

Directional Economics EMEA

12 December 2022

Please note that this is the non-investment research version of Directional Economics EMEA and does not include the investment strategies contained in the Global Markets Research version



A dangerous descent

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



Contents

Summary	3
Country summaries: CE4	4
Country summaries: Other Central & Eastern Europe	4
Country summaries: CIS	5
ING main macroeconomic and financial forecasts	6
ING EM FX and local rates views summary	7
CEE4 FX: Don't blame it all on global factors	8
Methodology of Global-Regional-Local decomposition.....	8
Key takeaways.....	13
Countries	14
Azerbaijan.....	14
Bulgaria.....	14
Croatia.....	14
Czech Republic.....	14
Hungary.....	14
Kazakhstan.....	14
Poland.....	14
Romania.....	14
Serbia.....	14
Turkey.....	14
Ukraine.....	14

Chris Turner

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

Rafal Benecki

Chief Economist, Poland
 rafal.benecki@ing.pl

Dmitry Dolgin

Chief Economist, Russia and CIS
 dmitry.dolgin@ing.de

Leszek Kasek

Senior Economist, Poland
 leszek.kasek@ing.pl

Muhammet Mercan

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

Piotr Poplawski

Senior Economist
 piotr.poplawski@ing.pl

Frantisek Taborsky

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

Valentin Tataru

Chief Economist, Romania
 valentin.tataru@ing.com

Péter Virovác

Senior Economist, Hungary
 péter.virovác@ing.com

With thanks to Michał Rubaszek

Summary

Watchers of the Central and Eastern European (CEE) economies are well aware that the region went into the supply shocks of 2020 and 2022 with very tight labour markets and that local central banks were some of the first to embark on tightening cycles in 2021. After aggressive rate hikes, expectations are high that this region will be the first to see a decisive turn lower in inflation and the first to witness large monetary easing cycles.

The problem for policymakers in the region is that the descent from peak inflation and peak interest rates will be a dangerous one. While it is clear that the decline in real incomes will weigh on consumption and investment into 2023 – and clear that growth in the region will be substantially weaker – what is not clear is how quickly inflation will fall. Over-zealous easing by central banks in the region could easily result in the kind of policy mistakes recently witnessed in the UK.

Equally, governments keen to shield consumers from the energy price shock will also be muting some of the restrictive monetary conditions already in place. And one of our main concerns for 2023 is that while headline inflation may indeed fall sharply, the improvement in core inflation will be barely noticeable. This could create some trouble for CEE bond markets.

At the same time questions will be asked as to whether governments have the means to deliver the soft landings which financial markets expect. The degree to which the Polish government can unlock EU funds in an election year remains to be seen. And having under-performed in 2022, we feel that Hungarian assets may be due a re-rating in 2023 given our view that progress can be made with the EU.

Weak, bordering on recessionary growth rates across the region, stilted easing cycles and the fog of war clearly creates a challenging climate for asset markets in the region. In terms of FX markets, we expect most CEE currencies to trade out volatile ranges with no clear trends – which is effectively the same story we see for EUR/USD. Elsewhere we expect that the Turkish lira will need to soften to address the loss of competitiveness witnessed this year. Turkish elections in June will also come under close scrutiny.

On the subject of FX, we examine the importance of global, regional and local factors in determining the path of CEE4 currencies. What becomes clear from the team's quantitative work is that local factors played a much bigger role in determining the performance of the Czech koruna and Hungarian forint this year – serving as a timely reminder that local insights are essential for understanding CEE4 FX.

As always, please use this Directional Economics as both a reference guide to core forecasts in the region and as a beacon of local insights to navigate through the twists and turns of the CEE. Our local economists and strategists have built up a loyal following among our investor and corporate client base and this publication bears testament to their expertise.

Please note that this is the non-investment research version of Directional Economics EMEA and does not include the investment strategies contained in the Global Markets Research version.

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

Country summaries: CE4

Czech Republic

In our view, the Czech economy entered recession in 3Q, mainly due to a fall in household demand. Within the CEE region, we expect the deepest economic contraction in the Czech Republic. Moreover, the level of leading indicators is the main downside risk to our forecasts. Nevertheless, the labour market remains tight and, were it not for government measures, inflation would rise further. Core inflation accelerated again in October and is proving more persistent. The Czech National Bank last hiked rates in June and we do not expect further monetary tightening despite the board's mention of risks. We see a reversal in monetary policy, an end to FX intervention and rate cuts likely before the end of the first half of next year. Fiscal policy incorporates plans for consolidation for next year, but still far from the levels of the pre-Covid years.

Poland

The Polish economy has proved its resilience despite the war in Ukraine, the energy shock and global monetary tightening. In 2023 we see a major GDP slowdown, but the main risks are a persistently high core inflation and government borrowing needs. In an election year extra spending cannot be excluded. CPI inflation should drop, but persistently high core is a concern as the policy mix is not tight enough to fight it. As such, the risk of renewed asset swap widening is significant in 2023. In late-2022, this is overshadowed by supportive sentiment in core markets and hopes for unlocking access to the EU Recovery Fund. The zloty is still pricing a premium of around 3% for 'political' factors, ie, the war with Ukraine or tense relations with the EU. While it is hard to predict those fading in 2023, fundamentals behind the zloty should improve. The lower C/A deficit and inflow of foreign funding should help to stabilise PLN in 2023.

Hungary

Although Hungary still faces a trifecta of challenges, the technical recession during late-2022 and early-2023 will provide a tailwind to tackle the issues. We expect inflation to gradually descend from its early-2023 peak, reaching single-digit territory by the end of the year if price caps are extended. At the same time, negative net real wage growth and tighter monetary and fiscal policies will keep domestic demand muted. The latter will be driven by postponed public investment spending and windfall taxes. Retreating consumption and lower investment activity reduces the country's import need, which is also supported by a spreading awareness of energy usage. Improving external balance and diminishing net external financing need will boost the relative attractiveness of Hungarian assets, especially the forint. We are bullish in every aspect.

Romania

This year could go down in Romania's history as one in which domestic factors have swirled the waters to the least extent in recent times. The economy grew largely at potential (though data revisions increasingly upset us), inflation inched above expectations but is the lowest in the CEE4 space and, most unusually by local standards, there was very little political noise. However, the elephant (ie, twin deficits) is still in the room. While the 2022 budget deficit will close within the 5.74% of GDP target, the 18-19% nominal GDP growth achieved should have permitted a much better performance. In this context, reaching a budget deficit of 3.0% of GDP in 2024 (electoral year) looks incredibly challenging. Meanwhile, the current account gap won't stop widening, driven chiefly by a gushing trade deficit.

Country summaries: Other Central & Eastern Europe

Bulgaria

The 'zero tolerance' to corruption policy promised by the Continuing the Change party hit a wall rather quickly and the government coalition lasted for only six months. Another inconclusive snap election took place in October 2022, with the next one due in March 2023. We expect political uncertainty to persist over the medium term and believe this will postpone by at least a year the 2024 self-imposed euro adoption target, but this would be the most benign outcome, in our view. After four general elections in 18 months, an understandable 'politics fatigue' on the part of the electorate might validate more extremist parties. Meanwhile, the interim government(s) are likely to remain fiscally responsible, though the outlook starts to become somewhat foggier.

Serbia

On 2 November 2022 the IMF announced a €2.4 billion 24-month Stand-By Arrangement with Serbia. This will help to address "emerging external and fiscal financing needs" as the outlook for the current account deficit is to reach around 9.0% of GDP in both 2022 and 2023 while the fiscal gap will flirt with 4.0% this year. In short, the country needs financing, and the current choppy markets made the IMF look appealing despite the strings attached. Adding insult to injury, regional developments, be it the conflict in Ukraine or the Kosovo car plates dispute, are making it increasingly difficult for Serbia to sustain its ambivalent stance. Absent more clarity, Serbia's progress as an EU candidate might see little improvement, while its long-awaited investment grade rating could remain distant.

Croatia

For many generations of Croatians, 1 January 2023 will be a day to remember. After painstaking efforts to recover from the 2008-09 deep recession and put public finances back on track, the country will join the eurozone in relatively solid economic shape. Somewhat overshadowed by the eurozone accession, joining the Schengen area will also be a major milestone, with the potential to further boost Croatia's exports of goods and especially services. Essentially, on 1 January 2023, Croatia's EU integration story will be complete, with no other major milestones to be achieved in the coming years. In the short term, we believe that despite already being largely reflected in current ratings, the Eurozone and Schengen accession could bring another one notch upgrade from at least one agency.

Turkey

A worsening global backdrop weighing on exports and higher FX volatility, coupled with macro-prudential measures to contain credit growth, will impair private consumption and investment. We have seen falling PMI, weak industrial production and a decline in electricity consumption. In this environment, the policy mix has tilted to a more supportive stance with: (i) another Credit Guarantee Fund package that could reverse recent momentum loss in lending, but timing is not specified yet; (ii) the signal of an expansionary stance on the fiscal side in the medium-term plan; and (iii) rate cuts by the CBT with an emphasis on the importance of keeping financial conditions supportive finalised at 9% in November MPC meeting. Given tighter regulations on the asset side that selectively limit loan growth, cuts are not easing financial conditions as fast, while recent sentiment indicators show a recovery.

Country summaries: CIS

Azerbaijan

The momentum of post-Covid recovery is gradually fading for Azerbaijan, but the country has two tactical strengths: gas and fiscal reserves. With the EU headed to lose Russia as a supplier of 150bcm of gas annually, the vast Shakh-Deniz is a big asset. Also, the country has some fiscal space for providing more support to the household income.

Azerbaijan's strong external and fiscal position should make it easy to place Eurobonds at the end of 2023, which are needed to refinance existing debt anyway. The risks to the local markets are coming from locally driven stories, such as long-standing tensions with Armenia, high inflationary risks driven by import-dependency, as well as a small and highly dollarized local banking sector.

Ukraine

The economy is struggling with a significant trade deficit (US\$5.4bn in I-VIII 2022), reliant on international aid to shore up its FX reserves, currently at US\$25.2bn. The scale of FX intervention has decreased since the July peak (from US\$4bn to US\$2bn in October). Likely intensification of the war may again push up the scale of intervention required to stabilise the currency. That is why we expect the NBU to allow for further depreciation of the hryvnia, possibly in 1H23.

Longer-term prospects for the Ukrainian currency largely hinge on the timing of the end of the war and subsequent inflow of foreign aid. Various estimates indicate that the restoration may cost up to US\$750bn (or nearly four times Ukrainian's 2021 GDP). A fraction of this should suffice to drive US\$/UAH lower.

Kazakhstan

Kazakhstan is under pressure from multiple global issues that will constrain economic growth in the near term, including a moderation of the post-Covid recovery, elevated inflation, regional geopolitical challenges and local constraints, such as oilfield maintenance and the need for fiscal consolidation. Meanwhile, higher oil prices are the tactical consolation prize, reinforcing Kazakhstan's finances. Strategically, the country performance could benefit from diversification of trade flows, potentially higher oil output and partial replacement of Russia as a supplier to the EU. Meanwhile, the capital account might benefit if political reform following President Tokayev's re-election leads to an improved business climate outside the oil sector. This should make Kazakhstan's financial instruments a potentially defensive play in the face of volatile global markets.

ING main macroeconomic and financial forecasts

Real GDP (% YoY)

	3Q22	4Q22F	1Q23F	2Q23F	2022F	2023F
Azerbaijan	3.8	2.5	2.5	2.8	4.8	3.0
Bulgaria	3.2	1.3	0.8	0.7	3.0	1.4
Croatia	5.2	4.2	1.5	0.4	6.4	1.6
Czech Republic	1.7	-0.4	-1.3	-1.0	2.4	-0.2
Hungary	4.0	0.5	-1.0	-1.5	4.8	0.1
Kazakhstan	2.8	2.8	3.6	3.8	2.8	3.8
Poland	3.6	2.5	-2.0	1.2	5.0	1.0
Romania	4.0	4.2	2.7	1.8	4.8	1.8
Serbia	1.1	-0.2	0.9	0.7	2.2	2.2
Turkey	3.9	2.0	2.0	3.7	5.0	2.5
Ukraine	-34.4	-40.0	-17.5	12.0	-31.7	3.1
Eurozone*	2.1	1.2	0.1	-0.7	1.3	-0.1
US*	1.8	0.6	0.8	0.3	1.1	-0.6

*% QoQ annualised

Source: National sources, Macrobond, ING estimates

Exchange rate (quarterly is eop, annual is avg)

	3Q22	4Q22F	1Q23F	2Q23F	2022F	2023F
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	7.53	7.53	7.53	7.53	7.53	7.53
EUR/CZK	24.60	24.50	24.50	25.00	24.55	24.75
EUR/HUF	421.4	400.0	390.0	380.0	390.3	389.0
USD/KZT	476.0	480.0	480.0	470.0	466.0	474.0
EUR/PLN	4.87	4.75	4.81	4.74	4.69	4.73
EUR/RON	4.95	4.94	4.95	5.10	4.95	4.98
EUR/RSD	117.3	117.3	117.3	117.4	117.4	117.4
USD/TRY	18.50	18.70	19.33	20.30	16.68	20.87
USD/UAH	36.60	37.00	40.00	38.50	33.10	38.30
EUR/USD	0.97	1.02	0.98	1.00	1.08	1.00

Source: National sources, Macrobond, ING estimates

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

	3Q22	4Q22F	1Q23F	2Q23F	2022F	2023F
Azerbaijan	15.6	15.4	13.3	11.2	13.8	10.5
Bulgaria	18.6	16.1	12.5	9.2	15.2	10.2
Croatia	12.8	12.1	9.7	5.6	10.6	6.4
Czech Republic	18.0	15.5	12.6	9.5	15.0	10.2
Hungary	20.1	23.3	22.5	18.8	14.4	16.7
Kazakhstan	17.7	20.4	17.0	12.8	14.6	13.4
Poland	17.2	17.2	17.9	14.2	14.3	14.5
Romania	15.9	16.3	13.8	10.6	13.7	11.0
Serbia	14.0	14.6	13.3	10.2	11.8	9.7
Turkey	83.5	68.0	47.4	38.0	72.7	42.0
Ukraine	24.6	30.0	28.0	24.0	22.5	24.0
Eurozone	9.3	10.2	8.4	6.4	8.38	5.85
US	8.3	7.4	5.9	3.8	8.08	3.7

Source: National sources, Macrobond, ING estimates

Central Bank rate (% eop)

	3Q22	4Q22F	1Q23F	2Q23F	2022F	2023F
Azerbaijan	7.75	8.00	8.00	8.00	8.00	7.50
Bulgaria	0.00	0.60	1.10	1.10	0.60	1.10
Croatia	3.00	3.00	3.00	3.00	3.00	3.00
Czech Republic	7.00	7.00	7.00	6.50	6.04	6.21
Hungary	13.00	13.00	13.00	12.75	13.00	11.25
Kazakhstan	14.50	16.75	16.25	14.25	16.75	11.75
Poland	6.75	6.75	6.75	6.75	6.75	6.75
Romania	5.50	6.75	6.75	6.75	6.75	6.50
Serbia	3.50	5.50	5.75	5.75	5.00	5.50
Turkey	12.00	9.00	9.00	9.00	9.00	9.00
Ukraine	25.00	25.00	25.00	25.00	25.00	25.00
Eurozone	1.25	2.50	3.00	3.00	0.94	3.00
US*	3.25	4.50	5.00	5.00	3.17	4.00

*Upper level of 25bp range

Source: Macrobond, ING estimates

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

	3Q22	4Q22F	1Q23F	2Q23F	2022F	2023F
Azerbaijan	n/a	n/a	n/a	n/a	n/a	n/a
Bulgaria	5.00	6.00	6.20	6.30	6.00	6.00
Croatia	4.30	4.00	3.90	4.20	3.00	4.00
Czech Republic	5.40	5.65	5.40	5.15	4.40	4.80
Hungary	9.77	8.00	7.80	7.50	7.59	7.52
Kazakhstan	n/a	n/a	n/a	n/a	n/a	n/a
Poland	7.13	6.77	6.88	6.89	6.09	6.88
Romania	8.70	8.00	8.10	7.90	7.60	7.90
Serbia	7.60	7.30	8.00	7.80	6.20	7.60
Turkey	11.99	10.07	14.69	15.38	17.77	15.53
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	2.10	1.90	2.00	1.80	1.50	1.83
US	3.75	3.75	4.00	3.75	3.30	3.50

Source: National sources, Macrobond, ING estimates

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

	3Q22	4Q22F	1Q23F	2Q23F	2022F	2023F
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	7.25	7.25	7.25	6.70	6.39	6.43
Hungary	13.30	16.00	14.60	12.75	9.90	13.10
Kazakhstan	15.50	17.75	17.25	15.25	15.70	14.60
Poland	7.21	7.10	6.91	6.92	6.48	6.92
Romania	7.93	7.75	7.75	7.55	6.10	7.40
Serbia	3.40	5.30	5.55	5.55	4.80	5.30
Turkey	14.80	10.50	15.29	15.67	15.95	15.49
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	1.17	2.20	2.70	2.60	0.64	2.63
US	3.50	4.60	4.90	4.75	3.40	4.41

Source: National sources, Macrobond, ING estimates

ING EM FX and local rates views summary

Country	Foreign exchange	Local debt and rates
Czech Republic	The CNB may not have been active in the market in October and November given the EUR/CZK well below the intervention level of 24.60-70. If the CNB is not forced to intervene, we believe 2Q23 will be an opportunity to end this regime, which should allow the koruna to weaken slightly towards 25.0. Until then, we expect it to remain below the intervention level.	The CNB is sticking to the rhetoric of "no change or rate hike" and "higher rates for longer". We view current market valuations as too aggressive in terms of rate cuts especially in the short and medium term. MinFin finished this year's financing, however, CZGB remains at record cheap levels compared to the IRS curve.
Hungary	We believe forint is likely to be moved by non-monetary events and shocks in the short run. We expect a positive outcome on the rule of law issue, unlocking forint potential. Positioning is already inclined to the long side, so we expect a rather gradual drift below 400 EUR/HUF next year.	If the HUF remains under control, we see more room for normalisation of the short end of the IRS curve. However, the timing of NBH policy normalisation is a risk and low liquidity may be painful. Financing through HGB next year should be no problem for MinFin, however we see a better story elsewhere in the region.
Poland	According to our estimates, the zloty is still undervalued by roughly 3% against the euro, but we expect it to remain on the weaker side until the end of 1Q23 due to the local story. We expect a boost later, but risks remain high given the election year. EU funds is a key issue in view of the MinFin's conversion strategy in the market.	In our view, the market is too aggressively pricing in cuts next year, while we see persistent core inflation and stable NBP rates. In fiscal policy, we believe that Poland will be a negative outlier next year within the region. In an election year, government borrowing needs are a major risk.
Romania	As long as EU funds keep pouring in, we believe that the NBR has the will to keep the RON stable. We think that stability could be maintained at least through the winter. Further RON trips to stronger levels cannot be ruled out	ROMGBs have become a sweet spot within the CEE region, benefitting from a stable political situation, EU-controlled fiscal policy, stable FX and smooth access to EU funds. Needs next year will be only slightly lower, but given the cash buffer, flexibility in secondary and the hard-currency market, MinFin should have no trouble.
Ukraine	The economy is struggling with a massive trade deficit, reliant on international aid to shore up its FX reserves, currently at US\$25.2bn. The scale of FX intervention has decreased since the July peak. Likely intensification of the war may again push up the scale of intervention. That is why we expect the NBU to allow further depreciation of the hryvnia, possibly in 1H23.	The war has eroded internal capacity to mobilise public revenues and made the country dependent on external grants and loans. Public expenditures have been driven by defence and essential social spending and have led to an unprecedented fiscal deficit of about 20% of GDP in 2022. Since the war began through to end-October, Ukraine has disbursed US\$23bn of financial assistance.
Kazakhstan	Foreign trade is thriving due to higher oil prices and production. Capital flows have so far been also favourable thanks to a recovery in corporate borrowing and state repatriation measures. Assuming business-friendly reforms and diversification of trade, the tenge may show defensive performance in the face of a decline in the global risk appetite.	
Turkey	FX reserves that have been quite volatile this year have shown a rapid recovery since end-July despite rate cuts since August. ING's REER model increased by more than 15%, implying significant real appreciation since end-2021, however, we think TRY will remain on a gradual depreciation path, assuming that additional credit and fiscal stimulus are kept limited.	The domestic borrowing requirement seems to be markedly high, attributable to the supportive fiscal stance. The rate outlook in the near term is likely to be determined by the CBT's policy of strengthening demand for local government bonds via security maintenance requirements and direct purchases from the secondary market.

Source: ING



Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl



Piotr Poplawski
Senior Economist
piotr.poplawski@ing.pl



Dmitry Dolgin
Chief Economist, Russia and CIS
dmitry.dolgin@ing.de



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

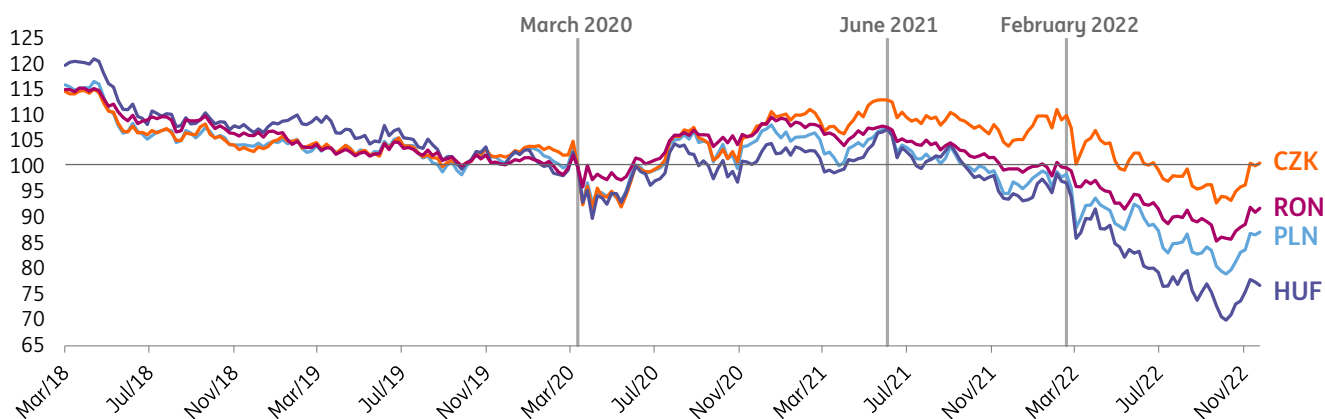
With thanks to Michał Rubaszek

CEE4 FX: Don't blame it all on global factors

Since the beginning of the coronavirus pandemic in March 2020, the currencies of CEE4 countries (Czech Republic, Hungary, Poland and Romania) have exhibited similar short-term (weekly) dynamics¹ but diverse mid-term trends against the USD. In the period from 15 March 2020 to 27 November 2022, the HUF depreciated against the dollar by 23%, PLN by 13% and RON by 8%, whereas CZK appreciated by 1% (Figure 1). Such a divergence was barely observed prior to the Covid outbreak as, during the two years preceding it, the CEE4 currencies showed a relatively similar 13-17% depreciation against USD. This suggests that the post-Covid divergence is not a technical event but, rather, that it has fundamental roots. In this article we take a closer look at the common and individual drivers of these CEE4 FX movements to show that it's highly likely that for the past two years fundamentals have played a more important role.

Also, noteworthy, after March 2020, the CEE4 currencies differentiate in terms of their reaction to the initial one-month long risk off (from -3% for RON to -10% for HUF), the subsequent recovery of April 2020–June 2021 (from 10% for RON to 23% for CZK) and by the scale of subsequent depreciation (from -11% for CZK to -28% for HUF). It is also evident from Figure 1 that the difference in the relative performance of HUF against PLN and RON started to be more pronounced after the beginning of the war in Ukraine, suggesting some fundamental or political factors have been at play.

Fig 1 The evolution of CEE4 currencies against the USD (index, 15 March 2020=100)



An increase represents domestic currency appreciation against the USD
Source: Macrobond, ING

Methodology of Global-Regional-Local decomposition

Factors at play in divergence of CEE4 FX movements

The divergence in the CEE4 FX movements since the Covid outbreak suggests that even though the pandemic was a powerful global event that had a similar effect on currency movements in the region, other factors have been at play, which deserves a closer look. In other words, in addition to global movements, domestic factors have played a role, and these are the key focus of this article.

¹ The correlation of short-term (weekly) movements of CEE4 currencies ranged between 0.79 for HUF/USD-RON/USD pair to 0.92 for PLN/USD-CZK/USD pair

Global-regional-local decomposition framework

Global factor by far the most important determinant of weekly exchange rate movements of CEE4 currencies

FX weekly fluctuations
 Global = most important
 Regional = 7-22% impact
 Local = relatively small role

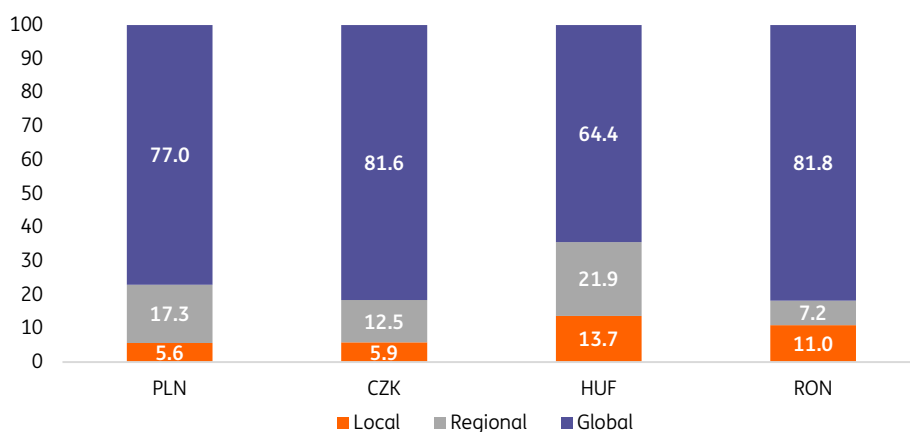
To distinguish the factors behind the CEE4 FX movements, we use the global-regional-local (GRL) decomposition², which is based on the methods of Principal Component Analysis³. According to the framework, the dynamics of the USD vs any CEE4 currency can be expressed as the sum of three uncorrelated components: global, regional and local. This statistical framework allows us to decompose the divergent trends of CEE4 currencies against USD presented in Figure 1, as well as to identify the sources of short-term exchange rate co-movement. In the latter case, this can be done by computing the contribution of GRL factors to the variance of short-term fluctuations⁴.

We define the global factor as the first principal component for the weekly movements of the CEE4 currencies plus the other 14 EME currencies (RSD, TRY, ZAR, ILS, BRL, MXN, CLP, CNY, INR, IDR, KRW, PHP, SGD, TWD) against USD. Next, the regional factor is extracted as the first principal component of the remaining part of CEE4 currency movements. The local component is the remaining part of the exchange rate dynamics.

GRL decomposition of weekly fluctuations – it’s almost all about the global factor

Figure 2 reveals that the global factor, which accounts for between 64% for HUF and 82% for RON variability, is by far the most important determinant of weekly exchange rate fluctuations for all CEE4 currencies⁵. This very high correlation of the global factor with the US dollar index (DXY) indicates that, over the short run, the dollar’s value is driving CEE4 volatility. The contribution of the regional factor, which is correlated with the EUR/USD rate, ranges from 7 to 22%, whereas the role of the local component is relatively small, especially for PLN and CZK.

Fig 2 Contribution of GRL factors to CEE4 FX changes, variance between March 2020 and November 2022



Source: Macrobond, ING

GRL decomposition of trends – local is the most interesting

Over the analysed period, the global factor was responsible for CEE4 currency depreciation against the USD of between -6% for RON and -10% for CZK (Figure 3). This element of the FX movement can be explained by the upward trend in the USD index of

² Extensive academic literature suggests that this method can be applied to address several questions related to international spillovers. Kose et al. (2003) showed that it can be used to investigate the joint dynamics of real vector variables over the business cycle across countries. Neely and Rapach (2011) proved that it is useful to understand co-movement of inflation rates. Chiappini and Lahet (2020) showed that the framework can be used to investigate the joint dynamics of exchange rates.

³ There is ample evidence that the joint dynamics of exchange rates can be summarised by a small number of uncorrelated components (eg, Engel et al., 2015, and Verdelhan, 2018), including the CEE4 currencies (eg, Chiappini and Lahet, 2020, and Jaworski, 2021).

⁴ The GRL decomposition can be written down as identity: $\Delta s_{it} = \Delta s_{it}^{glob} + \Delta s_{it}^{reg} + \Delta s_{it}^{loc}$, where s_{it} is the USD rate of currency i at the end of week t. Given that GRL factors are uncorrelated, this implies that the variance of FX fluctuations is the sum of three components: $Var(\Delta s_{it}) = Var(\Delta s_{it}^{glob}) + Var(\Delta s_{it}^{reg}) + Var(\Delta s_{it}^{loc})$.

⁵ On our findings, the contribution of the global factor is slightly higher than in Chiappini and Lahet (2020), who found that in years 2006-15 it amounted between 46 and 62% for CEE4 currencies.

Regional factor resulted in a relatively small divergence between CEE4 currencies

FX deviation between countries
 Global = most correlated
 Regional = relatively small role
 Local = main source of deviation

7% over the period. We note the muted global influence on RON relative to other currencies in the group, which could be explained by its more tightly managed FX regime that aims to reduce RON short-term volatility.

Another observation is that the role of the regional factor was relatively small, standing at between 1ppt and 2ppt. This reflects a very low difference in the performance between CEE4 and the broader set of EMEA currencies over the analysed period. In our opinion, two opposing effects have been at play. On the one hand, CEE4 economies were quite overheated before the pandemic and provided a strong anticyclical policy response in reaction to Covid, which made them vulnerable to global inflation shock. Moreover, the fallout of the conflict in Ukraine caused an aversion to CEE4 assets, which undermined their currencies. On the other hand, EU membership makes CEE4 currencies less vulnerable to global risk compared to other EMEA currencies.

Lastly, the local (country-specific) component was the main source of divergence in FX dynamics of CEE4 currencies. In the case of CZK, it made a positive 12ppt contribution, for PLN and RON it was responsible for a moderate -2ppt, but for HUF it knocked off 13ppt versus the dollar. Importantly, comparing the post March 2020 performance versus USD with the dynamics prior to the Covid outbreak, CZK has remained the strongest of the group, while HUF remained the weakest. That leads us to believe, that Covid was a global factor that pushed all currencies in the same direction, but at the same time made the local differences more visible and acute.

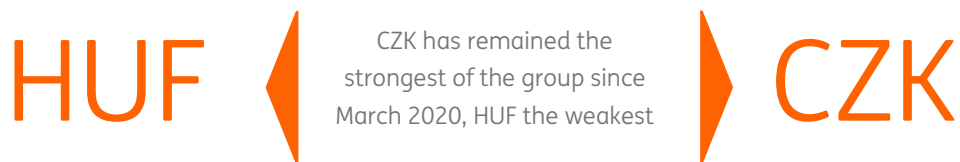
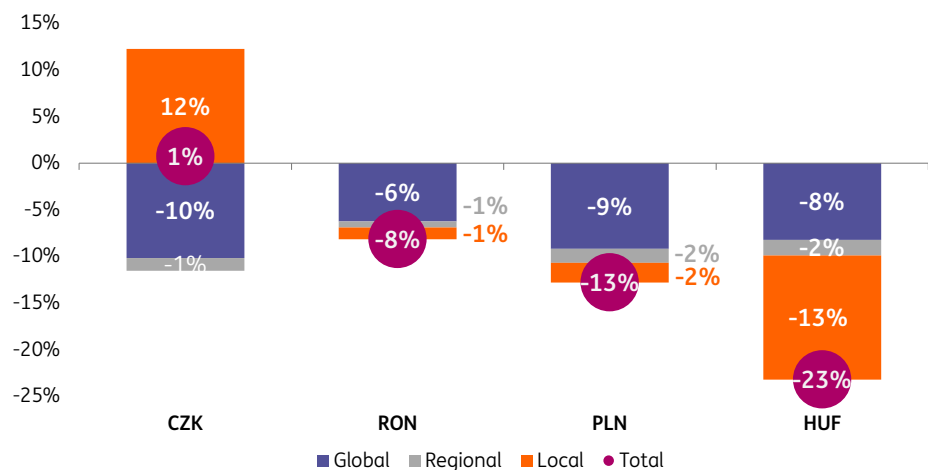


Fig 3 Decomposition of CEE4 currencies performance against USD, March 2020–November 2022



An increase stands for domestic currency appreciation against the USD. The chart refers to the period 15 March 2020–27 November 2022
 Source: Macrobond, ING

Interpretation – making economic sense of domestic factors

Our view is that the divergent trends in the local component of CEE4 exchange rates are related to differences in macroeconomic fundamentals as well as the increased role of these fundamentals for FX markets in times of elevated economic uncertainty. This is illustrated by Figure 4, in which we collate a set of structural indicators relevant to understanding FX market developments.

Fig 4 Macroeconomic fundamentals of CEE4 countries

Variable	Year	Czech Republic	Hungary	Poland	Romania
GDP growth rate (% YoY)	2020-22 avg	-0.1	2.7	2.5	2.3
Current Account (% GDP)	2020-22 avg	-1.1	-3.7	-0.6	-6.8
EU share in exports (%)	2021	71	82	75	76
Share of imports in local energy mix (%)	2020	38.9	56.6	42.8	28.2
Share of gas in local energy mix (%)	2020	18.1	33.6	17	30.1
Share of gas imports in gas consumption (%)	2020	86	75.6	78.3	16.6
Share of Russia in gas imports (%)	2020	100	95.1	55.5	-
Gas storage cap. (% of annual consumption)	2021	43.8	56.4	15.5	25.3
International Inv. Position (% GDP)	2021	-15.6	-53.1	-39.5	-47.2
Avg. annual resid. RE price growth (%) S&P	2018-21	9	12	6	1
Fiscal balance (% GDP)	2020-22 avg	-5.2	-6.5	-4.3	-7.7
Government debt (% of GDP)	2021	42	76.8	53.8	48.9
Non-resident share in govt debt (%)	2021	30	31	32	49
FX share in govt debt (%)	2021	8	22	22	52
Potential EU funds disbursement (% GDP)		20	34	30	34
CPI Inflation (% YoY)	Oct 2022	15.1	21.1	17.9	15.3
	2024F	3.2	4.9	4.8	4.5
	2025F	2	3.6	3.2	3.3
GDP per capita (US\$000)	2021	26.8	18.7	17.9	14.8
De jure FX regime	Nov 2022	free floating	free floating	free floating	managed float
Rating (S&P/Moody's/Fitch) + outlook	Nov 2022	AA-/Aa3/AA- Sta/Neg/Neg	BBB/Baa2/BBB Neg/Sta/Sta	A-/A2/A- Sta/Sta/Sta	BBB-/Baa3/BBB- Sta/Sta/Neg
Regulatory quality	2021	87.50	68.75	75.96	62.98

Notes: The forecast for inflation is taken from FocusEconomics, Consensus Forecast, Central & Eastern Europe, November 2022. Regulatory quality is taken from Worldwide Governance Indicators of the World Bank

Source: Eurostat, IMF WEO, IEA, Focus Economics, European Commission, S&P, ING

Czech Republic is most developed economy of CEE4, in terms of GDP per capita and quality of institutions

In our opinion, the arguments behind the relative strength of CZK are twofold. First, the Czech Republic is the most developed economy, both in terms of GDP per capita and the quality of institutions. It is the only CEE4 country classified by the IMF as an Advanced Economy rather than Emerging Economy. Second, the medium-term fundamentals of the Czech Republic are relatively sound. The international investment position and public debt are at sustainable levels, whereas inflation, albeit currently high, is forecast to return to target by 2025. For these reasons the Czech Republic has the highest credit rating among CEE4 economies and domestic fundamentals have been exerting a steady upward pressure on the value of CZK since the outbreak of Covid.

When considering more forward-looking fundamentals, while having the lowest GDP growth rate in the group, the Czech Republic is somewhat insulated from potential external activity and current account shocks, among others thanks to the lowest share of the EU in exports (71%). The vulnerability of the current account from the imports side due to growth in energy prices seems not too high, given the moderate share of imports in the local energy mix. Also, there is lower evident dependence on the availability of EU funds, which is more of the case for the rest of the CEE4 group. Looking at the capital flows, there could have been an effect of hot capital inflows, as real estate prices seem to have been growing at elevated rates in recent years, meaning vulnerability of a reversal in the case of an economic downturn. Fluctuations in the CZK FX rate are not too relevant to the government given the low share of FX-denominated government debt (8%) and the declining non-resident share in gross public debt (30%).

Relatively weak HUF has high levels of public and net foreign debt combined with fiscal and current account deficits

The local fundamentals for the relatively weak HUF are different and, in most cases, the opposite to the CZK. High levels of public and net foreign debt combined with fiscal and current account deficits⁶ potentially raise concerns about medium-term sustainability, especially in an environment of rising interest rates. This is reflected in the relatively low level of credit ratings issued by international credit agencies combined with a negative

⁶ The rapid current account balance deterioration in Hungary after 2020, which accelerated in 2022, was driven mainly by trade balance developments

Fig 5 Interpretation – making economic sense of domestic factors

Czech Republic	<ul style="list-style-type: none"> • Thanks to the FX floor in 2013-17, the Czech National Bank has become a credible activist central bank in CEE4 for the markets, and during these years it built up the largest FX reserves relative to GDP in the region, but also one of the highest in the world. • Thus, with the onset of the Ukraine-Russia conflict, the CNB only needed to signal its readiness to defend the koruna, followed by the most hawkish hiking sequence in the region, which led to a limiting of both excessive depreciation and volatility of the koruna. • Then, during the board changes in May this year, the CNB stepped in for a second time, and its commitment to dampen "excessive volatility" continues to this day. Thus, at the cost of 16% FX reserves, the CNB has kept the CZK at pre-February levels, which is reflected in the positive contribution of local factors, the only country within the CEE4 to achieve this. • On top of that, on the macro side, the Czech Republic has the lowest twin deficit in the region while benefitting from a stable political situation and relations with the EU and access to EU funds, turning the market attention to other countries in region. • For next year, given its comfortable situation, we expect the central bank to further be ready to intervene in the market while the twin deficit will halve. Local factors should continue to keep the koruna at current levels, but more importantly defend against a depreciation in case of negative developments.
Hungary	<ul style="list-style-type: none"> • Share of imports in the local energy mix is not just outright high in Hungary, but the highest in the CEE. Thus, the energy crisis and the price shock impacted the country's current account balance in a really significant manner. Indeed, it fell off a cliff as the energy related current account deficit went from a monthly average of €0.5bn (pre-Covid) to €1.7bn in August 2022. This put a structural pressure on the HUF. • The monetary and fiscal policy legacy from Covid-times also put additional pressure on the HUF. The inflated balance sheet of the National Bank of Hungary, the complex monetary policy and the twists and turns of it have limited the effectiveness of monetary transmission. On top of that, pre-election fiscal loosening added fuel to the fire, generating additional inflationary pressure and now Hungary is facing the highest inflation in the region. • The Hungarian government's political stance in the Ukraine-Russia war – playing somewhat of a balancing act between the European Union and Russia – might have also triggered some scepticism from investors towards the country. • The ongoing political wrestling regarding EU funds, which started with the Rule-of-Law procedure in April 2022, has not helped the forint either. The possibility of an irreversible financial punishment has hovered over Hungary's fiscal policy, debt financing and net external financing outlook like the sword of Damocles, translating into a higher risk premium in Hungarian assets, including the forint.
Poland	<ul style="list-style-type: none"> • The neutral contribution of local factors to PLN performance between March 2020 and November 2022 is consistent with the strong track record of the economy pre-pandemic: upside surprises on GDP, sound fiscal metrics (rising government revenues/GDP, low fiscal deficits and public debt/GDP). Polish manufacturing and exports outperformed CEE peers during the post-pandemic recovery and the economy is relatively energy independent. • However, starting in 2021, macro stability worsened, ie, C/A deficit and CPI grew. This trend amplified in 2022, particularly due to rising costs of energy imports. It became increasingly difficult to stabilise the zloty, given relatively loose NBP policy. This trend occurred across the whole region though, which explains why the local factor was relatively weak. • Our other FX tools (gauging €/PLN against other market variables) indicate a 3% risk premium on the zloty, stemming from the ongoing conflict with the EU or proximity to the war. • Looking ahead, we expect political risk to rise ahead of elections, which undermine government funding. Also, in Poland persistency of high core inflation is one of the worst in region. But lower energy prices should help tighten the trade deficit, thus some premium on PLN may remain.
Romania	<p>Relatively weak fundamental factors are balanced against a tightly managed floating regime</p> <ul style="list-style-type: none"> • Romania's current account deficit might get close to 9.0% in 2022, with the deteriorating terms of trade explaining no more than 2ppt of the C/A widening in 2022. • The budget deficit remains relatively sizeable at an estimated 5.74% of GDP in 2024 but there are relatively credible plans to bring it closer to 3.0% in 2024. • Largely offsetting the above, the National Bank of Romania already has a long tradition of a veritable managed floating regime. It is fair to say that markets have gained increased confidence in the NBR's ability to impose temporary "lines in the sand" whenever they consider it appropriate to tame FX volatility. • Stabilisation of the currency is via a mix of straightforward FX selling (on which the NBR never discloses any details regarding size, timing, etc) and tighter liquidity management which pushes carry rates higher. The latter is usually a consequence of the first. • Over time, the currency is generally allowed to follow its natural course, but boundaries can be quite strict in the short to medium term.

Source: ING

With contributions from Péter Virovác and Valentin Tataru

rating outlook. Apart from the above stock-flow issues, there are signals of inflation expectations de-anchoring, which is reflected in relatively high consensus inflation forecasts. Even though in the short-term upward inflation surprises usually lead to nominal FX appreciation, especially if they are accompanied by monetary policy tightening expectations, in the medium and long-term, high and persistent domestic inflation requires exchange rate depreciation to restore international price competitiveness. Our view is that for HUF, the latter channel dominated in 2022.

Looking ahead, the risks of negative surprises on Hungary's economic activity and finances are elevated, given the high dependence on the EU in terms of exports and financing (EU funds expected to be available for Hungary by 2027 are equivalent to almost 35% of its 2021 GDP, and are subject to political discussions), as well as elevated dependence on non-EU energy imports. Also, Hungary has enjoyed even stronger capital inflow in the real estate market, meaning vulnerability to reversal.

Local fundamentals of PLN and RON are sometimes closer to those for CZK and in other cases more similar to HUF

Figure 4 also illustrates that the local fundamentals of PLN and RON, the mid-performers in terms of FX, are sometimes closer to those for CZK (eg, public debt) and in other cases more similar to HUF (eg, international investment position, sovereign ratings and outlook). Consensus forecasts for inflation in Poland and Romania in 2025 are slightly lower than in Hungary, but they are still above inflation targets of 2.5%. For these reasons, the impact of the local factor on PLN and RON has been broadly neutral. It can be added that for RON some of the market pressure on the FX market, related to Romania's vulnerable fiscal and external positions as well as risky growth profile, could have been offset by the managed FX regime, which allows officials to protect the leu⁷. Moreover, Romania is the least dependent on energy commodity imports among CEE4 countries.

From a forward-looking perspective, the mid-performers are facing challenges, such as Romania's large twin deficit and therefore exposure to global downturn or Poland's tensions with the EU and proximity to adverse geopolitical reality in the region. But at the same time, Romania's lower energy import dependency and less hot real estate market, as well as Poland's solid GDP growth trend and relatively stable structure of CA deficit⁸ could serve as mitigating factors.

Key takeaways

Our conclusion is that, over recent years, the short-term fluctuations of CEE4 currencies have been driven predominantly by global factors, but medium-term trends have been strongly related to local fundamentals. In the current environment of elevated economic uncertainty and high inflation, this implies that economic policy affecting the fiscal position, the current account balance and inflation exerts a sizeable impact on the value of CEE4 currencies.

Looking at the currencies case by case, it seems the Czech economy can afford the relative strength of CZK, though there might be signs of hot capital inflows playing a part in the recent appreciation. HUF weakness seems to reflect the macro fundamentals as well as the idiosyncratic risk premium and serve as a mechanism of maintaining competitiveness. By that logic, RON seems to be overvalued relative to its macro fundamentals, with weaker levels prevented by a more active central bank involvement on the FX market. At the same time, Romania is tactically benefitting from the stronger RON given lower imported inflation, and avoids higher financial costs related to the elevated share of FX public debt. Lastly, Poland's fundamentals seem to be structurally closer to Czech fundamentals, but may have higher vulnerability to internal and international politics in the region.

⁷ On the differences in the stance of CEE4 central banks towards FX weakness, see our article at <https://thinking.com/snaps/ce4-fx-how-tolerant-are-cbs-to-fx-weakness>

⁸ The current account deficit in Poland is to a large extent driven by the balance on net primary income (mostly profits of foreign-owned companies), which is largely transformed into net inflow of FDI (based on retained earnings)

References:

Chiappini R., Lahet D., (2020). Exchange rate movements in emerging economies - Global vs regional factors in Asia. *China Economic Review* 60: article 101386.

Engel Ch., Mark N., West K., (2015). Factor Model Forecasts of Exchange Rates, *Econometric Reviews* 34: 32-55.

Jaworski K., 2021. Forecasting exchange rates for Central and Eastern European currencies using country-specific factors, *Journal of Forecasting* 40: 977-999.

Kose M.A., Otrok C., Whiteman C.H. (2003), International Business Cycles: World, Region and Country-specific factors, *American Economic Review* 93: 1216-1239.

Neely C.J., Rapach D.E., (2011). International comovements in inflation rates and country characteristics, *Journal of International Money and Finance* 30: 1471-1490.

Verdelhan A., (2018). The Share of Systematic Variation in Bilateral Exchange Rates. *Journal of Finance* 73: 375-418.

Countries

Forecast summary

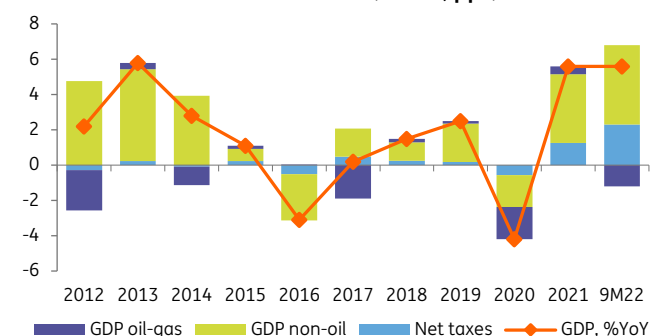
	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	3.8	2.5	2.5	2.8	3.2	4.8	3.0
CPI (%YoY)*	15.6	15.4	13.3	11.2	7.6	13.8	10.5
Policy interest rate (eop, %)	7.75	8.00	8.00	8.00	7.50	8.00	7.50
3m interest rate (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AZN*	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/AZN*	1.67	1.67	1.62	1.67	1.70	1.79	1.67

Macro Trend	Political Cycle	Ratings	FC	LC
Activity +	Presidential: 2025	S&P	BB+	BB+
Fiscal Tighter	Parliamentary: 2025	Moody's	Ba1	Ba1
Monetary Tighter	Local: n/a	Fitch	BB+	BB+

*Quarterly data is eop, annual is average

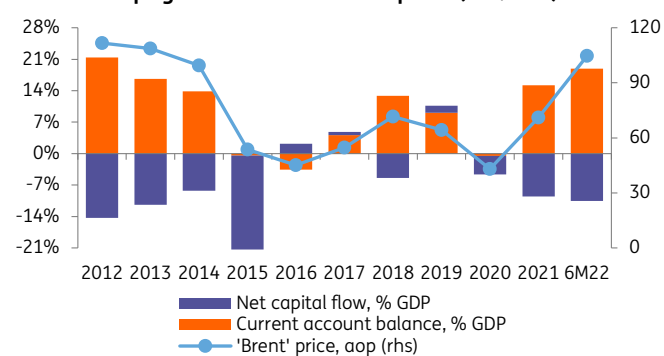
Source: National sources, ING estimates

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



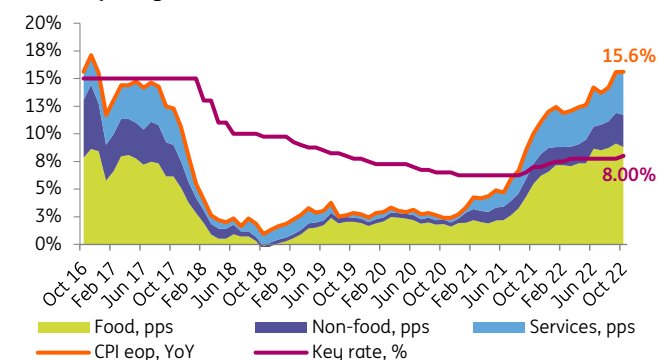
Source: CEIC, IMF, ING

Balance of payments and Brent oil price (US\$/bbl)



Source: CEIC, ING

CPI and policy rate (%)



Source: CEIC, ING

Benefiting from geopolitical turmoil

The momentum of post-Covid recovery is gradually fading for Azerbaijan, but the country has two tactical strengths: gas and fiscal reserves. With the EU headed to lose Russia as a supplier of 150bcm of gas annually, the vast Shakh-Deniz is a big asset. Also, the country has some fiscal space for providing more support to the household income.

Azerbaijan's strong external and fiscal position should make it easy to place Eurobonds at the end of 2023, which are needed to refinance existing debt anyway. The risks to the local markets are coming from locally driven stories, such as long-standing tensions with Armenia, high inflationary risks driven by import-dependency, as well as a small and highly dollarized local banking sector.

Activity slowing, but gas and budget policy offer support

GDP showed 5.6% YoY growth in 9M22 but has moderated since 3Q22 due to maturing oil fields and declining household income. On the bright side, the fuel sector should remain supported by growing gas production, as gas supply to the EU is set to double to 10-12bcm in 2022 vs 2021 and could increase to 20bcm by 2027 if the EU were to guarantee this demand, giving Azerbaijan confidence to commit to vast capex. Meanwhile, the non-fuel sector may get fiscal support as the current c.US\$75/bbl breakeven leaves room for generosity. Support on Karabakh may increase from 2.3-2.4% to 2.8-3.0% of GDP in 2023, while direct support to low-income households may rise from the current 11-12% to 14% of GDP, leaving the non-oil deficit at a sizeable 26-28% of non-oil GDP but still well covered by oil revenues.

Current account supported by geopolitics

The geopolitical turmoil of 2022 has created favorable conditions for Azerbaijan's external trade through higher oil and gas prices and additional demand for gas volumes from the EU, partially offsetting the supply that used to come from Russia. The current account is set expand from 15% to 21% of GDP in 2022 and may remain close to those levels in 2023 assuming a favorable house view on oil. A sizeable 30-40% of it will be used to gain sovereign FX assets. Meanwhile, a US\$1.0-1.2bn Eurobond placement is planned for end-2023 to refinance the debt maturing in early 2024. This is likely to be met with demand given the country's solid financial position. On the other hand, the stable net FDI outflow of 2-4% of GDP remains a sign of the challenging investment climate.

Inflation close to peaks, but local risks are still high

Azerbaijan is no exception to the post-Covid global inflationary trend, with CPI accelerating from 3-5% in 2020 to 15%+ currently. The pass-through of global trends into local CPI could be amplified due to high import-dependency of local consumption. Around 25-30% of local retail trade is imported, and food self-sufficiency is low. As a result, even though current CPI feels like a peak, average CPI should remain in low double digits in 2023, and upward risks to year-end expectations are high. Downside to the key rate is limited as CPI is well above the target range of 2-6%. Monetary transmission is restrained by the small banking sector, pegged FX, and high dollarization of deposits of around 49-51% in 2021-22.

Azerbaijan

dmitry.dolgin@ing.de

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	2.2	5.8	2.8	1.1	-3.1	0.2	1.5	2.5	-4.2	5.6	4.8	3.0	2.5
Real oil GDP (%YoY)	-5.1	0.9	-2.9	0.6	0.1	-5.3	0.5	0.4	-4.3	3.5	-1.0	-2.0	0.0
Real non-oil GDP (%YoY)	9.7	9.9	7.0	1.1	-4.4	2.8	2.0	4.0	-2.6	7.2	10.0	6.0	4.0
Investment (%YoY)	18.0	15.1	-1.7	-11.1	-26.1	-2.6	-4.4	-3.3	-8.3	-8.2	1.0	0.0	-1.0
Industrial production (%YoY)	-2.3	1.8	-0.7	2.4	-0.5	-3.4	1.5	1.8	-5.0	5.2	4.2	2.9	2.4
Unemployment rate (year-end, %)	5.2	5.0	4.9	5.0	5.0	5.0	4.9	4.8	6.3	6.0	5.5	5.0	5.0
Nominal GDP (AZNbn)	55	58	59	54	60	70	80	82	72	93	122	132	139
Nominal GDP (€bn)	54	56	57	48	34	36	40	43	37	47	68	79	82
Nominal GDP (US\$bn)	70	74	75	53	38	41	47	48	43	55	72	78	82
GDP per capita (US\$)	7,447	7,825	7,843	5,469	3,860	4,129	4,720	4,773	4,211	5,408	7,036	7,470	7,765
Gross domestic saving (% of GDP)	50.0	47.8	43.7	30.9	28.5	31.1	36.6	31.7	23.5	26.7	30.4	31.0	31.0
Prices													
CPI (average, %YoY)	1.1	2.4	1.4	4.0	12.4	12.9	2.3	2.6	2.8	6.4	13.8	10.5	5.0
CPI (year-end, %YoY)	-0.3	3.6	-0.1	7.7	15.5	7.9	1.6	2.4	2.7	12.0	15.4	4.8	5.0
Wage rates (nominal, %YoY)	8.7	6.2	5.7	4.5	7.4	5.9	2.9	16.6	11.4	3.4	13.4	12.0	4.5
Fiscal balance (% of GDP)													
Consolidated government balance	n/a	1.8	2.9	-5.3	0.3	-1.5	5.9	9.1	-6.5	4.2	6.1	6.0	3.7
Consolidated primary balance	n/a	3.2	4.3	-3.8	2.4	0.9	8.7	10.9	-4.4	6.3	7.5	7.2	5.5
Total public debt	n/a	n/a	8.6	19.8	20.6	22.5	18.7	17.7	21.4	26.5	20.0	19.0	19.0
External balance													
Exports (US\$bn)	33	32	28	16	13	15	21	20	13	22	30	30	27
Imports (US\$bn)	10	11	9	10	9	9	11	11	10	10	13	13	13
Trade balance (US\$bn)	22	21	19	6	4	6	10	9	2	11	17	18	14
Trade balance (% of GDP)	31.9	27.8	25.2	11.0	11.1	15.0	20.9	17.8	5.8	1.6	23.2	22.8	17.5
Current account balance (US\$bn)	15	12	10	0	-1	2	6	4	0	8	14	14	11
Current account balance (% of GDP)	21.5	16.5	13.6	-0.4	-3.6	4.1	12.8	9.1	-0.5	15.2	19.0	18.5	14.0
Net FDI (US\$bn)	0.8	1.1	2.4	0.8	1.9	0.3	-0.8	-1.4	-0.8	-2.2	-1.0	-1.5	-2.0
Net FDI (% of GDP)	1.1	1.5	3.2	1.5	5.1	0.7	-1.7	-2.9	-1.8	-4.1	-1.4	-1.9	-2.5
Current account balance plus FDI (% of GDP)	22.6	18.0	16.8	1.1	1.5	4.8	11.1	6.2	-2.3	11.1	17.6	16.6	11.5
Foreign exchange reserves ex gold (US\$bn)	12	14	14	5	4	5	6	6	6	7	8	8	9
Import cover (months of merchandise imports)	13	15	18	6	5	7	6	7	8	8	7	8	8
Debt indicators													
Gross external debt (US\$bn)	11	11	12	13	15	15	16	16	16	16	17	16	16
Gross external debt (% of GDP)	15.5	14.3	16.1	25.1	38.5	37.4	34.4	33.0	37.1	29.3	23.7	20.6	19.6
Gross external debt (% of exports)	33.2	33.3	42.8	85.5	110.4	101.0	78.0	79.7	125.5	141.9	57.3	52.5	59.7
Lending to corporates/households (% of GDP)	22.4	26.5	31.4	40.0	27.2	16.7	16.3	18.7	20.1	18.4	17.0	18.0	20.0
Interest & exchange rates													
Central bank key rate (year-end, %)	5.00	4.75	3.50	3.00	15.00	15.00	9.75	7.50	6.25	7.25	8.00	7.50	6.75
Broad money supply (average, %YoY)	20.7	15.0	11.8	-1.1	-2.0	9.0	5.7	20.0	1.1	18.7	20.0	12.0	5.0
3m interest rate (Bakibor, average, %)	7.8	9.7	10.8	9.2	13.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
3m interest rate spread over US\$-Euribor(ppt)	726	947	1,059	918	1,380	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)	0.79	0.78	0.78	1.56	1.77	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70
USD/AZN exchange rate (average)	0.79	0.78	0.78	1.02	1.60	1.72	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/AZN exchange rate (year-end)	1.04	1.08	0.95	1.70	1.87	2.04	1.95	1.91	2.09	1.94	1.67	1.70	1.87
EUR/AZN exchange rate (average)	1.01	1.04	1.04	1.14	1.77	1.94	2.01	1.90	1.94	1.97	1.79	1.67	1.70
Brent oil price (annual average, US\$/bbl)	112	109	99	52	44	54	71	64	42	71	101	104	90

Source: National sources, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	7.9	6.8	5.7	3.8	2.5	2.5	2.8	3.2	3.4	2.5	2.8	3.2	2.8
CPI (eop, %YoY)	12.0	12.1	14.2	15.6	15.4	13.3	11.2	7.6	4.8	5.0	5.0	5.0	5.0
Central bank key rate (eop, %)	7.25	7.75	7.75	7.75	8.00	8.00	8.00	7.50	7.50	7.00	7.00	6.75	6.75
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)	1.93	1.89	1.78	1.67	1.67	1.62	1.67	1.70	1.70	1.73	1.79	1.82	1.87

Source: National sources, ING estimates

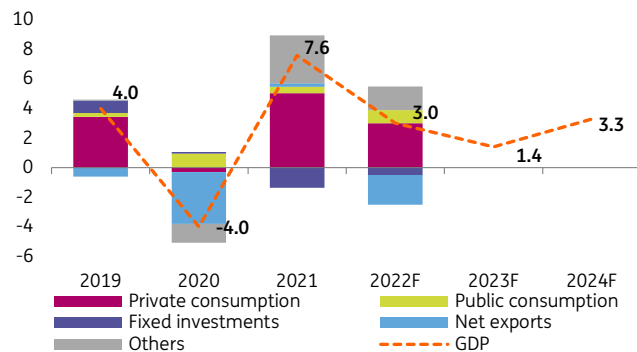
Forecast summary

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	3.2	1.3	0.8	0.7	1.5	3.0	1.4
CPI (%YoY)*	18.6	16.1	12.5	9.2	8.2	15.2	10.2
Policy interest rate (%)	0.00	0.60	1.10	1.10	1.10	0.60	1.10
10yr yield (%)*	5.00	6.00	6.20	6.30	6.10	6.00	6.00
USD/BGN	1.99	2.00	2.06	2.00	1.96	1.90	2.00
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: 2025	S&P	BBB	BBB
Fiscal	Parliamentary: 2023	Moody's	BBB	BBB
Monetary	Local: 2023	Fitch	Baa1	Baa1

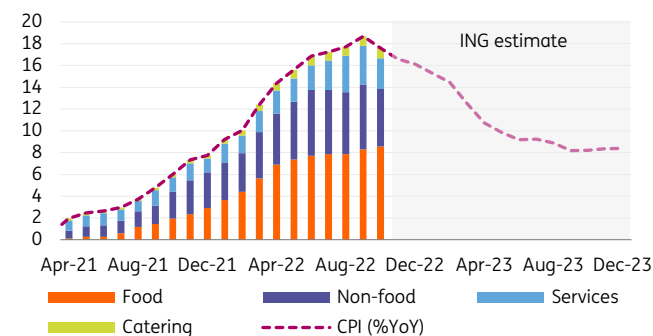
*Quarterly data is eop. annual is average
Source: National sources. ING estimates

Real GDP (%YoY) and contributions (ppt)



Source: NSI, ING

Inflation (%YoY) and main components (ppt)



Source: NSI, ING

An almost wasted year

Far from saying “we told you so”, our previous [Directional Economics piece on Bulgaria](#) pointed out that the “zero tolerance” to corruption policy promised by the Continuing the Change party would hit a wall rather quickly. The government coalition lasted for only six months. Another inconclusive snap election took place in October 2022, with the next one due to take place in March 2023. We expect the political uncertainty to persist over the medium term and believe that this will postpone by at least one year the 2024 self-imposed euro adoption target, but this would be the most benign outcome in our view. After four general elections in 18 months, an understandable ‘politics fatigue’ on the part of the electorate might validate more extremist parties. Meanwhile, the interim government(s) are likely to remain fiscally responsible, though the outlook starts to become somewhat foggier.

Not a bad year but slowdown follows

Given the very robust growth in 1H22 when the economy advanced by over 4.0%, and the flash 3Q22 GDP showing a 3.2% expansion, it will be rather difficult for the Bulgarian economy to close 2022 with a real GDP growth below 3.0%. For 2023, however, the outlook turns rather grim as the contraction in disposable income due to high inflation will start to yield more pronounced negative results in consumption. Moreover, the anticipated eurozone contraction will mean more subdued export demand, which will hit the economy in 1H23. Increased absorption of EU funds will be one of the few opportunities to offset these developments, but without a stable government to deliver straight-through implementation, our 1.4% GDP growth estimate for 2023 looks quite reasonable.

The peak is behind, but inflation will remain high

While it could be subject to a degree of flexibility from the EU when assessing euro adoption, the price stability criteria is obviously not on track for Bulgaria. We believe that inflation has peaked (at 18.6% in September 2022) and a gradual slowdown is to follow. Single-digit inflation could be seen as early as late-2Q23, but the subsequent pace of the slowdown looks a lot less steep which means that inflation could still stabilise well above the three best performing EU member states. This assumes household protection measures remain fully in place in 2023 and partially in 2024. Phasing out the support measures earlier would lift the inflation profile by up to 4ppt, depending on the exact specifications of the support measures.

Bulgaria

valentin.tataru@ing.com

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	0.4	0.3	1.9	4.0	3.0	2.8	2.7	4.0	-4.0	7.6	3.0	1.4	3.3
Private consumption (%YoY)	3.3	-2.4	2.7	3.6	3.6	3.9	3.6	5.9	-0.3	8.0	3.1	0.8	2.8
Government consumption (%YoY)	-1.8	0.7	-0.1	1.8	2.2	4.3	5.4	2.0	8.3	4.0	2.5	3.3	1.9
Investment (%YoY)	1.8	0.5	3.5	2.7	-6.6	3.2	5.4	4.5	0.6	-7.5	-1.5	5.6	4.2
Industrial production (%YoY)	-0.6	0.2	2.1	2.8	2.5	4.1	0.3	0.5	-5.9	8.9	15.0	2.0	2.5
Unemployment rate (annual, %)	11.1	11.3	11.2	10.1	8.7	7.2	6.2	5.6	7.4	5.5	4.7	4.6	4.5
Nominal GDP (BGNbn)	82.6	82.2	84.2	89.6	95.4	102.8	110.0	120.4	120.5	139.0	162.0	178.0	192.0
Nominal GDP (€bn)	42.2	42.0	43.1	45.8	48.8	52.6	56.2	61.6	61.4	71.1	82.8	91.0	98.2
Nominal GDP (US\$bn)	55.0	55.8	56.2	50.3	53.9	60.3	66.2	68.8	71.2	82.7	85.3	89.2	104.1
GDP per capita (US\$)	7,600	7,700	7,800	7,100	7,600	8,600	9,500	9,900	10,300	12,000	12,400	13,100	15,500
Gross domestic saving (% of GDP)	18.6	20.4	20.4	21.9	23.9	24.1	23.8	24.2	22.3	22.8	21.8	21.8	22.3
Prices													
CPI (average %YoY)	3.0	0.9	-1.4	-0.1	-0.8	2.1	2.8	3.1	1.7	3.3	15.2	10.2	6.4
CPI (year-end %YoY)	4.3	-1.6	-0.9	-0.4	0.1	2.8	2.7	3.8	0.1	7.8	16.1	8.4	5.6
Wage rates (nominal %YoY)	5.6	8.6	2.4	7.9	7.0	10.5	7.4	12.0	8.7	12.0	13.5	10.0	8.0
Fiscal balance (% of GDP)													
Consolidated government balance	-0.8	-0.7	-5.4	-1.9	0.3	1.6	1.7	2.1	-3.8	-3.9	-2.9	-3.3	-2.5
Consolidated primary balance	0.0	0.0	-4.5	-0.9	1.2	2.4	2.4	2.7	-3.3	-3.4	-2.5	-2.0	-1.8
Total public debt	16.7	17.1	27.1	25.9	29.1	25.1	22.1	20.0	24.5	23.9	24.0	25.4	26.5
External balance													
Exports (€bn)	20.8	22.3	22.0	22.9	24.0	27.8	28.5	29.8	27.9	35.0	49.0	50.0	52.5
Imports (€bn)	25.5	25.8	26.1	26.3	26.2	30.2	32.1	33.7	30.6	39.2	54.9	56.5	59.4
Trade balance (€bn)	-4.7	-3.6	-4.1	-3.5	-2.1	-2.4	-3.6	-3.9	-2.7	-4.2	-5.9	-6.5	-6.9
Trade balance (% of GDP)	-11.1	-8.5	-9.5	-7.6	-4.4	-4.6	-6.4	-6.4	-4.4	-5.9	-7.1	-7.2	-7.0
Current account balance (€bn)	-0.4	0.5	0.5	0.0	1.5	1.7	0.5	1.1	0.0	-0.3	0.1	-0.7	0.9
Current account balance (% of GDP)	-0.8	1.3	1.2	0.0	3.1	3.3	0.9	1.9	-0.1	-0.4	0.1	-0.8	0.9
Net FDI (€bn)	1.1	1.2	0.1	1.9	0.6	1.3	0.8	1.2	2.8	1.1	1.2	1.2	1.2
Net FDI (% of GDP)	2.5	3.0	0.3	4.1	1.2	2.5	1.3	2.0	4.5	1.6	1.4	1.3	1.3
Current account balance plus FDI (% of GDP)	1.7	4.2	1.6	4.1	4.2	5.8	2.3	3.9	4.5	1.2	1.6	0.6	2.2
Foreign exchange reserves (€bn)	15.6	14.4	16.5	20.3	23.9	23.7	25.1	24.8	30.9	34.6	35.9	36.4	39.6
Import cover (months of merchandise imports)	7.3	6.7	7.6	9.2	11.0	9.4	9.4	8.8	12.1	10.6	7.8	7.7	8.0
Debt indicators													
Gross external debt (€bn)	37.7	36.9	39.3	36.7	38.1	37.7	37.2	37.7	39.3	41.2	42.8	44.1	45.0
Gross external debt (% of GDP)	89	88	91	80	78	72	66	61	64	58	52	48	46
Gross external debt (% of exports)	182	166	178	160	159	136	131	127	141	118	87	88	86
Lending to corporates/households (% of GDP)	65.1	65.5	58.8	54.4	51.5	49.4	49.8	48.9	54.7	51.5	48.8	49.7	50.6
Interest & exchange rates													
Central bank key rate (year-end %)	0.03	0.02	0.02	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.60	1.10	1.10
Broad money supply (average %YoY)	8.4	8.9	1.1	8.8	7.6	7.7	8.8	9.9	10.9	10.7	10.0	10.5	11.0
3yr yield (average %)	2.65	1.50	1.59	1.03	0.36	0.08	-0.05	-0.20	0.05	-0.05	2.60	4.20	4.00
10yr yield (average %)	4.55	3.54	3.42	2.83	2.19	1.60	0.94	0.46	0.40	0.30	3.50	6.00	6.00
USD/BGN exchange rate (year-end)	1.48	1.42	1.62	1.80	1.86	1.63	1.71	1.74	1.60	1.72	2.00	1.96	1.78
USD/BGN exchange rate (average)	1.50	1.47	1.50	1.78	1.77	1.70	1.66	1.75	1.69	1.68	1.90	2.00	1.85
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

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	10.2	4.4	3.9	3.2	1.3	0.8	0.7	1.5	2.3	3.2	3.2	3.1	3.6
CPI (eop. %YoY)	7.8	12.3	16.8	18.6	16.1	12.5	9.2	8.2	8.4	6.9	6.7	5.2	5.6
Central bank key rate (eop. %)	0.00	0.00	0.00	0.00	0.60	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
10yr yield (eop. %)	0.30	0.70	1.70	5.00	6.00	6.20	6.30	6.10	6.10	6.00	6.00	6.00	6.00
USD/BGN exchange rate (eop)	1.72	1.77	1.87	1.99	2.00	2.06	2.00	1.96	1.96	1.92	1.86	1.83	1.78
EUR/BGN exchange rate (eop)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96

Source: National sources. ING estimates

Forecast summary

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	5.2	4.2	1.5	0.4	1.8	6.4	1.6
CPI (%YoY)*	12.8	12.1	9.7	5.6	4.3	10.6	6.4
Policy interest rate (eop, %)	3.00	3.00	3.00	3.00	3.00	3.00	3.00
10yr yield (%)*	4.30	4.00	3.90	4.20	4.00	3.00	4.00
USD/HRK*	7.77	7.69	7.93	7.68	7.53	7.32	7.69
EUR/HRK*	7.53	7.53	7.53	7.53	7.53	7.53	7.53

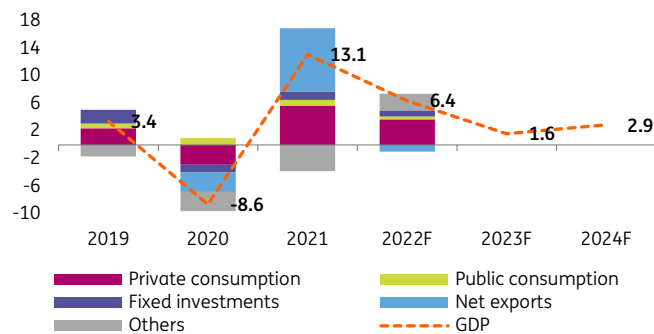
Macro Trend	Political Cycle	Ratings	FC	LC
Activity =	Presidential: 2025	S&P	BBB+	BBB+
Fiscal Loose	Parliamentary: 2024	Moody's	Baa2	Baa2
Monetary Loose	Local: 2025	Fitch	BBB+	BBB+

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

Eurozone and Schengen accession

For many generations of Croatians, 1 January 2023 will be a day to remember. After years of painstaking efforts to recover from the 2008-09 deep recession and put public finances back on track, the country will join the eurozone in a relatively solid economic shape. Somewhat overshadowed by the eurozone accession, joining the Schengen area will also be a major milestone, with the potential to further boost Croatia's exports of goods and especially services. Essentially, on 1 January 2023, Croatia's EU integration story will be complete, with no other major milestones to be achieved in the coming years. In the short term, we believe that despite already being largely reflected in current ratings, the Eurozone and Schengen accession could bring another one notch upgrade from at least one agency.

Real GDP (YoY%) and contributions (ppt)

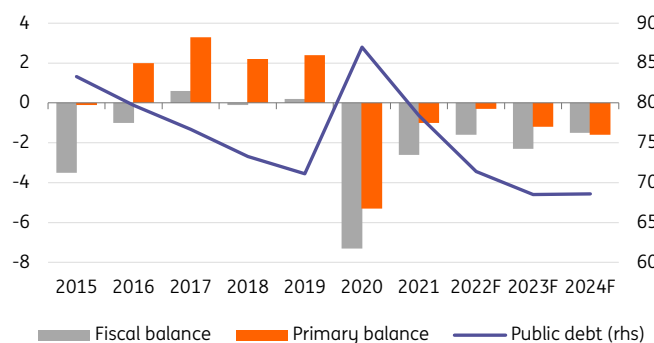


Source: Eurostat, ING

What a comeback this was

Unlike the aftermath of the 2008-09 crisis when it took six years for the Croatian economy to resume growth, the post-pandemic recovery has been extremely fast. As usual, a strong tourist season made quite a difference, but tourism revenues in 2022 have dwarfed the record 2019 levels by some 30% to 40% despite a slightly lower number of tourists. This was due partly to inflation but also to the qualitative improvements in the sector which is now able to tap into more premium public. Looking to 2023, the outlook is influenced by an expected slowdown in the eurozone which will affect the demand for goods and services. Nevertheless, public investments should act as a backstop for a flattening private consumption, hence we maintain our 1.6% GDP growth estimate for 2023.

Public debt and fiscal balance (% of GDP)



Source: Eurostat, ING

Getting back on track

The revised official targets for the fiscal balance point to a 1.6% of GDP deficit in 2022 and 2.3% in 2023, which given the current macro assumptions seem to be sensible estimates. An important aspect is how well the support measures for households will work in practice. In theory, their cost (estimated at around 5% of GDP) will be largely offset by revenues from EU funds and energy companies. Combined with the lower GDP growth and some remaining public sector arrears, it could mean that risks for exceeding the deficit next year are skewed to the upside. Nevertheless, primary deficits remain under control and with GDP growth still holding on, the overall debt position should continue to improve.

Croatia

valentin.tataru@ing.com

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	-2.3	-0.4	-0.4	2.5	3.6	3.4	2.8	3.4	-8.6	13.1	6.4	1.6	2.9
Private consumption (%YoY)	-2.4	-1.6	-2.5	0.4	3.1	3.1	3.3	4.1	-5.1	9.9	6.4	1.6	2.7
Government consumption (%YoY)	-1.1	0.4	1.0	-1.0	1.1	2.2	2.3	3.1	4.3	3.0	1.8	2.0	2.5
Investment (%YoY)	-4.5	1.0	-2.3	8.2	5.0	1.6	3.9	9.0	-5.0	4.7	6.0	1.3	2.1
Industrial production (%YoY)	-5.4	-1.6	1.2	2.4	5.1	2.0	-1.0	0.5	-3.5	6.6	2.0	2.2	2.2
Unemployment rate (year-end, %)	20.9	21.5	19.4	17.6	14.8	12.2	9.6	7.9	9.5	7.4	6.9	6.2	5.8
Nominal GDP (HRKbn)	336	337	336	345	357	373	391	413	380	439	520	550	570
Nominal GDP (€bn)	74	44	44	45	47	50	53	56	50	58	69	73	76
Nominal GDP (US\$bn)	97	59	57	50	52	57	62	62	58	68	71	71	80
GDP per capita (US\$)	22,600	13,900	13,500	11,800	12,500	13,900	15,200	15,300	14,400	16,500	17,800	17,900	20,000
Gross domestic saving (% of GDP)	17.0	17.1	18.3	20.6	21.9	22.3	22.3	22.5	17.1	20.3	20.3	21.3	20.8
Prices													
CPI (average, %YoY)	3.4	2.2	-0.2	-0.5	-1.1	1.1	1.5	0.8	0.1	2.6	10.6	6.4	3.9
CPI (year-end, %YoY)	4.6	0.3	-0.5	-0.6	0.2	1.2	0.9	1.4	-0.7	5.5	12.1	3.6	4.0
Wage rates (net nominal, %YoY)	-0.6	-0.8	0.3	-3.4	2.5	5.3	1.0	7.7	3.0	5.6	6.1	9.0	5.0
Fiscal balance (% of GDP)													
Consolidated government balance	-5.5	-5.5	-5.2	-3.5	-1.0	0.6	-0.1	0.2	-7.3	-2.6	-1.6	-2.3	-1.5
Consolidated primary balance	-2.5	-2.5	-1.8	-0.1	2.0	3.3	2.2	2.4	-5.3	-1.0	-0.3	-1.2	-1.6
Total public debt	69.3	80.0	83.7	83.3	79.7	76.7	73.3	71.1	87.0	78.4	71.4	68.5	68.6
External balance													
Exports (€bn)	9.6	9.6	10.4	11.5	12.3	14.0	14.5	15.2	14.9	19.2	24.0	25.2	26.2
Imports (€bn)	16.2	16.5	17.1	18.5	19.7	21.9	23.7	25.0	22.9	28.4	40.0	42.8	44.6
Trade balance (€bn)	-6.6	-6.9	-6.8	-7.0	-7.4	-7.9	-9.2	-9.8	-8.0	-9.2	-16.0	-17.6	-18.4
Trade balance (% of GDP)	-8.9	-15.6	-15.4	-15.4	-15.6	-15.8	-17.4	-17.5	-15.9	-15.8	-23.2	-24.1	-24.3
Current account balance (€bn)	-0.8	-0.5	0.1	1.5	1.0	1.7	0.9	1.6	-0.3	1.8	0.0	1.0	2.0
Current account balance (% of GDP)	-1.1	-1.0	0.3	3.2	2.1	3.4	1.8	2.9	-1.5	3.1	0.0	1.4	2.6
Net FDI (€bn)	-1.1	-0.7	-0.7	-0.2	-2.0	-1.1	-0.8	-3.4	-0.7	-2.8	-3.6	-1.7	-1.7
Net FDI (% of GDP)	-1.4	-1.7	-1.6	-0.4	-4.2	-2.2	-1.6	-6.1	-1.3	-4.8	-5.2	-2.3	-2.3
Current account balance plus FDI (% of GDP)	-2.5	-2.7	-1.3	2.8	-2.1	1.2	0.2	-3.2	-2.8	-1.7	-5.2	-0.9	0.4
Foreign exchange reserves ex gold (€bn)	11.2	12.9	12.7	13.7	13.5	15.7	17.4	18.6	18.9	25.0	27.2	28.1	29.0
Import cover (months of merchandise imports)	8.3	9.4	8.9	8.9	8.2	8.6	8.8	8.9	9.9	10.6	8.2	7.9	7.8
Debt indicators													
Gross external debt (€bn)	47.6	48.5	49.1	48.2	44.7	43.7	42.7	40.3	40.1	44.8	47.0	47.6	48.2
Gross external debt (% of GDP)	64.1	109.1	111.6	106.6	94.5	87.4	81.0	72.4	79.5	77.0	68.2	65.3	63.8
Gross external debt (% of exports)	494	505	473	418	363	312	294	265	269	233	196	189	184
Lending to corporates/households (% of GDP)	70.4	70.0	68.4	64.6	60.2	57.0	55.5	54.0	61.0	54.6	51.1	51.9	53.4
Interest & exchange rates													
Central bank key rate (year-end, %)	6.00	6.00	6.00	6.00	6.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Broad money supply (average, %YoY)	5.7	4.6	3.2	3.8	4.6	3.0	4.7	4.1	7.6	9.4	10.0	8.9	7.9
3yr yield (average, %)	n/a	n/a	4.00	4.10	3.50	2.60	1.80	0.70	0.50	0.15	1.60	2.90	3.00
10yr yield (average, %)	6.50	6.10	5.00	4.30	3.60	3.10	2.90	2.30	1.15	1.00	3.00	4.00	4.20
USD/HRK exchange rate (year-end)	5.73	5.55	6.33	7.03	7.19	6.20	6.46	6.63	6.18	6.64	7.69	7.54	6.85
USD/HRK exchange rate (average)	3.47	5.71	5.85	6.93	6.81	6.50	6.30	6.64	6.53	6.48	7.32	7.69	7.11
EUR/HRK exchange rate (year-end)	7.56	7.63	7.66	7.64	7.56	7.44	7.41	7.44	7.55	7.52	7.53	7.53	7.53
EUR/HRK exchange rate (average)	4.52	7.58	7.63	7.61	7.53	7.46	7.42	7.42	7.54	7.54	7.53	7.53	7.53

Source: National sources, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	12.2	7.8	8.7	5.2	4.2	1.5	0.4	1.8	2.6	3.1	3.0	2.7	2.8
CPI (eop, %YoY)	5.5	7.3	12.0	12.8	12.1	9.7	5.6	4.3	3.6	3.7	4.0	4.0	4.0
Central bank key rate (eop, %)	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
10yr yield (eop, %)	1.15	2.15	3.60	4.30	4.00	3.90	4.20	4.00	4.00	4.20	4.10	4.30	4.20
USD/HRK exchange rate (eop)	6.64	6.81	7.16	7.77	7.69	7.93	7.68	7.53	7.53	7.38	7.17	7.04	6.85
EUR/HRK exchange rate (eop)	7.52	7.57	7.53	7.53	7.53	7.53	7.53	7.53	7.53	7.53	7.53	7.53	7.53

Source: National sources, ING estimates

Forecast summary

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	1.7	-0.4	-1.3	-1.0	0.0	2.4	-0.2
CPI (%YoY)*	18.0	15.5	12.6	9.5	7.1	15.0	10.2
Policy interest rate (%)	7.00	7.00	7.00	6.50	5.50	6.04	6.21
3m interest rate (%)*	7.25	7.25	7.25	6.70	5.70	6.39	6.43
10yr yield (%)*	5.40	5.65	5.40	5.15	4.60	4.40	4.80
USD/CZK*	25.10	25.00	25.80	25.50	25.00	23.40	25.20
EUR/CZK*	24.60	24.50	24.50	25.00	25.00	24.55	24.75

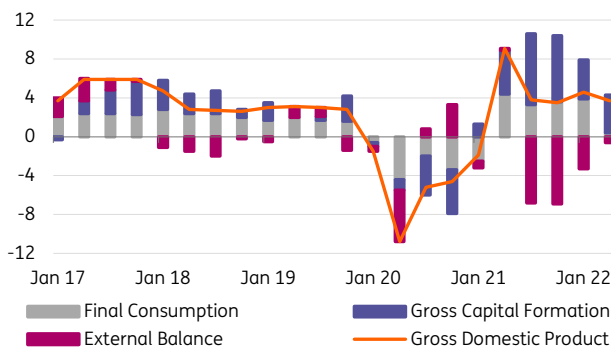
Macro Trend		Political Cycle		Ratings	FC	LC
Activity	-	Presidential: 2023		S&P	AA-	AA
Fiscal	Looser	Parliamentary: 2025		Moody's	Aa3	Aa3
Monetary	Tighter	Local: 2024		Fitch	AA-	AA-

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

Deepest economic contraction in CEE

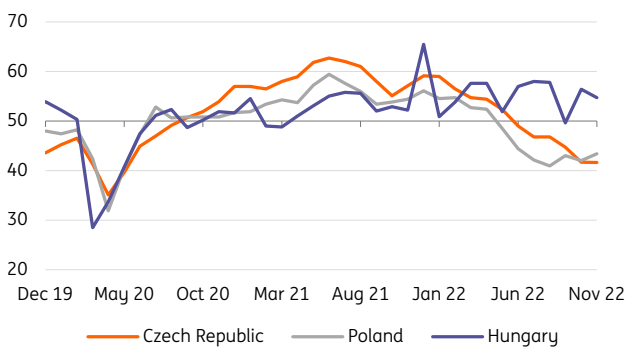
In our view, the Czech economy entered recession in 3Q, mainly due to a fall in household demand. Within the CEE region, we expect the deepest economic contraction in the Czech Republic. Moreover, the level of leading indicators is the main downside risk to our forecasts. Nevertheless, the labour market remains tight and, were it not for government measures, inflation would rise further. Core inflation accelerated again in October and is proving more persistent. The Czech National Bank last hiked rates in June and we do not expect further monetary tightening despite the board's mention of risks. We see a reversal in monetary policy, an end to FX intervention and rate cuts likely before the end of the first half of next year. Fiscal policy incorporates plans for consolidation for next year, but still far from the levels of the pre-Covid years.

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



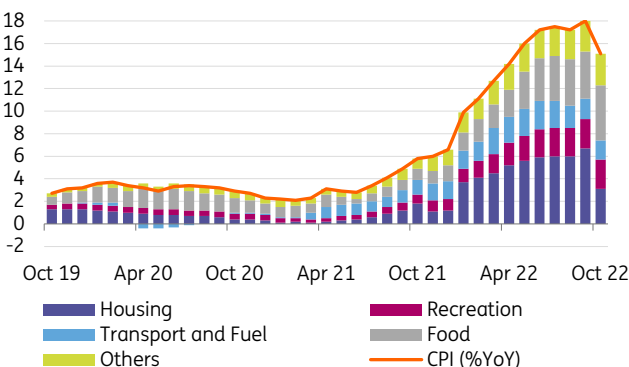
Source: CZSO, ING

PMIs heading to pandemic levels



Source: Macrobond, ING

Structure of inflation (ppt)



Source: CZSO, ING

Macro digest

According to the second release, the Czech economy grew by 1.7% YoY and contracted by 0.2% QoQ in the third quarter and thus, in our view, started a period of recession. The main reason for the contraction was lower household consumption, which has fallen for the fourth quarter in a row. The fall in disposable income is limiting demand, especially for durable goods. On the other hand, the contribution of investment to growth is still positive but the smallest since the beginning of last year. The contribution of the foreign balance also turned positive for the first time since the beginning of last year. Looking ahead, for 1H23 we expect the QoQ pace of economic contraction to deepen, with the economy stagnating in 3Q23 and only returning to visible growth in 4Q23.

The labour market remains a strong anchor of the Czech economy. Unemployment has risen only marginally from historic lows in 2019 and we do not expect it to exceed 3% in the coming years. Nominal wage growth will remain near record highs at just below 8% YoY but will not turn positive in real terms until 3Q23 at the earliest.

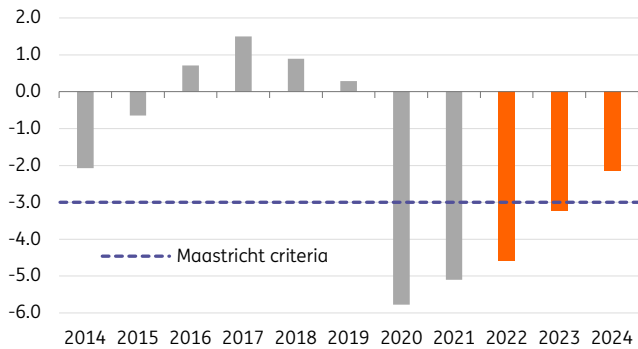
The picture indicated by the leading indicators is the main risk to our forecasts. The PMI is deep in recession territory and only slightly above the record low levels of the Covid years. The PMI points to a sharp decline in output and new orders and rising cost pressures. A CZSO survey shows that shortages of materials and equipment are the main barrier to growth for a third of businesses, while insufficient demand is a major obstacle for a quarter. Consumer confidence bounced back from a low in November, probably due to government measures, but remains near record lows.

Inflation fell from 18.0% to 15.1% while the CNB expected 17.4% YoY in October. The surprise can be explained by the government's measures to tackle high energy prices. On the other hand, core inflation accelerated sharply again from 0.3% to 1.2% MoM, almost back to the mid-year peak. In annual terms, it thus remained almost unchanged for the fifth month in a row at 14.6%, above the CNB's forecast. Moreover, the central bank itself admits that government measures have cut 3.5ppt off inflation, implying actual inflation at 18.6% YoY, which would indicate a new record high. Looking ahead, we expect inflation to remain at similar levels until the end of the year and the change in government measures in January to have a similar effect on CPI as current measures had. Barring a surprise upwards repricing in January, the peak in inflation should be over and we expect the first single-digit numbers in the second half of the year. However, core inflation is still surprising to the upside and proving more persistent, which we think will lead to a slower decline.

Czech Republic

frantisek.taborsky@ing.com

General government balance (% of GDP)

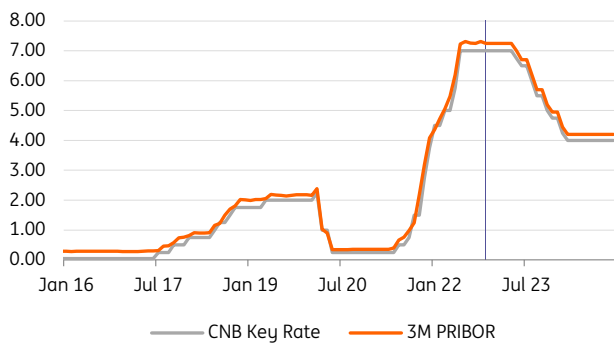


Source: MinFin, ING

Only slow consolidation of public finances

MinFin approved an increase in the state budget deficit in November to CZK375bn (5.5% of GDP), reflecting new government measures including the saving tariff and revised tax revenues. For next year, the plan expects a deficit of CZK295bn. In both cases, we remain on the optimistic side with a slightly lower deficit in our forecast due to traditionally underestimated tax revenues. However, the pace of fiscal consolidation is still far from the pre-Covid years. On the other hand, municipalities are running record budget surpluses, which improves the overall public finance picture. We expect a deficit of 4.6% for this year and 3.2% of GDP for next year. Given the strong nominal GDP growth, government debt will remain below 45% of GDP. In our view, the risk of a downgrade remains.

CNB rate and PRIBOR

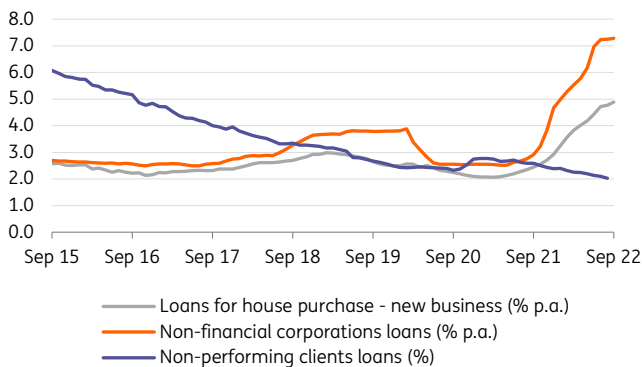


Source: MinFin, ING

Hiking cycle is over, attention turns to the first cut

The Czech National Bank halted the hiking cycle in August and although the board still mentions risks that could lead to additional interest rate hikes, we turn our attention to the first interest rate cut next year. We see the current board as more dovish than the previous one and therefore see the possibility of a decision to cut before the end of the second quarter given the downturn in the economy, the risks of a deeper recession and inflation heading into single-digit territory. The CNB still sees the equilibrium interest rate at 3% which, with a record strong koruna, currently indicates very tight monetary conditions in the eyes of central bankers. In the meantime, we expect continued FX interventions to defend the koruna, which we think are likely to continue during 1Q next year.

Interest rates and NPL

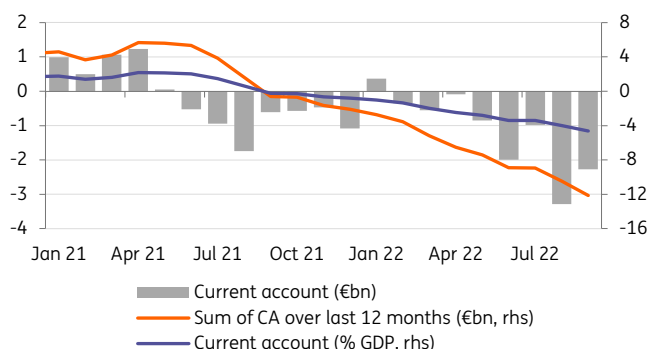


Source: CNB, ING

Mortgage market frozen, companies financing in euros

The volume of new mortgages has remained stagnant for the past three months after a strong fall in 2Q22. Year-on-year, the volume of new mortgages is down 80%. This is due to the significant rise in interest rate but also the frontloading effect last year before the CNB tightened mortgage lending rules and implemented further key rate hikes. New CZK loans to corporates have fallen by 40% this year, but some of the corporate sector is responding to the current situation of high koruna rates by switching to FX financing. The share of euro-loans in total new loans to businesses has thus reached two-thirds in recent months. However, even taking FX loans into account, this year's new lending to corporates has been falling, responding to monetary policy tightening.

Current account



Source: CNB, ING

Deepest current account deficit since 2003

The trade balance has deteriorated significantly in recent months, mainly due to higher energy prices and import growth. We have seen an improvement on the export side in recent months, but we do not expect a quick return to positive levels. Also contributing to the CA deficit is the involvement of Ukrainian immigrants, whose wages are reflected as payments to non-residents. In addition, dividend outflows abroad have increased significantly in recent months, reaching the highest volume on record when looking at a rolling 3M sum. Thus, we expect a current account deficit of 5.1% of GDP for this year, essentially the worst result since 2003. For next year, we expect the trade balance to improve and energy prices to normalise, which should lead to the deficit falling to 3.5% of GDP.

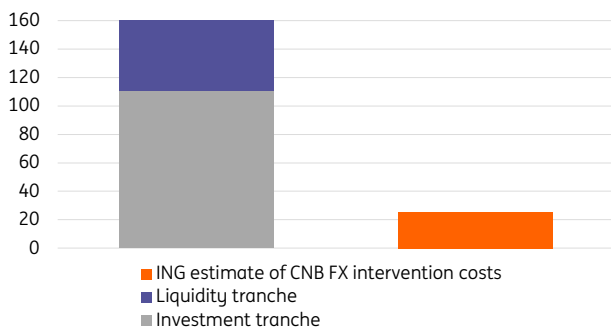
Czech Republic

FX – spot vs forward and INGF



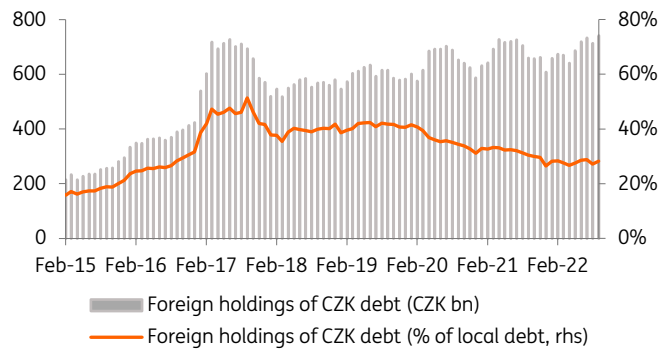
Source: Eikon, ING

CNB FX reserves before the start of interventions (€bn)



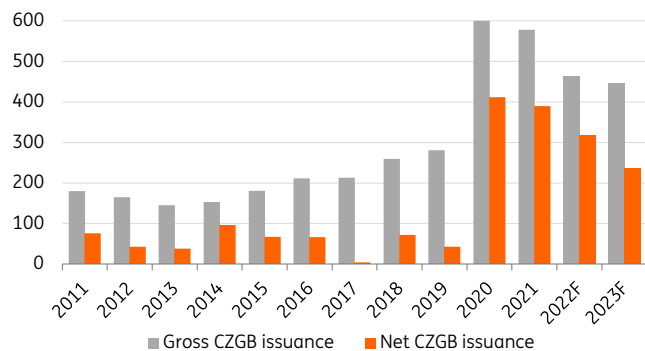
Source: Macrobond, ING

Foreign holders of CZGB (%)



Source: Macrobond, ING

CZGB issuance (CZKbn)



Source: MinFin, ING forecast

FX

The CZK market has been under the control of the CNB since mid-May with the intention to "prevent excessive fluctuations of the koruna". According to official figures, the central bank spent €25.5bn (16% of FX reserves) to defend the koruna from May to September.

According to our estimates, the CNB may not have been active in the market in October and November given the EUR/CZK level has remained well below the intervention level of 24.60-70. The CNB is thus in a very comfortable situation, and we expect this regime to continue at least until the end of 1Q next year. If current market conditions persist and the CNB is not forced to intervene significantly, we believe 2Q23 will be an opportunity to end this regime, which should allow the koruna to weaken slightly towards EUR/CZK 25.0, however, we expect the koruna to strengthen again in the second half of the year due to the economic recovery and the EUR/USD turnaround.

Market attention in recent months has been focused on the koruna only during the CNB meetings, building short positioning in view of the end of the central bank intervention regime. However, we expect this decision later than most.

Fixed income

The CNB is sticking to the rhetoric of "no change or rate hike" and "higher rates for longer" and, in our view, it is too early to reverse this mood on the markets. However, market rates have fallen from levels above the CNB's forecast to well below it in recent weeks. Currently, the market sees the first rate cut in four months and a near return to the equilibrium level of 3.00% in two years, while the CNB forecast expects the key rate to still be above 4.50% at the end of 2024. Overall, we view current market valuations as too aggressive in terms of rate cuts. In addition, despite the recent move, the long end of the IRS curve is still lagging behind core rates, according to our model, which points to higher levels.

The June peak of the CNB hiking cycle and the upward revision of the state budget disrupted the traditional seasonality in CZGB issuance and unusually boosted supply in recent months, which we believe led to significant cheapening in ASW. For next year, we expect only slightly lower gross CZGB supply, but on a net basis it is almost half the volume of the Covid years. Thus, in our view, CZGBs have a lot of room to normalise in relative terms against the IRS curve. In addition, CZGBs can benefit relative to their regional peers from stable FX, a relatively low twin deficit and a politically stable situation domestically and with the EU. In nominal terms, we think current yields are in rather expensive territory, but in relative terms we see a lot of room for normalisation.

Czech Republic

frantisek.taborsky@ing.com

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	-0.8	0.0	2.3	5.4	2.5	5.2	3.2	3.0	-5.5	3.6	2.4	-0.2	2.5
Private consumption (%YoY)	-1.1	0.9	1.4	3.9	3.7	3.9	3.3	2.6	-7.4	4.1	0.6	-0.7	2.0
Government consumption (%YoY)	-1.9	2.4	1.0	1.8	2.5	1.8	3.9	2.5	4.2	1.5	0.7	1.0	1.2
Investment (%YoY)	-3.3	-2.2	3.3	9.7	-3.0	4.9	10.0	5.9	-6.0	0.7	5.0	0.8	2.9
Industrial production (%YoY)	2	1.5	9.1	2.2	0.8	7.5	3.5	0.9	-6.1	10.8	1.9	2.3	3.2
Unemployment rate (year-end, %)	7.2	6.8	5.8	4.6	3.7	2.4	2.1	2.1	3.1	2.3	2.4	2.9	3.0
Nominal GDP (CZKbn)	4,089	4,143	4,346	4,625	4,797	5,111	5,411	5,791	5,709	6,108	6,799	7,430	7,645
Nominal GDP (€bn)	163	165	159	170	175	190	201	207	190	202	222	213	226
Nominal GDP (US\$bn)	209	212	209	188	196	219	249	253	246	282	292	294	338
GDP per capita (US\$)	19,868	20,146	19,903	17,834	18,583	20,641	23,427	23,669	23,002	26,829	27,194	27,368	31,468
Gross domestic saving (% of GDP)	31.1	30.7	32.3	33.9	33.7	33.9	33.1	33.6	32.8	32.9	32.0	32.2	32.4
Prices													
CPI (average, %YoY)	3.3	1.4	0.4	0.3	0.7	2.5	2.1	2.8	3.2	3.8	15.0	10.2	5.5
CPI (year-end, %YoY)	2.4	1.4	0.1	0.1	2.0	2.4	2.0	3.2	2.3	6.6	15.5	8.5	3.2
Wage rates (nominal, %YoY)	2.5	-0.1	2.9	3.2	4.4	6.8	8.1	7.9	4.6	4.8	7.5	7.7	5.6
Fiscal balance (% of GDP)													
Consolidated government balance	-3.9	-1.3	-2.1	-0.6	0.7	1.5	0.9	0.3	-5.8	-5.1	-4.6	-3.2	-2.2
Consolidated primary balance	-2.5	0.1	-0.6	0.4	1.6	2.2	1.6	1.0	-5.0	-4.3	-3.6	-2.0	-1.3
Total public debt	44.2	44.4	41.9	39.7	36.6	34.2	32.1	30.0	37.7	42.0	42.9	42.9	44.3
External balance													
Exports (€bn)	108.4	107.2	114.4	119.6	122.0	133.4	141.0	143.8	131.7	154.0	157.7	159.3	167.2
Imports (€bn)	105.9	103.1	109.1	114.8	116.0	127.2	137.2	138.1	124.9	154.3	160.0	160.2	167.2
Trade balance (€bn)	2.6	4.1	5.3	4.8	6.1	6.2	3.8	5.7	6.8	-0.3	-2.3	-0.9	0.0
Trade balance (% of GDP)	1.6	2.6	3.6	3.2	4.0	4.0	2.4	3.6	4.4	-0.2	-1.0	-0.4	0.0
Current account balance (€bn)	-2.5	-0.8	0.3	0.8	3.2	3.0	0.9	0.7	4.3	-2.0	-11.3	-7.5	-5.7
Current account balance (% of GDP)	-1.5	-0.5	0.2	0.4	1.8	1.5	0.4	0.3	2.0	-0.8	-5.1	-3.5	-2.5
Net FDI (€bn)	4.8	0.3	-2.9	1.8	-6.9	-1.7	-2.0	-5.3	-5.6	-0.2	-2.5	-2.4	-2.5
Net FDI (% of GDP)	3.0	0.2	-1.9	1.1	-3.9	-0.9	-0.9	-2.4	-2.6	-0.1	-0.9	-0.8	-0.8
Current account balance plus FDI (% of GDP)	1.4	-0.3	-1.7	1.5	-2.1	0.6	-0.5	-2.0	-0.6	-0.9	-5.9	-3.3	-2.7
Foreign exchange reserves ex gold (€bn)	34	43	45	59	81	120	125	132	134	153	140	145	150
Import cover (months of merchandise imports)	3.5	4.6	4.5	5.5	7.6	10.2	9.9	10.2	11.6	10.6	10.5	10.9	10.8
Debt indicators													
Gross external debt (€bn)	95.0	97.5	104.3	112.8	123.0	168.4	169.9	172.0	163.6	170.5	185	190	188
Gross external debt (% of GDP)	58.4	62.0	70.3	75.2	81.3	108.4	106.5	108.0	105.8	107.0	83.3	89.2	83.2
Gross external debt (% of exports)	93	97	96	100	109	132	126	124	127	110.7	117.3	119.3	112.4
Lending to corporates/households (% of GDP)	48.1	49.4	48.4	48.5	49.9	49.8	50.3	49.8	53.4	52.6	49.3	46.9	47.8
Interest & exchange rates													
Central bank key rate (year-end, %)	0.05	0.05	0.05	0.05	0.05	0.50	1.75	2.00	0.25	3.75	7.00	4.75	4.00
Broad money supply (average, %YoY)	5.2	4.5	5.2	7.8	8.9	9.9	5.5	6.8	9.7	9.9	5.8	8.0	7.0
3m interest rate (Pribor, average, %)	1.00	0.46	0.36	0.31	0.29	0.41	1.27	2.12	0.86	1.13	6.20	6.40	4.30
3m interest rate spread over Euribor (ppt)	47	24	15	32	55	74	159	248	130	168	620	429	232
2yr yield (average, %)	0.92	0.31	0.18	-0.06	-0.31	-0.20	1.06	1.57	0.59	1.60	5.45	5.40	4.10
10yr yield (average, %)	2.82	2.11	1.56	0.70	0.44	1.06	2.02	1.61	1.18	1.97	4.40	4.80	4.20
USD/CZK exchange rate (year-end)	19.01	19.89	22.86	24.87	25.70	21.29	22.43	22.69	21.47	21.88	25.00	24.50	21.45
USD/CZK exchange rate (average)	19.56	19.56	20.76	24.59	24.44	23.37	21.75	22.93	23.21	21.69	23.90	25.25	22.60
EUR/CZK exchange rate (year-end)	25.10	27.34	27.66	27.02	27.02	25.51	25.72	25.42	26.24	24.89	24.50	24.50	23.60
EUR/CZK exchange rate (average)	25.14	25.98	27.53	27.28	27.03	26.33	25.65	25.67	26.46	25.64	24.60	24.75	23.95

Source: National sources, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	3.5	4.6	3.6	1.7	-0.4	-1.3	-1.0	0.0	1.7	2.3	2.3	2.5	2.9
CPI (eop, %YoY)	6.6	12.7	17.2	18.0	15.5	11.3	9.5	7.1	8.5	7.1	5.3	4.3	3.2
Central bank key rate (eop, %)	3.75	5.00	7.00	7.00	7.00	7.00	6.50	5.50	4.75	4.00	4.00	4.00	4.00
3m interest rate (eop, %)	4.08	5.06	7.23	7.25	7.25	7.25	6.70	5.70	4.95	4.20	4.20	4.20	4.20
10yr yield (eop, %)	2.86	3.82	4.91	5.40	5.65	5.40	5.15	4.60	4.10	4.10	4.15	4.25	4.35
USD/CZK exchange rate (eop)	21.88	22.06	23.60	25.09	25.00	25.80	25.50	25.00	24.50	23.80	22.85	22.25	21.45
EUR/CZK exchange rate (eop)	24.89	24.40	24.74	24.59	24.50	24.50	25.00	25.00	24.50	24.30	24.00	23.80	23.60

Source: National sources, ING estimates

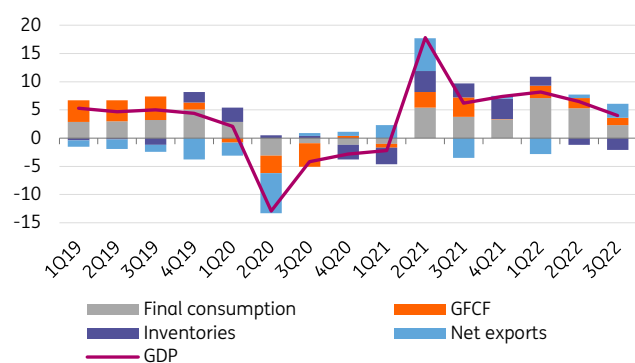
Forecast summary

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	4.0	0.5	-1.0	-1.5	0.3	4.8	0.1
CPI (%YoY)*	20.1	23.3	22.5	18.8	11.6	14.4	16.7
Policy interest rate (eop, %)	13.00	13.00	13.00	12.75	12.00	13.00	11.25
3m interest rate (%)*	13.30	16.00	14.60	12.75	11.75	9.90	13.10
10yr yield (%)*	9.77	8.00	7.80	7.50	7.25	7.59	7.52
USD/HUF*	429.9	408.2	410.5	387.8	385.0	378.9	396.9
EUR/HUF*	421.4	400.0	390.0	380.0	385.0	390.3	389.0

Macro Trend	Political Cycle	Ratings	FC	LC
Activity	Presidential: 2027	S&P	BBB	BBB
Fiscal	Parliamentary: 2026	Moody's	Baa2	Baa2
Monetary	Local: 2024	Fitch	BBB	BBB

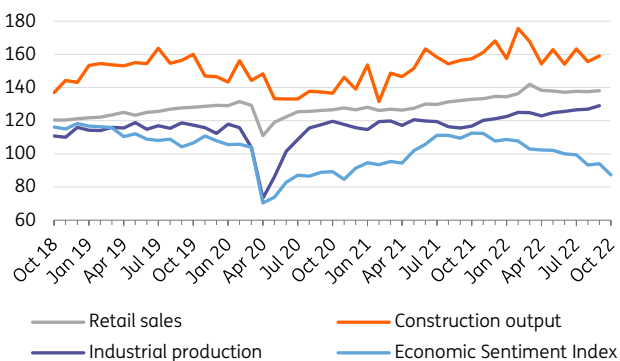
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

Contribution to YoY GDP growth (ppt)



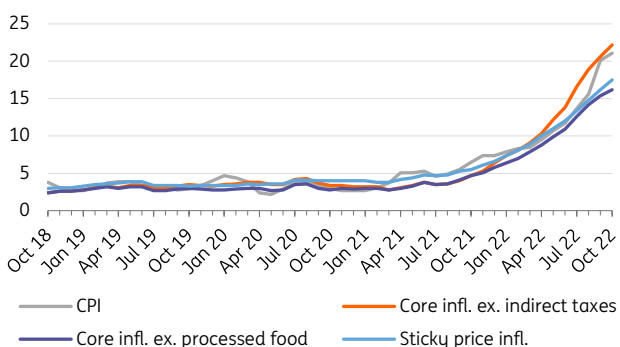
Source: Hungarian Central Statistical Office

Key activity indicators (swda; 2015 = 100%)



Source: Eurostat, Hungarian Central Statistical Office

Headline and underlying measures of inflation (%YoY)



Source: National Bank of Hungary

Bullish in every aspect

Although Hungary is still facing a trifecta of challenges, the technical recession during late-2022 and early-2023 will provide a tailwind to tackle the issues. We expect inflation to gradually descend from its early-2023 peak, reaching single-digit territory by the end of the year if price caps are extended. At the same time, negative net real wage growth and tighter monetary and fiscal policies will keep domestic demand muted. The latter will be driven by postponed public investment spending and windfall taxes. Retreating consumption and lower investment activity reduces the country's import need, which is also supported by a spreading awareness of energy usage. Improving external balance and diminishing net external financing need will boost the relative attractiveness of Hungarian assets, especially the forint. We are bullish in every aspect.

Macro digest

After the post-Covid led rebound in 2021, this year started on a strong footing. GDP growth came in at 7.3% YoY during the first half of 2022. Despite all the challenges presented by the war and resultant energy crisis, Hungarian economic activity was boosted by rising domestic demand. A key source of this was the government's pre-election spending spree during the first quarter. As this positive momentum of re-opening and fiscal easing starts to fade and the challenge of rising energy bills and extreme inflation starts to bite, the economy's quarterly based performance is beginning to slump.

The two biggest difficulties Hungary is facing – higher energy bills and increasing unemployment – didn't fully impact the economy in the third quarter. Nonetheless, the 0.4% quarter-on-quarter drop in real GDP means that we've already seen the first leg of the expected technical recession in Hungary. We expect the drop to continue in the fourth quarter mainly due to falling consumption and shrinking investment activity. Real wage growth reached negative territory in September, while lending activity also dropped. In the corporate sector, we see companies going out of business or reducing working hours due to skyrocketing energy costs. Big data also suggests the economy has been on a downtrend.

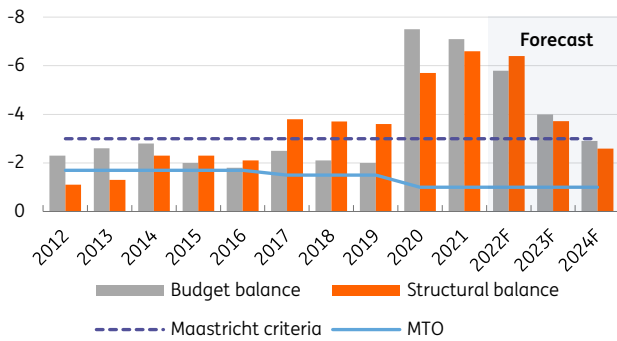
But despite the weak second half, the strong first half will save the year: we see 2022 GDP growth at around 4.8%. When it comes to the 2023 outlook, the negative carry-over effect, the ongoing fiscal and monetary tightening and the shrinking purchasing power of households will take their toll. We expect 0.1% GDP growth on average in 2023, followed by a marked rebound in 2024 as Hungary will have access to EU funds, boosting investment activity.

Headline inflation moved to 21.1% YoY in October, the highest reading since 1996. 58% of the price pressure is from the food, alcoholic beverages, and tobacco sectors. This is due to a combination of a weather-related supply-side shock in agriculture, the high cost-sensitivity to energy in the food industry and the transmitted tax changes affecting food products and retailers. In the short run, we expect further increases in CPI, though the peak might be near. Negative real wage growth, thus decreasing aggregate demand, is reducing the pricing power of corporates. Price expectations of retailers have also started to drift lower, pointing to an impending turnaround in inflation. The peak could be around 23% (if price caps are extended), followed by a gradual slowdown during the first half of 2023 and a more rapid normalisation in the second half of next year. However, the full-year average in 2023 could be higher – around 16.7% – than the average in 2022, which we forecast to come in at 14.4%.

Hungary

peter.virovacz@ing.com

Budget and structural balance of general government (%)

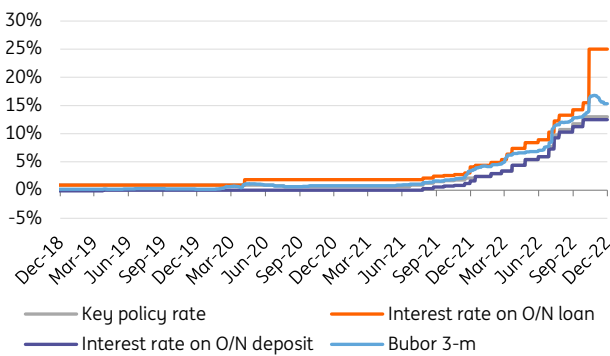


Source: AMECO, ING estimates

Fiscal consolidation is on the way

During the first half of 2022, there was a major fiscal spending spree, not necessarily unrelated to the April general election. As the energy crisis deepened, the government introduced significant fiscal tightening during the second half of this year. Against this backdrop, we don't see an issue with the 6.1% of GDP deficit target. Indeed, it might be even better due to the higher nominal GDP. Fiscal consolidation will continue in 2023 via limited investment spending and temporary windfall tax revenues. Shrinking nominal financing need and strong nominal GDP growth will help reach the Maastricht deficit criteria by 2024. Expected EU funds inflow will significantly help the budget, especially the sum of €5bn related to the 2014-2020 Cohesion Fund, which is due by mid-2024.

Benchmark policy rate and interest rate corridor

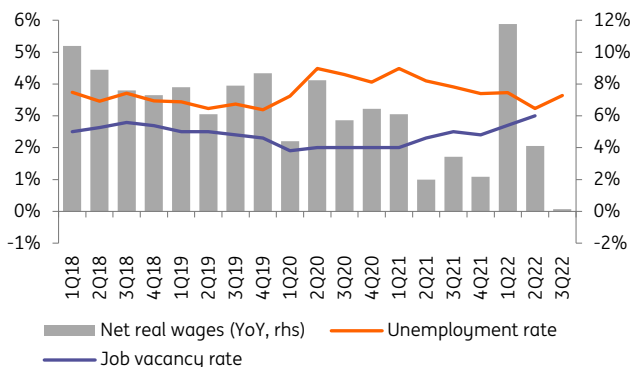


Source: National Bank of Hungary

Central bank keeps its hawkish "whatever it takes" stance

The recent monetary policy setup lies on three pillars. The 13% base rate will remain unchanged for a long period, ensuring structural price stability. In the meantime, monetary tightening will continue with liquidity measures. Roughly half (c.HUF5bn) of the excess liquidity is tied up in long-term facilities like the 2-month deposit and the required reserve. The other half sits in the one-day quick deposit facility at 18% and one-day FX swap facility at 17%, as parts of the third pillar. These are to stabilise financial markets. We see the gradual convergence of the effective (18%) rate to the base rate in parallel with a permanent improvement in both external and internal risks. Timing wise, this means a reversal of the "whatever it takes" hawkish stance might start only in the first quarter of 2023.

Unemployment, job vacancy rate and wage growth

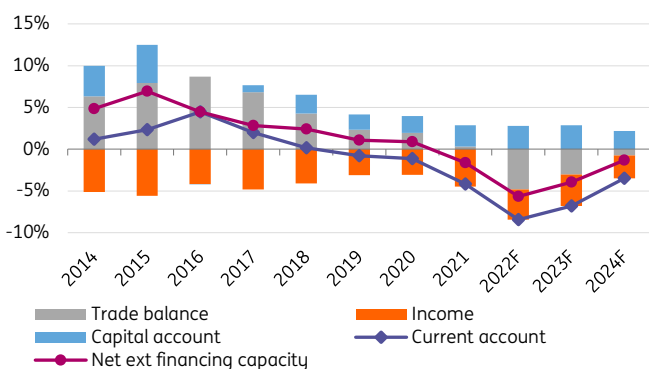


Source: Hungarian Central Statistical Office, ING estimates

Labour market shows resilience under stress

The unemployment rate has started to rise as companies are operating under severe stress. However, the move from a near-record low 3.2% to 3.6% in 3Q22 is nowhere near to a collapse. A high level of orders keeps manufacturers optimistic and in need of labour. By contrast, in the services sector, where energy and labour account for a greater part of costs, companies have reduced working hours, laid off employees or gone out of business. Due to this duality, we expect the unemployment rate to peak at only around 4.5% during mid-2023. With an above 20% inflation, we see tough negotiations between employers and employees about next year's salaries. In our view, real wage growth - reaching practically zero in 3Q - will turn negative and remain so until the end of next year.

Structure of the current account (% of GDP)



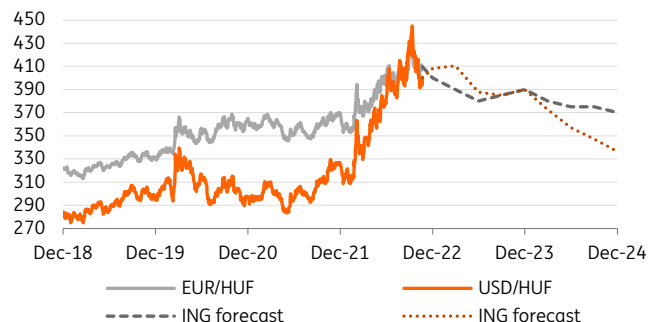
Source: National Bank of Hungary, ING estimates

The worst in current account deficit might soon be over

Due to the energy crisis, Hungary's trade balance of goods has been on a downtrend. But we see light at the end of the tunnel. With the changes in the utility bill support scheme, households have started to be more aware of their energy usage. Companies have spent more on energy efficiency lately. Hungary has already secured its gas supply throughout the winter. This means less pressure on the external balance from an energy import view going forwards. With falling consumption and a reduction in investment activity by households and the public sector, import needs will retreat as well in the coming quarters. However, this improvement comes too late, so we see an 8.4% of GDP deficit in 2022 with a slight improvement in the balance to -6.8% of GDP next year.

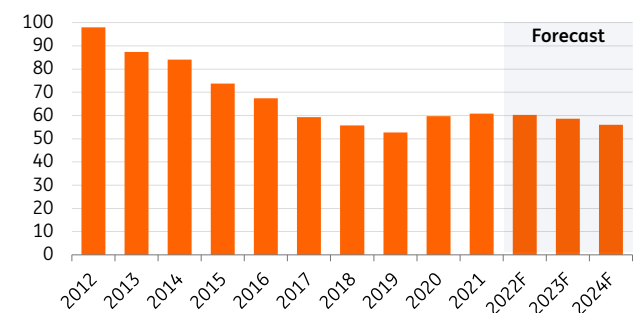
Hungary

FX – spot and INGF



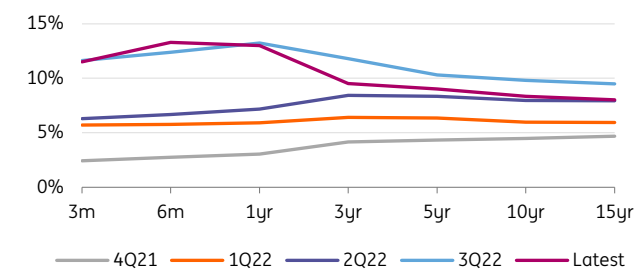
Source: National Bank of Hungary, ING estimates

Evolution of gross external debt (% of GDP)



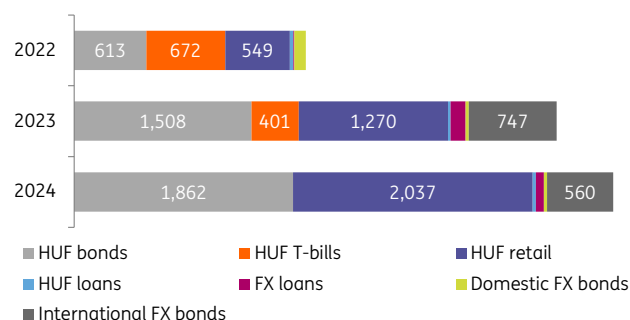
Source: National Bank of Hungary, ING estimates

Local curve (%)



Source: Government Debt Management Agency

Public debt redemption profile (end-Sep 2022, HUFbn)



Source: Government Debt Management Agency

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

When it comes to the Hungarian forint, we believe it is more likely to be moved by non-monetary events and shocks in the short run. The government's conflict with the EU over the rule of law has entirely dominated the market and will remain a major issue at least until the end of this year, in our view. We expect a positive outcome on the rule of law issue and an unlocking of the potential of the forint, which has lost by far the most in the CEE region this year. As some form of positive outcome of this story seems to be priced in already, and also market positioning seems to have flipped to a slightly longer view in recent weeks, in our view, the EU story has become asymmetric for the HUF. So instead of a jump in forint strength, we expect a gradual drift lower below 400 EUR/HUF next year. However, our strong conviction regarding a positive outcome for Hungary makes the forint our currency of choice in the CEE4 space. Moreover, in our view, Poland will take the baton of major market attention from Hungary next year with its ongoing conflict with the EU, looming elections, expansionary fiscal policy and a central bank trying in vain to end the hiking cycle. On the other hand, we believe that the period of emergency NBH meetings is over, that the EU story is coming to an end, fiscal policy is pointing to tangible consolidation and that the current account deficit should come under control.

Fixed income (with Frantisek Taborsky, EMEA FX & FI Strategist)

If the forint remains under control, we see more room for normalisation of the short end of the IRS curve. On the other hand, the long end should decline to a lesser extent also due to the support of core rates, resulting in bull steepening. However, the timing of NBH policy normalisation remains a risk and low liquidity of the market may be painful.

On the HGBs side, we see favourable supply conditions and ASW levels have finally returned to normal territories. The AKK's focus on the long end of the curve and basically zero issuance in the short-end maturity bucket supports our steepening bias. However, we see that the EU story is more about FX trades and the FI market is still struggling. Therefore, we see better value in other countries in the region for now but believe HGB's time will come soon, and we remain constructive in our views.

On the back of a tough year for Hungary's external bonds, we see current valuations as attractive given optimism of some improvement in the key areas of EU funds, fiscal policy, energy issues and the external balance. We think spread levels on the nation's euro-denominated bonds in particular have room to compress versus regional and rating peers. This preference should be supported by expectations that near-term external issuance is likely to be in dollars rather than euros.

Hungary

peter.virovacz@ing.com

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	-1.3	1.8	4.2	3.7	2.2	4.3	5.4	4.9	-4.5	7.1	4.8	0.1	3.3
Private consumption (%YoY)	-2.3	-0.2	2.5	3.7	4.8	4.7	4.8	5.1	-1.3	5.0	7.1	-1.1	2.7
Government consumption (%YoY)	-0.4	5.6	8.9	1.3	0.5	3.8	4.2	9.4	3.9	3.1	1.5	0.3	2.4
Investment (%YoY)	-3.0	9.8	12.2	4.9	-10.6	19.7	16.3	12.8	-7.1	5.2	7.3	4.6	5.6
Industrial production (%YoY)	-1.8	1.1	7.7	7.4	0.9	4.6	3.5	5.6	-6.0	9.5	7.1	4.5	5.8
Unemployment rate (year-end, %)	10.0	8.7	7.4	6.0	4.4	3.7	3.6	2.9	4.1	3.7	4.1	4.0	3.6
Nominal GDP (HUFbn)	28,997	30,352	32,805	34,965	36,207	39,275	43,386	47,665	48,412	55,126	63,953	70,739	75,996
Nominal GDP (€bn)	100	102	106	113	116	127	136	147	138	154	164	182	201
Nominal GDP (US\$bn)	130	136	139	124	129	146	160	164	159	179	169	178	213
GDP per capita (US\$)	12,970	13,715	14,299	12,711	13,109	14,630	16,423	16,784	16,124	18,719	17,420	18,399	22,011
Gross domestic saving (% of GDP)	20.9	24.4	24.6	25.6	26.0	25.1	27.0	27.8	26.2	27.4	24.7	24.3	24.5
Prices													
CPI (average, %YoY)	5.7	1.7	-0.2	-0.1	0.4	2.4	2.8	3.4	3.3	5.1	14.4	16.7	5.6
CPI (year-end, %YoY)	5.0	0.4	-0.9	0.9	1.8	2.1	2.7	4.0	2.7	7.4	23.3	8.3	3.0
Wage rates (nominal, %YoY)	4.6	3.4	3.0	4.3	6.2	12.9	11.3	11.4	9.7	8.7	16.5	9.9	6.5
Fiscal balance (% of GDP)													
Consolidated government balance	-2.5	-2.5	-2.9	-1.9	-1.8	-2.4	-2.1	-2.0	-7.5	-7.1	-5.8	-4.0	-2.9
Consolidated primary balance	2.2	1.9	1.2	1.4	1.3	0.2	0.2	0.2	-5.2	-4.9	-2.9	-1.0	-0.1
Total public debt	78.2	77.2	76.5	75.8	74.9	72.1	69.1	65.3	79.3	76.8	75.4	73.1	71.0
External balance													
Exports (€bn)	80.0	81.3	84.5	90.5	93.0	100.7	104.9	109.1	105.0	119.2	143.1	162.8	177.8
Imports (€bn)	73.3	74.7	78.2	81.9	83.3	92.6	99.3	104.8	99.4	117.6	149.0	167.1	179.7
Trade balance (€bn)	6.7	6.6	6.3	8.6	9.7	8.1	5.5	4.3	5.6	1.6	-6.0	-4.3	-1.9
Trade balance (% of GDP)	6.6	6.4	5.9	7.6	8.4	6.4	4.1	3.0	4.1	1.1	-3.6	-2.4	-1.0
Current account balance (€bn)	1.6	3.6	1.3	2.6	5.2	2.5	0.2	-1.1	-1.6	-6.4	-13.8	-12.4	-7.1
Current account balance (% of GDP)	1.6	3.5	1.2	2.3	4.5	2.0	0.2	-0.8	-1.1	-4.2	-8.4	-6.8	-3.5
Net FDI (€bn)	4.1	2.1	5.1	2.3	3.9	5.1	5.6	3.4	4.8	5.6	2.1	3.8	5.2
Net FDI (% of GDP)	4.1	2.0	4.8	2.0	3.3	4.0	4.1	2.3	3.5	3.6	1.3	2.1	2.6
Current account balance plus FDI (% of GDP)	5.7	5.5	6.0	4.4	7.8	6.0	4.2	1.5	2.3	-0.6	-7.2	-4.7	-0.9
Foreign exchange reserves ex gold (€bn)	31.8	32.6	33.7	30.0	24.0	22.6	25.8	26.5	31.8	30.8	31.3	34.1	37.9
Import cover (months of merchandise imports)	5.2	5.2	5.2	4.4	3.5	2.9	3.1	3.0	3.8	3.1	2.5	2.4	2.5
Debt indicators													
Gross external debt (€bn)	98.2	89.3	89.3	83.2	78.3	75.3	75.9	77.2	82.3	93.5	98.8	106.7	112.5
Gross external debt (% of GDP)	98	87	84	74	67	59	56	53	60	61	60	59	56
Gross external debt (% of exports)	123	110	106	92	84	75	72	71	78	78	69	66	63
Lending to corporates/households (% of GDP)	48.8	44.6	41.1	33.8	32.2	31.3	31.3	32.3	36.1	35.7	32.4	29.7	28.3
Interest & exchange rates													
Central bank key rate (year-end, %)	5.75	3.00	2.10	1.35	0.90	0.90	0.90	0.90	0.60	2.40	13.00	11.25	5.75
Broad money supply (average, %YoY)	-1.3	4.1	4.1	4.7	4.6	9.6	13.9	7.5	14.5	17.4	18.5	17.5	13.3
3m interest rate (Bubor, average, %)	7.00	4.32	2.41	1.61	0.99	0.15	0.12	0.19	0.69	1.46	9.90	13.10	8.20
3m interest rate spread over Euribor(ppt)	647	410	220	162	125	48	44	55	113	201	970	1099	622
3yr yield (average, %)	7.4	4.8	3.5	2.1	1.5	0.9	1.3	0.8	1.0	2.0	8.6	7.6	6.7
10yr yield (average, %)	7.9	5.9	4.8	3.4	3.1	3.0	3.0	2.5	2.2	3.1	7.6	7.5	6.9
USD/HUF exchange rate (year-end)	220.8	216.0	260.3	288.3	295.7	258.3	280.4	294.8	298.9	324.5	408.2	390.0	336.4
USD/HUF exchange rate (average)	222.4	223.7	236.6	282.3	281.6	269.5	270.9	291.1	304.0	308.2	378.9	396.9	356.6
EUR/HUF exchange rate (year-end)	291.3	296.9	314.9	313.1	311.0	310.1	321.5	330.5	365.1	369.0	400.0	390.0	370.0
EUR/HUF exchange rate (average)	289.4	296.9	308.7	309.9	311.5	309.2	318.9	325.4	351.2	358.5	390.3	389.0	378.0

Source: National sources, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	7.4	8.2	6.5	4.0	0.5	-1.0	-1.5	0.3	2.5	3.8	3.9	3.1	2.5
CPI (eop, %YoY)	7.4	8.5	11.7	20.1	23.3	22.5	18.8	11.6	8.3	6.8	6.1	4.6	3.0
Central bank key rate (eop, %)	2.40	4.40	7.75	13.00	13.00	13.00	12.75	12.00	11.25	10.25	8.75	7.25	5.75
3m interest rate (eop, %)	4.21	6.48	8.40	13.30	15.40	14.60	12.75	11.75	11.00	9.75	8.25	6.75	5.25
10yr yield (eop, %)	4.48	5.97	7.96	9.77	8.00	7.80	7.50	7.25	7.05	7.05	7.00	6.80	6.75
USD/HUF exchange rate (eop)	323.7	334.0	378.4	429.9	408.2	410.5	387.8	385.0	390.0	372.5	357.1	350.5	336.4
EUR/HUF exchange rate (eop)	369.0	369.6	396.8	421.4	400.0	390.0	380.0	385.0	390.0	380.0	375.0	375.0	370.0

Source: National sources, ING estimates

Kazakhstan

Dmitry Dolgin, Chief Economist, Russia & CIS

Forecast summary

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	2.8	2.8	3.6	3.8	3.8	2.8	3.8
CPI (%YoY)*	17.7	20.4	17.0	12.8	9.1	14.6	13.4
Policy interest rate (%)	14.50	16.75	16.25	14.25	12.25	16.75	11.75
3m interest rate (%)*	15.50	17.75	17.25	15.25	13.25	15.70	14.60
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT*	476	480	480	470	470	466	474
EUR/KZT*	467	490	470	470	470	480	465

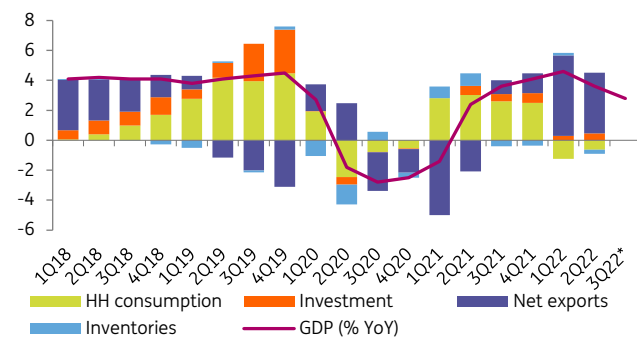
Macro Trend		Political Cycle		Ratings	FC	LC
Activity	+	Presidential: 2029		S&P	BBB-	BBB-
Fiscal	Tighter	Parliamentary: 2023		Moody's	Baa2	Baa2
Monetary	Tighter	Local: n/a		Fitch	BBB	BBB

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

A balancing act/defensive play

Kazakhstan is under pressure from multiple global issues that will constrain economic growth in the near term, including a moderation of the post-Covid recovery, elevated inflation, regional geopolitical challenges and local constraints, such as oilfield maintenance and the need for fiscal consolidation. Meanwhile, higher oil prices are the tactical consolation prize, reinforcing Kazakhstan's finances. Strategically, the country performance could benefit from diversification of trade flows, potentially higher oil output and partial replacement of Russia as a supplier to the EU. Meanwhile, the capital account might benefit if political reform following President Tokayev's re-election leads to an improved business climate outside the oil sector. This should make Kazakhstan's financial instruments a potentially defensive play in the face of volatile global markets.

GDP growth and major contributors (%YoY)

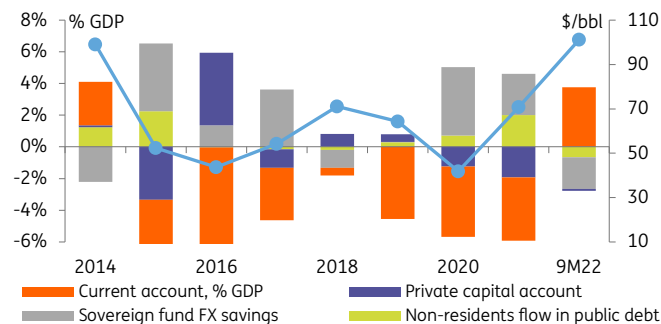


Source: CEIC, ING; *preliminary GDP print

Economic activity challenged by fiscal consolidation

After the recovery of 2021, activity is now moderating due to slowdowns in Russia and China (40% of foreign trade). The oil sector is restrained by maintenance and 85% dependence on Russian transport infrastructure. The non-oil sector is pressured by lower household income and fiscal consolidation. This year's deficit is set to narrow from -4.4% of GDP to -1.4%, in part due to lower expenditure. The process will continue into 2023-25 given the need to reduce oil price breakeven from US\$110-140/bbl in 2021-22 to US\$55-76/bbl in 2023-25. The plan assumes a 3% of GDP increase in non-oil revenues, which may restrain activity. In the longer run, Kazakhstan may benefit from the new geopolitical reality if political reforms lead to economic diversification and better business sentiment.

Balance of payments and oil price

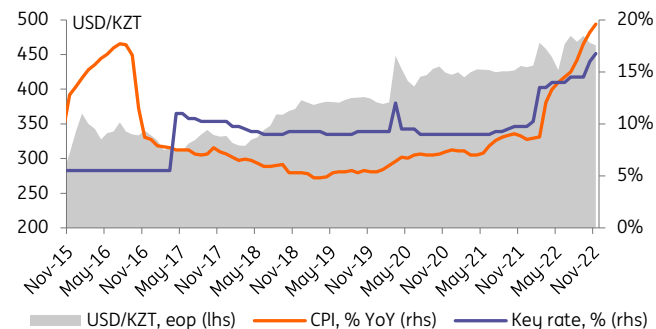


Source: CEIC, ING

Local fundamentals supportive of tenge

2022 has been a successful year for Kazakhstan's external trade as, thanks to high oil prices, exports grew 48% YoY in 9M22, and the current account is US\$7.9bn in surplus vs a US\$5.6bn deficit in 9M21. Oil production of 1.5mbpd is below the OPEC+ quota of 1.6mbpd, and the official target of 1.9-2.0mbpd, suggesting scope for higher exports in 2023. But oilfield maintenance and dependence on Russian pipelines are downside risk factors. The capital flows are so far also favorable for KZT: in 9M22, private outflow narrowed to US\$0.3bn vs US\$3.8bn in 2021, thanks to a recovery in corporate borrowing and state repatriation measures. Assuming continued business-friendly reforms and further diversification of trade, the tenge may show defensive performance in the face of a decline in the global risk appetite.

USD/KZT, CPI and NBK rate (%)



Source: CEIC, Refinitiv, ING

CPI and rates

Kazakhstan is not an exception to the global trend of higher inflationary pressure. Although food inflation appears to be the primary driver, it is enough to provoke higher general inflationary expectations in the economy, forcing the central bank to respond accordingly to CPI being as high as 19.5-21% at year-end, significantly above the target band of 4-6%. In addition, the recent influx of Russian immigrants in 3Q22 seems to have spurred demand and led to another wave of inflation. Relative to expected CPI in 12 months, the current key rate of 16.75% assumes a highly positive real key rate.

Kazakhstan

dmitry.dolgin@ing.de

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	4.8	6.0	4.2	1.2	1.1	4.1	4.1	4.5	-2.5	4.3	2.8	3.8	3.5
Private consumption (%YoY)	10.1	10.6	1.1	1.8	1.2	1.5	6.1	6.1	-3.7	5.1	2.5	3.6	3.4
Government consumption (%YoY)	13.5	1.7	9.8	2.4	2.3	2.1	-14.1	15.5	12.8	-1.1	3.2	2.0	0.0
Investment (%YoY)	4.1	6.9	4.2	3.7	2.0	5.8	17.5	8.8	-3.9	3.7	4.0	3.5	3.0
Industrial production (%YoY)	0.7	2.5	0.3	-1.6	-1.1	7.3	4.4	4.1	-0.5	3.6	2.5	3.5	4.0
Unemployment rate (year-end, %)	5.3	5.2	5.0	5.1	5.0	4.9	4.9	4.8	4.9	4.9	4.8	4.8	4.8
Nominal GDP (KZTbn)	31,015	35,999	39,676	40,884	46,971	54,379	61,820	69,533	70,714	83,952	98,000	115,356	128,390
Nominal GDP (€bn)	162	178	167	166	124	147	152	162	150	168	204	248	251
Nominal GDP (US\$bn)	208	237	221	184	137	167	179	182	171	197	210	243	266
GDP per capita (US\$)	12,417	13,898	12,797	10,493	7,699	9,226	9,790	9,793	9,120	10,308	10,912	12,478	13,480
Gross domestic saving (% of GDP)	43.5	39.9	40.8	34.6	33.8	36.9	39.6	38.6	34.3	39.5	40.2	41.0	41.0
Prices													
CPI (average, %YoY)	5.1	5.8	6.7	6.6	14.7	7.4	6.0	5.2	6.8	8.0	14.6	13.4	7.5
CPI (year-end, %YoY)	6.0	4.8	7.4	13.6	8.5	7.1	5.3	5.4	7.5	8.4	20.4	7.7	7.0
Wage rates (nominal, %YoY)	12.5	7.8	10.9	4.2	13.4	5.5	7.9	14.8	14.0	17.0	19.2	17.4	10.8
Fiscal balance (% of GDP)													
Consolidated government balance	8.3	7.6	6.1	9.6	-4.4	-4.1	2.6	-0.4	-3.7	-4.4	-1.4	1.0	1.1
Consolidated primary balance	8.7	8.1	6.7	10.3	-3.3	-3.2	3.6	0.5	-2.6	-3.1	-0.1	1.6	1.7
Total public debt	12.3	12.3	14.3	22.1	24.3	24.8	24.9	23.7	29.2	27.4	27.0	27.0	27.5
External balance													
Exports (US\$bn)	86	85	79	45	35	47	60	58	48	60	82	84	73
Imports (US\$bn)	47	49	42	34	27	31	35	41	39	41	45	46	44
Trade balance (US\$bn)	40	36	37	11	9	16	25	17	9	19	37	39	29
Trade balance (% of GDP)	19.2	15.2	16.5	5.9	6.5	9.8	13.9	9.4	5.0	9.6	17.6	15.8	11.1
Current account balance (US\$bn)	2	2	6	-7	-8	-6	-1	-8	-8	-8	7	7	-2
Current account balance (% of GDP)	1.1	0.8	2.8	-3.7	-6.2	-3.3	-0.5	-4.6	-4.4	-4.0	3.3	3.1	-0.6
Net FDI (US\$bn)	12	8	5	3	14	4	5	6	6	2	4	5	6
Net FDI (% of GDP)	5.7	3.4	2.1	1.8	10.0	2.3	2.8	3.2	3.4	1.0	1.9	1.8	2.3
Current account balance plus FDI (% of GDP)	6.8	4.2	4.9	-1.9	3.9	-1.1	2.3	-1.3	-1.0	-3.0	5.2	4.9	1.6
Foreign exchange reserves ex gold (US\$bn)	22	19	22	20	20	18	17	10	12	11	13	15	14
Import cover (months of merchandise imports)	6	5	6	7	9	7	6	3	4	3	3	4	4
Debt indicators													
Gross external debt (US\$bn)	137	150	157	153	164	167	160	160	165	165	170	180	190
Gross external debt (% of GDP)	65.8	63.4	71.0	83.0	119.1	100.4	89.4	87.8	96.1	83.6	80.9	74.0	71.3
Gross external debt (% of exports)	158	176	199	341	461	354	268	274	346	273	207	214	259
Lending to corporates/households (% of GDP)	32.1	31.4	30.5	31.0	27.1	24.4	25.5	24.5	26.1	24.0	24.0	24.5	25.0
Interest & exchange rates													
Central bank key rate (year-end, %)	5.50	5.50	5.50	16.00	12.00	10.25	9.25	9.25	9.00	9.75	16.75	11.75	9.25
Broad money supply (average, %YoY)	7.9	10.2	10.4	33.8	15.6	-1.7	7.0	2.4	16.9	20.8	11.0	5.0	5.0
3m interest rate (TONIA, average, %)	2.50	6.50	7.13	10.40	15.50	11.75	10.25	10.20	10.75	8.86	15.70	14.60	11.10
3m interest rate spread over US\$-Euribor (ppt)	191	628	692	1,042	1,576	1,208	1,057	1,056	1,118	941	1,549	1,252	914
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)	151	154	182	339	333	332	384	381	421	435	480	470	490
USD/KZT exchange rate (average)	149	152	179	222	342	326	345	383	413	426	466	474	482
EUR/KZT exchange rate (year-end)	199	211	222	371	352	398	439	427	516	488	490	470	539
EUR/KZT exchange rate (average)	192	202	238	247	378	369	407	429	472	500	480	465	511
Brent oil price (annual average, US\$/bbl)	112	109	99	52	44	54	71	64	42	71	100	104	90

Source: National sources, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	4.1	4.6	3.6	2.8	2.8	3.6	3.8	3.8	3.8	3.8	3.7	3.5	3.4
CPI (eop, %YoY)	8.5	12.1	14.5	17.7	20.4	17.0	12.8	9.1	7.7	7.5	7.7	7.7	7.0
Central bank key rate (eop, %)	9.75	13.50	14.00	14.50	16.75	16.25	14.25	12.25	11.75	10.75	10.75	9.75	9.25
3m interest rate (eop, %)	10.75	14.50	15.00	15.50	17.75	17.25	15.25	13.25	12.75	11.75	11.75	10.75	10.25
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)	435	471	470	476	480	480	470	470	470	480	480	490	490
EUR/KZT exchange rate (eop)	496	523	494	467	490	470	470	470	470	490	504	529	539

Source: National sources, ING estimates

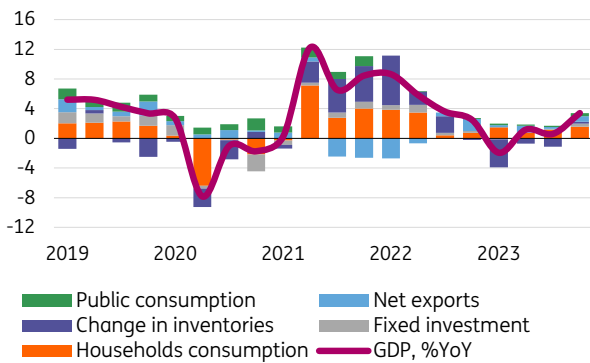
Forecast summary

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	3.6	2.5	-2.0	1.2	1.0	5.0	1.0
CPI (%YoY)*	17.2	17.2	17.9	14.2	11.2	14.3	14.5
Policy interest rate (eop, %)	6.75	6.75	6.75	6.75	6.75	6.75	6.75
3m interest rate (%)*	7.21	7.10	6.91	6.92	6.92	6.48	6.92
10yr yield (%)*	7.13	6.77	6.88	6.89	6.92	6.09	6.88
USD/PLN*	4.97	4.85	5.06	4.84	4.63	4.50	4.83
EUR/PLN*	4.87	4.75	4.81	4.74	4.63	4.69	4.73

Macro Trend	Political Cycle	Ratings	FC	LC
Activity -	Presidential: 2025	S&P	A-	A
Fiscal Loose	Parliamentary: 2023	Moody's	A2	A2
Monetary Neutral	Local: 2023-24	Fitch	A-	A-

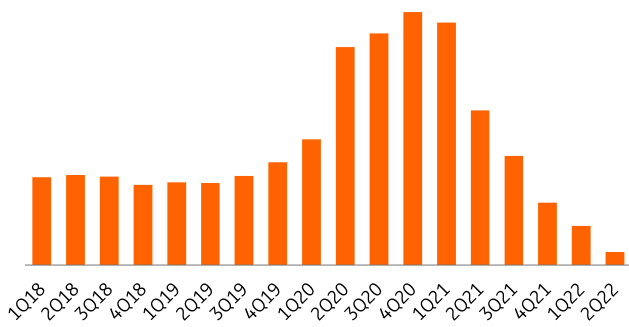
*Quarterly data is eop, annual is avg
Source: National sources, ING estimates

GDP composition (%YoY)



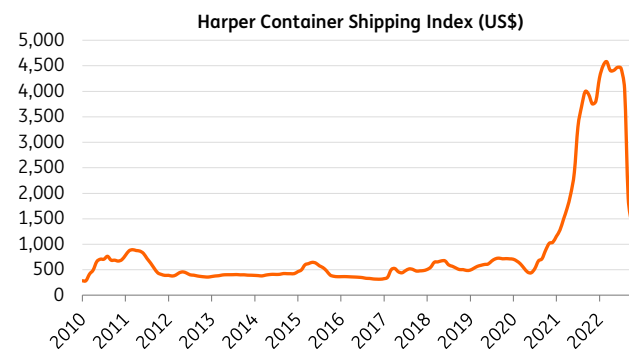
Source: Polish Statistical Office, ING forecast

Household savings rate, last four quarters (%)



Source: Eurostat, ING

Tensions in supply chains subsided in 2022 (US\$)



Source: Macrobond

Proven resilience

Over 2022 the Polish economy has proven its resilience despite the war in Ukraine, the energy shock and global monetary tightening. In 2023 we see a major GDP slowdown, but the main risks are a persistently high core inflation and the government's borrowing needs. In an election year one cannot exclude extra spending. CPI inflation should drop, but persistently high core is a concern as the policy mix is not tight enough to fight it. As such, the risk of renewed asset swap widening is significant in 2023. In late-2022, this is overshadowed by supportive sentiment in core markets and hopes for unlocking access to the EU Recovery Fund.

The zloty is still pricing a premium of around 3% for 'political' factors, ie, the war with Ukraine or tense relations with the EU. While it is hard to predict those fading in 2023, fundamentals behind the zloty should improve. The lower C/A deficit and inflow of foreign funding should help to stabilise PLN in 2023.

Macro digest

A post-pandemic recovery in the services sector given the release of pent-up demand and solid performance of industry that benefitted from normalising supply chains resulted in robust economic growth in 2022. Even war in Ukraine, which led to unprecedented uncertainty in both households and enterprise sectors, has not derailed 2022 GDP. A substantial part of GDP growth in 1H22 was linked to re-stocking. At the same time, household consumption was supported by a 3% fiscal impulse, demand from refugees and a decline in the savings rate. But elevated inflation has started biting into real disposable incomes in 2H22. Buoyant activity in 1H22 should translate into 2022 GDP growth around 5.0%, after a hefty 6.8% posted in 2021.

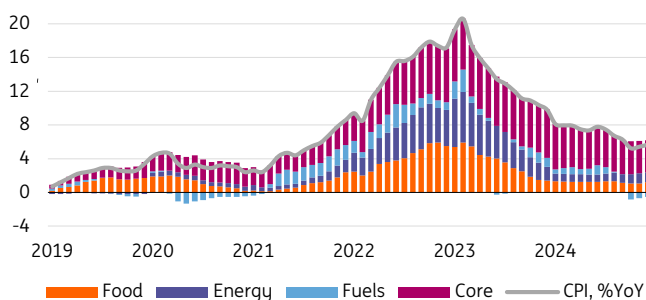
The economic outlook for upcoming quarters and 2023 as a whole appears rather weak. Deteriorating external demand (possible recession in Germany) and tighter financial conditions both in Poland and abroad (high interest rates) create an unfavourable environment for economic expansion and could negatively impact private investment. Ongoing tensions between Warsaw and Brussels on the rule of law froze funds from the Recovery Fund and, despite signs of willingness to compromise, the flow of EU money may not be unlocked before the Autumn 2023 general election, or the flows may be low. This may potentially hamper public investment as high social spending and sizable borrowing needs could force authorities to seek fiscal savings. Household consumption growth is expected to slow as consumers will be under pressure from rising prices and declining real disposable incomes. The result will be a slowdown of GDP growth, to 1.0% in 2022, with softer growth of consumption and fixed investments. Inventory cycle turnaround will weigh on activity as well next year. At the same time, net exports should positively contribute to economic growth amid weaker imports.

Persistently high inflation will probably remain a number one economic problem in 2023 as well. Even a negative output gap is unlikely to be enough to contain strong second round effects, in our view. With real interest rates remaining negative, credit holidays and the MPC choosing to refrain from further policy tightening, the core inflation should entrench at a high level in the coming quarters. At the same time, scope for fiscal measures to cushion the hardship of high inflation for households and businesses is narrower than in 2022. Still, Poland has sound credit, given low public debt by European standards, however authorities should note an upswing in interest on debt that may become more painful when GDP and inflation slow from current high levels.

Poland

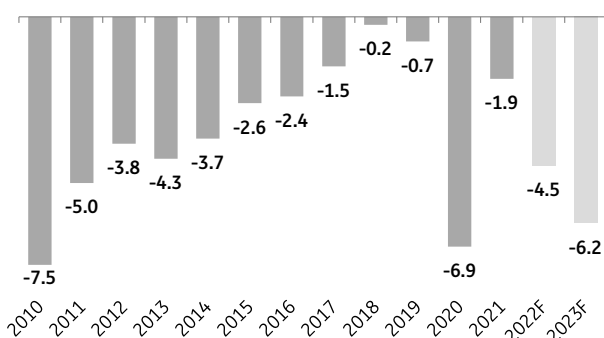
rafal.benecki@ing.pl

CPI inflation and its composition (% , percentage points)



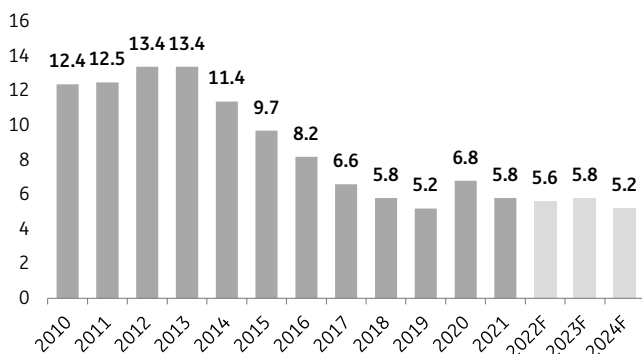
Source: Polish Statistical Office, ING forecast

General government balance (% of GDP)



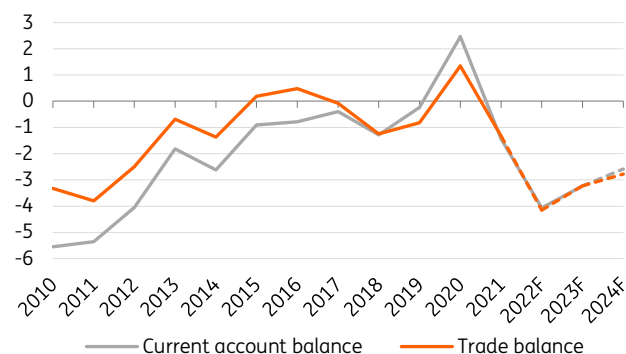
Source: Eurostat, ING forecast

Registered unemployment in Poland (% of labour force)



Source: Polish Statistical Office, ING forecast

Current account and trade balance (% of GDP)



Source: NBP, ING forecast

Rates to remain stable despite persistently high inflation

We expect CPI to peak above 20% YoY in February 2023, then slow to c.10% in 4Q23, but the majority of that is due to base effects in food and fuel, while core inflation should remain persistently elevated above 10%YoY in 2023. The negative output gap may not be enough to significantly contain second round effects. Also, a high countercyclical rise in the minimum wage of 19.6% should add to core CPI. We see a high overhang of energy costs, hidden in the election year, to resurface in 2024. Also, in our view, the NBP's projection is too optimistic on energy commodities for 2023-24. The MPC effectively ended the tightening cycle. We see a strong discrepancy between the de jure CPI target (2.5%+/-1%) and de facto target (slow disinflation, economic soft landing). We see risk of new NBP tightening in 2023-24, as CPI should stay above target.

Risk of fiscal expansion in an election year

Although solid activity and high inflation translated into buoyant tax revenues, fiscal deficit is projected to widen in 2022 as a result of high social spending and cuts in both direct (PIT) and indirect taxes (lower VAT on energy, fuel and food to soften energy shock).

The general government deficit is projected to widen further from around 4.5% of GDP in 2022 to 6.2% of GDP despite abandoning temporary cuts in VAT and excise duty on electricity, natural gas and petrol. Higher military spending will be accompanied by generous social outlays. The technocrats proposed some spending cuts in 2023, but risk of new outlays ahead of the Autumn 2023 general election is still elevated.

Slowdown is not an imminent threat to labour market

Labour market conditions remain tight in 2022. The economy easily absorbed an additional 400k immigrant/refugee workers from Ukraine, as shortages of labour remain one of the key problems for business expansion in Poland. The activity rate of refugees has been high even though the structure of refugees was dominated by females and their children.

With labour scarcity, companies are likely to hoard labour. Despite economic slowdown, unemployment should remain low. Companies prefer the adjustment of costs via a decline in real wages, however, this may prove difficult in 2023 due to the planned high increase in the minimum wage of 19.6%, so wage dynamics should remain elevated despite a recession scenario causing high core inflation.

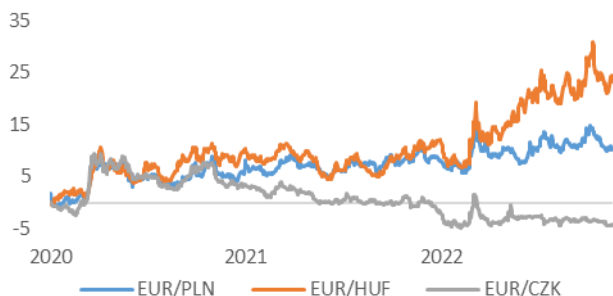
External imbalance to moderate

The current account turned from a 2.5% of GDP surplus in 2021 to a substantial deficit of 4.1% of GDP in 2022 to date as terms of trade deteriorated markedly as a result of soaring prices of imported energy following Russia's invasion of Ukraine.

In 2023, the trade gap should narrow from around 4.2% of GDP to 3.2% of GDP as Polish exports are usually resilient to economic slowdown, while imports are more sensitive to a deterioration in economic conditions. Terms of trade are likely to stabilise, and energy imports likely to remain at elevated levels. At the same time, high spending on military equipment will push imports up.

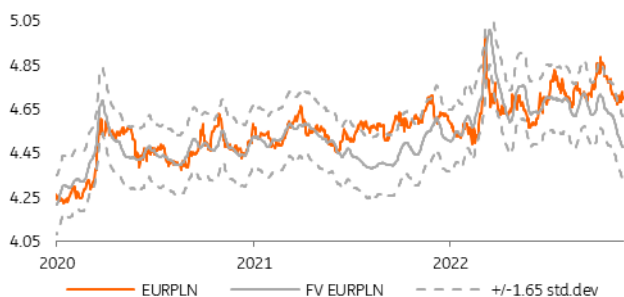
Poland

CEE FX performance since 2020 (%)



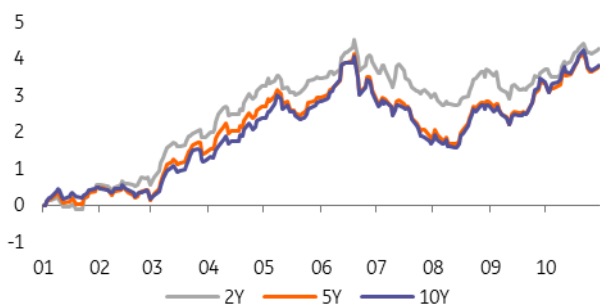
An increase represents depreciation of CEE currency
Source: Macrobond

€/PLN – ING's long-term equilibrium model since 2020



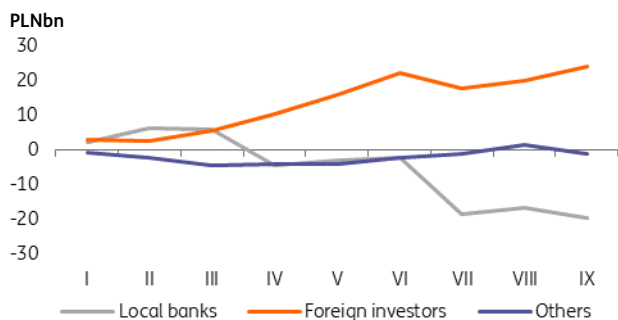
Source: Macrobond, ING estimates

The 2-, 5- and 10-year yields in 2022 (%)



Source: Macrobond

Structure of POLGBs holders; change since January 2022



Source: MinFin

FX

Our long-term equilibrium €/PLN model (gauging €/PLN against other market variables) continues to suggest that the zloty is still some 3% undervalued against the euro. We attribute this to a mix of risks, both external, particularly the conflict in Ukraine, and internal, particularly tensions with the EU, elevated CPI risk and expansionary fiscal policy undermining POLGBs. Many analysts suggest a renewed Russian offensive in Spring. If Russia simultaneously attempts to put economic pressure on EU, this could again sour the CEE sentiment.

Fundamental backing behind the zloty should improve next year, but local policy risk will rise. We expect the C/A deficit to tighten, owing to, eg, more favourable terms on trade. Poland is also likely to draw some €20bn from the 'old' EU budget. Moreover, the government decided to lean towards hard currency funding. All these are likely to be converted via the market under the current MoF FX strategy. Also, FDI inflow should remain solid, already at net €16bn in 1H22. 4Q23 may prove more difficult, as refilling natural gas reserves may again prove costly.

Domestic politics is a major unknown. The proximity of October elections is a key risk for fiscal consolidation for 2023. The government is attempting to reset relations with the EU, possibly encouraged by Hungary's pro-EU turn. While reaching an actual compromise will take time (and may prove impossible ahead of the general elections), it is likely to improve Poland's market perception. Moreover, opinion polls show increasing support for EU-oriented opposition, which the markets find supportive for PLN.

Fixed income

In general, election year (2023) government borrowing needs are a major risk. We forecast the general government deficit will jump from 4.5% to 6.2% of GDP. We estimate total 2023 borrowing needs at PLN190bn (including agency debt, foreign funding, etc). This will include social programmes, military spending, prefinancing EU-backed projects, etc. Moreover, weakening domestic activity (particularly household consumption) suggests risks of even higher borrowing needs due to a potentially softer tax base.

Based on our estimates, local buyers, mostly banks, should purchase PLN80-90bn net next year. This stems from continued lacklustre demand for credits (particularly mortgages), while deposit growth recovers. The Ministry of Finance may also reduce its high cash buffer (currently at PLN128bn) by PLN30-40bn. The rest should be covered by foreigners, either in PLN or hard currency.

The government has already tapped the US\$ market. Moreover, government foreign purchases (eg, of military equipment) may offer additional funding sources from sellers. As such, despite the very large headline number, covering 2023 borrowing needs is manageable unless the government decides on last minute spending ahead of the 2023 elections. Asset swap widening on the long end is a major risk though. We are also yet to see if the 2023 MoF issuance policy will limit the relatively high bond market volatility we have seen this year.

Poland

rafal.benecki@ing.pl

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	1.5	0.9	3.8	4.4	3.0	5.1	5.9	4.4	-2.0	6.8	5.0	1.0	2.5
Private consumption (%YoY)	0.9	0.0	3.4	3.8	3.6	6.3	4.4	3.5	-3.6	6.3	3.8	1.8	1.0
Government consumption (%YoY)	-0.3	2.4	4.0	2.4	2.0	2.7	3.5	6.5	4.9	5.0	0.4	1.3	1.5
Investment (%YoY)	-2.0	0.3	11.7	6.9	-7.6	1.6	112.6	6.2	-2.3	2.1	3.1	0.5	2.1
Industrial production (%YoY)	1.4	2.4	3.5	4.8	2.9	6.5	6.0	4.3	-1.0	15.3	10.5	2.1	5.0
Unemployment rate (year-end, %)	13.4	13.4	11.4	9.7	8.2	6.6	5.8	5.2	6.8	5.8	5.6	5.8	5.2
Nominal GDP (PLNbn)	1,613	1,630	1,7001	1,799	1,853	1,983	2,127	2,289	2,338	2,624	3,050	3,431	3,725
Nominal GDP (€bn)	385	388	406	430	425	466	499	532	526	574	648	723	769
Nominal GDP (US\$bn)	495	516	539	477	470	525	589	596	600	679	672	708	811
GDP per capita (US\$)	12,850	13,395	14,005	12,405	12,231	13,661	15,320	15,528	15,631	17,800	17,155	17,906	20,540
Gross domestic saving (% of GDP)	20.3	20.5	21.4	23.1	23.2	22.9	23.5	24.2	24.4	24.9	23.9	21.6	21.5
Prices													
CPI (average, %YoY)	3.7	0.9	0.0	-0.9	-0.6	2.0	1.6	2.3	3.4	5.1	14.3	14.5	7.5
CPI (year-end, %YoY)	2.4	0.7	-1.0	-0.5	0.8	2.1	1.1	3.4	2.4	8.6	17.2	10.4	6.6
Wage rates (nominal, %YoY)	3.5	2.6	3.8	3.5	4.1	5.6	7.1	6.6	4.8	8.6	12.6	10.8	7.5
Fiscal balance (% of GDP)													
Consolidated government balance	-3.8	-4.3	-3.7	-2.6	-2.4	-1.5	-0.2	-0.7	-6.9	-1.9	-4.5	-6.2	-4.5
Consolidated primary balance	-1.1	-1.7	-1.7	-0.8	-0.7	0.1	1.2	0.6	-5.6	-0.8	-3.0	-4.3	-2.5
Total public debt	54.5	56.9	51.3	51.3	54.5	50.8	48.7	45.7	57.1	53.8	51.5	53.5	55.2
External balance													
Exports (€bn)	140.5	147.5	157.0	171.4	177.5	202.0	217.0	220.3	220.6	263.6	322.1	326.6	342.6
Imports (€bn)	150.1	150.2	162.6	170.6	175.5	202.4	223.3	224.7	213.6	271.2	348.9	349.9	365.3
Trade balance (€bn)	-9.7	-2.7	-5.6	0.8	2.0	-0.4	-6.2	-4.4	7.0	-7.6	-26.8	-23.2	-22.6
Trade balance (% of GDP)	-2.5	-0.7	-1.4	0.2	0.5	-0.1	-1.2	-0.8	1.3	-1.3	-4.1	-3.2	-2.9
Current account balance (€bn)	-15.7	-7.1	-10.7	-3.9	-3.4	-1.8	-6.4	-1.2	12.9	-8.3	-26.2	-23.3	-21.0
Current account balance (% of GDP)	-4.0	-1.8	-2.6	-0.9	-0.8	-0.4	-1.3	-0.2	2.4	-1.4	-4.0	-3.2	-2.7
Net FDI (€bn)	4.4	3.1	10.3	9.5	3.3	7.0	14.2	10.9	12.5	23.4	25.7	18.0	20.0
Net FDI (% of GDP)	1.1	0.8	2.5	2.2	0.8	1.5	2.8	2.0	2.4	4.1	4.0	2.5	2.6
Current account balance plus FDI (% of GDP)	-2.9	-1.0	-0.1	1.3	0.0	1.1	1.6	1.8	4.8	2.6	-0.1	-0.7	-0.1
Foreign exchange reserves (€bn)	82.5	77.0	82.7	87.2	108.5	94.5	102.2	114.3	125.7	146.6	155.1	157.1	159.6
Import cover (months of merchandise imports)	6.6	6.2	6.1	6.1	7.4	5.6	5.5	6.1	7.1	6.5	5.3	5.4	5.2
Debt indicators													
Gross external debt (€bn)	280.0	279.5	293.9	304.0	321.4	319.8	317.3	316.7	307.4	322.7	335.0	348.6	361.6
Gross external debt (% of GDP)	72.2	71.2	71.9	70.6	75.2	68.4	63.7	59.5	58.4	56.2	51.7	48.2	47.0
Gross external debt (% of exports)	199	190	187	177	181	158	146	144	139	122	104	107	106
Lending to corporates & households (% of GDP)	53.7	54.9	56.3	57.2	57.8	56.0	56.5	54.9	54.3	52.3	49.1	47.5	48.1
Interest & exchange rates													
Central bank key rate (year-end, %)	4.25	2.50	2.00	1.50	1.50	1.50	1.50	1.50	0.10	1.75	6.75	6.75	6.75
Broad money supply (average, %YoY)	9.5	6.2	6.4	8.3	10.2	6.1	7.0	9.5	14.8	10.8	7.5	10.0	7.0
3m interest rate (WIBOR, average, %)	4.91	3.02	2.51	1.75	1.70	1.73	1.71	1.72	0.66	0.55	6.48	6.92	6.89
3m interest rate spread over EURIBOR (ppt)	438	280	230	176	196	206	203	208	110	110	628	481	491
2yr yield (average, %)	4.34	3.01	2.48	1.73	1.66	1.89	1.59	1.57	0.53	0.83	6.32	7.27	7.16
10yr yield (average, %)	5.04	4.05	3.52	2.71	3.05	3.44	3.22	2.38	1.52	1.95	6.09	6.88	6.93
USD/PLN exchange rate (year-end)	3.10	3.02	3.52	3.92	4.20	3.47	3.75	3.80	3.77	4.05	4.85	4.72	4.12
USD/PLN exchange rate (average)	3.22	3.16	3.21	3.81	3.94	3.71	3.62	3.85	3.84	3.93	4.50	4.83	4.36
EUR/PLN exchange rate (year-end)	4.09	4.15	4.26	4.26	4.42	4.17	4.30	4.26	4.61	4.60	4.75	4.72	4.53
EUR/PLN exchange rate (average)	4.19	4.20	4.19	4.18	4.36	4.26	4.26	4.30	4.44	4.57	4.69	4.73	4.60

Source: National sources, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	8.5	8.6	5.8	3.6	2.5	-2.0	1.2	1.0	3.4	2.5	2.5	2.6	2.4
CPI (eop, %YoY)	8.6	11.0	15.5	17.2	17.2	17.9	14.2	12.0	10.4	8.6	7.8	6.9	6.6
Central bank key rate (eop, %)	1.75	3.50	6.00	6.75	6.75	6.75	6.75	6.75	6.75	6.75	6.75	6.75	6.75
3m interest rate (eop, %)	2.54	4.77	7.05	7.21	7.00	6.91	6.92	6.92	6.92	6.91	6.91	6.91	6.83
10yr yield (eop, %)	3.64	5.23	6.92	7.13	6.77	6.88	6.89	6.92	6.99	6.99	6.97	6.89	6.75
USD/PLN exchange rate (eop)	4.04	4.20	4.46	4.97	4.85	5.06	4.84	4.63	4.72	4.55	4.37	4.22	4.12
EUR/PLN exchange rate (eop)	4.60	4.65	4.68	4.87	4.75	4.81	4.74	4.63	4.72	4.66	4.59	4.54	4.53

Source: National sources, ING estimates

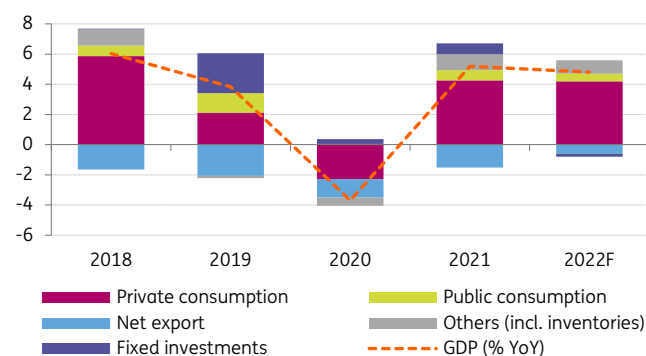
Forecast summary

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	4.0	4.2	2.7	1.8	1.0	4.8	1.8
CPI (%YoY)*	15.9	16.3	13.8	10.6	9.4	13.7	11.0
Policy interest rate (eop, %)	5.50	6.75	6.75	6.75	6.75	6.75	6.50
3m interest rate (%)*	7.93	7.75	7.75	7.55	7.45	6.10	7.40
10yr yield (%)*	8.70	8.00	8.10	7.90	7.80	7.60	7.90
USD/RON*	5.05	5.04	5.21	5.20	5.10	4.81	5.08
EUR/RON*	4.95	4.94	4.95	5.10	5.10	4.95	4.98

Macro Trend		Political Cycle		Ratings	FC	LC
Activity	⊖	Presidential: 2024		S&P	BBB-	BBB-
Fiscal	Loose	Parliamentary: 2024		Moody's	Baa3	Baa3
Monetary	Loose	Local: 2024		Fitch	BBB-	BBB-

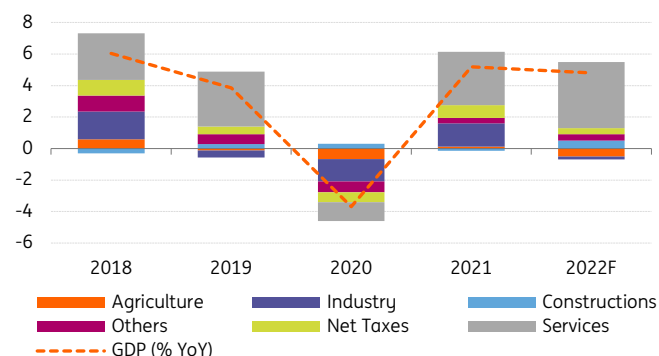
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

GDP (YoY%) and components (ppt)



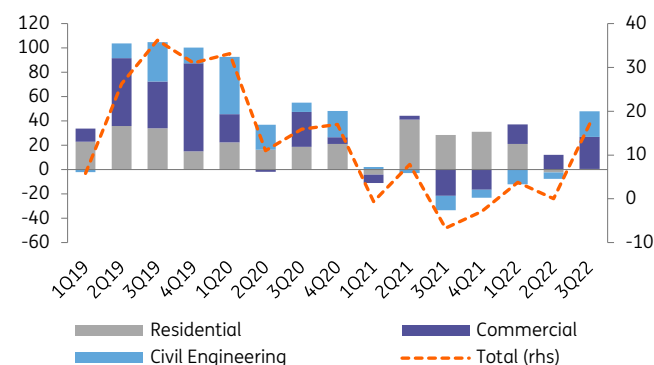
Source: NIS, ING

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



Source: NIS, ING

Construction sector holding on (YoY% growth)



Source: NIS, ING

Unsettling calm

This year could go down in Romania's history as one in which domestic factors have swirled the waters to the least extent in recent times. The economy grew largely at potential (though data revisions increasingly upset us), inflation inched above expectations but is the lowest in the CEE4 space and, most unusually by local standards, there was very little political noise. However, the elephant (ie, twin deficits) is still in the room. While the 2022 budget deficit will close within the 5.74% of GDP target, the 18-19% nominal GDP growth achieved should have permitted a much better performance. In this context, reaching a budget deficit of 3.0% of GDP in 2024 (electoral year) looks incredibly challenging. Meanwhile, the current account gap won't stop widening, driven chiefly by a gushing trade deficit.

Marred by data revisions

Despite some encouraging signs from the eurozone recently (link [here](#) and [here](#)) the environment remains clearly recessionary, with most, if not all, estimates pointing to a GDP contraction in 2023. We believe that Romania's capacity to fend-off the damaging impact of these external developments is limited. Further muddling our estimations for 2023 and beyond was a significant GDP data revision from the local statistics, which has revised 1Q22 quarterly growth down from 5.3% to 1.5% (!) and 2Q22 growth from 1.8% to 1.3%. This has led us to revise the 2022 growth from 6.6% to 4.8% without changing any assumptions for the last quarter.

High-frequency data suggests that 4Q22 might create a stronger positive carry-over into 2023, making our 1.8% GDP estimate for next year a touch on the bearish side. While we do not expect a technical recession, we think that the real negative wage growth from 2022 will start to be more visible in 2023's private consumption levels which, in turn, could put the service sector on hold for a couple of quarters. Possibly coming to offset the private sector slowdown should be public investments. These are, however, very much dependent on EU funds absorption and, by extension, on the administrative capacity to absorb them. We remain mildly optimistic that Romania will stay on track with the RRP implementation, albeit delays are almost a given.

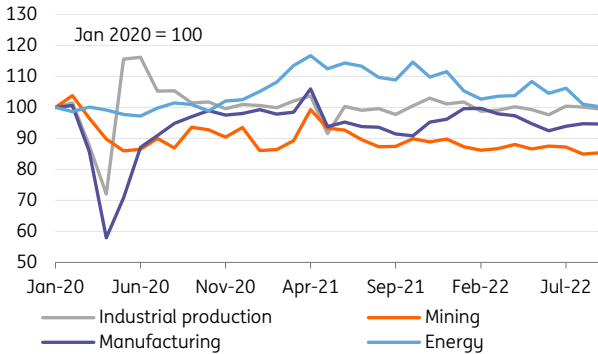
On the monetary policy front, having reached a key rate of 6.75% in November, the NBR is either at or very close to the end of the hiking cycle. We narrowly favour no more hikes in 2023, though we admit that chances are high for another 25bp increase in January. Maybe more importantly, NBR's commitment to firm liquidity management seems to be under question given the relatively low carry rates seen into this year end. This relates to the liquidity situation that is likely to have improved substantially in November and should continue to do so in December, on the back of accelerated spending by the Treasury. Mopping up this liquidity is likely to take a good couple of months, as the NBR seems to prefer absorption via FX interventions rather than deposit auctions.

The relatively uneventful political scene in 2022 has been rather remarkable after years of political turmoil. As per the current coalition agreement, the PNL prime minister will resign in May 2023 and a PSD prime minister should be voted by the same coalition. While there are no real signs to spell trouble currently, the perspective of the very important 2024 electoral year makes it somewhat hard to picture a completely serene change of power in May-June 2023.

Romania

valentin.tataru@ing.com

Industry still below pre-pandemic levels

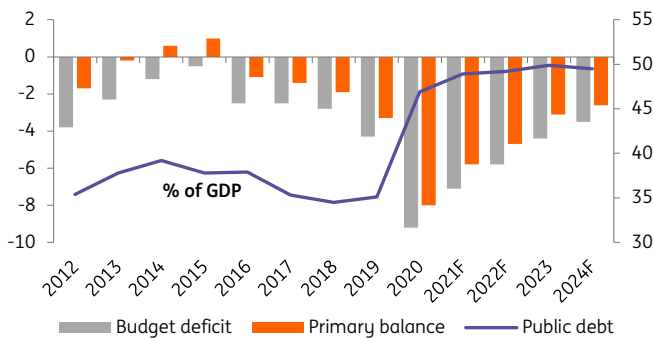


Source: NBR, ING

Resuming a longer-term downside trend

Industrial production is likely to close 2022 in contraction territory, continuing its longer-term weakening trend that started well before the pandemic. By subsector, the main areas under pressure are the chemical industry (affected by closures due to high energy prices), furniture and related wood products (due to issues in securing raw materials), metallurgy and, somewhat surprisingly, the automotive industry, which, despite some robust gains in recent months, is still some 3.0% below 2021 levels (January-September data). Limited advances in the food, textile and pharma industries couldn't offset the overall weakening trend. The latest data points to deteriorating confidence in manufacturing, on lower order books, and production outlook surpassing the small decrease in inventories.

Fiscal picture should improve gradually

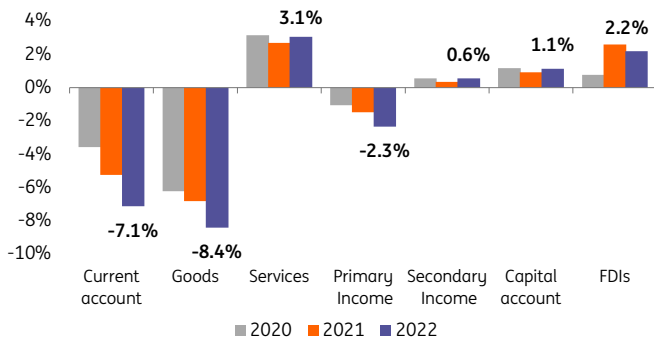


Source: Eurostat, ING

What was easier is now behind

The 3.37% of GDP budget deficit reached by October increased expectations for a better-than-expected budget execution. Yet, despite a stellar nominal GDP growth that boosted revenues, the policymakers seem committed to spend in line with the 5.7% official target, meaning that in November and December some 2.3-2.4% of GDP (approximately RON33bn) will be injected. Under the current agreement with the EU, the next milestone will be a 4.4% of GDP budget gap in 2023 and the long awaited 3.0% in 2024. While the downward trend of the budget deficit is likely to persist, it will be very difficult to reach the target in 2024 considering that nominal GDP growth in 2023 and 2024 will not get even close to this year's c.18% and the approaching electoral season.

Current account deficit increase (% of GDP, Jan-Sep 2022)

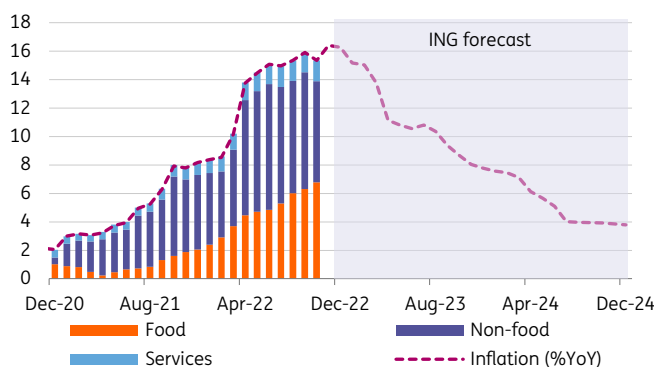


Source: NBR, ING

Widening no matter what

While on the budget deficit side the policymakers seem committed to reach 3.00% of GDP in 2024, the developments on the current account side are worrying to say the least. Due to unfavourable terms of trade dynamics (especially in the energy sector) but also on the back of robust GDP growth in 1H22, the trade balance deficit could flirt with levels last touched in 2008 when it surpassed 16.0% of GDP. This represents a significant structural weakness and will be the main driver behind a C/A deficit of around 9.0% in 2022. Strong EU funds absorption will be key to balance this unstable picture, but this can hold only so much. Sooner or later a C/A correction will be needed. Absent a functional exchange rate valve, rather painful internal devaluations might come by themselves.

Inflation (YoY%) and main components (ppt)



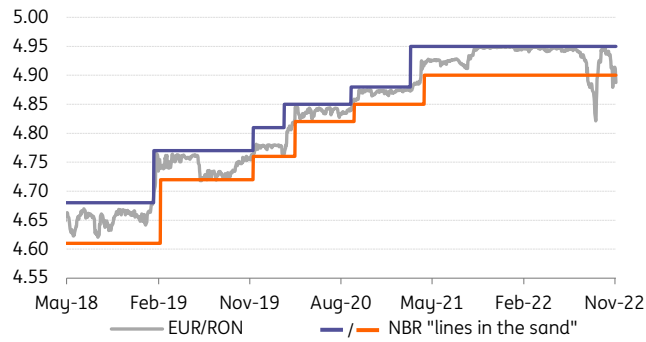
Source: NIS, ING

Inching lower but not back on target any time soon

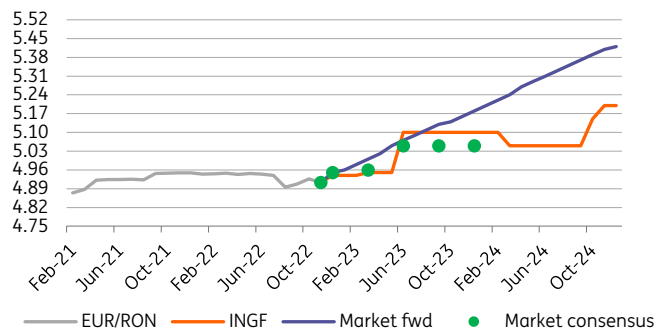
We have attempted to call the inflation peak already twice this year, but we now have a stronger reason than ever to believe that November-December will mark the summit at around 16.3%: there are no more months left in the year to see higher prints. 1Q23 could still see inflation in the 15% area, but we believe that strong base effects and economic deceleration will make it very difficult for inflation to return. We estimate Dec-2023 inflation at 7.8%. Notably, we do not see inflation within the NBR's 1.5-3.5% target range in the following two years, though in 2H24 it should get very close to the upper bound. All things considered, the current inflation profile would justify no more rate hikes from the NBR, though another 25bp hike to 7.00% in January is still a strong option.

Romania

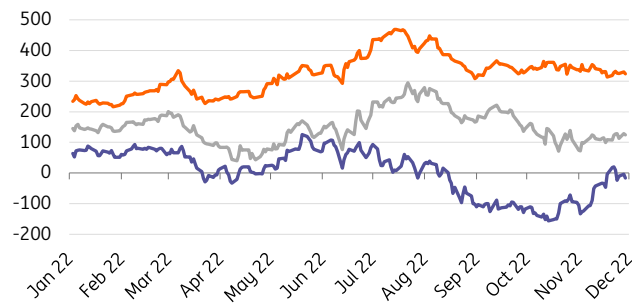
Veritable managed floating



FX – spot vs forward and INGF



10y ROMGBs spreads vs CEE3 (bp)



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

Given the ever-higher inflation and a retail propensity to switch into euro whenever the geo-politics goes sour, the NBR did not have much of a choice in 2022 but to keep the EUR/RON as stable as ever. This was done through a combination of FX interventions and high carry rates via a firm liquidity management which essentially meant that the NBR became a net creditor to the banking system. The episodic leu strengthening from August-September was marked by one-off inflows and subsequent developments proved that a prolonged appreciation cannot be sustained. As long as EU funds keep pouring in, we believe that the NBR has the means and the will to keep the pair stable. We think that stability could be maintained at least through the winter. Afterwards, a marginal upward adjustment above the 5.00 level could be allowed only if several conditions are met: global risk-off fades, inflation is credibly on a downwards path, the economy is growing, and the population's behaviour normalises.

The NBR has shown a strong commitment to keeping FX under control.

Romania

valentin.tataru@ing.com

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	1.9	0.2	4.1	3.2	2.9	8.2	6.0	3.8	-3.7	5.2	4.8	1.8	3.7
Private consumption (%YoY)	1.6	-3.3	3.5	5.8	6.6	11.6	9.3	3.2	-3.7	7.0	7.0	1.2	4.8
Government consumption (%YoY)	15.6	-4.2	11.8	-9.0	10.1	-1.9	8.6	8.6	2.5	15.5	-1.0	7.7	2.0
Investment (%YoY)	3.0	-5.5	5.3	7.5	-2.0	5.4	0.2	12.4	1.4	3.0	3.3	6.2	4.8
Industrial production (%YoY)	3.0	7.7	6.2	2.7	3.1	8.6	5.0	-3.6	-9.5	7.4	-2.1	2.9	2.1
Unemployment rate (year-end, %)	8.8	9.0	8.3	8.1	6.7	5.7	4.9	5.0	6.3	5.7	5.4	5.1	4.8
Nominal GDP (RONbn)	621	632	669	713	752	852	959	1064	1067	1182	1400	1578	1704
Nominal GDP (€bn)	139	143	150	160	167	186	206	224	221	240	280	306	326
Nominal GDP (US\$bn)	181	190	196	176	185	214	243	251	251	279	288	300	346
GDP per capita (US\$)	9,100	9,500	9,900	8,900	9,500	11,000	12,500	13,000	13,100	14,500	15,100	16,000	18,400
Gross domestic saving (% of GDP)	21.5	24.4	24.6	24.7	22.7	21.4	20.0	20.2	20.2	20.2	20.7	20.6	20.8
Prices													
CPI (average, %YoY)	3.3	4.0	1.1	-0.6	-1.6	1.3	4.6	3.8	2.6	5.1	13.7	11.0	5.2
CPI (year-end, %YoY)	5.0	1.6	0.8	-0.9	-0.5	3.3	3.3	4.0	2.1	8.2	16.3	7.8	3.8
Wage rates (nominal, %YoY)	4.9	4.8	5.2	8.3	13.0	14.2	13.1	14.9	6.7	7.1	11.6	10.0	8.0
Fiscal balance (% of GDP)													
Consolidated government balance	-3.8	-2.3	-1.2	-0.5	-2.5	-2.5	-2.8	-4.3	-9.2	-7.1	-5.8	-4.4	-3.5
Consolidated primary balance	-1.7	-0.2	0.6	1.0	-1.1	-1.4	-1.9	-3.3	-8.0	-5.8	-4.7	-3.1	-2.6
Total public debt	35.4	37.8	39.2	37.8	37.9	35.3	34.5	35.1	46.9	48.9	49.2	49.9	49.5
External balance													
Exports (€bn)	45.0	49.6	52.5	54.6	57.4	62.6	67.4	68.7	61.8	73.9	91.0	100.5	107.8
Imports (€bn)	54.6	55.3	58.6	63.0	67.4	75.6	82.8	86.3	80.5	98.4	123.9	137.5	148.6
Trade balance (€bn)	-9.6	-5.7	-6.1	-8.4	-10.0	-13.0	-15.4	-17.6	-18.7	-24.5	-32.9	-37.0	-40.8
Trade balance (% of GDP)	-6.9	-4.0	-4.1	-5.2	-6.0	-7.0	-7.5	-7.9	-8.5	-10.2	-11.6	-11.7	-12.3
Current account balance (€bn)	-6.6	-1.4	-0.4	-1.3	-2.7	-5.8	-9.5	-10.9	-10.9	-17.5	-25.1	-26.0	-26.5
Current account balance (% of GDP)	-4.7	-1.0	-0.3	-0.8	-1.6	-3.1	-4.6	-4.9	-4.9	-7.3	-8.9	-8.2	-8.0
Net FDI (€bn)	2.1	2.9	2.7	2.9	4.8	4.8	4.9	4.8	2.9	8.8	7.3	5.4	7.6
Net FDI (% of GDP)	1.5	2.0	1.8	1.8	2.9	2.6	2.4	2.1	1.3	3.7	2.6	1.7	2.3
Current account balance plus FDI (% of GDP)	-3.2	1.0	1.5	1.0	1.3	-0.5	-2.2	-2.7	-3.6	-3.6	-6.3	-6.5	-5.7
Foreign exchange reserves ex gold (€bn)	31.2	32.5	32.2	32.2	34.2	33.5	33.1	32.9	37.4	40.5	46.3	48.1	49.5
Import cover (months of merchandise imports)	6.9	7.1	6.6	6.1	6.1	5.3	4.8	4.6	5.6	4.9	4.5	4.2	4.0
Debt indicators													
Gross external debt (€bn)	100.9	100.8	97.2	94.7	94.3	97.4	99.8	109.8	126.8	136.6	145.0	148.8	150.8
Gross external debt (% of GDP)	72	71	65	59	56	52	48	49	57	57	52	49	46
Gross external debt (% of exports)	224	203	185	173	164	156	148	160	205	185	159	148	140
Lending to corporates/households (% of GDP)	35.9	34.1	31.0	29.9	28.5	26.5	25.4	24.5	25.7	26.5	25.0	25.0	25.4
Interest & exchange rates													
Central bank key rate (year-end, %)	6.00	5.25	4.00	2.75	1.75	1.75	1.75	2.50	1.50	1.75	6.75	6.50	5.50
Broad money supply (average, %YoY)	6.2	7.9	4.1	6.8	7.8	11.4	8.8	10.9	15.3	15.8	7.0	7.0	9.0
3m interest rate (Robor average, %)	5.34	4.22	2.54	1.40	0.89	1.15	2.80	3.15	2.38	1.82	6.10	7.40	6.30
3m interest rate spread over Euribor (ppt)	4.8	4.0	2.3	1.4	1.2	1.5	3.1	3.5	2.8	2.4	5.9	5.3	4.3
3yr yield (average, %)	6.3	4.8	3.3	1.9	1.5	1.9	3.7	3.7	3.3	2.9	7.2	7.6	6.8
10yr yield (average, %)	6.7	5.3	4.6	3.5	3.3	3.9	4.7	4.5	3.9	3.8	7.6	7.9	7.2
USD/RON exchange rate (year-end)	3.36	3.26	3.70	4.17	4.32	3.88	4.07	4.26	3.97	4.35	5.04	5.10	4.73
USD/RON exchange rate (average)	3.42	3.33	3.41	4.05	4.06	3.98	3.95	4.24	4.24	4.24	4.81	5.08	4.86
EUR/RON exchange rate (year-end)	4.43	4.48	4.48	4.52	4.54	4.66	4.66	4.78	4.87	4.95	4.94	5.10	5.20
EUR/RON exchange rate (average)	4.46	4.42	4.44	4.45	4.49	4.57	4.65	4.75	4.84	4.93	4.95	4.98	5.15

Source: National sources, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	1.3	6.4	5.1	4.0	4.2	2.7	1.8	1.0	2.0	2.9	3.5	4.0	4.0
CPI (eop, %YoY)	8.2	10.2	15.1	15.9	16.3	13.8	10.6	9.4	7.8	7.1	5.1	4.0	3.8
Central bank key rate (eop, %)	1.75	2.50	3.75	5.50	6.75	6.75	6.75	6.75	6.50	6.00	5.50	5.50	5.50
3m interest rate (eop, %)	3.01	4.60	6.44	7.93	7.75	7.75	7.55	7.45	7.40	6.85	6.50	6.25	6.00
10yr yield (eop, %)	5.25	6.10	8.80	8.70	8.00	8.10	7.90	7.80	7.90	7.60	7.30	7.00	6.90
USD/RON exchange rate (eop)	4.37	4.45	4.74	5.05	5.04	5.21	5.20	5.10	5.10	4.95	4.81	4.72	4.73
EUR/RON exchange rate (eop)	4.95	4.95	4.95	4.95	4.94	4.95	5.10	5.10	5.10	5.05	5.05	5.05	5.20

Source: National sources, ING estimates

Forecast summary

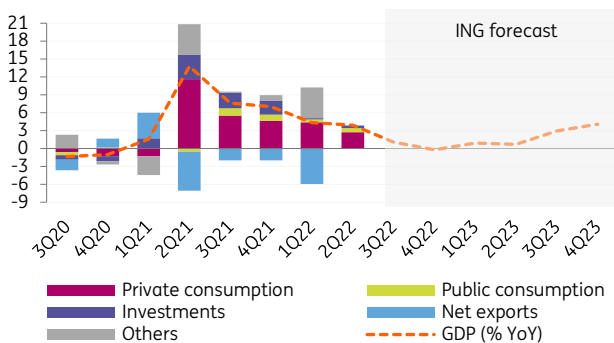
	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	1.1	-0.2	0.9	0.7	2.9	2.2	2.2
CPI (%YoY)*	14.0	14.6	13.3	10.2	7.1	11.8	9.7
Policy interest rate (eop, %)	3.50	5.50	5.75	5.75	5.75	5.00	5.50
3m interest rate (%)*	3.40	5.30	5.55	5.55	5.55	4.80	5.30
10yr yield (%)*	7.60	7.30	8.00	7.80	7.70	6.20	7.60
USD/RSD*	119.6	119.7	123.5	119.8	117.4	114.0	119.8
EUR/RSD*	117.3	117.3	117.3	117.4	117.4	117.4	117.4

Macro Trend		Political Cycle	Ratings	FC	LC
Activity	-	Presidential: 2027	S&P	BB+	BB+
Fiscal	Loose	Parliamentary: 2026	Moody's	Ba2	Ba2
Monetary	Loose	Local: 2026	Fitch	BB+	BB+

*Quarterly data is eop, annual is average

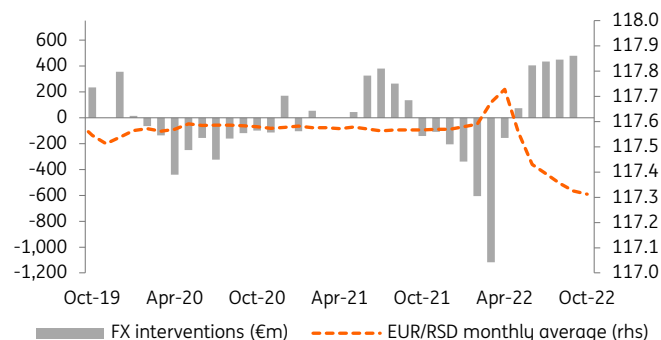
Source: National sources, ING estimates

Real GDP (%YoY) and contributions (ppt)



Source: Eurostat, ING

FX stability remains the main policy tool



Source: NBS, ING

Tough policy choices blurring the outlook

On 2 November 2022 the IMF announced a €2.4billion 24-month Stand-By Arrangement with Serbia. This will help to address “emerging external and fiscal financing needs” as the outlook for the current account deficit is to reach around 9.0% of GDP in both 2022 and 2023 while the fiscal gap will flirt with 4.0% this year. In short, the country needs financing, and the current choppy markets made the IMF look appealing despite the strings attached. Adding insult to injury, regional developments, be it the conflict in Ukraine or the Kosovo car plates dispute, are making it increasingly difficult for Serbia to sustain its ambivalent stance. Absent more clarity, Serbia’s progress as an EU candidate might see little improvement, while its long-awaited investment grade rating could remain distant.

A soft-landing is shaping up

After a reasonably strong 1H22 when the economy advanced by over 4.0% (albeit supported heavily by consumption), the third quarter disappointed as growth slowed to 1.1% YoY and even printed a 1.2% quarterly contraction (at the time of writing, 29 Nov, details of the 3Q22 growth and eventual data revisions have not been released). With inflation eating into people’s real disposable income, government spending under pressure from the high cost of energy imports and a visible slowdown in external demand already, the 2023 outlook cannot be too bright. Moreover, the IMF agreement is likely to come with strings attached in terms of structural reforms which, if implemented, could improve medium- and long-term growth at the expense of short-term growth.

IMF could require a firmer policy stance

Beyond the proposed reforms on the fiscal side, the IMF deal will undoubtedly shape the monetary policy as well. The IMF press release specifically mentions that “the macroeconomic policy mix should be tight to contain high inflation and support exchange rate stability” and “the ongoing monetary tightening is crucial to ensure that inflation does not become entrenched”. Essentially, we read this as a signal that IMF is relatively comfortable with the current FX stability policy but that interest rates should continue to be increased. We have revised our terminal key rate forecast from 4.50% to 5.75% which should be reached in 1Q23. Modest rate cuts could be envisaged starting 4Q23 once core markets stabilise and inflation is safely within single digits.

Serbia

valentin.tataru@ing.com

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	-0.7	2.9	-1.6	1.8	3.3	2.1	4.5	4.3	-0.9	7.5	2.2	2.2	3.8
Private consumption (%YoY)	-1.7	-1.7	-0.1	-0.6	1.9	2.2	3.1	3.6	-1.9	7.7	3.9	3.0	3.9
Government consumption (%YoY)	0.4	-2.1	1.0	-3.8	0.0	3.0	3.8	2.0	2.8	2.7	3.1	2.2	1.6
Investment (%YoY)	13.9	-12.0	-3.4	6.2	5.0	6.3	17.5	17.2	-1.9	12.5	2.0	5.0	4.0
Industrial production (%YoY)	-2.2	5.5	-6.5	8.4	4.7	3.5	1.5	0.2	0.4	6.1	1.0	3.0	4.0
Unemployment rate (average, %)	25.9	24.0	20.6	18.9	16.4	14.5	13.7	11.2	9.7	11.0	9.9	9.5	9.0
Nominal GDP (RSDbn)	3810	4121	4161	4315	4528	4761	5073	5422	5502	6269	7083	7579	8109
Nominal GDP (€bn)	33.5	35.9	34.4	35.5	36.7	40.2	42.9	46.1	46.8	53.3	60.4	64.6	69.0
Nominal GDP (US\$bn)	48.5	56.4	47.3	50.8	50.8	43.5	45.4	51.4	54.0	62.0	62.1	63.3	73.2
GDP per capita (US\$)	6,700	7,900	6,600	7,200	7,200	6,200	6,500	7,400	7,800	9,000	9,000	9,200	9,300
Gross domestic saving (% of GDP)	5.5	9.2	8.4	11.6	13.3	13.0	14.0	15.2	15.9	17.2	17.5	17.6	17.7
Prices													
CPI (average, %YoY)	7.3	7.7	2.1	1.4	1.1	3.1	2.0	1.9	1.6	4.1	11.8	9.7	5.6
CPI (year-end, %YoY)	12.2	2.2	1.8	1.6	1.5	3.0	2.0	1.9	1.3	7.9	14.6	5.3	6.0
Wage rates (nominal, %YoY)	8.9	6.2	1.4	-0.2	3.7	4.0	3.7	10.6	9.4	9.6	12.0	10.4	11.4
Fiscal balance (% of GDP)													
Consolidated government balance	-6.4	-5.1	-6.2	-3.5	-1.2	1.1	0.6	-0.2	-8.0	-4.1	-3.9	-3.2	-2.8
Consolidated primary balance	-4.7	-3.0	-3.5	-0.5	1.7	3.6	2.7	1.8	-6.0	-2.4	-2.3	-1.7	-1.1
Total public debt	54.3	56.7	65.4	70.7	68.5	60.1	54.4	52.9	58.6	57.1	55.1	53.5	51.9
External balance													
Exports (€bn)	8.7	11.0	11.2	12.0	13.4	15.1	16.3	17.5	17.1	21.6	25.4	29.9	35.1
Imports (€bn)	14.7	15.5	15.2	16.1	17.1	19.4	21.9	23.9	23.0	28.6	33.6	39.5	46.5
Trade balance (€bn)	-6.0	-4.5	-4.0	-4.0	-3.6	-4.3	-5.6	-6.3	-5.9	-7.0	-8.2	-9.7	-11.4
Trade balance (% of GDP)	-17.8	-12.4	-11.7	-11.4	-9.9	-10.8	-13.1	-13.7	-12.6	-13.1	-13.6	-15.0	-16.5
Current account balance (€bn)	-3.7	-2.1	-2.0	-1.2	-1.1	-2.1	-2.1	-3.2	-2.0	-2.3	-5.0	-4.4	-4.0
Current account balance (% of GDP)	-11.0	-5.8	-5.8	-3.5	-2.9	-5.1	-4.8	-6.9	-4.2	-4.4	-8.6	-7.3	-5.8
Net FDI (€bn)	0.8	1.3	1.2	1.8	1.9	2.4	3.2	3.6	2.9	3.6	3.0	3.1	3.2
Net FDI (% of GDP)	2.2	3.6	3.6	5.1	5.2	6.0	7.4	7.7	6.2	6.8	5.0	4.7	4.6
Current account balance plus FDI (% of GDP)	-8.7	-2.2	-2.2	1.6	2.2	0.9	2.5	0.8	2.0	2.4	-3.3	-2.1	-1.2
Foreign exchange reserves ex gold (€bn)	10.9	11.2	9.9	10.4	10.2	10.0	11.3	13.4	13.5	16.5	16.6	17.2	18.2
Import cover (months of merchandise imports)	8.9	8.7	7.8	7.7	7.2	6.2	6.2	6.7	7.1	6.9	5.9	5.2	4.7
Debt indicators													
Gross external debt (€bn)	25.6	25.6	25.7	26.2	26.5	25.5	26.7	28.3	30.8	36.5	39.0	40.0	41.0
Gross external debt (% of GDP)	76.5	71.3	74.7	73.9	72.2	63.5	62.1	61.3	65.8	68.4	64.6	61.9	59.4
Gross external debt (% of exports)	293	233	230	218	197	170	164	161	181	169	153	134	117
Lending to corporates/households (% of GDP)	47.2	44.8	46.5	41.0	40.8	40.6	41.4	42.0	45.5	43.5	43.5	44.4	46.1
Interest & exchange rates													
Central bank key rate (year-end, %)	11.25	9.50	8.00	4.50	4.00	3.50	3.00	2.25	1.00	1.00	5.00	5.50	5.00
Broad money supply (average, %YoY)	14.7	5.6	5.9	5.8	9.2	8.0	7.3	12.4	15.5	14.9	7.8	7.0	8.8
3m interest rate (Belibor, year-end, %)	11.75	8.88	9.85	3.83	3.47	3.12	3.03	1.64	1.18	0.90	4.80	5.30	4.90
3m interest rate spread over Euribor (ppt)	11.2	8.7	9.6	3.8	3.7	3.5	3.4	2.0	1.6	1.5	4.6	3.2	2.9
3yr yield (year-end, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	3.2	2.1	1.9	6.00	6.20	6.00
10yr yield (year-end, %)	n/a	n/a	n/a	n/a	n/a	n/a	4.8	4.0	3.1	3.6	7.30	7.70	7.50
USD/RSD exchange rate (year-end)	79.3	80.9	86.2	83.1	99.5	111.2	117.1	104.9	96.3	103.4	119.7	117.4	106.8
USD/RSD exchange rate (average)	78.6	73.1	88.0	84.9	89.1	109.4	111.8	105.4	101.8	101.0	114.0	119.8	110.8
EUR/RSD exchange rate (year-end)	113.7	114.6	121.0	121.6	123.5	118.5	118.2	117.6	117.6	117.6	117.3	117.4	117.5
EUR/RSD exchange rate (average)	113.6	113.1	117.4	120.8	123.2	121.3	118.3	117.8	117.6	117.6	117.4	117.4	117.5

Source: National sources, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	7.0	4.3	3.9	1.1	-0.2	0.9	0.7	2.9	4.1	4.3	4.1	3.7	3.1
CPI (eop, %YoY)	7.9	9.1	11.9	14.0	14.6	13.3	10.2	7.1	5.3	5.4	5.5	5.7	6.0
Central bank key rate (eop, %)	1.00	1.00	2.50	3.50	5.00	5.75	5.75	5.75	5.50	5.00	5.00	5.00	5.00
3m interest rate (eop, %)	0.90	0.90	2.30	3.40	4.80	5.55	5.55	5.55	5.30	4.95	4.90	4.90	4.90
10yr yield (eop, %)	3.60	5.50	6.90	7.60	7.30	8.00	7.80	7.70	7.70	7.80	7.60	7.50	7.50
USD/RSD exchange rate (eop)	103.9	105.5	112.7	119.6	119.7	123.5	119.8	117.4	117.4	115.1	111.9	109.8	106.8
EUR/RSD exchange rate (eop)	117.6	117.8	117.4	117.3	117.3	117.3	117.4	117.4	117.4	117.4	117.4	117.5	117.5

Source: National sources, ING estimates

Forecast summary

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (% YoY)	3.9	2.0	2.0	3.7	2.8	5.0	2.5
CPI (% YoY)*	83.5	68.0	47.4	38.0	38.6	72.7	42.0
Policy interest rate (eop, %)	12.00	9.00	9.00	9.00	9.00	9.00	9.00
3m interest rate (%)*	14.80	10.50	15.29	15.67	16.01	15.95	15.49
10yr yield (%)*	11.99	10.07	14.69	15.38	16.44	17.77	15.53
USD/TRY*	18.50	18.70	19.33	20.30	21.77	16.68	20.87
EUR/TRY*	18.13	19.07	18.95	20.30	21.77	17.58	20.82

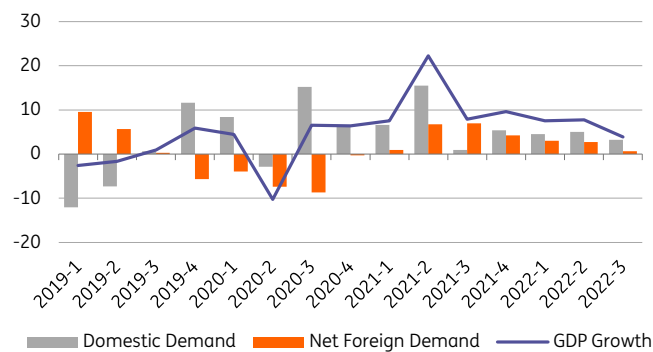
Macro Trend	Political Cycle	Ratings	FC	LC
Activity ▼	Presidential: June 2023	S&P	B	B
Fiscal Looser	Parliamentary: June 2023	Moody's	B3	B3
Monetary Looser	Local: March 2024	Fitch	B	B

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

Policy mix tilted to a more supportive stance

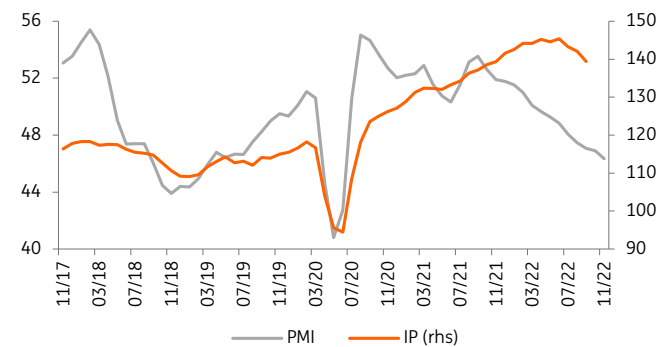
Worsening global backdrop weighing on exports and higher FX volatility, coupled with macro-prudential measures to contain credit growth, is expected to impair private consumption and investment. We have seen signals with dropping PMI, weak industrial production and a decline in electricity consumption. In this environment, the policy mix has tilted to a more supportive stance with: (i) another Credit Guarantee Fund package that can reverse recent momentum loss in lending, but timing is not specified yet; (ii) signal of an expansionary stance on the fiscal side in the medium term plan (MTP); (iii) rate cuts by the CBT with an emphasis on importance of keeping financial conditions supportive that was finalised at 9% in November MPC meeting. Given tighter regulations on the asset side that selectively limit loan growth, cuts are not easing financial conditions as fast, while recent sentiment indicators show a recovery.

GDP growth (% YoY)



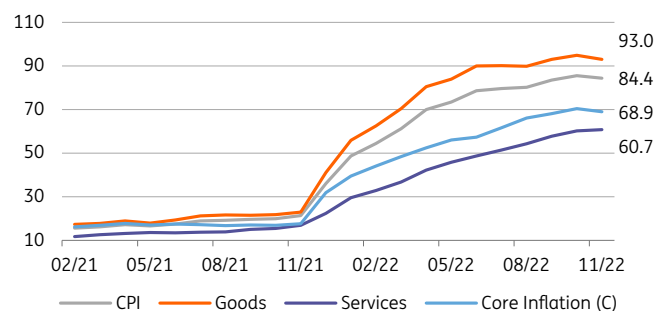
Source: TurkStat, ING Bank

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



Source: ICI, TurkStat, ING Bank

Inflation (% YoY)



Source: TurkStat, ING Bank

Macro digest

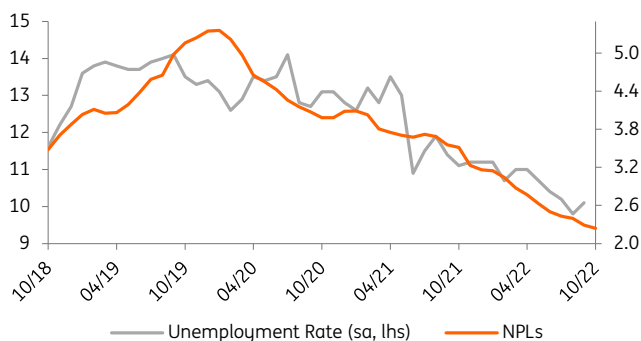
Third quarter GDP in Turkey turned out to be 3.9% YoY, close to market consensus. Breakdown of year-on-year growth reveals continuing strong support from private consumption as well as contributions from net exports and government spending, while investment activity has further moderated and fell into negative territory. 3Q GDP translates into a slightly negative quarter-on-quarter growth rate at -0.1% after seasonal adjustments, showing significant deceleration over 2Q at 1.9%. This is the first negative reading since the breakout of Covid-19 pandemic in 2Q20. So, it is quite clear that economic activity slows from the third quarter onwards mainly on the back of a worsening global backdrop that is leading to an adverse impact on exports and macro-prudential measures containing credit growth. According to frequent indicators in 4Q so far that allow us to follow changes in economic activity more quickly and closely the slowdown in economic activity strengthened as there is a clear downward trend in electricity consumption and the annual percentage change has recently been negative. Stagnant external demand conditions further weighed on pace of exports in November while the PMI in October was at the lowest level since the start of the pandemic. Given this backdrop, we expect 5.0% growth for this year and a decline to 2.5% in 2023, while risks are on the upside given efforts of policy makers to ease financial conditions to support growth.

After a long uptrend that has continued since May 2021, annual inflation dropped for the first time in November. This implies that the October inflation was likely the peak and we will see a further drop in the annual figure in the near term with large supportive base effects if stability in the Lira continues. However, inflationary pressures still remain broad-based as all CPI categories except clothing have contributed positively to the increase in November inflation. PPI inflation, on the other hand, recorded a sharp drop in the last month with the lowest monthly reading in more than two years and a large base from last year. The CBT started an easing cycle in August and continued rate cuts until November which is not compatible with the marked deterioration in inflation. Instead of controlling demand, the current policy stance focuses on managing disinflation by boosting supply. For this purpose, the CBT keeps interest rates low while focusing on selective credit policy and pursuing a 'lirisation' strategy. Given this backdrop, we think annual inflation will remain elevated, closing the year below 70% and declining to 40-45%Y in May mainly due to strong base effects and stability in the currency. However, risks to the outlook next year are on the upside given a deterioration in pricing behaviour, higher trend inflation and still elevated level of cost-push pressures.

Turkey

muhammet.mercan@ing.com.tr

Unemployment vs NPLs (%)

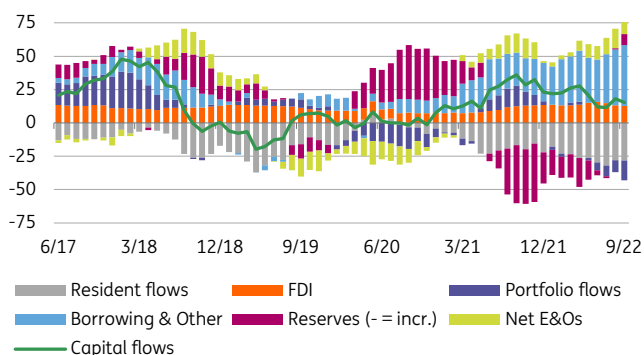


Source: TurkStat, BRSA, ING Bank

Rapid recovery in employment

The labour market outlook has been improving as the seasonally adjusted unemployment rate in August was at the lowest since March 2014, though we saw a slight increase in September. Accordingly, both male and female employment has returned to pre-2018 volatility levels, while the informality rate is now close to the lowest in the current series, started in 2014. Alternative unemployment rates are also on the decline showing the extent of recovery in labour market conditions. Keeping the unemployment on this track would be a major objective for the government ahead of the 2023 elections. Additionally, erosion in purchasing power has been a concern, though policymakers are working to mitigate the effects with large salary hikes. The latest signals from the government imply another major adjustment in early 2023.

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

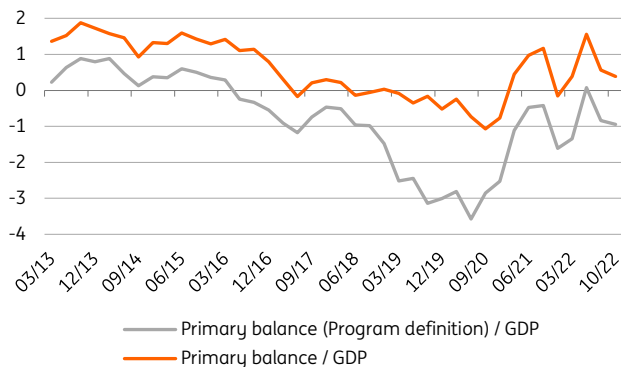


Source: CBT, ING Bank

External rebalancing is not currently in sight

The current account deficit has been on a rapid expansionary path since early this year driven by commodity imports, particularly a higher energy bill. We expect the current account to remain under pressure in the near term given the marked deterioration in the terms of trade impacted by energy prices, an accommodative policy stance and the Eurozone as Turkey's major trade partner facing significant growth pressure. On the capital account, net errors and omissions, which is not a stable source of funding, has been the major financing item, while the global backdrop turning less supportive also adds challenges. Official reserves, on the other hand, recorded an increase on a year-to-date basis. However, the CBT's rate cuts against a backdrop of high external finance requirements and a global risk-off mode could weigh on FX reserves.

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

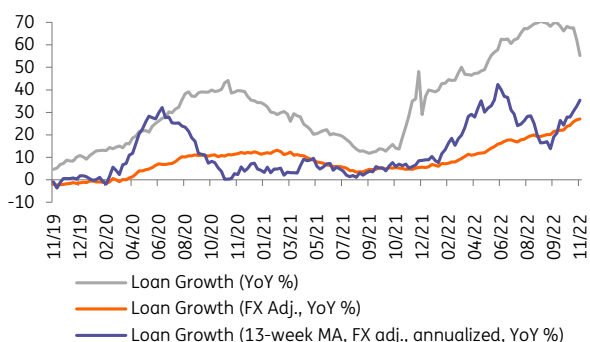


Source: Ministry of Treasury and Finance, ING Bank

Budget spending has accelerated lately

While the budget bottom-line, according to IMF-defined metrics, is still better this year so far than in the same period last year, a significant deterioration was seen over the summer months with an acceleration in spending. Higher spending on a year-to-date basis is attributable to current transfers as the government targets to support households' real purchasing power against high inflation along with higher personnel expenditures and lending to SEEs, particularly state energy company, to finance increasing import costs. Revenues were impacted by a jump in tax collection from corporates. The government sees a more expansionary fiscal stance for the remainder of this year (3.4% of GDP) compared with the performance so far and looks for a steady improvement thereafter with the deficit narrowing to 1.5% of GDP by the end of 2025.

Banking sector volume expansion



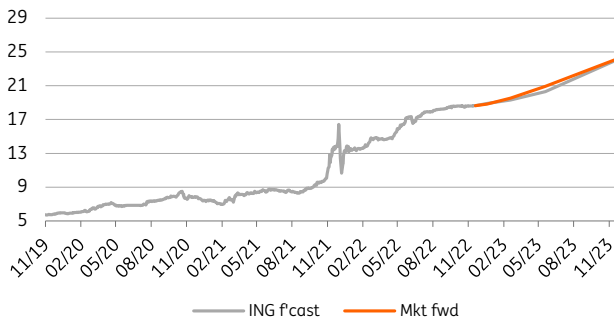
Source: BRSA, ING Bank

CBT moves support decline in FX deposits

With a series of banking sector regulations, corporate lending has slowed notably, while retail lending has also lost momentum. But, there have been signals of stabilisation in corporate lending momentum in recent weeks and state banks' appetite, especially on non-SME corporate loans, seems to be a bit stronger. The CBT also relies on security maintenance requirements on banks' FX liabilities to facilitate a higher share of TRY deposits. Accordingly, we have seen higher deposit rates in the sector so as to expand the TRY deposit base and minimise holdings for TRY government bonds. In recent weeks, locals' USD and EUR deposits declined significantly, while a large portion of decline is attributable to corporates. However, the decline in the FX deposit base has not translated into a rise in FX-protected deposits, showing moderating demand lately.

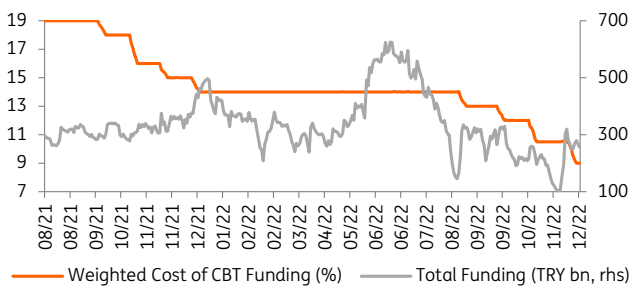
Turkey

FX – spot vs forward and INGF



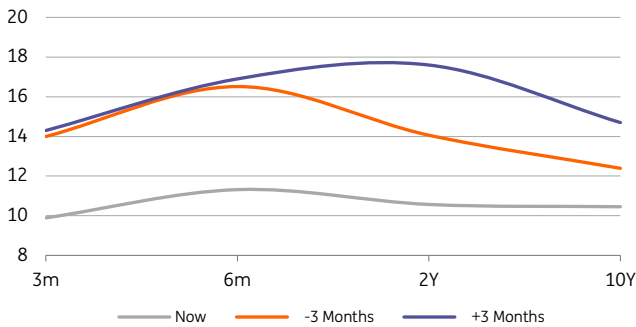
Source: Bloomberg, ING estimates

CBT funding



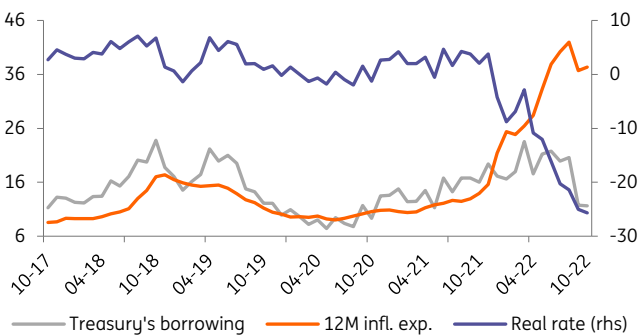
Source: CBT, ING Bank

Yield curve (%)



Source: Bloomberg, ING estimates

Real interest rate (%)



Source: Treasury, CBT, ING Bank

FX and external debt

FX reserves that have been quite volatile this year have shown a rapid recovery since end-July despite rate cuts since August. Also, another boost to reserves in the near term is likely if Turkey and Saudi Arabia finalise the US\$5bn deposit deal. On the other hand, net reserves excluding swaps, which were on a downward trend, recovered notably recently. In this environment, the real effective exchange rate increased by more than 15%, implying significant real appreciation since end-2021. On the inflation side, elevated headline, continuing external imbalances, and a less supportive global backdrop increasing pressure on an already challenging capital flow outlook will remain prevailing themes. We think TRY will remain on a gradual depreciation path on a nominal basis in the near term, assuming that additional credit and fiscal stimulus measures are kept limited. Regarding external debt, continued monetary easing has had limited impact on Turkey external bond spreads in recent months, despite headline inflation above 80%. Signs of further foreign support, such as the recent US\$5bn deposit from Saudi Arabia, should help mitigate concerns over external financing needs, a key strength in comparison to some of the more vulnerable single-B credits. A strong local bid has also been a technical tailwind keeping short-end spreads anchored. However, spreads still look tight versus the single-B peer group, while Eurobond refinancing needs rise in the coming years, and geopolitical headline risks remain, including in relation to increased military action in Syria.

Fixed income

While expecting domestic debt rollover at 133.2%, above what was envisaged in the programme for this year, the Treasury plans to cut the ratio to 114% in 2023. The rise in debt redemptions next year - by c.0.4ppt of GDP - stems from domestic debt, given that external debt redemptions will decline slightly as a percentage of GDP. So, the domestic borrowing requirement seems to be markedly high, attributable to the supportive fiscal stance. It should also be noted that the CBT finalised its rate cut cycle and announced new policy guidance, signalling further macro-prudential measures in December to support the effectiveness of the monetary transmission mechanism. While the fiscal stance turned more supportive in recent months, another Credit Guarantee Fund package that could reverse recent momentum loss in lending also seems to be on the agenda. In this regard, content and direction of additional macro-prudential measures to be introduced by the CBT will be key for the macro and financial outlook. In this environment, both 2Y and 10Y yields have remained anchored so far given large security maintenance requirements (for banks exceeding the quantity and price restrictions on loans set by the CBT) and CBT purchases from primary dealers. Upwards revision in the securities maintenance ratios in October facilitated another bout of decline in bond yields. The rate outlook in the near term is likely to be determined by the CBT's policy of strengthening demand for local government bonds via security maintenance requirements and direct purchases from the secondary market.

Turkey

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (% YoY)	4.8	8.5	4.9	6.1	3.3	7.5	3.0	0.8	1.9	11.4	5.0	2.5	4.0
Private consumption (% YoY)	3.2	7.6	3.1	5.2	3.7	5.9	0.5	1.5	3.2	15.3	16.1	2.9	4.5
Government consumption (% YoY)	6.8	8.0	3.1	3.9	9.5	5.0	6.5	3.8	2.5	2.6	7.6	0.5	0.2
Investment (% YoY)	2.9	14.2	4.9	9.3	2.2	8.3	-0.2	-12.5	7.4	7.4	1.2	-0.5	1.8
Industrial production (% YoY)	4.2	7.2	5.7	5.8	3.4	9.0	1.3	-0.5	1.6	17.5	6.8	2.3	4.2
Unemployment rate (year-end, %)	8.3	8.9	9.9	10.3	10.9	10.9	10.9	13.7	13.1	12.0	10.6	11.0	10.7
Nominal GDP (TRYbn)	1,581	1,823	2,055	2,351	2,627	3,134	3,759	4,312	5,048	7,249	14,207	20,057	27,067
Nominal GDP (€bn)	684	717	681	707	779	763	664	676	623	671	808	964	993
Nominal GDP (US\$bn)	885	946	937	856	867	861	774	760	712	788	852	961	1042
GDP per capita (US\$)	11,675	12,582	12,178	11,085	10,964	10,696	9,792	9,213	8,535	9,359	9,997	11,153	11,960
Gross domestic saving (% of GDP)	23.4	23.9	24.9	25.2	26.0	26.0	26.8	26.1	26.6	31.9	30.0	27.6	28.5
Prices													
CPI (average, % YoY)	8.9	7.5	8.9	7.7	7.8	11.1	16.3	15.2	12.3	19.6	72.7	42.0	29.8
CPI (year-end, % YoY)	6.2	7.4	8.2	8.8	8.5	11.9	20.3	11.8	14.6	36.1	68.0	40.0	20.0
Wage rates (nominal, % YoY)	9.7	10.9	10.1	13.8	21.9	9.2	18.4	25.6	17.0	19.2	70.7	45.7	32.4
Fiscal balance (% of GDP)													
Consolidated government balance	-1.9	-1.0	-1.1	-1.0	-1.1	-1.5	-1.9	-2.8	-3.4	-2.7	-3.8	-4.0	-3.0
Consolidated primary balance	1.2	1.7	1.3	1.3	0.8	0.3	0.0	-0.5	-0.8	-0.2	-1.3	-1.1	-0.5
Total public debt	32.4	31.1	28.4	27.3	27.9	27.9	30.1	32.6	39.7	41.8	36.0	38.4	37.4
External balance													
Exports (US\$bn)	161.9	167.4	173.3	154.9	152.6	169.2	178.9	182.2	168.4	224.7	255.4	251.6	261.9
Imports (US\$bn)	227.3	249.3	239.9	203.9	192.6	227.8	219.7	199.0	206.3	254.0	342.1	322.3	328.1
Trade balance (US\$bn)	-65.4	-81.9	-66.6	-49.0	-39.9	-58.6	-40.8	-16.8	-37.9	-29.3	-86.8	-70.6	-66.2
Trade balance (% of GDP)	-7.4	-8.7	-7.1	-5.7	-4.6	-6.8	-5.3	-2.2	-5.3	-3.7	-10.2	-7.3	-6.3
Current account balance (US\$bn)	-48.0	-55.9	-38.8	-27.3	-26.8	-40.6	-20.7	6.8	-35.5	-7.3	-49.3	-31.1	-22.7
Current account balance (% of GDP)	-5.4	-5.9	-4.1	-3.2	-3.1	-4.7	-2.7	0.9	-5.0	-0.9	-5.8	-3.2	-2.2
Net FDI (US\$bn)	13.7	13.6	13.3	19.3	13.9	11.1	13.0	9.3	7.8	13.3	12.3	11.6	12.5
Net FDI (% of GDP)	1.6	1.4	1.4	2.3	1.6	1.3	1.7	1.2	1.1	1.7	1.4	1.2	1.2
Current account balance plus FDI (% of GDP)	-3.9	-4.5	-2.7	-0.9	-1.5	-3.4	-1.0	2.1	-3.9	0.8	-4.3	-2.0	-1.0
Foreign exchange reserves ex gold (US\$bn)	100.3	112.0	106.3	95.7	92.1	84.1	72.0	81.2	50.0	72.6	77.8	74.8	78.2
Import cover (months of merchandise imports)	5.3	5.4	5.3	5.6	5.7	4.4	3.9	4.9	2.9	3.4	2.7	2.8	2.9
Debt indicators													
Gross external debt (US\$bn)	357.3	405.2	416.9	402.8	405.9	450.9	426.8	415.8	433.0	444.4	459.4	471.8	478.7
Gross external debt (% of GDP)	40	43	44	47	47	52	55	55	61	56	54	49	46
Gross external debt (% of exports)	221	242	241	260	266	266	239	228	257	198	180	188	183
Lending to corporates/households (% of GDP)	50.3	57.7	60.2	63.1	66.0	66.9	63.7	61.5	70.4	67.5	52.3	49.5	43.5
Interest & exchange rates													
Central bank key rate (year-end, %)	5.50	4.50	8.25	7.50	8.00	8.00	24.00	12.00	17.00	14.00	9.00	9.00	9.00
Broad money supply (average, % YoY)	10.2	22.2	11.9	17.1	18.3	15.7	19.1	26.1	36.0	44.6	97.0	42.2	36.0
3m interest rate (TRLIBOR, average, %)	8.9	6.1	8.6	9.9	8.9	11.6	19.1	18.8	11.0	18.0	16.0	15.5	15.3
3m interest rate spread over US\$-Libor(ppt)	836	581	837	960	812	1029	1671	1684	1071	1794	1255	1108	1254
2yr yield (average, %)	8.1	7.6	9.2	9.8	9.7	11.8	18.9	17.2	11.9	18.5	19.9	18.4	18.0
10yr yield (average, %)	8.6	8.3	9.3	9.4	10.1	11.0	15.8	15.5	12.7	18.2	17.8	15.5	15.8
USD/TRY exchange rate (year-end)	1.78	2.13	2.32	2.92	3.53	3.79	5.29	5.95	7.43	13.32	18.70	24.00	27.50
USD/TRY exchange rate (average)	1.79	1.93	2.19	2.75	3.03	3.64	4.85	5.67	7.09	9.20	16.68	20.87	25.97
EUR/TRY exchange rate (year-end)	2.35	2.93	2.81	3.17	3.70	4.55	6.05	6.67	9.08	15.14	19.07	24.00	30.25
EUR/TRY exchange rate (average)	2.31	2.54	3.02	3.33	3.37	4.11	5.66	6.37	8.11	10.81	17.58	20.82	27.26
Brent oil price (annual average, US\$/bbl)	112.40	109.55	99.35	52.08	43.31	54.13	71.17	64.72	41.80	71.25	101.25	103.75	92.00

Source: National sources, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (% YoY)	9.6	7.5	7.7	3.9	2.0	2.0	3.7	2.8	1.5	3.0	3.6	4.3	5.1
CPI (eop, % YoY)	36.1	61.1	78.6	83.5	68.0	47.4	38.0	38.6	40.0	36.8	31.4	26.4	20.0
Central bank key rate (eop, %)	14.00	14.00	14.00	12.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00
3m interest rate (eop, %)	21.03	17.29	19.18	14.80	10.50	15.29	15.67	16.01	15.74	15.55	15.47	14.98	14.61
10yr yield (eop, %)	24.32	25.36	19.36	11.99	10.07	14.69	15.38	16.44	16.07	16.01	15.80	15.64	15.55
USD/TRY exchange rate (eop)	13.32	14.67	16.69	18.50	18.70	19.33	20.30	21.77	24.00	24.96	25.86	26.70	27.50
EUR/TRY exchange rate (eop)	15.14	16.24	17.51	18.13	19.07	18.95	20.30	21.77	24.00	25.46	27.15	28.84	30.25

Source: National sources, ING estimates

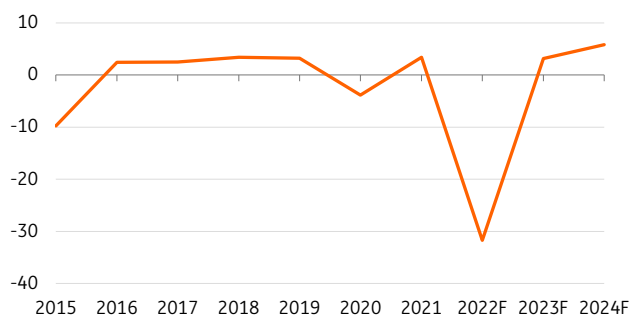
Forecast summary

	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	2022F	2023F
Real GDP (%YoY)	-34.4	-40.0	-17.5	12.0	8.0	-31.7	3.1
CPI (%YoY)*	24.6	30.0	28.0	24.0	23.0	22.5	24.0
Policy interest rate (eop, %)	25.0	25.0	25.0	25.0	25.0	25.0	25.0
USD/UAH*	36.6	37.0	40.0	38.5	37.7	33.1	38.3
EUR/UAH*	35.9	36.3	38.0	37.7	37.7	34.1	37.5

Macro Trend		Political Cycle		Ratings	FC	LC
Activity	-	Presidential: 2024		S&P	CCC+	CCC+
Fiscal	Neutral	Parliamentary: 2023		Moody's	Caa3	Caa3
Monetary	Restrictive	Local: 2024		Fitch	CC	CCC-

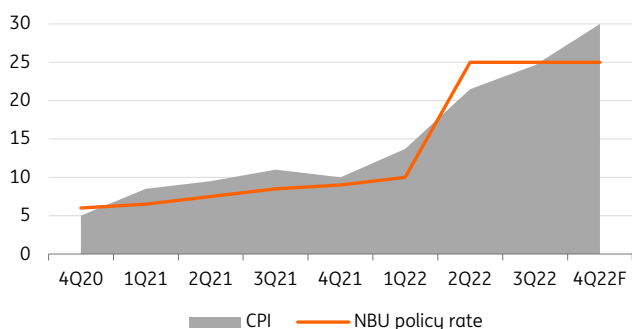
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

GDP growth (%)



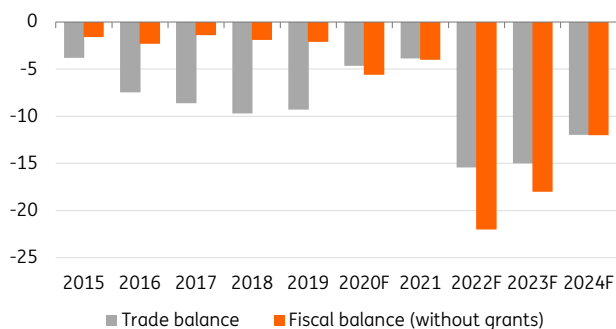
Source: NSI, ING

Inflation and NBU policy rate (%)



Source: NBU, ING

Fiscal and external trade balance (% of GDP)



Source: Ministry of Finance, NBU, ING

Significant trade deficit

The economy is struggling with a significant trade deficit (US\$5.4bn in I-VIII 2022), reliant on international aid to shore up its FX reserves, currently at US\$25.2bn. The scale of FX intervention has decreased since the July peak (from US\$4bn to US\$2bn in October). Likely intensification of the war may again push up the scale of intervention required to stabilise the currency. That is why we expect the NBU to allow for further depreciation of the hryvnia, possibly in 1H23.

Longer-term prospects for the Ukrainian currency largely hinge on the timing of the end of the war and subsequent inflow of foreign aid. Various estimates indicate that the restoration may cost up to US\$750bn (or nearly four times Ukrainian's 2021 GDP). A fraction of this should suffice to drive US\$/UAH lower.

War has depleted GDP by around a third in 2022

The Russian invasion of Ukraine has brought about severe human, social and economic losses. It is estimated that 7m people have left the country as refugees with another 7m displaced internally. GDP in 2022 is to shrink by around one third. Extensive countrywide air strikes on Ukraine's infrastructure and energy blackouts will see GDP in 4Q22 contract by about 40% in YoY terms. Active fighting on the ground continues across about 15% of Ukraine's territory.

The outlook remains highly uncertain as the war becomes more protracted and intense, though focused in the Eastern regions. The recovery scenario hinges on no military escalation, continued external assistance and access to Black Sea ports.

Controlling inflation required 15ppt NBU interest rate hike

The war immediately lifted CPI inflation levels from 10%YoY in 4Q21 to above 20% in 2Q22 and around 30% in 4Q22. The NBU introduced extraordinary measures, including capital controls and FX interventions, to defend the hryvnia and maintain financial stability. But, as FX reserves declined, it was forced to hike interest rates by 15ppt to 25% in early June and introduce 25% UAH devaluation in mid-July. Earlier Ukraine agreed with external creditors to defer debt payments by two years.

Provided the situation remains broadly unchanged, we assume interest rates will remain flat in 2023 as inflation pressures ease, before gradually declining later on.

Wartime spending and tax losses ballooned fiscal deficit

The war has eroded internal capacity to mobilise public revenues and made the country dependent on external grants and loans. Public expenditures have been driven by defence and essential social spending and have led to an unprecedented fiscal deficit of about 20% of GDP in 2022 (with grants, the estimate is c.8% of GDP).

Since the war began through to end-October, Ukraine has disbursed US\$23bn of financial assistance, largely from the US, EU, IFIs and as bilateral aid from Western countries and Japan. To September, around US\$10bn of fiscal deficit was monetised at the NBU. Given that exports fell more than imports, the external trade gap increased but should moderate in the next few years.

Ukraine

leszek.kasek@ing.pl

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F
Activity													
Real GDP (%YoY)	0.2	0.0	-6.6	-9.8	2.4	2.5	3.4	3.2	-3.8	3.4	-31.7	3.1	5.8
Private consumption (%YoY)	8.4	6.9	-8.3	-20.7	2.1	7.7	8.8	10.9	1.7	7.7	-27.0	9.0	9.0
Government consumption (%YoY)	4.5	-0.9	1.1	1.7	-0.5	2.4	0.2	-13.6	-0.7	1.8	17.0	10.0	8.0
Investment (%YoY)	5.0	-8.4	-24.0	-9.2	20.4	18.8	14.3	11.7	-21.3	7.6	-75.0	15.0	25.0
Industrial production (%YoY)	-0.7	-4.3	-10.1	-13.0	2.8	0.4	3.0	-0.5	-4.0	3.5	3.6	3.5	3.5
Unemployment rate (year-end, %)	8.0	7.6	10.6	9.5	9.7	9.9	9.3	8.5	9.0	8.5	8.4	8.0	8.0
Nominal GDP (UAHbn)	1405	1465	1587	1989	2385	2983	3561	3975	4090	4742	4067	5301	6508
Nominal GDP (€bn)	136	138	101	83	85	98	111	138	133	147	120	141	178
Nominal GDP (US\$bn)	176	183	133	91	93	112	131	153	147	174	123	138	189
GDP per capita (US\$)	3900	4000	3100	2121	2200	2600	3050	3600	3400	4100	2800	3200	4300
Gross national saving (% of GDP)	13.1	9.3	9.9	13.3	14.8	12.3	15.3	12.2	12.2	12.2	11.1	11.5	12.0
Prices													
CPI (average, %YoY)	0.6	-0.3	12.1	48.5	14.9	14.5	11.0	7.9	3.0	9.8	22.5	24.0	14.3
CPI (year-end, %YoY)	-0.2	0.5	24.9	43.3	12.4	13.7	9.8	4.1	5.0	10.0	30.0	21.0	11.0
Wage rates (nominal, %YoY)	14.9	8.0	6.1	21.1	23.3	37.0	24.8	18.4	10.4	20.9	-12.0	30.0	25.0
Fiscal balance (% of GDP)													
Consolidated government balance	-4.1	-4.3	-4.5	-1.6	-2.3	-1.4	-1.9	-2.1	-5.6	-4.0	-22.0	-18.0	-12.0
Consolidated primary balance	-2.2	-1.8	-1.5	2.8	1.9	2.4	1.2	0.9	-2.1	-1.6	-18.9	-14.9	-8.9
Total public debt	36.7	39.9	69.4	79.0	80.9	71.8	60.9	50.2	60.4	50.7	65.9	80.8	89.7
External balance													
Exports (US\$bn)	64.4	59.1	50.6	35.4	33.6	39.7	43.3	46.1	45.1	63.1	44.0	47.3	51.6
Imports (US\$bn)	86.3	81.2	57.7	38.9	40.5	49.4	56.1	60.4	52.0	69.8	63.0	68.0	74.2
Trade balance (US\$bn)	-21.8	-22.1	-7.1	-3.5	-6.9	-9.7	-12.7	-14.3	-6.9	-6.7	-19.0	-20.7	-22.6
Trade balance (% of GDP)	-12.4	-12.1	-5.3	-3.8	-7.5	-8.6	-9.7	-9.3	-4.7	-3.9	-15.4	-15.0	-12.0
Current account balance (US\$bn)	-7.2	-4.1	-0.3	0.4	-3.8	-3.7	-4.5	-4.2	5.2	-3.2	3.5	0.5	-3.0
Current account balance (% of GDP)	-4.1	-2.2	-0.2	0.4	-4.1	-3.3	-3.4	-2.7	3.5	-1.8	2.8	0.4	-1.6
Net FDI (US\$bn)	7.2	4.1	0.3	3.0	3.3	3.6	4.4	-5.2	0.1	-6.9	-0.1	1.0	2.0
Net FDI (% of GDP)	4.1	2.2	0.2	3.3	3.5	3.2	3.4	-3.4	0.1	-4.0	-0.1	0.7	1.1
Current account balance plus FDI (% of GDP)	0.0	0.0	0.0	3.7	-0.5	-0.1	0.0	-6.1	3.6	-5.8	2.8	1.1	-0.5
Foreign exchange reserves (US\$bn)	25.4	18.8	10.0	13.2	15.3	18.9	17.7	25.3	29.1	30.9	24.8	23.7	24.5
Import cover (months of merchandise imports)	3.5	2.8	2.1	4.1	4.5	4.6	3.8	5.0	6.7	5.3	4.7	4.2	4.0
Debt indicators													
Gross external debt (US\$bn)	134.6	142.1	125.3	117.7	112.5	115.5	114.7	121.1	121.3	115.0	122.8	130.4	131.4
Gross external debt (% of GDP)	76.6	77.6	94.0	129.0	120.8	103.0	87.6	78.9	82.3	66.1	99.8	94.2	69.6
Gross external debt (% of exports)	208.9	240.4	247.9	332.3	335.2	290.9	264.6	262.7	268.7	182.3	279.1	275.7	254.9
Lending to corporates/households (% of GDP)	56.4	60.4	62.4	48.4	41.3	33.7	29.8	24.5	23.1	21.6	27.3	27.0	28.0
Interest & exchange rates													
Central bank key rate (year-end, %)	7.5	6.5	14.0	22.0	14.0	14.5	18.0	13.5	6.0	9.0	25.0	25.0	22.0
Broad money supply (average, %YoY)	12.8	17.6	5.3	3.9	10.9	9.6	5.7	12.6	28.6	12.0	18.6	19.0	20.0
2yr yield (average, %)	20.0	13.9	17.9	18.9	19.4	15.7	17.8	17.2	13.0	12.5	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	8.0	15.8	24.0	27.2	28.1	27.7	23.7	28.3	27.3	37.0	37.0	32.0
USD/UAH exchange rate (average)	8.0	8.0	11.9	21.9	25.6	26.6	27.2	25.8	27.0	27.3	33.1	38.3	34.5
EUR/UAH exchange rate (year-end)	10.6	11.0	19.1	26.1	28.6	33.7	31.8	26.6	34.6	31.0	36.3	37.0	35.2
EUR/UAH exchange rate (average)	10.4	10.6	15.5	24.0	28.3	30.5	32.0	28.8	31.2	31.8	34.1	37.5	36.6

Source: National sources, IMF, ING estimates

Quarterly forecasts

	4Q21	1Q22	2Q22	3Q22	4Q22F	1Q23F	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F
Real GDP (%YoY)	6.1	-15.1	-37.2	-34.4	-40.0	-17.5	12.0	8.0	10.0	9.5	5.8	4.6	3.3
CPI (eop, %YoY)	10.0	13.7	21.5	24.6	30.0	28.0	24.0	23.0	21.0	18.0	16.0	12.0	11.0
Central bank key rate (eop, %)	9.0	10.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	22.0	19.0	17.0	15.0
USD/UAH exchange rate (eop)	27.3	29.3	29.3	36.6	37.0	40.0	38.5	37.7	37.0	36.4	36.0	33.5	32.0
EUR/UAH exchange rate (eop)	31.1	32.4	30.7	35.9	36.3	38.0	37.7	37.7	37.0	37.1	37.8	35.8	35.2

Source: NBU, Ukrstat, Macrobond, ING estimates

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“**ING**”) solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies). The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is deemed authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. The nature and extent of consumer protections may differ from those for firms based in the UK. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <https://www.ing.com>.