawkish history

The Czech National Bank has held interest rates unchanged since June 2022, at 7.00%. At its November meeting, two of the seven board members voted to cut rates for the first time. With inflation falling, it is clear that rate cuts are near. However, the central bank has shown that it wants to remain cautious until the last minute. At this point, it appears that rates will remain unchanged in December as well. Thus, the next opportunity is the February meeting, which is now our baseline for the start of the cutting cycle. However, given the later release of January inflation, it is easy to find reasons to postpone this further, until the March meeting. Looking ahead, we expect the CNB to gradually accelerate the pace of rate cuts and we should get to 4.00% by the end of 2024.

Interest rates and NPL (%)

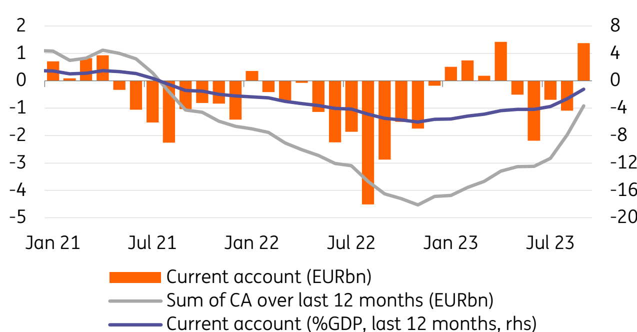


Source: CNB, ING

Mortgage market recovering despite the hawkish CNB

In June, the central bank decided for the first time to reduce the countercyclical capital buffer for banks, by 25bp to 2.25%, and to relax mortgage limits. Since then, it has made a few other adjustments aimed at easing credit conditions without changing interest rates. The mortgage market thus showed signs of recovery in the third quarter, with double-digit month-on-month growth. The economy appears to have adjusted to high interest rates and banks are beginning to compete more with each other in offering the lower rates that financial market conditions allow. NPLs remain at record lows despite past increases in central bank interest rates. The capital adequacy ratio of banks has reached 22%, near the all-time high.

Current account



Source: CNB, ING

Current account roughly balanced

The current account showed a significant improvement in the first half of the year, driven by a positive trade balance. In the second half of the year, the seasonal outflow of dividends abroad was more of a factor. The September figure returned to a significant current account surplus, again due to foreign trade but also due to foreign income inflows. Overall, the current account could end up roughly balanced this year and we should see a slight surplus next year.

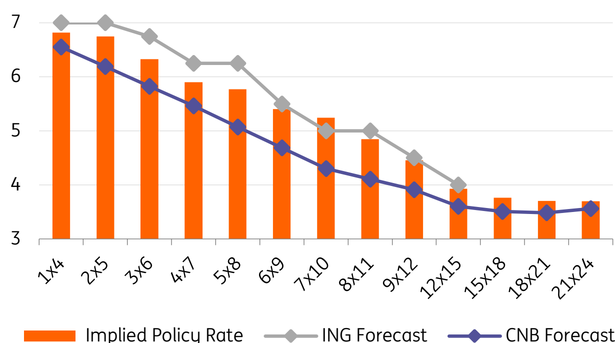
Czech Republic

Strategy

FX – spot vs forward and INGF

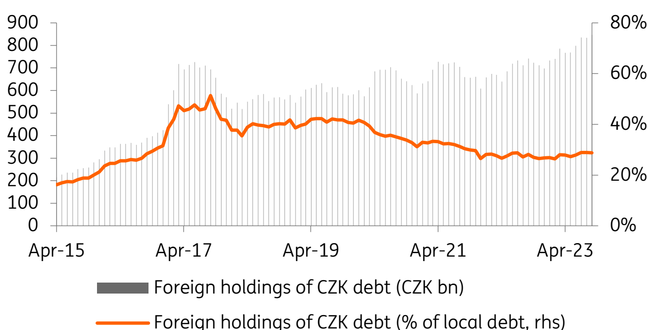
Source: Eikon, ING

Market expectations



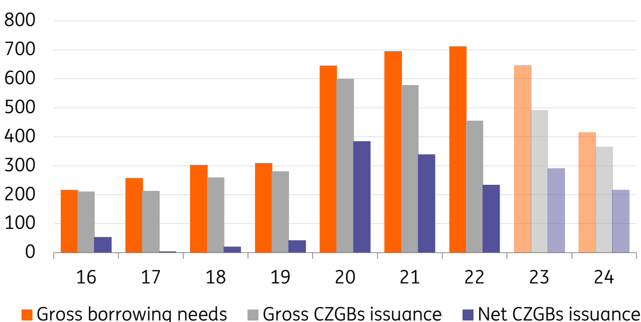
Source: Eikon, ING

Foreign holders of CZGB (%)



Source: Macrobond, ING

CZGBs issuance outlook (CZKbn)



Source: MinFin, ING

FX strategy

Given that the CNB is yet to start any cutting cycle it is hard to be positive on CZK in the short term. Although most of a cutting cycle has already been priced in the IRS curve, we believe there is still room for EUR/CZK to go up. Moreover, markets have had the habit of aggressively pricing down CZK as soon as the central bank gives them a reason to - the start of rate cutting is likely to cause some pain in the CZK market. On the other hand, we don't expect EUR/CZK to get above 25.00 for any extended period of time.

We see this as a story for the first quarter only and we think the CZK has a good chance to appreciate again later on. We expect the macro picture to start to improve. The current account is effectively balanced and we expect a slight surplus next year. We believe that, despite the current weak economic performance, the combination of inflation being on target (uniquely in the CEE region), fiscal consolidation and a hawkish central bank in a cutting cycle will be rewarded by markets with a stronger CZK.

Overall, we expect EUR/CZK to be closer to 25.00 by the end of 2023 and in early 2024. We expect levels around 24.50 for most of next year and it should test 24.00 again by the end of the year.

Fixed Income strategy

Financial markets are currently pricing in a 20bp rate cut for the December CNB meeting and 40bp for the February meeting. Overall, we see the market as once again pricing in too much in cuts for December and for 1Q in total. On the other hand, if we look beyond the 1y horizon, we believe there is room to price in more rate cuts. The terminal rate is currently priced slightly above 3.50% at the 1.5y horizon but thereafter the market expects the CNB to very quickly raise rates again. The absence of the beginning of a cutting cycle and high core rates in our view distort the curve in the belly and long end where we see the greatest mispricing at the moment. The CNB sees 3% as the equilibrium rate the cutting cycle should be heading to while it still sees the long end at c.4%. Overall, we see the whole curve as lower for the coming months, with some flattening bias later, after the start of the cutting cycle.

The CZGB picture for next year is net positive. On the supply side, we expect a significant 25% YoY drop in issuance due to a lower deficit but also a favourable maturity calendar. Risks are towards even lower supply due to incoming EU money and possibly a better deficit than MinFin expects. On the demand side, we believe CZGBs are still cheap against both CEE peers and the IRS curve. Therefore, we like CZGBs, both outright long and long in ASW, which we believe will head into negative territory early next year. Once the market corrects the mispricing at the long end of the IRS curve, we believe CZGBs will outperform the IRS and spreads will tighten significantly, back to historical averages.

Czech Republic

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	0.0	2.3	5.4	2.5	5.2	3.2	3.0	-5.5	3.6	2.4	-0.4	1.4	2.2
Private consumption (%YoY)	0.9	1.4	3.9	3.7	3.9	3.3	2.6	-7.4	4.1	-0.8	-3.2	2.6	3.6
Government consumption (%YoY)	2.4	1.0	1.8	2.5	1.8	3.9	2.5	4.2	1.4	0.6	2.5	1.1	1.1
Investment (%YoY)	-2.2	3.3	9.7	-3.0	4.9	10.0	5.9	-6.0	0.8	3.0	2.9	4.5	3.2
Industrial production (%YoY)	1.5	9.1	2.2	0.8	7.5	3.5	0.9	-6.1	10.8	16.1	-0,9	2.1	3.5
Unemployment rate (year-end, %)	6.8	5.8	4.6	3.7	2.4	2.1	2.1	3.1	2.3	2.4	2.5	2.7	2.8
Nominal GDP (CZKbn)	4,143	4,346	4,625	4,797	5,111	5,411	5,791	5,709	6,108	6,785	7,310	7,547	7,921
Nominal GDP (€bn)	165	159	170	175	190	201	207	190	202	276	304	307	328
Nominal GDP (US$bn)	212	209	188	196	219	249	253	246	282	290	329	338	370
GDP per capita (US$)	20,146	19,903	17,834	18,583	20,641	23,427	23,669	23,002	26,829	27,179	29,945	30,762	33,674
Gross domestic saving (% of GDP)	30.7	32.3	33.9	33.7	33.9	33.1	33.6	32.8	32.9	31.3	32.0	31.5	31.0
Prices													
CPI (average, %YoY)	1.4	0.4	0.3	0.7	2.5	2.1	2.8	3.2	3.8	15.1	10.9	2.4	2.0
CPI (year-end, %YoY)	1.4	0.1	0.1	2.0	2.4	2.0	3.2	2.3	6.6	15.8	7.1	2.2	2.0
Wage rates (nominal, %YoY)	-0.1	2.9	3.2	4.4	6.8	8.1	7.9	4.6	5.8	5.3	7.4	6.5	6.0
Fiscal balance (% of GDP)													
Consolidated government balance	-1.3	-2.1	-0.6	0.7	1.5	0.9	0.3	-5.8	-5.1	-3.6	-3.3	-2.4	-1.7
Consolidated primary balance	0.1	-0.6	0.4	1.6	2.2	1.6	1.0	-5.0	-4.3	-2.1	-2.5	-2.0	-1.7
Total public debt	44.4	41.9	39.7	36.6	34.2	32.1	30.0	37.7	42.0	44.2	44.6	46.0	46.2
External balance													
Exports (€bn)	107.2	114.4	119.6	122.0	133.4	141.0	143.8	131.7	154.0	157.7	159.3	167.2	176.9
Imports (€bn)	103.1	109.1	114.8	116.0	127.2	137.2	138.1	124.9	154.3	160.0	169.9	179.7	192.4
Trade balance (€bn)	4.1	5.3	4.8	6.1	6.2	3.8	5.7	6.8	-0.3	-4.0	10.6	12.5	15.5
Trade balance (% of GDP)	2.6	3.6	3.2	4.0	4.0	2.4	3.6	4.4	-0.2	-1.5	3.5	4.1	4.7
Current account balance (€bn)	-0.8	0.3	0.8	3.2	3.0	0.9	0.7	4.3	-2.0	-16.9	-2.5	0.0	1.0
Current account balance (% of GDP)	-0.5	0.2	0.4	1.8	1.5	0.4	0.3	2.0	-0.8	-6.1	-0.8	0.0	0.3
Net FDI (€bn)	0.3	-2.9	1.8	-6.9	-1.7	-2.0	-5.3	-5.6	-0.2	-7.0	-3.1	-2.4	-2.9
Net FDI (% of GDP)	0.2	-1.9	1.1	-3.9	-0.9	-0.9	-2.4	-2.6	-0.1	-2.5	-1.0	-0.8	-0.9
Current account balance plus FDI (% of GDP)	-0.3	-1.7	1.5	-2.1	0.6	-0.5	-2.0	-0.6	-0.9	-8.6	-1.8	-0.8	-0.6
Foreign exchange reserves ex gold (€bn)	43	45	59	81	120	125	132	134	153	140	130	130	130
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	7.0	6.8	6.5
Debt indicators													
Gross external debt (€bn)	97.5	104.3	112.8	123.0	168.4	169.9	172.0	163.6	170.5	185.0	190.0	188.0	190.7
Gross external debt (% of GDP)	62.0	70.3	75.2	81.3	108.4	106.5	108.0	105.8	107.0	83.3	89.2	83.2	85.1
Gross external debt (% of exports)	97	96	100	109	132	126	124.0	127.0	110.7	117.3	119.3	112.4	111.4
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	46.9	47.8	46.5
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	7.00	4.00	3.00
Broad money supply (average, %YoY)	4.5	5.1	7.3	9.1	11.7	6.6	6.3	9.0	9.6	6.4	8.9	8.5	8.1
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	7.12	4.86	3.23
3m interest rate spread over Euribor (ppt)	24	15	32	55	74	159	248	130	168	620	367	111	23
2yr yield (average, %)	0.31	0.18	-0.06	-0.31	-0.20	1.06	1.57	0.59	1.60	5.45	4.2	3.0	2.5
10yr yield (average, %)	2.11	1.56	0.70	0.44	1.06	2.02	1.61	1.18	1.97	4.40	4.61	4.21	3.00
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	23.08	20.65	20.54
USD/CZK exchange rate (average)	19.56	20.76	24.59	24.44	23.37	21.75	22.93	23.21	21.69	23.36	22.29	21.79	20.50
EUR/CZK exchange rate (year-end)	27.34	27.66	27.02	27.02	25.51	25.72	25.42	26.24	24.89	24.16	24.70	23.75	23.00
EUR/CZK exchange rate (average)	25.98	27.53	27.28	27.03	26.33	25.65	25.67	26.46	25.64	24.56	24.07	24.19	23.38

Source: National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	-0.4	-0.4	-0.6	-0.6	-0.1	0.4	1.0	1.8	2.4	2.0	2.3	2.3	2.3
CPI (eop, %YoY)	15.5	16.4	11.2	8.1	7.9	2.6	2.4	2.3	2.2	2.1	2.0	2.0	2.0
Central bank key rate (eop, %)	7.00	7.00	7.00	7.00	7.00	6.25	5.00	4.00	4.00	3.50	3.00	3.00	3.00
3m interest rate (eop, %)	7.26	7.18	7.13	7.10	7.05	6.30	5.05	4.05	4.05	3.60	3.10	3.10	3.10
10yr yield (eop, %)	5.10	4.67	4.38	4.85	4.55	4.55	4.45	4.20	4.05	4.15	4.15	4.15	4.15
USD/CZK exchange rate (eop)	22.56	21.65	21.78	23.10	23.10	22.70	22.25	21.45	20.65	20.45	20.60	20.80	20.55
EUR/CZK exchange rate (eop)	24.16	23.40	23.77	24.42	24.70	24.50	24.50	24.00	23.75	23.50	23.25	23.25	23.00

Source: National sources, ING estimates

Hungary

Péter Virovácz, Chief Economist

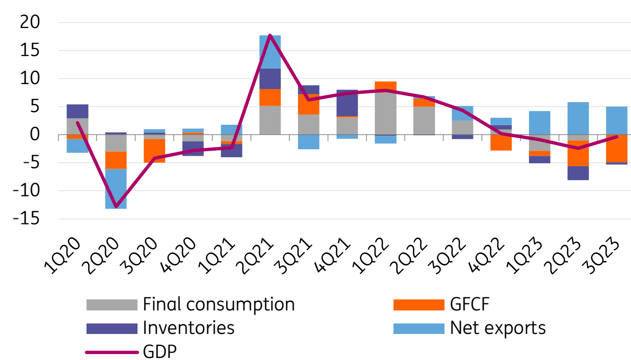
Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	-0.4	1.5	2.4	3.5	3.4	-0.6	3.0
CPI (%YoY)*	12.2	6.1	4.1	5.3	4.9	17.8	5.1
Policy interest rate (eop, %)	13.00	10.75	8.75	7.50	7.00	10.75	7.00
3m interest rate (%)*	12.27	9.90	8.25	7.15	6.75	14.21	7.43
10yr yield (%)*	7.37	6.80	6.60	6.50	6.60	7.66	6.62
USD/HUF*	370.0	350.5	340.7	331.8	325.9	352.9	332.1
EUR/HUF*	391.3	375.0	368.0	365.0	365.0	381.1	368.6

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2027	S&P	BBB-	BBB-
Fiscal	Tighter	Parliamentary: 2026	Moody's	Baa2	Baa2
Monetary	Tight	Local: 2024	Fitch	BBB	BBB

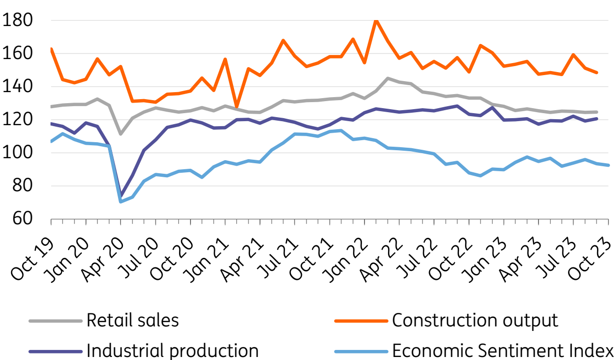
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

Contribution to YoY GDP growth (ppt)



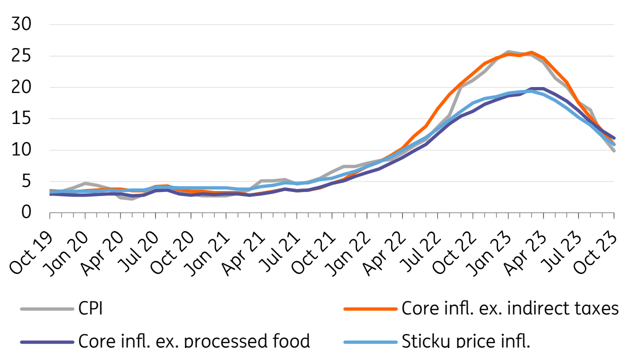
Source: Hungarian Central Statistical Office

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: The bumpy road to recovery begins

The good news is that Hungary has put the worst behind it and is on the road to recovery. The bad news is that we expect this road to be bumpy, as our GDP growth forecast of 3% in 2024 is based on the following positive assumptions: We see an agreement with the EU before the end of 2023, a potential boost to investment next year. While we see the positive real wage growth supporting the gradual improvement in consumption in 2024, we expect Hungary to avoid a strong reflation, although the risk is clearly there. New export capacities should help maintain a balanced growth structure, leading to a wider current account surplus. The inflow of EU funds will relieve a heavy burden on the budget, which can continue to consolidate. Improving external and internal balances, reduced financing needs and the highest positive real interest rates in the region lead us to be constructive on Hungarian assets next year.

Macro digest

In the first half of 2023, the Hungarian economy was torn between a technical recession and stagnation. The highest inflation rate in the European Union effectively stifled economic activity, as detailed GDP data for the first half of 2023 shows. In fact, every sector except agriculture reported a decline in output during this period, as the loss of purchasing power curbed consumption, while high interest rates and budget woes led to a collapse in investment. However, as widely expected, the economy has begun to recover from the cost-of-living crisis, as evidenced by positive QoQ GDP growth in the third quarter.

However, even if the economic data in the second half of 2023 is likely to be much stronger than in the first half, this year will be a lost year - a recessionary year, as we expect GDP to contract by 0.6% in 2023 as a whole. The good news is that the economy is starting to pull itself out of the ditch, but the road to full recovery will be a long one. In addition to a positive carry-over effect into 2024, we expect consumption to pick up slowly in the coming quarters, in line with a gradual recovery in consumer confidence and parallel positive real wage growth. Moreover, in a declining interest rate environment, investment activity is also likely to start recovering.

Given the current tight fiscal situation, access to EU funds will be crucial. In our base case, we expect an agreement to be reached this year, which in turn will help investment activity to pick up significantly. As a result, we expect the full-year GDP growth in 2024 to be around 3%, however, in the absence of EU funds we would be happy to see GDP growth reach the 1-2% range.

Fortunately, as in the case of economic activity, the worst is behind us in terms of inflation, with the headline figure falling back to single digits in October for the first time in 18 months. However, this does not mean that the fight against inflation is over, as we expect headline inflation to retreat to the central bank's tolerance band only in 2025. So far this year, the vast majority of disinflation can be attributed to base effects, but the limited pricing power of companies is also evident. As we believe that more disinflation is in the pipeline, we expect the 2023 year-end headline reading to sink below 7%. In terms of full-year forecasts, we expect this year's average inflation to be 17.7%, while in 2024 as a whole, to retreat to around 5.1%. Nevertheless, we see a couple of upside risks to our inflation forecast for next year, mostly stemming from either consumption related elements or taxes. In this regard, the expected high minimum wage increase and subsequent high real wage growth might strengthen the pricing power of companies, while the increase in excise duty on fuel from January may act as a headwind to the disinflation process.

Hungary

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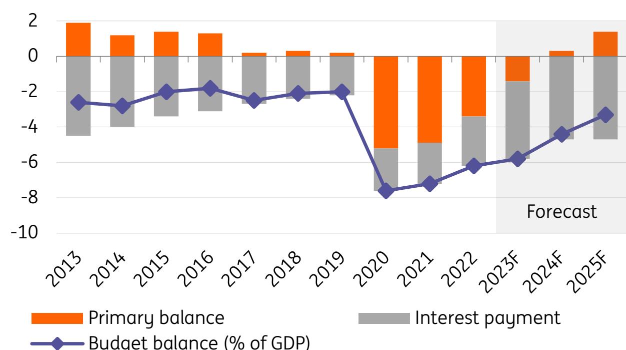
Budget and structural balance of general government (%)

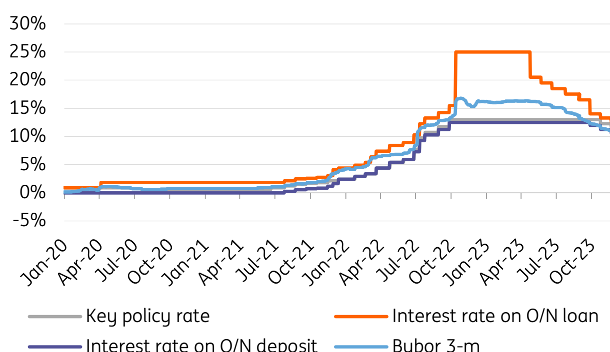


Source: AMECO, ING estimates

Consumption is the Achilles' heel of the Hungarian budget

This year, the cost of living crisis has hit the budget hard, as the revenue side has been heavily dependent on the inflow of indirect taxes. The Maastricht deficit target was revised from 3.9% to 5.2% of GDP, while the cash-flow-based target based on the financing need proxy was at 85% in October. Next year's fiscal situation looks fragile, as the official 2.9% deficit target for 2024 was announced this summer, but since then, the macro and fiscal outlooks have deteriorated versus government assumptions. Next year's budget depends on consumption picking up, because until it does the budget will continue to suffer. In this regard, the 2024 retail bond strategy will be crucial, as a potentially less attractive deal from the AKK might limit inflows and reinvestment, and thereby boost consumption rather than savings.

Benchmark policy rate and interest rate corridor

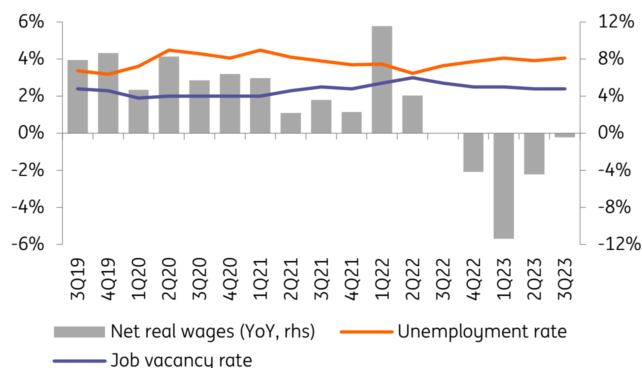


Source: National Bank of Hungary

Positive real interest rates are in the spotlight

The National Bank of Hungary (NBH) completed the normalisation of monetary policy in September and has since embarked on a cautious cycle of 75bp rate cuts. The central bank's reaction function is very clear, as it is carefully assessing incoming macroeconomic data and the external risk environment. The latest forward guidance was explicit, signalling that 75bp is the baseline step size until February if conditions do not deteriorate. We therefore expect the base rate to fall to 9.25% in February and reach 7% by the middle of next year, as we calculate there will be a downshift in the size of the cuts starting from March. From the third quarter of 2024 onwards, we expect a pause for a prolonged period, offering positive real interest rates of around 200bp for HUF assets.

Unemployment, job vacancy rate and wage growth

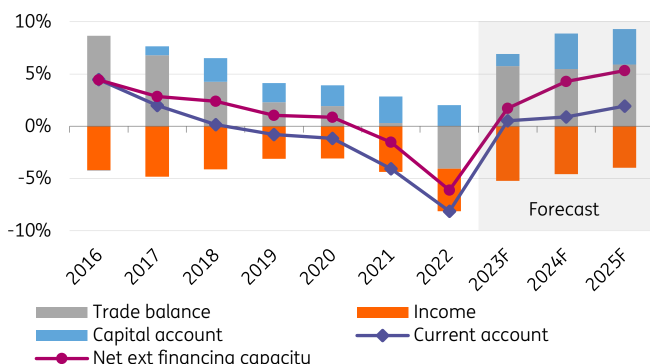


Source: Hungarian Central Statistical Office, ING estimates

Tight labour market is a double-edged sword

The labour market has remained remarkably stable despite sky-high inflation plunging the economy into a technical recession. In our view, a structural labour shortage may be one reason behind the resilience, which does, however, entail a long-term inflation risk. For this reason, the need for a generally tight monetary policy stance in the future is evident. Clearly, tight labour markets pose upside risks to both GDP and inflation, but we believe that if productivity can keep pace, then the risk of reflation will be limited. As for real wages, the year-long trend of negative year-on-year growth ended in September, but in our view the turnaround will have limited impact on consumption in the short-term. With consumer confidence at a ten-year low, we expect a long and gradual path to a full recovery.

Structure of the current account (% of GDP)



Source: National Bank of Hungary, ING estimates

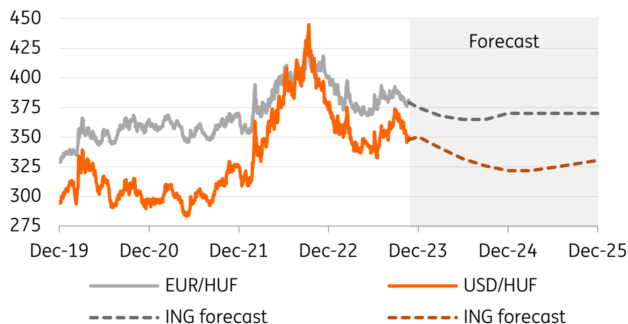
Current account balance is set to improve further

The collapse in domestic demand led to a slowdown in economic activity in the first half of the year, which rapidly reduced the need for imports, along with lower energy prices. These factors have led to persistent trade excesses, while the current account (CA) was in surplus in the second and third quarters of 2023. Our expectation is that the CA will close with a small surplus this year, and an even larger excess supported by new export capacities next year. We can, however, pinpoint two downside risks to our forecast, both impacting the import side. If EU funds were to flow earlier and in larger amounts than expected, import needs could increase. In addition, if the economic recovery is faster than expected, this could push up the import bill, therefore limiting the surplus in the CA.

Hungary

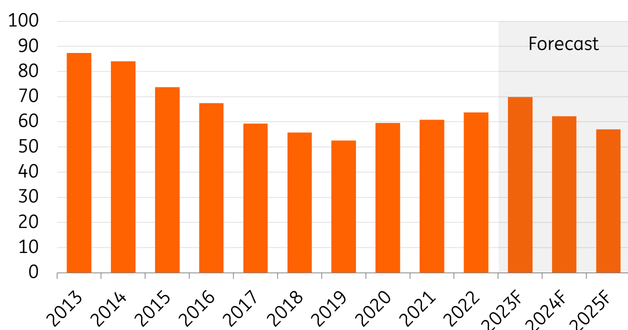
Strategy

FX – spot and INGF



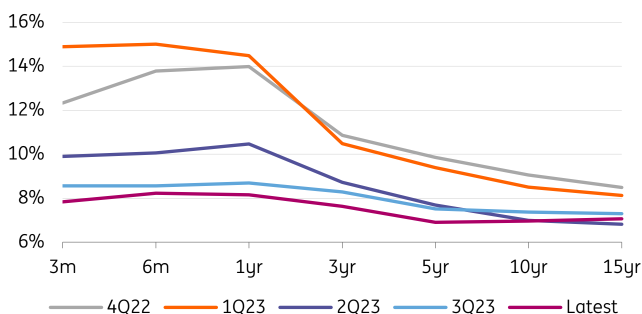
Source: National Bank of Hungary, ING estimates

Evolution of gross external debt (% of GDP)



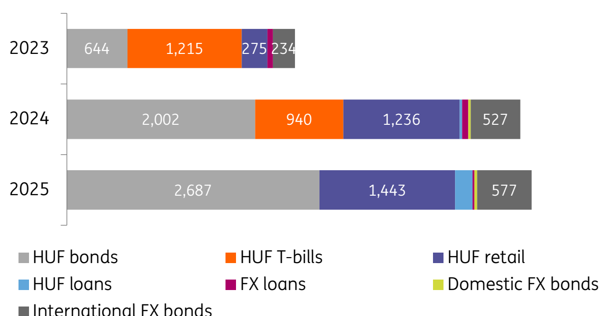
Source: National Bank of Hungary, ING estimates

Local curve (%)



Source: Government Debt Management Agency

Public debt redemption profile (end-Sep 2023, HUFbn)



Source: Government Debt Management Agency

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

The forint has come a long way since the emergency rate hike last October. From all-time highs, EUR/HUF was trading as low as 370 in mid-2023. Since then, we have seen a correction as a result of global market sentiment and rising core yields. However, over the past month, risk aversion has receded and the weaker dollar is paving the way for another HUF breakout.

In the short term we will probably need to see some catalysts for fresh gains. The main contributor could be the EU funds story. Our baseline is an agreement before the end of 2023, giving Hungary the opportunity to partially access the Cohesion Fund as well as advance payments from the RRF and REPowerEU. As a result, we remain positive on the HUF. If all goes well, we expect EUR/HUF to return to the 370-375 range before the end of the year. The recent weakness probably hasn't changed the market's long positioning much and we should still keep that in mind in case of bad news.

For next year, we differ significantly from the market consensus in HUF, which is based on a more optimistic view of the general macroeconomic stance. We see a substantial recovery, continued disinflation, a higher current account surplus, tighter fiscal policy and the highest positive real interest rate in the CEE region, on top of the expected access to EU funds and some possible rating upgrades. This could lead to a forint appreciation towards 365 (or even below) around mid-2024 if nothing goes wrong. Towards the end of next year, the decline in the real interest rates will reduce the relative attractiveness of the HUF, leading to a small correction.

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

HGBs have rallied significantly since peak yields but we believe there is still much to offer. The NBH is continuing its rapid cutting cycle and disinflation is still benefiting from the base effect. Hungary's Debt Management Agency (AKK) indicates a slight 7% YoY decline in gross HGB supply for next year, however, retail bonds remain the main funding instrument in Hungary, and overall borrowing needs are down 17% YoY. On the negative side, we expect the budget deficit to be revised upwards later next year. However, AKK has a buffer in retail bond issuance, which should take pressure off HGB issuance, in our view.

Hungary's fairly modest Eurobond issuance plans for 2024 (€3.8bn gross including up to US$2bn in USD and benchmark EUR green bond in 1H24, or €2bn net) are a positive relative to its CEE peers. At the same time, external and fiscal metrics are improving, while potential progress on EU funds remains something of a wildcard that could offer a positive or negative catalyst. In this context there are reasons to be optimistic for next year, while new issuance 1Q24 could be an interesting opportunity.

Hungary

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	1.8	4.2	3.7	2.2	4.3	5.4	4.9	-4.5	7.1	4.6	-0.6	3.0	3.6
Private consumption (%YoY)	-0.2	2.5	3.7	4.8	4.7	4.8	5.1	-1.3	4.8	6.5	-3.1	2.6	3.4
Government consumption (%YoY)	5.6	8.9	1.3	0.5	3.8	4.3	9.5	3.9	2.5	0.4	-0.1	0.4	1.8
Investment (%YoY)	9.8	12.2	4.9	-10.6	19.7	16.3	12.8	-7.1	5.8	0.1	-8.8	4.8	5.3
Industrial production (%YoY)	1.1	7.7	7.4	0.9	4.6	3.5	5.6	-6.0	9.5	6.1	-4.0	5.0	6.8
Unemployment rate (year-end, %)	7.9	6.9	5.7	4.1	3.5	3.3	2.9	4.2	3.8	3.8	3.9	3.6	3.4
Nominal GDP (HUFbn)	30,352	32,805	34,965	36,207	39,275	43,387	47,674	48,425	55,199	66,075	74,251	81,154	87,626
Nominal GDP (€bn)	102	106	113	116	127	136	147	138	154	169	195	220	237
Nominal GDP (US$bn)	136	140	124	128	145	159	164	159	182	177	210	244	270
GDP per capita (US$)	13,715	14,299	12,711	13,109	14,630	16,423	16,787	16,129	18,744	18,287	21,919	25,480	28,175
Gross domestic saving (% of GDP)	25.1	25.2	25.9	26.0	25.1	27.0	27.6	26.1	26.6	26.0	22.5	23.7	24.9
Prices													
CPI (average, %YoY)	1.7	-0.2	-0.1	0.4	2.4	2.8	3.4	3.3	5.1	14.5	17.7	5.1	4.2
CPI (year-end, %YoY)	0.4	-0.9	0.9	1.8	2.1	2.7	4.0	2.7	7.4	24.5	6.1	6.2	3.0
Wage rates (nominal, %YoY)	3.4	3.0	4.3	6.2	12.9	11.3	11.3	9.8	8.9	17.4	12.5	7.5	6.0
Fiscal balance (% of GDP)													
Consolidated government balance	-2.6	-2.8	-2.0	-1.8	-2.5	-2.1	-2.0	-7.6	-7.2	-6.2	-5.8	-4.4	-3.3
Consolidated primary balance	1.9	1.2	1.4	1.3	0.2	0.3	0.2	-5.2	-4.9	-3.4	-1.4	0.3	1.4
Total public debt	77.2	76.5	75.8	74.9	72.1	69.1	65.3	79.3	76.7	73.9	73.8	70.5	66.4
External balance													
Exports (€bn)	81.3	84.5	90.5	93.0	100.7	104.9	109.1	105.0	119.2	142.5	149.1	160.0	170.5
Imports (€bn)	74.7	78.2	81.9	83.3	92.6	99.3	104.8	99.4	117.6	151.7	141.3	150.6	159.6
Trade balance (€bn)	6.6	6.3	8.6	9.7	8.1	5.5	4.3	5.6	1.6	-9.1	7.8	9.3	11.0
Trade balance (% of GDP)	6.4	5.9	7.6	8.4	6.4	4.1	3.0	4.1	1.1	-5.4	4.0	4.2	4.6
Current account balance (€bn)	3.6	1.3	2.6	5.2	2.5	0.2	-1.2	-1.5	-6.5	-13.9	1.0	2.0	4.6
Current account balance (% of GDP)	3.5	1.2	2.3	4.5	2.0	0.2	-0.8	-1.1	-4.2	-8.2	0.5	0.9	1.9
Net FDI (€bn)	2.1	5.1	2.3	3.9	5.1	5.6	3.1	4.6	6.0	8.0	7.1	8.0	6.5
Net FDI (% of GDP)	2.0	4.8	2.0	3.3	4.0	4.1	2.1	3.3	3.9	4.8	3.6	3.6	2.7
Current account balance plus FDI (% of GDP)	5.5	6.0	4.4	7.8	6.0	4.2	1.3	2.2	-0.3	-3.5	4.2	4.5	4.7
Foreign exchange reserves ex gold (€bn)	32.6	33.7	30.0	24.0	22.6	25.8	26.5	31.8	30.8	30.8	29.8	34.5	41.1
Import cover (months of merchandise imports)	5.2	5.2	4.4	3.5	2.9	3.1	3.0	3.8	3.1	2.4	2.5	2.7	3.1
Debt indicators													
Gross external debt (€bn)	89.3	89.4	83.2	78.3	75.3	75.9	77.1	82.2	93.6	107.5	136.2	137.0	134.9
Gross external debt (% of GDP)	87	84	74	67	59	56	53	60	61	64	70	62	57
Gross external debt (% of exports)	110	106	92	84	75	72	71	78	79	75	91	86	79
Lending to corporates/households (% of GDP)	44.6	41.1	33.8	32.2	31.3	31.3	32.3	36.1	35.7	33.3	30.3	28.5	27.9
Interest & exchange rates													
Central bank key rate (year-end, %)	3.00	2.10	1.35	0.90	0.90	0.90	0.90	0.60	2.40	13.00	10.75	7.00	5.00
Broad money supply (average, %YoY)	4.1	4.1	4.7	4.6	9.6	13.9	7.5	14.5	17.4	16.3	4.0	6.0	9.0
3m interest rate (Bubor, average, %)	4.32	2.41	1.61	0.99	0.14	0.12	0.19	0.69	1.46	9.97	14.21	7.43	5.47
3m interest rate spread over Euribor(ppt)	409	221	164	130	46	43	54	112	203	953	1076	368	247
3yr yield (average, %)	4.8	3.5	2.1	1.5	0.9	1.3	0.8	1.0	2.0	8.5	9.0	6.8	5.6
10yr yield (average, %)	5.9	4.8	3.4	3.1	3.0	3.0	2.5	2.2	3.1	7.6	7.7	6.6	6.6
USD/HUF exchange rate (year-end)	216.7	260.2	287.3	296.2	258.5	279.6	295.1	299.3	323.7	373.9	350.5	321.7	330.4
USD/HUF exchange rate (average)	223.2	233.8	281.7	283.1	271.2	272.5	290.5	305.4	303.8	372.7	352.9	332.1	324.6
EUR/HUF exchange rate (year-end)	296.9	314.9	313.1	311.0	310.1	321.5	330.5	365.1	369.0	400.3	375.0	370.0	370.0
EUR/HUF exchange rate (average)	296.9	308.7	309.9	311.5	309.2	318.9	325.4	351.2	358.5	391.3	381.1	368.6	370.0

Source: National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	0.2	-0.9	-2.4	-0.4	1.5	2.4	3.5	3.4	2.8	3.0	3.1	3.8	4.6
CPI (eop, %YoY)	24.5	25.2	20.1	12.2	6.1	4.1	5.3	4.9	6.2	5.0	4.3	3.7	3.0
Central bank key rate (eop, %)	13.00	13.00	13.00	13.00	10.75	8.75	7.50	7.00	7.00	6.50	5.75	5.50	5.00
3m interest rate (eop, %)	16.18	16.30	15.17	12.27	9.90	8.25	7.15	6.75	6.75	6.00	5.35	5.00	5.00
10yr yield (eop, %)	9.05	8.50	6.99	7.37	6.80	6.60	6.50	6.60	6.60	6.70	6.60	6.50	6.40
USD/HUF exchange rate (eop)	373.9	351.5	340.2	370.0	350.5	340.7	331.8	325.9	321.7	321.7	324.6	327.4	330.4
EUR/HUF exchange rate (eop)	400.3	381.0	371.1	391.3	375.0	368.0	365.0	365.0	370.0	370.0	370.0	370.0	370.0

Source: National sources, ING estimates

Kazakhstan

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	3.7	4.5	3.5	3.0	4.5	4.7	4.0
CPI (%YoY)*	11.8	9.8	8.9	8.6	8.0	14.8	8.4
Policy interest rate (%)	16.50	15.75	14.75	13.75	12.75	15.75	11.75
3m interest rate (%)*	16.8	15.5	14.5	13.5	12.5	15.9	13.5
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT*	478	460	460	460	465	455	463
EUR/KZT*	505	492	497	506	521	491	514

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

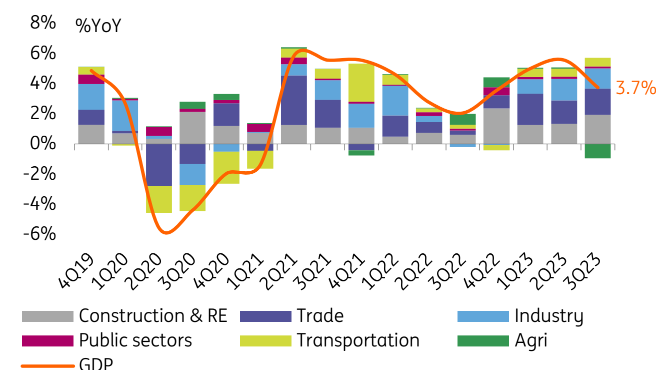
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

Country strategy: Fiscal policy is the key watch factor

Despite some slowdown in 3Q23, Kazakhstan is on track to post c.4.5-5.0% GDP growth in 2023 provided there are no material disruptions in the oil sector, while the disinflation continues and allows further easing in the monetary policy. Meanwhile, the fiscal policy seems to be back in easing mode given the appetite for more social and investment spending. That should also support growth but might create inflationary risks if overdone.

Wider budget deficit amid the announced tightening in the fiscal rule means that less oil revenues can be used to finance current expenditures. All else being equal, it means a higher borrowing requirement and lower support to the tenge from the state capital flows, unless more non-residents participate in bond placements.

GDP growth and major contributors (%YoY)

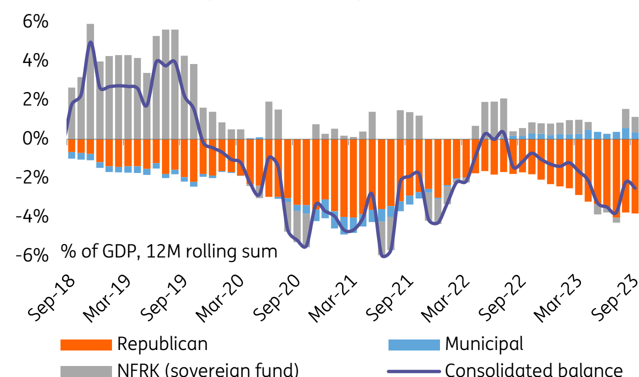


Source: National sources CEIC, ING

GDP on track to 4.5-5.0% in 2023 despite sluggish 3Q23

Although Kazakhstan's GDP growth softened from 5.3% YoY in 1H23 to 3.7% YoY in 3Q23, 1ppt of this slowdown was driven mainly by the agriculture sector, while the remainder was due to telecoms and IT. The core construction and trade sectors continue to show stable growth, and the largely oil-driven industrial output growth reached upper single digits in 3Q23 and October after a sluggish 2H22 and 1Q23. We continue to see full-year GDP growth at around 4.5-5.0% this year, with some moderation to 4.0% in 2024 amid possible postponement of production at the Tengiz oilfield. The support factors for growth include credit expansion, a likely 4-6ppt key rate cut in 2024-25 from the current 15.75% amid the expected slowdown in the CPI to 6-7% by the end of 2025, and some signs of renewed easing in the fiscal policy, which became evident in 1H23.

Consolidated budget balance by components (% GDP)

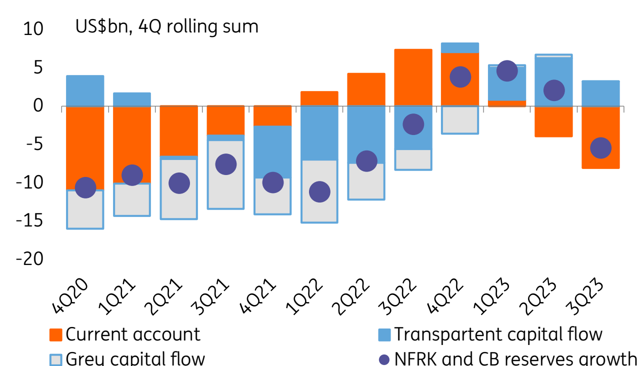


Source: National sources CEIC, ING

Budget deficit is widening, more borrowing is needed

After an improvement in the fiscal balance caused by the exceptional macroeconomic conditions of 2022, Kazakhstan's consolidated budget deficit widened from 1.3% of GDP at end-2022 to 2.5% as of end-September (12M rolling basis), while the republican budget (the key non-fuel element) deficit widened from 2.3% to 3.8% of GDP. The widening took place due to higher expenditure on human and physical capital, as well as on social support. Meanwhile, the announced tightening fiscal rule means a lower role for NFRK, the oil fund, in financing the deficit and a higher role for borrowing. We see the 2023-24 republican budget deficit at 3-4% of GDP (KZT4.5-5.0tr) per year, which should be the corresponding borrowing requirement. The finance ministry has so far preferred to focus on domestic borrowing, but that might change in the case of a wider-than-expected budget deficit.

Key components of balance of payments (US$bn)



Source: National sources CEIC, ING

State capital flows are key for the tenge

Kazakhstan's balance of payments is showing normalisation. The current account is back to deficit amid moderation of oil prices and fast 25-30% YoY growth in imports, predominantly from China. Meanwhile, the private capital flows are somewhat positive but not enough to fully offset the current account deficit. In this context, state capital flows, represented by transactions of NFRK and state foreign borrowing, may become pivotal for the domestic foreign exchange market. Currently, the sale of FX oil revenues of NFRK are recovering following a temporary decline in 2H22 and 1Q23. At the same time, the tighter fiscal rule means a lowering of FX sales over the next three years. This may translate into a return to a weaker KZT in the longer run after relatively strong near-term performance.

Kazakhstan

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	6.0	4.2	1.2	1.1	4.1	4.1	4.5	-2.5	4.3	3.2	4.7	4.0	5.0
Private consumption (%YoY)	10.6	1.1	1.8	1.2	1.5	6.1	6.1	-3.7	6.3	4.0	6.5	4.5	3.5
Government consumption (%YoY)	1.7	9.8	2.4	2.3	2.1	-14.1	15.5	12.8	-2.4	4.3	20.0	4.0	6.0
Investment (%YoY)	5.5	4.4	4.2	3.0	4.5	5.4	13.8	-0.2	2.6	3.8	20.0	4.0	6.0
Industrial production (%YoY)	2.5	0.3	-1.6	-1.1	7.3	4.4	-4.1	-0.5	3.6	1.1	4.5	3.5	5.0
Unemployment rate (average, %)	5.2	5.0	5.0	5.0	4.9	4.9	4.8	4.8	4.0	4.9	4.7	4.7	4.6
Nominal GDP (KZTbn)	35,999	39,676	40,884	46,971	54,379	61,820	69,533	70,649	83,952	103,766	120,692	133,444	149,424
Nominal GDP (€bn)	178	167	166	124	148	152	162	150	167	214	287	320	350
Nominal GDP (US$bn)	237	221	184	137	167	179	182	171	197	225	265	288	307
GDP per capita (US$)	13,891	12,807	10,511	7,715	9,248	9,813	9,813	9,122	10,371	11,484	13,199	14,128	14,822
Gross domestic saving (% of GDP)	40	41	35	34	37	40	39	34	38	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	5.8	6.7	6.6	14.7	7.4	6.0	5.2	6.8	8.0	14.9	14.8	8.4	6.6
CPI (year-end, %YoY)	4.8	7.4	13.6	8.5	7.1	5.3	5.4	7.5	8.4	20.3	9.8	7.3	6.1
Wage rates (nominal, %YoY)	7.8	10.9	4.1	13.4	5.5	7.9	14.8	14.0	17.5	23.1	17.7	12.2	10.9
Fiscal balance (% of GDP)													
Consolidated government balance	7.6	6.1	9.6	-4.4	-4.1	2.6	-0.4	-3.7	-4.3	-1.3	-2.3	-2.0	-1.9
Consolidated primary balance	8.1	6.7	10.3	-3.3	-3.2	3.6	0.5	-2.6	-3.1	0.0	-0.7	-0.3	-0.1
Total public debt	12.3	14.3	22.1	24.3	24.8	24.9	23.7	29.2	26.2	24.4	24.8	26.0	26.6
External balance													
Exports (US$bn)	87.7	70.1	41.6	37.0	49.5	59.0	59.5	44.1	65.8	85.6	78.2	82.8	81.4
Imports (US$bn)	49.2	42.5	33.9	26.6	31.0	35.0	41.1	38.1	41.6	50.6	59.7	62.7	63.9
Trade balance (US$bn)	38.5	27.7	7.7	10.5	18.5	24.0	18.4	6.0	24.2	35.0	18.5	20.1	17.4
Trade balance (% of GDP)	16.3	12.5	4.2	7.6	11.1	13.4	10.1	3.5	12.3	15.5	7.0	7.0	5.7
Current account balance (US$bn)	4.5	-2.9	-10.0	-7.0	-3.4	-1.8	-7.0	-11.0	-2.7	7.1	-8.8	-7.8	-9.7
Current account balance (% of GDP)	1.9	-1.3	-5.4	-5.1	-2.1	-1.0	-3.9	-6.4	-1.4	3.1	-3.3	-2.7	-3.2
Net FDI (US$bn)	8.0	4.7	3.3	13.7	3.8	5.0	5.9	5.9	1.9	8.0	6.0	4.0	2.0
Net FDI (% of GDP)	3.4	2.1	1.8	10.0	2.3	2.8	3.3	3.4	1.0	3.6	2.3	1.4	0.7
Current account balance plus FDI (% of GDP)	5.3	0.8	-3.6	4.9	0.2	1.8	-0.6	-3.0	-0.4	6.7	-1.1	-1.3	-2.5
Gross international reserves (US$bn)	24.7	29.2	27.9	29.7	31.0	30.9	29.0	35.6	34.4	35.1	35.0	37.0	38.0
Import cover (months of merchandise imports)	6.0	8.3	9.9	13.4	12.0	10.6	8.5	11.2	9.9	8.3	7.0	7.1	7.1
Debt indicators													
Gross external debt (US$bn)	150	157	153	164	167	160	160	164	164	161	164	167	171
Gross external debt (% of GDP)	63	71	83	119	100	89	88	96	83	71	62	58	56
Gross external debt (% of exports)	171	224	367	442	339	272	268	372	249	188	79	70	69
Lending to corporates/households (% of GDP)	31.4	30.5	31.0	27.1	23.4	21.2	19.9	20.7	22.0	23.9	24.7	25.2	25.2
Interest & exchange rates													
Central bank key rate (year-end, %)	5.50	5.50	16.00	12.00	10.25	9.25	9.25	9.00	9.75	16.75	15.75	11.75	9.75
Money supply (%YoY)	1.5	-8.2	8.0	46.2	7.5	7.1	11.0	19.2	24.1	18.0	15.0	12.0	7.0
3m interest rate (TONIA, average, %)	6.5	7.1	10.4	15.5	11.8	10.3	10.2	10.8	8.9	15.5	15.9	13.5	10.0
3m interest rate spread over US$-Euribor (ppt)	6.25	6.88	10.07	14.70	10.46	7.90	7.91	10.15	8.66	12.90	10.7	8.7	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)	154	182	339	333	332	384	381	421	432	463	460	470	500
USD/KZT exchange rate (average)	152	179	222	342	326	345	383	413	426	460	455	463	487
EUR/KZT exchange rate (year-end)	211	222	371	352	398	439	427	516	488	493	492	541	560
EUR/KZT exchange rate (average)	202	238	246	379	368	407	429	471	504	485	491	514	555
Brent oil price (annual average, US$/bbl)	109	99	54	45	55	72	64	43	71	99	84	90	80

Source: CEIC, National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	3.6	5.0	5.6	3.7	4.5	3.5	3.0	4.5	5.0	5.5	5.5	4.5	4.5
CPI (eop, %YoY)	20.3	18.1	14.6	11.8	9.8	8.9	8.6	8.0	7.3	7.0	6.7	6.4	6.1
Central bank key rate (eop, %)	16.75	16.75	16.75	16.50	15.75	14.75	13.75	12.75	11.75	11.25	10.75	10.25	9.75
3m interest rate (eop, %)	15.72	16.54	14.89	16.80	15.45	14.45	13.45	12.45	11.45	10.95	10.45	9.95	9.45
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)	463	456	451	478	460	460	460	465	470	480	490	495	500
EUR/KZT exchange rate (eop)	496	494	493	505	492	497	506	521	541	552	559	559	560

Source: CEIC, National sources, ING estimates

Poland

Rafał Benecki, Chief Economist

Forecast summary

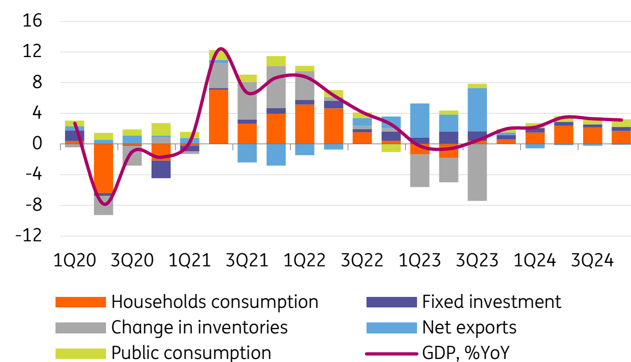
	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	0.5	2.0	2.2	3.4	3.1	0.4	3.0
CPI (%YoY)*	8.2	6.8	4.9	5.0	6.8	11.6	5.8
Policy interest rate (eop, %)	6.00	5.75	5.75	5.75	5.75	5.75	5.75
3m interest rate (%)*	5.77	5.80	5.80	5.85	5.85	6.50	5.85
10yr yield (%)*	5.91	5.40	5.60	5.65	5.64	5.95	5.73
USD/PLN*	4.37	4.07	4.01	3.86	3.77	4.21	3.82
EUR/PLN*	4.64	4.36	4.33	4.25	4.22	4.54	4.25

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Local: 2024	S&P	A-	A
Fiscal	Loose	Presidential: 2025	Moody's	A2	A2
Monetary	Neutral	Parliamentary: 2027	Fitch	A-	A-

*Quarterly data is eop, annual is avg

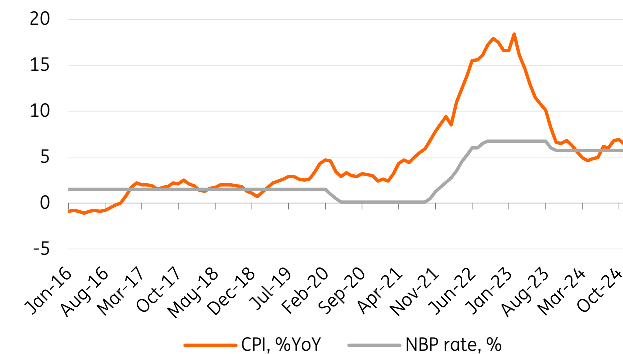
Source: National sources, ING estimates

GDP composition (%YoY)



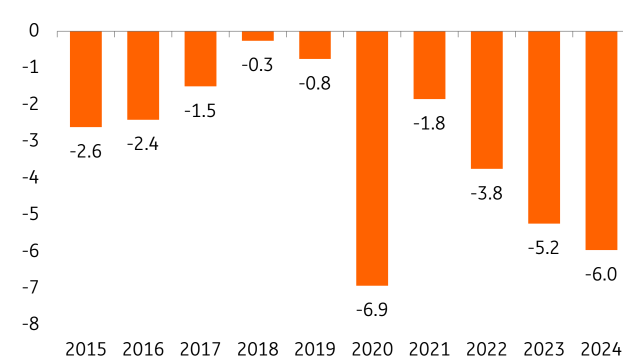
Source: Polish Statistical Office, ING forecasts

CPI inflation and NBP rate (%)



Source: Polish Statistical Office, National Bank of Poland

General government balance (% of GDP)



Source: Eurostat, ING forecasts

Country strategy: Convergence to start

The October general elections brought a fundamental shift for both the economy and financial markets. For years foreign investors have avoided Polish bonds and equity. We see few 'low hanging fruit' that the new government can utilise to restore a stronger, more balanced growth. The main aim is to unlock private investment and facilitate inflows of foreign capital, both FDI and portfolio. In tandem with EU money inflows, this is particularly positive for the zloty, possibly pushing €/PLN to lower levels. Main risks for POLGBs include record 2024 borrowing needs (7.5% of GDP), but MinFin has multiple funding options to avoid yield spikes (abundant local savings, FCL, cash buffer). The MPC has shifted to a neutral bias and should hold rates flat until end-2024. We see the short end pricing in too much easing, tighter asset swaps across the curve and stable long yields, particularly given the attractive 300bp spread over Bunds.

Macro digest: It's not all about the (EU) money

In recent years, private investment has stalled on high tax risk, with GDP driven mainly by inflationary consumption. The more business-friendly climate and stronger institutions should unlock private company outlays, given their high profits and deposits. Also, the EU funds blockage saga is coming to an end with a pro-European government about to retake power. Poland will soon receive c.€5bn in REPowerEU prepayments without preconditions, however, unlocking the Recovery & Resilience Funds (RRF) still requires meeting horizontal milestones, including action on restoring the rule of law in Poland.

So, is it all about the (EU) money? No. Even though RRF funds may facilitate financing record-high borrowing needs in 2024, the impact on the real economy will be broadly comparable to 2023 as the structural part of the EU budget should slow in the transition year before a new financial perspective replaces the previous one. 2024 is all about the private consumption rebound, and fixed investments should slowly catch up after years of underperformance. We forecast GDP to expand by 3% in 2024 on the back of household consumption, with real disposable income back to pre-pandemic growth after the sluggish 0.4% GDP growth estimated for 2023. Public consumption will also be robust (3.4%) given high indexation of public sector wages. Fixed investment growth is projected to ease to 3.0% from the 6.2% seen in 2023 amid the EU funds inflow cycle. We assume change in inventories will no longer be such a drag and net exports to have a slightly negative impact on GDP change.

Inflation is projected to continue moderating with a better short-term outlook but still above target in 2H24 and, overall, among the highest in the EU. Measures protecting households from higher energy prices will ease upward CPI pressure in 1H24, but recovery of consumer demand along with robustly rising wages should restore higher core inflation in 2H24. With the NBP target unlikely to be met before late 2025, the MPC is expected to keep NBP rates unchanged throughout 2024 (with the main policy rate still at 5.57%).

With monetary policy set to be moderate in 2024, the focus may turn to fiscal policy. The 2024 draft budget proposed by the outgoing PiS government envisaged a general government deficit next year at 4.5% of GDP but, given the new spending proposals of the incoming coalition (with wage hikes for teachers and administration staff) and a potential shortfall of tax revenues versus forecasts, this might rise to 6% of GDP, boosting already high 2024 borrowing needs.

Poland

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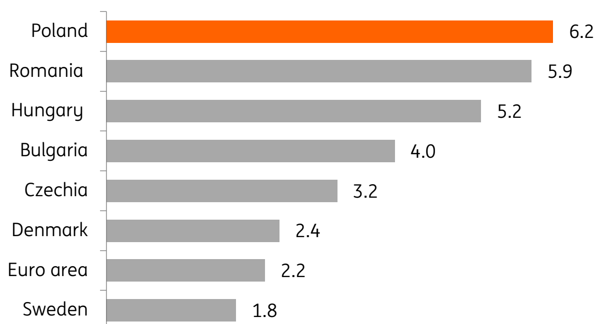
HICP inflation in 2024 (EC autumn forecast) (%)

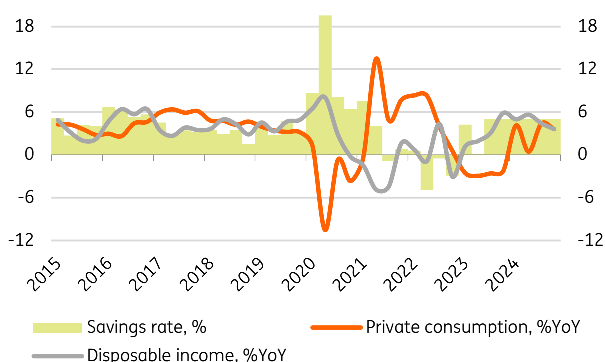


Source: Eurostat, European Commission

CPI inflation to continue running above the NBP target

Poland's short-term inflation outlook seems a bit better than expected, but for the mid-term CPI should stay above the NBP target. The 2024 average is likely to be the highest of EU member states given expansionary fiscal policy, economic recovery and monetary loosening over Autumn 2023. The authorities are also likely to withdraw some measures that have contained upward pressure on prices in the past. At the start of 2024, VAT on food is expected to be restored (at 5% instead of 0%) and policy actions shielding households from higher energy prices are likely to be lifted in the middle of next year. In such an environment we see annual average CPI inflation in 2024 at c.6%. Downside CPI risks include potential PLN firming and a more disinflationary global backdrop.

Real disposable income and private consumption (%YoY)

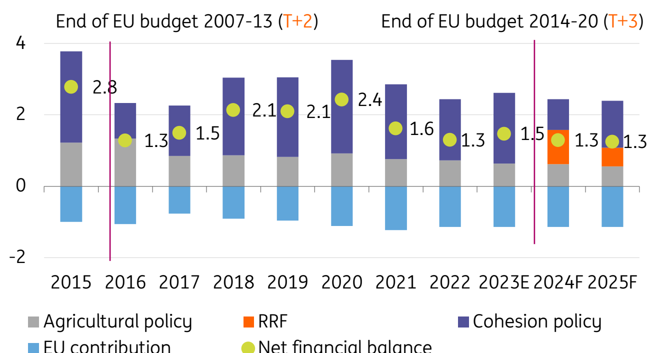


Source: Eurostat, ING forecast

Economic recovery to be led by a rebound in consumption

Lower inflation, generous social benefits in an election year and consistently buoyant wage growth have led to a rebound in households' real disposable income. Along with improving consumer confidence, this should allow private consumption to bounce back. We expect private and public consumption (high social spending) to lead economic growth in 2024. Inventory adjustment should no longer weigh on GDP performance and the contribution from net exports is expected to be broadly neutral. At the same time, fixed investment growth is projected to moderate – the previous EU programme has ended and the beginning of a new financial perspective and launch of a large scale RRF programme usually offers some time for public investment to recover.

RRF to fill the drop in cohesion funds in 2024 (% of GDP)

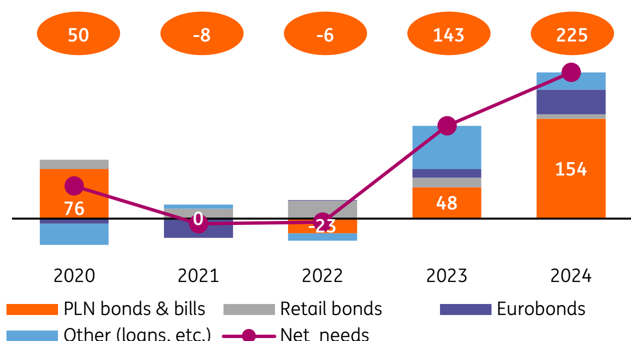


Source: Ministry of Finance, NBP, ING forecasts

EU payments from the RRF in 2024 may add to the upside

With 2024 a transition year between two EU financial perspectives (old 2013-20 and new 2021-27), Poland should face a sharp drop in cohesion policy funds. The unlocking of RRF payments is expected to fill the grant component of this gap. Inclusion of the REPowerEU programme and the government's request to the EC to triple RRF loans should help. The total RRF allocation to Poland is €60bn, of which €25bn is grants and €35bn preferential loans. In our baseline scenario, we assume Poland will absorb €8bn in grants and €12bn of loans in 2024. In an optimistic scenario the disbursements from both grants and loans could be hiked by up to 50%. This would require huge mobilisation on the Polish side and a lot of EC flexibility in RRF implementation.

Net borrowing needs in 2024 (draft budget bill) (PLNbn)



Source: Ministry of Finance

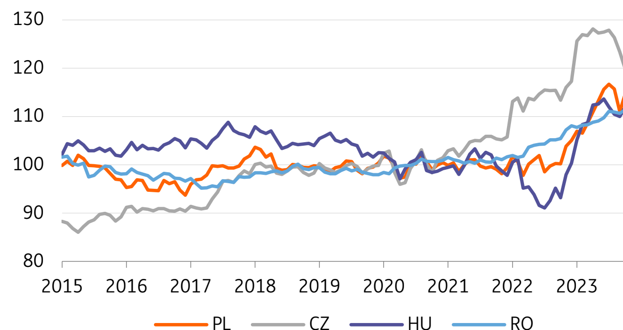
Loose fiscal policy on postponed consolidation

Fiscal policy might be in the spotlight in 2024. Given the political calendar (with European and local elections next year) the new government needs to deliver on some election pledges already in the 2024 budget. Along with a potential shortfall in tax revenues, this might boost the general government deficit from 4.5% of GDP in the PiS draft budget to 6.0% of GDP. Gross borrowing needs might also rise from an all-time high of 6.0% to 7.5% of GDP. The European fiscal framework will prompt fiscal consolidation but this is likely to start in 2H25. The authorities plan to tap a full array of financing sources in 2024 (POLGBs, Eurobonds, RRF loans, credit from military vendors and potentially even T-bills and part of the record high cash buffer if transferred from 2023).

Poland

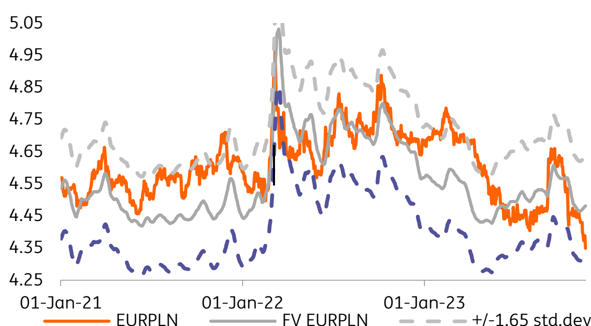
Strategy

Real effective FX rates (higher = stronger currency



An increase represents appreciation of CEE currency
Source: Macrobond

€/PLN – ING relative value model since 2020



Source: Macrobond, ING estimates

FX strategy

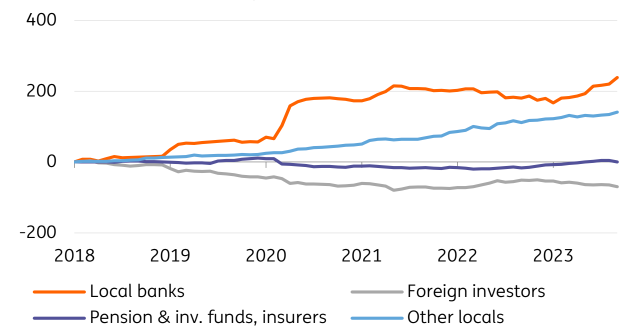
CEE currencies have significantly appreciated in real terms in 2023 with domestic inflation being higher than in the core economy markets. According to BIS estimates, the zloty has gained over 10%. Normally this should lead to depreciation in nominal rates (ie, €/PLN), but the political change in Poland is likely to keep the zloty bid. By year end we expect €/PLN to move below 4.35 and to 4.20-4.25 in 2024, with a risk of stronger levels. Poland is to receive advance payments from the EU Recovery Fund at the turn of 2023, while the current account is in surplus. A hawkish repricing is also possible.

Polish exports are profitable, with €/PLN remaining above 4.30 (survey data). The question is what the new government's approach to a stronger PLN might be. We think the main priority would be to let PLN appreciate - to facilitate funding of high borrowing needs, with a higher PLN that undermines exports a secondary concern.

The indications of our short-term model for €/PLN have moved somewhat in recent weeks, suggesting scope for a stronger zloty. This is, among other things, the result of lower expectations for further NBP rate cuts. On our estimates, overvaluation of the zloty should be apparent from the vicinity of 4.30.

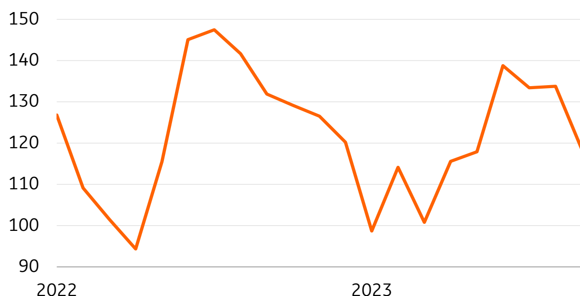
PLN prospects for 2024 largely hinge on Poland's GDP outperformance versus CEE, foreign capital inflows, RRF payments and the outlook for €/US$ (positive). For many years foreign investors have avoided Polish bond and equity markets (see chart in the fixed income section), which should change. Structural improvements in Poland's current account point to a stronger PLN. The main risk is geopolitics.

POLGBs holders (change in PLNbn since 2018)



Source: Macrobond

MoF cash buffer – a lot of space for a reduction (PLNbn)



Source: MinFin

Fixed income strategy

The short end still prices in much monetary easing over the next 24 months. The MPC stance changed to neutral following the elections and we expect no rate cuts until the end of 2024. While the MoF plans significant short-end (T-bill) issuance next year (PLN55bn), the local banks' net savings surprise on the upside (c.PLN120bn in 2H23) should enable the MinFin to cope with local funding in 1H24. Long end prospects are mixed, rather than negative. While net borrowing needs for 2024 are significant (we see these at up to 7.5% of GDP vs 6% planned and 4.2% this year), we expect the government to use different funding sources. The MoF could use its high cash buffer, having originally aimed to cut this by PLN64bn already in 2023. To date the fall has been relatively slow (PLN13bn YoY). Military spending (off-budget, c.PLN40bn in 2024) should be mostly covered outside the bond market via (foreign) vendor funding (a Korean banks consortium, estimated at US$22.7bn). Poland may also consider FCL and increase FX issuance as well. Strong net savings growth in local banks (to c.3% of GDP in 2H23) suggests solid purchases from local banks too. In 1H24 MinFin could, we believe, rely on local funding and dilute concerns about high debt supply. In such an environment we expect foreign investors to return to POLGBs as currently their share in POLGBs is around half that seen in other CEEs. We rather expect crossover funds from dedicated EM investors to return. Also, ING expects a significant €/US$ rise. Overall, we see the short end pricing in too much easing, tighter asset swaps across the curve and stable long yields, noting the attractive 300bp spread over Bunds.

Poland

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	0.9	3.8	4.4	3.0	5.1	5.9	4.5	-2.0	6.9	5.3	0.4	3.0	3.5
Private consumption (%YoY)	0.0	3.4	3.8	3.6	6.3	4.4	3.5	-3.6	6.2	5.2	-1.0	3.4	4.5
Government consumption (%YoY)	2.4	4.0	2.4	2.0	2.7	3.5	6.5	4.9	5.0	0.3	1.6	4.6	3.5
Investment (%YoY)	0.3	11.7	6.9	-7.6	1.6	12.6	6.2	-2.3	1.2	4.9	6.2	3.0	7.5
Industrial production (%YoY)	1.8	4.1	6.0	3.6	6.2	5.4	5.1	-1.9	14.7	9.5	-1.0	7.1	5.5
Unemployment rate (year-end, %)	13.4	11.4	9.7	8.2	6.6	5.8	5.2	6.8	5.8	5.2	5.2	5.0	4.8
Nominal GDP (PLNbn)	1 630	1 701	1 798	1 853	1 983	2 127	2 288	2 338	2 631	3 067	3 465	3 792	4 111
Nominal GDP (€bn)	388	406	430	425	466	499	532	526	576	651	763	884	950
Nominal GDP (US$bn)	516	539	477	470	525	589	596	600	681	676	823	977	1 091
GDP per capita (US$)	13 395	14 005	12 405	12 231	13 661	15 320	15 528	15 631	17 850	17 860	21 798	25 943	29 026
Gross domestic saving (% of GDP)	20.5	21.4	23.1	23.2	22.9	23.5	24.2	24.4	25.1	23.9	25.5	25.3	25.0
Prices													
CPI (average, %YoY)	0.9	0.0	-0.9	-0.6	2.0	1.6	2.3	3.4	5.1	14.4	11.6	5.8	5.0
CPI (year-end, %YoY)	0.7	-1.0	-0.5	0.8	2.1	1.1	3.4	2.4	8.6	16.6	6.8	6.5	4.7
Wage rates (nominal, %YoY)	2.6	3.8	3.5	4.1	5.6	7.1	6.6	4.8	8.6	12.9	12.0	10.9	9.3
Fiscal balance (% of GDP)													
Consolidated government balance	-4.3	-3.7	-2.6	-2.4	-1.5	-0.2	-0.7	-6.9	-1.8	-3.7	-5.2	-6.0	-3.6
Consolidated primary balance	-1.7	-1.7	-0.8	-0.7	0.1	1.2	0.7	-5.6	-0.7	-2.2	-3.2	-3.9	-3.6
Total public debt	57.1	51.3	51.3	54.5	50.8	48.7	45.7	57.2	53.6	49.3	50.4	54.0	55.7
External balance													
Exports (€bn)	145.6	152.8	164.0	169.2	191.2	205.2	220.3	220.5	263.6	322.1	337.6	345.6	367.9
Imports (€bn)	149.3	160.7	166.2	170.6	196.0	216.4	224.7	213.6	271.3	346.3	330.0	337.3	366.6
Trade balance (€bn)	-3.7	-7.9	-2.1	-1.3	-4.8	-11.3	-4.4	7.0	-7.7	-24.3	7.7	8.3	1.3
Trade balance (% of GDP)	-1.0	-1.9	-0.5	-0.3	-1.0	-2.3	-0.8	1.3	-1.3	-3.7	1.0	0.9	0.1
Current account balance (€bn)	-7.7	-11.7	-5.5	-4.3	-5.3	-9.6	-1.2	12.8	-7.4	-15.7	8.4	12.2	13.0
Current account balance (% of GDP)	-2.0	-2.9	-1.3	-1.0	-1.1	-1.0	-0.2	2.5	-1.3	-2.4	1.1	1.4	1.4
Net FDI (€bn)	3.1	10.3	9.5	3.3	7.0	14.2	10.9	12.5	22.0	23.9	24.5	29.0	35.0
Net FDI (% of GDP)	0.8	2.5	2.2	0.8	1.5	2.8	2.0	2.4	3.8	3.6	3.2	3.3	3.7
Current account balance plus FDI (% of GDP)	-1.2	-0.3	1.0	-0.2	0.4	0.9	1.8	4.8	2.5	1.2	4.3	4.7	5.0
Foreign exchange reserves (€bn)	77.1	82.6	86.9	108.1	94.6	102.3	114.5	125.6	146.6	156.5	169.9	184.9	198.9
Import cover (months of merchandise imports)	6.2	6.2	6.3	7.6	5.8	5.7	6.1	7.1	6.5	5.4	6.2	6.6	6.5
Debt indicators													
Gross external debt (€bn)	279.5	293.9	304.0	321.4	319.8	317.3	316.7	307.4	323.3	347.6	381.0	406.0	418.5
Gross external debt (% of GDP)	71.1	73.7	72.0	76.7	67.3	64.2	58.9	60.7	56.5	53.1	49.9	45.9	44.1
Gross external debt (% of exports)	189.7	195.9	188.8	192.6	163.9	156.0	142.5	144.8	123.5	108.0	112.8	117.5	113.8
Lending to corporates & households (% of GDP)	49.3	49.8	50.4	51.3	49.4	49.3	48.1	47.4	44.0	37.8	35.6	37.1	39.1
Interest & exchange rates													
Central bank key rate (year-end, %)	2.50	2.00	1.50	1.50	1.50	1.50	1.50	0.10	1.75	6.75	5.75	5.75	5.25
Broad money supply (average, %YoY)	6.2	6.4	8.3	10.2	6.1	7.0	9.5	14.8	10.8	7.1	7.5	8.5	7.5
3m interest rate (WIBOR, average, %)	3.02	2.51	1.75	1.70	1.73	1.71	1.72	0.66	0.55	6.04	6.50	5.85	5.56
3m interest rate spread over EURIBOR (ppt)	279	231	178	201	205	202	207	109	112	560	305	210	285
2yr yield (average, %)	3.01	2.48	1.73	1.66	1.89	1.59	1.57	0.53	0.83	6.33	5.78	5.64	4.68
10yr yield (average, %)	4.05	3.52	2.71	3.05	3.44	3.22	2.38	1.52	1.95	6.11	5.95	5.73	5.09
USD/PLN exchange rate (year-end)	3.01	3.51	3.90	4.18	3.48	3.76	3.80	3.76	4.06	4.40	4.07	3.65	3.76
USD/PLN exchange rate (average)	3.16	3.16	3.77	3.94	3.78	3.61	3.84	3.90	3.86	4.46	4.21	3.82	3.69
EUR/PLN exchange rate (year-end)	4.15	4.26	4.26	4.42	4.17	4.30	4.26	4.61	4.60	4.69	4.36	4.20	4.22
EUR/PLN exchange rate (average)	4.20	4.19	4.18	4.36	4.26	4.26	4.30	4.44	4.57	4.69	4.54	4.25	4.21

Source: National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	2.5	-0.3	-0.6	0.5	2.0	2.2	3.5	3.1	3.1	3.2	3.7	3.6	3.7
CPI (eop, %YoY)	16.6	16.1	11.5	8.2	6.8	4.9	5.0	6.8	6.5	5.1	5.6	4.6	4.7
Central bank key rate (eop, %)	6.75	6.75	6.75	6.00	5.75	5.75	5.75	5.75	5.75	5.50	5.50	5.25	5.25
3m interest rate (eop, %)	7.02	6.89	6.90	5.77	5.80	5.80	5.85	5.85	5.90	5.70	5.68	5.45	5.40
10yr yield (eop, %)	6.86	6.06	5.78	5.91	5.40	5.60	5.65	5.64	5.34	5.18	5.12	5.05	5.01
USD/PLN exchange rate (eop)	4.40	4.29	4.11	4.37	4.07	4.01	3.86	3.77	3.65	3.66	3.66	3.67	3.77
EUR/PLN exchange rate (eop)	4.69	4.68	4.45	4.64	4.36	4.33	4.25	4.22	4.20	4.20	4.20	4.21	4.22

Source: National sources, ING estimates

Romania

Valentin Tataru, Chief Economist | Stefan Posea, Economist

Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	0.2	0.9	2.8	1.9	2.8	1.5	2.8
CPI (%YoY)*	8.1	7.4	7.4	6.2	5.2	10.7	6.0
Policy interest rate (eop, %)	7.00	7.00	7.00	6.75	6.00	7.00	5.50
3m interest rate (%)*	6.50	6.25	6.00	5.70	5.50	6.60	5.70
10yr yield (%)*	7.15	7.00	7.10	7.00	6.90	6.90	6.70
USD/RON*	4.97	4.98	4.98	5.04	5.04	4.59	4.52
EUR/RON*	4.70	4.65	4.61	4.58	4.50	4.96	5.02

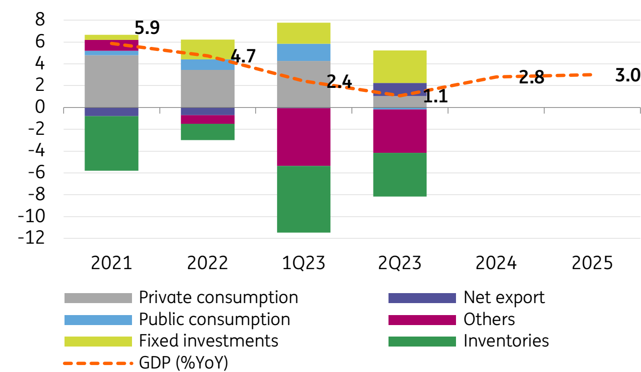
Macro trend		Political cycle	Ratings	FC	LC
Activity	=	Presidential: 2024	S&P	BBB-	BBB-
Fiscal	Loose	Parliamentary: 2024	Moody's	Baa3	Baa3
Monetary	Neutral	Local: 2024	Fitch	BBB-	BBB-

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

Country strategy: fiscal consolidation derailed again

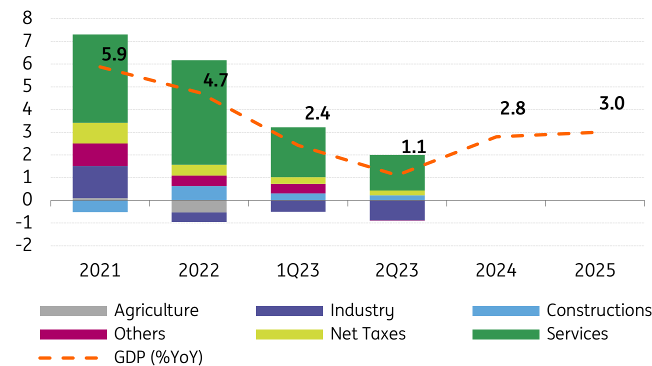
While visibly slowing, the economy remains in the expansion zone on increased infrastructure investments boosted by reasonably good EU funds absorption. On the downside, the fiscal consolidation story is a bit derailed, as the country will not get even close to the -3.0% of GDP budget deficit target over the next couple of years. The government has already increased the tax burden on the private sector in a context of weaker economic activity – and most likely this is just a preview of a bigger fiscal reform coming next year after elections. All in all, we think that the deficit reduction pace will test to the maximum the EU's tolerance level and the provisions of the Excessive Deficit Procedure, but that the country will eventually deliver the bare minimum needed to keep EU funds flowing.

GDP (YoY%) and components (ppt)



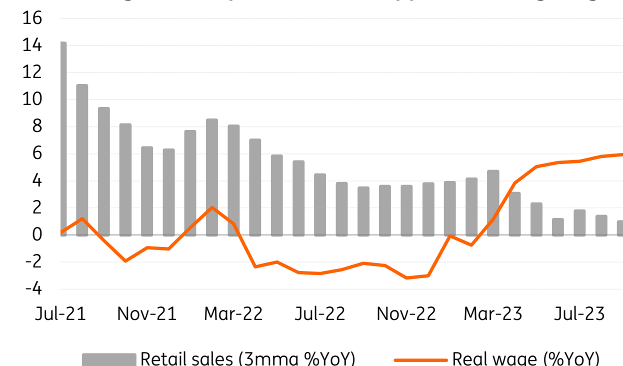
Source: NIS, ING

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



Source: NIS, ING

Weakening consumption to find support in rising wages



Source: NIS, ING

Investments lead the way

While the economy still showed some resilience in the first half of 2023, annual growth dynamics almost flattened in the third quarter. We think that data due on 7 December is likely to show that investments remained strong in the third quarter of 2023, net exports improved, and that private consumption weakened further. On the latter, despite persistently strong wage growth which has been offsetting inflation since April, a positive impact is yet to be seen. While some improvements could show up in 4Q23, we think that most positive effects will be visible next year.

On the supply side, civil engineering projects and most other activities related to public investments have been outperforming the rest of the economy, boosting activity in the construction sector. Only recently, industry has started to improve slightly but it cannot turn around an otherwise bleak performance over this year. It remains to be seen whether agriculture will surprise positively as many seem to expect.

In the second half of the year, the fiscal story came back into the spotlight. In short, as of this autumn, taxes increased, the minimum wage went up by 10% and, at the time of writing (24 November) a pension reform vital for EU funds absorption is about to get the President's approval. The latter will lead to an averaging up of pensions, as the government wants to have both no income losses for pensioners and to curb the various inequities built in the pension system over the years; the reform is also required by the EU as a milestone for the fourth RRF tranche. The Ministry of Finance conditioned its positive assessment of the pensions project on future offsetting measures, which we think is likely to happen soon after the 2024 elections.

On the monetary policy front, despite the recent derailing of the disinflationary path, we still expect the National Bank of Romania (NBR) to cut rates at some point in 2Q24. We anticipate this for the April meeting, although May is now equally likely too. While the risks of a high-for-longer scenario have increased markedly, our more bearish view on growth versus the consensus supports, to an extent, our below-consensus view on inflation. In practice, however, the historically high excess interbank liquidity tolerated by the Bank has already been achieving the outcome of a conventional policy ease, anchoring the market rates to the deposit facility. We therefore see increased chances for the NBR to start the official cutting cycle later and in smaller steps than in our current base case. On EUR/RON, we don't project any meaningful deviations from the 'magical' 5.00 ahead given the relatively sticky behaviour of inflation.

Romania

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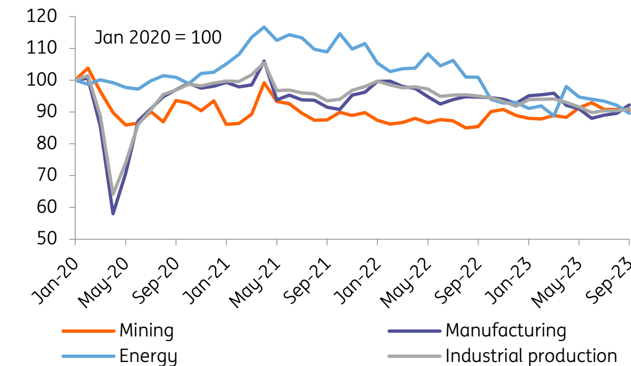
Industry still below pre-pandemic levels

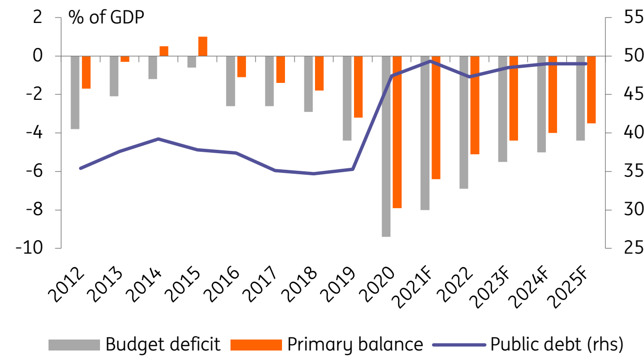


Source: NSI, ING

Some mild improvements recently

Industrial production contracted by 2.0% in 2022 and 5.0% year-to-date. As of September 2023, it remains 9.0% below its pre-pandemic levels (ie, January 2020). Among the few brighter spots are the auto, PC & electronics manufacturing, food and oil extraction sectors, which have shown the strongest performance year-to-date. Among them, the PC & electronics and the food industries are above their pre-pandemic levels too. On the downside, clothing, chemical products and metallurgy are all more than 33% below their pre-pandemic levels. Looking forwards, the latest confidence data points to further improvements in early 4Q23. The total number of employees remained fairly constant throughout the year, though shifts occurred within subsectors.

Fiscal consolidation delayed

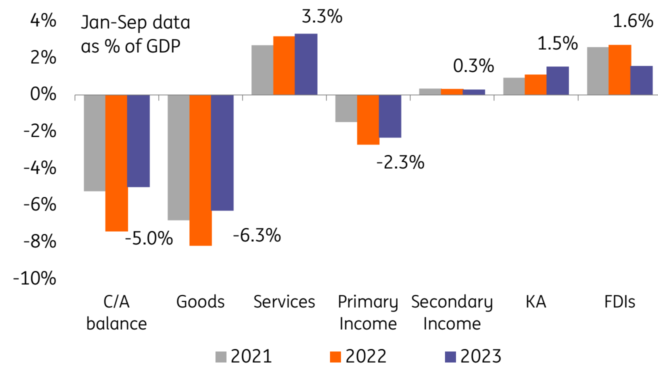


Source: Eurostat, ING

Elections and social demands could derail the adjustment

Ending 2023 with the initial 4.4% deficit target proved indeed a very challenging task and the fiscal balance now looks set for a deficit of 5.5% or slightly higher this year. As of September 2023, the deficit reached 3.6%. Some small bits of extra-revenues are already coming in from the removal of some fiscal benefits as of October. However, the largest bulk of revenues resulting from the fiscal package are projected in 2024 – roughly 1.0% of GDP in 2024. As the recently adopted rise in pensions will add significant pressures on expenditures especially starting 2025, offsetting measures become almost a certainty. As it will be unpopular for officials to debate tax hikes before elections, we think that a proper fiscal reform is due shortly after.

Current account deficit remains Achille's heel (% of GDP)

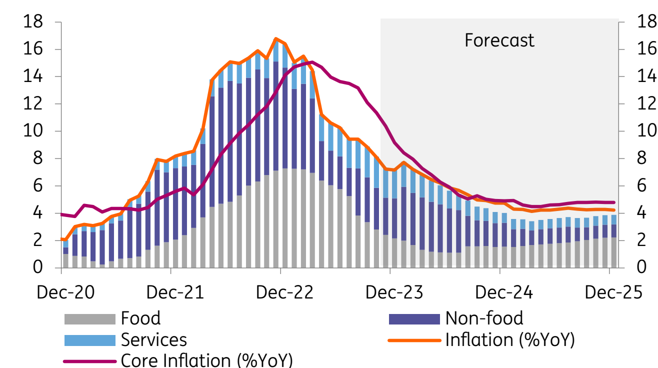


Source: NBR, ING

Economic slowdown cools import demand

After reaching a whopping -9.4% of GDP in 2022 on the back of worsening terms of trade (essentially higher energy prices), the current account deficit (CAD) seems on track to print below -7.0% of GDP this year. This is not necessarily for the best reasons. Better terms of trade are helping somewhat (at most 1ppt we think) while the rest of the recovery is largely due to the economic slowdown which translated into lower imports, while exports still hold on reasonably well. Given that we anticipate an acceleration of consumption in 2024, corroborated with a fiscal gap closing slower than planned and largely stable demand from the Eurozone countries, we estimate that a future CAD will be very limited. Nevertheless, as the fiscal consolidation will continue albeit at a slower pace, we should see a slow grind lower for Romania's CAD.

Inflation (YoY%) and main components (ppt)



Source: NIS, ING

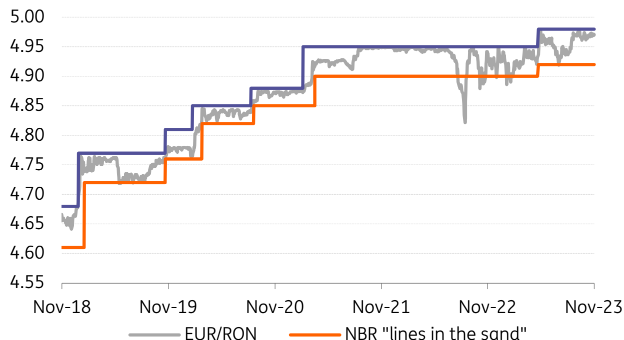
Coming lower, but a bumpy road still lies ahead

Inflation has recently proved marginally stickier than our estimates, pointing to the fact that the disinflationary path is not a given and raising the risk of a high-for-longer rates scenario. We revise our end-2023 projection higher from 7.1% to 7.4% and our end-2024 projection from 4.1% to 4.7%. Higher excise duties, VAT and the potential impact of revenue taxes on companies coming in at the beginning of next year constitute the key drivers and upside risks. That said, our new forecasts are still at the lower end of consensus, partly due to a weaker demand channel stemming from our below-consensus view on growth. As such, we expect inflation to go below the NBR's 7.00% key rate in early 2Q24, a likely prerequisite for the beginning of the cutting cycle.

Romania

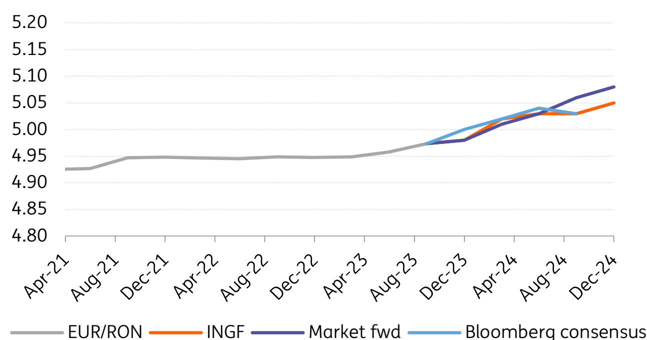
Strategy

Adjusting the range but not the story



Source: NBR, ING estimates

FX – spot vs forward and INGF



Source: NBR, Bloomberg, ING estimates

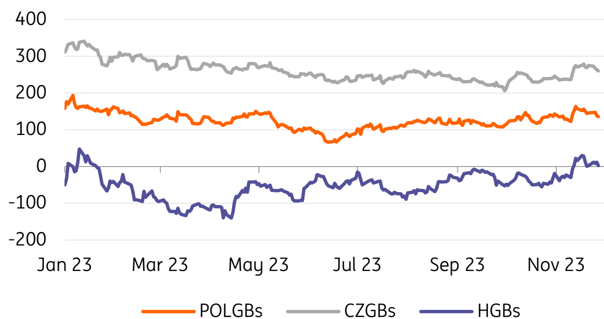
FX strategy *(with Frantisek Taborsky, EMEA FX & FI Strategist)*

Not much has changed in the FX space in recent months. The higher volatility of the first half of the year is gone and EUR/RON is holding steady in the 4.960-4.975 range and we don't expect much movement in the short term.

With persistent inflation in Romania proving to be the most tricky within the CEE region, the central bank is in no great hurry to address the current account deficit and overvalued FX. Banking sector liquidity remains in record surplus, but the central bank has not had much opportunity to intervene.

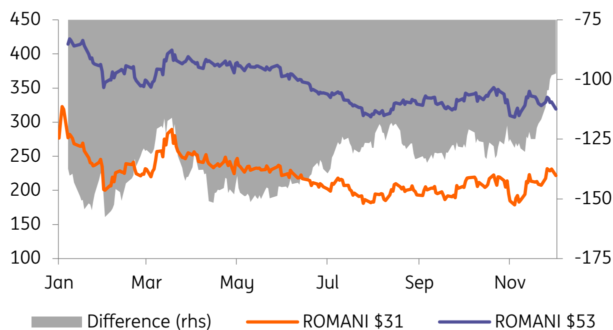
So, the question for next year is when the central bank will allow the magical 5.00 EUR/RON threshold to be crossed. Our economists expect this move in the second quarter with possibly a bit more movement in the second half of the year. For now, we don't see much of a story here, but once inflation manages to get closer to the target, we believe the central bank could communicate more openly on the current account problem and the RON overvaluation, which could open up some space in the forward market before the actual spot moves up.

10y ROMGBs spreads vs CEE3 (bp)



Source: Refinitiv, ING

ROMANI $53 vs $31 spread (bp)



Source: Refinitiv, ING

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

With some disappointment over the pace of fiscal adjustment and remaining structural weaknesses from large twin deficits, there is potential for investor sentiment towards ROMANI Eurobonds to weaken next year. Possible political noise around the elections adds to this risk, while supply, as always, is likely to remain a technical headwind. Some recent weakness on the back of pension reforms is likely to have slightly cleaned up positioning, and spreads at the wide end of the region and rating groups mean the bonds should remain supported in a risk-on environment.

On the local side, gross supply of ROMGBs should fall by 16% YoY, according to our estimates, but given the fiscal risk this does not change the picture much. Market positioning, the central bank's postponement of the cutting cycle and the most persistent inflation in the region may thus be an issue here as well.

Romania

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	0.3	4.1	3.2	2.9	8.2	6.0	3.9	-3.7	5.7	4.6	1.5	2.8	3.0
Private consumption (%YoY)	-4.3	3.7	5.6	5.7	11.5	9.0	3.4	-3.7	7.9	5.5	1.9	3.6	3.9
Government consumption (%YoY)	-0.1	0.5	0.9	-9.1	11.3	-0.5	6.7	-2.6	3.8	3.9	1.7	2.6	1.6
Investment (%YoY)	-5.5	5.3	7.5	-2.0	5.4	0.2	12.4	1.4	2.0	7.7	6.2	5.9	6.1
Industrial production (%YoY)	7.7	6.2	2.7	3.1	8.6	5.0	-3.6	-9.5	7.4	-2.0	-4.2	2.1	1.9
Unemployment rate (average, %)	7.1	6.8	6.8	5.9	5.7	4.2	3.9	5.0	5.6	5.6	5.5	5.4	5.3
Nominal GDP (RONbn)	632	669	713	752	852	959	1,064	1,067	1,187	1,410	1,585	1,728	1,883
Nominal GDP (€bn)	143	150	160	167	186	206	224	221	241	285	320	344	371
Nominal GDP (US$bn)	190	199	176	184	213	241	251	251	284	299	345	382	423
GDP per capita (US$)	9,500	10,000	8,900	9,400	10,800	12,400	12,900	13,100	14,900	15,700	18,200	20,200	22,500
Gross domestic saving (% of GDP)	24.4	24.6	24.7	22.7	21.4	20.0	20.2	20.2	19.9	19.9	20.0	20.1	20.3
Prices													
CPI (average, %YoY)	4.0	1.1	-0.6	-1.6	1.3	4.6	3.8	2.6	5.1	13.8	10.7	6.0	4.3
CPI (year-end, %YoY)	1.6	0.8	-0.9	-0.5	3.3	3.3	4.0	2.1	8.2	16.4	7.4	4.7	4.2
Wage rates (nominal, %YoY)	4.8	5.2	8.3	13.0	14.2	13.1	14.9	6.7	7.1	12.2	14.5	10.0	8.0
Fiscal balance (% of GDP)													
Consolidated government balance	-2.1	-1.2	-0.6	-2.6	-2.6	-2.9	-4.4	-9.4	-8.0	-6.9	-5.5	-5.0	-4.4
Consolidated primary balance	-0.3	0.5	1.0	-1.1	-1.4	-1.8	-3.2	-7.9	-6.4	-5.1	-4.4	-4.0	-3.5
Total public debt	37.6	39.2	37.8	37.4	35.1	34.7	35.3	47.4	49.3	47.3	48.5	49.0	49.0
External balance													
Exports (€bn)	49.6	52.5	54.6	57.4	62.6	67.4	68.7	62.1	74.7	92.0	93.8	101.3	108.4
Imports (€bn)	55.3	58.6	63.0	67.4	75.6	82.8	86.3	80.5	98.4	126.0	119.7	128.1	135.8
Trade balance (€bn)	-5.7	-6.1	-8.4	-10.0	-13.0	-15.4	-17.6	-18.4	-23.7	-34.0	-25.9	-26.7	-27.3
Trade balance (% of GDP)	-4.0	-4.1	-5.2	-6.0	-7.0	-7.5	-7.9	-8.3	-9.8	-11.9	-8.1	-7.8	-7.4
Current account balance (€bn)	-1.4	-0.4	-1.3	-2.7	-5.8	-9.5	-10.9	-10.9	-17.5	-26.9	-22.0	-23.5	-25.0
Current account balance (% of GDP)	-1.0	-0.3	-0.8	-1.6	-3.1	-4.6	-4.9	-4.9	-7.3	-9.4	-6.9	-6.8	-6.7
Net FDI (€bn)	2.9	2.7	2.9	4.8	4.8	4.9	4.8	2.9	8.8	8.8	6.1	6.3	6.5
Net FDI (% of GDP)	2.0	1.8	1.8	2.9	2.6	2.4	2.1	1.3	3.7	3.1	1.9	1.8	1.7
Current account balance plus FDI (% of GDP)	1.0	1.5	1.0	1.3	-0.5	-2.2	-2.7	-3.6	-3.6	-6.4	-5.0	-5.0	-5.0
Foreign exchange reserves ex gold (€bn)	32.5	32.2	32.2	33.0	32.3	31.8	31.7	36.2	37.1	43.2	54.0	58.0	60.0
Import cover (months of merchandise imports)	7.1	6.6	6.1	5.9	5.1	4.6	4.4	5.4	4.5	4.1	5.4	5.4	5.3
Debt indicators													
Gross external debt (€bn)	100.8	97.2	94.7	94.3	97.4	99.8	109.8	126.8	136.6	144.6	163.0	165.0	167.0
Gross external debt (% of GDP)	71	65	59	56	52	48	49	57	57	51	51	48	45
Gross external debt (% of exports)	203	185	173	164	156	148	160	204	183	157	174	163	154
Lending to corporates/households (% of GDP)	34.1	31.0	29.9	28.5	26.5	25.4	24.5	25.7	26.5	24.7	23.0	24.0	24.8
Interest & exchange rates													
Central bank key rate (year-end, %)	5.25	4.00	2.75	1.75	1.75	1.75	2.50	1.50	1.75	6.75	7.00	5.50	5.00
Broad money supply (average, %YoY)	7.9	4.1	6.8	7.8	11.4	8.8	10.9	15.3	15.8	6.9	10.0	9.0	8.0
3m interest rate (Robor average, %)	4.22	2.54	1.40	0.89	1.15	2.80	3.15	2.38	1.82	6.19	6.60	5.70	4.30
3m interest rate spread over Euribor (ppt)	4.0	2.3	1.4	1.2	1.5	3.1	3.5	2.8	2.4	5.8	3.2	2.1	1.4
3yr yield (average, %)	4.8	3.3	1.9	1.5	1.9	3.7	3.7	3.3	2.9	7.2	6.5	6.3	5.7
10yr yield (average, %)	5.3	4.6	3.5	3.3	3.9	4.7	4.5	3.9	4.0	7.6	6.9	6.7	6.2
USD/RON exchange rate (year-end)	3.27	3.70	4.15	4.32	3.88	4.06	4.27	3.97	4.34	4.62	4.65	4.39	4.54
USD/RON exchange rate (average)	3.32	3.37	4.04	4.08	4.01	3.98	4.24	4.24	4.18	4.71	4.59	4.52	4.45
EUR/RON exchange rate (year-end)	4.48	4.48	4.52	4.54	4.66	4.66	4.78	4.87	4.95	4.94	4.98	5.05	5.09
EUR/RON exchange rate (average)	4.42	4.44	4.45	4.49	4.57	4.65	4.75	4.84	4.93	4.95	4.96	5.02	5.07

Source: National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	4.6	2.4	1.0	0.2	0.9	2.8	1.9	2.8	3.3	3.0	3.1	2.9	3.0
CPI (eop, %YoY)	16.4	14.5	10.3	8.1	7.4	7.4	6.2	5.2	4.7	4.1	4.3	4.2	4.2
Central bank key rate (eop, %)	6.75	7.00	7.00	7.00	7.00	7.00	6.75	6.00	5.50	5.50	5.50	5.25	5.00
3m interest rate (eop, %)	7.57	6.85	6.60	6.50	6.25	6.00	5.70	5.50	5.20	5.00	4.75	4.50	4.50
10yr yield (eop, %)	8.20	7.35	7.10	7.15	7.00	7.10	7.00	6.90	6.70	6.70	6.50	6.50	6.30
EUR/RON exchange rate (eop)	4.95	4.95	4.97	4.97	4.98	4.98	5.04	5.04	5.05	5.05	5.08	5.08	5.09
USD/RON exchange rate (eop)	4.62	4.57	4.56	4.70	4.65	4.61	4.58	4.50	4.39	4.39	4.46	4.50	4.54

Source: National sources, ING estimates

Serbia

Valentin Tataru, Chief Economist | Stefan Posea, Economist

Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	3.5	3.3	3.8	3.2	2.7	2.3	3.2
CPI (%YoY)*	10.2	7.6	5.6	4.5	4.4	12.5	5.0
Policy interest rate (eop, %)	6.50	6.50	6.50	5.75	5.50	6.50	5.50
3m interest rate (eop,%)	5.60	5.70	5.60	5.40	5.10	5.60	4.70
10yr yield (%)*	6.30	6.30	6.20	6.00	5.90	6.30	5.80
USD/RSD*	110.80	109.52	108.51	106.53	104.63	108.60	105.60
EUR/RSD*	117.20	117.19	117.19	117.18	117.18	117.20	117.20

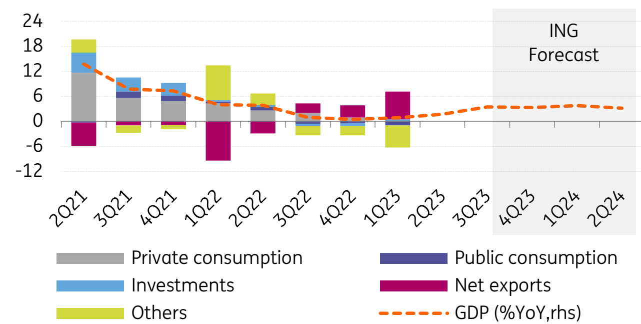
Macro trend		Political cycle	Ratings	FC	LC
Activity	–	Presidential: 2027	S&P	BB+	BB+
Fiscal	Loose	Parliamentary: 2023	Moody's	Ba2	Ba2
Monetary	Neutral	Local: 2026	Fitch	BB+	BB+

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

Country strategy: Go West?

While annual growth has regained pace, political and social stability has been less rosy in the second half of 2023 so far. Key risk factors include any further complications in relations with Kosovo and snap elections due on 17 December amid internal discontent and EU demands. The country's commitment to EU sanctions on Russia is still in question. All in all, the path towards EU integration is currently somewhat rocky. On the other hand, the country's finances have been better than expected and the 2023 fiscal deficit projection has been revised from -3.3% to -2.8% of GDP. In 2024, the government expects a further reduction to -2.2% and plans to allocate 6.8% of GDP to capital investments, primarily infrastructure. Together with recent historic highs for FDI inflows, this bodes well for GDP and positive feedback loops ahead.

Real GDP (%YoY) and contributions (ppt)

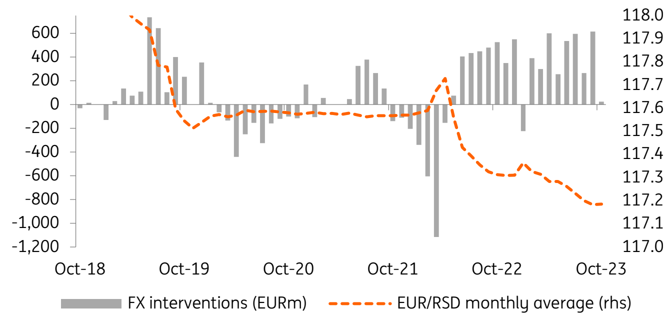


Source: Eurostat, ING estimates

Activity finding its pace again

After losing speed in the first half of the year, the economy firmed up in 3Q23, growing by 3.5% annually according to flash estimates. The key drivers were net exports, fixed investments, and public spending. Looking ahead, we expect growth to gradually revert to its pre-pandemic trend. Consumption will be supported by real wage growth, which switched into positive territory in 2Q23. Investments are set to remain strong ahead – planned capital projects and the positive impact of the 2027 World Expo in Belgrade should be key drivers. That said, our view is that Serbia's key trading markets will slow by more than most expect and this is set to weigh on exports. All told, we expect annual growth to remain constant in 2023, at 2.3%, and accelerate to 3.2% in 2024.

FX stability remains the main policy tool

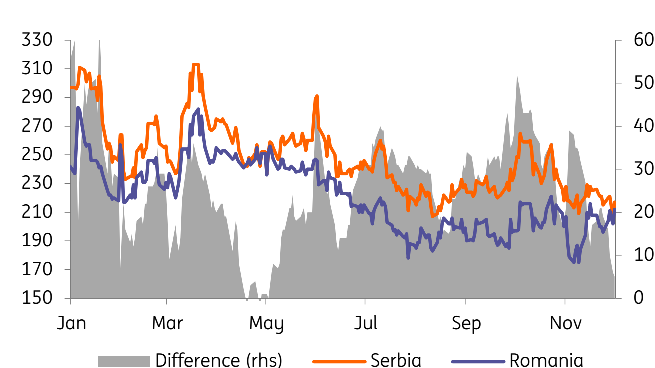


Source: NBS, ING

Central Bank's firm grip on the currency set to remain

After raising the policy rate by 550bp to 6.50% in a bit more than a year, we think that the NBS has now ended its hiking cycle (on pause since August). The Bank now expects lagged effects and liquidity fine-tunning. Our scenario envisions a first rate cut in 2Q24, when interest rates should have consolidated in positive territory. On inflation, for end-2024 we think that price pressures will revolve around the upper limit of the target band (3.0% ± 1.5ppt), ahead of the Bank's estimation of a mid-point reach. We maintain our expectations for a flat and intervention-driven EUR/RSD. Should inflation prove stickier, then mild appreciation of the dinar could be tolerated by the NBS.

SERBIA USD credit spreads vs ROMANI (bp)



Source: ICE, Refinitiv, ING

SERBIA credit: Fundamentals fight against political risk

With a falling current account deficit, growing FX reserves and positive fiscal revisions, Serbia's fundamental credit metrics are generally on an improving path, offering few issues for investors to worry about on the macro front. As ever though, political risks remain at the front of mind, with EU-mediated peace talks over Kosovo seemingly stalled in their current phase. Upcoming parliamentary elections add to the uncertainty, even if there appears to be little likelihood of wholesale policy changes.

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Serbia

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	2.9	-1.6	1.8	3.3	2.1	4.5	4.3	-0.9	7.7	2.6	2.3	3.2	3.7
Private consumption (%YoY)	-1.7	-0.1	-0.6	1.9	2.2	3.1	3.7	-1.9	7.8	4.0	3.3	4.2	4.5
Government consumption (%YoY)	-2.1	0.9	-3.7	0.0	2.9	3.7	1.9	2.8	4.1	0.4	0.8	1.6	2.6
Investment (%YoY)	-12.0	-3.4	6.2	5.1	6.6	17.5	17.2	-1.9	15.7	1.9	4.0	4.2	4.8
Industrial production (%YoY)	5.5	-7.3	7.3	5.2	3.9	1.3	0.3	0.4	6.4	1.6	2.5	2.4	2.6
Unemployment rate (average, %)	24.0	20.6	18.9	16.4	14.5	13.7	11.2	9.7	11.0	9.4	8.8	8.4	8.0
Nominal GDP (RSDbn)	4121	4161	4315	4528	4761	5073	5422	5504	6272	7098	8234	8948	9709
Nominal GDP (€bn)	35.9	34.4	35.5	36.7	40.2	42.9	46.1	46.8	53.3	60.5	70.3	76.4	82.9
Nominal GDP (US$bn)	56.4	47.3	50.8	50.8	43.5	45.4	51.5	53.8	63.0	63.5	78.7	89.3	95.3
GDP per capita (US$)	7,900	6,700	7,200	7,300	6,200	6,500	7,500	7,800	9,300	9,300	11,700	13,300	14,400
Gross domestic saving (% of GDP)	9.2	8.4	11.6	13.3	13.0	14.0	15.2	15.9	17.2	15.5	15.7	15.9	16.0
Prices													
CPI (average, %YoY)	7.7	2.1	1.4	1.1	3.1	2.0	1.9	1.6	4.1	11.9	12.5	5.0	4.8
CPI (year-end, %YoY)	2.2	1.8	1.6	1.5	3.0	2.0	1.9	1.3	7.9	15.1	7.6	4.4	5.3
Wage rates (nominal, %YoY)	6.2	1.4	-0.2	3.7	4.0	3.7	10.6	9.4	9.6	13.8	15.8	13.1	11.3
Fiscal balance (% of GDP)													
Consolidated government balance	-5.1	-6.2	-3.5	-1.2	1.1	0.6	-0.2	-8.0	-4.1	-3.1	-2.8	-2.2	-1.6
Consolidated primary balance	-3.0	-3.5	-0.5	1.7	3.6	2.7	1.8	-6.0	-2.4	-1.7	-1.4	-1.0	-0.6
Total public debt	56.7	65.4	70.7	68.5	60.1	54.4	52.9	58.6	57.1	55.6	52.0	51.6	50.5
External balance													
Exports (€bn)	11.0	11.2	12.0	13.4	15.1	16.3	17.5	17.1	21.9	27.6	28.9	30.2	31.6
Imports (€bn)	15.5	15.2	16.1	17.1	19.4	21.9	23.9	23.1	28.9	39.0	34.6	35.7	36.8
Trade balance (€bn)	-4.5	-4.0	-4.0	-3.6	-4.3	-5.6	-6.3	-5.9	-7.1	-11.4	-5.7	-5.5	-5.3
Trade balance (% of GDP)	-12.4	-11.7	-11.4	-9.9	-10.8	-13.1	-13.7	-12.7	-13.3	-18.9	-8.2	-7.2	-6.3
Current account balance (€bn)	-2.1	-2.0	-1.2	-1.1	-2.1	-2.1	-3.2	-1.9	-2.3	-4.2	-1.5	-2.5	-3.0
Current account balance (% of GDP)	-5.8	-5.8	-3.5	-2.9	-5.1	-4.8	-6.9	-4.1	-4.2	-6.9	-2.1	-3.3	-3.6
Net FDI (€bn)	1.3	1.2	1.8	1.9	2.4	3.2	3.6	2.9	3.7	4.3	3.4	3.5	3.7
Net FDI (% of GDP)	3.6	3.6	5.1	5.2	6.0	7.4	7.7	6.3	6.9	7.2	4.9	4.6	4.4
Current account balance plus FDI (% of GDP)	-2.2	-2.2	1.6	2.2	0.9	2.5	0.8	2.2	2.6	0.3	2.7	1.4	0.8
Foreign exchange reserves ex gold (€bn)	11.2	9.9	10.4	10.2	10.0	11.3	13.4	13.5	16.5	19.4	25.8	29.0	32.0
Import cover (months of merchandise imports)	8.7	7.8	7.7	7.2	6.2	6.2	6.7	7.0	6.8	6.0	8.9	9.7	10.4
Debt indicators													
Gross external debt (€bn)	25.6	25.7	26.2	26.5	25.5	26.7	28.3	30.8	36.5	41.9	42.9	44.0	45.1
Gross external debt (% of GDP)	71.3	74.7	73.9	72.2	63.5	62.1	61.3	65.8	68.4	69.3	61.1	57.6	54.5
Gross external debt (% of exports)	233	230	218	197	170	164	161	180	167	152	149	146	143
Lending to corporates/households (% of GDP)	41.0	40.8	40.6	40.9	40.3	41.4	42.0	45.5	43.4	40.3	41.3	42.6	44.2
Interest & exchange rates													
Central bank key rate (year-end, %)	9.50	8.00	4.50	4.00	3.50	3.00	2.25	1.00	1.00	5.00	6.50	5.50	5.00
Broad money supply (average, %YoY)	4.6	7.6	6.6	11.6	3.6	14.5	8.4	18.1	13.3	6.9	7.0	8.8	10.2
3m interest rate (Belibor, year-end, %)	8.88	9.85	3.83	3.47	3.12	3.03	1.64	0.90	0.94	4.95	5.60	4.70	4.20
3m interest rate spread over Euribor (ppt)	8.7	9.7	3.9	3.8	3.4	3.3	2.0	1.3	1.5	4.5	2.3	1.1	1.3
3yr yield (year-end, %)	n/a	n/a	n/a	n/a	n/a	n/a	3.2	2.1	2.4	6.0	5.80	5.20	5.00
10yr yield (year-end, %)	n/a	n/a	n/a	n/a	n/a	4.8	4.0	3.1	3.6	7.0	6.30	5.80	5.60
USD/RSD exchange rate (year-end)	80.9	86.2	83.1	99.5	111.2	117.1	105.0	96.4	103.1	109.6	109.5	101.9	104.6
USD/RSD exchange rate (average)	73.1	88.0	84.9	89.1	109.4	111.8	105.2	102.3	99.6	111.9	108.6	105.6	102.8
EUR/RSD exchange rate (year-end)	114.6	121.0	121.6	123.5	118.5	118.2	117.6	117.6	117.6	117.3	117.19	117.18	117.17
EUR/RSD exchange rate (average)	113.1	117.4	120.8	123.2	121.3	118.3	117.8	117.6	117.6	117.4	117.20	117.19	117.18

Source: National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	0.5	0.9	1.7	3.5	3.3	3.8	3.2	2.7	3.1	3.3	3.5	3.8	4.0
CPI (eop, %YoY)	15.1	16.2	13.7	10.2	7.6	5.6	4.5	4.4	4.4	4.4	4.6	5.1	5.3
Central bank key rate (eop, %)	5.00	5.75	6.00	6.50	6.50	6.50	5.75	5.50	5.50	5.00	5.00	5.00	5.00
3m interest rate (eop, %)	4.95	5.47	5.60	5.60	5.60	5.60	5.40	5.10	4.70	4.40	4.20	4.20	4.20
10yr yield (eop, %)	7.30	6.50	6.25	6.30	6.30	6.20	6.00	5.90	5.80	5.80	5.75	5.80	5.60
USD/RSD exchange rate (eop)	109.57	108.21	107.46	110.85	109.52	108.51	106.53	104.63	101.90	101.90	102.78	103.69	104.62
EUR/RSD exchange rate (eop)	117.30	117.29	117.23	117.20	117.19	117.19	117.18	117.18	117.18	117.18	117.17	117.17	117.17

Source: National sources, ING estimates

Turkey

Muhammet Mercan, Chief Economist

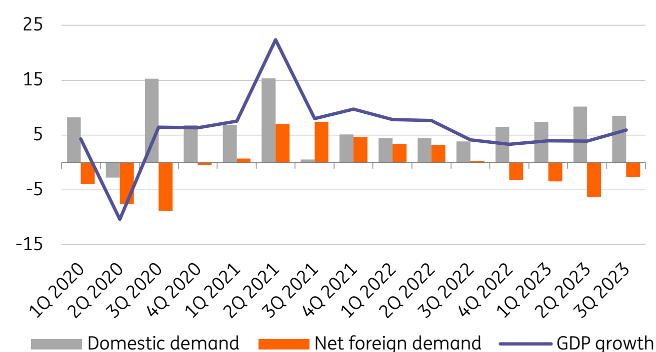
Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (% YoY)	5.9	3.1	4.4	3.0	1.6	4.2	2.5
CPI (% YoY)*	61.5	66.9	67.1	71.4	46.5	54.1	56.7
Policy interest rate (eop, %)	30.00	42.50	45.00	45.00	45.00	42.50	40.00
3m interest rate (%)*	40.16	44.64	44.07	43.14	41.79	19.39	42.74
10yr yield (%)*	27.15	28.34	27.78	26.69	25.99	18.92	26.89
USD/TRY*	27.37	30.00	33.31	35.52	37.01	24.29	35.35
EUR/TRY*	28.95	32.10	35.97	39.07	41.45	26.13	38.98

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: May-28	S&P	B	B
Fiscal	Loose	Parliamentary: May-28	Moody's	B3	B3
Monetary	Tightening	Local: Mar-24	Fitch	B	B

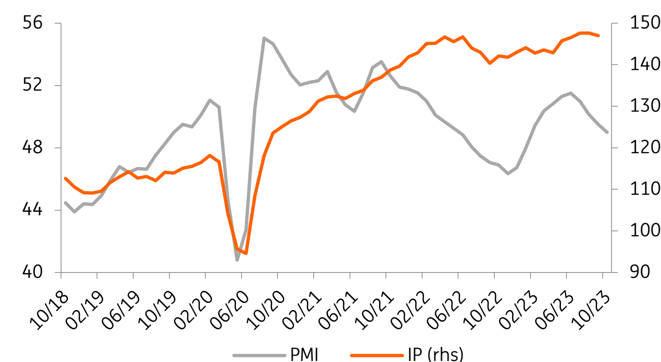
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

GDP growth (%YoY)



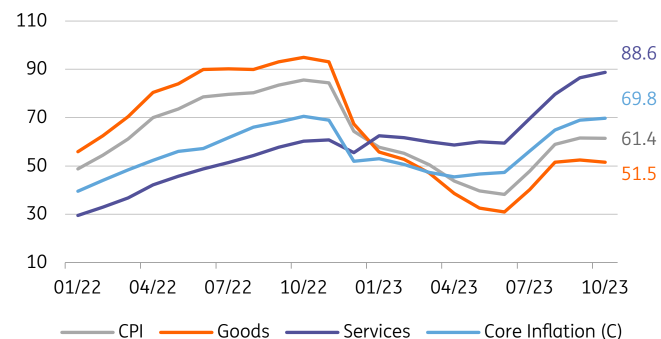
Source: TurkStat, ING Bank

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



Source: ICI, TurkStat, ING Bank

Inflation (%YoY)



Source: TurkStat, ING Bank

Country strategy: Moving towards orthodoxy

Since the elections there has been a shift to more orthodoxy with: (1) strong rate hikes and quantitative tightening in monetary policy: the CBT's focus has shifted to anchoring inflation expectations and achieving disinflation, while signalling further tightening steps. In this environment deposit and lending rates have moved up, with quantitative and selective credit tightening moves reinforcing rate hikes and supporting the plan to unwind the FX-protected deposit scheme. FX reserves have increased markedly since the presidential run-off; (2) efforts to reduce the budget deficit; and (3) moves to gradually unwind regulations that have contributed to a challenging operating environment for banks. We have seen a significant improvement in sentiment. Sustaining this momentum and further reducing risk premia will require ongoing efforts to move to full orthodoxy.

Macro digest

Turkish GDP growth in 3Q turned out to be 5.9% year-on-year, better than market consensus, on the back of still strong private consumption despite a moderation compared with previous quarters, robust investment and accelerating government consumption. Net exports turned out to be a drag again. 3Q GDP translates into quarter-on-quarter growth at 0.3% after seasonal adjustments, showing momentum loss in comparison to a relatively 2Q strong reading at 3.3%. The easing sequential performance is attributable to household consumption turning negative for the first time since the last quarter of 2020 and a negative contribution from stocks despite solid investment appetite and the supportive impact of net exports. Recent indicators on the other hand show that the gap between aggregate demand and supply that has led to significant pricing pressures is continuing to narrow, with gradual policy tightening since the elections. This should also be supportive for the external imbalances, with expected pressure on import demand. We expect GDP growth this year to be 4.2% as momentum is still strong. We envisage a further slowdown to 2.5% for 2024, reflecting the full impact of the rate hikes. That said, the risks are to the upside – with the government's latest Medium Term Plan (MTP) forecast at 4.0%, in addition to a continuing supportive fiscal stance and a potential recovery in foreign capital inflows.

While the CBT indicates that pass-through from the post-election adjustment in FX, wages and taxes has been 'largely completed', deterioration in pricing behaviour, exchange rate related risks, and the possibility of adjustment in administered prices hint that CPI inflation will likely remain elevated in the near term. On a positive note, the underlying trend for core and headline CPI has started to improve. The continuation of recent stability in the Lira, moderation in domestic demand and consumer subsidies for electricity and natural gas prices will also be supportive for the outlook. Regarding PPI, the decline in the annual figure from close to triple digits at the end of last year highlights a recovery in cost pressures despite an increase in the TL equivalent of import prices. For CPI, we expect annual inflation to continue to rise for the remainder of this year, to above 65% - households are expected to exceed the free natural gas usage limit, which in turn will boost monthly inflation. Inflation will likely remain elevated until mid-2024, with further increases above 70% on seasonal effects in January and unfavourable base effects in May. The second half the year, on the other hand, will likely see a sharp downtrend – reflecting this year's high base and further impact of tighter policy, pulling inflation to 42% at year-end.

Turkey

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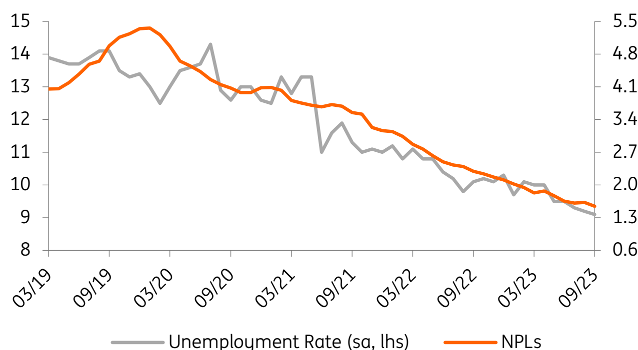
Unemployment vs NPLs (%)

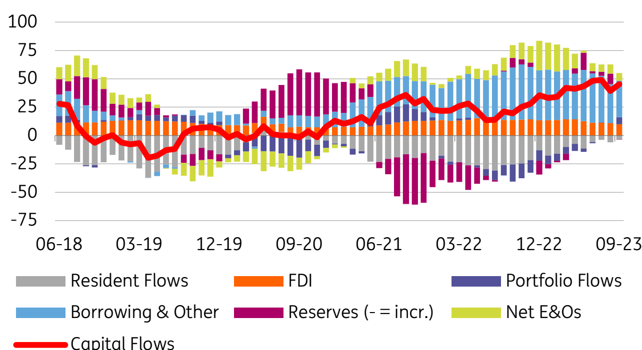


Source: TurkStat, BRSA, ING Bank

Unemployment rate at its lowest for a decade

The unemployment rate (seasonally adjusted) continued its long declining trend, falling to 9.1% in September, its lowest since end-2013. It stood at above 14% during the pandemic. Male unemployment is close to the lowest point in the current series that started in January 2005, at 7.5%. The increase in female job generation has been more limited, with unemployment at 12.3% versus the series low at 7.8%. Labour market conditions will remain sensitive to economic activity and the domestic demand outlook. Given the ongoing tightening in monetary and macro prudential policies accompanied by the slowdown in credit expansion, GDP growth is likely to remain moderate. This implies that there will be a trend change in the unemployment rate towards double digits again, as envisaged by the MTP.

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

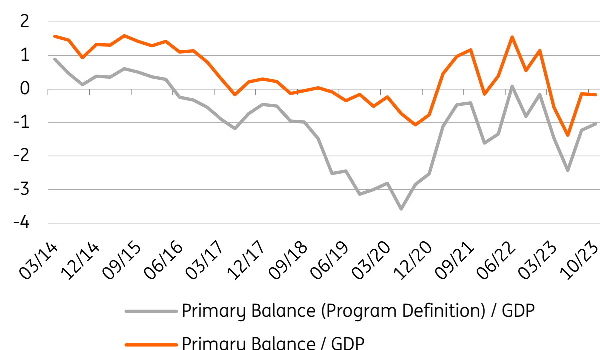


Source: CBT, ING Bank

Current account deficit continues its decline

Domestic demand pushing imports significantly upwards and a deterioration in the gold trade balance weighed on the current account in the first half of 2023. With the largest monthly surplus since late 2021, the recovery in the 12M rolling current account deficit that started in August accelerated in September (to c.5.2% of GDP). We expect the deficit to be c.4.2% of GDP at the end of 2023, with a gradual decline to 2.5% in 2024. The capital account on the other hand has been quite weak, despite some recent signals of recovery. Increasing Eurobond issuance by banks and higher private sector net borrowing, in return providing further support to official reserves that have been recovering since May, have helped. The ongoing pivot to a more conventional policy stance will be critical for recovery in investor confidence and hence identified flows.

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

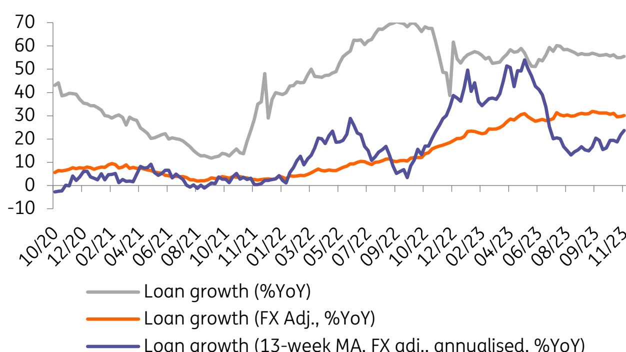


Source: Ministry of Treasury and Finance, ING Bank

Last two months of year key for 2023 budget performance

Budget results of the past two months have reflected a worsening in the deficit compared to the same period last year. This was on the back of high non-interest expenditures driven by an acceleration in transfers to SEEs and spending on personnel, despite continued strong increases in direct and indirect tax collection. The budget saw a deficit of TRY618.4bn (2.8% of GDP) on a 12m rolling basis. In the new MTP, the budget deficit forecast for 2023 was revised to 6.4% of GDP. This suggests a near doubling of the YTD deficit in the last two months of the year if all appropriations are fully utilised. The fiscal stance will remain accommodative in 2024, with another wide deficit at 6.4% of GDP mainly due to continuing earthquake-related spending. The fiscal outlook for next year suggests that fiscal policy will not be fully supportive for the CBT in fighting inflation.

Banking sector volume expansion



Source: BRSA, ING Bank

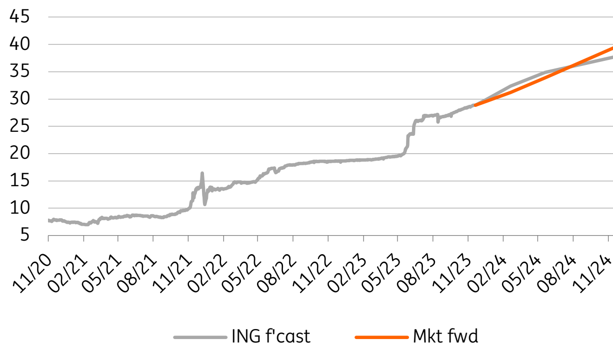
TRY lending likely to remain under control

Loan and deposit interest rates have substantially increased, helped by the tight monetary policy and the simplification steps. TRY commercial loan rates have exceeded 50% - the peak of the past 20 years – so reducing the appetite of companies to borrow in TRY. In this environment FX loans have become attractive again, specifically for those with FX revenue generation capability. There have been momentum gains in FX loans lately, as measured by the 13-week moving average annualised growth rate. This indicator turned to positive in state banks while remaining negative in private banks, although the pace of recovery is noteworthy. On the TRY side, while there are efforts to facilitate commercial lending, consumer loans are decelerating. There is consensus on credit growth remaining muted given the current tightening bias.

Turkey

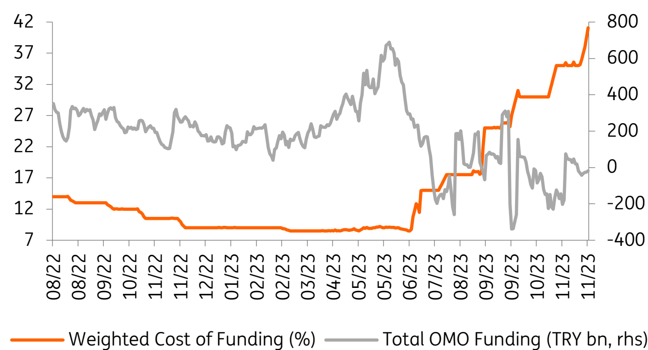
Strategy

FX – spot vs forward and ING forecast



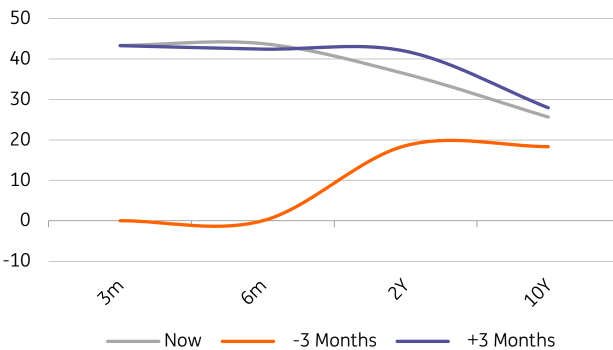
Source: Bloomberg, ING estimates

CBT funding



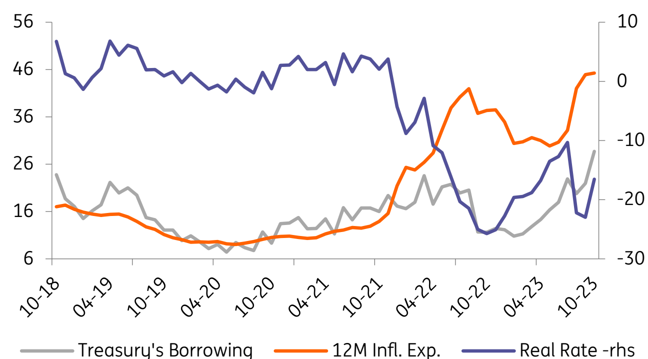
Source: CBT, ING estimates

Yield curve (%)



Source: Bloomberg, ING estimates

Real interest rate (%)



Source: Treasury, CBT, ING estimates

FX strategy

The CBT decided to slow the pace of monetary tightening and to complete the tightening cycle in a short period. There are grounds for a more gradual approach: (1) the inflation release in October indicated that the underlying trend is starting to improve. The latest data is in line with the outlook presented in the last Inflation Report of 2023, according to the bank; (2) inflation expectations and pricing behaviour are showing signs of improvement. Indeed, survey-based measures of inflation expectations for 12 months ahead declined by 1.3ppt in November, to 43.9% YoY. The November rate hike has brought the compound policy rate to 49%, above the 12-month inflation expectation in the CBT's Market Participant Survey; (3) on financial conditions, the CBT announced a number of regulations after the October MPC, easing security maintenance, increasing the target rise in the share of retail TRY deposits and introducing additional reserve requirement hikes. These moves, in turn, led to a significant adjustment in government bond yields. Tighter credit conditions are likely to continue to support normalisation in domestic demand; (4) recent data indicates that the gap between aggregate demand and supply is slowly narrowing, with gradual policy tightening since the elections; and, lastly, (5) the bank signalled its intent not to start cutting earlier and remained committed to keeping its tight stance for longer to ensure sustained price stability. Gross reserves have increased markedly since the elections, something that is likely to continue in the period ahead - with expected UAE funding, a likely recovery in portfolio flows and higher debt rollover ratios for banks and corporates.

Fixed Income strategy

With progress on monetary tightening, and with rates high enough to control lending and support de-dollarization, the CBT (i) further simplified rate caps on loans, and (ii) eliminated security maintenance requirements on TRY cash loans and securities issued by the non-financial sector and purchased by banks. Additionally, renewal of FX-protected deposit accounts and conversion to TRY deposits to facilitate de-dollarization (by increasing the share of TRY accounts) are no longer subject to security maintenance. Instead, commissions on reserve requirements for FX deposits are to be utilised for this purpose. As a result, government bond yields have adjusted significantly higher, especially in shorter maturities, implying an inverted yield curve. However, the MB's firm stance on disinflation and guidance on the tightening process in the November MPC initiated a rally in the yields with an across the board decline in all maturities. Additionally, we see increasing appetite of non-resident investors with around US$1.8bn inflows (including repos) in the past four weeks, though their share in domestic debt is at a mere 0.8% as of October. This implies there is significant room to increase depending on the progress in the current policy framework. FinMin Mehmet Simsek announced that they would re-evaluate the swap limit, among the biggest obstacles for foreign investors to turn to TRY-based assets, though he did not provide any detail about the timing of such a move. That would reduce the cost of hedging TRY exposure and hence encourage more capital inflows into Turkey's bond markets.

Turkey

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	8.5	4.9	6.1	3.3	7.5	3.0	0.8	1.9	11.4	5.5	4.2	2.5	3.5
Private consumption (%YoY)	7.5	3.1	5.3	3.8	5.9	0.7	1.5	3.2	15.4	18.9	10.9	2.3	3.8
Government consumption (%YoY)	8.0	3.1	3.9	9.5	5.0	5.9	3.9	2.2	3.0	4.2	4.8	4.6	1.7
Investment (%YoY)	14.2	4.9	9.3	2.2	8.3	0.1	-12.5	7.3	7.2	1.3	4.6	-3.1	2.0
Industrial production (%YoY)	7.2	5.7	5.8	3.4	9.0	1.3	-0.5	1.6	17.5	5.7	3.9	2.5	3.5
Unemployment rate (year-end, %)	8.9	9.9	10.3	10.9	10.9	10.9	13.7	13.1	12.0	10.5	9.7	10.8	10.3
Nominal GDP (TRYbn)	1,823	2,055	2,351	2,627	3,134	3,761	4,318	5,049	7,256	15,012	25,144	39,159	51,133
Nominal GDP (€bn)	717	681	707	779	763	664	677	623	671	849	962	1005	1065
Nominal GDP (US$bn)	946	937	856	867	861	775	761	712	788	900	1035	1108	1213
GDP per capita (US$)	12,582	12,178	11,085	10,964	10,696	9,792	9,213	8,536	9,369	10,589	12,069	12,768	13,831
Gross domestic saving (% of GDP)	23.9	24.9	25.2	26.0	26.0	26.8	25.8	26.4	30.5	30.0	27.2	28.5	28.9
Prices													
CPI (average, %YoY)	7.5	8.9	7.7	7.8	11.1	16.3	15.2	12.3	19.6	72.3	54.1	56.7	26.6
CPI (year-end, %YoY)	7.4	8.2	8.8	8.5	11.9	20.3	11.8	14.6	36.1	64.3	66.9	42.0	20.0
Wage rates (nominal, %YoY)	16.6	15.6	18.3	20.7	13.4	15.9	18.3	6.8	39.7	88.2	67.2	63.6	32.3
Fiscal balance (% of GDP)													
Consolidated government balance	-1.0	-1.1	-1.0	-1.1	-1.5	-1.9	-2.8	-3.4	-2.6	-0.9	-4.1	-6.4	-3.5
Consolidated primary balance	1.7	1.3	1.3	0.8	0.3	0.0	-0.5	-0.8	-0.2	1.1	-1.5	-3.1	0.0
Total public debt	31.1	28.4	27.3	27.9	27.9	30.0	32.6	39.6	41.7	31.7	31.6	34.0	33.8
External balance													
Exports (US$bn)	167.4	173.3	154.9	152.6	169.2	178.9	182.2	168.4	224.7	253.4	253.5	277.0	293.7
Imports (US$bn)	249.3	239.9	203.9	192.6	227.8	219.7	199.0	206.3	254.0	343.0	338.7	350.5	371.4
Trade balance (US$bn)	-81.9	-66.6	-49.0	-39.9	-58.6	-40.8	-16.8	-37.9	-29.3	-89.6	-85.2	-73.5	-77.7
Trade balance (% of GDP)	-8.7	-7.1	-5.7	-4.6	-6.8	-5.3	-2.2	-5.3	-3.7	-10.0	-8.2	-6.6	-6.4
Current account balance (US$bn)	-55.9	-38.8	-27.3	-26.8	-40.6	-20.7	6.8	-35.5	-7.2	-49.1	-44.3	-29.5	-30.4
Current account balance (% of GDP)	-5.9	-4.1	-3.2	-3.1	-4.7	-2.7	0.9	-5.0	-0.9	-5.5	-4.3	-2.7	-2.5
Net FDI (US$bn)	13.6	13.3	19.3	13.9	11.1	13.0	9.3	7.8	13.3	13.6	9.9	11.6	13.5
Net FDI (% of GDP)	1.4	1.4	2.3	1.6	1.3	1.7	1.2	1.1	1.7	1.5	1.0	1.0	1.1
Current account balance plus FDI (% of GDP)	-4.5	-2.7	-0.9	-1.5	-3.4	-1.0	2.1	-3.9	0.8	-3.9	-3.3	-1.6	-1.4
Foreign exchange reserves ex gold (US$bn)	112.0	106.3	95.7	92.1	84.1	72.0	81.2	50.0	72.6	82.9	89.3	93.7	97.7
Import cover (months of merchandise imports)	5.4	5.3	5.6	5.7	4.4	3.9	4.9	2.9	3.4	2.9	3.2	3.2	3.2
Debt indicators													
Gross external debt (US$bn)	405.3	416.8	402.9	405.8	450.5	425.8	413.9	428.7	437.0	458.5	485.2	503.1	520.0
Gross external debt (% of GDP)	43	44	47	47	52	55	54	60	55	51	47	45	43
Gross external debt (% of exports)	242	241	260	266	266	238	227	255	194	181	191	182	177
Lending to corporates/households (% of GDP)	57.7	60.2	63.1	65.9	66.8	63.6	61.4	70.7	67.4	50.4	46.3	40.4	37.7
Interest & exchange rates													
Central bank key rate (year-end, %)	4.50	8.25	7.50	8.00	8.00	24.00	12.00	17.00	14.00	9.00	42.50	40.00	22.50
Broad money supply (average, % YoY)	22.2	11.9	17.1	18.3	15.7	19.1	26.1	36.0	53.6	60.7	68.5	56.7	31.6
3m interest rate (TRLibor, average, %)	6.1	8.6	9.9	8.9	11.6	19.1	18.8	11.0	18.0	15.7	19.4	42.7	28.8
3m interest rate spread over US$-Libor(ppt)	581	837	960	812	1029	1671	1684	1071	1794	1225	1417	3809	2570
2yr yield (average, %)	7.6	9.2	9.8	9.7	11.8	18.9	17.2	11.9	18.5	19.2	21.5	39.0	29.6
10yr yield (average, %)	8.3	9.3	9.4	10.1	11.0	15.8	15.5	12.7	18.2	17.6	18.9	26.9	22.7
USD/TRY exchange rate (year-end)	2.13	2.32	2.92	3.53	3.79	5.29	5.95	7.43	13.32	18.69	30.00	38.00	45.00
USD/TRY exchange rate (average)	1.93	2.19	2.75	3.03	3.64	4.85	5.67	7.09	9.20	16.68	24.29	35.35	42.15
EUR/TRY exchange rate (year-end)	2.93	2.81	3.17	3.70	4.55	6.05	6.67	9.08	15.14	20.00	32.10	43.70	50.40
EUR/TRY exchange rate (average)	2.54	3.02	3.33	3.37	4.11	5.66	6.37	8.11	10.81	17.68	26.13	38.98	47.99
Brent oil price (annual average, US$/bbl)	109.55	99.35	52.08	43.31	54.13	71.17	64.72	41.80	71.25	99.25	84.50	90.25	80.25

Source: National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	3.3	4.0	3.9	5.9	3.1	4.4	3.0	1.6	1.3	2.6	3.1	3.8	4.4
CPI (eop, %YoY)	64.3	50.5	38.2	61.5	66.9	67.1	71.4	46.5	42.0	32.3	26.5	23.1	20.0
Central bank key rate (eop, %)	9.00	8.50	15.00	30.00	42.50	45.00	45.00	45.00	40.00	35.00	30.00	25.00	22.50
3m interest rate (eop, %)	10.85	14.38	21.22	40.16	44.64	44.07	43.14	41.79	38.19	33.84	29.36	24.73	22.81
10yr yield (eop, %)	9.83	10.49	16.79	27.15	28.34	27.78	26.69	25.99	25.24	24.56	21.87	21.43	20.84
USD/TRY exchange rate (eop)	18.69	19.16	26.05	27.37	30.00	33.31	35.52	37.01	38.00	40.17	42.03	43.63	45.00
EUR/TRY exchange rate (eop)	20.00	20.79	28.43	28.95	32.10	35.97	39.07	41.45	43.70	46.20	47.92	49.30	50.40

Source: National sources, ING estimates

Ukraine

Leszek Kąsek, Senior Economist

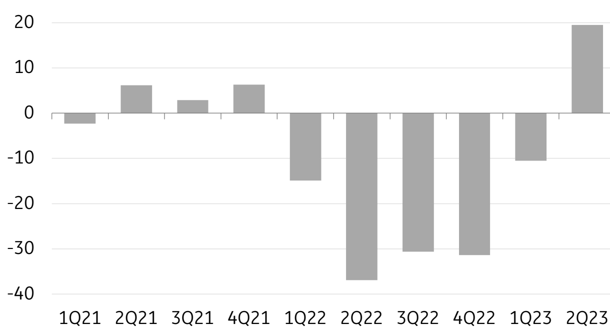
Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	7.5	4.0	3.5	3.5	3.2	4.5	3.5
CPI (%YoY)*	7.1	5.5	6.0	8.0	9.5	11.7	8.1
Policy interest rate (%)	20.0	15.0	15.0	15.0	15.0	22.4	15.0
USD/UAH*	36.6	37.0	37.5	38.0	36.6	36.7	38.4
EUR/UAH*	38.6	39.6	40.5	41.9	38.6	39.5	42.8

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2024 (tbc)	S&P	CCC+	CCC+
Fiscal	Easing	Parliamentary: after war	Moody's	Caa3	Caa3
Monetary	Easing	Local: after war	Fitch	CC	CCC-

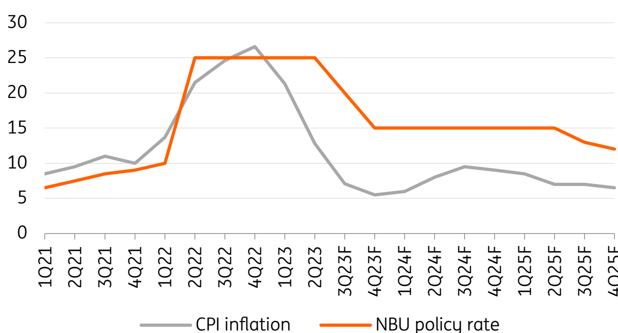
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

GDP growth (YoY, %)



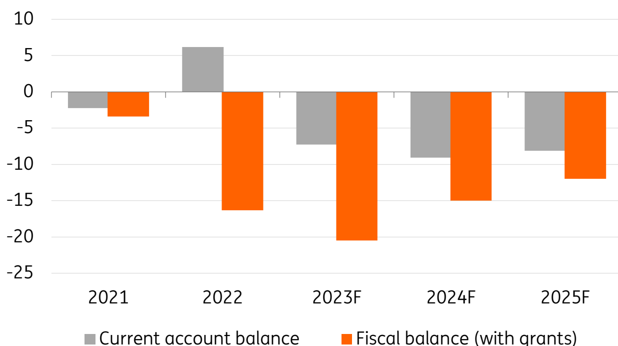
Source: NSI, NBU, ING

Inflation and NBU policy rate (period end, YoY, %)



Source: NBU, ING

Fiscal and current account balances (% of GDP)



Source: Ministry of Finance, NBU, ING

Country strategy: Unsustainable hryvnia gains

NBU policy since September has been a surprise. The bank has freed the hryvnia exchange rate but has increased the scale of interventions to drive US$/UAH lower. Half of this move lower has already corrected, but we expect further hryvnia losses. Ukraine maintains a significant current account deficit, and this is unlikely to end for some years. The NBU might continue to try to counter this via FX intervention but, despite foreign aid, FX reserves have been falling. Long-term prospects for the hryvnia are fundamentally negative. Russian aggression is unlikely to end any time soon. The damage to the Ukrainian economy will likely only intensify and we expect the NBU to allow some hryvnia weakening in the long run, but probably not before the conflict ends.

Wartime economy returned to positive growth in 2023

The Russian war in Ukraine has become a protracted conflict, with little chance of ending in 2024, but rather no earlier than 2025. Around 18% of Ukraine's territory is occupied, half of this (Crimea) having been annexed in 2014. With active fighting localised mainly in Donbas to the east of the country, and with electricity provision restored, in 2Q23 the economy resumed and posted its first positive YoY growth since the invasion began.

The economy is on a war footing, with continued support through foreign aid, heightened public consumption and defence spending. Exports were helped by the Black Sea Grain Initiative but Russia stopped this in July. Six million people remain refugees abroad.

Sharp inflation deceleration enabled large NBU rate cuts

On the back of FX and financial sector stability and with interest rates at 25% from 2Q22, aided by positive external disinflation trends, CPI inflation fell from above 25% in late 2022 to slightly above 5% in 4Q23. Food prices for consumers benefited from good harvests and from lower prices on global commodity markets.

Encouraged by favourable inflation projections, the National Bank of Ukraine cut its key policy rate by 3ppt in late July, then by 2ppt in mid-September, and 4ppt in late October - to 16%. The NBU also signalled a 1ppt cut in mid-December. However, as inflation is projected to pick up in 2024, the NBU is now expected to keep rates higher for longer, and to resume interest rate cuts in 2H25.

Foreign aid set to narrow while imbalances remain high

Foreign grants and loans (mainly from preferred creditors) covered to a large extent the huge fiscal and external imbalances caused by the war. In 2022, the fiscal balance including grants reached 16% of GDP - without grants it would have been c.10% of GDP higher. A 35% collapse in exports and 20% fall in imports led to a wide trade gap but – thanks to foreign transfers – the current account recorded a surplus, which switched to a sizeable deficit though in 2023. The large fiscal and trade gaps are set to persist in the medium term, with the country facing gradually decreasing flows of external grants. This will require continued macroeconomic policy mix and pro-EU institutional reforms to sustain still significant donor support and credibility for foreign investors. Large foreign investments are unlikely before the war ends and reconstruction starts.

Ukraine

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	0.0	-6.6	-9.8	2.4	2.5	3.4	3.2	-3.8	3.4	-29.1	4.5	3.5	5.0
Private consumption (%YoY)	6.9	-8.3	-20.7	2.1	7.7	8.8	10.9	1.7	6.9	-26.7	5.0	6.0	7.0
Government consumption (%YoY)	-0.9	1.1	1.7	-0.5	2.4	0.2	-13.6	-0.7	0.8	18.0	5.0	-3.0	-5.0
Investment (%YoY)	-8.4	-24.0	-9.2	20.4	18.8	14.3	11.7	-21.3	9.1	-35.3	9.0	10.0	15.0
Industrial production (%YoY)	-4.3	-10.1	-13.0	2.8	0.4	3.0	-0.5	-4.0	3.5	-60.0	5.0	7.0	10.0
Unemployment rate (year-end, %)	7.6	10.6	9.5	9.7	9.9	9.3	8.5	9.0	9.8	24.5	19.4	10.6	9.2
Nominal GDP (UAHbn)	1,465	1,587	1,989	2,385	2,983	3,561	3,975	4,090	4,742	4,188	4,987	5,679	6,496
Nominal GDP (€bn)	138	100	82	84	99	111	137	132	146	122	120	130	202
Nominal GDP (US$bn)	183	132	90	93	112	130	153	151	173	128	129	152	176
GDP per capita (US$)	4,000	3,100	2,119	2,200	2,600	3,050	3,600	3,400	4,200	3,700	3,900	4,500	5,100
Gross national saving (% of GDP)	9.3	9.9	13.3	14.8	12.3	15.3	12.2	12.2	12.8	17.6	9.5	9.8	11.3
Prices													
CPI (average, %YoY)	-0.3	12.1	48.5	14.9	14.5	11.0	7.9	3.0	9.8	21.6	11.7	8.1	7.3
CPI (year-end, %YoY)	0.5	24.9	43.3	12.4	13.7	9.8	4.1	5.0	10.0	26.6	5.5	9.0	6.5
Wage rates (nominal, %YoY)	8.0	6.1	21.1	23.3	37.0	24.8	18.4	10.4	20.9	6.0	17.0	15.0	15.0
Fiscal balance (% of GDP)													
Consolidated government balance	-4.3	-4.5	-1.6	-2.3	-1.4	-2.0	-2.2	-5.3	-3.4	-16.3	-20.5	-15.0	-12.0
Consolidated primary balance	-1.8	-1.5	2.8	1.9	2.4	1.2	0.9	-2.1	-1.6	-13.2	-17.4	-11.9	-8.9
Total public debt	39.9	69.4	79.0	80.9	71.8	60.9	50.2	60.4	48.9	78.5	89.9	95.8	99.7
External balance													
Exports (US$bn)	59.1	50.6	35.4	33.6	39.7	43.3	46.1	45.1	63.1	40.9	37.0	38.9	40.8
Imports ((US$bn)	81.2	57.7	38.9	40.5	49.4	56.1	60.4	52.0	69.8	56.2	62.0	65.1	69.0
Trade balance (US$bn)	-22.1	-7.1	-3.5	-6.9	-9.7	-12.7	-14.3	-6.9	-6.7	-15.3	-25.0	-26.3	-28.2
Trade balance (% of GDP)	-12.1	-5.4	-3.8	-7.5	-8.6	-9.7	-9.3	-4.5	-3.9	-11.9	-19.4	-17.3	-16.1
Current account balance (US$bn)	-4.1	-0.3	0.4	-3.8	-3.7	-4.5	-4.1	5.3	-3.9	8.0	-9.9	-13.4	-13.5
Current account balance (% of GDP)	-2.2	-0.2	0.5	-4.1	-3.3	-3.4	-2.7	3.5	-2.3	6.2	-7.7	-8.8	-7.7
Net FDI (US$bn)	4.1	0.3	3.0	3.3	3.6	4.4	-5.2	0.1	4.2	0.6	0.7	0.8	3.5
Net FDI (% of GDP)	2.2	0.2	3.3	3.5	3.2	3.4	-3.4	0.1	2.4	0.5	0.5	0.5	2.0
Current account balance plus FDI (% of GDP)	0.0	0.0	3.8	-0.5	-0.1	0.0	-6.1	3.6	0.2	6.7	-7.1	-8.3	-5.7
Foreign exchange reserves (US$bn)	18.8	10.0	13.2	15.3	18.9	17.7	25.3	29.1	30.9	28.5	41.0	44.0	45.0
Import cover (months of merchandise imports)	2.8	2.1	4.1	4.5	4.6	3.8	5.0	6.7	5.3	6.1	7.9	8.1	7.8
Debt indicators													
Gross external debt (US$bn)	142.1	125.3	117.7	112.5	115.5	114.7	121.7	125.7	129.7	131.0	153.0	171.4	184.9
Gross external debt (% of GDP)	77.6	94.7	130.2	120.8	103.0	87.9	79.3	83.3	74.9	102.2	118.7	112.9	105.3
Gross external debt (% of exports)	240.4	247.9	332.3	335.2	290.9	264.6	264.0	278.4	205.5	320.2	413.5	441.2	453.3
Lending to corporates/households (% of GDP)	60.4	62.4	48.4	41.3	33.7	29.8	24.5	23.1	21.6	26.5	27.0	28.0	29.0
Interest & exchange rates													
Central bank key rate (year-end, %)	6.5	14.0	22.0	14.0	14.5	18.0	13.5	6.0	9.0	25.0	15.0	15.0	12.0
Broad money supply (average, %YoY)	17.6	5.3	3.9	10.9	9.6	5.7	12.6	28.6	12.0	20.8	23.0	13.0	10.0
2yr yield (average, %)	13.9	17.9	18.9	19.4	15.7	17.8	17.2	13.0	12.5	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)	8.0	15.8	24.0	27.2	28.1	27.7	23.7	28.3	27.3	36.6	37.0	39.0	39.0
USD/UAH exchange rate (average)	8.0	11.9	21.9	25.6	26.6	27.2	25.8	27.0	27.3	32.4	36.7	38.4	39.0
EUR/UAH exchange rate (year-end)	11.0	19.2	26.2	28.4	33.5	31.7	26.4	34.7	30.9	39.0	39.6	44.9	43.7
EUR/UAH exchange rate (average)	10.6	15.7	24.3	28.3	30.0	32.1	28.9	30.8	32.3	34.1	39.5	42.8	44.3

Source: National sources, IMF, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	-31.4	-10.5	19.5	7.5	4.0	3.5	3.5	3.2	3.7	4.0	4.5	5.5	6.0
CPI (eop, %YoY)	26.6	21.3	12.8	7.1	5.5	6.0	8.0	9.5	9.0	8.5	7.0	7.0	6.5
Central bank key rate (eop, %)	25.0	25.0	25.0	20.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	13.0	12.0
USD/UAH exchange rate (eop)	36.6	36.6	36.6	36.6	37.0	37.5	38.0	39.0	39.0	39.0	39.0	39.0	39.0
EUR/UAH exchange rate (eop)	39.0	39.8	40.0	38.6	39.6	40.5	41.9	43.7	44.9	44.9	44.5	44.1	43.7

Source: NBU, Ukrstat, Macrobond, ING estimates

Uzbekistan

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	2023F	2024F
Real GDP (%YoY)	6.1	8.0	7.0	5.7	5.2	6.3	5.5
CPI (%YoY)*	8.8	8.7	8.2	11.6	11.5	9.7	10.4
Policy interest rate (eop, %)	14.00	14.00	14.00	14.00	14.00	14.00	14.00
USD/UZS*	12,184	12,352	12,507	12,661	12,816	11,791	12,661
EUR/UZS*	12,897	13,217	13,507	13,927	14,353	12,734	14,054

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-

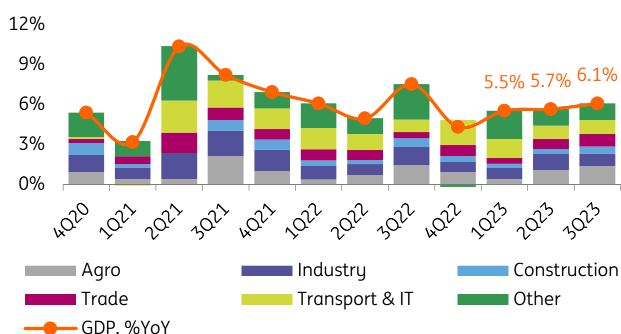
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

Country strategy: Watch out for inflation and FX trends

Uzbekistan is managing to sustain a high GDP growth rate with a high degree of diversification, however, on the financing side, this growth appears to be increasingly reliant on domestic credit and fiscal easing. Meanwhile, the room for monetary easing appears limited given the elevated CPI growth and expectations of higher inflation following the expected household tariff liberalisation in 2024.

The prospects for the soum remain an open question. From a balance of payments perspective, the current account is under pressure of growing imports from China, while private capital is in net outflow for the second year in a row. Meanwhile, being the worst performing CIS4 FX to date amid positive real rates and prospects of more state foreign borrowing, we do not exclude some relief in the depreciation pressure on UZS in the coming couple of quarters.

GDP growth by components (%YoY, ppt)

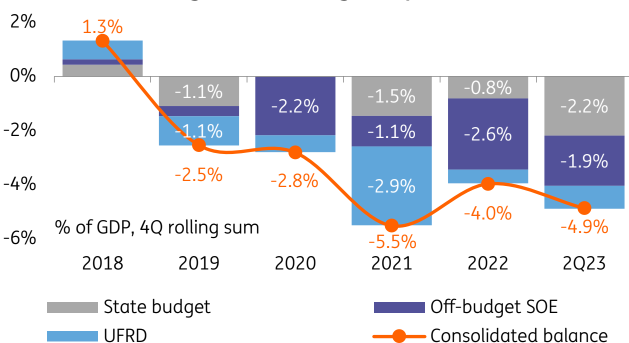


Source: National sources, CEIC, ING

Steady diversified growth, increasingly reliant on credit

Uzbekistan's GDP growth reached 5.8% YoY in 9M23 and is likely to reach 6.0-6.5% YoY for the full year, aided by the low base effect of 4Q22. The growth structure by sector appears diversified as output in agriculture and heavy industries normalised following the power outages at the beginning of the year. Domestic demand seems supported by aggressive expansion in retail lending – by 40% YoY in real terms (55% YoY in nominal terms) to 13% of GDP. Currently the YoY increase in the retail loan portfolio corresponds to more than 90% of the retail turnover increase, which raises questions about the sustainability of the credit-financed consumption growth amid volatile household income performance. The CPI picture suggests mounting risks in 2024 due to expected tariff liberalisation, preventing the central bank from rate cuts.

Consolidated budget balance by components (% GDP)

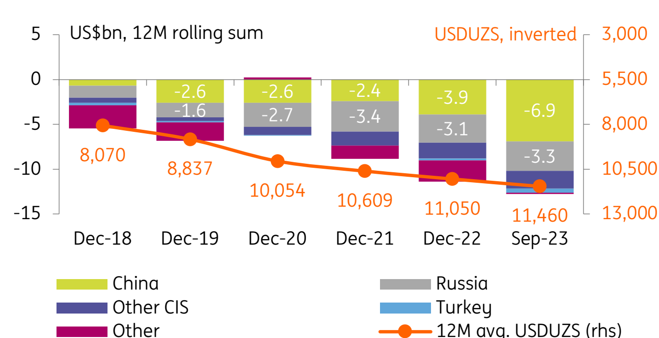


Source: National sources, CEIC, ING

Fiscal policy is back to easing

The consolidated budget deficit widened by almost 1ppt during 1H23, driven by continued expansion of spending, which is up from 25.5% of GDP in 2018 to 37.8% as of mid-2023. Key drivers of higher state spending are social support (12-13% of GDP), including energy subsidies to low-income families, and state investments (6% of GDP). Meanwhile, the revenue side is generally softer, also due to a reduction in VAT. As a result, given a likely desire to avoid social tensions amid household tariff liberalisation, we see a widening of the consolidated budget deficit to 5.0-5.5% of GDP before stabilising at around 3-4%. With c.10% of GDP worth of liquid state savings in UFRD, borrowing would seem to be the primary source of the deficit, suggesting an upside to public debt, currently at 35% of GDP.

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



Source: National sources, CEIC, ING

Trade deficit with China widens, capital outflow persists

The balance of payments in 2023 show little visible change from previous years, characterised by a widening trade deficit, mostly due to imports from China (25% of total) needed to sustain Uzbekistan's large investment programme. Exports, which are gold-heavy (40% of total) are also growing, but in a more volatile fashion. The current account deficit, having shrunk to a low of US$0.6bn in 2022 is now back to a normal c.US$3bn as of mid-2023 (4Q rolling basis), while net private capital outflow remains around US$4bn for the second year in a row. The state (net borrowing) remains the only support factor for the soum but given that UZS has been the worst performing CIS FX for a while now amid positive real rates, we do not exclude some temporary relief in the next couple of quarters.

Uzbekistan

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	7.3	6.9	7.2	5.9	4.4	5.5	6.0	2.0	7.4	5.7	6.3	5.5	5.7
Real oil GDP (%YoY)	8.8	8.7	11.9	8.3	4.2	7.0	5.6	0.3	11.7	11.4	5.5	6.0	6.0
Real non-oil GDP (%YoY)	8.6	8.4	6.7	2.7	1.5	4.8	5.7	1.4	3.1	1.3	2.0	3.0	2.0
Investment (%YoY)	11.3	9.8	9.4	4.1	19.4	29.9	38.1	-4.4	2.9	0.9	10.0	7.0	8.0
Industrial production (%YoY)	7.5	4.5	5.3	5.4	5.2	10.8	6.6	0.7	8.8	5.2	5.7	5.0	5.5
Unemployment rate (year-end, %)	4.9	5.2	5.2	5.2	5.4	9.3	9.1	11.1	9.8	8.9	8.2	8.0	7.8
Nominal GDP (UZStn)	153	187	221	255	317	427	533	606	738	888	1,036	1,207	1,384
Nominal GDP (€bn)	55.1	60.9	77.6	77.9	54.1	44.6	53.8	52.7	58.8	76.4	81.4	85.9	92.2
Nominal GDP (US$bn)	73.3	80.9	86.2	86.2	61.9	52.5	60.1	60.2	69.6	80.4	87.9	95.3	105.2
GDP per capita (US$)	2,420	2,628	2,754	2,705	1,917	1,604	1,795	1,759	1,993	2,255	2,393	2,547	2,758
Gross domestic saving (% of GDP)	22.6	23.4	21.5	19.6	23.2	24.6	24.3	25.0	23.6	21.3	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	11.8	9.3	8.8	8.1	13.9	17.5	14.5	12.9	10.8	11.4	9.7	10.4	8.6
CPI (year-end, %YoY)	10.3	10.4	7.6	9.8	18.8	14.3	15.2	11.2	10.0	12.3	8.7	11.1	6.3
Wage rates (nominal, %YoY)	n/a	n/a	n/a	n/a	n/a	25.0	27.5	15.0	20.3	20.8	20.0	19.4	16.6
Fiscal balance (% of GDP)													
Consolidated government balance	2.2	1.9	-0.3	0.7	1.1	1.3	-2.5	-2.8	-5.5	-4.0	-5.2	-4.1	-3.3
Consolidated primary balance	2.2	1.9	-0.3	0.7	1.2	1.4	-2.2	-2.3	-4.8	-3.3	-4.5	-3.4	-2.5
Total public debt	6.2	6.1	10.0	8.2	19.3	19.6	28.5	37.4	36.6	34.9	37.5	38.9	40.0
External balance													
Exports (US$bn)	n/a	10.6	9.5	8.6	10.2	11.4	13.9	12.8	14.1	17.1	21.4	23.5	25.9
Imports (US$bn)	n/a	13.5	11.6	11.0	12.4	18.3	21.2	19.0	22.9	28.3	35.4	37.9	39.8
Trade balance (US$bn)	n/a	-3.0	-2.1	-2.4	-2.2	-6.9	-7.3	-6.2	-8.8	-11.2	-14.0	-14.3	-13.9
Trade balance (% of GDP)	n/a	-3.7	-2.4	-2.8	-3.6	-13.0	-12.1	-10.3	-12.6	-13.9	-15.9	-15.0	-13.2
Current account balance (US$bn)	n/a	2.1	0.9	0.2	1.5	-3.6	-3.4	-3.0	-4.9	-0.6	-4.0	-6.3	-7.9
Current account balance (% of GDP)	n/a	2.6	1.0	0.2	2.4	-6.8	-5.6	-5.0	-7.0	-0.8	-4.6	-6.6	-7.5
Net FDI (US$bn)	n/a	0.8	1.0	1.7	1.8	0.6	2.3	1.7	2.3	2.5	2.7	3.0	3.3
Net FDI (% of GDP)	n/a	1.0	1.2	1.9	2.9	1.2	3.8	2.9	3.3	3.1	3.1	3.2	3.2
Current account balance plus FDI (% of GDP)	n/a	3.6	2.2	2.2	5.3	-5.6	-1.8	-2.2	-3.8	2.3	-1.4	-3.5	-4.3
Gross international reserves (US$bn)	14.1	24.1	24.3	26.4	28.1	27.1	29.2	34.9	35.1	35.8	33.3	32.3	33.0
Import cover (months of merchandise imports)	n/a	21.4	25.2	28.7	27.2	17.8	16.5	22.0	18.4	15.2	11.3	10.2	10.0
Debt indicators													
Gross external debt (US$bn)	9.7	11.6	13.4	14.6	15.6	17.1	24.3	33.3	42.3	50.8	56.8	59.8	64.8
Gross external debt (% of GDP)	13.2	14.3	15.6	17.0	25.1	32.3	40.3	55.3	60.8	63.2	64.6	62.7	61.6
Gross external debt (% of exports)	n/a	109.9	141.3	169.2	153.3	150.0	174.6	259.7	299.1	296.9	265.6	254.2	250.4
Lending to corporates/households (% of GDP)	n/a	n/a	n/a	20.6	34.8	39.2	38.9	45.2	43.7	43.4	44.0	44.4	45.2
Interest & exchange rates													
Central bank key rate (year-end, %)	12.00	10.00	9.00	9.00	14.00	16.00	16.00	14.00	14.00	15.00	14.00	14.00	10.00
Money supply (%YoY)	n/a	15.7	24.3	23.5	40.2	14.1	13.9	17.7	29.7	30.2	15.0	27.6	18.3
3m interest rate (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
3m interest rate spread over US$-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)	2,202	2,422	2,791	3,225	8,120	8,404	9,506	10,466	10,818	11,229	12,352	12,970	13,359
USD/UZS exchange rate (average)	2,093	2,310	2,569	2,965	5,126	8,133	8,861	10,055	10,614	11,046	11,791	12,661	13,165
EUR/UZS exchange rate (year-end)	3,026	2,931	3,030	3,393	9,745	9,563	10,657	12,787	12,303	12,022	13,217	14,915	14,962
EUR/UZS exchange rate (average)	2,783	3,066	2,851	3,280	5,869	9,573	9,895	11,493	12,548	11,627	12,734	14,054	15,008
Brent oil price (annual average, US$/bbl)	109	99	54	45	55	72	64	43	71	99	84	90	80

Source: National sources, ING estimates

Quarterly forecasts

	4Q22	1Q23	2Q23	3Q23	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F
Real GDP (%YoY)	4.3	5.5	5.7	6.1	8.0	7.0	5.7	5.2	4.0	4.0	5.5	6.5	6.7
CPI (eop, %YoY)	12.3	11.7	8.7	8.8	8.7	8.2	11.6	11.5	11.1	9.9	8.7	7.5	6.3
Central bank key rate (eop, %)	15.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	13.00	12.00	11.00	10.00
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/UZS exchange rate (eop)	11,229	11,419	11,490	12,184	12,352	12,507	12,661	12,816	12,970	13,067	13,165	13,262	13,359
EUR/UZS exchange rate (eop)	12,022	12,402	12,540	12,897	13,217	13,507	13,927	14,353	14,915	15,027	15,008	14,986	14,962

Source: National sources, ING estimates

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