ING

Economic & Financial Analysis

Directional Economics EMEA

12 June 2023

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

Making the best of it

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

EMEA Economics and Strategy Team

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Summary

After facing three years of headwinds to economic growth, the economies of Central and Eastern Europe (CEE) might just be on the verge of an upturn. So far this year, most economies have managed to avoid the most pessimistic forecasts. And moving into the second half we see the region 'making the best' of an admittedly still challenging environment.

In our main article we analyse which economies in the region might be able to benefit from: (1) modestly improving trade trends; (2) lower energy prices; and (3) the return of tourism to pre-pandemic levels.

While forecasts for a rebound in global trade are not particularly aggressive, trade has already delivered an important offset to poor domestic demand in the region. In theory, the more open economies of Hungary and the Czech Republic stand to benefit more from the improvement in merchandise trade volumes.

Lower energy prices benefit the region as a whole – particularly Turkey. Higher energy prices wreaked havoc on CEE external balances last year and lower prices this year are most welcome. Lower energy prices also support governments – in the likes of the Czech Republic and Poland – in encouraging fuel retailers not to expand margins. This will help the disinflation process across the region.

When it comes to tourism, Turkey, Hungary and Poland have all typically enjoyed net positive tourism receipts. Romania notably runs a net negative position here. A return of tourism to pre-pandemic levels can certainly provide some support. These effects will be felt more keenly in Croatia and Bulgaria, where tourism is worth one-fifth of GDP.

Incorporating these trends into our overall forecasts for the region, our team of economists feel that growth trends will improve in the second half. A major driver of this will be the broad disinflation process, where we forecast 2024 inflation at roughly half that seen in 2023. The evidence of disinflation should be enough to start/extend easing cycles in Hungary, the Czech Republic and even a one-off cut in Poland this year. Romania may be tempted to join in with lower rates if it sees peers making the move.

The clear disinflation process should also mean less pressure on real household incomes and suggests that domestic demand will not weigh as heavily on activity as it has done during the recent cost of living crisis.

However, there will be key differences across the region driven by the local political climate. Fiscal policy is one clear example here. Fiscal policy looks set to stay loose into October elections in Poland, while the Czech Republic is embarking on an aggressive fiscal consolidation programme. Equally politics plays a role in the region's access to EU funds, where we should know a lot more by September/October this year.

Turkey, again, is very much focused on its own political cycle. A new economics team faces a much greater challenge in getting inflation under control. It is early days, but hints of more orthodox policy points to large rate hikes through the summer. Looking further across the region, we note the improvement in Ukraine's FX reserves amidst the tragedy of the ongoing conflict.

As always, this Directional Economics showcases ING's global reach with our local team of experts in the CEE region. Please reach out to them with any questions. We very much hope you enjoy reading it as much as we do sharing our latest views.

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

Country summaries: CE4

Czech Republic

In 1Q23, we believe the Czech economy may have ended a soft recession, given the previous QoQ decline of 2H22 turned into stagnation but remained still negative in YoY terms (-0.4%). We expect the annual growth of GDP to remain negative in the first half of 2023. This reflects a continued decline in household consumption, which fell deeply by 6.4% YoY, following a sharp decline in the inflation-driven fall of purchasing power of households, while corporates cut their investment on the back of weak foreign demand and high costs of lending. On a positive note, inflation is on a declining trend owing to an ongoing decline in core inflation, given a slowdown of food and fuel prices. This is likely to prevent the CNB from increasing interest rates despite the still tight labour market and the risk of a potential wage-inflation spiral.

Hungary

The worst might be behind Hungary. Yes, the economy is still in a technical recession, but we see a way out from it by the second half of 2023. A key source of the recovery lies in the growing disinflation process. The collapse of the domestic demand erases the repricing power of companies. Thus, we see a single-digit headline inflation by the year-end and further normalisation in 2024. This means a positive real wage growth yet again from late-2023. However, with depleted household savings and tighter fiscal headroom, we hardly see a boom in domestic demand. The recovery will be export driven, thus we see a quick return to surplus in the current account balance. Improving external financing needs and the new era of monetary policy (eg, persistent positive real interest rates from late-2023) lead us to be constructive towards Hungarian assets.

Poland

The Polish economy should reach a bottom in 1H23 but recovery in 2H23 could be sluggish as the main growth engine from last year (consumption) will improve only gradually with lower CPI and some election spending. Net exports should be the main growth driver depending on uncertain foreign demand. CPI peaked in February at 18.4%YoY but should fall to single digits in 3Q23 and 2024. July's NBP projection is likely to bring a lower CPI trajectory and the NBP may provide a single cut in 2H23 (50% possibility), also referring to strong PLN. We see risk of persistently high core CPI at c.5% in 2024-25. To achieve the 2.5% target, Poland needs a paradigm shift in policy, ie, nominal wages growth below 5%YoY, less consumption and more investment. PLN is no longer undervalued; we still see some appreciation. POLGBs curve may keep steepening due to rate cut expectations driving the short end and risk of spending affecting the long end, both from the ruling and opposition parties.

Romania

Benefiting from an unusual context of political stability (which we expect to continue) and positive investor sentiment, the economy continues to perform decently, with help from increasing public investment spending. Yet, having not used the high GDP growth from 2021-22 to accelerate deficit reduction, the government finds itself in an uncomfortable budgetary position. Sticking to the 4.4% of GDP budget deficit target this year is proving more than just challenging, as public wage requirements are catching up after two years of high inflation, while budget revenues are not increasing as planned. Historically, cutting investments was the general solution to stick within the deficit, hence we do not exclude this option. And this is just for 2023 budget. Moving lower to a 3.0% of GDP deficit in 2024 as per current strategy looks very ambitious to say the least.

Country summaries: Other Central & Eastern Europe

Bulgaria

It took five rounds of inconclusive snap elections in just over two years to end up with the political scene looking pretty much the same as it did at the start. During this time, Bulgaria missed the opportunity to join the Eurozone and Schengen area from 2024 and has lost precious time in absorbing EU funds from the Recovery and Resilience Facility. Even the usually praised prudent fiscal stance is coming under question as the interim governments had limited capacity to steer spending. Following the latest elections in April 2023, a grand coalition between GERB and Continuing the Change is shaping up. While common ground seems to have been found in the overall pro-EU policy direction, some details of the agreement (eg, prime minister rotation every nine months) are making the coalition a fragile one. Nevertheless, this is as good as it gets for now.

Croatia

The Eurozone and Schengen entrance on 1 January 2023 sealed the completion of Croatia's EU integration story. The economy has shown a remarkable resilience through the pandemic and Russia-Ukraine conflict, marking a striking difference compared to the 2008-09 global financial crisis. While there is a long way to go in terms of catching-up with the Eurozone average in almost all aspects, the authorities seem quite determined to make good use of the EU's Recovery and Resilience Facility, increasing fixed investments while keeping public deficits within very reasonable levels. Better terms of trade compared to 2022 and a tourism boost from Schengen entry might rebalance the external sector earlier than expected while quasi-balanced budgets could push the public debt ratio below the dreaded 60% of GDP over the next couple of years.

Serbia

The Stand-By-Arrangement (SBA) with the IMF concluded in late 2022 seems to have been an inspired policy choice, as it fostered better-than-expected twin deficits, while foreign direct investments remained strong. In this context and underpinned by stable ratings, Serbia successfully retuned to capital markets, issuing two Eurobonds in early 2023. It is not all rosy though, as relatively sound economic policies overlap major other challenges. In May 2023, the European Parliament voted with a large majority to validate a report which clearly states, among others, that Serbia's EU integration should be dependent on aligning with the EU on sanctions against Russia and on normalising the relations with Kosovo. At the limit, this could mean a limbo-time for Serbia until policymakers are ready to take decisive actions on most sensitive issues.

Turkey

President Erdogan was re-elected and the Erdogan-led People's Alliance won a simple majority in Parliament. The macro outlook points to a need to rebalance the economy given that: (1) the current account deficit has remained on an expansionary path; (2) total capital flows have remained weak; (3) there is a major fiscal expansion; and (4) the extra fiscal burden and the CBT's supportive stance create further pressure on already elevated inflation. In this environment, the main policy debate focuses on interest rate policy and whether there will be a return to a more conventional policy setting post-elections. The appointment of Mehmet Simsek as Minister of Economy and Finance shows an intention to return to conventional economic policies, though it is too early to decide the degree of orthodoxy. The signals imply that actions will be taken without delay following formation of new economy management.

Country summaries: CIS

Armenia

Armenia has benefited from a spillover of the war in Ukraine through net immigration of middle-class Russians and other CIS citizens, boosting services exports, domestic consumption and GDP, increasing its two-way trade with Russia and boosting budget revenues. Yet unless there is a new wave of immigration, growth is set to normalise amid still high unemployment and sluggish credit growth. Budget policy, prudent so far, may face higher military spending if tensions with Azerbaijan re-emerge.

As CPI passed its peak and monetary stance has been conservative so far, there is a scope for cautiously lower local rates. The FX rate, however, is now 24% stronger to USD vs end-2021 and is facing the risk of correction. On the plus side, the central bank has used the one-off windfall to boost reserves, strengthening external buffers.

Azerbaijan

As holder of vast gas reserves Azerbaijan is set to benefit from Russia's tensions with the EU through higher fuel exports and budget revenues amid conservative fiscal policy. At the same time, the country's trade ties with Russia are limited and diplomatic relations are relatively distant, lowering the risk of secondary sanctions and underpinning Azerbaijan's beneficial position.

Meanwhile, outside of strong foreign trade and financial position, Azerbaijan is challenged by a stagnation of the oil sector, slowing growth in non-fuel sectors, sticky elevated inflation, high dependency on food imports from Turkey and Russia, and the need to maintain relatively tight monetary policy. Tensions with Armenia, despite the recent diplomatic momentum, remain a risk and could also become a trigger for some easing in fiscal policy.

Kazakhstan

Kazakhstan is generally benefiting from Russia's geopolitical tensions through an inflow of high-skilled labour and businesses and opportunities for increased trade with the EU. That said, high dependence on the Russian pipeline infrastructure and the need to balance its relationship with the EU are the risk factors. In 2023, growth momentum may strengthen, but domestic constraints include a deteriorating inflationary outlook and high dependency on the oil sector, prone to sudden maintenance issues.
Financially, Kazakhstan's fiscal and external balances remain comfortable. Nevertheless, the scope for further strengthening of the Kazakhstani Tenge (KZT) appears limited given the expected return of the current account to deficit and likely normalisation of net private capital inflows in the face of risks of secondary sanctions related to ties with Russia.

Ukraine

Ukraine's international reserves exceeded nearly US$36bn in May, for the first time since 2011. This reflected continued foreign aid and lower monthly costs of FX interventions (c.US$2bn in May, down from the monthly peak of US$4bn in June 2022). This significantly deceases near-term odds of another devaluation of the hryvnia, as the central bank may prefer a stable currency to combat inflation.

The fundamental factors behind the hryvnia remain unsupportive though. Ukraine is running a significant trade deficit, as exports collapsed in 2022, while imports remained quite stable. With the central bank aiming to re-liberalise the FX market at some point this signals risk of further devaluation in the future.

Uzbekistan

Despite positive spillover from the Russia-Ukraine conflict, Uzbekistan's growth momentum is waning on a sluggish agriculture sector, gas supply disruptions, elevated inflation and unemployment amid growing population. Fiscal policy has been generous so far but is now likely to face some consolidation.

Still, with GDP growth of around 5-6% pa, a relatively sound fiscal and external position, and ongoing reform agenda, the country looks attractive. A move to investment grade could be a trigger for the local FX (which is now under gradual depreciation pressure), but the prospects of that are clouded by the recent constitutional reform and the increase in trade with Russia, which might entail higher risks of secondary sanction scrutiny by the US and EU.

ING main macroeconomic and financial forecasts

Real GDP (% YoY)

	1Q23	2Q23F	3Q23F	4Q23F	2023F	2024F
Armenia	12.1	7.0	6.0	5.0	7.5	5.7
Azerbaijan	0.4	2.8	3.2	3.4	2.0	2.5
Bulgaria	2.0	1.6	1.7	1.7	1.7	3.1
Croatia	2.8	1.9	3.0	2.9	2.7	2.5
Czech Republic	-0.1	0.2	0.7	1.7	0.6	1.9
Hungary	-0.9	-1.2	0.6	2.0	0.2	3.1
Kazakhstan	4.9	5.2	4.7	4.0	4.7	4.0
Poland	-0.3	1.0	0.9	3.0	1.2	2.4
Romania	2.3	3.0	2.3	2.4	2.5	3.7
Serbia	0.7	0.4	2.1	2.9	1.6	3.8
Turkey	4.0	5.0	1.7	0.0	2.5	3.0
Ukraine	-13.0	15.0	3.5	3.5	2.3	4.1
Uzbekistan	5.5	5.2	6.2	6.7	5.9	5.5
Eurozone*	-0.4	1.0	0.7	0.1	0.5	0.5
US*	1.3	2.0	-1.5	-2.2	1.2	0.0

*% QoQ annualised

Source: National sources, Bloomberg, ING estimates

Exchange rate (quarterly is eop, annual is avg)

	1Q23	2Q23F	3Q23F	4Q23F	2023F	2024F
USD/AMD	389	384	390	406	400	416
USD/AZN	1.70	1.70	1.70	1.70	1.70	1.70
EUR/BGN	1.96	1.96	1.96	1.96	1.96	1.96
EUR/HRK	-	-	-	-	-	
EUR/CZK	23.5	23.7	23.7	23.5	23.6	23.2
EUR/HUF	381.0	369.0	378.0	372.0	377.2	368.0
USD/KZT	456	455	460	465	460	472
EUR/PLN	4.68	4.50	4.43	4.45	4.53	4.50
EUR/RON	4.94	4.98	4.97	5.02	4.98	5.06
EUR/RSD	117.3	117.3	117.3	117.3	117.3	117.3
USD/TRY	19.16	24.00	25.00	26.00	22.43	28.22
USD/UAH	39.9	37.0	39.0	39.0	38.7	37.4
USD/UZS	11,229	11,430	11,450	11,477	11,365	11,592
EUR/USD	1.08	1.08	1.13	1.18	1.12	1.17

*Quarterly data is eop, annual is average

Source: National sources, Bloomberg, ING estimates

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

	1Q23	2Q23F	3Q23F	4Q23F	2023F	2024F
Armenia	5.4	2.2	1.9	3.1	3.7	4.6
Azerbaijan	13.6	12.0	8.2	5.9	10.7	6.2
Bulgaria	14.0	9.6	7.3	6.6	10.4	5.0
Croatia	11.8	7.8	5.7	4.4	7.4	4.3
Czech Republic	16.5	12.0	9.0	9.2	11.6	2.6
Hungary	25.2	20.2	12.8	7.9	18.3	5.0
Kazakhstan	18.1	15.0	11.9	10.0	15.0	8.6
Poland	16.1	11.8	9.5	7.8	12.1	6.1
Romania	14.5	9.9	8.5	6.9	10.5	5.0
Serbia	16.2	12.6	9.1	6.7	11.9	4.9
Turkey	50.5	38.1	42.5	51.0	45.7	40.3
Ukraine	21.3	15.5	15.0	15.0	16.7	12.6
Uzbekistan	11.3	9.9	9.5	9.2	10.2	7.7
Eurozone	8.0	6.9	3.8	3.0	5.4	2.5
US	5.8	4.2	3.5	2.8	4.1	2.0

Source: National sources, Bloomberg, ING estimates

Central Bank rate (%, eop)

	1Q23	2Q23F	3Q23F	4Q23F	2023F	2024F
Armenia	10.75	10.25	8.75	7.75	7.75	6.00
Azerbaijan	8.75	9.00	8.75	8.50	8.50	7.50
Bulgaria	2.17	2.60	2.80	3.00	3.00	2.70
Croatia	3.50	3.75	4.25	4.25	4.25	3.25
Czech Republic	7.00	7.00	7.00	6.50	6.90	4.80
Hungary	13.00	13.00	13.00	11.50	11.50	5.25
Kazakhstan	16.75	16.75	16.00	15.00	15.00	11.00
Poland	6.75	6.75	6.75	6.50	6.50	5.75
Romania	7.00	7.00	7.00	7.00	7.00	5.50
Serbia	5.75	6.25	6.25	6.25	6.25	5.25
Turkey	8.50	20.00	30.00	30.00	30.00	30.00
Ukraine	25.0	25.0	25.0	25.0	25.0	19.0
Uzbekistan	15.00	14.00	13.00	12.00	12.00	10.00
Eurozone	3.50	4.00	4.25	4.25	4.25	3.25
US	5.00	5.25	5.25	4.25	4.25	3.00

*Upper level of 25bp range

[1] Refi Rate

Source: Bloomberg, ING estimates

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

	1Q23	2Q23F	3Q23F	4Q23F	2023F	2024F
Armenia	11.80	n/a	n/a	n/a	n/a	n/a
Azerbaijan	n/a	n/a	n/a	n/a	n/a	n/a
Bulgaria	4.20	4.40	4.50	4.50	4.40	4.25
Croatia	3.70	3.80	3.80	3.90	3.80	3.90
Czech Republic	4.60	4.30	3.80	3.30	4.00	3.00
Hungary	8.50	7.05	7.15	6.95	7.63	6.83
Kazakhstan	n/a	n/a	n/a	n/a	n/a	n/a
Poland	6.03	6.00	6.00	5.95	6.04	5.90
Romania	7.35	7.10	7.15	7.15	7.20	6.90
Serbia	6.50	6.25	6.30	6.50	6.50	5.90
Turkey	10.49	15.33	22.67	25.42	17.21	25.11
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a
Uzbekistan	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	2.30	2.50	2.30	2.20	2.33	2.13
US	3.50	4.00	3.50	3.00	3.50	3.06

Source: National sources, Bloomberg, ING estimates

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

	1Q23	2Q23F	3Q23F	4Q23F	2023F	2024F
Armenia	11.00	n/a	n/a	n/a	n/a	n/a
Azerbaijan	n/a	n/a	n/a	n/a	n/a	n/a
Bulgaria	n/a	n/a	n/a	n/a	n/a	n/a
Croatia	n/a	n/a	n/a	n/a	n/a	n/a
Czech Republic	7.30	7.20	6.90	6.40	4.90	5.00
Hungary	16.30	15.00	13.50	11.00	14.50	6.90
Kazakhstan	16.50	16.50	15.50	14.50	15.80	12.60
Poland	6.89	6.95	6.78	6.70	6.86	6.51
Romania	6.85	6.60	6.50	6.50	6.50	6.00
Serbia	5.47	5.80	5.80	5.80	5.80	4.85
Turkey	11.07	27.56	33.76	36.78	24.57	33.93
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a
Uzbekistan	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	3.00	3.60	3.80	3.70	3.53	3.23
US	4.90	5.20	5.20	4.20	4.88	3.05

Source: National sources, Bloomberg, ING estimates

ING EM FX and local rates views summary

Country	Foreign exchange	Local debt and rates
Czech Republic	The CZK still has a lot to offer - high carry, balanced market positioning and a central bank ready to intervene in the FX market if the koruna weakens. In addition, the CZK has by far the highest beta against EUR/USD in the region, making it a good proxy for a global story view with a high CEE carry element.	We believe the market has gone too far with the pricing of the CNB rate cuts this year and along with the heavy received market positioning we see an opportunity for an upward re-pricing of the IRS curve. CZGBs offer good value with the prospect of a near halving of supply next year.
Hungary	We expect that the market will continue to favour the HUF, which will continue to maintain a significantly higher carry within the region in the second half of the year. In our view, the playing field for the forint will be in the range of EUR/HUF 368-378 and we target year-end at 372.	The market is pricing in a large portion of NBH normalisation, but we believe that the fast disinflation and a strong forint will support further market bets on policy easing. We see a lower and steeper curve. HGBs are getting expensive after the recent rally.
Poland	The Polish zloty has closed the gap with the CEE region and although it should remain on a strengthening trajectory it is no longer undervalued in our view. We target 4.45 EUR/PLN for the end of the year. However, currently, the significant long positioning of the market and election noise over the coming months will be hurdles.	The NBP is the most dovish central bank in the CEE region and with inflation falling, the market will price in more rate cuts both this year and next. Moreover, inflation has the potential to surprise to the downside. POLGBs are seen as the cheapest bonds in CEE, while funding is fully under control, pricing too many negatives.
Romania	The new range is likely to be 4.94-4.98 EUR/RON, with no expectation of moves to the lower levels. We envisage at least one more upward shift before the year-end. We target the EUR/RON level of 5.02 for the end of the year.	ROMGBs offer the best funding situation and disinflation profile in the CEE region. In addition, they are the only ones to offer a steep curve and reward for duration. However, spreads against CEE peers and heavy long positioning may indicate a problem for the next rally. The overall direction remains clear, further gains may be at a slower pace.
Ukraine	FX reserves exceeded nearly US$36bn in May, for the first time since 2011. This reflected continued foreign aid and lower monthly costs of FX interventions. This significantly deceases near-term odds of another devaluation of the UAH, as the central bank may prefer a stable currency to combat inflation. The fundamentals behind UAH remain unsupportive though.	Ukraine has benefited from declines in global commodity prices and the CPI is dampened by the high statistical base. However, we expect the NBU to wait for a more decisive period of disinflation and start rate cuts in early 2024. Public and external financing needs have been met by foreign flow. The fiscal position is set to deteriorate further but improve gradually in the medium term.
Kazakhstan	KZT appreciation since 3Q22 was based on the substantial atypical net private capital inflow, which could prove volatile. USD/KZT has now almost recovered to levels seen before February 2022, and the new fiscal rule assumes lower state sales of FX out of NFRK. In addition, risk of Russia-related secondary sanctions may push Kazakhstan be more cautious about trade flows.	
Turkey	Under the CBT policy with indirect FX interventions and regulations to control locals' FX demand, gross FX reserves have been under pressure since the beginning of this year. Given this backdrop, there is a consensus that points to a normalisation in the conduct of the monetary policy. We target 26.0 USD/TRY for the end of the year.	The CBT has maintained its purchases from the secondary market, still below 6% vs the limit set at 7% of total assets of the CBT weekly statement. In the aftermath of elections, signals implying a change in policy direction are likely to determine the bond market outlook. Markets are pricing in more orthodoxy in the policy ahead than anticipated earlier.

Source: ING

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CEE: Making the best of it

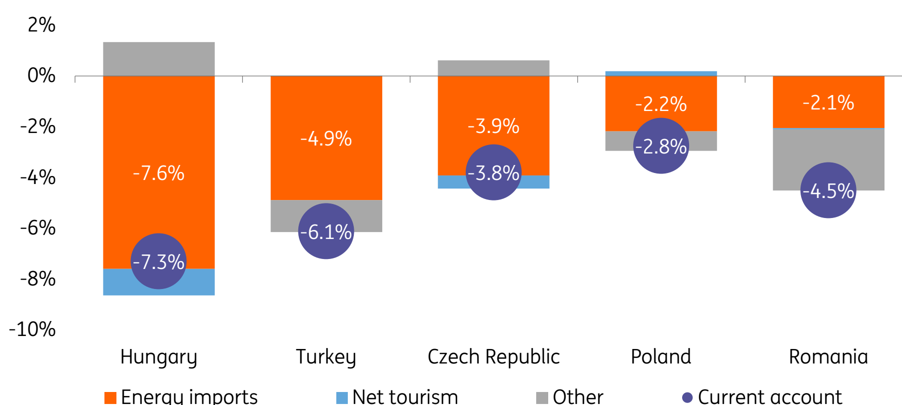
Looking at opportunities presented by global trends

2023 will prove another tough year for global growth. Central bankers in most advanced economies will keep their collective foot on the monetary brake pedal. Yet trade volumes and tourism should improve, plus energy prices are substantially lower than a year ago. In this article, we take a look at how selected Central and Eastern European (CEE) economies could benefit on a relative basis.

Key observations

- Looking at what an improvement in the external trade environment could mean for the region, we note Hungary and the Czech Republic are the more open economies, Poland and Romania the more closed. Turkey's more geographically diversified trade mix has helped. Better trade trends should prove an important offset to weaker domestic demand in the region, although we caution that foreign value-add in exports is quite high. Given the recent Turkish lira depreciation, sectors using imported inputs at the lowest rate, eg, labour-intensive industries, could fare better.
- The spike in energy prices did most of the damage to the external imbalances over 2021-22 and falling prices should now be a welcome boon – especially to Hungary and Turkey. Lower energy prices may also give governments more room to pressure margins of the fuel retailers – helping to make the case for rate cuts especially in the CE4 region later this year. Romania's relative self-sufficiency in energy suggests it will not be a major beneficiary of this story.
- When it comes to tourism, none of the selected CEE countries we cover in this article come close to the near 20% of GDP that tourism represents in the likes of Croatia, Bulgaria and Montenegro. Yet a further recovery in tourism back to pre-2019 levels would certainly be positive for the likes of Turkey, Hungary and Poland – countries that run net positive balances in terms of tourism receipts.

Fig 1 Current account evolution by components: 2022 vs 2019 (% of GDP)



Source: National sources, UNWTO, IMF, ING

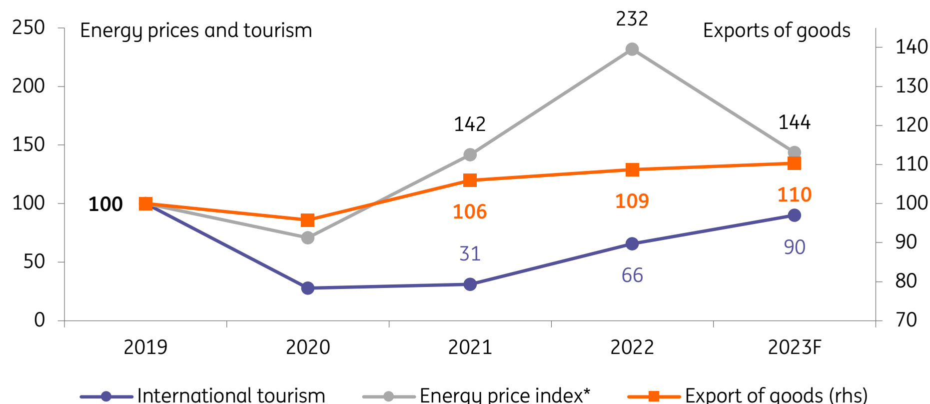
Trawling for the positives

Restrictive monetary policy, tighter credit conditions and declining confidence levels point to slowing growth in many parts of the world. The Central and Eastern Europe (CEE) region is no exception, where weakening domestic demand will keep growth rates under pressure.

Pick up in global trade, drop in energy prices, rebound in tourism may benefit the CEE region

In later sections of this *Directional Economics* publication, we discuss whether policymakers will be in a position to address this slowdown with easier monetary policy. Yet the prospect of lower policy rates is not the only positive for the region. In this article, we look at which of our selected countries in the CEE region stand to benefit from: (1) a pick-up in trade volumes; (2) the drop in energy prices; and (3) a rebound in tourism.

Fig 2 Indices of global exports, energy prices, tourism; 2019 = 100



*Includes crude oil, natural gas and coal price indices
Source: IMF, UNWTO, ING

At a first glance, the CEE is seen as a group of countries that share a few similarities, such as membership in regional economic and political unions, a similar level of income and population, global supply chain specialisation, historical connections, negative current accounts and a high role of trade with the EU.

That said, there are differences within the group that call for a separate analysis of the exposure to global trends. For example, the Czech Republic is a slower-growing developed economy by international standards, while the rest are faster-growing developing economies. There are as well differences in the domestic and foreign policy course that also affect the economic ties.

Channels of influence: GDP growth, current account, CPI

We see several channels through which the outlined global trends manifest themselves in the economic realities of the CEE. Physical trade volumes and services/tourism are factored into net exports and economic growth, the values of trade are contributing to current accounts and FX expectations, while commodity inputs affect the CPI trends (and the current account). In this article, we explore the exposure of selected CEE countries, the Czech Republic, Hungary, Poland, Romania and Turkey – as a group and individually – in terms of these channels and see how they factor in the expected economic and financial performance.

Global merchandise trade is slowing down, but keeps growing

To set the scene, we look at which countries in the region stand to benefit the most from the pick-up in trade. Global merchandise trade surpassed pre-Covid levels in 2021 but has proved sluggish since. Yet factors like the expected, but so far delayed, Chinese recovery, lower shipping costs and a weaker dollar should support trade over coming years. The IMF expects global merchandise trade to return to 3-4% pa growth rates in 2024-25 after temporarily slowing to 1.5% in 2023.

Sharp decline in energy prices is 2023's key positive trend

Another positive trend we examine is that of the sharp decline in energy prices. After a 63% spike in 2022 (including a 100% spike in natural gas) global energy prices (oil, gas, coal) are expected to post a 40% decline this year, according to the IMF. While we acknowledge that energy prices are subject to upside risks (largely supply related), there are big differences in how lower energy prices will play out across the region – both through energy's share of imports and weight in CPI baskets.

Tourism still has a potential for further recovery

And lastly, we look at the positive expectations for tourism, which unlike merchandise trade has yet to recover to pre-pandemic levels. This is bouncing back with the removal of epidemiological constraints and a catch up on the previously under-consumed services.

According to UNWTO (World Tourism Organization), despite showing 86% YoY growth in 1Q23, the number of international arrivals globally is still 20% below 1Q19 levels. The re-opening of China is one of the most important factors supporting expectations of further recovery. UNWTO's panel experts expect better tourism performance later this year and a return to 2019 levels in 2024 or somewhat later.

We take a look at how each of the three factors will impact countries across the region.

1 Trade

World trade is changing – can the CEE profit?

Since September 2022, world trade has fallen by around 4%. The pandemic shock to global consumption has played a large role in trade trends in recent years. The initial phase of the pandemic resulted in lopsided consumption towards goods, which has now reversed towards services demand. Businesses also increased inventories early last year as supply chain problems persisted, which is now reversing.

While the 'bullwhip effect' of stockpiling across the supply chain added to trade volumes earlier, the process of stock reduction now creates extra slack in the figures. Although this process was not finished yet in the first quarter of 2023, we expect trade to recover mildly over the course of this year on the back of the reopening of China and further easing of supply chain problems, starting at the end of the first quarter.

We expect global trade to post 1% growth in 2023

All in all, we expect total trade to grow at just 1% compared to last year, with 2024 offering a 2% gain in trade volume. This means trade will drop below global GDP growth and is expected to continue in the slow lane compared to long-term averages.

The upside risks to this outlook relate to our sluggish growth outlook for advanced markets. If a faster growth pace was to be maintained, this would clearly increase our expectations for global trade growth. Also, the current consumption mix is still favouring services compared to goods as consumers are catching up on leisure activities that were restricted during lockdowns. If that were to switch back more quickly, this would be a boon for global trade.

Recent years have been characterised by wake up calls for global trade. From lockdown-led supply-chain disruptions to the US-China trade war, and from the Suez blockage to war and sanctions, the very globalised production model has been challenged a fair bit. In response, deglobalisation has become a key theme in economics, but the question is how that is really going to play out.

It looks like diversification of sourcing products is the most dominant response to the supply chain problems seen in recent years. Since 2016, we have seen steady increases in diversification of imports from advanced economies. Interestingly, we do see notable differences between Europe and the US. In the EU, we note relatively little diversification so far outside of the pandemic shock. The US is the main diversification force at the moment. American imports are now a lot more diversified than they were in 2016 and this is mainly driven by a clear trend towards a lower dependency on China for imports.

Still, we expect diversification of imports to also increase further when looking at Europe; think of the swift move away from imports from Russia. 'Friendshoring', or closer trade ties with geopolitical allies, is likely to be a theme of the coming years and the big question is whether CEE can gain from this development. With world trade growing moderately, there are still opportunities to accelerate export growth if positioned well towards the right markets.

Bert Colijn, Senior Economist, Eurozone

CEE trade exposure

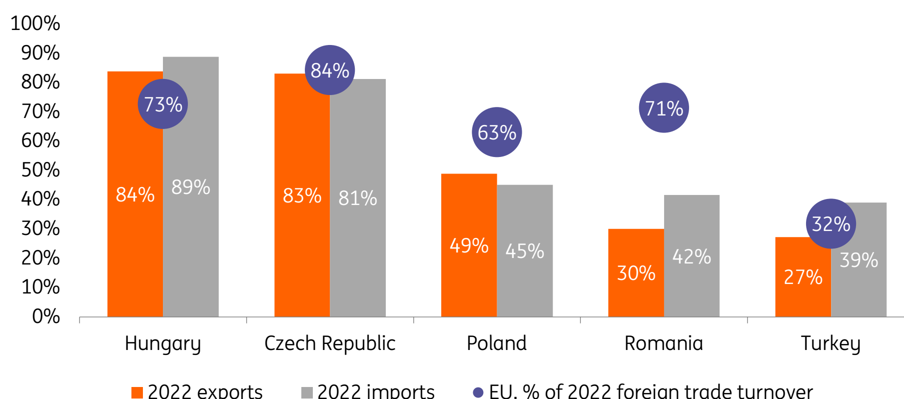
Selected CEE countries: Czech Republic, Hungary, Poland, Romania and Turkey

If we take a helicopter view, our selected CEE countries as a group are well integrated into global trade and the region plays an important role in global value chains. However, if we focus in, we can find a lot of differences in the exposure to external shocks in merchandise trade.

Hungary and the Czech Republic appear to be the most integrated into global trade, especially with EU

A regular talking point here is the faster-growing regions in merchandise trade. Unsurprisingly, the direct exposure of the CEE countries is greatest towards the EU (60-85%), with one exception. This is Turkey, where the EU accounts for 30-35% of exports and imports. Thus, Turkey's trade structure looks less concentrated, making trade more resilient to external shocks, but more dependent on the foreign policy balancing. Meanwhile, other CEE countries, like the Czech Republic, Romania and Hungary are more heavily dependent on the EU with 70-80% share of external trade.

Fig 3 CEE foreign trade and ties to EU (% of GDP)



Source: National sources, WTO, ING

Looking at the question of whether trade with China can be a key differentiator, the direct exposure to China is still relatively small in the CEE region, at around 1.3-1.7% of total merchandise exports. However, a pivot eastwards is being recorded in some countries, including Hungary's 'Eastern Opening' policy.

Due to geopolitical tensions with the US, China is repositioning itself. Its share in EU imports has increased from 7% to 9%, while in US imports China's share has dropped from 20% to 15% in recent years. The main channel of China's expected increase in CEE trade could therefore manifest itself not directly, but through a potential increase in CEE's trade with the EU. As an example, the 1Q23 data suggests that Germany saw imports from Poland and Romania each increase 17% YoY with a 10% YoY drop in Chinese imports (and an 86% YoY drop in Russian supplies).

CEE trade trends

In line with the dynamics of the EU, CEE economic activity is currently moderating across the board, with exports being a transmission channel. And while some countries are suffering more due to the drop in purchasing power (like Hungary with the biggest real wage growth drop since the 2008-2009 global financial crisis), the modest pick-up in global trade is providing some support, as is the scope for further recovery.

Fig 4 Key indicators of real exports and GDP across selected CEE countries

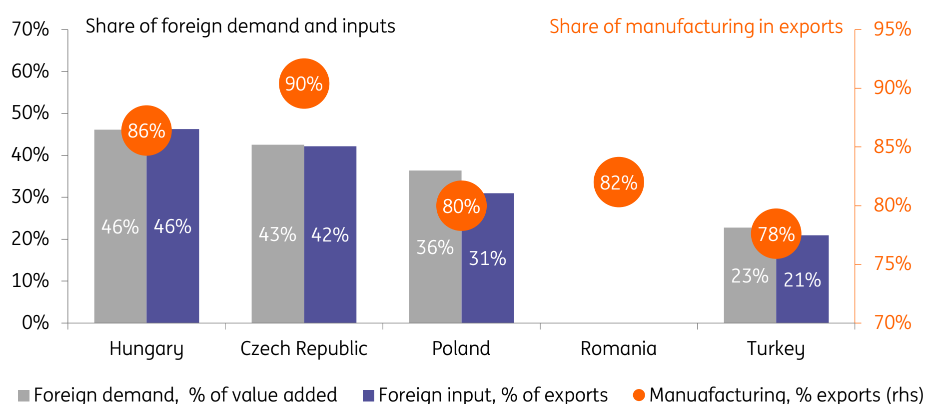
	Czech Republic		Hungary		Poland		Romania		Turkey	
	2022	2023F	2022	2023F	2022	2023F	2022	2023F	2022	2023F
Real exports (% YoY)	5.7	5.9	11.8	5.4	6.2	0.6	8.9	7.0	9.1	-0.1
GDP (% YoY)	2.5	-0.4	4.6	0.2	5.1	1.2	4.7	2.5	5.6	2.5
Net exports (pps of GDP change)	-3.1	3.4	0.7	3.0	0.2	1.8	-0.7	-0.2	0.6	-0.1

Source: National sources, ING

Hungary and the Czech Republic also rely heavily on foreign inputs when it comes to domestic production and exports

Trends in the Czech Republic and Hungary stand out - already showing signs of a pick-up on the net export side. But the direct contribution of net exports to GDP performance is usually low in the region. In general, a pick-up in foreign trade should normally be supportive of economic growth through domestic production and consumption, if a country's export sector is based more on domestic value-added and less on imports. That means good trade figures with low real impacts.

Fig 5 Integration into global chains



Source: WTO, OECD, National sources, ING

It is probably worth sharing the experience of Hungary as, among our group, its value added has the highest level of integration into the global chains. Despite the significant pick-up in car and EV battery manufacturing, one of the country's key industries, this comes with a caveat. In Hungary, the motor vehicles sector has an almost 65% share of foreign value-added in the export content. This means that for every €100 of exports in car manufacturing, Hungary needs €65 of imports as well.

Unfortunately, the latest figure for this trade-in-value-added data is based on 2018 input-output tables. Since then, the machinery sector in Hungary has seen a revolution with the boost in the manufacture of batteries and accumulators. Machinery is yet another sector with a high share of foreign value-added. The 2018 figures show a 60% share of imported content in this sector, but with a recent focus shift in this sector, we think this import share could now be around 70-75%. The bottom line is that the crown jewels in export activity are heavily dependent on imports, thus generating a relatively low share of domestic value-added.

As a summary on foreign trade, the CEE region contains big, rather closed economies like Poland or Turkey, while Romania looks more mid-ground. But export activity itself will not tell us much about the full picture when it comes to a positive global trade shock. A positive global shock – even if it comes from China's reopening and easing supply chain pressure – will not be able to boost economic activity if the foreign value-added share is high within exports.

Of course, sometimes quantity can beat quality, especially if there is a boom in the capacity of the export-driven manufacturing sector. Yet this might only prove a short-term victory that does not necessarily translate into a sustainable growth profile in the

long term. For longer-term improvements, countries would need to focus on investments that are able to make the local SME sector a sound contributor as Tier1/Tier2 suppliers. Or an alternative would be just to lure in FDI where the product itself is less input-intensive or a country adopts that part of the production line that contains higher value added (like R&D and innovation or marketing, logistics, post-sales services).

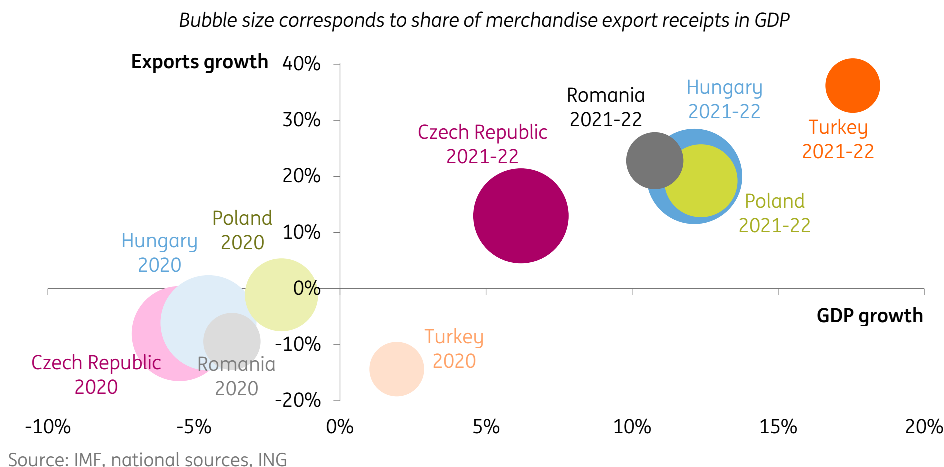
Looking across the economies, **Hungary** is extremely exposed to external demand, thus the normalisation is somewhat counterbalancing the drop in domestic demand. The same applies to the **Czech Republic**, where trade appears to be one of the few engines of growth. As we discuss in a recent article, **Poland** is looking at the benefits of potential nearshoring trends. Being the least open economy in the CE4 space, **Romania** has suffered the least from the downturn in world trade but should also benefit less when the trade recovery happens. As for the nearshoring process, to the extent it will gain relevance, Romania is unlikely to be among the first to benefit.

For an economy like **Turkey,** the growing need for macro rebalancing means a policy shift is expected following the elections. While the post-election macro adjustment is likely to include conventional monetary tightening, the Central Bank of Turkey (CBT) has already allowed an increase in the pace of Turkish lira depreciation since the presidential runoff.

Lira depreciation could increase investment costs required for capacity expansion or hike the cost of intermediate goods if the dependency on imports is quite high. Certainly, the economy has shifted to an import-intensive production and export structure over time. Yet, the import dependency ratio varies across the sectors: as (1) sectors using imported inputs at the lowest rate are composed of labour-intensive industries; whereas (2) capital-intensive sectors have a higher import dependency. Thus, labour-intensive sectors will be beneficiaries of TRY depreciation.

Fig 6 CEE real exports versus GDP growth, 2020 and cumulative 2021-22

Bubble size corresponds to share of merchandise export receipts in GDP



Source: IMF, national sources, ING

2 Energy

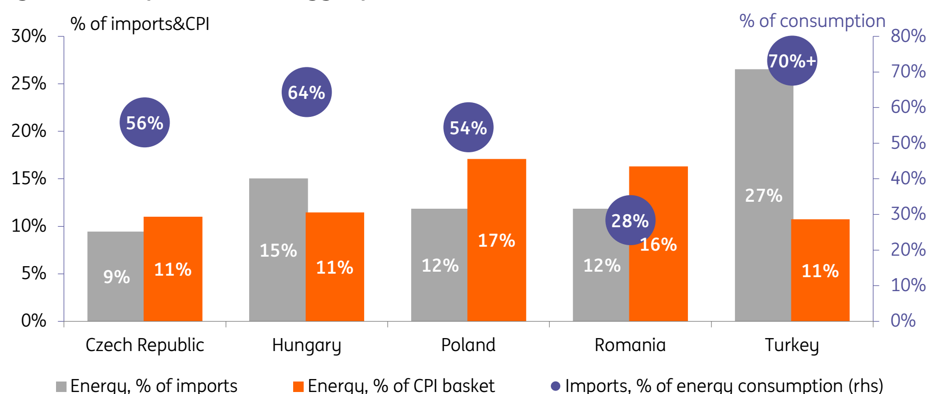
CEE exposure to energy inputs

All the selected CEE countries share high dependence on the energy inputs

As all the selected CEE countries under our coverage are energy importers, commodity prices are an important contributor to trade balances and domestic prices. As of 2022, at the time of the spike in commodity prices, energy products accounted for 9-15% of CEE merchandise imports and 27% of Turkey's imports. The import dependency of the local energy consumption varies from 28% in Romania to 54-64% in the rest of CEE and is as high as over 70% in Turkey.

Meanwhile, the direct share of energy, including consumer prices for fuel and energy prices in the domestic CPI basket is 11-18%. Based on these indicators, Czech Republic's trade balance and CPI at a first glance appears the least vulnerable to energy price swings, Hungary and Turkey appear more sensitive on the trade balance side, while Poland is more sensitive on the local price front.

Fig 7 CEE exposure to energy inputs



Source: National sources, IMF, ING

Energy price trends: impact on CEE imports

Each 10% increase or decline in the energy price index in the past three years resulted in, on average, a 7-8% change in energy imports.

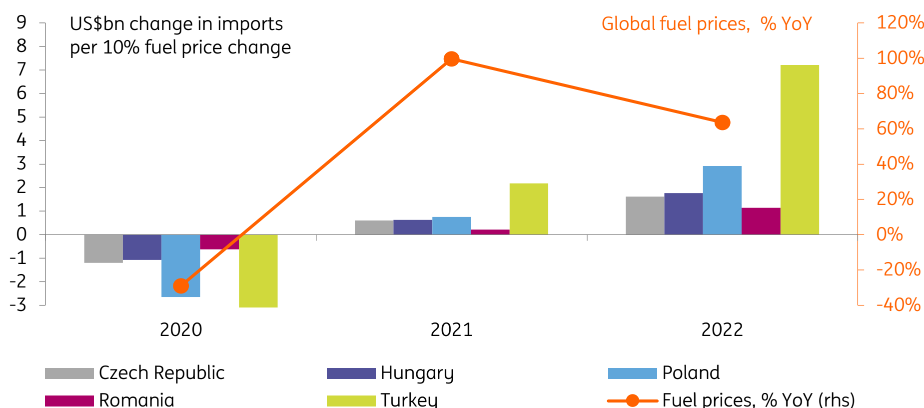
Commodity prices increased for two years over 2021 and 2022. The IMF's index of energy prices, including oil, natural gas and coal went up 100% in 2021 and 64% in 2022. The increases had a straightforward effect on the trade balances of the selected CEE countries through a respective increase in nominal imports. Each 10% increase or decline in the energy price index in the past three years resulted in, on average, a 7-8% change in energy imports.

In 2022, higher energy imports contributed around 43-59% to the increase in the overall merchandise imports in our selected CEE countries

In nominal terms, that corresponds to a US$0.7bn increase or decline in annual imports for Romania, c.US$1.2bn for the Czech Republic and Hungary, US$2.1bn for Poland, and US$4.5bn for Turkey. In 2022, higher energy imports contributed around 43-59% to the increase in the overall merchandise imports in our selected CEE countries, with the Czech Republic on the lower border of the range and Hungary on the upper.

Unsurprisingly, higher energy prices were also the primary reason for the worsening in the trade deficits in most of the countries. Now, the reversal in the price dynamic should have the opposite effect. However, a return to 2021 price levels will not result in an equivalent nominal reduction in energy imports due to a likely inertia in contract prices versus spot prices.

Fig 8 Fuel imports per 10% global price change, 2020 to 2022



Source: IMF, national sources, ING

Energy price trends: impact on CEE CPI

Representing 11-18% of the consumer basket, energy prices matter for the CPI dynamic in the CEE, and last year's spike in global commodities translated into an acceleration of the CPI, the headline more so than the core CPI. However, it should be noted that the post-Covid spike in price growth results not only from energy inputs, but also other supply- and demand-side factors that are not the focus of this exercise.

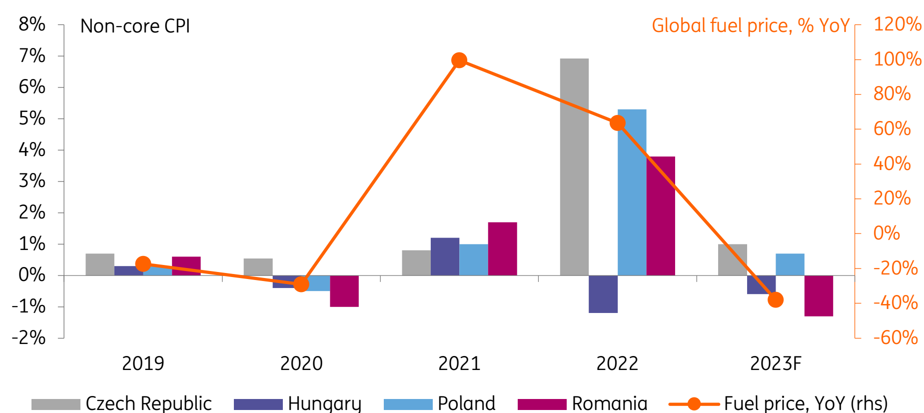
One observation we have is that, unlike the trade balance, global commodity prices pass through into the local consumer prices with a lag and to a lesser extent due to price offsetting countermeasures taken by local governments. Looking at the non-core portions of country CPIs, it appears that Turkey saw the biggest non-core CPI growth of 12ppt in 2022, but that could have been largely the effect of the country's unorthodox monetary policy and TRY depreciation.

Among our selected CEE countries, the Czech Republic and Poland saw the biggest (5-7ppt) non-core consumer price increases in 2022, while Hungary's pick up in headline CPI seems to have been a result of a polycrisis (indirect effect of energy shocks, supply chain disruptions, rapid HUF weakening and productivity issues, mainly in agriculture). The Czech Republic's sharper pass-through appears surprising given its relatively low share of energy in the CPI.

Czech Republic, Poland and Romania are expected to see a deceleration of overall CPI by 1.6-4.1ppt thanks to a 4.6-5.9% slowdown in non-core CPI, while Hungary may see a pick-up.

Looking forward, the positive effect of 2023 energy price moderation will only have a limited effect on CPI trends due to inertia and the fact that the drop or moderation in local energy price growth will be offset by continued acceleration in the core CPI. Within the CEE space, the Czech Republic, Poland and Romania are expected to see a deceleration of overall CPI by 1.6-4.1ppt thanks to a 4.6-5.9% slowdown in non-core CPI, while Hungary may see a pick-up. Turkey is a separate case, where CPI is expected to decelerate from 64% in 2022 to 47% in 2023, and purely on the core CPI components.

Fig 9 CE4 non-core CPI versus global energy prices



Source: IMF, national sources, ING

Looking at the impact on individual countries, energy has had only an indirect effect on **Hungary's** inflation due to government support measures. Thus, the drop in global energy prices will have only a lagged positive impact on inflation. Like others in the region, lower energy prices are creating opportunities for the **Czech** and **Polish** governments to pressure the margins of the fuel retailers. This creates downside risks to inflation and could provide room for rate cuts later this year.

While being self-sufficient in energy to the greatest extent, **Romania** is still a price taker and had to abruptly cap prices for consumers. Even so, consumption dropped by 9.3% in 2022 and the acceleration of photovoltaic panel installation is determining large structural changes within the energy system. The business economy has nevertheless been exposed to higher prices and, to the extent possible, it might want to recover some of the losses when prices revert to more normal levels.

Turkey meets only a quarter of its energy demand from national resources (importing 99% of its natural gas and 93% of the petroleum it uses). While the country has been trying to diversify energy sources, lower energy prices should help to significantly improve external imbalances and reduce dependency on its suppliers.

3 Tourism

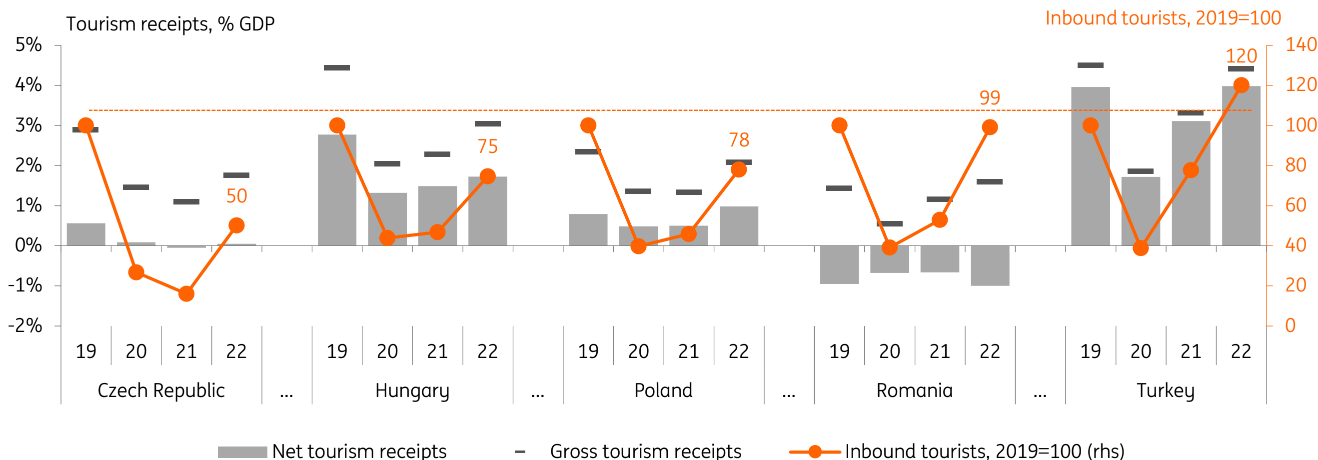
The CEE region in general offers quite a heterogenous picture in terms of tourism importance and development. Some countries in the region (eg, Croatia, Bulgaria, Montenegro) are highly dependent on tourism revenues and its indirect effects, which can account for more-or-less a fifth of their GDP. These countries benefited greatly from a tourism boom that lasted almost a decade but which came to an abrupt end in 1Q20.

However, the selected CEE countries we cover in this article have more sophisticated economies and although they may still have sizeable tourist sectors (eg, Hungary and Turkey), the diversification of their economies offers an important cushion in less impressive tourist years. The type of tourism also varies greatly among these countries, not only between Turkey and CE4 but even within the CE4. Hungary and the Czech Republic benefit more from tourism focused on their capital cities, while for Poland and Romania, tourism is less concentrated and more evenly spread across regions. Turkey, on the other hand, offers a broad range of mass tourism destinations, both cultural and leisure.

As elsewhere, 2020 was a lost year for tourism in the CEE, with lingering effects into 2021 as well. In fact, apart from Turkey, which has recovered strongly, CEE countries are still struggling to reach pre-pandemic levels in terms of total tourist arrivals. While

Poland and Romania are only marginally above 2019 levels, Hungary and the Czech Republic have a lot more to recover. It is worth mentioning that domestic tourism has been the main driver of recovery in many countries - one of the few positive dynamics that developed through the pandemic.

Fig 10 Key indicators of foreign tourism, selected CEE countries (2019-2022)



Source: Eurostat, UNWTO, national sources, ING

Turkey's arrivals are already 20% above pre-Covid levels, while Hungary has the biggest gap to close

If we turn our attention only to international arrivals, the picture is even more grim for the CE4 group, as no country was above 2019 levels by the end of 2022. Arguably, the outlook appears much better for Hungary, which, on the one hand, still has more to recover while, on the other hand, should benefit from the ongoing Chinese reopening and new direct flights between China and Hungary. To some extent, this could have positive spillover effects for the Czech Republic given the proximity and relatively good connecting infrastructure.

While relative comparisons have their advantages, they can grossly understate the huge nominal differences between Turkey and the rest of the CE4. Prior to the pandemic, the combined CE4 international arrivals significantly exceeded Turkey's arrivals (with a clear trend nevertheless in favour of the latter), but the situation has changed dramatically in the post-pandemic era as CE4 numbers have dropped roughly to one third of Turkey's.

It is worth mentioning that of the five countries, Turkey, Hungary and Poland have a clear positive balance when it comes to travel receipts and expenditure, while the Czech Republic flirts with negative balances and Romania is a confident net payer of tourism receipts.

The importance of the tourism sector for the CE4 and Turkey is generally above the EU average, with a tendency to be quite sizeable in Turkey and Hungary. Given its size and geographic location, Turkey stands out both in nominal and relative terms, whether in respect of tourism's importance for GDP, the number of visitors, air connectivity or types of tourism it can provide.

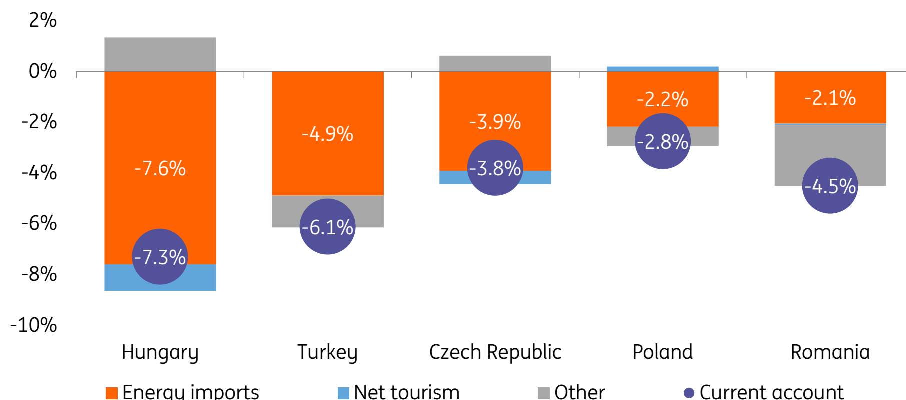
Having ranked in the top five countries worldwide by number of tourists visiting, **Turkey's** tourism revenues help to some extent compensate for the large goods deficit in the balance of payments. Improvements in tourism are likely to maintain its healthy growth trend in the period ahead.

The CE4 economies offer yet again a rather heterogenous picture, with Romania somewhat departing from the group when it comes to road and rail connectivity with the west, though arguably offering a wider range of destination types. As **Romania i**s not particularly well connected with its CEE peers it cannot match Turkey's much wider accessibility for types of tourism.

Tourism is key for **Hungary** with a high share within its GDP and the potential for more growth from Asian tourists. And a return of tourism should be welcome for both Poland and the Czech Republic, although net tourism receipts seem less important for the latter.

Bringing it together in the current account

Fig 11 Current account evolution by components, 2022 vs 2019 (% of GDP)



Source: National sources, UNWTO, IMF, ING

Bringing it all together, Figure 11 summarises all that we were trying to focus on. The current account is the most sensitive and most complex indicator representing an overall picture of the merchandise trade, tourism and energy-related shocks. Increased energy prices have played by far the largest role in the deterioration of the current accounts of each country since 2019 and price reversals should ensure a reversal of deteriorating trends.

Hungary proved to be impacted the most by these combined shocks which puts it in a position to gain the most in a recovery period. Hungary stands out with its relatively large tourism sector and, at the same time, as being one of the most open economies in Europe, hence exposed to global goods and services trade shocks (be it positive or negative). For **Romania**, on the other hand, we do not expect to see significant gains from a reversal of the tide.

At the margin, it could be argued that the **Czech Republic** could gain more than **Poland** on these themes given its more open economy – although in reality the diverging fiscal stances of these countries (ongoing loose fiscal policy in Poland and tight fiscal policy in the Czech Republic) will have a far greater impact on growth over the next two years.

Despite the partial increase in **Turkey's** share in world exports, the current account deficit reached the highest level of the past five years recently as import costs increased much more than export revenues. Given this backdrop, lower energy prices and a continuing strength of the tourism sector will remain key for Turkey's external outlook. However, domestic factors should play a more important role to contain imbalances in the near term as: (1) a change in policy mix towards a tighter stance to control domestic demand, and hence import demand; and (2) the likely normalisation of gold imports on the back of improving confidence, should help narrow the current account deficit.

Countries

Armenia

Dmitry Dolgin, Chief Economist, Russia & CIS

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	12.1	7.0	6.0	5.0	6.5	7.5	5.7
CPI (%YoY)*	5.4	2.2	1.9	3.1	4.7	3.7	4.6
Policy interest rate (eop, %)	10.75	10.25	8.75	7.75	7.25	7.75	6.00
3m interest rate (%)*	11.0	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (%)*	11.8	n/a	n/a	n/a	n/a	n/a	n/a
USD/AMD*	389	384	390	406	410	400	416
EUR/AMD*	421	415	441	479	492	448	487

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

*Quarterly data is eop, annual is average

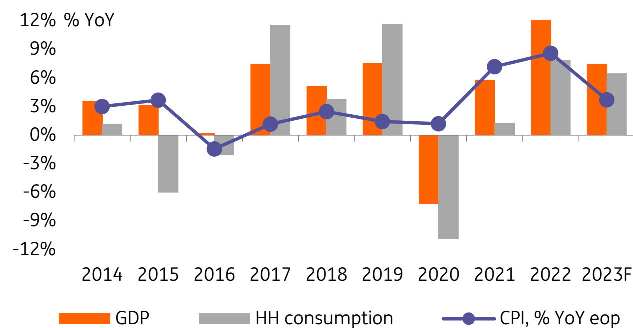
Source: National sources, ING estimates

Country strategy: Running too hot?

Armenia has benefited from a spillover of the war in Ukraine through net immigration of middle-class Russians and other CIS citizens, boosting services exports, domestic consumption and GDP, increasing its two-way trade with Russia and boosting budget revenues. Yet unless there is a new wave of immigration, growth is set to normalise amid still high unemployment and sluggish credit growth. Budget policy, prudent so far, may face higher military spending if tensions with Azerbaijan re-emerge.

As CPI passed its peak and monetary stance has been conservative so far, there is a scope for cautiously lower local rates. The FX rate, however, is now 24% stronger to USD vs end-2021 and is facing the risk of correction. On the plus side, the central bank has used the one-off windfall to boost reserves, strengthening external buffers.

GDP growth and CPI

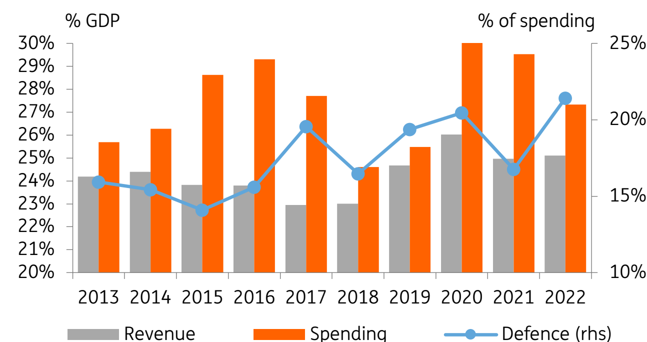


Source: National sources, ING

Activity moderates but remains strong

Following a significant 12.6% spike in GDP in 2022 thanks to the increase in migration, trade and capital flows from Russia (in addition to a post-Covid rebound in tourism) and 12.2% YoY in 1Q23, Armenia's GDP growth is set to moderate in 2023, but to remain robust at around 7-8%. As most Russian immigrants, equating to around 2% of Armenia's permanent population, are likely to stay in the medium-term, consumption seems well supported. Meanwhile, with unemployment high in double digits, private credit growth negative, and fiscal policy not generous, local domestic support factors appear muted. On the plus side, the deceleration of CPI from 10.3% at mid-2022 to 3.2% YoY in April amid a stronger Armenian Dram (AMD) and higher base effect, creates room for cautious cuts in the key rate from the current 10.75%.

Key parameters of consolidated budget

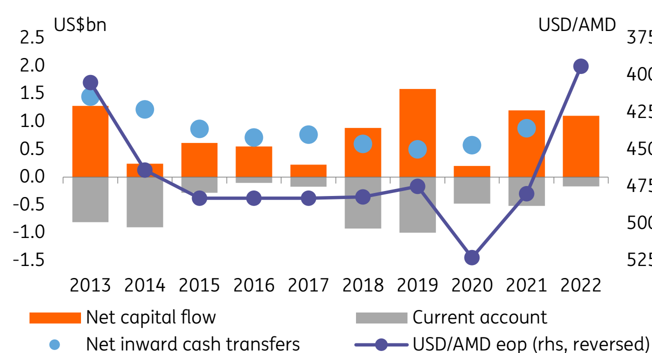


Source: National sources, ING

Fiscal discipline in focus

In 2022, Armenia showed fiscal restraint in the face of extra revenues, allowing it to halve the fiscal deficit to 2.2% GDP. Military tensions with Azerbaijan, despite recent diplomatic momentum, create upward risks to military spending, which totalled 5.6% GDP in 2022 and exceeded the initial plan by 40%, and with a 20%+ weight in total spending may put the overall fiscal discipline to the test. In 2023-25, the deficit may gravitate towards 3% GDP and is likely to be financed mostly domestically in AMD amid little competition with private sector borrowing and elevated FX depreciation risks following AMD's 24% appreciation to USD vs the end-2021 level, the strongest appreciation in the peer group. The FX appreciation in 2022 was also a key factor in reducing government debt ratios, which will remain sensitive to FX movements.

Current account, remittances and Armenian Dram (AMD)



Source: National sources, ING

Correction in AMD not excluded

Immigration of c.65,000 people from CIS led to a positive balance of payments shock and 24% appreciation of USD/AMD since end-2021. Higher export of services (inward travel) was the main driver of a narrowing of the current account deficit by US$350m YoY to -US$170m. The merchandise trade deficit widened by US$500m due to proxy trade with Russia which accounts for 28% of exports and 43% of imports. Net inflow of personal money transfers increased by US$1.7bn YoY to US$2.6bn but remained as FX within the banking system, not increasing the net capital inflow or lending. Mid-2022, AMD appreciation slowed to 2% per quarter, and the 4Q22 BoP points to a normalisation of flows, signalling potential correction in AMD. Yet the extra US$0.9bn accumulated by the Central Bank in 2022 could be used to smooth future AMD moves.

Armenia

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	3.3	3.6	3.2	0.2	7.5	5.2	7.6	-7.2	5.8	12.6	7.5	5.7	4.2
Private consumption (%YoY)	2.3	1.2	-6.0	-2.1	11.6	3.8	11.7	-10.9	1.3	7.9	6.5	5.5	4.0
Government consumption (%YoY)	7.6	-1.2	4.7	-2.4	-2.1	-3.0	12.9	9.2	-6.2	6.7	6.0	5.0	4.0
Fixed investment (%YoY)	-7.0	-2.2	2.5	-11.4	9.7	4.8	4.4	-1.5	23.6	9.5	20.0	6.0	5.0
Industrial production (%YoY)	7.3	2.6	5.1	6.8	12.6	4.2	9.0	-0.9	3.3	7.9	3.0	5.0	7.0
Unemployment rate (average, %)	16.2	17.6	18.5	18.0	17.8	19.0	18.3	18.2	15.5	13.0	12.5	13.0	14.0
Nominal GDP (AMDbn)	4,556	4,829	5,044	5,067	5,564	6,017	6,543	6,182	6,983	8,497	9,473	10,473	11,371
Nominal GDP (€bn)	8.5	8.6	9.6	9.6	10.1	10.5	12.2	11.1	11.7	18.5	21.2	21.5	22.6
Nominal GDP (US$bn)	11.1	11.6	10.6	10.5	11.5	12.5	13.6	12.6	13.9	19.5	23.7	25.2	26.0
GDP per capita (US$)	3,686	3,856	3,519	3,532	3,878	4,201	4,601	4,266	4,681	6,587	7,642	8,122	8,398
Gross domestic saving (% of GDP)	14.8	13.3	18.5	17.1	16.9	15.0	10.1	15.9	17.0	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	5.7	3.0	3.7	-1.4	1.2	2.5	1.4	1.2	7.2	8.6	3.7	4.6	4.2
CPI (year-end, %YoY)	5.6	4.6	-0.2	-1.2	5.6	1.3	0.7	3.7	7.7	8.3	3.1	4.7	3.9
Wage rates (nominal, %YoY)	4.1	8.2	8.2	1.6	1.9	4.0	5.8	3.9	7.6	15.5	15.0	10.0	7.0
Fiscal balance (% of GDP)													
Consolidated government balance	-1.5	-1.9	-4.8	-5.5	-4.8	-1.6	-0.8	-5.1	-4.6	-2.2	-2.0	-2.3	-2.6
Consolidated primary balance	-0.6	-0.7	-3.4	-3.7	-2.6	0.6	1.4	-2.7	-2.0	0.4	0.6	0.3	0.0
Total public debt	36.3	39.4	44.1	51.9	53.7	51.2	50.1	63.5	60.3	49.3	50.3	51.5	52.8
External balance													
Exports (US$bn)	1.6	1.7	1.6	1.9	2.4	2.7	3.4	2.7	3.3	5.5	5.0	5.1	5.2
Imports (US$bn)	3.8	3.8	2.8	2.9	3.8	4.5	5.1	4.1	4.8	7.6	7.2	7.4	7.6
Trade balance (US$bn)	-2.2	-2.1	-1.2	-1.0	-1.4	-1.8	-1.7	-1.4	-1.5	-2.0	-2.2	-2.3	-2.3
Trade balance (% of GDP)	-19.7	-17.7	-11.2	-9.3	-12.2	-14.2	-12.6	-10.9	-10.9	-10.5	-9.4	-9.1	-9.0
Current account balance (US$bn)	-0.8	-0.9	-0.3	-0.1	-0.2	-0.9	-1.0	-0.5	-0.5	-0.2	-0.6	-0.7	-0.8
Current account balance (% of GDP)	-7.3	-7.8	-2.7	-1.0	-1.5	-7.4	-7.3	-3.8	-3.7	-0.9	-2.4	-2.8	-3.0
Net FDI (US$bn)	0.3	-1.3	0.0	0.2	0.1	0.7	0.1	-0.2	0.4	1.4	1.0	1.2	1.5
Net FDI (% of GDP)	2.4	-11.2	-0.5	2.1	0.8	6.0	0.9	-2.0	2.7	7.4	4.2	4.8	5.8
Current account balance plus FDI (% of GDP)	-4.9	-19.0	-3.1	1.2	-0.7	-1.5	-6.4	-5.7	-1.0	6.5	1.8	2.0	2.7
Foreign exchange reserves ex gold (US$bn)	2.3	1.5	1.8	2.2	2.3	2.3	2.8	2.6	3.2	4.1	4.6	5.1	5.6
Import cover (months of merchandise imports)	7.0	4.8	7.6	9.2	7.3	6.0	6.7	7.7	8.1	6.5	7.7	8.3	8.9
Debt indicators													
Gross external debt (US$bn)	8.7	8.5	8.9	10.0	10.5	10.9	12.4	12.9	13.8	15.3	16.0	16.5	17.5
Gross external debt (% of GDP)	78.5	73.6	84.5	94.4	91.3	87.7	90.9	102.1	99.9	78.2	67.4	65.4	67.1
Gross external debt (% of exports)	534	503	549	526	441	401	368	475	423	276	321	322	334
Lending to corporates/households (% of GDP)	36.4	41.3	37.8	39.3	41.2	44.4	48.0	59.1	51.3	44.9	44.1	44.6	46.4
Interest & exchange rates													
Central bank key rate (year-end, %)	7.75	8.50	8.75	6.25	6.00	6.00	5.50	5.25	7.75	10.75	7.75	6.00	6.00
Broad money supply (%YoY)	14.9	-3.5	5.2	24.8	28.9	13.2	21.4	14.8	12.8	13.4	17.0	15.0	12.0
3m interest rate (average, %)	n/a	7.50	12.09	8.56	6.11	6.02	5.83	5.44	7.10	10.00	n/a	n/a	n/a
3m interest rate spread over US$-Libor (ppt)	n/a	7.25	11.76	7.76	4.82	3.67	3.54	4.84	6.90	7.45	n/a	n/a	n/a
2yr yield (average, %)	n/a	8.93	13.30	11.15	7.68	7.04	6.80	6.17	8.22	10.62	n/a	n/a	n/a
10yr yield (average, %)	n/a	11.26	14.92	14.00	11.10	9.72	9.48	7.99	9.39	11.24	n/a	n/a	n/a
USD/AMD exchange rate (year-end)	405	464	483	483	483	482	475	523	480	394	406	426	447
USD/AMD exchange rate (average)	410	416	478	480	483	483	480	489	504	435	400	416	437
EUR/AMD exchange rate (year-end)	559	561	525	509	580	551	533	640	544	422	479	490	515
EUR/AMD exchange rate (average)	547	560	543	517	545	570	537	559	596	460	448	487	502
Brent oil price (average, US$/bbl)	109	99	52	44	54	71	64	42	71	99	90	89	75

Source: National sources, Macrobond, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	13.1	14.8	12.7	12.1	7.0	6.0	5.0	6.5	6.0	5.5	5.2	4.0	4.0
CPI (eop, %YoY)	10.3	9.9	8.3	5.4	2.2	1.9	3.1	4.7	5.0	4.6	4.6	4.4	4.2
Central bank key rate (eop, %)	9.25	10.00	10.75	10.75	10.25	8.75	7.75	7.25	6.75	6.50	6.00	6.00	6.00
3m interest rate (eop, %)	10.16	10.59	11.23	11.02	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	11.35	11.79	11.99	11.75	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AMD exchange rate (eop)	406	406	394	389	384	390	406	410	415	420	426	430	435
EUR/AMD exchange rate (eop)	426	398	422	421	415	441	479	492	486	483	490	495	500

Source: National sources, Macrobond, ING estimates

Azerbaijan

Dmitry Dolgin, Chief Economist, Russia & CIS

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	0.4	2.8	3.2	3.4	4.0	2.0	2.5
CPI (%YoY)*	13.6	12.0	8.2	5.9	7.0	10.7	6.2
Policy interest rate (eop, %)	8.75	9.00	8.75	8.50	8.25	8.50	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*	1.84	1.84	1.92	2.01	2.04	1.88	1.99

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

*Quarterly data is eop, annual is average

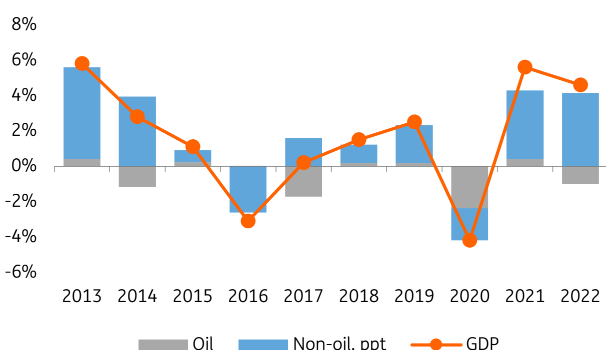
Source: National sources, ING estimates

Country strategy: a balanced play

As holder of vast gas reserves Azerbaijan is set to benefit from Russia's tensions with the EU through higher fuel exports and budget revenues amid conservative fiscal policy. At the same time, the country's trade ties with Russia are limited and diplomatic relations are relatively distant, lowering the risk of secondary sanctions and underpinning Azerbaijan's beneficial position.

Meanwhile, outside of strong foreign trade and financial position, Azerbaijan is challenged by a stagnation of the oil sector, slowing growth in non-fuel sectors, sticky elevated inflation, high dependency on food imports from Turkey and Russia, and the need to maintain relatively tight monetary policy. Tensions with Armenia, despite the recent diplomatic momentum, remain a risk and could also become a trigger for some easing in fiscal policy.

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

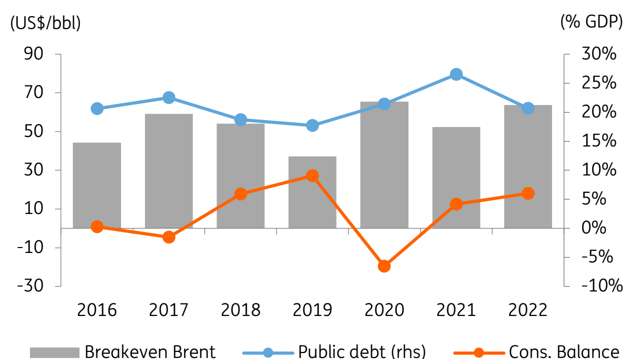


Source: CEIC, National sources, ING

Activity to slow

Azerbaijan's GDP growth slowed to 4.6% in 2022, on lower oil production and a tighter fiscal stance (see below). In 2023-24, growth is set to moderate further to 2.0-2.5 pa on stagnation in oil output and an end to the positive spillover from the Russia/Ukraine conflict. In 4M23, GDP growth was 0.1% YoY amid a 2.4% YoY drop in oil-led industrial production. Later, support will still come from the growing gas trade with the EU and some pickup in consumer and lending activity. While the fiscal policy has some scope for easing, monetary policy is unlikely to provide support because of the elevated CPI, currently at 13%, which prevents the Central Bank of Azerbaijan (CBAZ) from materially lowering the key rate, currently at 9.00%. In 2023, average CPI may slow to 10%, but the outlook is vulnerable to negative developments given the 43% dependence on imports from Russia and Turkey.

Fiscal balance and breakeven oil price

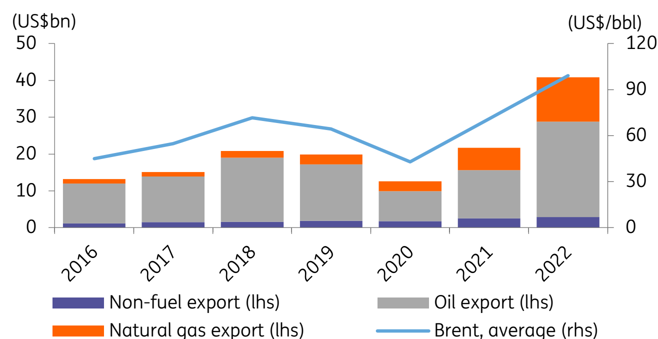


Source: CEIC, National sources, ING

Fiscal stance remains tight

In line with our expectations, the consolidated budget surplus was 6% of GDP in 2022 on higher oil prices, healthy non-oil revenue collection and relatively restrained spending. Breakeven oil increased from US$52/bbl in 2021 to US$64/bbl, which is still comfortable. The reintroduction of fiscal rules in 2022 should limit further expansion in spending, as the non-oil deficit is targeted to narrow by 5ppt of GDP by 2026. Meanwhile, high inflation, tensions with Armenia, despite the recent diplomatic momentum, and capex on new territories of around 3% of GDP pa create moderate upward risks to spending. Each US$10/bbl oil price increase assures around 1.5% of GDP of oil revenues, and the recent and upcoming windfall translates into higher state savings (62% of GDP) and early redemption of debt, currently at only 20% of GDP (including guarantees).

Key exports indicators



Source: CEIC, National sources, ING

Exports to be supported by growing gas supplies

In 2022, Azerbaijan's current account surplus spiked by US$15bn to US$23.5bn, or 30% of GDP thanks to higher oil prices, as well as higher volumes and prices of gas supplies. Fuel accounts for 93% of exports, of which c.65% is attributable to oil. In 2023, the current account should remain at around US$20bn, as a decline in oil and gas prices will be partially offset by growing gas supplies amid stable exports. Gas exports to the EU went up from 8.1bcm in 2021 to 11.4bcm (51% of total gas exports) in 2022 and are targeted to reach 20bcm by 2027, supporting the current account and economic activity. Azerbaijan's relatively distant relationship with Russia (outside of Russia's 21% share in Azerbaijani imports) lowers the exposure to the risk of secondary sanctions.

Azerbaijan

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	5.8	2.8	1.1	-3.1	0.2	1.5	2.5	-4.2	5.6	4.6	2.0	2.5	2.7
Real oil GDP (%YoY)	0.9	-2.9	0.6	0.1	-5.3	0.5	0.4	-6.5	1.4	-2.7	-0.5	0.5	1.5
Real non-oil GDP (%YoY)	9.9	7.0	1.1	-4.4	2.8	2.0	4.0	-2.9	7.1	9.0	4.0	3.7	3.5
Investment (%YoY)	15.1	-1.7	-11.1	-21.7	2.8	-4.3	5.5	-7.3	-4.5	5.5	12.0	3.0	5.0
Industrial production (%YoY)	1.8	-0.7	2.4	-0.5	-3.4	1.5	1.8	-4.0	5.0	-1.1	0.5	1.7	3.0
Unemployment rate (average, %)	5.0	4.9	5.0	5.0	5.0	4.9	4.9	6.4	6.4	5.8	5.5	5.4	5.3
Nominal GDP (AZNbn)	58.2	59.0	54.4	60.4	70.3	80.1	81.9	72.6	93.2	133.8	146.3	156.1	168.3
Nominal GDP (€bn)	55.8	56.6	47.8	34.2	36.2	39.9	43.0	37.4	46.3	74.6	77.6	78.5	85.4
Nominal GDP (US$bn)	74.2	75.2	53.0	37.9	40.9	47.1	48.2	42.7	54.8	78.7	86.1	91.8	99.0
GDP per capita (US$)	7,977	7,991	5,562	3,929	4,199	4,798	4,864	4,281	5,473	7,819	8,200	8,663	9,251
Gross domestic saving (% of GDP)	48	44	31	29	31	37	32	24	27	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	2.4	1.4	4.0	12.4	12.9	2.3	2.6	2.8	6.7	13.8	10.7	6.2	5.0
CPI (year-end, %YoY)	3.6	-0.1	7.7	15.5	7.9	1.6	2.3	2.6	12.0	14.3	5.9	7.0	3.2
Wage rates (nominal, %YoY)	6.2	5.7	4.5	7.4	5.9	2.9	16.6	11.4	3.4	14.7	11.7	7.2	6.0
Fiscal balance (% of GDP)													
Consolidated government balance	1.8	2.9	-5.3	0.3	-1.5	5.9	9.1	-6.5	4.2	6.0	3.9	3.6	1.4
Consolidated primary balance	3.2	4.3	-3.8	2.4	0.9	8.7	10.9	-4.4	6.3	7.3	5.0	4.7	2.4
Total public debt	n/a	8.6	19.8	20.6	22.5	18.7	17.7	21.4	26.5	20.7	20.0	19.0	18.0
External balance													
Exports (US$bn)	31.8	28.3	15.6	13.2	15.2	20.8	19.9	12.6	21.7	40.9	39.0	39.6	35.0
Imports (US$bn)	11.2	9.3	9.8	9.0	9.0	11.0	11.3	10.1	10.4	13.5	14.6	15.2	15.3
Trade balance (US$bn)	20.6	18.9	5.8	4.2	6.1	9.8	8.5	2.5	11.3	27.4	24.5	24.4	19.7
Trade balance (% of GDP)	27.8	25.2	11.0	11.1	15.0	20.9	17.7	5.9	20.6	34.8	28.4	26.6	19.9
Current account balance (US$bn)	12.2	10.2	-0.2	-1.4	1.7	6.1	4.4	-0.2	8.3	23.5	19.8	18.8	14.6
Current account balance (% of GDP)	16.5	13.6	-0.4	-3.6	4.1	12.8	9.1	-0.5	15.1	29.8	23.0	20.5	14.8
Net FDI (US$bn)	1.1	2.4	0.8	1.9	0.3	-0.8	-1.4	-0.8	-3.7	-5.1	-3.0	-2.0	-1.0
Net FDI (% of GDP)	1.5	3.2	1.5	5.0	0.7	-1.7	-2.9	-1.9	-6.7	-6.5	-3.5	-2.2	-1.0
Current account balance plus FDI (% of GDP)	18.0	16.8	1.1	1.4	4.9	11.1	6.2	-2.4	8.4	23.3	19.5	18.3	13.8
Foreign exchange reserves (US$bn)	14.2	13.8	5.0	4.0	5.3	5.6	6.3	6.4	7.1	9.0	10.0	11.0	12.0
Import cover (months of merchandise imports)	15.3	17.7	6.1	5.3	7.0	6.1	6.7	7.6	8.2	8.0	8.2	8.7	9.4
Debt indicators													
Gross external debt (US$bn)	11	12	13	15	15	16.2	15.8	15.8	14.6	15.0	14.5	14.5	14.5
Gross external debt (% of GDP)	14.8	16.0	24.5	39.6	36.7	34.4	32.8	37.0	26.6	19.1	16.8	15.8	14.6
Gross external debt (% of exports)	34.6	42.5	83.4	113.5	99.0	77.9	79.5	125.5	67.3	36.7	37.1	36.6	41.5
Lending to corporates & households (% of GDP)	26.5	31.4	40.0	27.2	16.7	16.3	18.7	20.0	18.4	15.1	15.6	15.9	15.9
Interest & exchange rates													
Central bank key rate (year-end, %)	4.75	3.50	3.00	15.00	15.00	9.75	7.50	6.25	7.25	8.25	8.50	7.50	6.50
Broad money supply (average, %YoY)	15.0	11.8	-1.3	-1.9	9.0	5.7	20.0	1.1	18.7	23.6	14.7	11.2	10.4
3m interest rate (Bakibor, average, %)	9.7	10.8	9.2	13.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
3m interest rate spread over US$-Euribor (ppt)	947	1,059	918	1,380	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AZN exchange rate (year-end)	0.78	0.78	1.56	1.80	1.70	1.70	1.70	1.70	1.70	1.70	1.7	1.7	1.7
USD/AZN exchange rate (average)	0.78	0.78	1.03	1.60	1.72	1.70	1.70	1.70	1.70	1.70	1.7	1.7	1.7
EUR/AZN exchange rate (year-end)	1.08	0.95	1.7	1.87	2.04	1.95	1.91	2.08	1.93	1.82	2.0	2.0	2.0
EUR/AZN exchange rate (average)	1.04	1.04	1.14	1.77	1.94	2.01	1.90	1.94	2.01	1.79	1.9	2.0	2.0
Brent oil price (annual average, US$/bbl)	109	99	52	44	54	71	64	42	71	99	90	89	75

Source: CEIC, National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	6.3	3.8	3.1	0.4	2.8	3.2	3.4	4.0	2.5	2.0	1.5	2.5	2.7
CPI (eop, %YoY)	14.2	15.6	14.3	13.6	12.0	8.2	5.9	7.0	5.7	6.1	7.0	3.2	5.1
Central bank key rate (eop, %)	7.8	7.75	8.25	8.75	9.00	8.75	8.50	8.25	8.00	7.75	7.50	7.25	7.00
3m interest rate (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AZN exchange rate (eop)	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/AZN exchange rate (eop)	1.77	1.66	1.82	1.84	1.84	1.92	2.01	2.04	1.99	1.96	1.96	1.96	1.96

Source: CEIC, National sources, ING estimates

Bulgaria

Valentin Tataru, Chief Economist

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	2.0	1.6	1.7	1.7	2.4	1.7	3.1
CPI (%YoY)*	14.0	9.6	7.3	6.6	5.3	10.4	5.0
Base rate (eop,%)	2.17	2.60	2.80	3.00	2.90	3.00	2.70
10yr yield (%)*	4.20	4.40	4.50	4.50	4.30	4.40	4.25
USD/BGN	1.81	1.81	1.73	1.66	1.63	1.66	1.70
EUR/BGN	1.96	1.96	1.96	1.96	1.96	1.96	1.96

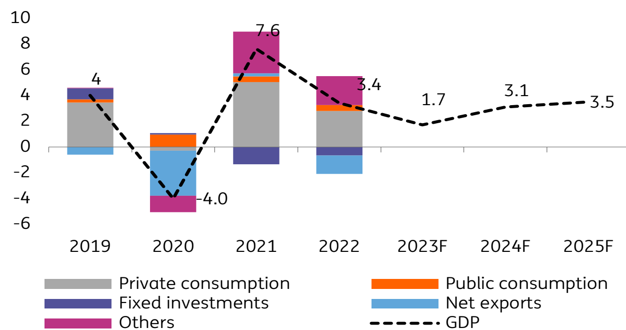
Macro trend		Political cycle	Ratings	FC	LC
Activity	=	Presidential: 2025	S&P	BBB	BBB
Fiscal	Loose	Parliamentary: 2027	Moody's	Baa1	Baa1
Monetary	Loose	Local: 2023	Fitch	BBB	BBB

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

Country strategy: Wasted time

It took five rounds of inconclusive snap elections in just over two years to end up with the political scene looking pretty much the same as it did at the start. During this time, Bulgaria missed the opportunity to join the Eurozone and Schengen area from 2024 and has lost precious time in absorbing EU funds from the Recovery and Resilience Facility. Even the usually praised prudent fiscal stance is coming under question as the interim governments had limited capacity to steer spending. Following the latest elections in April 2023, a grand coalition between GERB and Continuing the Change is shaping up. While common ground seems to have been found in the overall pro-EU policy direction, some details of the agreement (eg, prime minister rotation every nine months) are making the coalition a fragile one. Nevertheless, this is as good as it gets for now.

Real GDP (%YoY) and contributions (ppt)

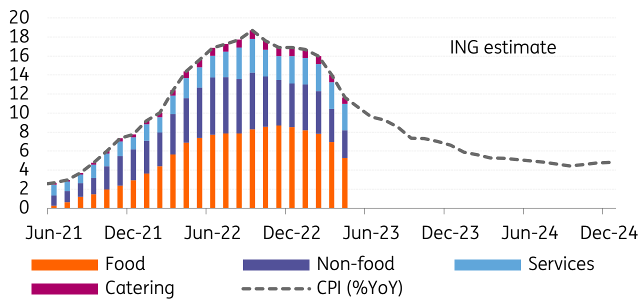


Source: NSI, ING

Decoupling from politics only lasts so long

One year of real negative wage growth and two years of political uncertainty have dampened consumer morale. This has led to a slowdown in private consumption as revealed by the retail sales numbers that show three consecutive months of contraction (February-April 2023), a first since 2009. We believe this could be a bottom for consumption as the strong wage advances (which we estimate at 15.0% for 2023) should prop-up consumer spending. A stable government will also give a boost to EU-funded investments, though it might be too late to reap the benefits in 2023. We expect a fairly anaemic 1.7% GDP growth in 2023, followed by an acceleration to 3.1% in 2024 should political stability prevail.

Inflation (%YoY) and main components (ppt)

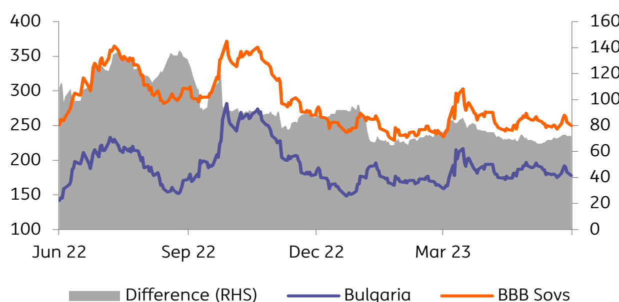


Source: NSI, ING

Moving lower but not low enough

With past energy prices out of the statistical base and current prices on a downturn, inflation started to ease considerably over the past couple of months. We estimate that HICP inflation will average 9.2% in 2023, from 13.0% in 2022. In 2024, HICP inflation could average around 4.5% which would mean that Bulgaria will not be even close to meeting the price stability criterion for Eurozone entry. We currently estimate the average for the three best performing EU member states to be below 2.0% in 2024. Given the significant real convergence that Bulgaria still needs to deliver (which could come with some associated inflationary pressures), it will take quite an indulgence by the EU to overlook the price stability criterion.

BGARIA credit spreads vs BBB EUR sovereigns (bp)



Source: ICE, Refinitiv, ING

BGARIA credit: Some hope for political stability

While it remains uncertain how successful a grand coalition will be in implementing structural reforms and how stable such a government may be, the recent agreement offers some hope for an end to the political uncertainty that has plagued Bulgaria and therefore a reduction in the political risk premium. In the longer term, signs of concrete progress towards Eurozone accession will be key. Bulgaria is one of the weaker performers YTD among CEE EUR sovereigns and underlying fundamentals are very strong (current account near balance, low government debt and strong FX reserve position).

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Bulgaria

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	-0.6	1.0	3.4	3.0	2.8	2.7	4.0	-4.0	7.6	3.4	1.7	3.1	3.5
Private consumption (%YoY)	-3.9	1.4	2.8	2.2	2.5	3.7	6.0	-0.6	8.8	4.8	2.8	3.8	4.0
Government consumption (%YoY)	0.7	-0.1	1.8	2.2	4.3	5.3	2.0	8.3	0.4	6.5	-1.1	2.1	3.0
Investment (%YoY)	0.5	3.5	2.7	-6.6	3.2	5.4	4.5	0.6	-8.3	-4.3	6.5	2.8	4.0
Industrial production (%YoY)	0.2	2.1	2.8	2.5	4.0	0.3	0.5	-6.3	10.1	12.8	-4.0	0.9	2.2
Unemployment rate (eop, %)	14.2	11.4	9.0	7.7	6.7	5.7	5.3	6.3	4.6	4.1	4.4	4.2	4.0
Nominal GDP (BGNbn)	82.2	84.2	89.6	95.4	102.8	110.0	120.4	120.5	139.0	165.4	185.0	197.0	210.8
Nominal GDP (€bn)	42.0	43.1	45.8	48.8	52.6	56.2	61.6	61.6	71.1	84.6	94.6	100.7	107.8
Nominal GDP (US$bn)	55.9	56.8	50.4	53.7	59.9	65.8	68.9	70.9	83.9	88.8	105.9	117.8	123.9
GDP per capita (US$)	7,700	7,900	7,100	7,600	8,500	9,400	9,900	10,300	12,200	13,100	15,600	17,300	18,200
Gross domestic saving (% of GDP)	20.4	20.4	21.9	23.9	24.1	23.8	24.2	22.3	22.8	21.5	20.7	20.4	20.1
Prices													
CPI (average %YoY)	0.9	-1.4	-0.1	-0.8	2.1	2.8	3.1	1.7	3.3	15.3	10.4	5.0	5.0
CPI (year-end %YoY)	-1.6	-0.9	-0.4	0.1	2.8	2.7	3.8	0.1	7.8	16.9	6.6	4.8	5.3
Wage rates (nominal %YoY)	8.6	2.4	7.9	7.0	10.5	7.4	12.0	8.6	12.0	13.7	15.0	8.0	7.0
Fiscal balance (% of GDP)													
Consolidated government balance	-0.7	-5.4	-1.9	0.3	1.6	1.7	2.1	-3.8	-3.9	-2.8	-2.9	-2.8	-2.5
Consolidated primary balance	0.0	-4.5	-0.9	1.2	2.4	2.4	2.7	-3.3	-3.4	-2.3	-3.9	-3.3	-2.5
Total public debt	17.0	27.0	25.9	29.1	25.1	22.1	20.0	24.5	23.9	22.9	26.5	28.2	27.5
External balance													
Exports (€bn)	22.3	22.0	22.9	23.1	26.9	27.7	29.1	27.3	34.4	45.9	46.8	49.2	51.6
Imports (€bn)	25.8	26.1	26.3	24.1	27.7	30.4	32.0	29.2	37.3	50.8	52.3	55.0	57.7
Trade balance (€bn)	-3.6	-4.1	-3.5	-1.0	-0.8	-2.7	-2.9	-1.9	-2.9	-4.9	-5.5	-5.8	-6.1
Trade balance (% of GDP)	-8.5	-9.5	-7.6	-2.0	-1.5	-4.8	-4.7	-3.2	-4.1	-5.8	-5.8	-5.7	-5.6
Current account balance (€bn)	0.5	0.5	0.0	1.5	1.7	0.5	1.1	0.0	-1.3	-0.6	-0.7	-0.5	0.0
Current account balance (% of GDP)	1.3	1.2	0.0	3.1	3.3	0.9	1.9	0.0	-1.9	-0.7	-0.7	-0.5	0.0
Net FDI (€bn)	1.2	0.1	1.9	0.6	1.3	0.8	1.2	2.8	1.3	2.0	2.0	2.1	2.2
Net FDI (% of GDP)	-3.0	-0.3	-4.1	-0.6	-1.3	-0.8	-1.2	-2.8	-1.3	-2.0	-2.2	-2.1	-2.0
Current account balance plus FDI (% of GDP)	-1.7	0.9	-4.1	2.5	2.0	0.2	0.6	-2.7	-3.2	-2.7	-2.9	-2.6	-2.0
Foreign exchange reserves (€bn)	14.4	16.5	20.3	23.9	23.7	25.1	24.8	30.9	34.6	38.4	39.7	42.3	45.5
Import cover (months of merchandise imports)	6.7	7.6	9.2	11.9	10.2	9.9	9.3	12.7	11.1	9.1	9.1	9.2	9.5
Debt indicators													
Gross external debt (€bn)	36.9	39.3	36.7	38.1	37.7	37.2	37.7	39.3	41.2	44.4	46.2	47.1	48.0
Gross external debt (% of GDP)	88	91	80	78	72	66	61	64	58	53	49	47	45
Gross external debt (% of exports)	166	178	160	165	140	134	129	144	120	97	99	96	93
Lending to corporates/households (% of GDP)	65.5	58.8	54.4	51.5	49.4	49.8	48.9	54.7	51.4	48.8	49.6	51.1	52.9
Interest & exchange rates													
Base interest rate (year-end %)	0.02	0.02	0.01	0.00	0.00	0.00	0.00	0.00	0.00	1.30	3.00	2.70	2.50
Broad money supply (average %YoY)	8.9	1.1	8.8	7.6	7.7	8.8	9.9	10.9	10.7	13.2	13.9	14.5	15.3
3yr yield (average %)	1.50	1.59	1.03	0.36	0.08	-0.05	-0.20	0.05	-0.05	2.50	3.00	2.80	2.50
10yr yield (average %)	3.54	3.42	2.83	2.19	1.60	0.94	0.46	0.40	0.30	4.30	4.40	4.25	4.00
USD/BGN exchange rate (year-end)	1.43	1.62	1.79	1.86	1.63	1.70	1.75	1.60	1.72	1.92	1.66	1.70	1.70
USD/BGN exchange rate (average)	1.47	1.48	1.78	1.78	1.72	1.67	1.75	1.70	1.66	1.86	1.75	1.67	1.70
EUR/BGN exchange rate (year-end)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
EUR/BGN exchange rate (average)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96

Source: National sources. ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	3.9	2.9	2.6	2.0	1.6	1.7	1.7	2.4	2.9	3.1	3.6	3.6	3.6
CPI (eop. %YoY)	16.9	18.7	16.9	14.0	9.6	7.3	6.6	5.3	5.0	4.4	4.8	5.0	5.0
Base interest rate (eop. %)	0.00	0.00	1.30	2.17	2.60	2.80	3.00	2.90	2.80	2.70	2.70	2.60	2.50
10yr yield (eop. %)	1.18	4.04	4.30	4.20	4.40	4.50	4.50	4.30	4.20	4.25	4.25	4.10	4.00
USD/BGN exchange rate (eop)	1.86	2.02	1.92	1.81	1.81	1.73	1.66	1.63	1.67	1.70	1.70	1.70	1.70
EUR/BGN exchange rate (eop)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96

Source: National sources. ING estimates

Croatia

Valentin Tataru, Chief Economist

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	2.8	1.9	3.0	2.9	2.2	2.7	2.5
CPI (%YoY)*	11.8	7.8	5.7	4.4	4.0	7.4	4.3
Policy interest rate (eop, %)	3.50	3.75	4.25	4.25	4.25	4.25	3.25
10yr yield (%)*	3.70	3.80	3.80	3.90	3.95	3.80	3.90

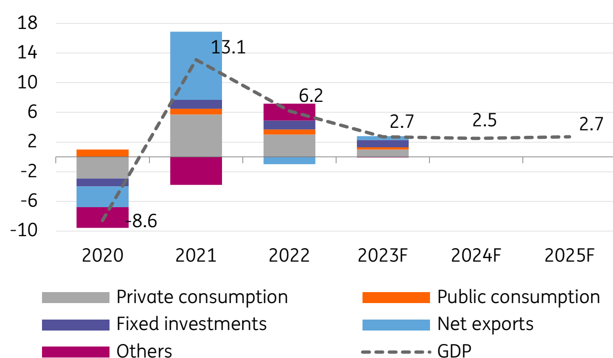
Macro trend		Political cycle	Ratings	FC	LC
Activity	=	Presidential: 2024	S&P	BBB+	BBB+
Fiscal	Neutral	Parliamentary: 2024	Moody's	Baa2	Baa2
Monetary	Tighter	Local: 2025	Fitch	BBB+	BBB+

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

Country strategy: Seizing the good momentum

The Eurozone and Schengen entrance on 1 January 2023 sealed the completion of Croatia's EU integration story. The economy has shown a remarkable resilience through the pandemic and Russia-Ukraine conflict, marking a striking difference compared to the 2008-09 global financial crisis. While there is a long way to go in terms of catching-up with the Eurozone average in almost all aspects, the authorities seem quite determined to make good use of the EU's Recovery and Resilience Facility, increasing fixed investments while keeping public deficits within very reasonable levels. Better terms of trade compared to 2022 and a tourism boost from Schengen entry might rebalance the external sector earlier than expected while quasi-balanced budgets could push the public debt ratio below the dreaded 60% of GDP over the next couple of years.

Real GDP (YoY%) and contributions (ppt)

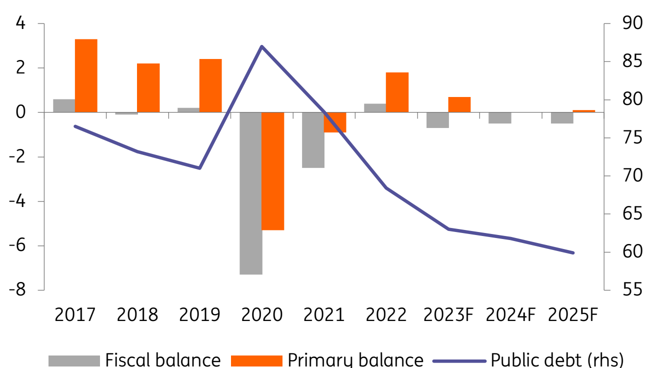


Source: Eurostat, ING

At the right speed given the context

Unlike most of its main EU partners that are experiencing mediocre growth at best, Croatia still managed to produce above potential growth rates in 2022. Momentum looks good in 2023 as well. Trends are clearly moderating in industry, construction and retail trade, with retail exposed to a generally weaker consumer confidence. However, this is likely to change for the better as real wage growth has already turned positive in 1Q23 but it will take a couple of quarters for consumers to start noticing the wage dynamics. All aside, the prospects for the tourist season look very good, authorities expecting a record year both in terms of number of tourists and revenues. We therefore reinforce our above-consensus GDP growth estimate of 2.7% for 2023 with upside risk.

Public debt and fiscal balance (% of GDP)

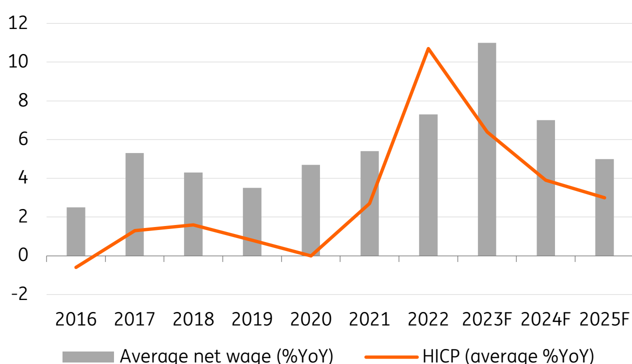


Source: Eurostat, ING

On the right track

The revised official targets for the 2023 budget gap point to a 0.7% of GDP deficit, compared to an initial deficit estimate of 2.3%. In essence, as in 2022 that ended with a 0.4% of GDP surplus, the government is partly using the better-than-anticipated budget revenues to improve its budget metrics. In this context, the country has already returned to running primary balance surpluses which are expected to continue in the coming years. We estimate that this will enable the debt-to-GDP ratio to dip below the dreaded 60% of GDP in 2025, having exceeded this level for 15 years. Looking forwards, we still anticipate the country to run small negative fiscal balances, as the phasing out of energy support measures will overlap increased social spending.

HICP inflation and wage rates



Source: Eurostat, CBS, ING

Inflation is coming down but wage pressure remains

After marking the top at 13.0% back in November 2022, the harmonised index of consumer prices (HICP) inflation has continually slowed to reach 8.5% in May, mostly on the back of energy price base effects. As the import price pressure starts to fade as well, the producer price growth is also visibly - though not as rapidly - decelerating. Core inflation, on the other hand, is reacting with lagged effects and we expect it to stay roughly 0.5ppt above headline inflation for the rest of the year. The clear upside risks stem from wage pressures, as the purchasing power loss from 2H21 and 2022 now needs to be compensated. This comes on the back of an already tight labour market as the unemployment rate might hit record lows this year.

Croatia

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	-0.4	-0.4	2.5	3.6	3.4	2.8	3.4	-8.5	13.1	6.2	2.7	2.5	2.7
Private consumption (%YoY)	-1.6	-2.5	0.4	3.1	3.1	3.3	4.1	-5.1	9.9	5.1	2.1	1.9	2.0
Government consumption (%YoY)	0.4	1.0	-1.0	1.1	2.2	2.3	3.1	4.3	3.0	3.2	1.1	1.2	0.5
Investment (%YoY)	1.0	-2.3	8.2	5.0	1.6	3.9	9.0	-5.0	4.7	5.8	2.2	1.8	1.7
Industrial production (%YoY)	-1.5	1.1	2.5	4.8	1.9	-0.7	0.6	3.4	6.3	1.6	-2.0	2.2	1.9
Unemployment rate (year-end, %)	20.2	19.6	17.4	15.0	12.4	9.9	7.8	9.0	8.1	6.8	6.2	5.8	5.5
Nominal GDP (€bn)	44.7	44.6	45.7	47.3	49.5	51.9	54.8	50.5	58.2	67.4	73.1	77.1	81.7
Nominal GDP (US$bn)	59	59	50	52	56	61	61	58	69	71	82	90	94
GDP per capita (US$)	14,000	13,900	12,000	12,500	13,700	14,900	15,100	14,500	17,600	18,100	21,000	23,100	24,700
Gross domestic saving (% of GDP)	17.6	18.6	20.6	21.3	21.7	21.5	21.2	16.1	19.9	21.2	21.1	20.9	20.8
Prices													
HICP (average, %YoY)	2.3	0.2	-0.3	-0.6	1.3	1.6	0.8	0.0	2.7	10.7	6.4	3.9	3.0
HICP (year-end, %YoY)	0.5	-0.1	-0.3	0.7	1.3	1.0	1.3	-0.3	5.2	12.7	5.7	3.3	3.0
Wage rates (net nominal, %YoY)	-0.8	0.3	-3.4	2.5	5.3	4.3	3.5	4.7	5.4	7.3	11.0	7.0	5.0
Fiscal balance (% of GDP)													
Consolidated government balance	-5.5	-5.2	-3.5	-1.0	0.6	-0.1	0.2	-7.3	-2.5	0.4	-0.7	-0.5	-0.5
Consolidated primary balance	-2.5	-1.8	-0.1	2.0	3.3	2.2	2.4	-5.3	-0.9	1.8	0.7	0.0	0.1
Total public debt	80.1	83.8	83.2	79.7	76.5	73.2	71.0	87.0	78.4	68.4	63.0	61.8	59.9
External balance													
Exports (€bn)	9.6	10.4	11.5	12.3	14.0	14.5	15.2	14.9	18.4	24.1	25.3	26.3	27.4
Imports (€bn)	16.5	17.1	18.5	19.7	21.9	23.7	25.0	22.9	28.4	41.9	44.8	46.7	48.7
Trade balance (€bn)	-6.9	-6.8	-7.0	-7.4	-7.9	-9.2	-9.8	-8.0	-10.0	-17.8	-19.5	-20.4	-21.3
Trade balance (% of GDP)	-15.5	-15.2	-15.2	-15.6	-15.9	-17.7	-17.8	-15.9	-17.2	-26.4	-26.7	-26.4	-26.0
Current account balance (€bn)	-1.0	0.3	3.2	2.2	3.4	1.8	2.9	-0.5	3.1	-3.3	-1.9	-0.5	0.0
Current account balance (% of GDP)	-2.2	0.7	7.0	4.6	6.9	3.5	5.3	-1.5	5.3	-4.9	-2.6	-0.6	0.0
Net FDI (€bn)	-0.7	-0.7	-0.2	-2.0	-1.1	-0.8	-3.4	-0.7	-2.8	-3.7	-1.8	-1.9	-1.9
Net FDI (% of GDP)	-1.7	-1.5	-0.4	-4.2	-2.2	-1.6	-6.3	-1.4	-4.8	-5.6	-2.5	-2.5	-2.4
Current account balance plus FDI (% of GDP)	-3.9	-0.9	6.6	0.4	4.6	1.8	-1.0	-2.9	0.5	-10.5	-5.1	-3.1	-2.4
Foreign exchange reserves ex gold (€bn)	12.9	12.7	13.7	13.5	15.7	17.4	18.6	18.9	25.0	27.9	31.2	33.0	34.1
Import cover (months of merchandise imports)	9.4	8.9	8.9	8.2	8.6	8.8	8.9	9.9	10.6	8.0	8.4	8.5	8.4
Debt indicators													
Gross external debt (€bn)	48.7	49.5	48.6	45.1	43.9	42.8	40.6	41.3	47.2	47.5	47.6	48.2	47.6
Gross external debt (% of GDP)	108.9	111.1	106.3	95.2	88.6	82.4	74.1	81.8	81.1	70.5	65.1	62.5	58.2
Gross external debt (% of exports)	507	478	422	366	313	294	267	277	257	197	188	183	174
Lending to corporates/households (% of GDP)	70.0	69.2	65.2	60.3	56.5	54.7	53.3	61.0	54.5	52.3	53.8	55.1	56.6
Interest & exchange rates													
Central bank key rate (year-end, %)	6.00	6.00	6.00	6.00	3.00	3.00	3.00	3.00	3.00	3.00	4.00	3.25	3.00
3yr yield (average, %)	n/a	4.00	4.10	3.50	2.60	1.80	0.70	0.50	0.15	1.60	3.20	3.40	3.20
10yr yield (average, %)	6.10	5.00	4.30	3.60	3.10	2.90	2.30	1.15	1.00	4.00	3.80	3.90	3.80
EUR/USD (average)	1.33	1.32	1.1	1.1	1.14	1.17	1.12	1.15	1.18	1.05	1.12	1.17	1.15
EUR/USD (end-period)	1.37	1.21	1.09	1.05	1.2	1.15	1.12	1.22	1.14	1.07	1.18	1.15	1.15

Source: National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	8.7	5.3	3.5	2.8	1.9	3.0	2.9	2.2	2.4	2.6	2.8	2.7	2.7
CPI (eop, %YoY)	12.0	12.8	13.1	10.7	6.7	5.5	4.1	4.2	4.3	4.3	4.4	4.2	4.0
Central bank key rate (eop, %)	0.00	1.25	2.50	3.50	4.00	4.25	4.25	4.25	3.75	3.50	3.25	3.00	3.00
10yr yield (eop, %)	3.60	3.50	4.10	3.70	3.80	3.80	3.90	3.95	4.00	3.80	3.80	3.85	3.75

Source: National sources, ING estimates

Czech Republic

Vojtěch Benda, Chief Economist, Frantisek Taborsky EMEA FX & FI Strategist

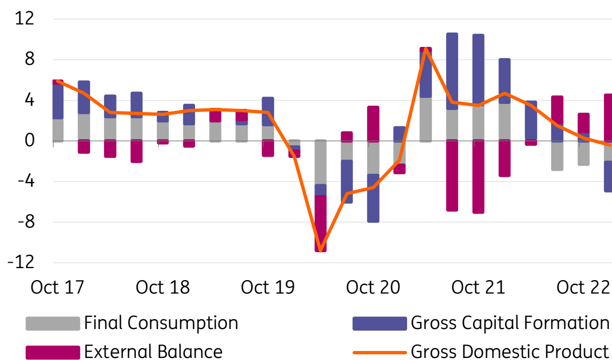
Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (% YoY)	-0.1	0.2	0.7	1.7	1.8	0.6	1.9
CPI (% YoY)*	16.5	12.0	9.0	9.2	2.4	11.6	2.6
Policy interest rate (%)	7.0	7.0	7.0	6.5	6.0	6.9	4.8
3m interest rate (%)*	7.3	7.2	6.9	6.4	5.9	4.9	5.0
10yr yield (%)*	4.6	4.3	3.8	3.3	3.3	4.0	3.0
USD/CZK*	21.8	21.9	21.0	19.9	19.6	21.1	19.8
EUR/CZK*	23.5	23.7	23.7	23.5	23.5	23.6	23.2

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

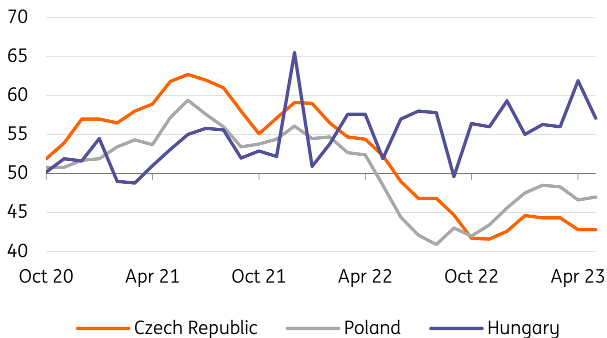
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

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



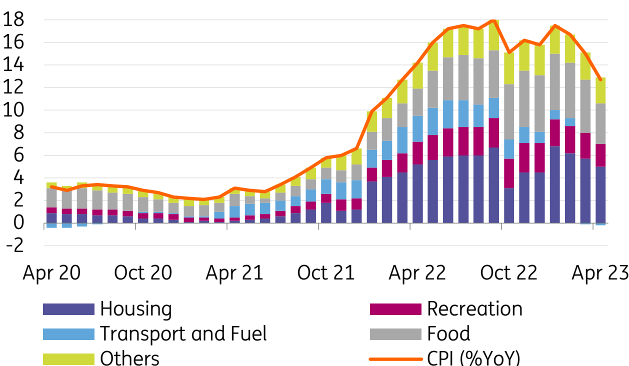
Source: CZSO, ING

Czech PMI underperforming region



Source: Macrobond, ING

Structure of inflation (ppt)



Source: CZSO, ING

Escape from recession but growth likely to be anaemic

In 1Q23, we believe the Czech economy may have ended a soft recession, given the previous QoQ decline of 2H22 turned into stagnation but remained still negative in YoY terms (-0.4%). We expect the annual growth of GDP to remain negative in the first half of 2023. This reflects a continued decline in household consumption, which fell deeply by 6.4% YoY, following a sharp decline in the inflation-driven fall of purchasing power of households, while corporates cut their investment on the back of weak foreign demand and high costs of lending. On a positive note, inflation is on a declining trend owing to an ongoing decline in core inflation, given a slowdown of food and fuel prices. This is likely to prevent the CNB from increasing interest rates despite the still tight labour market and the risk of a potential wage-inflation spiral.

Macro digest

After two consecutive declines in GDP growth during the second half of 2022, the Czech economy in 1Q23 stagnated but remained negative in YoY terms (-0.4%). The main obstacle in economic recovery remained private consumption, which declined in the first quarter of 2023 by 6.4% YoY, as double-digit inflation squeezed markedly the purchasing power of households, while high interest rates and soft foreign demand led companies to reduce the growth of investment. We expect the annual growth of GDP to remain negative in the first half of 2023 due to still declining household consumption. During the remainder of 2023, however, the economy is likely to show signs of a recovery, as gradually receding inflation will weigh less on the real purchasing power of households and the ongoing improvement of the external environment should support a recovery of exports. Yet, investment demand is likely to remain weak due to persistently high interest rates.

The unemployment rate (ILO) fell 3.6% to 3.5% in May. However, it stagnated at 3.6% on a seasonally adjusted basis. Nevertheless, the overall labour market in the Czech Republic remains extremely tight, even though firms in the PMI survey reported further layoffs in May due to fewer new orders. However, recent developments in the Czech industry and retail sector are not very favourable, which could be reflected in the pressure to lay off employees. For the time being, however, companies are still trying to hold on to employees in the hope of a recovery in demand. The overheated labour market is thus also reflected in rapid wage growth, particularly in industry and construction. The first quarter showed nominal growth of 8.6% YoY, but in real terms growth is deep in negative territory and a turnaround can only be expected in the third quarter.

Inflation, in our view, posted its last double-digit reading in May and will continue its swift disinflation for the rest of the year. The slowdown or even decline in inflation can be seen across the consumer basket. However, the main drivers are and will be food, fuel and housing prices. Food and housing prices in particular, in our view, still have the potential to collapse faster than expected and headline inflation will surprise more to the downside. At the moment, year-end inflation should be around 8% YoY and, thanks to a large base effect and the re-pricing of energy prices, we should be in the 3-4% range as early as January next year.

Czech Republic

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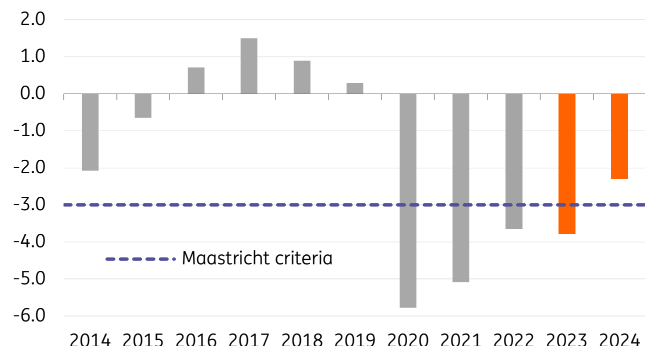
General government balance (% of GDP)

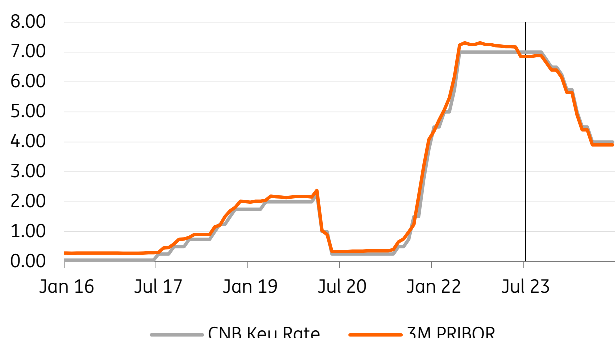


Source: MinFin, ING

Government promises fiscal package to tame deficit

May's state budget deficit of CZK270bn, the worst result in history, confirmed the trend of weak tax revenues. For this year, the government is projecting a deficit of CZK295bn, however, given current developments, it plans to introduce measures to tame the growing deficit. Thus, for this year, we expect a general government deficit of 3.8% of GDP. Looking ahead, for the next two years, the government has unveiled a large consolidation package that will soon enter the legislative process. The government is targeting a deficit of 1.8% for next year and 1.2% of GDP for 2025, which would be by far the lowest number in the region. We expect slightly higher numbers (2.3% and 1.8%), but in any case, consolidation will be ongoing, which makes a difference.

CNB rate and PRIBOR

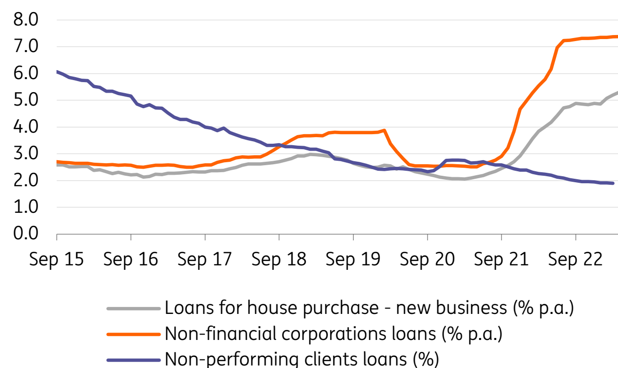


Source: Macrobond, ING

Rate cuts will be topic for CNB from August meeting

The central bank put a possible interest rate hike back on the table in March due to an overheated labour market and expansionary monetary policy. However, recent data has been rather weaker and we believe the reasons for a rate hike are gone. Still, the CNB will want to be hawkish in June. Later, however, rapidly falling inflation could turn the narrative around very quickly. Starting with the CNB's new forecast in August, we think the board's focus will shift to cutting rates. We believe the main indicator for the first rate cut is spot headline inflation. Should inflation confirm its direction below 8% YoY by the end of this year, we could see a rate cut as early as autumn or early winter. Otherwise, the board may wait until 1Q24. However, recent data tends to point to an earlier cut this year.

Interest rates and NPL

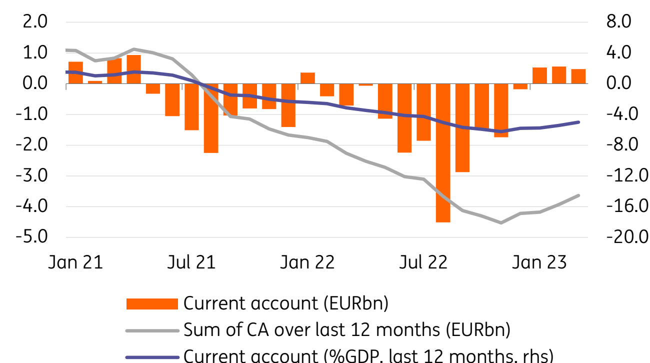


Source: CNB, ING

CNB relaxes mortgage limits and reduces CCY buffer

The credit market essentially froze after monetary policy tightening translated into higher loans rates. The mortgage market has been showing high double-digit YoY declines in loan volume for a long time but, on the other hand, we have seen some signs of recovery in recent months. At the same time, the CNB eased mortgage lending limits (DSTI) slightly in June and reduced the countercyclical capital buffer from 2.50% to 2.25%. This may prolong the recovery in the mortgage market, which we have so far considered rather temporary. However, non-performing loans remain on a downward trend despite the impact of high inflation on household disposable incomes. The banking sector's capital adequacy ratio remains at the highest levels in the region.

Current account



Source: CNB, ING

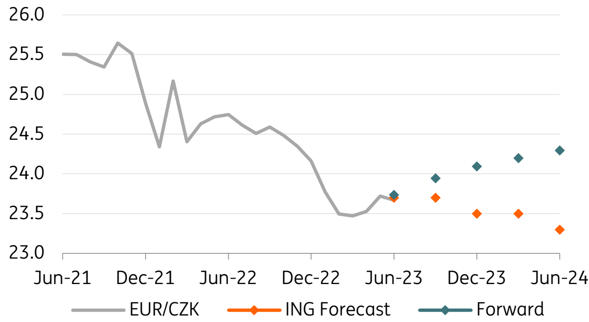
Current account returns to surplus

The current account returned to surplus this year, mainly due to the reversal in the trend of foreign trade and, of course, the improvement in the energy situation. We expect the positive trend to continue, but at the same time we may see a pick-up in demand and higher imports of goods and services in the second half of the year. Moreover, the dividend period is yet to come which will also slow down the improvement in the current account surplus. Overall, we expect a current account surplus of 0.3% of GDP this year and a further improvement to 1.0% next year.

Czech Republic

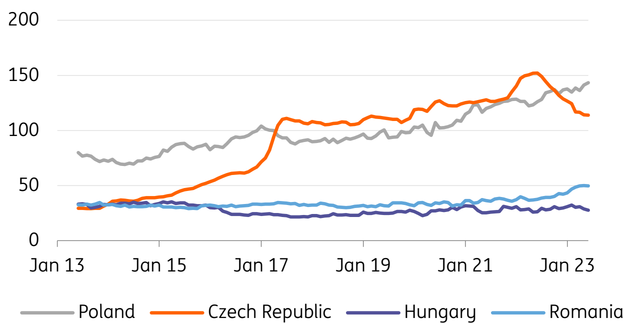
Strategy

FX – spot vs forward and INGF



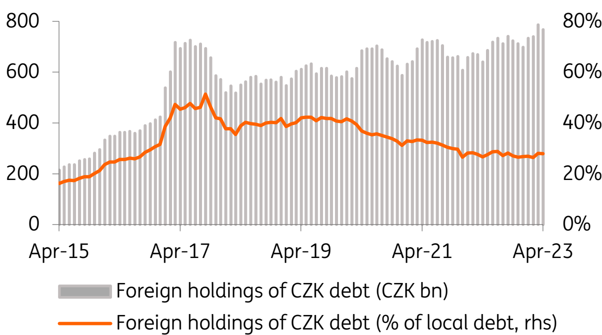
Source: Eikon, ING

CNB FX reserves declined but remain significant (€bn)



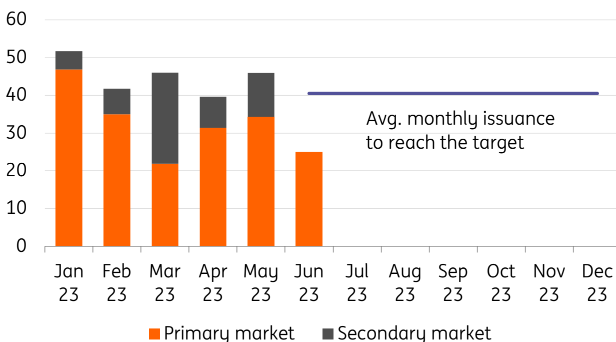
Source: Macrobond, ING

Foreign holders of CZGB (%)



Source: Macrobond, ING

CZGBs issuance (CZKbn)



Source: MinFin, ING forecast

FX strategy

The Czech koruna reached essentially its strongest levels against the euro in history in 2Q and remains below EUR 24/CZK. However, the attractiveness of the koruna declined in May as the CNB hawkish story came to an end and attention shifted elsewhere in the region. We think the koruna still has a lot to offer - high carry, balanced market positioning and a central bank ready to intervene in the FX market if the koruna weakens. In addition, the CZK has by far the highest beta against EUR/USD in the region, making it a good proxy for a global story view with a high CEE carry element.

Financial markets are currently pricing in too much rate cutting this year. Thus, any central bank hints of rate cuts, which is not a topic for the CNB at the moment, or lower inflation numbers should not threaten the crown, unlike other currencies within the region. Moreover, in our base case scenario, we expect EUR/USD to rebound in the coming months, which should benefit the koruna the most in the region. This is also helped in many ways by a more balanced market positioning versus PLN or HUF, for example. Thus, we expect the koruna to stay in the current range of 23.50-24.00 EUR/CZK with trips to lower levels depending on the global story.

Fixed Income strategy

The financial markets are pricing in a first 25bp rate cut in September and 95bp overall this year, while we see room for only one or at most two 25bp rate cuts this year. Thus, we think the market has gone too far and the CNB meeting should be a reminder of CNB hawkishness despite lower inflation numbers, which are not sufficiently low for the central bank yet. Overall, we see the market calling for an upward correction in rates.

In the bond space, MinFin has covered roughly 46% of CZGBs issuance this year in our view and we expect monthly supply to remain roughly flat for the rest of this year with perhaps slightly weaker summer months due to lower liquidity. Despite the government budget issues this year, the market tends to focus on the longer horizon indicating a significant tightening of fiscal policy. Thus, MinFin's plan implies that the supply of CZGBs may next year fall to 60-65% of this year, while we see a risk of even lower bond supply due to the government's efforts to draw more EU loans from RRF programmes. Coupled with a very friendly inflation profile within the region and the current popularity of CZGBs among investors, we believe demand will remain for the rest of this year. A downward shift in supply should lead to a significant tightening of the ASW spread and a return to negative territory, in our view.

Czech Republic

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (% YoY)	0.0	2.3	5.4	2.5	5.2	3.2	3.0	-5.5	3.5	2.5	0.6	1.9	2.2
Private consumption (% YoY)	0.9	1.4	3.9	3.7	3.9	3.3	2.6	-7.4	4.1	-0.9	-1.6	3.2	2.0
Government consumption (% YoY)	2.4	1.0	1.8	2.5	1.8	3.9	2.5	4.2	1.5	0.6	2.1	0.3	2.0
Investment (% YoY)	-2.2	3.3	9.7	-3.0	4.9	10.0	5.9	-6.0	0.7	6.2	1.7	4.8	5.0
Industrial production (% YoY)	1.5	9.1	2.2	0.8	7.5	3.5	0.9	-6.1	10.8	2.6	1.7	4.0	3.2
Unemployment rate (year-end, %)	6.8	5.8	4.6	3.7	2.4	2.1	2.1	3.1	2.3	2.4	2.8	3.0	3.0
Nominal GDP (CZKbn)	4,143	4,346	4,625	4,797	5,111	5,411	5,791	5,709	6,108	6,794	7,405	7,835	8,030
Nominal GDP (€bn)	165	159	170	175	190	201	207	190	202	222	314	338	352
Nominal GDP (US$bn)	212	209	188	196	219	249	253	246	282	292	351	395	405
GDP per capita (US$)	20,146	19,903	17,834	18,583	20,641	23,427	23,669	23,002	26,829	27,194	27,368	31,468	31,738
Gross domestic saving (% of GDP)	30.7	32.3	33.9	33.7	33.9	33.1	33.6	32.8	32.9	32.0	32.2	32.4	32.0
Prices													
CPI (average, % YoY)	1.4	0.4	0.3	0.7	2.5	2.1	2.8	3.2	3.8	15.1	11.2	2.1	2.0
CPI (year-end, % YoY)	1.4	0.1	0.1	2.0	2.4	2.0	3.2	2.3	6.6	15.8	8.5	2.0	2.0
Wage rates (nominal, % YoY)	-0.1	2.9	3.2	4.4	6.8	8.1	7.9	4.6	4.8	6.5	8.8	7.9	7.2
Fiscal balance (% of GDP)													
Consolidated government balance	-1.3	-2.1	-0.6	0.7	1.5	0.9	0.3	-5.8	-5.1	-3.6	-3.8	-2.3	-1.7
Consolidated primary balance	0.1	-0.6	0.4	1.6	2.2	1.6	1.0	-5.0	-4.3	-2.9	-2.0	-1.3	-1.0
Total public debt	44.4	41.9	39.7	36.6	34.2	32.1	30.0	37.7	42.0	44.1	44.8	45.3	45.6
External balance													
Exports (€bn)	107.2	114.4	119.6	122.0	133.4	141.0	143.8	131.7	154.0	157.7	159.3	167.2	176.9
Imports (€bn)	103.1	109.1	114.8	116.0	127.2	137.2	138.1	124.9	154.3	160.0	160.2	167.2	180.5
Trade balance (€bn)	4.1	5.3	4.8	6.1	6.2	3.8	5.7	6.8	-0.3	-2.3	-0.9	0.0	-3.6
Trade balance (% of GDP)	2.6	3.6	3.2	4.0	4.0	2.4	3.6	4.4	-0.2	-1.0	-0.4	0.0	-2.1
Current account balance (€bn)	-0.8	0.3	0.8	3.2	3.0	0.9	0.7	4.3	-2.0	-11.3	-7.5	-5.7	-12.1
Current account balance (% of GDP)	-0.5	0.2	0.4	1.8	1.5	0.4	0.3	2.0	-0.8	-5.1	-3.5	-2.5	-5.5
Net FDI (€bn)	0.3	-2.9	1.8	-6.9	-1.7	-2.0	-5.3	-5.6	-0.2	-2.5	-2.4	-2.5	-1.4
Net FDI (% of GDP)	0.2	-1.9	1.1	-3.9	-0.9	-0.9	-2.4	-2.6	-0.1	-0.9	-0.8	-0.8	-0.2
Current account balance plus FDI (% of GDP)	-0.3	-1.7	1.5	-2.1	0.6	-0.5	-2.0	-0.6	-0.9	-5.9	-3.3	-2.7	-4.7
Foreign exchange reserves ex gold (€bn)	43	45	59	81	120	125	132	134	153	140	100	95	90
Import cover (months of merchandise imports)	4.6	4.5	5.5	7.6	10.2	9.9	10.2	11.6	10.6	7.3	7.0	6.8	6.5
Debt indicators													
Gross external debt (€bn)	97.5	104.3	112.8	123.0	168.4	169.9	172.0	163.6	170.5	185.0	190.0	188.0	190.7
Gross external debt (% of GDP)	62.0	70.3	75.2	81.3	108.4	106.5	108.0	105.8	107.0	83.3	89.2	83.2	85.1
Gross external debt (% of exports)	97	96	100	109	132	126	124.0	127.0	110.7	117.3	119.3	112.4	111.4
Lending to corporates/households (% of GDP)	49.4	48.4	48.5	49.9	49.8	50.3	49.8	53.4	52.6	49.3	46.9	47.8	46.5
Interest & exchange rates													
Central bank key rate (year-end, %)	0.05	0.05	0.05	0.05	0.50	1.75	2.00	0.25	3.75	7.00	6.50	4.00	3.00
Broad money supply (average, % YoY)	4.5	5.2	7.8	8.9	9.9	5.5	6.8	9.7	9.6	6.4	8.8	11.5	8.2
3m interest rate (Pribor, average, %)	0.46	0.36	0.31	0.29	0.41	1.27	2.12	0.86	1.13	6.20	7.09	4.98	3.20
3m interest rate spread over Euribor (ppt)	24	15	32	55	74	159	248	130	168	620	337	179	53
2yr yield (average, %)	0.31	0.18	-0.06	-0.31	-0.20	1.06	1.57	0.59	1.60	5.45	4.2	3.0	2.5
10yr yield (average, %)	2.11	1.56	0.70	0.44	1.06	2.02	1.61	1.18	1.97	4.40	4.0	3.0	3.0
USD/CZK exchange rate (year-end)	19.89	22.86	24.87	25.70	21.29	22.43	22.69	21.47	21.88	22.56	19.9	20.0	19.6
USD/CZK exchange rate (average)	19.56	20.76	24.59	24.44	23.37	21.75	22.93	23.21	21.69	23.36	21.1	19.8	19.8
EUR/CZK exchange rate (year-end)	27.34	27.66	27.02	27.02	25.51	25.72	25.42	26.24	24.89	24.16	23.5	23.0	22.5
EUR/CZK exchange rate (average)	25.98	27.53	27.28	27.03	26.33	25.65	25.67	26.46	25.64	24.56	23.6	23.2	22.8

Source: National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (% YoY)	3.7	1.6	-0.4	-0.1	0.2	0.7	1.7	1.8	1.8	1.9	2.2	2.4	2.2
CPI (eop, % YoY)	17.2	18.0	15.5	16.5	12.0	9.0	9.2	2.4	2.2	2.1	2.0	2.0	2.0
Central bank key rate (eop, %)	7.00	7.00	7.00	7.0	7.0	7.0	6.5	6.0	4.5	4.0	4.0	3.5	3.0
3m interest rate (eop, %)	7.23	7.25	7.25	7.3	7.2	6.9	6.4	5.9	4.6	4.1	4.1	3.6	3.1
10yr yield (eop, %)	4.91	5.40	5.65	4.6	4.3	3.8	3.3	3.3	3.2	3.0	2.8	2.8	3.2
USD/CZK exchange rate (eop)	23.6	25.1	25.0	21.8	21.9	21.0	19.9	19.6	20.0	20.2	20.0	19.8	19.7
EUR/CZK exchange rate (eop)	24.7	24.6	24.5	23.5	23.7	23.7	23.5	23.5	23.4	23.2	23.0	22.8	22.7

Source: National sources, ING estimates

Hungary

Péter Virovácz, Chief Economist

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	-0.9	-1.2	0.6	2.0	3.1	0.2	3.1
CPI (%YoY)*	25.2	20.2	12.8	7.9	5.2	18.3	5.0
Policy interest rate (eop, %)	13.00	13.00	13.00	11.50	8.00	11.50	5.25
3m interest rate (%)*	16.30	15.00	13.50	11.00	7.50	14.50	6.90
10yr yield (%)*	8.50	7.05	7.15	6.95	7.00	7.63	6.83
USD/HUF*	349.9	341.7	334.5	315.3	306.7	336.8	314.5
EUR/HUF*	381.0	369.0	378.0	372.0	368.0	377.2	368.0

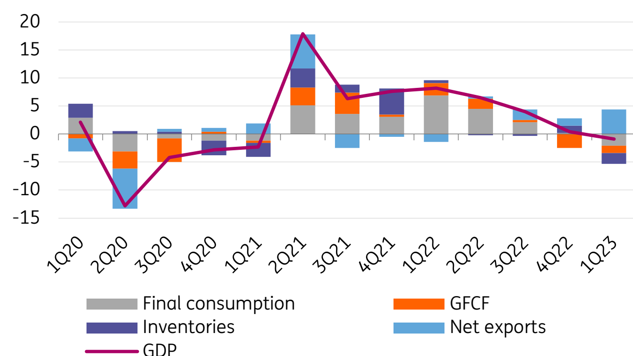
Macro trend		Political cycle	Ratings	FC	LC
Activity	–	Presidential: 2027	S&P	BBB-	BBB-
Fiscal	Tighter	Parliamentary: 2026	Moody's	Baa2	Baa2
Monetary	Tighter	Local: 2024	Fitch	BBB	BBB

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

Country strategy: Challenging but optimistic

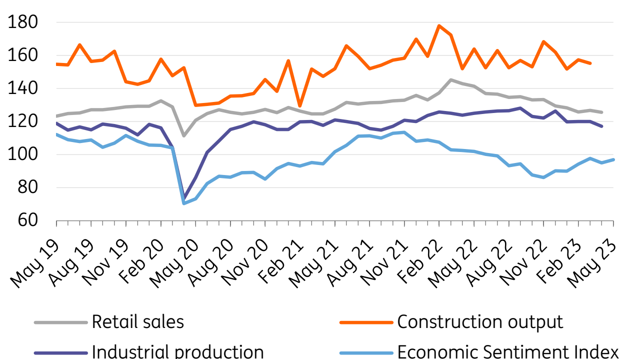
The worst might be behind Hungary. Yes, the economy is still in a technical recession, but we see a way out from it by the second half of 2023. A key source of the recovery lies in the growing disinflation process. The collapse of the domestic demand erases the repricing power of companies. Thus, we see a single-digit headline inflation by the year-end and further normalisation in 2024. This means a positive real wage growth yet again from late-2023. However, with depleted household savings and tighter fiscal headroom, we hardly see a boom in domestic demand. The recovery will be export driven, thus we see a quick return to surplus in the current account balance. Improving external financing needs and the new era of monetary policy (eg, persistent positive real interest rates from late-2023) lead us to be constructive towards Hungarian assets.

Contribution to YoY GDP growth (ppt)



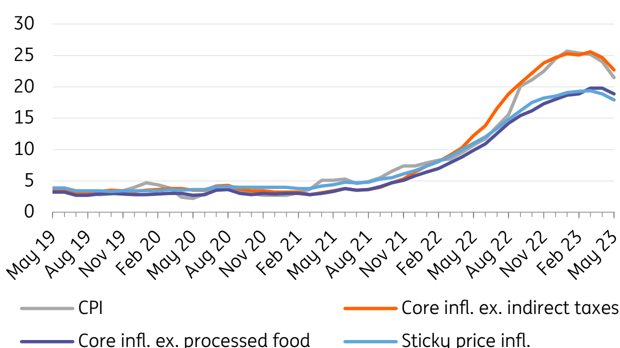
Source: Hungarian Central Statistical Office

Key activity indicators (swda; 2015 = 100%)



Source: Eurostat, Hungarian Central Statistical Office

Headline and underlying measures of inflation (%YoY)



Source: National Bank of Hungary

Macro digest

The Hungarian economy has been stuck in a technical recession for three quarters (3Q22–1Q23) due to sky-high inflation suffocating economic activity. Consumption has been markedly slowing down since last autumn, as households cope with double-digit price increases, resulting in deteriorating purchasing power. On top of this, the high interest rate environment prompted a collapse in private investment activity, coupled with the government's mandated freeze on public investments. The only silver lining has been net exports, recently. Export activity is helped by pent-up production in car and battery manufacturing, while imports slow on lower energy demand.

We expect the economy to emerge from the technical recession in the second quarter of this year, although the year-on-year growth will remain negative. As most economic sectors are still struggling amid weak domestic demand, the one sector that stands out on the positive side is agriculture. The reason for this lies in base effects, which this time will help a lot, as last year's energy crisis and drought wreaked havoc on the performance of agriculture. Though this year's weather has been favourable as well. In this regard, the fate of the overall 2023 GDP growth rather depends on the performance of agriculture as domestic demand will remain weak for the remainder of the year, curbing industry, construction and services.

In parallel with an acceleration of the disinflationary process, we expect the economy to display a rebound from the third quarter, delivering growth in every aspect for the remainder of the year. However, we expect a modest growth rate of 0.2% for 2023 followed by a 3.1% GDP expansion next year, boosted by both returning consumption growth and rising investment activity next to positive net exports.

Headline inflation retreated to 21.5% YoY in May, after peaking in January, while core inflation has also improved, with services being the only component where we see upside risks in the short run. As for the other components, food inflation has moderated for five months, while both motor fuel and household energy prices have recently declined, supported by a fall in global energy prices and a stronger HUF. We expect inflation to continue to retreat gradually in the coming months, as demand is vastly constrained by the loss of household purchasing power. In addition, base effects are contributing significantly to this year's disinflationary process, which will accelerate from the third quarter onwards, thus we see the year-end reading dipping comfortably below 10%. At the same time, we expect inflation to average around 18% for this year, with balanced risks to our forecast. However, after two years of double-digit average inflation figures, we expect the full-year average to come in at around 5% in 2024.

Hungary

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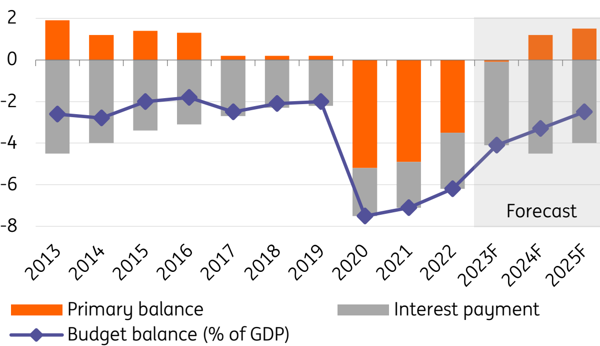
Budget and primary balance of general government (%)

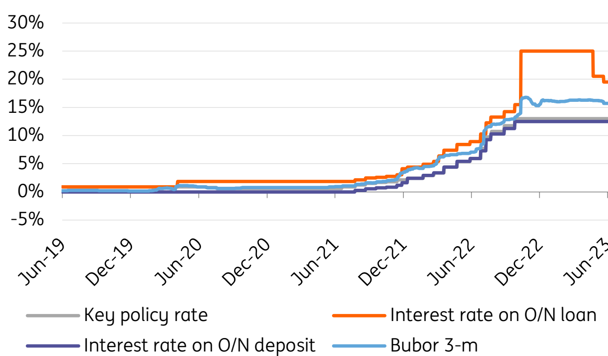


Source: AMECO, ING estimates

Fiscal discipline should not be up for debate

We continue to believe that despite the year-to-date cash-flow based deficit reaching 81% of the full-year deficit target by May, the budget situation still looks manageable. However, we can pinpoint some key slippages, namely less inflow via indirect taxes on the revenue side and higher debt servicing costs on the expenditure side. Despite the year-to-date bleak performance, the government is committed to the 3.9% Maastricht-deficit criteria, but a slight adjustment might be needed to ensure that the target is met. The need for an adjustment significantly increases next year as both sides of the budget are more uncertain based on our gloomier outlook versus the government's. In addition, the revival of the excessive deficit procedure in 2024 should alert policymakers that fiscal discipline should not be up for debate.

Benchmark policy rate and interest rate corridor

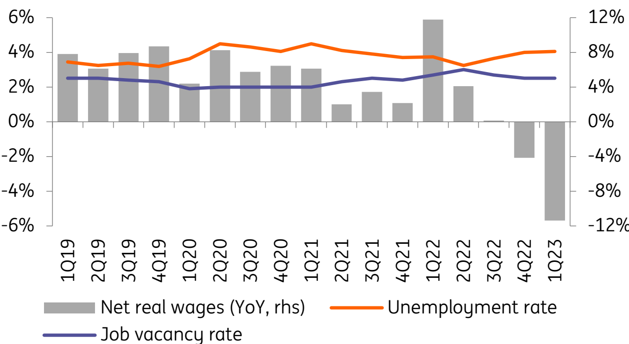


Source: National Bank of Hungary

Effective normalisation of monetary policy has started

After extreme scenarios have been priced out, the central bank started effective normalisation in May, by cutting the rate of the O/N quick deposit tender by 100bp to 17%. The normalisation process started by emphasising the separation of market stability (ensured by the overnight tools) and price stability (cured by the base rate). In this regard, a cut in the base rate is not on the table yet, as the merger of the effective rate with the base rate must happen first. We expect this convergence to be finalised by September, following which we see the first cut in the base rate in December. However, as highlighted by the NBH, positive real interest rates are needed to support the disinflationary process, at which point we believe Hungary can turn its back on the era of negative real rates for good.

Unemployment, job vacancy rate and wage growth

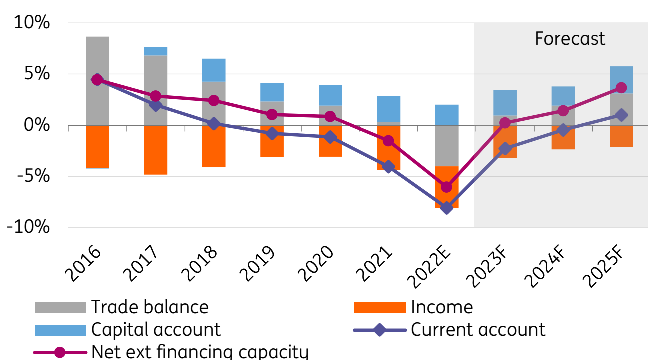


Source: Hungarian Central Statistical Office

Labour shortage poses a structural problem

We believe that labour shortage has evolved from a cyclical to a structural problem, which entails a long-term inflation risk, hence the need for a tighter monetary policy stance in the future. In this context, we have not seen widespread layoffs, which could explain the resilience of the labour market that, in our view, will continue. The story is different for real wages. Amid sky-high inflation, March is the seventh consecutive month in which real wage growth has been negative, but we expect a turnaround in the fourth quarter. In our view, this is more likely to boost savings as households have already tapped into their savings to offset the impact of inflation. Therefore, this positive income shock implies less upside impact on inflation and more downside on GDP growth, in our base case.

Structure of the current account (% of GDP)



Source: National Bank of Hungary, ING estimates

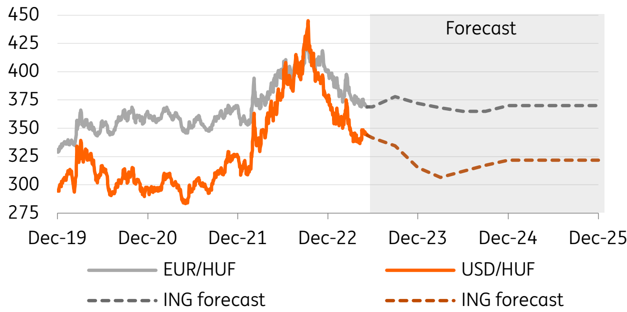
Current account deficit to show marked improvement

Last year's energy crisis eroded the country's trade balance in goods, leading to a year-end current account balance of -8.2% of GDP. As the energy issue appears to be easing this year, pressure on the current account from the import side is softening significantly, with the trade balance posting positive readings for the past three months. In addition, inflation has weighed on consumption and high interest rates held back investments, further reducing import demand. Conversely, the export side carries huge growth potential, as new export capacities have improved significantly recently due to EV battery plants, while car manufacturers are dealing with large backlogs. With all these factors combined, we expect the current account to close this year with a balance of only -2.2% of GDP.

Hungary

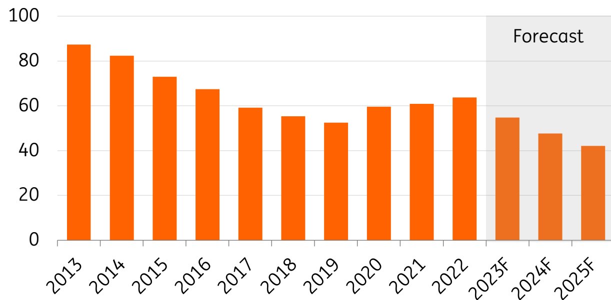
Strategy

FX – spot and INGF



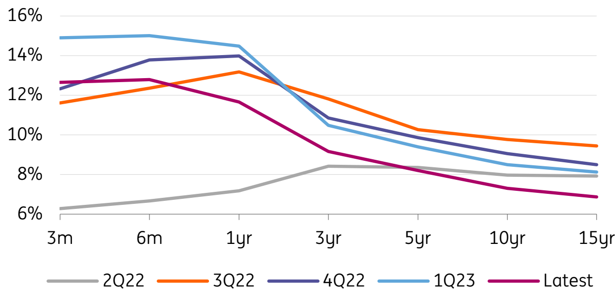
Source: National Bank of Hungary, ING estimates

Evolution of gross external debt (% of GDP)



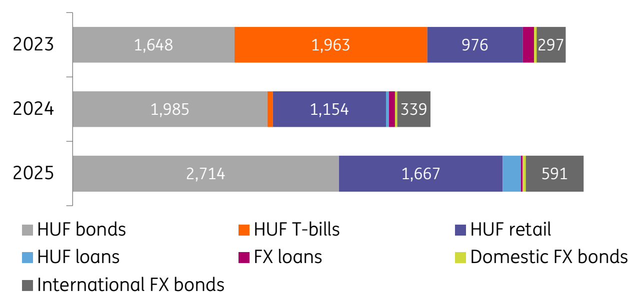
Source: National Bank of Hungary, ING estimates

Local curve (%)



Source: Government Debt Management Agency

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



Source: Government Debt Management Agency

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

HUF has been the clear winner YTD in the CEE region thanks to the subsiding energy crisis and very attractive carry due to the extreme high interest rate environment. Despite the first rate cut, HUF did not weaken thanks to the NBH's transparent communication, which we expect will continue to remain as transparent as it has been so far this year. We expect that the market will continue to favour the forint, which will continue to maintain a significantly higher carry within the region in the second half of the year. In our view, the playing field for the forint will be in the range of EUR/HUF 368-378 in the coming months and we target 372 for the end of the year. Thus, we do not see much room for a move lower from current levels, which is supported by the very long positioning of the market. This will prevent further gains in the forint. We can still expect the NBH monetary policy and EU money story to be the main drivers. Higher volatility will remain in the market in the second half of the year and we may see some seasonal FX weakness especially during the summer months. However, market expectations for EU money are rather cautious and so we do not see room for a big sell-off, similar to that at the end of last year over this issue. Moreover, we should see a deal ultimately being agreed between the EC and the Hungarian government. Overall, we continue to like the forint and the NBH normalisation story. We expect investors might use any EUR/HUF spike to build new positions in forint and benefit from the significant carry.

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

The market is pricing in a large portion of NBH monetary policy normalisation, but we believe that the region's fastest disinflation and a record strong forint will support further market bets on policy easing. Our bias remains for a lower and steeper curve.. On the bond side, despite fiscal risks, we see this year's funding fully under AKK's control. HGBs post the highest gains within the region YTD, supported by the NBH's successful normalisation story and government measures. On the other hand, HGBs are getting expensive after the recent rally.

In the hard currency space, current valuations look about fair for REPHUN, with spread levels towards the wider end of the BBB tier. Headline risk remains high amid the ongoing EU fund negotiations and geopolitical noise, which mean there are potential upside and downside catalysts, and volatility will remain elevated. Meanwhile, fundamentals are recovering from last year's energy shock, in particular on the external accounts. Further FX issuance is likely later in the year, with the AKK guiding for a potential benchmark size EUR issue, in part to prefinance for 2024.

Hungary

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	1.8	4.2	3.7	2.2	4.3	5.4	4.9	-4.5	7.2	4.6	0.2	3.1	3.8
Private consumption (%YoY)	0.5	0.9	2.7	1.0	1.7	-0.9	1.9	-5.9	0.8	6.5	-2.3	1.9	4.4
Government consumption (%YoY)	5.6	8.9	1.3	0.5	3.8	4.3	9.5	3.9	2.5	-1.3	0.5	0.3	1.3
Investment (%YoY)	9.8	12.2	4.9	-10.6	19.7	16.3	12.8	-7.1	6.5	1.2	-4.3	5.6	5.3
Industrial production (%YoY)	1.1	7.7	7.4	0.9	4.6	3.5	5.6	-6.0	9.5	5.8	-2.4	8.7	6.5
Unemployment rate (year-end, %)	7.9	6.9	5.7	4.1	3.5	3.3	2.9	4.2	3.8	3.8	4.0	3.6	3.5
Nominal GDP (HUFbn)	30,352	32,805	34,965	36,207	39,275	43,387	47,674	48,425	55,255	66,616	78,446	86,226	93,103
Nominal GDP (€bn)	102	106	113	116	127	136	147	138	154	170	208	234	252
Nominal GDP (US$bn)	136	140	124	128	145	159	164	159	182	179	233	274	289
GDP per capita (US$)	13,715	14,299	12,711	13,109	14,630	16,423	16,787	16,129	18,763	18,448	24,072	28,374	30,007
Gross domestic saving (% of GDP)	25.1	25.2	25.9	26.0	25.1	27.0	27.6	26.1	26.3	22.3	18.4	21.3	22.4
Prices													
CPI (average, %YoY)	1.7	-0.2	-0.1	0.4	2.4	2.8	3.4	3.3	5.1	14.5	18.3	5.0	3.1
CPI (year-end, %YoY)	0.4	-0.9	0.9	1.8	2.1	2.7	4.0	2.7	7.4	24.5	7.9	3.7	3.0
Wage rates (nominal, %YoY)	3.4	3.0	4.3	6.2	12.9	11.3	11.3	9.8	8.9	17.4	16.0	7.5	6.0
Fiscal balance (% of GDP)													
Consolidated government balance	-2.6	-2.8	-2.0	-1.8	-2.5	-2.1	-2.0	-7.5	-7.1	-6.2	-4.1	-3.3	-2.5
Consolidated primary balance	1.9	1.2	1.4	1.3	0.2	0.2	0.2	-5.2	-4.9	-3.5	-0.1	1.2	1.5
Total public debt	77.2	76.5	75.8	74.9	72.1	69.1	65.3	79.3	76.6	73.3	69.2	66.3	63.9
External balance													
Exports (€bn)	81.3	84.5	90.5	93.0	100.7	104.9	109.1	105.0	119.2	142.2	155.1	162.2	174.2
Imports (€bn)	74.7	78.2	81.9	83.3	92.6	99.3	104.8	99.4	117.6	150.8	155.8	157.8	168.1
Trade balance (€bn)	6.6	6.3	8.6	9.7	8.1	5.5	4.3	5.6	1.6	-8.6	-0.7	4.4	6.1
Trade balance (% of GDP)	6.4	5.9	7.6	8.4	6.4	4.1	3.0	4.1	1.1	-5.0	-0.3	1.9	2.4
Current account balance (€bn)	3.6	1.3	2.6	5.2	2.5	0.2	-1.1	-1.6	-6.3	-13.7	-4.7	-1.1	2.5
Current account balance (% of GDP)	3.5	1.2	2.3	4.5	2.0	0.2	-0.8	-1.1	-4.1	-8.1	-2.2	-0.4	1.0
Net FDI (€bn)	2.1	5.1	2.3	3.9	5.1	5.6	3.2	4.8	5.6	7.3	7.7	8.0	6.5
Net FDI (% of GDP)	2.0	4.8	2.0	3.3	4.0	4.1	2.2	3.5	3.6	4.3	3.7	3.4	2.6
Current account balance plus FDI (% of GDP)	5.5	6.0	4.4	7.8	6.0	4.2	1.4	2.3	-0.4	-3.7	1.5	3.0	3.6
Foreign exchange reserves ex gold (€bn)	32.6	33.7	30.0	24.0	22.6	25.8	26.5	31.8	30.8	30.8	32.5	34.4	36.1
Import cover (months of merchandise imports)	5.2	5.2	4.4	3.5	2.9	3.1	3.0	3.8	3.1	2.5	2.5	2.6	2.6
Debt indicators													
Gross external debt (€bn)	89.4	87.6	82.4	78.4	75.1	75.4	77.0	82.1	93.9	108.6	114.0	111.5	106.0
Gross external debt (% of GDP)	87	82	73	67	59	55	53	60	61	64	55	48	42
Gross external debt (% of exports)	110	104	91	84	75	72	71	78	79	76	74	69	61
Lending to corporates/households (% of GDP)	44.6	41.1	33.8	32.2	31.3	31.3	32.3	36.1	35.7	33.0	29.0	28.0	27.3
Interest & exchange rates													
Central bank key rate (year-end, %)	3.00	2.10	1.35	0.90	0.90	0.90	0.90	0.60	2.40	13.00	11.50	5.25	5.00
Broad money supply (average, %YoY)	4.1	4.1	4.7	4.6	9.6	13.9	7.5	14.5	17.4	16.3	-1.1	2.5	6.1
3m interest rate (Bubor, average, %)	4.32	2.41	1.61	0.99	0.14	0.12	0.19	0.69	1.46	9.97	14.50	6.90	5.02
3m interest rate spread over Euribor(ppt)	409	221	164	130	46	43	54	112	203	953	1078	371	235
3yr yield (average, %)	4.8	3.5	2.1	1.5	0.9	1.3	0.8	1.0	2.0	8.5	9.7	6.9	5.5
10yr yield (average, %)	5.9	4.8	3.4	3.1	3.0	3.0	2.5	2.2	3.1	7.6	7.6	6.8	6.2
USD/HUF exchange rate (year-end)	216.7	260.2	287.3	296.2	258.5	279.6	295.1	299.3	323.7	374.1	315.3	321.7	321.7
USD/HUF exchange rate (average)	223.2	233.8	281.7	283.1	271.2	272.5	290.5	305.4	303.8	372.7	336.8	314.5	321.7
EUR/HUF exchange rate (year-end)	296.9	314.9	313.1	311.0	310.1	321.5	330.5	365.1	369.0	400.3	372.0	370.0	370.0
EUR/HUF exchange rate (average)	296.9	308.7	309.9	311.5	309.2	318.9	325.4	351.2	358.5	391.3	377.2	368.0	370.0

Source: National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	6.5	4.0	0.4	-0.9	-1.2	0.6	2.0	3.1	3.3	3.1	3.0	3.2	3.3
CPI (eop, %YoY)	11.7	20.1	24.5	25.2	20.2	12.8	7.9	5.2	5.7	4.2	3.7	3.1	3.1
Central bank key rate (eop, %)	7.75	13.00	13.00	13.00	13.00	13.00	11.50	8.00	6.75	6.00	5.25	5.00	5.00
3m interest rate (eop, %)	8.40	13.30	16.18	16.30	15.00	13.50	11.00	7.50	6.25	6.00	5.25	5.00	5.00
10yr yield (eop, %)	7.96	9.77	9.05	8.50	7.05	7.15	6.95	7.00	6.85	6.75	6.50	6.65	6.30
USD/HUF exchange rate (eop)	380.0	428.6	375.7	349.9	341.7	334.5	315.3	306.7	312.0	317.4	321.7	321.7	321.7
EUR/HUF exchange rate (eop)	396.8	421.4	400.3	381.0	369.0	378.0	372.0	368.0	365.0	365.0	370.0	370.0	370.0

Source: National sources, ING estimates

Kazakhstan

Dmitry Dolgin, Chief Economist, Russia & CIS

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	4.9	5.2	4.7	4.0	3.5	4.7	4.0
CPI (%YoY)*	18.1	15.0	11.9	10.0	9.4	15.0	8.6
Policy interest rate (%)	16.75	16.75	16.00	15.00	14.00	15.00	11.00
3m interest rate (%)*	16.5	16.5	15.5	14.5	13.5	15.8	12.6
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT*	456	455	460	465	470	460	472
EUR/KZT*	494	491	520	549	564	515	552

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

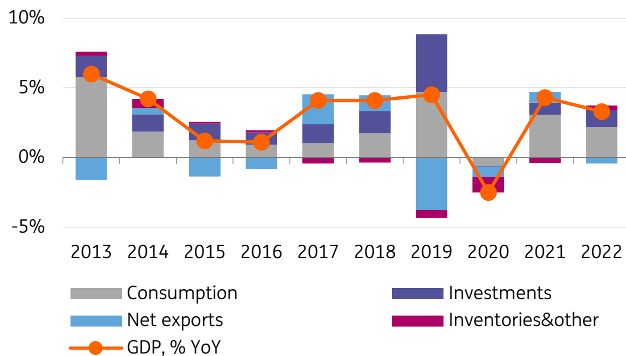
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

Country strategy: growth to recover, but FX risks mount

Kazakhstan is generally benefiting from Russia's geopolitical tensions through an inflow of high-skilled labour and businesses and opportunities for increased trade with the EU. That said, high dependence on the Russian pipeline infrastructure and the need to balance its relationship with the EU are the risk factors. In 2023, growth momentum may strengthen, but domestic constraints include a deteriorating inflationary outlook and high dependency on the oil sector, prone to sudden maintenance issues.

Financially, Kazakhstan's fiscal and external balances remain comfortable. Nevertheless, the scope for further strengthening of the Kazakhstani Tenge (KZT) appears limited given the expected return of the current account to deficit and likely normalisation of net private capital inflows in the face of risks of secondary sanctions related to ties with Russia.

GDP growth and major contributors (%YoY, ppt)

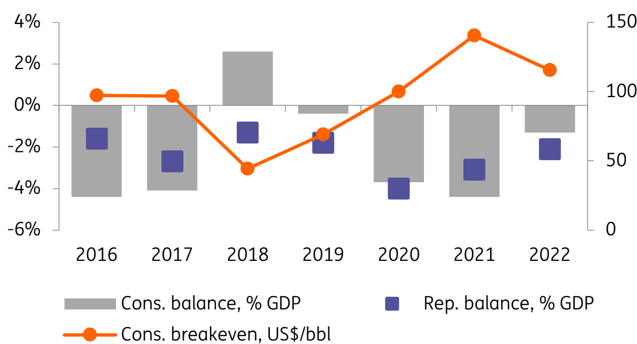


Source: CEIC, National sources, ING

Economic activity gaining momentum

Following a 1ppt slowdown to 3.3% GDP growth in 2022, Kazakhstan is on track to post GDP acceleration in 2023-24 thanks to continued growth in consumption and a recovery in industrial (including oil production after a somewhat erratic 2022). 1Q23 GDP growth was 4.9% YoY. Support factors include the presence of c.100,000 Russian immigrants (1% of the permanent population) and relocated companies, growing consumer lending and wages, expansion of oil production and exports to the EU. Meanwhile, sticky elevated inflation remains a concern, preventing any easing of monetary policy, while fiscal support is also limited. Kazakhstani oil exports' dependence on Russia is a growing concern, with 80% of oil exports going through the Caspian Pipeline Consortium (CPC) pipeline and extra supplies to the EU via the Druzhba pipeline. Also, Kazakhstan is on the US/EU watch in terms of compliance with Russian sanctions.

Key fiscal indicators (% GDP, lhs) (US$/bbl, rhs)

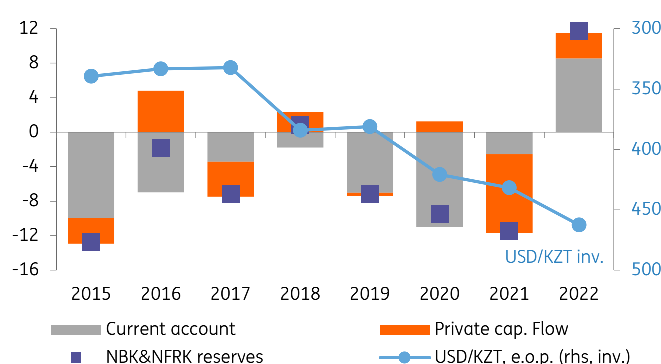


Source: CEIC, National sources, ING

Fiscal policy tends to return to conservatism

Last year was lucrative for the budget, as thanks to a US$20/bbl increase in the Brent oil price and recovery in production after a sluggish 2020-21, along with some restraint on the expenditure side, the consolidated budget deficit shrank by 3ppt to 1.3% of GDP, and breakeven Brent fell from US$140/bbl to US$116/bbl. The new budget rules introduced in 2023 suggest that the government is targeting a cautious approach to spending to limit the breakeven, which is still elevated. A tighter limit on the sovereign fund (NFRK) outlays suggests a higher role of borrowing, mostly domestic, in financing the Republican budget deficit (which should remain at 2-3% of GDP pa as most of the oil revenues go to the sovereign fund directly). The public debt should remain limited at around 25-30% of GDP unless the policy is eased.

Key balance of payment items and KZT (US$bn, lhs)



Source: CEIC, National sources, ING

KZT increasingly reliant on volatile capital flows

After showing a US$8.5bn surplus in 2022, the current account returned to a US$1.5bn deficit in 1Q23 and is likely to remain negative on moderation of oil prices and growth in imports. In fact, the current account surplus has been shrinking since 2Q22, the breakeven Brent increased from US$77/bbl to US$81/bbl in 2022, and the KZT appreciation since 3Q22 was based on the substantial atypical net private capital inflow of c.US$3bn per quarter, which could prove volatile. USD/KZT has now almost recovered to levels seen before February 2022, and the new fiscal rule assumes lower state sales of FX out of NFRK. In addition, risk of Russia-related secondary sanctions may push Kazakhstan to be more cautious about its financial and trade flows.

Kazakhstan

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	6.0	4.2	1.2	1.1	4.1	4.1	4.5	-2.5	4.3	3.3	4.7	4.0	4.0
Private consumption (%YoY)	10.6	1.1	1.8	1.2	1.5	6.1	6.1	-3.7	6.3	2.0	5.7	4.3	3.7
Government consumption (%YoY)	1.7	9.8	2.4	2.3	2.1	-14.1	15.5	12.8	-2.4	9.1	5.0	4.5	4.0
Investment (%YoY)	5.5	4.4	4.2	3.0	4.5	5.4	13.8	-0.2	2.6	3.6	5.0	4.5	4.0
Industrial production (%YoY)	2.5	0.3	-1.6	-1.1	7.3	4.4	-4.1	-0.5	3.6	1.1	4.0	4.2	4.0
Unemployment rate (average, %)	5.2	5.1	5.0	4.9	4.9	4.8	4.8	4.9	4.9	4.9	4.8	4.7	4.7
Nominal GDP (KZTbn)	35,999	39,676	40,884	46,971	54,379	61,820	69,533	70,649	83,952	102,892	115,785	125,547	139,312
Nominal GDP (€bn)	171	177	116	133	138	146	163	138	171	208	282	311	329
Nominal GDP (US$bn)	237	221	184	137	167	179	182	171	197	224	252	266	286
GDP per capita (US$)	13,891	12,807	10,510	7,715	9,248	9,813	9,813	9,122	10,371	11,381	12,980	13,711	14,670
Gross domestic saving (% of GDP)	40	41	35	34	37	40	39	34	40	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	5.8	6.7	6.6	14.7	7.4	6.0	5.2	6.8	8.0	15.0	15.0	8.6	6.7
CPI (year-end, %YoY)	4.8	7.4	13.6	8.5	7.1	5.3	5.4	7.5	8.4	20.3	10.0	7.4	6.2
Wage rates (nominal, %YoY)	7.8	10.9	4.1	13.4	5.5	7.9	14.8	14.0	17.5	23.1	18.5	12.6	10.7
Fiscal balance (% of GDP)													
Consolidated government balance	7.6	6.1	9.6	-4.4	-4.1	2.6	-0.4	-3.7	-4.4	-1.3	-1.0	-0.7	-0.9
Consolidated primary balance	8.1	6.7	10.3	-3.3	-3.2	3.6	0.5	-2.6	-3.1	0.0	0.3	0.6	0.4
Total public debt	12.3	14.3	22.1	24.3	24.8	24.9	23.7	29.2	26.2	24.9	26.5	27.5	28.5
External balance													
Exports (US$bn)	87.7	70.1	41.6	37.0	49.5	59.0	59.5	44.1	65.8	86.1	84.0	87.4	81.9
Imports (US$bn)	49.2	42.5	33.9	26.6	31.0	35.0	41.1	38.1	41.6	49.8	54.2	56.9	58.1
Trade balance (US$bn)	38.5	27.7	7.7	10.5	18.5	24.0	18.4	6.0	24.2	36.4	29.7	30.5	23.8
Trade balance (% of GDP)	16.3	12.5	4.2	7.6	11.1	13.4	10.1	3.5	12.3	16.3	11.8	11.5	8.3
Current account balance (US$bn)	4.5	-2.9	-10.0	-7.0	-3.4	-1.8	-7.0	-11.0	-2.6	8.5	-1.3	-1.7	-4.8
Current account balance (% of GDP)	1.9	-1.3	-5.4	-5.1	-2.1	-1.0	-3.9	-6.4	-1.3	3.8	-0.5	-0.6	-1.7
Net FDI (US$bn)	8.0	4.7	3.3	13.7	3.8	5.0	5.9	5.9	1.9	7.9	6.0	4.0	2.0
Net FDI (% of GDP)	3.4	2.1	1.8	10.0	2.3	2.8	3.3	3.4	1.0	3.5	2.4	1.5	0.7
Current account balance plus FDI (% of GDP)	5.3	0.8	-3.6	4.9	0.2	1.8	-0.6	-3.0	-0.3	7.4	1.9	0.9	-1.0
Foreign exchange reserves ex gold (US$bn)	19.2	21.8	20.3	20.1	18.5	16.5	10.1	12.1	10.8	14.6	14.1	13.6	13.1
Import cover (months of merchandise imports)	4.7	6.2	7.2	9.1	7.2	5.7	2.9	3.8	3.1	3.5	3.1	2.9	2.7
Debt indicators													
Gross external debt (US$bn)	150	157	153	164	167	160	160	164	164	160	163	166	170
Gross external debt (% of GDP)	63	71	83	119	100	89	88	96	83	72	65	63	60
Gross external debt (% of exports)	171	224	367	442	339	272	268	372	249	186	77	72	73
Lending to corporates/households (% of GDP)	31.4	30.5	31.0	27.1	23.4	21.2	19.9	20.7	22.0	24.4	26.1	27.2	27.2
Interest & exchange rates													
Central bank key rate (year-end, %)	5.50	5.50	16.00	12.00	10.25	9.25	9.25	9.00	9.75	16.75	15.00	11.00	9.00
Broad money supply (average, %YoY)	1.5	-8.2	8.0	46.2	7.5	7.1	11	19.2	24.1	18.0	18.0	15.0	10.0
3m interest rate (TONIA, average, %)	6.5	7.1	10.4	15.5	11.8	10.3	10.2	10.8	8.9	15.5	15.8	12.6	9.3
3m interest rate spread over US$-Euribor (ppt)	6.25	6.88	10.07	14.70	10.46	7.90	7.91	10.15	8.66	12.90	11.2	9.5	6.3
2yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT exchange rate (year-end)	154	182	339	333	332	384	381	421	432	463	465	480	500
USD/KZT exchange rate (average)	152	179	222	342	326	345	383	413	426	460	460	472	487
EUR/KZT exchange rate (year-end)	211	222	371	352	398	439	427	516	488	493	548.7	552	575
EUR/KZT exchange rate (average)	211	224	351	352	395	423	426	511	491	494	515	552	560
Brent oil price (annual average, US$/bbl)	109	99	52	44	54	71	64	42	71	99	90	89	75

Source: CEIC, National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	2.8	2.0	3.9	4.9	5.2	4.7	4.0	3.5	4.1	4.0	4.2	4.5	4.0
CPI (eop, %YoY)	14.5	17.7	20.3	18.1	15.0	11.9	10.0	9.4	8.7	8.1	7.4	7.1	6.8
Central bank key rate (eop, %)	14.00	14.50	16.75	16.75	16.75	16.00	15.00	14.00	13.00	12.00	11.00	10.50	10.00
3m interest rate (eop, %)	14.12	14.01	15.72	16.54	16.50	15.50	14.50	13.50	12.50	11.50	10.75	10.25	10.00
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)	470	476	463	456	455	460	465	470	470	475	480	480	485
EUR/KZT exchange rate (eop)	494	467	494	494	491	520	549	564	550	546	552	552	558

Source: CEIC, National sources, ING estimates

Poland

Rafał Benecki, Chief Economist

Forecast summary

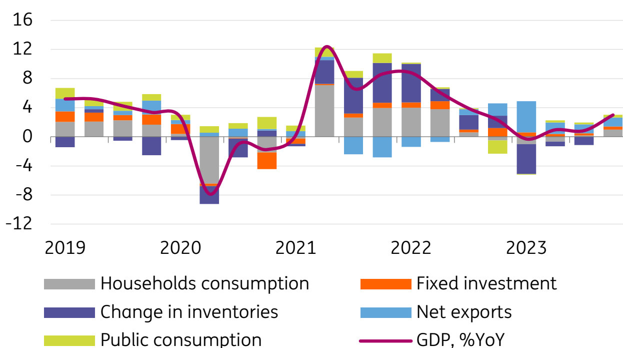
	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	-0.3	1.0	0.9	3.0	2.6	1.2	2.4
CPI (%YoY)*	16.1	11.8	9.5	7.8	6.5	12.1	6.1
Policy interest rate (eop, %)	6.75	6.75	6.75	6.50	6.50	6.50	5.75
3m interest rate (%)*	6.89	6.95	6.78	6.70	6.70	6.86	6.51
10yr yield (%)*	6.03	6.00	6.00	5.95	5.95	6.04	5.90
USD/PLN*	4.29	4.09	3.85	3.71	3.73	4.04	3.85
EUR/PLN*	4.68	4.50	4.43	4.45	4.48	4.53	4.50

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

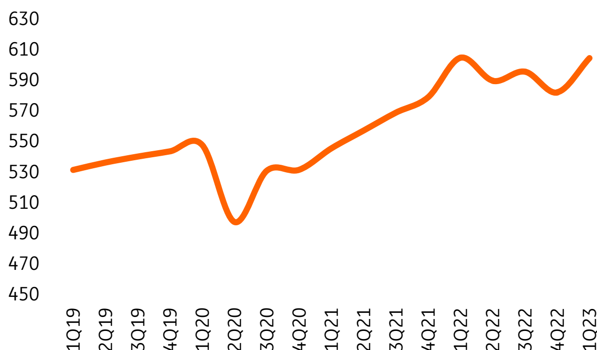
Source: National sources, ING estimates

GDP composition (%YoY)



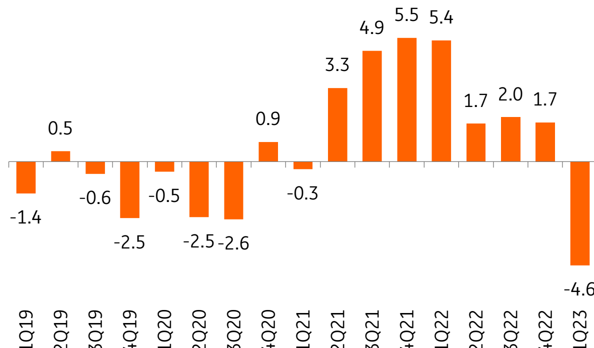
Source: Polish Statistical Office, ING forecasts

Real GDP (PLNbn, 2015 prices, SA)



Source: Eurostat

Change in inventories contribution to YoY GDP (ppt)



Source: Polish Statistical Office

Country strategy: FX inflows signal market bet for change

The Polish economy should reach a bottom in 1H23 but recovery in 2H23 could be sluggish as the main growth engine from last year (consumption) will improve only gradually with lower CPI and some election spending. Net exports should be the main growth driver depending on uncertain foreign demand. CPI peaked in February at 18.4%YoY but should fall to single digits in 3Q23 and 2024. July's NBP projection is likely to bring a lower CPI trajectory and the NBP may provide a single cut in 2H23 (50% possibility), also referring to strong PLN. We see risk of persistently high core CPI at c.5% in 2024-25. To achieve the 2.5% target, Poland needs a paradigm shift in policy, ie, nominal wages growth below 5%YoY, less consumption and more investment. PLN is no longer undervalued; we still see some appreciation. POLGBs curve may keep steepening due to rate cut expectations driving the short end and risk of spending affecting the long end, both from the ruling and opposition parties.

Macro digest

Economic growth was choppy and uneven in 2022 amid energy and war shocks, but the Polish economy managed to expand by a hefty 5.1% even though economic conditions deteriorated in the second half of the year. With wages failing to catch up with double-digit inflation, real disposable incomes of households deteriorated, weighing down on consumption. Consumption contracted in 4Q22 and 1Q23 in annual trends and is projected to remain weak most of 2023. At the same time, investment should continue expanding on the back of outlays by large firms and public infrastructure and military spending. 1Q23 brought a contraction in annual GDP (-0.3%), but it was shallower than expected. In 2023, GDP growth is projected at 1.2% as an improving foreign trade balance (subdued imports) will more than compensate for weak domestic demand exacerbated by destocking.

Consumer prices jumped by 14.4% in 2022 and average CPI is expected to remain double-digit in 2023, but inflation has passed the peak. The downward trend in the headline CPI is clear and core inflation started slower sequential growth. The strong disinflationary trends abroad (lower commodity prices, GVC in pre-pandemic conditions) and PLN firming, improved the outlook for core inflation decline, but it will moderate visibly lower than headline consumer inflation. Still, some policymakers flag a cut in NBP rates in late-2023. We still see risks of inflation anchoring above the upper bound over the medium term (tight labour market, wage pressure, fiscal expansion). As a result, the return of CPI to the NBP target of 2.5% is likely to be a long process. Nonetheless, we assess the odds of an NBP rate cut this year at nearly 50% given policy guidance from the NBP governor Glapiński, who said a rate cut is possible, provided inflation falls below 10% YoY, which we see in September (to be released at the beginning of October).

General elections in October 2023 have led to a series of fiscal pledges by the government. It has announced: a new permanent spending from 2024 (0.7% of GDP) and 0.6% of GDP one-off spending for 2023 (and 0.7% of GDP higher central deficit). The opposition joined in and declared additional fiscal spending if it gained power (2.4% of GDP). At the same time, the Recovery and Resilience funds for Poland remain frozen and any breakthrough in the conflict over the rule of law between Warsaw and Brussels is unlikely before the elections in Poland. Public debt is moderate by EU standards (below 50%) but Poland has a high structural deficit, foreign investors are eager to purchase Polish Eurobonds, unlike POLGBs, but high liquidity of the domestic banks ensures strong demand for POLGBs. In such an environment, public borrowing is not a challenge for authorities, at least not over the short to medium term.

Poland

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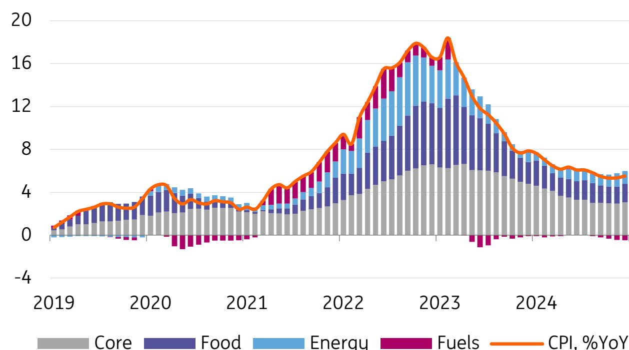
CPI inflation and its composition (%, percentage points)

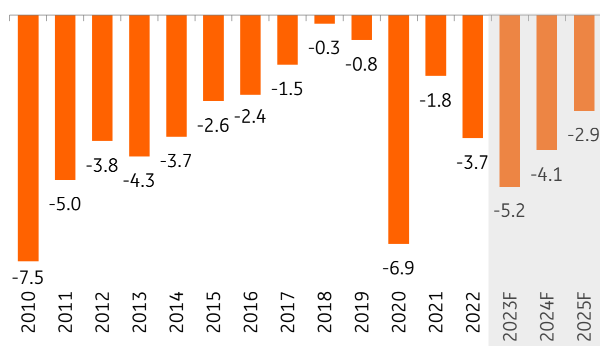


Source: Polish Statistical Office, ING forecasts

Disinflation in 2023, but NBP target still distant

CPI peaked in 1Q23, but below 20% YoY, and started trending downwards as the direct impact of the energy shock started to abate, leading to annual declines in gasoline and diesel prices as well as slower growth of energy for households. Upward pressure on food prices has also started moderating. Even core inflation peaked but declines are slower and core prices remain sticky. The legacy of the energy shock is still visible as businesses adjust their prices to cost levels. On top of that, the labour market remains tight and wages are expanding at double-digit pace. Core inflation is projected to moderate more slowly than headline inflation. The NBP target of 2.5% is unlikely to be reached before late-2025. In our view, the CPI picture doesn't justify a rate cut this year, but the NBP may refer to the strong PLN and the NBH and provide a single cut in 2H23.

General government balance (% of GDP)

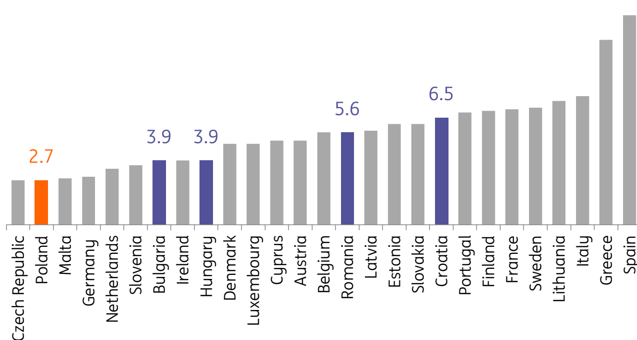


Source: Eurostat, ING forecasts

Poland outperformed on fiscal front in 2022, but high social, military and infrastructure spending ahead

In 2022, the general government deficit reached 3.7% of GDP but was below expectations. In 2023, we expect it to reach 5.2% of GDP. Authorities continue to bear the substantial cost of energy measures and are pursuing ambitious military and healthcare spending programmes. So far, pre-election pledges of the ruling party have reached 0.6% of GDP one-offs in 2023 and permanent from 2024 onwards at 0.7% of GDP, but more programmes are coming and the opposition also seems to be competing with the incumbents on that front. With public debt below 50% of GDP there are no immediate threats to fiscal sustainability, but the high structural deficit and high borrowing needs in the mid term are a challenge. Spending on energy transition, defence, healthcare and the risk to the RRF and EU funds call for careful choice of priorities.

LFS unemployment rate (Apr) (% of labour force, SA)

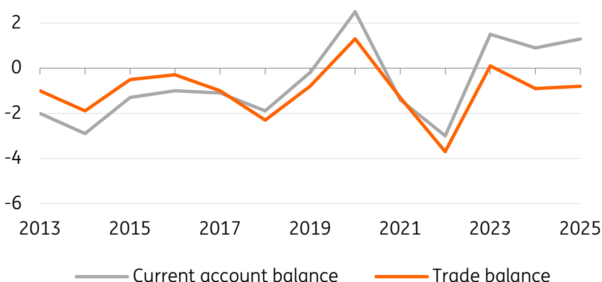


Source: Eurostat

Tight labour market and robust wages growth

Poland's labour force is driven by a combination of structural and cyclical factors, with the former dominating the overall picture so far. The continuous decline in working age population (some c.2m fewer over the past 12 years) has curbed labour supply although both an increase in participation rate and working immigrants (including the influx of refugees from Ukraine) has eased the pressure. With labour shortages in many sectors of the economy the cyclical employment adjustment is shallow and firms are hoarding labour. The unemployment rate in Poland will remain one of the lowest in the European Union. High inflation, scarcity of skilled workers and the high administrative increase in the minimum wage has put upward pressure on salaries. Nominal wages are projected to continue increasing at a double-digit pace in the coming quarters.

Current account and trade balance (% of GDP)



Source: NBP, ING forecasts

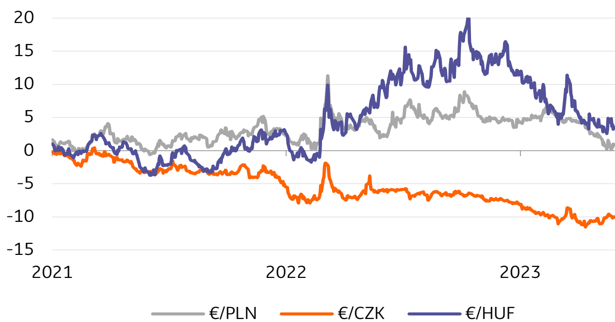
Swift switch from external CA deficit to a surplus in 2023

Poland's current account deficit widened to 3.0% of GDP in 2022 from 1.3% in 2021 on the back of record-high energy prices in Europe, in particular natural gas and coal prices. Their deliveries from Russia were terminated in early spring 2022. By contrast, radical decreases in energy commodity prices in 2023 together with a deceleration of domestic demand led to a swift improvement in Poland's external balance. We project a surplus of 1.5% of GDP this year as net exports is to be a major GDP growth driver. Poland's external CA balance is to moderate over 2024-2025 in line with strengthening of consumer and domestic demand. Also, elevated spending on military equipment is to push imports up.

Poland

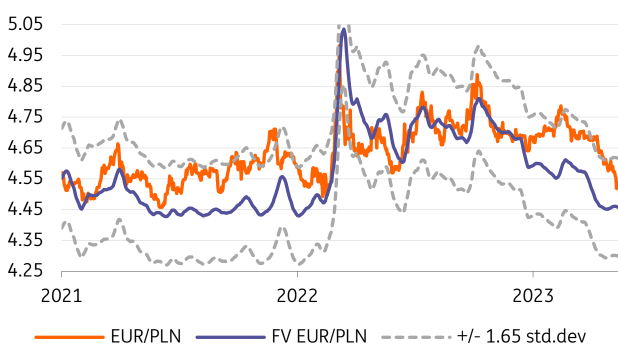
Strategy

CEE FX performance since 2021 (%)



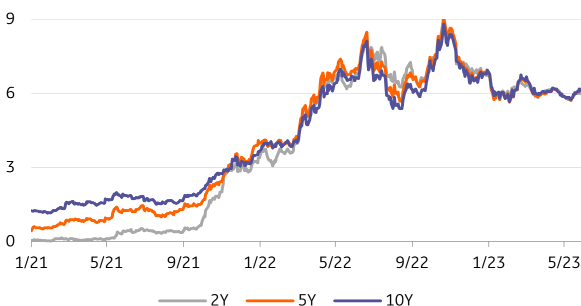
An increase represents depreciation of CEE currency
Source: Macrobond

€/PLN – ING relative value model since 2021



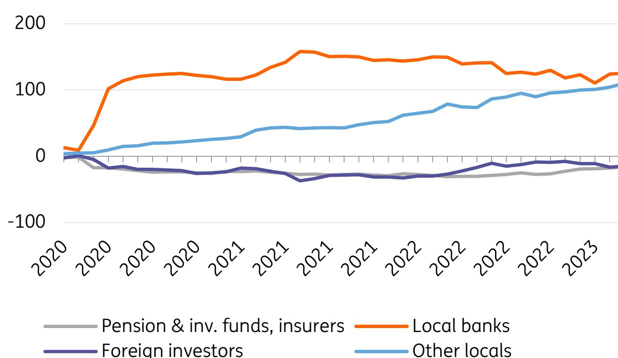
Source: Macrobond, ING estimates

The 2yr, 5yr and 10yr yields since 2021 (%)



Source: Macrobond

Structure of POLGBs holders; change since January 2020



Source: MinFin

FX strategy

The zloty significantly recovered in 2Q23, owing to a positive external environment but also improving domestic fundamentals. From a significant current account deficit, Poland quickly transitioned to a surplus. Moreover, the Ministry of Finance was seen tapping more into hard currency debt markets and, based on past MoF practices, it is likely some of these funds were converted via the market. We also think companies have made some contribution to foreign inflow to Poland.

These factors are likely to persist over the remainder of the year as well, given, for example, limited import demand and potentially elevated borrowing needs forcing the MoF to conduct further hard currency issues. On top of that, investors may also bet on a change of power after the general elections in October (political polls gauge this possibility at around 50%), Poland gaining prompt access to the Recovery Fund, etc, and build positions ahead.

However, based on our estimates, the zloty is no longer undervalued against the euro (see chart on left). The NBP has already effectively ended its tightening cycle and some MPC members signal prompt rate cuts. Simultaneously, markets are repricing Fed and ECB rate paths. In tandem with elevated inflation in recent years, which undermined the competitiveness of local companies to some extent, it should limit the scope for €/PLN to drop to around 4.40.

In 2024, we see €/PLN moving to a horizontal trend. The current account surplus is likely to fade given recovering domestic demand. Moreover, the government (regardless of whether the PiS retains power) is likely to try to limit zloty gains to shelter exporters.

Fixed income strategy

In 2023, POLGBs proved resilient, largely driven by local demand. While foreign investors reduced holdings, domestic purchases were heavy. This is particularly the case for local banks and individuals who bought over PLN4bn bonds net, out of a net issue of PLN12bn.

Until 4Q23 we see a risk of curve steepening. The pre-election fiscal promises fest has already started and both the ruling PiS and opposition are to unveil more, a clear risk for the long end. Moreover, the market expects the NBP to cut rates this year. While we see a minimal easing at best, incoming data should only support the market view.

However, we don't expect a larger rise in asset swaps or Bund spreads. The government may continue to both tap hard currency markets and the credit part of the Recovery Fund. The MoF may also reduce its significant cash buffer (PLN116bn). Thus, despite the high general government deficit, actual POLGBs issues may be tame.

Moreover, local demand for bonds should remain strong. Over-liquidity in the banking sector continues to rise, given lacklustre credit demand. This will both incentivise the banks to invest in POLGBs to avoid the asset tax, while further lowering deposit rates. This will increase the attraction of POLGBs to other local investors.

Even if the NBP were to cut rates this year, it will be minimal and followed by a long pause (given persistent core inflation). By contrast, the market expects a full easing cycle.

Poland

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	0.9	3.8	4.4	3.0	5.1	5.9	4.4	-2.0	6.9	5.1	1.2	2.4	3.5
Private consumption (%YoY)	0.0	3.4	3.8	3.6	6.3	4.4	3.5	-3.6	6.2	3.3	-0.2	2.5	3.5
Government consumption (%YoY)	2.4	4.0	2.4	2.0	2.7	3.5	6.5	4.9	5.0	-2.0	1.2	1.5	3.0
Investment (%YoY)	0.3	11.7	6.9	-7.6	1.6	12.6	6.2	-2.3	1.2	5.0	2.7	2.1	5.5
Industrial production (%YoY)	1.8	4.1	6.0	3.6	6.2	5.4	5.1	-1.9	14.7	10.7	2.1	5.0	4.0
Unemployment rate (year-end, %)	13.4	11.4	9.7	8.2	6.6	5.8	5.2	6.8	5.8	5.2	5.4	5.2	5.0
Nominal GDP (PLNbn)	1,630	1,701	1,799	1,853	1,983	2,127	2,289	2,338	2,631	3,078	3,484	3,756	4,009
Nominal GDP (€bn)	388	406	430	425	466	499	532	526	576	654	768	834	890
Nominal GDP (US$bn)	516	539	477	470	525	589	596	600	681	678	860	986	1,024
GDP per capita (US$)	13,395	14,005	12,405	12,231	13,611	15,320	15,528	15,631	17,850	17,923	22,783	26,178	27,246
Gross domestic saving (% of GDP)	20.5	21.4	23.1	23.2	22.9	23,5	24.2	24.4	25.1	25.4	26.3	25.7	25.7
Prices													
CPI (average, %YoY)	0.9	0.0	-0.9	-0.6	2.0	1.6	2.3	3.4	5.1	14.4	12.1	6.1	4.0
CPI (year-end, %YoY)	0.7	-1.0	-0.5	0.8	2.1	1.3	3.4	2.4	8.6	16.6	7.8	5.5	3.6
Wage rates (nominal, %YoY)	2.6	3.8	3.5	4.1	5.6	7.1	6.6	4.8	8.6	12.9	12.8	11.5	9.5
Fiscal balance (% of GDP)													
Consolidated government balance	-4.3	-3.7	-2.6	-2.4	-1.5	-0.3	-0.8	-6.9	-1.8	-3.7	-5.2	-4,1	-2.8
Consolidated primary balance	-1.7	-1.7	-0.9	-0.7	0.1	1.2	0.6	-5.6	-0.7	-2.2	-3.3	-2.1	-0.8
Total public debt	56.9	51.3	51.3	54.5	50.8	48.7	45.7	57.1	53.6	49.1	50.2	52.8	54.2
External balance													
Exports (€bn)	145.6	152.8	164.0	169.2	191.2	205.2	220.3	220.5	263.6	320.3	361.4	386.0	409.0
Imports (€bn)	149.3	160.7	166.2	170.6	196.0	216.4	224.7	213.6	217.2	344.5	360.3	392.8	416.3
Trade balance (€bn)	-3.7	-7.9	-2.1	-1.3	-4.8	-11.3	-4.4	7.0	-7.6	-24.2	1.1	-6.8	-7.3
Trade balance (% of GDP)	-1.0	-1.9	-0.5	-0.3	-1.0	-2.3	-0.8	1.3	-1.3	-3.7	0.1	-0.9	-0.8
Current account balance (€bn)	-7.7	-11.7	-5.5	-4.3	-5.3	-9.6	-1.2	12.8	-8.3	-19.5	11.7	7.1	11.9
Current account balance (% of GDP)	-2.0	-2.9	-1.3	-1.0	-1.1	-1.9	-0.2	2.5	-1.4	-3.0	1.5	0.9	1.3
Net FDI (€bn)	3.1	10.3	9.5	3.3	7.0	14.2	10.9	12.5	23.4	26.0	28.0	30.5	33.5
Net FDI (% of GDP)	0.8	2.5	2.2	0.8	1.5	2.8	2.0	2.4	4.1	3.9	4.3	4.0	4.0
Current account balance plus FDI (% of GDP)	-1.2	-0.3	1.0	-0.2	0.4	0.9	1.8	4.8	2.6	1.0	5.8	4.8	5.4
Foreign exchange reserves (€bn)	77.1	82.6	86.9	108.1	94.6	102.3	114.5	125.6	146.6	156.5	172.5	184.5	195.5
Import cover (months of merchandise imports)	6.2	6.2	6.3	7.6	5.8	5.7	6.1	7.1	6.5	5.4	5.7	5.6	5.6
Debt indicators													
Gross external debt (€bn)	279.5	293.9	304.0	321.4	319.8	317.3	316.7	307.4	322.7	345.6	332.9	343.8	350.8
Gross external debt (% of GDP)	71.1	73.7	72.0	76.7	67.3	64.2	58.9	60.7	56.4	52.8	50.9	44.8	42.1
Gross external debt (% of exports)	192.0	192.3	185.3	189.9	167.3	154.7	143.8	139.4	122.4	108.2	92	89	86
Lending to corporates & households (% of GDP)	54.9	56.3	57.2	57.8	56.0	56.5	59.2	55.2	56.8	51.2	52.7	54.6	57.1
Interest & exchange rates													
Central bank key rate (year-end, %)	2.50	2.00	1.50	1.50	1.50	1.50	1.50	0.10	1.75	6.75	6.50	5.75	5.00
Broad money supply (average, %YoY)	6.2	6.4	8.3	10.2	6.1	7.0	9.5	14.8	10.8	7.1	7.8	8.5	7.5
3m interest rate (WIBOR, average, %)	3.02	2.51	1.75	1.70	1.73	1.71	1.72	0.66	0.55	6.04	6.86	6.51	5.66
3m interest rate spread over EURIBOR (ppt)	279	231	178	201	205	202	207	109	112	560	314	336	299
2yr yield (average, %)	3.01	2.48	1.73	1.66	1.89	1.59	1.57	0.53	0.83	6.33	5.94	5.82	5.08
10yr yield (average, %)	4.05	3.52	2.71	3.05	3.44	3.22	2.38	1.52	1.95	6.11	6.04	5.90	5.53
USD/PLN exchange rate (year-end)	3.16	3.16	3.77	3.94	3.78	3.61	3.84	3.90	3.86	4.54	3.77	3.92	3.91
USD/PLN exchange rate (average)	3.16	3.16	3.77	3.94	3.78	3.61	3.84	3.90	3.86	4.46	4.04	3.85	3.91
EUR/PLN exchange rate (year-end)	4.20	4.19	4.18	4.36	4.26	4.26	4.30	4.44	4.57	4.71	4.45	4.51	4.50
EUR/PLN exchange rate (average)	4.20	4.19	4.18	4.36	4.26	4.26	4.30	4.44	4.57	4.69	4.53	4.50	4.50

Source: National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	6.1	3.9	2.3	-0.2	1.0	0.9	3.0	2.6	2.3	2.5	2.5	3.6	3.6
CPI (eop, %YoY)	15.5	17.2	16.6	16.1	11.8	9.5	7.8	6.5	6.1	5.5	5.5	4.5	4.6
Central bank key rate (eop, %)	6.00	6.50	6.75	6.75	6.75	6.50	6.50	6.50	6.50	6.50	5.75	5.75	5.75
3m interest rate (eop, %)	7.05	7.21	7.02	6.89	6.95	6.78	6.70	6.70	6.70	6.45	5.95	5.95	5.78
10yr yield (eop, %)	6.05	6.34	6.19	6.10	6.00	6.00	5.95	5.95	5.95	5.88	5.75	5.70	5.61
USD/PLN exchange rate (eop)	4.48	4.95	4.40	4.29	4.17	3.92	3.77	3.73	3.86	3.93	3.92	3.92	3.91
EUR/PLN exchange rate (eop)	4.68	4.87	4.69	4.68	4.50	4.43	4.45	4.48	4.52	4.52	4.51	4.51	4.50

Source: National sources, ING estimates

Romania

Valentin Tataru, Chief Economist

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	2.3	3.0	2.3	2.4	3.3	2.5	3.7
CPI (%YoY)*	14.5	9.9	8.5	6.9	5.8	10.5	5.0
Policy interest rate (eop, %)	7.00	7.00	7.00	7.00	6.50	7.00	5.50
3m interest rate (%)*	6.85	6.60	6.50	6.50	6.40	6.50	6.00
10yr yield (%)*	7.35	7.10	7.15	7.15	7.00	7.20	6.90
USD/RON*	4.57	4.61	4.40	4.25	4.18	4.45	4.32
EUR/RON*	4.94	4.98	4.97	5.02	5.02	4.98	5.06

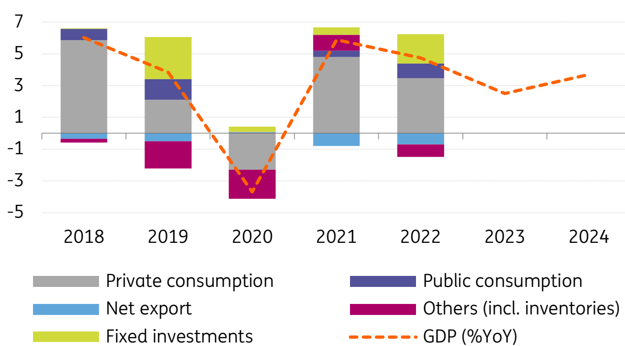
Macro trend		Political cycle	Ratings	FC	LC
Activity	=	Presidential: 2024	S&P	BBB-	BBB-
Fiscal	Loose	Parliamentary: 2024	Moody's	Baa3	Baa3
Monetary	Neutral	Local: 2024	Fitch	BBB-	BBB-

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

Country strategy: Getting difficult to pursue the reforms

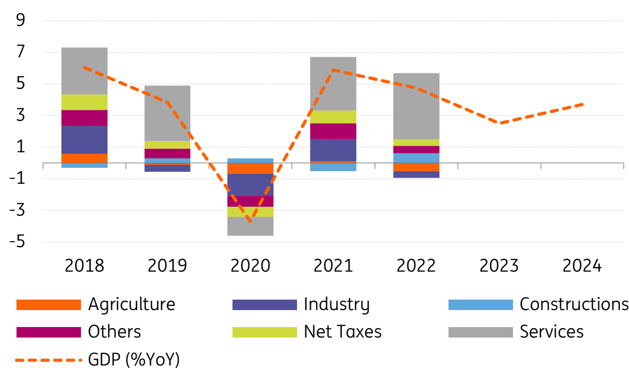
Benefiting from an unusual context of political stability (which we expect to continue) and positive investor sentiment, the economy continues to perform decently, with help from increasing public investment spending. Yet, having not used the high GDP growth from 2021-22 to accelerate deficit reduction, the government finds itself in an uncomfortable budgetary position. Sticking to the 4.4% of GDP budget deficit target this year is proving more than just challenging, as public wage requirements are catching up after two years of high inflation, while budget revenues are not increasing as planned. Historically, cutting investments was the general solution to stick within the deficit, hence we do not exclude this option. And this is just for 2023 budget. Moving lower to a 3.0% of GDP deficit in 2024 as per current strategy looks very ambitious to say the least.

GDP (YoY%) and components (ppt)



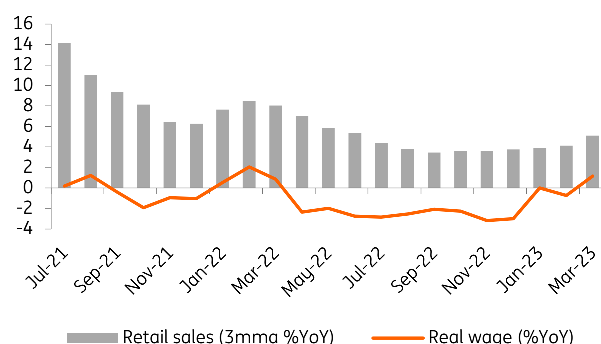
Source: NIS, ING estimates

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



Source: NIS, ING estimates

Construction sector holding on (YoY% growth)



Source: NIS, ING

Investments offsetting the slowdown in consumption

With a bit of help from the external context as well, which in the end hasn't performed as badly as expected, the economy remained on track and continued to post solid quarterly advances throughout 2022. The environment is clearly weaker in 2023, with a quasi-stagnant first quarter growth, despite hard frequency data looking rather solid. A welcome rebalancing in growth drivers from consumption to investments looks in the making, though we are not in a hurry to celebrate that, as the latest social demands might be partially satisfied by cutting into investment spending. This spending shift might in fact be growth supportive in the short term, though clearly not ideal from a medium- and long-term perspective. On the brighter side, real wage growth turned positive in March as the average net wage advanced by an eye-catching 15.7%, with above-average growth visible in sectors such as agriculture, IT services, transportation and construction, while the public sector has generally seen below-average wage growth. As real wage growth is set to accelerate further this year, a reacceleration of consumer spending could be envisaged in the second part of 2023.

With a significant electoral year ahead, discussions about future economic policies and tax revamps are all over the place. This is blurring to some extent the policy visibility post-elections, though we tend not to put a too heavy emphasis on the headlines these days. Should it want to continue to tap into the RRF money, any future government will need to deliver the already agreed reforms as per the National Recovery and Resilience Plan, with very little room for manoeuvre. While some delays are already accumulating and losing some parts of future tranches cannot be excluded, the vast majority of political parties seem to strongly support sticking with the agreed plan.

On the monetary policy front, we expect the National Bank of Romania (NBR) to cut rates when the first opportunity arises. Our central scenario assumes a rate cut once inflation inches below the key rate, which should happen in 1Q24. Nevertheless, if other regional central banks were to move ahead with cutting rates before the end of this year, we cannot rule out the NBR doing the same. For 2024, we expect a total of 150bp of rate cuts to 5.50%. 2024 inflation is likely to allow for even larger cuts, but we believe that the NBR will want to consolidate the lower inflation prints and will maintain a relevant positive differential between the key rate and inflation. The relative stability of the exchange rate should help as usual, with the EUR/RON rate expected to move upwards in small 1.0-2.0% increments each year.

Romania

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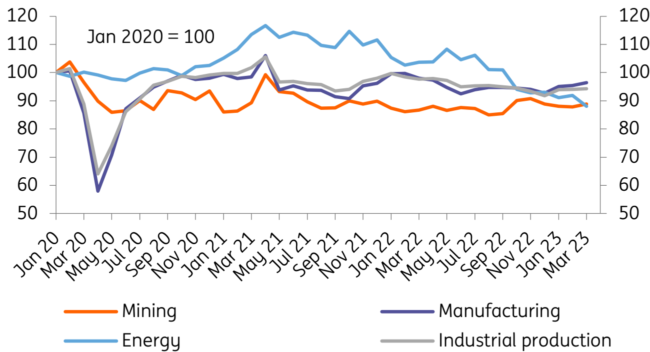
Industry still below pre-pandemic levels

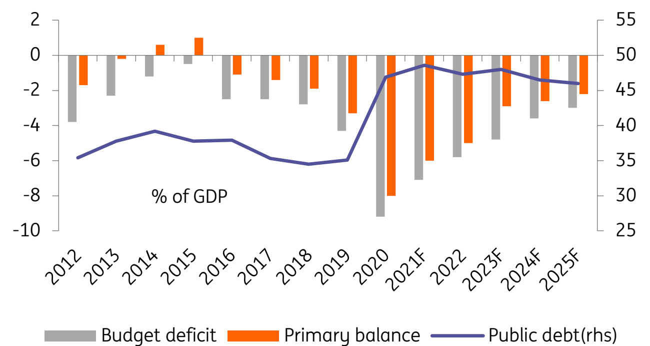


Source: NBR, ING

Stabilising in a mediocre zone

Industrial production contracted by 2.0% in 2022 and 4.6% year-to-date. As of March 2023, it remains almost 6.0% below its pre-pandemic levels (ie, January 2020). Among the few brighter spots are the food, automotive and pharma sectors which have continued their upward trend and are above both the pre-pandemic period and the similar period from 2022. On the downside, the textile and chemical industries are both some 35% below their pre-pandemic levels, followed by the metallurgical industry at 30% below. The latest confidence data does not look particularly encouraging as production expectations and capacity utilisation collapsed in May 2023 to a two-year low. The number of employees remained fairly constant, though significant shifts occurred within subsectors.

Fiscal picture is improving but we are not there yet

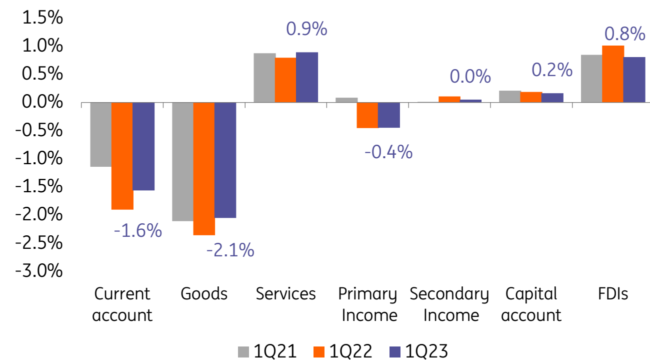


Source: Eurostat, ING

Elections and social demands could derail the adjustment

The 4.4% of GDP budget deficit target for 2023 was shaping up to be quite challenging and it definitely is. As of April 2023, the budget deficit reached 1.72% of GDP and already prompted the government to come up with a mild (read: insufficient) spending optimisation plan, amounting at best to some 0.3% of GDP. Given the social demands for higher wages (at the time of writing there is an ongoing major strike in the public education sector) and the lower GDP growth (leading to lower budget revenues), a more substantial adjustment is likely to be needed at the usual mid-year budget revision. The good news is that sticking to the 4.4% of GDP target for 2023 seems to be a priority. The bad news is that it might involve cutting public investments which were just catching up some speed.

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

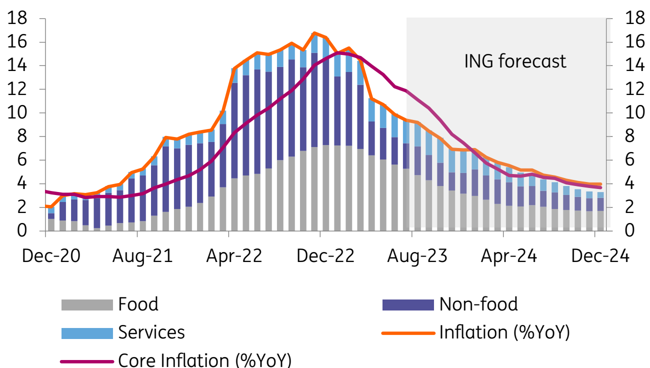


Source: NBR, ING

Economic slowdown and lower fiscal gap are helping

The current account deficit (CAD) surpassed the worst fears in 2022 as it reached 9.4% of GDP, from 7.3% in 2021. We estimate that at least 1ppt of the 2022 deterioration came from worsening terms of trade, which should be largely reversed in 2023. As mentioned many times already, we remain particularly worried about the stickiness of the CAD and blaming it on the fiscal deficit only holds so much. More positively, the financing structure of the CAD looks relatively sound. We estimate that over the next 3-4 years, between 70% and 80% of the deficit can be covered via non-debt-creating inflows such as FDIs and EU funds. As a consequence, we estimate that a CAD of 4.0-5.0% of GDP could be considered a 'natural' level for an emerging economy like Romania. But we're not there yet…

Inflation (YoY%) and main components (ppt)



Source: NIS, ING

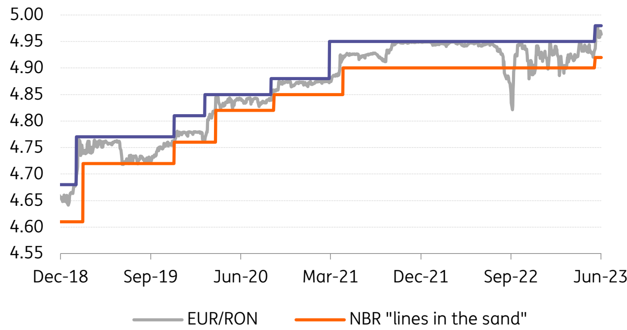
Switching to single digits by the Autumn

After remaining consistently at the lower end of inflation forecasts, it seems things are finally turning our way: inflation looks set to touch 7.0% by the end of 2023, driven by base effects, lower energy prices and an easing of food prices. We reduce our 2024 year-end estimate to 4.0% from 4.3% previously, while maintaining the view that inflation will not reach NBR's 1.5-3.5% target range over the next two years. These developments alone (especially those from 2024) would allow the NBR to cut the key rate quite significantly and still maintain a positive real rate. However, we believe that the NBR will want to consolidate the lower inflation prints and will maintain a relevant positive differential between the key rate and inflation, at least until we see inflation within NBR's target range.

Romania

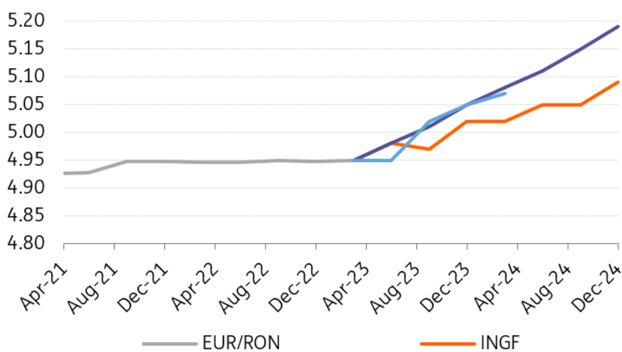
Strategy

Adjusting the range but not the story



Source: NBR, ING estimates

FX – spot vs forward and INGF



Source: NBR, Bloomberg, ING estimates

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

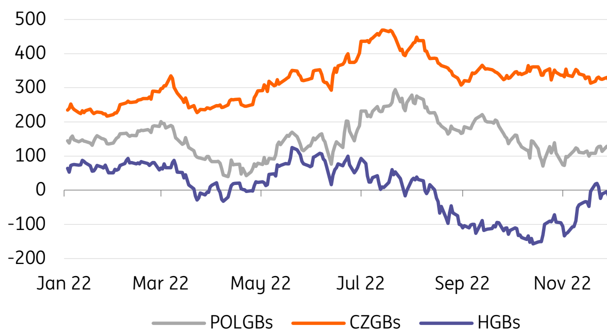
The recent EUR/RON move above 4.95 shows us that the NBR stance is becoming more relaxed, but we still think it is too early for a significant move higher. Inflation remains the number one concern for the central bank and although the current account deficit looks problematic, its resolution may still wait a little longer.

EUR/RON touched 4.98 in May, which seems like a new line in the sand for now. Considering the record level of excess liquidity in the market, we think that the situation cannot suit the central bank. Seen from this angle, allowing the EUR/RON to shift higher might be an attempt to stimulate upside market pressure and get some of the excess liquidity out of the system.

The new temporary range is likely to be 4.94-4.98, with no expectation of moves to the lower levels we saw in the first quarter of this year, supported by significant demand for ROMGBs. We envisage at least one more upward shift before the year-end, most likely once inflation converges towards the key rate. We target the EUR/RON level of 5.02 for the end of the year. We see larger moves as incompatible with the inflation target and beyond the central bank's pain threshold.

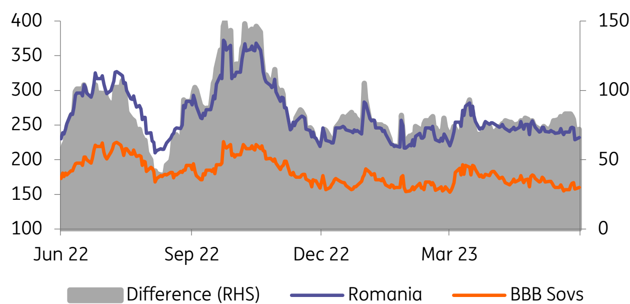
From a market perspective it is a hard playing field. The central bank's liquidity data shows that after allowing a move above 4.95 EUR/RON, the NBR seems rather tolerant of the situation, as liquidity hasn't diminished much in May versus April. If the central bank decides to tighten conditions significantly, we see a case for higher FX implied yields once again.

10y ROMGBs spreads vs CEE (bp)



Source: Refinitiv, ING

ROMANI USD credit versus BBB sovereigns (z-spread, bp)



Source: Refinitiv, ING

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

The combination of high yields, by far the best funding situation, a positive macro picture, not inverted ROMGBs curve and the inflation profile will, in our view, ensure market favour in 2H23. According to our calculations, MinFin has secured about 63% of issuance. Although the risk of adjustments to the funding plan due to fiscal slippage or EU funds delays is high, the additional issuance would not change the picture and the market would easily absorb it with scope for additional FX issuance. On the other hand, spreads against CEE peers and heavy long positioning may indicate a problem for the next rally. So, the overall direction of travel remains clear, further gains may be of a slower pace.

In the hard currency space, ROMANI credit has performed robustly this year, with spreads modestly tighter YTD in absolute terms and relative to the BBB peer group. Given the overall stable macro-outlook and limited political risks, in our view Romania remains a decent option for relatively high-quality carry (spreads are still the widest in the rating peer group for both USD and EUR paper). However, with positioning relatively heavy and a likely lack of further positive catalysts, we would see limited scope for significant spread tightening in the near term. Headlines around EU fund delays could be a potential negative catalyst for investors to take profit or reduce positions.

Romania

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	0.2	4.1	3.2	2.9	8.2	6.0	3.8	-3.7	5.9	4.7	2.5	3.7	3.5
Private consumption (%YoY)	-4.3	3.7	5.6	5.7	11.5	9.0	3.4	-3.7	7.9	5.5	2.7	4.8	4.9
Government consumption (%YoY)	-0.1	0.5	0.9	-9.1	11.3	-0.5	6.7	-2.6	3.8	3.9	1.7	2.8	1.6
Investment (%YoY)	-5.5	5.3	7.5	-2.0	5.4	0.2	12.4	1.4	2.0	7.7	6.2	8.0	8.0
Industrial production (%YoY)	7.7	6.2	2.7	3.1	8.6	5.0	-3.6	-9.5	7.4	-2.0	-1.0	2.1	1.9
Unemployment rate (year-end, %)	7.1	6.8	6.8	5.9	5.7	4.2	3.9	5.0	5.6	5.6	5.5	5.3	5.1
Nominal GDP (RONbn)	632	669	713	752	852	959	1064	1067	1187	1410	1591	1734	1890
Nominal GDP (€bn)	143	150	160	167	186	206	224	221	241	285	319	343	369
Nominal GDP (US$bn)	190	199	176	184	213	241	251	251	284	299	358	401	425
GDP per capita (US$)	9,500	10,000	8,900	9,400	10,800	12,400	12,900	13,100	14,900	15,700	18,800	21,200	22,600
Gross domestic saving (% of GDP)	24.4	24.6	24.7	22.7	21.4	20.0	20.2	20.2	19.9	19.9	19.9	20.1	20.4
Prices													
CPI (average, %YoY)	4.0	1.1	-0.6	-1.6	1.3	4.6	3.8	2.6	5.1	13.8	10.5	5.0	4.0
CPI (year-end, %YoY)	1.6	0.8	-0.9	-0.5	3.3	3.3	4.0	2.1	8.2	16.4	6.9	4.0	4.0
Wage rates (nominal, %YoY)	4.8	5.2	8.3	13.0	14.2	13.1	14.9	6.7	7.1	12.2	13.5	10.0	8.0
Fiscal balance (% of GDP)													
Consolidated government balance	-2.3	-1.2	-0.5	-2.5	-2.5	-2.8	-4.3	-9.2	-7.1	-5.8	-4.8	-3.6	-3.0
Consolidated primary balance	-0.2	0.6	1.0	-1.1	-1.4	-1.9	-3.3	-8.0	-6.0	-5.0	-2.9	-2.6	-2.2
Total public debt	37.8	39.2	37.8	37.9	35.3	34.5	35.1	46.9	48.6	47.3	48.0	46.5	46.0
External balance													
Exports (€bn)	49.6	52.5	54.6	57.4	62.6	67.4	68.7	62.1	74.7	92.0	100.3	108.3	115.9
Imports (€bn)	55.3	58.6	63.0	67.4	75.6	82.8	86.3	80.5	98.4	126.0	136.1	145.6	154.3
Trade balance (€bn)	-5.7	-6.1	-8.4	-10.0	-13.0	-15.4	-17.6	-18.4	-23.7	-34.0	-35.8	-37.3	-38.5
Trade balance (% of GDP)	-4.0	-4.1	-5.2	-6.0	-7.0	-7.5	-7.9	-8.3	-9.8	-11.9	-11.2	-10.9	-10.4
Current account balance (€bn)	-1.4	-0.4	-1.3	-2.7	-5.8	-9.5	-10.9	-10.9	-17.5	-26.9	-24.0	-24.8	-25.2
Current account balance (% of GDP)	-1.0	-0.3	-0.8	-1.6	-3.1	-4.6	-4.9	-4.9	-7.3	-9.4	-7.5	-7.2	-6.8
Net FDI (€bn)	2.9	2.7	2.9	4.8	4.8	4.9	4.8	2.9	8.8	9.6	9.8	10.2	10.6
Net FDI (% of GDP)	2.0	1.8	1.8	2.9	2.6	2.4	2.1	1.3	3.7	3.4	3.1	3.0	2.9
Current account balance plus FDI (% of GDP)	1.0	1.5	1.0	1.3	-0.5	-2.2	-2.7	-3.6	-3.6	-6.1	-4.4	-4.3	-4.0
Foreign exchange reserves ex gold (€bn)	32.5	32.2	32.2	33.0	32.3	31.8	31.7	36.2	37.1	43.2	48.1	50.4	52.6
Import cover (months of merchandise imports)	7.1	6.6	6.1	5.9	5.1	4.6	4.4	5.4	4.5	4.1	4.2	4.2	4.1
Debt indicators													
Gross external debt (€bn)	100.8	97.2	94.7	94.3	97.4	99.8	109.8	126.8	136.6	144.6	157.2	159.2	161.2
Gross external debt (% of GDP)	71	65	59	56	52	48	49	57	57	51	49	46	44
Gross external debt (% of exports)	203	185	173	164	156	148	160	204	183	157	157	147	139
Lending to corporates/households (% of GDP)	34.1	31.0	29.9	28.5	26.5	25.4	24.5	25.7	26.5	25.0	24.7	24.6	24.5
Interest & exchange rates													
Central bank key rate (year-end, %)	5.25	4.00	2.75	1.75	1.75	1.75	2.50	1.50	1.75	6.75	7.00	5.50	5.00
Broad money supply (average, %YoY)	7.9	4.1	6.8	7.8	11.4	8.8	10.9	15.3	15.8	6.9	7.0	9.0	11.0
3m interest rate (Robor average, %)	4.22	2.54	1.40	0.89	1.15	2.80	3.15	2.38	1.82	6.19	6.60	6.20	5.25
3m interest rate spread over Euribor (ppt)	4.0	2.3	1.4	1.2	1.5	3.1	3.5	2.8	2.4	5.8	3.0	3.1	2.6
3yr yield (average, %)	4.8	3.3	1.9	1.5	1.9	3.7	3.7	3.3	2.9	7.2	6.9	6.3	5.7
10yr yield (average, %)	5.3	4.6	3.5	3.3	3.9	4.7	4.5	3.9	4.0	7.6	7.2	6.9	6.3
USD/RON exchange rate (year-end)	3.27	3.70	4.15	4.32	3.88	4.06	4.27	3.97	4.34	4.62	4.25	4.43	4.48
USD/RON exchange rate (average)	3.32	3.37	4.04	4.08	4.01	3.98	4.24	4.24	4.18	4.71	4.45	4.32	4.45
EUR/RON exchange rate (year-end)	4.48	4.48	4.52	4.54	4.66	4.66	4.78	4.87	4.95	4.94	5.02	5.09	5.15
EUR/RON exchange rate (average)	4.42	4.44	4.45	4.49	4.57	4.65	4.75	4.84	4.93	4.95	4.98	5.06	5.12

Source: National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	5.0	3.7	4.5	2.3	3.0	2.3	2.4	3.3	3.7	4.2	4.0	4.1	4.1
CPI (eop, %YoY)	15.1	15.9	16.4	14.5	9.9	8.5	6.9	5.8	5.2	4.3	4.0	4.1	4.1
Central bank key rate (eop, %)	3.75	5.50	6.75	7.00	7.00	7.00	7.00	6.50	6.00	5.50	5.50	5.25	5.00
3m interest rate (eop, %)	6.44	7.93	7.57	6.85	6.60	6.50	6.50	6.40	6.20	5.90	5.75	5.50	5.25
10yr yield (eop, %)	7.80	8.30	8.20	7.35	7.10	7.15	7.15	7.00	7.00	6.90	6.90	6.50	6.25
USD/RON exchange rate (eop)	4.71	5.10	4.85	4.57	4.61	4.40	4.25	4.18	4.32	4.39	4.43	4.42	4.43
EUR/RON exchange rate (eop)	4.95	4.95	4.95	4.94	4.98	4.97	5.02	5.02	5.05	5.05	5.09	5.08	5.09

Source: National sources, ING estimates

Serbia

Valentin Tataru, Chief Economist

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	0.7	0.4	2.1	2.9	4.3	1.6	3.8
CPI (%YoY)*	16.2	12.6	9.1	6.7	4.7	11.9	4.9
Policy interest rate (eop, %)	5.75	6.25	6.25	6.25	6.00	6.25	5.25
3m interest rate (eop,%)	5.47	5.80	5.80	5.80	5.60	5.80	4.85
10yr yield (%)*	6.50	6.25	6.30	6.50	6.20	6.50	5.90
USD/RSD*	108.6	108.6	103.8	99.4	97.8	99.4	102.0
EUR/RSD*	117.3	117.3	117.3	117.3	117.3	117.3	117.3

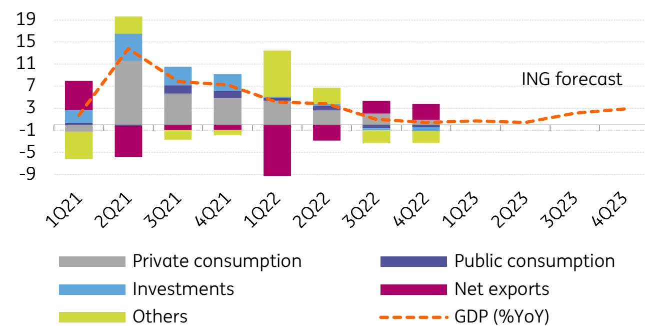
Macro trend		Political cycle	Ratings	FC	LC
Activity	–	Presidential: 2027	S&P	BB+	BB+
Fiscal	Loose	Parliamentary: 2026	Moody's	Ba2	Ba2
Monetary	Neutral	Local: 2026	Fitch	BB+	BB+

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

Country strategy: Increasingly difficult to muddle through

The Stand-By-Arrangement (SBA) with the IMF concluded in late 2022 seems to have been an inspired policy choice, as it fostered better-than-expected twin deficits, while foreign direct investments remained strong. In this context and underpinned by stable ratings, Serbia successfully retuned to capital markets, issuing two Eurobonds in early 2023. It is not all rosy though, as relatively sound economic policies overlap major other challenges. In May 2023, the European Parliament voted with a large majority to validate a report which clearly states, among others, that Serbia's EU integration should be dependent on aligning with the EU on sanctions against Russia and on normalising the relations with Kosovo. At the limit, this could mean a limbo-time for Serbia until policymakers are ready to take decisive actions on most sensitive issues.

Real GDP (%YoY) and contributions (ppt)

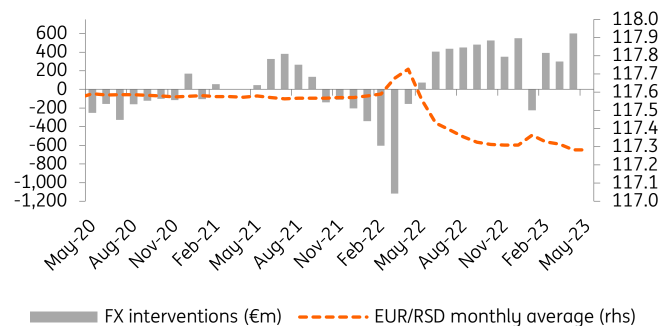


Source: Eurostat, ING

From hero to almost zero

The economy has been losing speed for a while as the growth pace gradually decelerated from double digits in mid-2021 to marginal advances in 4Q22 and 1Q23. The growth structure has been changing as well, as private consumption has begun to fade lately, after more than one year of real negative wage growth. With investments and net exports only partially offsetting the slower growth in consumption, we maintain a below consensus 1.6% GDP growth estimate for 2023. Geopolitics aside, we tend to see risks skewed to the upside, as Serbia's main trading partners should recover in 2H23 boosting exports. On the domestic front, double-digit wage growth will provide a backstop to slowing consumption while public investments are set to remain close to historical highs.

FX stability remains the main policy tool

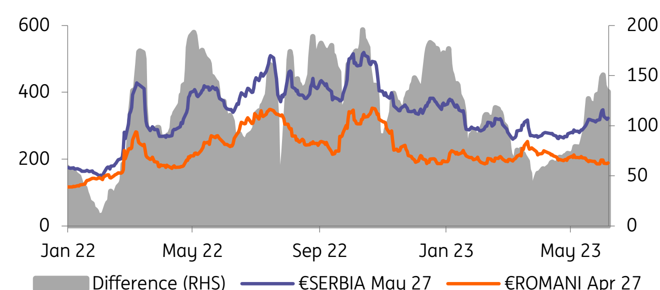


Source: NBS, ING

No deviation from the tight managed floating policy

After raising the policy rate by 525bp to 6.25% in a bit more than one year, the NBS might be taking its time now and contemplate the effects of past monetary tightening. We believe that the next policy decision will be a rate cut in 1Q24 when we will finally have positive real rates. However, despite the inflation peak being clearly behind, our central scenario does not envisage the headline inflation back within NBS's 1.5-4.5% target range over the next two years, but rather a stabilisation in the 5.00-6.00% interval. We maintain our expectations for an essentially flat EUR/RSD profile for the rest of 2023 and even through 2024, with FX interventions likely to occur in a rather narrow range around the 117.30 level.

SERBIA EUR credit vs ROMANI (z-spread, bp)



Source: Refinitiv, ING

SERBIA credit: Geopolitics drives headline risk

The recent flare up in Kosovo tensions (violent protests and calls for new regional elections) has opened up value for Serbia's Eurobonds - headline noise is likely to continue but should be contained by US and EU mediation. At the same time, credit fundamentals are recovering well from last year's energy shock, with a steady accumulation of FX reserves, narrowing current account deficit and government debt-to-GDP back on a downward trend. IMF support should also act as a policy anchor even if progress towards EU integration is slow.

James Wilson, EM Sovereign Strategist

Serbia

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	2.9	-1.6	1.8	3.3	2.1	4.5	4.3	-0.9	7.5	2.3	1.6	3.8	3.7
Private consumption (%YoY)	-1.7	-0.1	-0.6	1.9	2.2	3.1	3.7	-1.9	7.8	3.7	2.3	5.1	4.6
Government consumption (%YoY)	-2.1	0.9	-3.7	0.0	2.9	3.7	1.9	2.8	4.1	0.2	0.8	1.6	2.6
Investment (%YoY)	-12.0	-3.4	6.2	5.1	6.6	17.5	17.2	-1.9	15.9	-0.6	4.0	4.2	4.8
Industrial production (%YoY)	5.5	-7.3	7.3	5.2	3.9	1.3	0.3	0.4	6.4	1.6	2.0	2.4	2.6
Unemployment rate (average, %)	24.0	20.6	18.9	16.4	14.5	13.7	11.2	9.7	11.0	9.4	9.1	8.8	8.2
Nominal GDP (RSDbn)	4,121	4,161	4,315	4,528	4,761	5,073	5,422	5,504	6,270	7,091	8,070	8,885	9,595
Nominal GDP (€bn)	35.9	34.4	35.5	36.7	40.2	42.9	46.1	46.8	53.3	60.4	68.8	75.7	81.8
Nominal GDP (US$bn)	56.4	47.3	50.8	50.8	43.5	45.4	51.5	53.8	62.9	63.4	77.0	88.6	94.0
GDP per capita (US$)	7,900	6,700	7,200	7,300	6,200	6,500	7,500	7,800	9,300	9,300	11,500	13,200	14,200
Gross domestic saving (% of GDP)	9.2	8.4	11.6	13.3	13.0	14.0	15.2	15.9	17.2	16.1	16.2	16.4	16.6
Prices													
CPI (average, %YoY)	7.7	2.1	1.4	1.1	3.1	2.0	1.9	1.6	4.1	11.9	11.9	4.9	5.5
CPI (year-end, %YoY)	2.2	1.8	1.6	1.5	3.0	2.0	1.9	1.3	7.9	15.1	6.8	4.9	6.1
Wage rates (nominal, %YoY)	6.2	1.4	-0.2	3.7	4.0	3.7	10.6	9.4	9.6	13.8	15.7	13.3	11.4
Fiscal balance (% of GDP)													
Consolidated government balance	-5.1	-6.2	-3.5	-1.2	1.1	0.6	-0.2	-8.0	-4.1	-3.1	-2.8	-2.2	-1.6
Consolidated primary balance	-3.0	-3.5	-0.5	1.7	3.6	2.7	1.8	-6.0	-2.4	-1.6	-1.3	-0.4	-0.6
Total public debt	56.7	65.4	70.7	68.5	60.1	54.4	52.9	58.6	57.1	55.6	52.5	51.6	50.5
External balance													
Exports (€bn)	13.9	14.5	15.7	17.4	19.3	21.2	23.3	22.3	28.8	38.0	45.1	50.5	56.6
Imports (€bn)	17.8	18.1	18.6	19.6	22.3	25.3	28.0	26.4	33.4	45.0	53.7	60.9	69.2
Trade balance (€bn)	-3.8	-3.6	-2.9	-2.2	-3.0	-4.1	-4.6	-4.1	-4.6	-7.0	-8.6	-10.4	-12.5
Trade balance (% of GDP)	-10.7	-10.6	-8.2	-6.0	-7.5	-9.5	-10.0	-8.8	-8.7	-11.6	-12.4	-13.7	-15.3
Current account balance (€bn)	-2.1	-2.0	-1.2	-1.1	-2.1	-2.1	-3.2	-1.9	-2.3	-4.1	-3.6	-3.7	-3.4
Current account balance (% of GDP)	-5.8	-5.8	-3.5	-2.9	-5.1	-4.8	-6.9	-4.1	-4.2	-6.8	-5.2	-4.9	-4.2
Net FDI (€bn)	1.3	1.2	1.8	1.9	2.4	3.2	3.6	2.9	3.6	4.3	4.4	4.5	4.7
Net FDI (% of GDP)	3.6	3.6	5.1	5.2	6.0	7.4	7.7	6.2	6.8	7.1	6.4	6.0	5.8
Current account balance plus FDI (% of GDP)	-2.2	-2.2	1.6	2.2	0.9	2.5	0.8	2.1	2.6	0.3	1.1	1.1	1.6
Foreign exchange reserves ex gold (€bn)	11.2	9.9	10.4	10.2	10.0	11.3	13.4	13.5	16.5	19.4	21.9	22.6	23.9
Import cover (months of merchandise imports)	7.6	6.6	6.7	6.2	5.4	5.4	5.7	6.1	5.9	5.2	4.9	4.5	4.1
Debt indicators													
Gross external debt (€bn)	25.6	25.7	26.2	26.5	25.5	26.7	28.3	30.8	36.5	41.9	42.9	44.0	45.1
Gross external debt (% of GDP)	71.3	74.7	73.9	72.2	63.5	62.1	61.3	65.8	68.4	69.3	62.4	58.1	55.2
Gross external debt (% of exports)	184	178	167	152	132	126	121	138	127	110	95	87	80
Lending to corporates/households (% of GDP)	44.8	46.5	41.0	40.8	40.6	41.4	42.0	45.5	48.0	45.7	46.4	48.2	50.0
Interest & exchange rates													
Central bank key rate (year-end, %)	9.50	8.00	4.50	4.00	3.50	3.00	2.25	1.00	1.00	5.00	6.25	5.25	5.00
Broad money supply (average, %YoY)	4.6	7.6	6.6	11.6	3.6	14.5	8.4	18.1	13.3	6.9	7.0	8.8	10.2
3m interest rate (Belibor, year-end, %)	8.88	9.85	3.83	3.47	3.12	3.03	1.64	0.90	0.94	4.95	5.80	4.85	4.25
3m interest rate spread over Euribor (ppt)	8.7	9.7	3.9	3.8	3.4	3.3	2.0	1.3	1.5	4.5	1.9	1.6	1.6
3yr yield (year-end, %)	n/a	n/a	n/a	n/a	n/a	n/a	3.2	2.1	2.4	6.0	5.80	5.20	5.00
10yr yield (year-end, %)	n/a	n/a	n/a	n/a	n/a	4.8	4.0	3.1	3.6	7.0	6.50	5.90	5.75
USD/RSD exchange rate (year-end)	80.9	86.2	83.1	99.5	111.2	117.1	105.0	96.4	103.1	109.6	99.4	102.0	102.0
USD/RSD exchange rate (average)	73.1	88.0	84.9	89.1	109.4	111.8	105.2	102.3	99.6	111.9	104.7	100.3	102.0
EUR/RSD exchange rate (year-end)	114.6	121.0	121.6	123.5	118.5	118.2	117.6	117.6	117.6	117.3	117.3	117.3	117.3
EUR/RSD exchange rate (average)	113.1	117.4	120.8	123.2	121.3	118.3	117.8	117.6	117.6	117.4	117.3	117.3	117.3

Source: National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	3.8	1.0	0.4	0.7	0.4	2.1	2.9	4.3	4.1	3.7	3.1	3.3	3.5
CPI (eop, %YoY)	11.9	14.0	15.1	16.2	12.9	9.8	7.6	6.0	6.1	6.3	6.6	5.5	4.5
Central bank key rate (eop, %)	2.50	3.50	5.00	5.75	6.25	6.25	6.25	6.00	5.75	5.25	5.25	5.00	5.00
3m interest rate (eop, %)	2.32	3.40	4.95	5.47	5.80	5.80	5.80	5.50	5.40	5.10	4.85	4.75	4.75
10yr yield (eop, %)	6.90	7.60	7.30	6.50	6.25	6.30	6.50	6.20	6.00	5.90	5.90	5.80	5.75
USD/RSD exchange rate (eop)	111.8	120.9	115.0	108.6	108.6	103.8	99.4	97.8	100.3	102.0	102.0	102.0	102.0
EUR/RSD exchange rate (eop)	117.40	117.32	117.32	117.30	117.29	117.30	117.31	117.30	117.31	117.33	117.34	117.33	117.32

Source: National sources, ING estimates

Turkey

Muhammet Mercan, Chief Economist

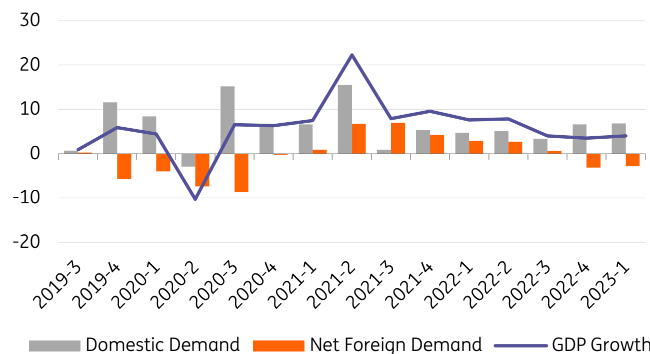
Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (% YoY)	4.0	5.0	1.7	0.0	1.5	2.5	3.0
CPI (% YoY)*	50.5	38.1	42.5	51.0	44.0	45.7	40.3
Policy interest rate (eop, %)	8.50	20.00	30.00	30.00	35.00	30.00	30.00
3m interest rate (%)*	11.07	27.56	33.76	36.78	36.91	24.57	33.93
10yr yield (%)*	10.49	15.33	22.67	25.42	25.82	17.21	25.11
USD/TRY*	19.16	24.00	25.00	26.00	27.57	22.43	28.22
EUR/TRY*	20.79	26.40	28.75	31.20	33.09	25.07	33.13

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

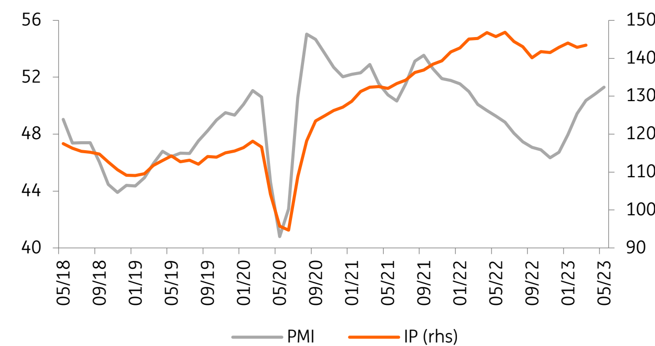
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

GDP growth, on a quarterly basis (% YoY)



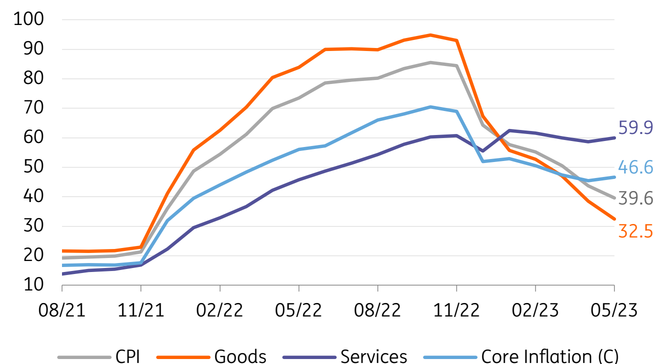
Source: TurkStat, ING Bank

PMI and IP (seasonally adjusted, 3m-ma, % YoY)



Source: ICI, TurkStat, ING Bank

Inflation (% YoY)



Source: TurkStat, ING Bank

Country strategy

President Erdogan was re-elected and the Erdogan-led People's Alliance won a simple majority in Parliament. The macro outlook points to a need to rebalance the economy given that: (1) the current account deficit has remained on an expansionary path; (2) total capital flows have remained weak; (3) there is a major fiscal expansion; and (4) the extra fiscal burden and the CBT's supportive stance create further pressure on already elevated inflation. In this environment, the main policy debate focuses on interest rate policy and whether there will be a return to a more conventional policy setting post-elections. The appointment of Mehmet Simsek as Minister of Economy and Finance shows an intention to return to conventional economic policies, though it is too early to decide the degree of orthodoxy. The signals imply that actions will be taken without delay following formation of new economy management.

Macro digest

1Q23 Turkish GDP growth came in at 4.0% year-on-year, slightly better than market consensus, on the back of private consumption, government consumption and gross fixed capital formation, while net exports were a drag once again. On a quarter-on-quarter basis, 1Q23 GDP growth was 0.3% after seasonal adjustments, showing some momentum loss compared with a relatively strong reading in 4Q22 of 0.9%. Moderating sequential performance is attributable to: (1) a deceleration in household consumption to the lowest growth rate since the last quarter of 2020, also likely reflecting the impact of the earthquake disaster; and (2) government expenditure turning negative while stocks positively contributed to the headline and investment appetite remained solid. Early indicators for 2Q23, on the other hand, hint at an acceleration in the GDP expansion on a yearly basis in comparison to 1Q23 given: (1) realisations of real sector confidence and capacity utilisation reflecting a continued strengthening in manufacturing, leaving the effects of the earthquake disaster behind; (2) further improvement in PMI to above the first quarter average, while confidence indicators for retail, construction and services show further improvement. As growth forecasts for 1H23 imply a better-than-expected performance, the macro indicators point to a need to rebalance the economy. In this regard, the assignment of a new economy management team and guidance on policy direction will be key for the outlook, in our view.

Annual inflation has remained on its downward path in May thanks to: (1) TurkStat's implementation of the 'zero price' method for natural gas subsidies. Accordingly, the natural gas sub-group saw a monthly price decline of 100%; (2) the 2003-based index average for May in the last five years pointed to a favourable base effect for this year. Core inflation (CPI-C) rose to 46.6% on an annual basis. This suggests that the exchange rate and commodity price-driven improvements in core inflation indicators in recent months may have come to an end. The underlying trend for the headline markedly recovered in comparison to the previous month thanks to goods inflation, while the services group has maintained the elevated trend given continuing pressures in rent, catering and telecommunication services. Despite the elections being behind us, at this stage uncertainty about exchange rates and interest rates persists, but it is expected that the new economy management team, led by Mehmet Simsek, will bring about significant changes in the CBT and the monetary and exchange rate policy to be implemented in the short term. Accordingly, a lira adjustment post-election and potential adjustments in wages and administered prices are likely to weigh on inflation momentum, while a new equilibrium in rates will be key to return to disinflation in the period ahead.

Turkey

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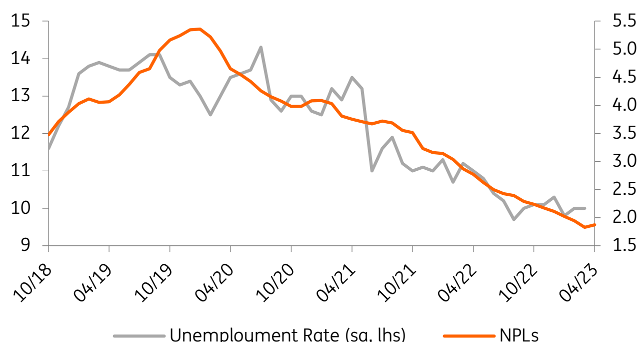
Unemployment vs NPLs (%)

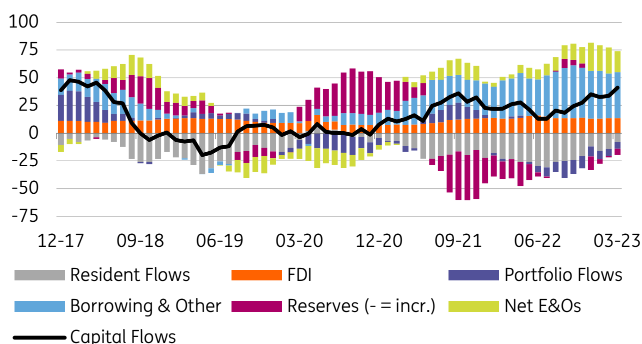


Source: TurkStat, BRSA, ING Bank

Unemployment rate stagnant lately

In the labour market, the seasonally adjusted unemployment rate has turned stagnant from 2H22 onwards with the latest March data standing at 10%. However, the actual rate is likely to be higher as TurkStat pointed out that the Household Labour Force Survey could not be conducted in certain cities due to the earthquake disaster. 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. Despite the same recovery trend in supplementary indicators for labour force, wider definitions of unemployment, ie, the composite measure of labour underutilisation, have remained well above of pre-2018 levels. This implies the labour market has not fully recovered since the pandemic and an expected slowdown in activity could further add to challenges on this front.

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

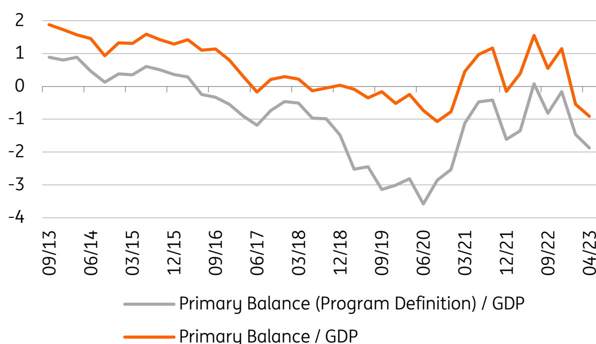


Source: CBT, ING Bank

Widening external imbalances

The current account deficit has expanded rapidly since early 2022 driven by commodity and gold imports in addition to the widening impact of strong domestic demand. A strong increase in tourism revenues has limited the extent of expansion. For the remainder of the year, an improvement is likely given the recent normalisation in energy prices and gold imports, while recovery in global demand and a possible change in policy mix to a tighter stance should also be supportive for the foreign trade balance. On the capital account, with official transfers from Russia and strong unidentified inflows, official reserves recorded an increase last year, though the quality of external financing continues to overshadow the outlook given tighter global financial conditions. In the first quarter of this year, total flows have again weakened in the absence of strong unidentified inflows, leading to pressure on international reserves.

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

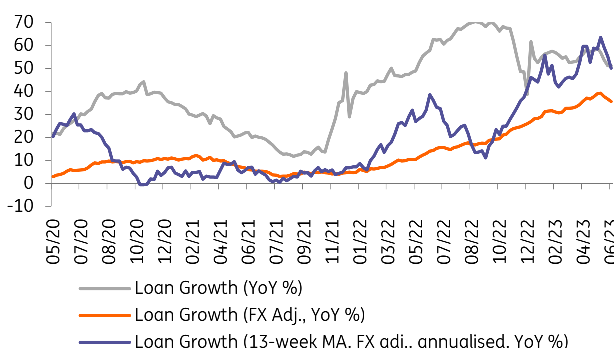


Source: Ministry of Treasury and Finance, ING Bank

Budget deficit on the rise

In the first four months of this year, there has been a major fiscal expansion pulling the central administration budget deficit to c.3.0% of GDP. According to the real budget trend based on the programme (IMF) defined primary balance realisation, which excludes one-off revenues, there was a deficit of around TRY42.5bn in April, bringing the primary balance for the last 12 months to a deficit of 1.9% of GDP. In addition, the 12-month budget balance excluding one-off revenues rose to a deficit of 2.8% of GDP. Going forward, elevated spending pressures during the election period and an expected slowdown in activity and reconstruction efforts after the earthquakes point to a higher deficit, to above 5% of GDP. However, tax hikes and administrative price hikes to address the widening in the budget deficit in 2H23 should not be ruled out.

Banking sector volume expansion



Source: BRSA, ING Bank

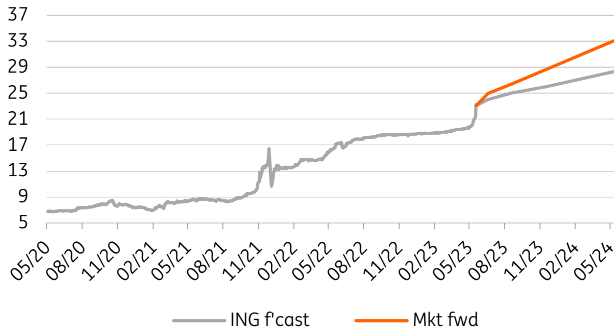
Signals of moderation in lending

The latest volume data after the elections hint at momentum loss. Accordingly: (1) non-SME corporate lending decelerated sharply in both state and private banks though appetite in the latter dropped to single digits in annualised 13-week moving average terms. This shows increasing challenges for corporates in accessing financing lately; (2) SME lending momentum hand is strong but there has been a moderation in private banks. On the retail side, (3) credit cards have remained on a strong growth path given the supportive impact of low real interest rates; (4) there are signals that momentum in mortgages is about to peak; (5) while the appetite for GPLs is on the decline, in recent months this has been more evident in state banks. Regarding deposits, FX deposit formation on both the retail and corporate sides remain in negative territory showing the impact of "liraization" moves to control residents' FX demand.

Turkey

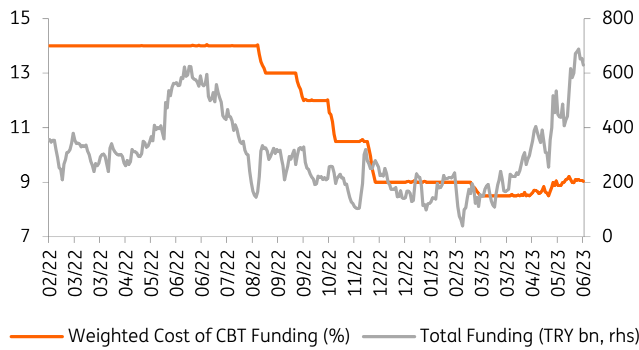
Strategy

FX – spot vs forward and INGF



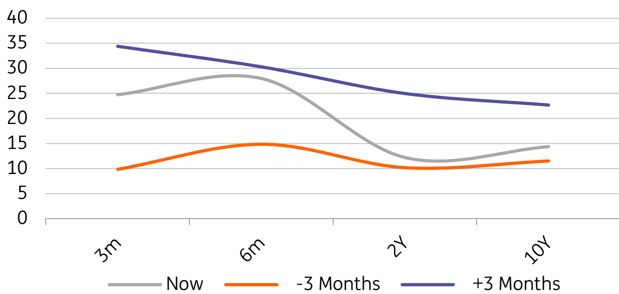
Source: Bloomberg, ING estimates

CBT funding



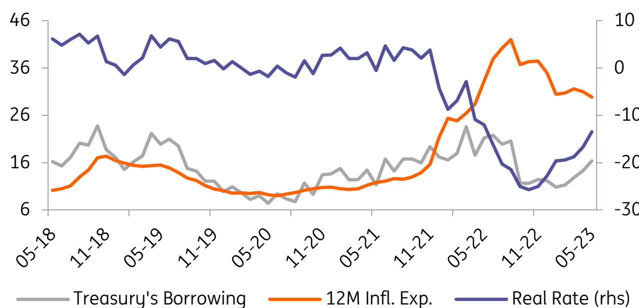
Source: CBT, ING Bank

Yield curve (%)



Source: Bloomberg, ING estimates

Real interest rate (%)



Source: Treasury, CBT, ING Bank

FX and External Debt strategy

Under the existing CBT policy with indirect FX interventions and regulations to control locals' FX demand, gross FX reserves have been under pressure since the beginning of this year. Gold reserves have also been on the decline lately, as the CBT directly matches gold demand given import restrictions introduced in February. Total reserves are around the US$100bn threshold, though, excluding swaps with banks and other CBs, the CBT's net reserve position is -US$61bn, an all-time low. Given this backdrop, there is a consensus that points to a normalisation in the conduct of the monetary policy with the narrowing corridor for muddling through. In this regard, the signals for a shift towards more conventional monetary policy have supported the sentiment in the days following the elections and any policy action after the new economy post appointments will be watched closely. Valuations for Turkey's Eurobonds have gone almost full circle over the past year, with a sharp sell-off after the first-round election results followed by a more recent recovery. Spread levels relative to single-B peers and the pickup over higher-rated BB sovereigns are now at the tight end of their range for the past year. In the near-term, concrete steps towards a shift to more orthodox economic policy is likely to be taken positively by the market on the back of recent market-friendly rhetoric, and technical factors should remain supportive given a persistent local bid for short-dated paper and light positioning from international investors. However, we remain cautious on the medium-term prospects for a durable return to orthodox policy and have concerns over the recent drain in FX reserves and spillover effects from currency pressures that will be difficult to solve.

Fixed Income strategy

The CBT has maintained its purchases from the secondary market, still below 6% vs the limit set at 7% of total assets of the CBT weekly statement for 2023. However, reserving the option to make additional purchases in 'the Monetary Policy and Liraization Strategy' for this year, the CBT can easily change the level and maintain purchases, if it sees a need. In addition, it actively uses security maintenance requirements for banks exceeding the quantity and price restrictions on loans set by the CBT (forcing them to buy LT (>4y) fixed rate government bonds) with an objective of strengthening the monetary transmission mechanism. Despite these purchases and security maintenance requirements, bond yields were under upward pressure ahead of the 14 May elections as market participants had priced a higher possibility of a scenario that saw a return to orthodox policies. Following the first round of elections, however, TRY bond yields rapidly adjusted downwards as policy continuity would argue for low FX volatility, low yields to persist in the near-term. In the aftermath of elections, signals implying a change in policy direction are likely to determine the bond market outlook. In fact, following the runoff, we have seen bond yields moving up again on newsflow about the appointment of Mehmet Simsek, the former economy minister, and expectations about the macro policy. His role as Minister of Economy and Finance places him in charge of the economy again and markets are pricing in more orthodoxy in the policy ahead than anticipated earlier.

Turkey

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (% YoY)	8.5	4.9	6.1	3.3	7.5	3.0	0.8	1.9	11.4	5.6	2.5	3.0	4.0
Private consumption (% YoY)	7.6	3.1	5.2	3.7	5.9	0.5	1.5	3.2	15.3	19.7	6.0	3.2	4.4
Government consumption (% YoY)	8.0	3.1	3.9	9.5	5.0	6.5	3.8	2.5	2.6	5.2	5.0	-0.4	0.0
Investment (% YoY)	14.2	4.9	9.3	2.2	8.3	-0.2	-12.5	7.4	7.4	2.8	-1.5	-1.7	3.8
Industrial production (% YoY)	7.2	5.7	5.8	3.4	9.0	1.3	-0.5	1.6	17.5	5.7	2.3	3.1	3.9
Unemployment rate (year-end, %)	8.9	9.9	10.3	10.9	10.9	10.9	13.7	13.1	12.0	10.5	11.0	11.5	10.6
Nominal GDP (TRYbn)	1,823	2,055	2,351	2,627	3,134	3,759	4,312	5,048	7,249	15,007	22,514	32,479	41,495
Nominal GDP (€bn)	717	681	707	779	763	664	676	623	671	849	898	980	1,178
Nominal GDP (US$bn)	946	937	856	867	861	774	760	712	788	900	1,004	1,151	1,355
GDP per capita (US$)	12,582	12,178	11,085	10,964	10,696	9,792	9,213	8,535	9,359	10,585	11,700	13,266	15,447
Gross domestic saving (% of GDP)	23.9	24.9	25.2	26.0	26.0	26.8	26.1	26.6	31.0	30.1	27.8	28.6	29.4
Prices													
CPI (average, % YoY)	7.5	8.9	7.7	7.8	11.1	16.3	15.2	12.3	19.6	72.3	45.7	40.3	23.2
CPI (year-end, % YoY)	7.4	8.2	8.8	8.5	11.9	20.3	11.8	14.6	36.1	64.3	51.0	30.0	19.0
Wage rates (nominal, % YoY)	16.6	15.6	18.3	20.7	13.4	15.9	18.3	6.8	39.7	88.2	56.7	50.0	28.8
Fiscal balance (% of GDP)													
Consolidated government balance	-1.0	-1.1	-1.0	-1.1	-1.5	-1.9	-2.8	-3.4	-2.7	-0.9	-5.0	-3.5	-2.5
Consolidated primary balance	1.7	1.3	1.3	0.8	0.3	0.0	-0.5	-0.8	-0.2	1.1	-2.5	-1.4	-0.7
Total public debt	31.1	28.4	27.3	27.9	27.9	30.1	32.6	39.7	41.8	31.8	37.1	36.8	36.0
External balance													
Exports (US$bn)	167.4	173.3	154.9	152.6	169.2	178.9	182.2	168.4	224.7	253.4	243.6	254.7	267.4
Imports (US$bn)	249.3	239.9	203.9	192.6	227.8	219.7	199.0	206.3	254.0	342.9	323.9	319.0	335.5
Trade balance (US$bn)	-81.9	-66.6	-49.0	-39.9	-58.6	-40.8	-16.8	-37.9	-29.3	-89.5	-80.3	-64.3	-68.1
Trade balance (% of GDP)	-8.7	-7.1	-5.7	-4.6	-6.8	-5.3	-2.2	-5.3	-3.7	-10.0	-8.0	-5.6	-5.0
Current account balance (US$bn)	-55.9	-38.8	-27.3	-26.8	-40.6	-20.7	6.8	-35.5	-7.2	-48.4	-36.8	-16.8	-18.0
Current account balance (% of GDP)	-5.9	-4.1	-3.2	-3.1	-4.7	-2.7	0.9	-5.0	-0.9	-5.4	-3.7	-1.5	-1.3
Net FDI (US$bn)	13.6	13.3	19.3	13.9	11.1	13.0	9.3	7.8	13.3	13.1	11.4	12.1	14.1
Net FDI (% of GDP)	1.4	1.4	2.3	1.6	1.3	1.7	1.2	1.1	1.7	1.5	1.1	1.0	1.0
Current account balance plus FDI (% of GDP)	-4.5	-2.7	-0.9	-1.5	-3.4	-1.0	2.1	-3.9	0.8	-3.9	-2.5	-0.4	-0.3
Foreign exchange reserves ex gold (US$bn)	112.0	106.3	95.7	92.1	84.1	72.0	81.2	50.0	72.6	82.9	67.5	76.5	83.9
Import cover (months of merchandise imports)	5.4	5.3	5.6	5.7	4.4	3.9	4.9	2.9	3.4	2.9	2.5	2.9	3.0
Debt indicators													
Gross external debt (US$bn)	405.2	416.8	402.9	406.1	450.8	426.3	414.6	430.2	439.3	459.0	465.1	462.8	470.2
Gross external debt (% of GDP)	43	44	47	47	52	55	55	60	56	51	46	40	35
Gross external debt (% of exports)	242	241	260	266	266	238	228	255	196	181	191	182	176
Lending to corporates/households (% of GDP)	57.7	60.2	63.1	65.9	66.8	63.6	61.5	70.7	67.5	50.4	49.5	40.7	36.9
Interest & exchange rates													
Central bank key rate (year-end, %)	4.50	8.25	7.50	8.00	8.00	24.00	12.00	17.00	14.00	9.00	30.00	30.00	20.00
Broad money supply (average, % YoY)	22.2	11.9	17.1	18.3	15.7	19.1	26.1	36.0	53.6	60.7	51.0	45.3	28.8
3m interest rate (TRLibor, average, %)	6.1	8.6	9.9	8.9	11.6	19.1	18.8	11.0	18.0	15.7	24.6	33.9	26.1
3m interest rate spread over US$-Libor(ppt)	581	837	960	812	1029	1671	1684	1071	1794	1225	1970	3088	2307
2yr yield (average, %)	7.6	9.2	9.8	9.7	11.8	18.9	17.2	11.9	18.5	19.2	19.3	27.9	24.1
10yr yield (average, %)	8.3	9.3	9.4	10.1	11.0	15.8	15.5	12.7	18.2	17.6	17.2	25.1	22.9
USD/TRY exchange rate (year-end)	2.13	2.32	2.92	3.53	3.79	5.29	5.95	7.43	13.32	18.69	26.00	29.00	32.00
USD/TRY exchange rate (average)	1.93	2.19	2.75	3.03	3.64	4.85	5.67	7.09	9.20	16.68	22.43	28.22	30.63
EUR/TRY exchange rate (year-end)	2.93	2.81	3.17	3.70	4.55	6.05	6.67	9.08	15.14	20.00	31.20	33.35	36.80
EUR/TRY exchange rate (average)	2.54	3.02	3.33	3.37	4.11	5.66	6.37	8.11	10.81	17.68	25.07	33.13	35.22
Brent oil price (annual average, US$/bbl)	109.55	99.35	52.08	43.31	54.13	71.17	64.72	41.80	71.25	99.25	89.50	91.00	75.25

Source: National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (% YoY)	7.8	4.0	3.5	4.0	5.0	1.7	0.0	1.5	2.3	3.6	4.3	3.3	3.7
CPI (eop, % YoY)	78.6	83.5	64.3	50.5	38.1	42.5	51.0	44.0	44.8	38.4	30.0	26.7	23.6
Central bank key rate (eop, %)	14.00	12.00	9.00	8.50	20.00	30.00	30.00	35.00	35.00	32.50	30.00	27.50	25.00
3m interest rate (eop, %)	19.18	14.80	10.48	11.07	27.56	33.76	36.78	36.91	35.86	31.90	29.26	27.70	26.81
10yr yield (eop, %)	19.36	11.99	9.83	10.49	15.33	22.67	25.42	25.82	25.00	24.28	24.11	23.27	22.79
USD/TRY exchange rate (eop)	16.69	18.50	18.69	19.16	24.00	25.00	26.00	27.57	28.38	28.79	29.00	29.75	30.50
EUR/TRY exchange rate (eop)	17.51	18.13	20.00	20.79	26.40	28.75	31.20	33.09	33.20	33.11	33.35	34.21	35.08

Source: National sources, ING estimates

Ukraine

Leszek Kąsek, Senior Economist

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	-13.0	15.0	3.5	3.5	2.5	2.3	4.1
CPI (%YoY)*	21.3	15.5	15.0	15.0	14.8	16.7	12.6
Policy interest rate (eop, %)	25.0	25.0	25.0	25.0	22.0	25.0	19.0
USD/UAH*	39.9	37.0	39.0	39.0	38.0	38.7	37.4
EUR/UAH*	36.7	40.0	44.1	46.0	45.6	41.7	43.6

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-

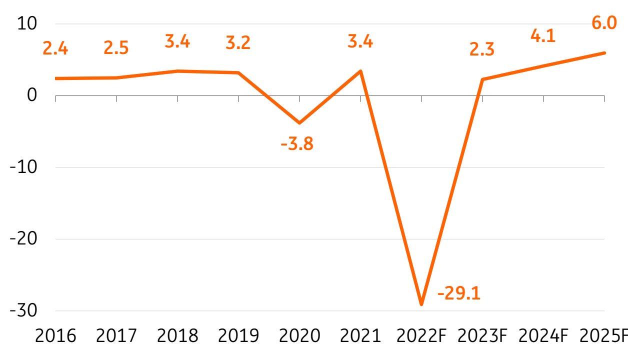
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

Country strategy: Limited short-term risks to the hryvnia

Ukraine's international reserves exceeded nearly US$36bn in May, for the first time since 2011. This reflected continued foreign aid and lower monthly costs of FX interventions (c.US$2bn in May, down from the monthly peak of US$4bn in June 2022). This significantly deceases near-term odds of another devaluation of the hryvnia, as the central bank may prefer a stable currency to combat inflation.

The fundamental factors behind the hryvnia remain unsupportive though. Ukraine is running a significant trade deficit, as exports collapsed in 2022, while imports remained quite stable. With the central bank aiming to re-liberalise the FX market at some point this signals risk of further devaluation in the future.

GDP growth (%)



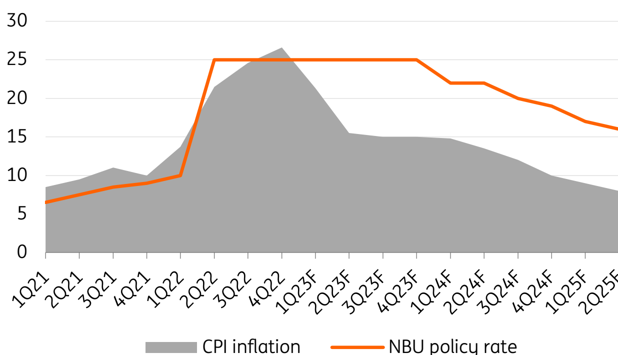
Source: NSI, NBU, ING

Positive growth in 2023 to follow 30% GDP wartime losses

The Russian invasion in 2022 has brought huge human, social and economic losses to Ukraine. The country's GDP shrank by nearly 30% in 2022. According to the World Bank estimates, sectoral output declined by about 60% in industry, 25% in agriculture and 20% in services. In the second half of 2022, severe disruptions to businesses were caused by damage to energy infrastructure, which impacted around 40% of Ukraine's power grids. Out of about 20 million refugees, 8 million are yet to return home.

The country's economy seems to have passed the greatest shock and, on our estimates, real GDP is set to recover gradually and reach 2% positive growth in 2023, and accelerate in subsequent years, driven mainly by consumption.

Inflation and NBU policy rate (%)



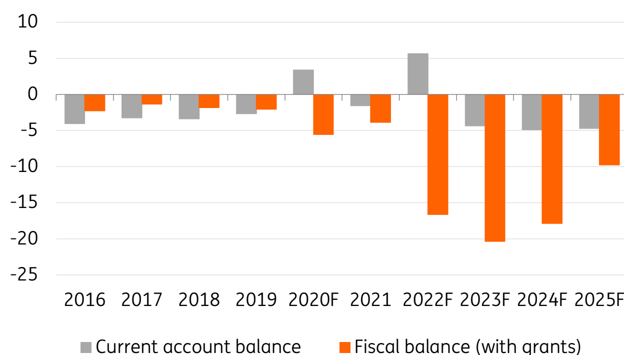
Source: NBU, ING

NBU's policy ensuring financial stability during the war

Throughout the conflict the National Bank of Ukraine has remained active and effective in ensuring financial and exchange rate stability and has controlled inflation by hiking interest rates to 25%. In 2022, a part of the extraordinary public needs was monetised by the NBU, but the impact of these interventions was broadly neutralised by mopping up the liquidity of the banking sector.

In recent months, Ukraine has benefited from declines in global energy commodity prices and the inflation rate is dampened by the high statistical base. CPI inflation slowed to 17.9%YoY in April, from 21.3% in March and 26.6% back in December. Core inflation slowed as well from 19.8% in March to 16.9% in April. Given heightened wartime uncertainty, we expect the NBU to wait for a more decisive period of disinflation and start interest rate cuts in early 2024.

Fiscal and current account balance (% of GDP)



Source: Ministry of Finance, NBU, IMF, ING

Fiscal and external accounts driven by external aid

Ukraine's huge public and external financing needs have been met by foreign grants and loans, including a new four-year IMF programme of US$15.6bn. In 2022, the fiscal balance reached almost 17% of GDP, without grants it was around 10% of GDP higher. A near 30% collapse in exports and fall in imports of less than 5% led to a huge trade gap but sizeable current account surplus as the gap was compensated for by foreign grants. From 2023, the CA is expected to post a large deficit but accompanied by rising FDI flows.

The fiscal position is set to deteriorate further this year but improve gradually in the medium term. Nonetheless, the country will continue to rely heavily on donors' support for internal defence, provision of social services and ensuring macroeconomic stability.

Ukraine

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022F	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	0.0	-6.6	-9.8	2.4	2.5	3.4	3.2	-3.8	3.4	-29.1	2.3	4.1	6.0
Private consumption (%YoY)	6.9	-8.3	-20.7	2.1	7.7	8.8	10.9	1.7	7.7	-17.9	4.0	5.0	7.0
Government consumption (%YoY)	-0.9	1.1	1.7	-0.5	2.4	0.2	-13.6	-0.7	0.3	16.7	1.0	1.0	2.0
Investment (%YoY)	-8.4	-24.0	-9.2	20.4	18.8	14.3	11.7	-21.3	7.6	-80.0	2.0	3.0	5.0
Industrial production (%YoY)	-4.3	-10.1	-13.0	2.8	0.4	3.0	-0.5	-4.0	3.5	-60.0	2.0	3.0	4.0
Unemployment rate (year-end, %)	7.6	10.6	9.5	9.7	9.9	9.3	8.5	9.0	8.5	23.2	19.6	10.6	8.4
Nominal GDP (UAHbn)	1,465	1,587	1,989	2,385	2,983	3,561	3,975	4,090	4,742	4,188	5,098	6,075	7,024
Nominal GDP (€bn)	136	100	82	84	99	111	137	132	146	122	122	139	218
Nominal GDP (US$bn)	179	132	90	93	112	130	153	151	173	128	132	162	190
GDP per capita (US$)	4,000	3,100	2,119	2,200	2,600	3,050	3,600	3,400	4,100	2,800	3,200	4,300	4,300
Gross national saving (% of GDP)	9.3	9.9	13.3	14.8	12.3	15.3	12.2	12.2	12.2	22.5	14.3	15.6	16.5
Prices													
CPI (average, %YoY)	-0.3	12.1	48.5	14.9	14.5	11.0	7.9	3.0	9.8	21.6	16.7	12.6	7.6
CPI (year-end, %YoY)	0.5	24.9	43.3	12.4	13.7	9.8	4.1	5.0	10.0	26.6	15.0	10.0	6.5
Wage rates (nominal, %YoY)	8.0	6.1	21.1	23.3	37.0	24.8	18.4	10.4	20.9	-12.0	10.0	15.0	15.0
Fiscal balance (% of GDP)													
Consolidated government balance, with grants	-4.3	-4.5	-1.6	-2.3	-1.4	-1.9	-2.1	-5.6	-3.9	-16.7	-20.4	-17.9	-9.8
Consolidated primary balance	-1.8	-1.5	2.8	1.9	2.4	1.2	0.9	-2.1	-1.6	-13.6	-17.3	-14.8	-6.7
Total public debt	39.9	69.4	79.0	80.9	71.8	60.9	50.2	60.4	50.4	81.7	99.0	105.0	104.0
External balance													
Exports (US$bn)	59.1	50.6	35.4	33.6	39.7	43.3	46.1	45.1	63.1	44.2	50.8	55.4	60.4
Imports ((US$bn)	81.2	57.7	38.9	40.5	49.4	56.1	60.4	52.0	69.8	64.7	67.9	74.0	80.7
Trade balance (US$bn)	-22.1	-7.1	-3.5	-6.9	-9.7	-12.7	-14.3	-6.9	-6.7	-20.5	-17.1	-18.6	-20.3
Trade balance (% of GDP)	-12.4	-5.4	-3.8	-7.5	-8.6	-9.7	-9.3	-4.5	-3.9	-16.0	-13.0	-11.5	-10.7
Current account balance (US$bn)	-4.1	-0.3	0.4	-3.8	-3.7	-4.5	-4.2	5.2	-2.8	7.3	-5.8	-8.0	-9.0
Current account balance (% of GDP)	-2.3	-0.2	0.5	-4.1	-3.3	-3.4	-2.7	3.4	-1.6	5.7	-4.4	-4.9	-4.7
Net FDI (US$bn)	4.1	0.3	3.0	3.3	3.6	4.4	-5.2	0.1	6.5	0.5	1.0	2.0	4.0
Net FDI (% of GDP)	2.3	0.2	3.3	3.5	3.2	3.4	-3.4	0.1	3.8	0.4	0.8	1.2	2.1
Current account balance plus FDI (% of GDP)	0.0	0.0	3.8	-0.5	-0.1	0.0	-6.1	3.5	2.1	6.1	-3.6	-3.7	-2.6
Foreign exchange reserves (US$bn)	18.8	10.0	13.2	15.3	18.9	17.7	25.3	29.1	30.9	28.5	29.6	32.4	35.0
Import cover (months of merchandise imports)	2.8	2.1	4.1	4.5	4.6	3.8	5.0	6.7	5.3	5.3	5.2	5.3	5.2
Debt indicators													
Gross external debt (US$bn)	142.1	125.3	117.7	112.5	115.5	114.7	121.1	121.3	115.0	122.8	130.4	131.4	132.4
Gross external debt (% of GDP)	79.5	94.7	130.2	120.8	103.0	87.9	78.9	80.4	66.5	95.9	99.0	80.9	69.7
Gross external debt (% of exports)	240.4	247.9	332.3	335.2	290.9	264.6	262.7	268.7	182.3	278.0	256.7	237.3	219.4
Lending to corporates/households (% of GDP)	60.4	62.4	48.4	41.3	33.7	29.8	24.5	23.1	21.6	26.5	27.0	28.0	29.0
Interest & exchange rates													
Central bank key rate (year-end, %)	6.5	14.0	22.0	14.0	14.5	18.0	13.5	6.0	9.0	25.0	25.0	19.0	13.0
Broad money supply (average, %YoY)	17.6	5.3	3.9	10.9	9.6	5.7	12.6	28.6	12.0	20.8	20.0	18.5	15.0
2yr yield (average, %)	13.9	17.9	18.9	19.4	15.7	17.8	17.2	13.0	12.5	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UAH exchange rate (year-end)	8.2	15.8	24.1	27.1	28.3	27.8	23.8	28.6	27.4	37.0	39.0	37.0	37.0
USD/UAH exchange rate (average)	8.2	12.0	22.0	25.6	26.6	27.3	25.9	27.1	27.4	32.7	38.7	37.4	37.0
EUR/UAH exchange rate (year-end)	11.4	19.1	26.2	28.6	33.9	31.8	26.7	35.0	31.1	39.5	46.0	42.6	42.6
EUR/UAH exchange rate (average)	10.8	15.8	24.2	28.4	30.1	32.2	29.0	30.9	32.4	34.3	41.7	43.6	32.2

Source: National sources, IMF, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	-36.9	-30.6	-31.4	-13.0	15.0	3.5	3.5	2.5	3.5	5.0	5.5	6.0	6.0
CPI (eop, %YoY)	21.5	24.6	26.6	21.3	15.5	15.0	15.0	14.8	13.5	12.0	10.0	9.0	8.0
Central bank key rate (eop, %)	25.0	25.0	25.0	25.0	25.0	25.0	25.0	22.0	22.0	20.0	19.0	17.0	16.0
USD/UAH exchange rate (eop)	31.0	36.3	39.5	39.9	37.0	39.0	39.0	38.0	37.5	37.0	37.0	37.0	37.0
EUR/UAH exchange rate (eop)	29.7	37.1	37.0	36.7	40.0	44.1	46.0	45.6	43.9	42.6	42.6	42.6	42.6

Source: NBU, Ukrstat, Macrobond, ING estimates

Uzbekistan

Dmitry Dolgin, Chief Economist, Russia & CIS

Forecast summary

	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2023F	2024F
Real GDP (%YoY)	5.5	5.2	6.2	6.7	7.0	5.9	5.5
CPI (%YoY)*	11.3	9.9	9.5	9.2	8.6	10.2	7.7
Policy int rate (eop, %)	15.00	14.00	13.00	12.00	12.00	12.00	10.00
3m interest rate (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UZS*	11,229	11,430	11,450	11,477	11,500	11,365	11,592
EUR/UZS*	12,021	12,344	12,939	13,543	13,800	12,728	13,562

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

*Quarterly data is eop, annual is average

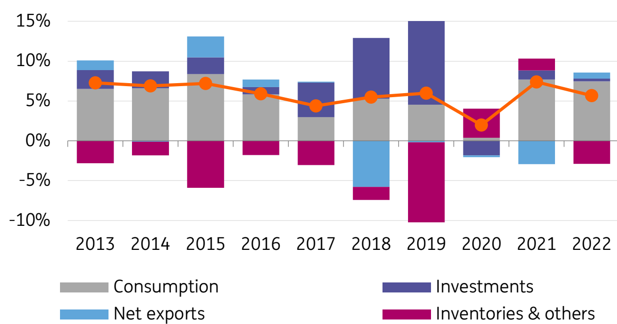
Source: National sources, ING estimates

Country strategy: limited benefits

Despite positive spillover from the Russia-Ukraine conflict, Uzbekistan's growth momentum is waning on a sluggish agriculture sector, gas supply disruptions, elevated inflation and unemployment amid growing population. Fiscal policy has been generous so far but is now likely to face some consolidation.

Still, with GDP growth of around 5-6% pa, a relatively sound fiscal and external position, and ongoing reform agenda, the country looks attractive. A move to investment grade could be a trigger for the local FX (which is now under gradual depreciation pressure), but the prospects of that are clouded by the recent constitutional reform and the increase in trade with Russia, which might entail higher risks of secondary sanction scrutiny by the US and EU.

GDP growth by components (% YoY and ppt)

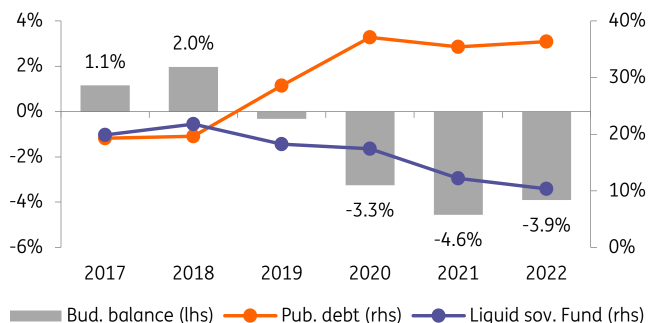


Source: National sources, ING

Growth momentum waning

Despite an inflow of c.100,000 (0.3% of the regular population) of immigrants from Russia and doubling of remittances to 18% of GDP, Uzbekistan's GDP growth slowed by 1.7ppt to 5.7% in 2022 on weak agriculture output (25% of GDP) and limited consumption on high unemployment. In 2023, growth is set to remain at 5-6% (1Q23 GDP is up 5.5% YoY). Support comes from a 3ppt cut in VAT and wider fiscal deficit in 1Q23, but constraints include normalisation of financial inflows from Russia, neutral effect of re-export/import of goods to/from Russia, gas supply disruptions (from Turkmenistan) in early-2023 and elevated inflationary pressure. CPI was 11% YoY in April and likely to stay double-digit (year average) with a weak Uzbekistani Sum, monetary easing (key rate decline in past month from 17% to 14%), expected liberalisation of tariffs mid-2023 and local harvest issues.

Key fiscal indicators (% of GDP)

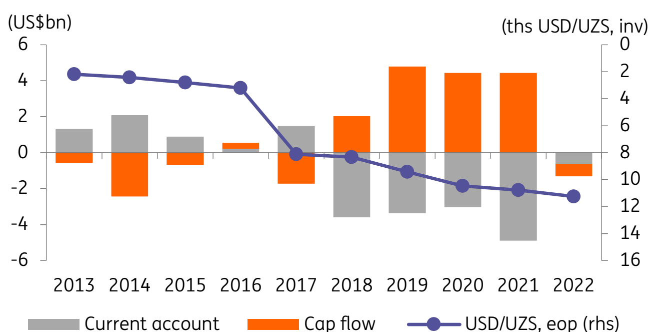


Source: National sources, ING

Fiscal position leaves little room for more generosity

With public debt at 36% of GDP (almost entirely external FX, long maturity) liquid FX state savings (UFRD) at 11% of GDP and a recent increase in expenditures to an historical high of 36% of GDP, Uzbekistan has little room for further fiscal generosity. In 2022, the consolidated deficit narrowed by 0.5ppt to 3.9% of GDP on higher revenues, and for 2023-24 higher tax measures and cost control (following the constitutional reform) are planned, potentially leading to further reduction in the deficit to 2-4% of GDP. However, one third of the revenues are commodities-dependent and volatile, while high inflation may require extra social spending. The deficit is expected to be financed primarily via external borrowing, but the NBU expects the share of external borrowing to drop from 66% to 52% in 2023.

Balance of payments and USD/UZS



Source: National sources, ING

Sum fails to benefit from geopolitical spillover

Uzbekistan's current account improved from its standard 5-7% of GDP deficit to just 0.8% in 2022 thanks to the inflow of remittances from Russia. However, the balance of trade did not improve, as higher exports of commodities (one third of exports) and extra trade with Russia (share of Russia in exports went up from 12% to 16%) were offset by higher imports (Russia share remained 20%). That said, improvement in the current account failed to be absorbed by the FX market (unlike Georgia and Armenia), as UZS has gradually depreciated by 6% against USD since mid-2022 and is now 6% below end-2021 levels, like RUB and KZT. This suggests some pressure on the capital account but, on the positive side, Uzbekistani Sum's depreciation risks seem to be under control.

Uzbekistan

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F	2025F
Activity													
Real GDP (%YoY)	7.3	6.9	7.2	5.9	4.4	5.5	6.0	2.0	7.4	5.7	5.9	5.5	6.0
Real oil GDP (%YoY)	8.8	8.7	11.9	8.3	4.2	7.0	5.6	0.3	11.7	11.4	6.3	8.5	8.0
Real non-oil GDP (%YoY)	8.6	8.4	6.7	2.7	1.5	4.8	5.7	1.4	3.1	1.3	4.0	5.0	4.0
Investment (%YoY)	11.3	9.8	9.4	4.1	19.4	29.9	38.1	-4.4	2.9	0.9	8.0	10.0	8.0
Industrial production (%YoY)	7.5	4.5	5.3	5.4	5.2	10.8	6.6	0.7	8.7	5.2	5.0	5.0	5.5
Unemployment rate (average, %)	4.9	5.1	5.2	5.2	5.8	9.3	9.0	10.5	9.6	8.9	8.5	8.3	8.0
Nominal GDP (UZStn)	153	187	221	255	317	427	533	606	738	888	1,012.8	1,130.1	1,252.4
Nominal GDP (€bn)	55.1	61.0	77.6	77.9	54.1	44.8	53.9	52.8	58.9	76.5	79.6	83.3	92.1
Nominal GDP (US$bn)	73.3	80.9	86.1	86.1	62.0	52.8	60.3	60.2	69.6	80.4	89.1	97.5	105.9
GDP per capita (US$)	2,403	2,609	2,728	2,682	1,898	1,588	1,779	1,742	1,973	2,231	2,426.6	2,605	2,778.4
Gross domestic saving (% of GDP)	29.5	30.3	25.7	24.3	31.9	35.4	34.7	33.5	33.2	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	7.0	6.4	5.5	5.6	9.5	17.5	14.5	12.9	10.8	11.4	10.2	7.7	6.1
CPI (year-end, %YoY)	6.8	6.1	5.6	5.7	14.4	14.3	15.2	11.1	10.0	12.3	9.2	6.8	5.5
Wage rates (nominal, %YoY)	n/a	n/a	n/a	n/a	n/a	25.0	27.5	15.0	20.3	21.1	20.0	17.7	14.1
Fiscal balance (% of GDP)													
Consolidated government balance	2.2	1.9	-0.3	0.7	1.1	2.0	-0.3	-3.3	-4.6	-3.9	-3.4	-2.9	-2.7
Consolidated primary balance	2.2	1.9	-0.3	0.7	1.2	2.1	-0.1	-3.0	-4.3	-3.6	-3.1	-2.5	-2.3
Total public debt	7.5	8.8	9.7	11.2	19.3	19.6	28.5	37.1	35.4	36.3	37.5	38.4	39.3
External balance													
Exports (US$bn)	11.1	10.6	9.5	8.6	10.2	11.4	13.9	12.8	14.1	17.1	20.0	23.0	25.3
Imports (US$bn)	14.0	13.5	11.6	11.0	12.4	18.3	21.2	19.0	22.9	28.3	34.0	37.4	39.3
Trade balance (US$bn)	-2.8	-3.0	-2.1	-2.4	-2.2	-6.9	-7.3	-6.2	-8.8	-11.2	-14.0	-14.4	-14.0
Trade balance (% of GDP)	-3.8	-3.7	-2.4	-2.8	-3.6	-13.0	-12.1	-10.3	-12.6	-13.9	-15.7	-14.8	-13.2
Current account balance (US$bn)	1.3	2.1	0.9	0.2	1.5	-3.6	-3.4	-3.0	-4.9	-0.6	-2.0	-4.4	-6.0
Current account balance (% of GDP)	1.8	2.6	1.0	0.2	2.4	-6.8	-5.6	-5.0	-7.0	-0.8	-2.2	-4.5	-5.6
Net FDI (US$bn)	0.7	0.8	1.0	1.7	1.8	0.6	2.3	1.7	2.3	2.5	3.0	3.5	3.8
Net FDI (% of GDP)	0.9	1.0	1.2	1.9	2.9	1.2	3.8	2.9	3.3	3.1	3.4	3.6	3.6
Current account balance plus FDI (% of GDP)	2.7	3.6	2.2	2.2	5.3	-5.6	-1.8	-2.2	-3.8	2.4	1.2	-0.9	-2.0
Foreign exchange reserves ex gold (US$bn)	14.1	13.6	13.7	14.2	14.0	12.4	12.8	14.7	14.2	12.7	13.0	13.5	13.0
Import cover (months of merchandise imports)	12.1	12.0	14.2	15.4	13.6	8.2	7.3	9.3	7.4	5.4	4.6	4.3	4.0
Debt indicators													
Gross external debt (US$bn)	9.7	11.6	13.4	15.1	16.9	18.4	26.0	35.9	42.3	50.8	55.8	60.8	65.8
Gross external debt (% of GDP)	13.2	14.3	15.6	17.5	27.3	34.8	43.1	59.6	60.8	63.2	62.6	62.4	62.1
Gross external debt (% of exports)	87.0	109.9	141.3	174.7	166.3	161.6	187.1	279.8	299.1	296.9	279.0	264.3	260.1
Lending to corporates/households (% of GDP)	n/a	n/a	n/a	20.6	34.8	31.4	39.7	45.7	44.2	43.9	45.4	46.2	47.3
Interest & exchange rates													
Central bank key rate (year-end, %)	12.00	10.00	9.00	9.00	14.00	16.00	16.00	14.00	14.00	15.00	12.00	10.00	8.50
Broad money supply (average, %YoY)	n/a	17.3	24.6	22.6	38.9	13.2	15.3	18.6	35.1	38.9	24.2	19.0	17.0
3m interest rate (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
3m interest rate spread over US$-Euribor(ppt)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UZS exchange rate (year-end)	2,202	2,422	2,810	3,218	8,120	8,328	9,429	10,478	10,786	11,252	11,477	11,707	11,941
USD/UZS exchange rate (average)	2,092	2,308	2,570	2,965	5,123	8,078	8,833	10,060	10,613	11,051	11,365	11,592	11,824
EUR/UZS exchange rate (year-end)	3,034	2,931	3,052	3,394	9,751	9,523	10,582	12,823	12,266	12,006	13,543	13,463	13,732
EUR/UZS exchange rate (average)	2,780	3,064	2,852	3,279	5,869	9,531	9,887	11,468	12,546	11,616	12,728	13,562	13,597
Brent oil price (annual average, US$/bbl)	109	99	52	44	54	71	64	42	71	99	90	89	75

Source: National sources, ING estimates

Quarterly forecasts

	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	1Q24F	2Q24F	3Q24F	4Q24F	1Q25F	2Q25F
Real GDP (%YoY)	5.1	6.2	5.7	5.5	5.2	6.2	6.7	7.0	5.7	5.2	4.0	4.5	6.5
CPI (eop, %YoY)	12.2	12.2	12.3	11.3	9.9	9.5	9.2	8.6	7.5	6.9	6.8	6.4	6.1
Central bank key rate (eop, %)	16.00	15.00	15.00	15.00	14.00	13.00	12.00	12.00	11.00	10.00	10.00	9.50	9.00
3m interest rate (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UZS exchange rate (eop)	10,863	11,011	11,229	11,419	11,430	11,450	11,477	11,500	11,550	11,650	11,707	11,750	11,800
EUR/UZS exchange rate (eop)	11,389	10,793	12,021	12,377	12,344	12,939	13,543	13,800	13,514	13,398	13,463	13,513	13,570

Source: National sources, ING estimates

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