Economic & Financial Analysis

EM Economics & Strategy

31 March 2021

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

Directional Economics EMEA: Some Like it Hot

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Summary

One of the hottest topics in financial markets right now is inflation. Certainly, there seem fewer concerns over growth trajectories even though the region is still struggling to gain control of the pandemic. Instead the focus is on whether the exceptional stimulus delivered in 2020 by politicians and central bankers alike has laid the groundwork for a persistent rise in inflation.

Unlike western counterparts, many economies in the CEEMEA space came into the Covid-19 crisis with relatively high levels of inflation – largely a legacy of tight labour markets. In theory, many central banks in the region (particularly CE4) should be questioning whether deeply negative real rate settings remain appropriate in 2021.

The focus of this edition of Directional Economics is to assess which policymakers will be more tolerant of inflation or, in other words, will be prepared to let their economies run hot. While many of the CEEMEA economies look set to witness above target inflation this year, those most exposed to the CPI pass-through from currency weakness and higher oil prices are the likes of Hungary and Turkey.

The key difference between the two is the question of real interest rate settings. Those in Hungary look set to become even more negative through 2Q21, while in Turkey the question is how long very positive real rates can be maintained.

Our call is that is Hungary is forced to react with rate hikes in 2Q21 – largely in response to pressure on the forint – even though policymakers would prefer very accommodative policy heading into elections in 2022. For Turkey, we are waiting to hear from the new CBT Governor. And in Poland, authorities are likely to look through the rise in inflation (peaking later in the year at 4%), helped by eventually a more stable currency.

Unlike central bankers in Hungary and Poland, those in the Czech Republic look set to embrace tighter monetary settings. We look for the first hike in 4Q21, followed by a further three in 2022.

Elsewhere in the region, Romania faces less pressure on the inflation front. Concerns do remain over Romania's twin deficits, however. Here the 5% of GDP current account deficit witnessed last year should be ringing alarm bells about structural imbalances. With next elections not until 2024, fortunately policy should have an opportunity to address these concerns with fiscal consolidation. 5%+ 2021 GDP growth should help.

Russia remains a growth laggard in the region and we pencil in only 2.5% growth this year after a 3% contraction in 2020. Yet the Central Bank of Russia has already moved to tighten policy settings and looks set to deliver a further 75bp tightening of policy this year – stamping out the threat of inflation.

Contrasting tolerance levels to inflation will have an impact on financial markets in the region. Within FX, the Czech Koruna should remain the outperformer and the Hungarian Forint the most fragile – until at least the NBH responds with rate hikes. Pre-emptive tightening from the CBR should also provide the Rouble with some insulation from geo-political challenges. Zloty performance should be somewhere mid-pack and the NBP's reluctance to tightening should see further steepening of local yield curves.

As usual, our Directional Economics report showcases ING's unique geographical footprint in the CEEMEA region. We hope you enjoy it and actively encourage you to reach out to our local experts.

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Country summaries: CE4

Czech Republic

Following a 5.6% GDP contraction in 2020 due to the Covid-19 crisis, we expect the Czech economy to grow by around 3% this year and accelerate further in 2022. Despite a more severe impact from the pandemic being felt in 1Q21, recovery should start in 2Q given vaccination and mass testing of company employees. The unemployment rate remains relatively low due to government measures, which are likely to continue, motivated by general elections in early October. The inflationary outlook has increased due to higher prices of commodities and we expect inflation to average around 2.5% this year. The Czech National Bank is likely to start monetary tightening in the second half of the year, given a prolonged impact of Covid, we see a first hike in 4Q21 and another three in 2022.

Hungary

Following 4.6% YoY GDP growth in 2019, the Hungarian economy saw a 5% YoY recession in 2020 as a result of the Covid-19 pandemic. This was a better-than-expected outcome, mainly spurred by export and investment activities. The atypically high fiscal deficit last year helped reduce damage in the labour market, while central bank moves alleviated the credit risks. Despite a third wave hitting in 1Q21, we see a 5.4% YoY rebound in economic activity for the year. Financial markets will focus on inflation, which we expect to average 4% YoY in 2021 due to supply side issues and energy price shocks. That could reignite underperformance of the forint, pushing the NBH to hike the 1-week deposit rate. As parliamentary elections are due in 2022, effective fiscal consolidation won't start this year.

Poland

Given the risks stemming from the third wave of the pandemic, we have a conservative growth forecast for 1Q21. But the vaccination is expected to accelerate significantly in 2Q21. This should gradually unlock the economy and bring a rebound in consumption. The expected rebound in global GDP should boost Poland's manufacturing sector, taking into account its high geographic and product diversification relative to the region. We estimate average CPI inflation of 3.4% in Poland in 2021-22. The low base for food and fuel prices will keep up the pressure over the coming months. Our elevated CPI forecast does not change our approach indicating that the central bank should keep rates unchanged until the term end - for the MPC in 1H22 and for Governor Glapiński in June 2022.

Romania

With elections concluded and the next electoral clash not until 2024, policymakers have a unique window of opportunity to do the right things. At heart, problems revolve around the fiscal consolidation process which should start this year. Along with this, we are increasingly anxious about Romania's external imbalances – namely the trade deficit and, by extension, the current account deficit, both of which expanded with the economic slump in 2020. These developments challenge the generally accepted idea that Romania's external deficits are largely driven by the fiscal deficit. While this could be the root cause, we suspect as well fundamental competitiveness issues for the real economy. That said, we remain quite upbeat in our outlook and revert to our belief that GDP growth will save the day again.

Country summaries: Other Central & Eastern Europe

Bulgaria

Bulgaria closed 2020 in a rather buoyant manner as the economy advanced by 2.2% in the last quarter supported by very strong net exports growth. All eyes are now on the 4 April general elections that are likely to result in a fragmented parliament. The ruling centre right GERB seems to be maintaining a marginal advantage in polls and could have the first opportunity to form a new government. Building a coalition is likely to be a complicated process given the limited compatibility among the few parties that have a chance of making the 4% threshold. In the bigger picture, we do not think the election results will change Bulgaria's EU orientation or commitment to euro adoption, but at worst a more numerous government coalition could alter the coherence of policymaking.

Croatia

Although badly affected by a plunging tourism sector, the Croatian economy performed relatively better than most European tourist destinations. We think that in 2021 Croatian tourism will outpace its peers given the nature of tourist arrivals in Croatia (mostly by road and not by air) and the relatively scattered touristic spots, which bodes well with the need for social distancing. Vaccination rollout will be key to a successful tourism season and to the economic recovery in general. Medium term, the ERM-II membership will continue to anchor the country's policies with most policymakers seemingly aligned for achieving euro adoption in 2023. We see this target as tight but doable. If not achieved, EU admission could be postponed until after the 2024-2025 electoral cycle.

Serbia

Having navigated a complicated 2020 in an impressively resilient manner, the Serbian economy looks on track to outperform (again) most - if not all - European economies in 2021. In achieving this, a few elements will need to align (and we think they will): a narrower but still sufficiently loose fiscal gap, a successful vaccine rollout, on-hold (hence stimulative) monetary policy and a restoration of external demand. On the downside, there seems to be little progress with the EU in opening new negotiation chapters while the prospects of early elections in 2022 could derail the reforms in the SOE sector and the related privatisation process. On the ratings front, we maintain our view that Serbia has a reasonable prospect of achieving investment grade by the end of 2022.

Turkey

The pandemic turned out to have a lesser impact on Turkey than on many other countries, with its supportive policy mix leading to a deterioration of inflation and external imbalances. The risk premium has also increased with accelerating dollarization and capital outflows last year. Policymakers responded with a number of positive steps to restore macroeconomic stability, while these efforts have been more evident on the monetary front. With the CBT's rate hikes along with the simplification of the policy framework, investor sentiment recovered, though the recent change in governorship has increased market uncertainty over the future path of policy rates and the monetary framework. With further guidance from the CBT, we will revisit our forecasts.

Country summaries: CIS

Kazakhstan

The economic recovery in Kazakhstan is ongoing but pressured by extended lockdowns, low vaccination rates, and by limited room for recovery in oil output this year. The good news is that despite the fiscal stimulus of 9% of GDP in 2020, the government preserved its financial strengths and, given the recovery in the oil price, we see room for a softer-than-expected approach to spending this year, which may provide an additional boost to growth. High oil prices should reinforce the position of the budget and tenge, allowing for better resilience against any global negativity, however the capital account transparency is a watch factor. Despite the relatively stable tenge, CPI in Kazakhstan is facing elevated risks, in line with global trends, which suggests no further room for monetary easing.

Russia

Russian GDP dropped defensively by 3.1% in 2020, in line with our expectations, and managed to preserve its macro strength, which is now helped by the oil price rally. But the economic recovery is challenged by the weak household income trend, low appetite for corporate investment and a likely tightening in the monetary policy stance throughout 2021. Russia's macro advantages should somewhat mitigate the negative effect of global bond market nervousness and help rouble and OFZ justify our constructive view. However, the Russia-specific weaknesses related to slow growth, susceptibility to higher CPI, and foreign policy challenges are a traditional set of risks to our view.

Ukraine

Given that Ukraine will probably draw another tranche from the IMF later in 2021, and conclude the US$5bn programme with less than US$3bn in withdrawals, the country will need to lean more on international markets. Recently, these markets became even more volatile than usual on the back of the reflation story in the US. This is very evident in Ukraine as CPI accelerated to 7.5% YoY and the NBU demonstrated its reliability and unexpectedly hiked the rates in early March 2021 despite rising Covid-19 contagions and regional lockdowns, and the slow pace of vaccinations. Growth is to rebound, driven by industry. In politics, the ruling party is increasingly fragmented in Parliament, and President Zelenskiy is struggling to maintain a reform course despite pressures and a vested interest.

ING main macroeconomic and financial forecasts

Real GDP (% YoY)

	4Q20	1Q21F	2Q21F	3Q21F	2021F	2022F
Bulgaria	-3.8	-3.3	8.6	5.6	4.1	3.9
Croatia	-7.0	-5.5	13.5	6.4	4.6	4.1
Czech Republic	-4.7	-2.1	8.3	2.9	3.1	4.1
Hungary	-3.6	-5.0	15.6	5.5	5.4	6.0
Kazakhstan	-2.2	0.8	3.1	3.1	3.2	3.7
Poland	-2.8	-2.3	9.6	4.4	4.5	5.0
Romania	-1.4	-1.8	12.4	7.5	5.5	5.0
Russia	-2.0	-0.5	6.0	3.0	2.5	2.2
Serbia	-1.0	0.4	12.0	5.4	5.5	5.0
Turkey	5.9	2.6	10.6	3.5	5.0	4.5
Ukraine	-1.2	-1.5	12.3	4.0	4.8	4.1
Eurozone*	-5.0	-1.9	12.2	1.5	3.6	3.5
US*	-2.4	0.4	13.3	7.1	6.9	4.6

*% QoQ annualised
Source: National sources, Bloomberg, ING estimates

Exchange rate (quarterly is eop, annual is avg)

	4Q20	1Q21F	2Q21F	3Q21F	2021F	2022F
EUR/BGN	1.96	1.96	1.96	1.96	1.96	1.96
EUR/HRK	7.54	7.55	7.52	7.51	7.54	7.54
EUR/CZK	26.2	26.1	25.7	25.6	25.8	25.3
EUR/HUF	362.6	365.0	360.0	365.0	364.5	375.0
USD/KZT	421	423	416	416	418	412
EUR/PLN	4.61	4.65	4.52	4.45	4.51	4.44
EUR/RON	4.88	4.89	4.89	4.92	4.89	4.92
USD/RUB	73.90	73.00	72.00	75.00	73.38	73.60
EUR/RSD	117.60	117.60	117.60	117.60	117.60	117.60
USD/TRY	7.43	7.30	7.40	7.60	7.49	8.18
USD/UAH	28.4	27.8	28.2	28.1	28.0	27.7
EUR/USD	1.22	1.22	1.22	1.25	1.23	1.25

Source: National sources, Bloomberg, ING estimates

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

	4Q20	1Q21F	2Q21F	3Q21F	2021F	2022F
Bulgaria	0.1	0.0	1.4	2.4	1.6	2.2
Croatia	0.2	0.2	0.2	0.5	1.0	1.3
Czech Republic	2.3	2.4	2.4	2.5	2.5	1.8
Hungary	2.7	3.4	4.6	4.2	4.0	2.8
Kazakhstan	7.5	7.0	6.5	6.3	6.7	6.1
Poland	2.4	2.8	3.5	3.5	3.4	3.4
Romania	2.1	3.1	2.8	2.7	3.0	2.8
Russia	4.9	5.7	5.3	5.3	5.1	4.1
Serbia	1.3	1.4	1.7	2.0	1.9	2.3
Turkey	14.6	15.8	14.6	14.0	14.3	10.5
Ukraine	5.0	7.5	8.0	8.0	7.8	6.3
Eurozone	-0.3	1.0	1.9	2.3	1.8	1.5
US	1.2	1.8	3.6	3.3	3.0	3.0

Source: National sources, Bloomberg, ING estimates

Central Bank rate (%, eop)

	4Q20	1Q21F	2Q21F	3Q21F	2021F	2022F
Bulgaria	0.00	0.00	0.00	0.00	0.00	0.00
Croatia	3.00	3.00	3.00	3.00	3.00	3.00
Czech Republic	0.25	0.25	0.25	0.25	0.75	1.50
Hungary	0.60	0.60	0.60	0.60	0.60	0.60
Kazakhstan	9.00	9.00	9.00	9.00	9.00	9.25
Poland	0.10	0.10	0.10	0.10	0.10	0.10
Romania	1.50	1.25	1.25	1.25	1.25	1.75
Russia	4.25	4.50	4.75	5.00	5.00	5.25
Serbia	1.00	1.00	1.00	1.00	1.00	1.50
Turkey	17.00	19.00	19.00	19.00	16.00	12.00
Ukraine	6.00	6.50	6.50	6.80	6.80	6.80
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00
US	0.25	0.25	0.25	0.25	0.25	0.25

*Lower level of 25bp range
Source: Bloomberg, ING estimates

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

	4Q20	1Q21F	2Q21F	3Q21F	2021F	2022F
Bulgaria	0.40	0.25	0.25	0.25	0.30	0.40
Croatia	0.70	0.60	0.60	0.65	0.65	0.80
Czech Republic	1.30	2.00	2.30	2.40	2.10	2.50
Hungary	2.08	2.85	3.00	3.00	2.81	3.20
Kazakhstan	n/a	n/a	n/a	n/a	n/a	n/a
Poland	1.24	1.55	1.70	1.75	1.62	1.89
Romania	2.90	3.00	2.90	3.00	3.00	3.00
Russia	6.27	6.70	6.50	6.30	6.40	6.30
Serbia	3.10	2.50	2.65	2.75	2.75	3.00
Turkey	12.90	14.22	13.93	13.82	13.84	13.11
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	-0.57	-0.20	-0.20	-0.10	-0.16	0.09
US	1.00	1.50	2.00	2.00	1.99	2.50

Source: National sources, Bloomberg, ING estimates

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

	4Q20	1Q21F	2Q21F	3Q21F	2021F	2022F
Bulgaria	n/a	n/a	n/a	n/a	0.00	0.15
Croatia	n/a	n/a	n/a	n/a	0.30	0.40
Czech Republic	0.40	0.40	0.40	0.40	0.40	1.20
Hungary	0.75	0.77	1.20	1.20	1.04	1.00
Kazakhstan	10.00	10.00	10.00	10.00	10.00	10.05
Poland	0.21	0.21	0.22	0.23	0.23	0.25
Romania	2.40	1.70	1.70	1.70	1.70	1.85
Russia	4.92	4.85	5.00	5.30	5.10	5.40
Serbia	0.90	0.90	0.95	1.00	0.90	1.20
Turkey	15.59	17.01	17.01	16.88	16.30	13.34
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	-0.55	-0.55	-0.50	-0.50	-0.50	-0.43
US	0.25	0.25	0.25	0.25	0.25	0.25

Source: National sources, Bloomberg, ING estimates

CEEMEA economic outlook

Some Like It Hot

As we go to press, the alarming rise in case rates across Europe and what they mean for the 2021 European recovery is weighing on sentiment. The good news is that we expect politicians to have largely overcome vaccine challenges this summer. Propelled by the tailwinds of better growth in 4Q20 and continued loose fiscal policy, our team remain constructive on CEEMEA growth rates in 2021.

This means that the theme of reflation could indeed make a comeback and become a pressing issue in the CEEMEA region. In fact, every country is expected to see CPI above target this year, with drivers behind those higher prices largely similar. Namely, higher core CPI, 're-opening' inflation and base effects.

But the scale and persistency of those CPI overshoots, as well as CPI trends, will differ. And some countries will be more tolerant of higher inflation than others. Hungary will see the largest overshoot, with CPI likely hitting 5% in April/May. Poland will also see CPI above the upper tolerance band, but the peak will come much later.

In contrast, Romanian and Czech CPIs will be more well behaved, albeit still above target. In Russia, CPI has likely already reached its peak and should start gradually decelerating while the Turkish CPI outlook looks more challenging.

We also consider which countries are most exposed to weaker FX and higher oil prices. Here, Hungary and Turkey stand out. Turkey suffers the highest oil pass through in the region, while Hungary, among free-floating currency regimes, exhibits the highest FX pass through.

Despite high inflation, the central banks' preferences vary. In the low yielding CEE space, the two central banks with the most worrying inflation profiles (NBP and NBH) are, and will continue to be, heavily reluctant to tighten. While the NBP is likely to get away with loose monetary policy, we expect the NBH to be forced into hikes in 2Q due to FX consideration.

We expect the CNB to raise rates later this year, despite less pressing price pressure compared to Poland and Hungary. Similar to the CBR (which has already started tightening), the CNB will hike due to its strong inflation targeting framework. But in contrast to frontloaded CBR tightening, we believe CNB hikes will be backloaded into late-2021.

Our call for CBT rate cuts in 2H21 remains unchanged, but the easing should come earlier and be more aggressive. As is likely going to be the case in Hungary in 2Q21, we do not rule out CBT tightening next quarter should the TRY need stabilising.

Lockdowns delay, but do not derail recoveries

CEE economies have had varying degrees of success in controlling the virus and rolling out vaccines. Currently, the Czech Republic certainly looks the underperformer in terms of case numbers and the extent of its lockdown restrictions, though Hungary and Poland are not too far behind.

As Europe has discovered, failure to roll out the vaccine has allowed vaccine-resistant strains to become more prevalent and ultimately forced policymakers into more severe restrictions. Political cycles in the CEE have also played a role in policymakers' appetite for more stringent restrictions.

In Figure 1 we highlight the relative performance of the region based on: (1) Covid-19 cases, (2) Vaccine programmes; and (3) current restrictions.

Fig 1 Covid-19: Cases, vaccines and restrictions - the current state of play

Key: Best performer | Worst performer

	Covid-19 cases	Vaccine doses (per 100 people)		Restrictions*	
	7-day per 100,000	Daily pace	Cumulative	Google mobility	Stringency
Bulgaria	365	0.07	5.4	-19	54
Croatia	179	0.31	9.5	-7.8	44
Czech Republic	555	0.34	12.9	-27.3	82
Hungary	635	0.55	21.9	-30.7	80
Kazakhstan	39	0.07	0.6	-16.2	57
Poland	433	0.2	13.4	-16.4	73
Romania	200	0.27	13.4	-14.8	64
Russia	45	0.28	7.3	-9.9	40
Serbia	405	0.29	32.0	-21.3	55
Turkey	176	0.34	15.7	-8.5	72
Ukraine	209	0.02	0.3	(Unmeasured)	60

*Google Mobility is a simple average of retail, workplace and grocery store mobility over time. Stringency is based on the Oxford Stringency Index.
All data based on last common value (in some cases around week commencing 22 March 2021)
Source: ING

Ultimately, if vaccines are the way out of this crisis, then successful vaccine rollouts will determine when economies can return to some kind of normal. The good news here, as Carsten Brzeski discusses in a recent podcast, is that 50-60% of Europe's population should be vaccinated by this summer, achieving a degree of herd immunity.

Within the CEE space herd immunity looks like it will largely be achieved by 3Q21 – albeit with a few exceptions. In the infographic in Figure 2 we showcase our best guess on when that may be achieved, alongside some of the positives and negatives in how the crisis has been handled. Southern Europe looks better positioned here with the Balkans potentially returning to full mobility as early as 2Q21.

Political cycles have played a role here as have vaccine purchasing programmes. On this latter point, Hungary stands out in being well supplied with vaccines. One of the bigger challenges across the region is confidence in the vaccine. This is particularly relevant for Russia, where trust in the locally produced vaccines seems to be slowing take-up rates.

Other challenges for the region include complacency following early successes with the first wave, and in some countries weaknesses in healthcare infrastructure are now being exposed.

Fig 2 Covid-19: How have countries performed and when will they re-open?

	What has gone right?	What has gone wrong?	75% of population vaccinated?	Return to full mobility?
Bulgaria	First wave was mild and well contained	April 2021 parliamentary elections may have limited the strength of containment measures	1Q21 2Q21 3Q21 **4Q21**	1Q21 **2Q21** 3Q21 4Q21
Croatia	A well-managed first wave, given the country a 'safer destination' perception through the summer	Parliamentary elections during mid-summer have delayed preparations for the second wave	1Q21 2Q21 **3Q21** 4Q21	1Q21 **2Q21** 3Q21 4Q21
Czech Republic	Performed well during first Spring wave, subsequent steps were late and prone to political intervention	1Q21 wave very severe, full lockdown (including industry) not approved	1Q21 2Q21 3Q21 **4Q21**	1Q21 2Q21 3Q21 **4Q21**
Hungary	Fast containment measures during first wave and pro-active ordering of vaccines from East (China and Russia)	Complacent attitude of early success meaning late reaction to third wave. Administrative problems have slowed vaccine roll out	**Could be end-2Q21** given large stock of vaccines. But only 70% may be prepared to use vaccine	1Q21 2Q21 **3Q21** 4Q21
Kazakhstan	Additional restrictive measures mid 2020 and yearend helped limit second wave	Weak healthcare infrastructure and delayed mobilization mean low vaccination rate	Govt expects only **32% by end 2021**	1Q21 2Q21 3Q21 **4Q21**
Poland	Prompt introduction of restrictions and high social discipline during first wave, vaccination campaign slightly above EU average	Underestimated second and third waves of the pandemic and ad hoc healthcare system management. Very low testing coverage	1Q21 2Q21 **3Q21** 4Q21	1Q21 2Q21 **3Q21** 4Q21
Romania	Adopted a clear set of rules mid 2020 as to how restrictive measures would work, helping manage expectations	Testing strategy varies widely between regions, leading to significant regional disparities	1Q21 2Q21 **3Q21** 4Q21	1Q21 **2Q21** 3Q21 4Q21
Russia	Fast mobilisation of state healthcare system and additional restrictive measures since 3Q20 helped slow second wave	Local vaccination rate very low due to lack of trust by the population	**Late 2022** optimistically	1Q21 2Q21 **3Q21** 4Q21
Serbia	Good co-ordination between authorities, impressive vaccine supply for small non-EU country	Weakened and unreformed healthcare system, showing its limitations during virus peaks	1Q21 **2Q21** 3Q21 4Q21	1Q21 **2Q21** 3Q21 4Q21
Turkey	Low mortality rate and quick vaccine rollout programme	Too much reliance on Chinese CoronaVac vaccine. Small batch of Pfizer may help in 2Q	1Q21 2Q21 **3Q21 4Q21**	**Uncertain**
Ukraine	Social mobilisation, volunteering during the first wave of pandemics	Very slow vaccine campaign. Only 111k doses administered to 21 March 2021 (0.25 per 100 people). Only 43% of Ukrainians are willing to vaccinate	**Late 2022** optimistically	**Uncertain**

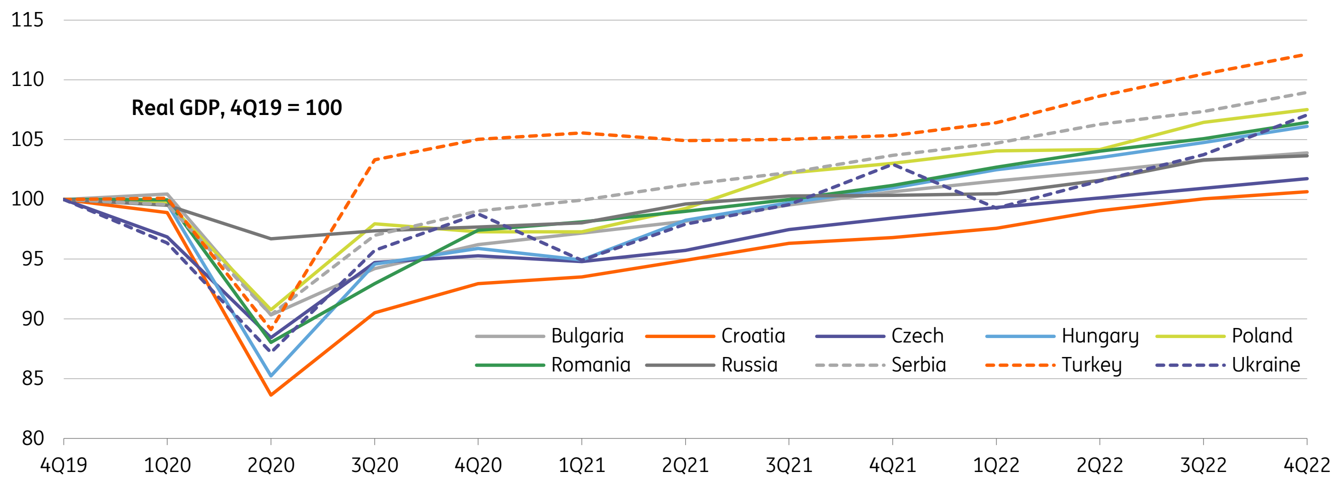
Source: ING

What does this mean for CEE growth?

As usual the country sections of Directional Economics provide a detailed breakdown of growth drivers but suffice to say here that the 2021 CEE recovery looks to be on track. Certainly, strong 4Q20 growth figures have provided a useful tailwind to the 2021 outlook, supported by continued loose fiscal policy and what should be the first release of the EU's Next Generation funds.

Apart from Turkey, which had already recovered by 3Q20, we believe those countries quickest to return to 2019 levels of activity will be Serbia, Russia and Poland. Some of the last to regain those levels will be the Czech Republic and Croatia.

Fig 3 Back on their feet: CEE economies return to pre-pandemic growth levels 2Q21-3Q22



Source: ING

With most reasonably confident that a recovery can come through and doubts emerging about structural shifts in supply chains, attention has understandably shifted to inflation. We now look at the sources of inflation drivers across the region, the persistence of inflation and – the focus of this article – which central bankers will apply the monetary brakes and which will let their economies run hot.

Reflation theme intact

Despite the ongoing extensions of lockdowns across Europe and CEE, the CEE reflation theme remains intact. CPI everywhere in the region remains above the respective targets and headline numbers are set to, in most of the cases, rise further. The general drivers are similar; already high core prices, the expected 're-opening' inflation in the service sector and base effects coming from high oil prices.

However, where countries will differ will be in the scale and persistency of the inflation overshoot and the direction of core CPI.

Here, Hungary stands out. The scale of the overshoot should be the most profound, with CPI possibly hitting 5% in April and May. This will be driven by one-offs (base effects coming from the oil price) as well as rising core CPI, an outcome of the local authorities running a high-pressure economy plus excise duty changes. Indeed, unlike the rest of the CEE, core CPI will remain sticky and high, above 4% throughout most of the year (Figure 4). This is in sharp contrast to rest of the region, where core prices should normalise from high 1Q levels. This means the headline CPI is also expected to stay persistently above 4% (the upper tolerance band) most of the year.

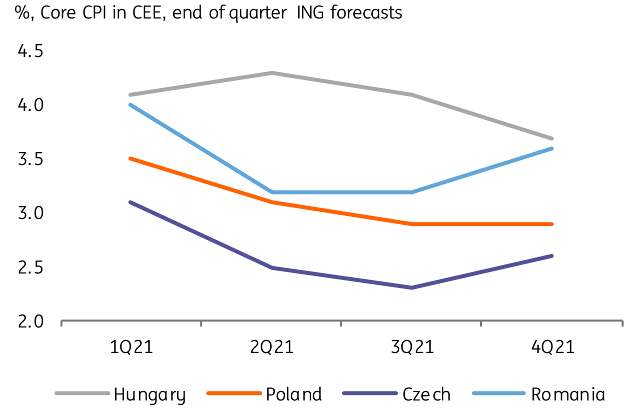
While Poland will also see a meaningful overshoot of the CPI target and, like Hungary, see CPI breach the upper tolerance band multiple times, the overshoot should be less profound and less driven by the core component. Peak Polish prices will also come much later than in Hungary (in December at 4% versus the Hungary CPI peak at around 5% in May).

The least pressing situation is in Romania, where high CPI in 2021 will largely be due to the increase associated with the liberalisation in energy prices, worth 0.6% this year. Without this, CPI should be at the target. Hence, the above-target CPI will be looked through by the NBR and investors, in our view.

Czech CPI should feel the offsetting factors of declining core prices on the one hand (due to base effects also stemming from VAT changes in tax rates last year), but the pro-inflationary pressure from volatile factors, such as a high oil price, on the other hand. This means that CPI will decline this year versus the 2020 average (in contrast to other CEE countries, where CPI will be higher or the same versus 2020 - Figure 5).

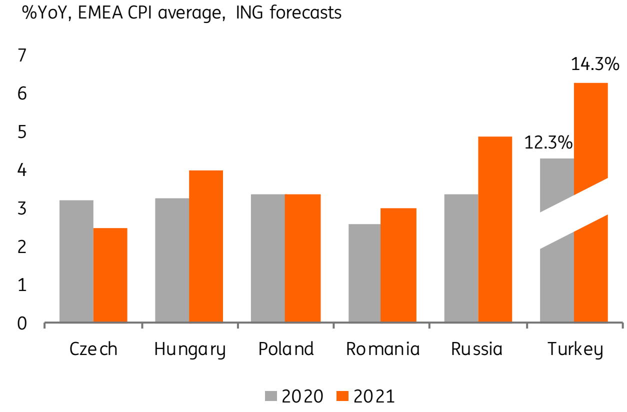
In Russia, CPI has likely reached its peak (March should be the same as the February 5.7% reading) and is expected to start gradually declining throughout the year, with a rapid deceleration at the year end - very close to the 4% level, largely due to base effects, such as more stable agriculture prices, from here. The possible RUB volatility is a risk – although the FX passthrough from the exchange rate into inflation is relatively muted (the second lowest in our CEEMEA basket, after PLN).

Fig 4 Hungarian core CPI will remain very elevated



Source: ING

Fig 5 Bar Czech, CPIs will be higher or same in 2021



Source: ING

While Russia has passed beyond the peak in CPI, the Turkish CPI outlook appears more challenging. Even before the lira sell off, inflation dynamics were defined by demand conditions, elevated services inflation, the recent uptrend in commodity prices and supply constraints during the pandemic. Now with a weaker TRY, this creates further upside risk to CPI and is likely to push the peak CPI level higher (to be reached in April, in our view).

Which countries are exposed the most to weaker FX and a higher oil price?

With price pressures building across the region, we look at two possible pro-inflationary risk factors to the already elevated CPI readings: currency depreciation and a higher oil price. As is evident below, the two high CPI economies of Hungary and Turkey stand out

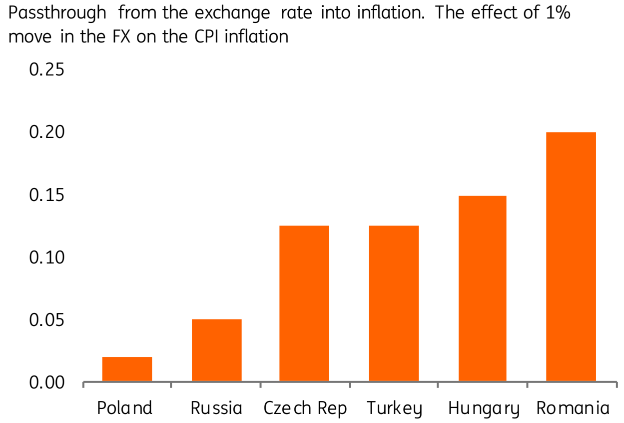
FX spill over into inflation

- In Figure 6, we show the estimates of FX pass-through for the region. While the FX pass-through is the highest in Romania (due to the euroization of the economy), the heavily managed nature of the currency means inflation should not be an imminent risk. Rather, among the freely floating currencies, Hungary sees the highest FX pass-through, underlying the risk to the already high CPI projections (particularly when HUF does not benefit from a current account surplus, unlike CZK and PLN). In contrast, Poland shows a very contained link between FX and CPI, which is a clear supportive factor for the current NBP stance on the currency. One reason behind such a low FX pass-through in Poland versus Czech and Hungary is the openness of the economy, with the latter two being meaningfully more open economies (Figure 7). Russia is expected to see the second lowest FX pass-through (which has halved over the past ten years), largely due to the inflation-targeting framework and lower Russia dependence on imported food items.

Oil price spill over into inflation

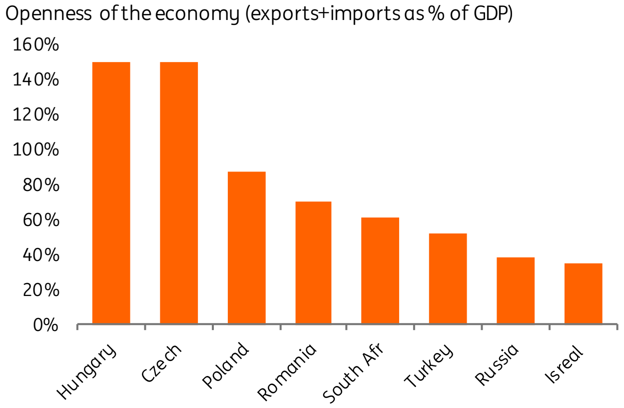
- The talk of a commodity super cycle and, up until recently, the meaningful rise in oil prices makes oil another clear pro-inflationary risk factor. This will be already evident in 2Q21 numbers as oil prices will heavily contribute to higher CPI in most countries due to the base effects stemming from low prices in 2Q20). Again, Hungary appears one of the most vulnerable here, showing the second-highest oil pass-through in the EMEA region (with the difference quite large when compared to its CEE peers), as per Figure 8. This is likely due to the specific tax situation (high VAT of 27%), FX volatility and a less energy efficient industrial sector. Turkey exhibits the highest oil pass-through, due to the increasing natural gas intensity of the Turkish economy and rising share of oil products in the consumer basket. In contrast, Russia CPI exhibits relative insulation of CPI from global oil prices through dampening mechanisms and direct price controls.

Fig 6 Hungary and Poland differ in FX pass-through



Source: ING, various central banks estimates

Fig 7 Poland less open than Hungary and Czech Republic



Source: ING

Central banks: Some prefer to run the economies hot, some are/will be pre-emptive

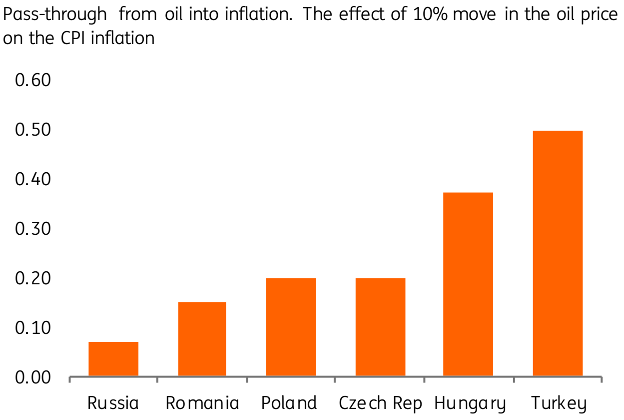
Despite clear upside price pressures in the region, central bank preferences vary and their reaction functions differ. In the low yielding CEE space, the two central banks with the most worrying inflation profiles (NBP and NBH) are heavily reluctant to tighten. The clear preference is to run the economy hot, with financial stability risks being the most likely impetus to hike, in our view. We think this will be the case for Hungary, where we expect the NBH to deliver FX stabilising hikes in response to the projected currency weakness in 2Q21.

In our view, a sharp spike in CPI in April and May is likely to lead the market to question the appropriateness of the policy stance (Figure 9). While the NBP will also face a rather pressing inflation outlook, the lower likelihood of currency pressure (unlike the HUF, the PLN benefits from a sizable current account surplus) and the negligible FX pass-through into CPI (Figure 4) mean that Polish Zloty weakness: (1) is less likely; (2) will have a lower implication for the CPI profile. This should give the NBP some breathing room to avoid tightening. Importantly, the central bank has a clear preference for zloty weakness, with a lower risk of a disorderly sell-off given the discussed current account surplus.

While the NBH is likely to be the first central bank to hike in the region (being forced into it by circumstances rather than hiking willingly), the most fundamentally hawkish CEE central bank remains the CNB. Although CPI pressures are not as pressing as in Hungary and Poland, the inflation-target minded CNB should start the tightening cycle later this year – we look for two hikes in 2Q21 and three in 2022. In Romania, the NBR is to remain on hold. Although, CPI will be above target, it will remain comfortably in the tolerance band, with the main reason behind the target overshoot this year being the spike in energy prices (which will be one-off). This should give the NBR clear comfort to remain on hold.

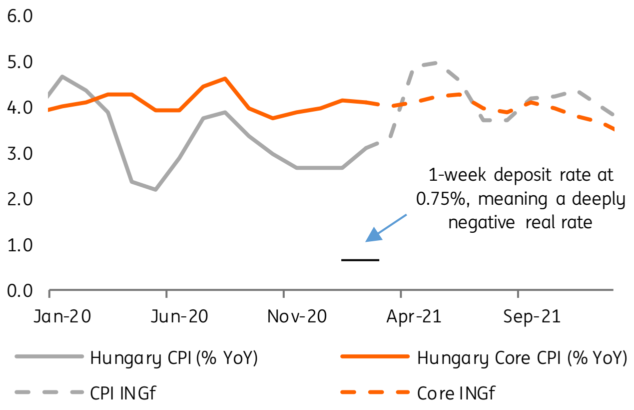
In contrast, the CBT and the CBR have already started the tightening cycle, albeit for different reasons. While the CBT has been forced to deliver a meaningful tightening to stabilise the currency (and more could be on cards given the unfavourable perception from the global investment community of the latest personnel changes within the CBT leadership), the CBR appeared to be pre-emptively reacting to the upside surprise to domestic inflation. We expect the CBR to continue tightening by delivering at least two additional hikes over the next three meetings (by July) with risks skewed to four hikes by the end of 3Q21. Deterioration in the US-Russia relations has introduced the risk of emergency rate hikes, albeit this not our base case. In the case of increased pressure on RUB, the CBR may opt to suspend FX purchases (instead of hiking rates) – as has been the case previously, such as during the 2H18 pressure on RUB.

Fig 8 Turkey and Hungary: High oil pass-through



Source: ING, various central banks estimates

Fig 9 Hungarian effective rate too low for too high CPI



Source: ING

As for CBT, the recent TRY sharp sell-off and the risk premium attached to TRY assets may warrant further tightening near term in order to stabilise the currency. As before, we look for some eventual reversal of the tight monetary stance in the second half of the year, but compared to our prior expectations, this may now start earlier (July versus October) and could be more pronounced.

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EMEA economics team

Countries

Bulgaria

Valentin Tataru, Economist, Bucharest

Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (%YoY)	-3.8	-3.3	8.6	5.6	4.6	4.1	3.9
CPI (%YoY)*	0.1	0.0	1.4	2.4	2.4	1.6	2.2
Policy interest rate (eop, %)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10yr yield (%)*	0.40	0.25	0.25	0.25	0.30	0.30	0.40
USD/BGN	1.60	1.66	1.60	1.56	1.53	1.59	1.56
EUR/BGN	1.96	1.96	1.96	1.96	1.96	1.96	1.96

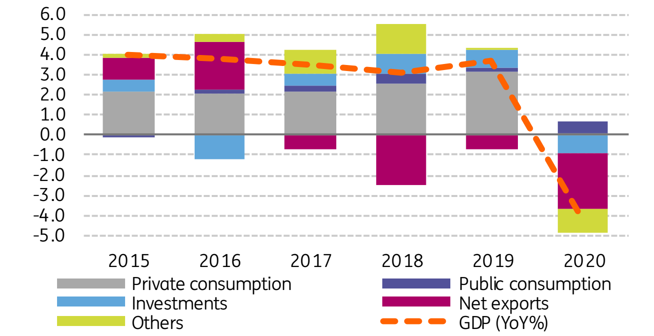
Macro Trend		Political Cycle	Ratings	FC	LC
Activity	▲	Presidential: Nov 2021	S&P	BBB	BBB
Fiscal	Loose	Parliamentary: Apr 2021	Moody's	BBB	BBB
Monetary	Loose	Local: 2023	Fitch	Baa1	Baa1

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

Country strategy: elections outcome should not matter

Bulgaria closed 2020 in a rather buoyant manner as the economy advanced by 2.2% in the last quarter supported by very strong net exports growth. All eyes are now on the 4 April general elections that are likely to result in a fragmented parliament. The ruling centre right GERB seems to be maintaining a marginal advantage in polls and could have the first opportunity to form a new government. Building a coalition is likely to be a complicated process given the limited compatibility among the few parties that have a chance of making the 4% threshold. In the bigger picture, we do not think the election results will change Bulgaria's EU orientation or commitment to euro adoption, but at worst a more numerous government coalition could alter the coherence of policymaking.

Real GDP (%YoY) and contributions (ppt)

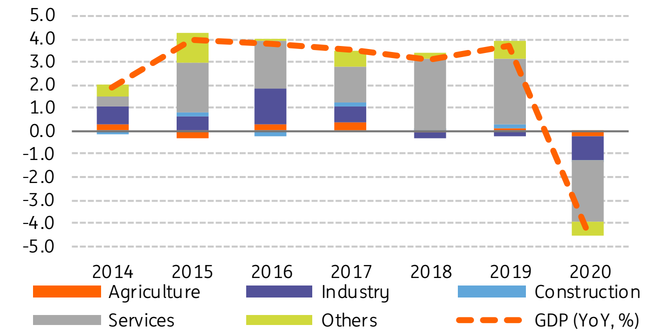


Source: NSI, ING

Consumption resilient in 2020, vaccination is key for 2021

Despite a more severe second (and as we write even third) wave of Covid-19, the relatively milder restrictions have been maintained largely unchanged and -combined with the inherent learning process in how to cope with the restrictions- have softened the economic contraction to just 4.2% in 2020. For the first half of 2021 we are mostly concerned about the slow vaccination rate (the slowest in Europe as of mid-March) which has the potential to dampen consumer sentiment and jeopardise the very important tourist season. To offset this, in 2021 fiscal support aims to remain large by local standards, hence an eventual private consumption anaemia should be offset by a rise in public investments and consumption.

Supply side GDP: no green shots just yet

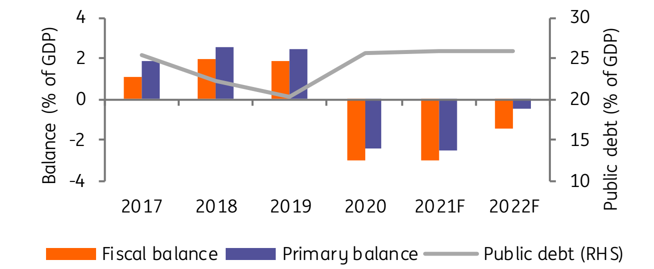


Source: NSI, ING

Construction and tourism to fuel growth in 2021

The significant dependence of Bulgaria's economy on external markets was highly visible in 2020 when virtually all economic sectors experienced a contraction. Things could change a bit in 2021 when we expect the construction sector to accelerate due to public infrastructure works (financed both from the local budget and EU funds). Another positive change will come from the export of services -namely tourism- which should definitely be better than in 2020, although there are still many unknowns at this point ranging from domestic vaccination pace to eventual digital vaccine passport schemes aimed at securing international travel. All considered, we see mild downside risks to our 4.1% GDP growth projection.

Government debt and fiscal balance (% of GDP)



Source: National sources, ING estimates

Bulgaria forecasts

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Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (%YoY)	0.6	2.4	0.4	0.3	1.9	4.0	3.8	3.5	3.1	3.7	-4.2	4.1	3.9
Private consumption (%YoY)	0.1	2.6	3.3	-2.4	2.7	3.6	3.6	3.9	4.6	5.2	0.3	3.0	2.8
Government consumption (%YoY)	2.1	2.3	-1.8	0.7	-0.1	1.8	2.2	4.3	5.3	2.0	7.5	5.0	1.0
Investment (%YoY)	-17.6	-4.4	1.8	0.5	3.5	2.7	-6.6	3.2	5.4	4.5	-5.1	4.0	5.0
Industrial production (%YoY)	1.9	6.2	-0.4	0.0	2.1	2.8	2.7	3.9	0.3	0.7	-6.2	3.0	3.8
Unemployment rate (year-end, %)	10.3	11.3	12.3	12.9	11.4	9.1	7.6	6.2	5.2	4.2	5.2	5.0	4.6
Nominal GDP (BGNbn)	74.4	80.7	82.2	82.0	83.9	89.4	95.1	102.3	109.7	119.8	118.6	130.0	140.0
Nominal GDP (€bn)	38.1	41.3	42.0	41.9	42.9	45.7	48.6	52.3	56.1	61.2	60.6	66.5	71.6
Nominal GDP (US$bn)	50.2	57.8	54.2	55.7	56.6	50.3	53.5	59.7	66.2	68.0	70.3	83.7	91.6
GDP per capita (US$)	6,800	7,500	7,500	7,700	7,800	7,000	7,600	8,600	9,500	9,900	10,200	12100	13300
Gross domestic saving (% of GDP)	19.8	21.8	18.8	20.6	20.6	22.0	24.0	24.2	23.8	24.3	20.7	24.8	24.9
Prices													
CPI (average, %YoY)	2.4	4.2	3.0	0.9	-1.4	-0.1	-0.8	2.1	2.8	3.1	1.7	1.6	2.2
CPI (year-end, %YoY)	4.5	2.8	4.3	-1.6	-0.9	-0.4	0.1	2.8	2.7	3.8	0.1	2.4	2.5
Wage rates (nominal, %YoY)	8.9	9.6	4.1	-1.6	-1.3	-2.0	-3.1	5.0	4.0	3.1	8.7	7.0	6.0
Fiscal balance (% of GDP)													
Consolidated government balance	-3.1	-2.0	-0.3	-0.5	-5.4	-1.7	0.1	1.1	2.0	1.9	-3.0	-3.0	-1.4
Consolidated primary balance	-2.4	-1.3	0.5	0.2	-4.6	-0.8	1.0	1.9	2.6	2.5	-2.4	-2.5	-0.5
Total public debt	15.4	15.2	16.7	17.1	27.1	26.0	29.3	25.3	22.3	20.2	25.7	26.0	26.0
External balance													
Exports (€bn)	15.6	20.3	20.8	22.3	22.0	22.9	24.0	27.8	28.5	29.8	26.7	29.0	32.0
Imports (€bn)	19.2	23.4	25.5	25.8	26.1	26.3	26.2	30.2	32.1	33.2	28.8	31.0	33.5
Trade balance (€bn)	-3.7	-3.1	-4.7	-3.6	-4.1	-3.5	-2.1	-2.4	-3.6	-3.5	-2.2	-2.0	-1.5
Trade balance (% of GDP)	-9.7	-7.6	-11.2	-8.5	-9.5	-7.6	-4.4	-4.6	-6.4	-5.6	-3.5	-3.0	-2.1
Current account balance (€bn)	-0.7	0.1	-0.4	0.5	0.5	0.1	1.6	1.8	0.6	1.8	0.7	1.7	2.5
Current account balance (% of GDP)	-1.8	0.2	-1.0	1.2	1.2	0.2	3.3	3.4	1.1	2.9	1.2	2.5	3.5
Net FDI (€bn)	0.9	1.2	1.1	1.2	0.1	1.9	0.6	1.3	0.8	0.8	0.4	0.7	0.8
Net FDI (% of GDP)	2.5	2.9	2.5	3.0	0.3	4.0	1.1	2.5	1.4	1.3	0.7	1.1	1.1
Current account balance plus FDI (% of GDP)	0.6	3.1	1.6	4.2	1.5	4.3	4.4	5.9	2.5	4.3	1.8	3.6	4.6
Foreign exchange reserves ex gold (€bn)	13.0	13.3	15.6	14.4	16.5	20.3	23.9	23.7	25.1	24.8	30.9	33.0	36.0
Import cover (months of merchandise imports)	8.1	6.8	7.3	6.7	7.6	9.2	11.0	9.4	9.4	9.0	12.9	12.8	12.9
Debt indicators													
Gross external debt (€bn)	37.0	36.3	37.7	36.9	39.3	33.5	34.2	33.9	34.5	35.2	36.8	37.6	38.3
Gross external debt (% of GDP)	97	88	90	88	92	73	70	65	61	57	61	57	54
Gross external debt (% of exports)	238	179	182	166	178	146	142	122	121	118	138	130	120
Lending to corporates/households (% of GDP)	68.1	64.8	65.4	65.7	59.0	54.6	51.7	49.7	49.9	49.1	51.9	52.0	52.4
Interest & exchange rates													
Central bank key rate (year-end, %)	n/a	n/a	n/a	n/a	n/a	n/a	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Broad money supply (average, %YoY)	6.4	12.2	8.4	8.9	1.1	8.8	7.6	7.7	8.8	9.9	10.9	11.4	12.0
3yr yield (average, %)	4.72	3.67	2.65	1.50	1.59	1.03	0.36	0.08	-0.05	-0.22	-0.15	0.00	0.15
10yr yield (average, %)	6.10	5.30	4.55	3.54	3.42	2.83	2.19	1.60	0.94	0.46	0.40	0.30	0.40
USD/BGN exchange rate (year-end)	1.47	1.50	1.48	1.43	1.62	1.79	1.86	1.63	1.70	1.75	1.60	1.53	1.60
USD/BGN exchange rate (average)	1.48	1.40	1.52	1.47	1.48	1.78	1.78	1.72	1.66	1.76	1.69	1.59	1.56
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

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (%YoY)	3.2	1.8	-8.5	-4.2	-3.8	-3.3	8.6	5.6	4.6	4.5	4.3	3.8	3.2
CPI (eop, %YoY)	3.8	3.0	1.6	0.9	0.1	0.0	1.4	2.4	2.4	2.5	2.5	2.5	2.5
Central bank key rate (eop, %)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
10yr yield (eop, %)	0.30	0.20	0.80	0.30	0.40	0.25	0.25	0.25	0.30	0.30	0.30	0.35	0.40
USD/BGN exchange rate (eop)	1.75	1.78	1.75	1.67	1.60	1.66	1.60	1.56	1.53	1.53	1.56	1.59	1.60
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

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Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (%YoY)	-7.0	-5.5	13.5	6.4	4.2	4.6	4.1
CPI (%YoY)*	0.2	0.2	0.2	0.5	1.4	1.0	1.3
Policy interest rate (eop, %)	3.00	3.00	3.00	3.00	3.00	3.00	3.00
10yr yield (%)*	0.70	0.60	0.60	0.65	0.65	0.65	0.80
USD/HRK*	6.18	6.40	6.16	6.01	5.88	6.13	6.03
EUR/HRK*	7.54	7.55	7.52	7.51	7.53	7.54	7.54

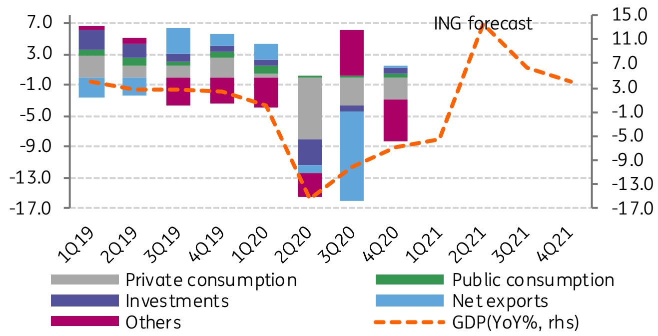
Macro Trend		Political Cycle	Ratings	FC	LC
Activity	▲	Presidential: 2025	S&P	BBB-	BBB-
Fiscal	Loose	Parliamentary: 2024	Moody's	Ba1	Ba1
Monetary	Loose	Local: 2021	Fitch	BBB-	BBB-

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

Country strategy: looking for the summer

Although badly affected by a plunging tourism sector, the Croatian economy performed relatively better than most European tourist destinations. We think that in 2021 Croatian tourism will outpace its peers given the nature of tourist arrivals in Croatia (mostly by road and not by air) and the relatively scattered touristic spots, which bodes well with the need for social distancing. Vaccination rollout will be key to a successful tourism season and to the economic recovery in general. Medium term, the ERM-II membership will continue to anchor the country's policies with most policymakers seemingly aligned for achieving euro adoption in 2023. We see this target as tight but doable. If not achieved, Eurozone admission could be postponed until after the 2024-2025 electoral cycle.

Real GDP (YoY%) and contributions (ppt)

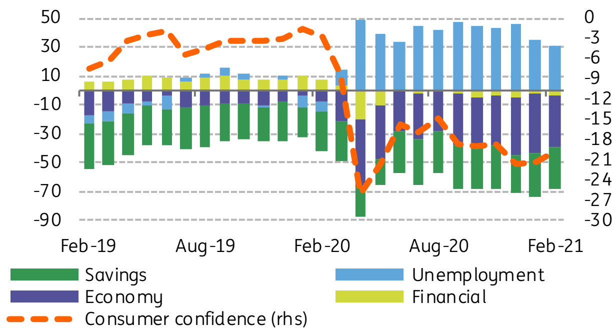


Source: Eurostat, ING

Public spending saved the day

Following the reintroduction of restrictive measures towards the end of 2020, public consumption and investments propped up the economy, which closed the year with a rather spectacular 2.7% quarterly advance, taking the full 2020 contraction to -8.4%. All eyes will be on a recovery of the tourism sector in 2021, for which Croatia looks better positioned than most European peers. Reaching pre-pandemic tourism levels is, however, unlikely for the next couple of years, hence the other growth pillar is likely to be the EU funds absorption which should boost public investments in sectors such as infrastructure and digitalisation. The construction sector, in particular, should benefit from an infusion of public funds.

Consumer morale remained depressed…

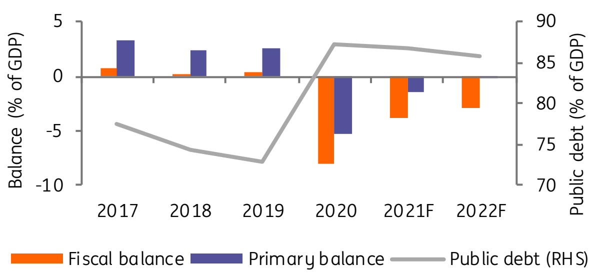


Source: Eurostat, ING

…as expectations point to a delayed recovery

While tourism activity should gradually improve, we are wary regarding recovery of what should constitute the main growth driver in 2021: domestic demand. We acknowledge that the accumulation of precautionary and involuntary savings has created a sizeable pent-up demand, but unleashing this demand is a different story. After the understandable April-May 2020 plunge in consumer confidence, subsequent months haven't brought marked improvement. Consumers remain sceptical in their assessment of employment opportunities and the general economic situation, leading to a very prudent savings behaviour. We think that it will take more than just a good tourism season to overcome this.

Government debt and fiscal balance (% of GDP)



Source: National sources, ING estimates

Croatia

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Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (%YoY)	-1.3	-0.2	-2.4	-0.4	-0.3	2.4	3.5	3.4	2.8	2.9	-8.4	4.6	4.1
Private consumption (%YoY)	-1.5	1.0	-2.4	-1.6	-2.5	0.2	3.1	3.2	3.3	3.6	-6.3	4.0	5.0
Government consumption (%YoY)	-0.6	0.5	-1.2	-0.1	1.6	-1.6	0.5	2.2	2.3	3.4	2.0	2.0	1.0
Investment (%YoY)	-15.2	-2.7	-3.3	1.4	-2.8	3.8	6.5	5.1	6.5	7.1	-2.9	7.0	6.0
Industrial production (%YoY)	-1.3	-1.3	-5.4	-1.6	1.2	2.4	5.1	2.0	-1.0	0.6	-3.4	3.0	2.0
Unemployment rate (year-end, %)	11.8	13.7	15.8	17.4	17.2	16.1	13.3	11.0	8.3	6.7	7.5	8.7	8.0
Nominal GDP (HRKbn)	329	334	331	332	331	340	351	368	385	402	370	380	400
Nominal GDP (€bn)	45	46	44	73	44	44	46	49	52	54	50	51	53
Nominal GDP (US$bn)	59	61	58	98	57	48	51	56	61	61	58	64	68
GDP per capita (US$)	13,800	14,100	13,600	23,000	13,400	11,500	12,300	13,600	14,900	14,900	14,300	15,600	17,000
Gross domestic saving (% of GDP)	19.4	18.2	17.2	17.4	18.6	20.8	22.2	22.6	22.6	22.4	18.5	18.4	18.6
Prices													
CPI (average, %YoY)	1.0	2.3	3.4	2.2	-0.2	-0.5	-1.1	1.1	1.5	0.8	0.3	1.0	1.3
CPI (year-end, %YoY)	1.9	2.1	4.6	0.3	-0.5	-0.6	0.2	1.2	0.9	1.4	-0.3	1.4	1.5
Wage rates (nominal, %YoY)	-0.5	1.5	1.1	0.7	0.2	-3.9	1.3	3.8	4.7	6.3	2.8	5.0	4.0
Fiscal balance (% of GDP)													
Consolidated government balance	-6.5	-8.0	-5.5	-5.6	-5.5	-3.5	-0.9	0.8	0.2	0.4	-8.0	-3.8	-2.8
Consolidated primary balance	-4.1	-5.3	-2.5	-2.4	-2.1	0.0	2.1	3.4	2.5	2.6	-5.2	-1.4	-0.2
Total public debt	57.7	64.2	70.0	81.0	84.7	84.3	80.8	77.5	74.3	72.8	87.4	86.8	85.8
External balance													
Exports (€bn)	8.9	9.6	9.6	9.5	10.4	11.7	12.5	14.2	14.8	15.4	13.4	14.0	15.0
Imports (€bn)	15.1	16.3	16.2	16.6	17.2	18.6	19.8	22.0	23.9	25.2	19.0	22.0	25.0
Trade balance (€bn)	-6.2	-6.7	-6.6	-7.1	-6.7	-6.9	-7.3	-7.8	-9.1	-9.8	-5.7	-8.0	-10.0
Trade balance (% of GDP)	-13.9	-14.6	-14.8	-9.6	-15.4	-15.5	-15.8	-15.9	-17.7	-18.1	-11.3	-15.8	-18.8
Current account balance (€bn)	-1.0	-0.8	-0.8	-0.5	0.1	1.5	1.0	1.7	0.9	1.5	-0.7	0.1	0.5
Current account balance (% of GDP)	-2.2	-1.7	-1.8	-0.6	0.3	3.3	2.2	3.5	1.8	2.8	-1.5	0.2	0.9
Net FDI (€bn)	0.8	0.9	1.1	0.7	0.7	0.2	2.0	1.1	0.8	1.1	0.5	0.5	0.6
Net FDI (% of GDP)	1.8	2.0	2.4	1.0	1.6	0.5	4.3	2.3	1.6	2.0	1.0	1.0	1.1
Current account balance plus FDI (% of GDP)	-0.4	0.4	0.6	0.4	1.8	3.7	6.5	5.8	3.4	4.8	-0.5	1.2	2.1
Foreign exchange reserves ex gold (€bn)	10.7	11.2	11.2	12.9	12.7	13.7	13.5	15.7	17.4	18.6	18.9	17.5	19.8
Import cover (months of merchandise imports)	8.5	8.3	8.3	9.3	8.9	8.9	8.2	8.6	8.8	8.9	11.9	9.5	9.5
Debt indicators													
Gross external debt (€bn)	49.4	49.1	47.6	48.5	49.1	48.2	44.7	43.7	42.7	40.9	40.6	42.1	43.2
Gross external debt (% of GDP)	110.1	107.1	106.9	66.0	112.3	108.4	96.9	89.5	82.7	75.4	81.4	83.1	81.3
Gross external debt (% of exports)	555	513	494	509	471	413	358	308	290	266	304	301	288
Lending to corporates/households (% of GDP)	73.2	75.4	71.4	70.5	69.3	65.5	61.2	58.0	56.3	55.5	62.7	65.5	68.2
Interest & exchange rates													
Central bank key rate (year-end, %)	6.00	6.00	6.00	6.00	6.00	6.00	0.50	0.30	0.30	0.30	0.30	0.30	0.30
Broad money supply (average, %YoY)	2.4	1.2	5.7	4.6	3.2	3.8	4.6	3.0	4.7	4.1	7.6	6.5	5.9
3yr yield (average, %)	n/a	n/a	n/a	4.00	3.50	2.50	1.60	1.10	0.40	0.20	0.40	0.30	0.40
10yr yield (average, %)	6.30	6.50	6.10	5.00	4.30	3.60	3.50	2.70	2.10	1.25	0.95	0.65	0.80
USD/HRK exchange rate (year-end)	5.55	5.80	5.73	5.57	6.33	7.01	7.20	6.20	6.45	6.64	6.28	5.88	6.17
USD/HRK exchange rate (average)	5.52	5.31	3.51	5.70	5.78	6.92	6.85	6.55	6.29	6.68	5.996	6.13	6.03
EUR/HRK exchange rate (year-end)	7.38	7.54	7.56	7.63	7.66	7.64	7.56	7.44	7.41	7.44	7.54	7.54	7.54
EUR/HRK exchange rate (average)	7.29	7.44	4.52	7.58	7.63	7.61	7.53	7.46	7.42	7.42	7.55	7.54	7.54

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (%YoY)	2.3	0.2	-15.4	-10.0	-7.0	-5.5	13.5	6.4	4.2	4.4	4.4	3.9	4.0
CPI (eop, %YoY)	1.4	0.6	-0.2	-0.7	0.2	0.2	0.2	0.5	1.4	0.9	1.3	1.4	1.5
Central bank key rate (eop, %)	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
10yr yield (eop, %)	0.60	1.20	1.45	0.80	0.70	0.60	0.60	0.65	0.65	0.70	0.75	0.75	0.80
USD/HRK exchange rate (eop)	6.64	6.94	6.68	6.44	6.18	6.40	6.16	6.01	5.88	5.90	6.00	6.11	6.17
EUR/HRK exchange rate (eop)	7.44	7.63	7.55	7.53	7.54	7.55	7.52	7.51	7.53	7.55	7.50	7.51	7.53

Source: National sources, ING estimates

Czech Republic

Jakub Seidler, Chief Economist Czech Republic

Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (% YoY)	-4.7	-2.1	8.3	2.9	3.3	3.1	4.1
CPI (% YoY)*	2.3	2.4	2.4	2.5	2.9	2.5	1.8
Policy interest rate (%)	0.25	0.25	0.25	0.25	0.75	0.75	1.50
3m interest rate (%)*	0.4	0.4	0.4	0.4	0.9	0.4	1.2
10yr yield (%)*	1.3	2.0	2.3	2.4	2.5	2.1	2.5
USD/CZK*	21.5	22.1	21.1	20.5	19.9	20.9	20.3
EUR/CZK*	26.2	26.1	25.7	25.6	25.5	25.8	25.3

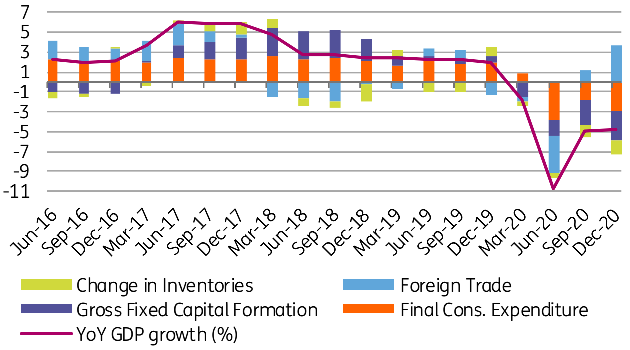
Macro Trend		Political Cycle	Ratings	FC	LC
Activity	▼	Presidential: 2023	S&P	AA-	AA
Fiscal	Looser	Parliamentary: 2021	Moody's	Aa3	Aa3
Monetary	Tighter	Local: 2024	Fitch	AA-	AA-

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

Country strategy

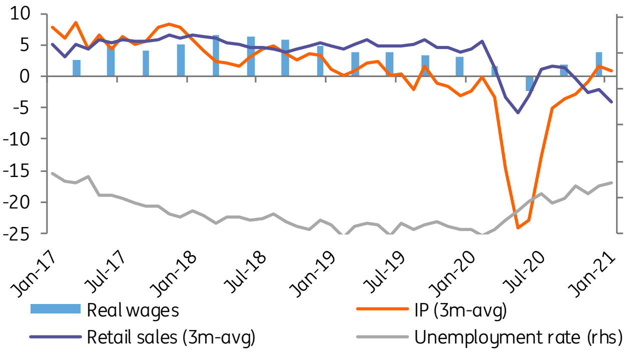
Following a 5.6% GDP contraction in 2020 due to the Covid-19 crisis, we expect the Czech economy to grow by around 3% this year and accelerate further in 2022. Despite a more severe impact from the pandemic being felt in 1Q21, recovery should start in 2Q given vaccination and mass testing of company employees. The unemployment rate remains relatively low due to government measures, which are likely to continue, motivated by general elections in early October. The inflationary outlook has increased due to higher prices of commodities and we expect inflation to average around 2.5% this year. The Czech National Bank is likely to start monetary tightening in the second half of the year, given a prolonged impact of Covid, we see a first hike in 4Q21 and another three in 2022.

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



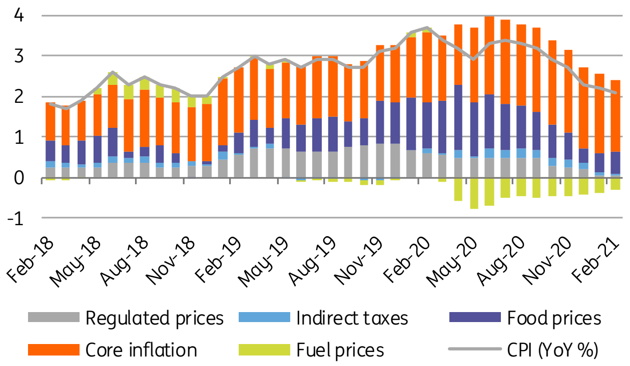
Source: CZSO, ING

Key activity indicators (% YoY)



Source: CZSO, ING

Structure of inflation (ppt)



Source: CZSO, CNB, ING

Macro digest

Czech GDP declined by 4.7% YoY in 4Q20, but despite the second Covid-19 wave, it avoided QoQ contraction due to strong net exports and government spending, each contributing around 1ppt to QoQ growth. For the whole of 2020, household consumption fell by 5.2%, fixed investment by 8.5% and exports and imports by 6%. Government consumption grew by 2.9%. The 2021 outlook remains uncertain due to the pandemic, but recovery from the end of 2Q seems likely and, taking into account the low base from 2020, the economy might grow around 3% this year, and accelerate further in 2022. GDP should return to pre-Covid-19 levels by mid-2022.

The labour market has fared relatively well given the current circumstances, with the unemployment rate increasing from 2.0% in February 2020 to only 3.3 % in January 2021. This is related to government programmes, which have been gradually extended until 2021, so any increase in unemployment this year should be modest. Wage growth slowed just mildly to 4.4% YoY after 6.4% in 2019 given supportive government programmes, exceptional bonuses in the healthcare sector, but also a statistical effect as a result of employees with below-average wages being laid off. In 2021, wages will again push higher with a 4% increase in the minimum wage, higher salaries in the education segment and further one-off bonuses for healthcare, however, companies might be reluctant to increase wages not only due to the Covid crisis, but also lower income tax increasing net wages of employees. Therefore, we anticipate only modest wage growth below 3% this year. Industrial production fell by 7% last year, but a solid recovery started in 2H20, unfortunately set off course by supply chain distributions in the automotive segment at the start of 2021. Car production fell by 12% last year. Retail sales fell just slightly by 0.7% (except car sales falling by 16%), though 1Q21 will remain weak due to prolonged restrictions.

Inflation reached 3.2% in 2020, the highest print since 2012, due to a combination of factors. First, an increase in excise tax for tobacco and alcoholic beverages. Second, a weaker koruna due to the Covid-19 outbreak was pro-inflationary due to increased prices of imported goods. Third, problems with the harvest given Covid-19 measures in some European countries led to higher prices of imported food. Fourth, housing related prices (including electricity) kept growing. A broadly expected slowdown in Czech CPI this year seems to be weaker now due to recent spike in commodity prices including oil. As such, fuel prices might contribute positively around 0.4ppt to YoY CPI having contributed negatively in 2020. We expect CPI around 2.5% but with a caveat given the many uncertainties and both pro- and anti-inflationary forces at play in the Covid-19 crisis.

Czech Republic

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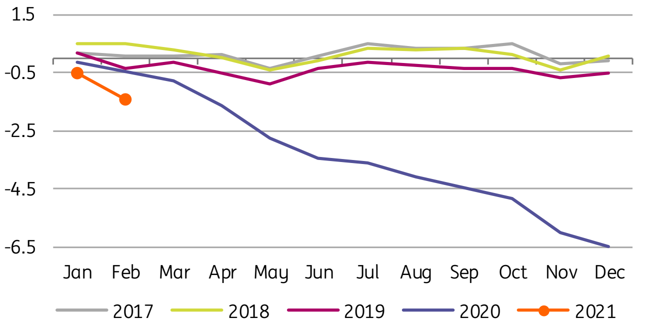
State budget (% of GDP, year-to-date balance)



Source: MinFin, ING

Fiscal watchdog warnings

The state deficit has been revised from an initially planned CZK320bn to CZK500bn. The third Covid-19 wave accounts for an increase in expenditures of CZK80bn, while a lowering of income tax from 20% to 15% will cause a broadly CZK100bn gap in revenues this year. As such, the 2021 deficit is heading towards – but likely slightly below – CZK500bn, or 8% of GDP, and total government indebtedness towards 42% of GDP after 30% in 2019. Though lower income taxes are promised for 2021 and 2022 only, this is not legally anchored. The Czech fiscal watchdog has warned that the current trend might lead to a debt-break of 55% of GDP by 2024, due to a limited public-finance consolidation strategy targeting a lowering of the structural deficit by only 0.5% GDP per year.

Total government measures to end-Dec 2020

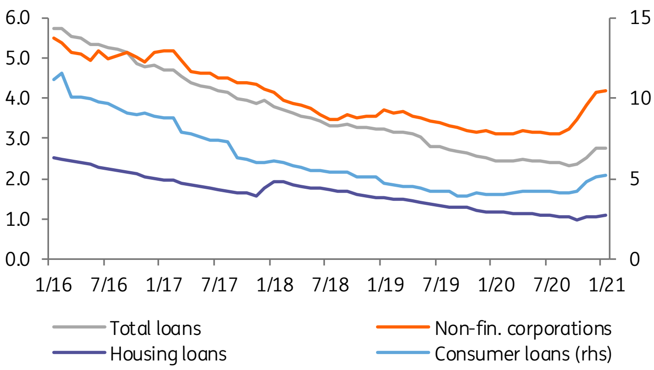
Measures	Central Govt (CZK bn)	Total Govt (CZK bn)	% of GDP
Wage compensations	37.0	37.0	0.7
Compensation for self-employed	16.1	24.4	0.4
Nursing	12.0	12.0	0.2
Tax abolition	7.5	14.4	0.3
Tax deferral	24.0	35.0	0.6
Sectoral help	14.9	8.6	0.2
Healtcare expenditures	58.7	58.7	1.0
Compensation to local governemnts	13.4		0.0
Total	**183.7**	**190.2**	3.4
Loan programs	64.2		1.1
Debt holiday (total volume of loans)	448		7.9

Source: MinFin, CNB, ING

Covid-19 extraordinary measures

The government introduced a set of measures last year to compensate for lockdown restrictions and lower demand related to the Covid crisis. However, impacted companies often complained about delays in support or its insufficient size. The various sectoral measures will be unified this year for companies with sales declines of 50%. Compensation for the self-employed will be doubled. Wage compensation will continue, limiting an increase in unemployment. Total support was around 3.5% of GDP in 2020. Official government figures are slightly higher as they account for items that are not linked to the crisis, eg, cancelling of 4% property transaction tax (CZK11bn gap in revenues), one-off pension increase (CZK15bn) or increasing social security payments (CZK20bn).

Non-performing loans (%)

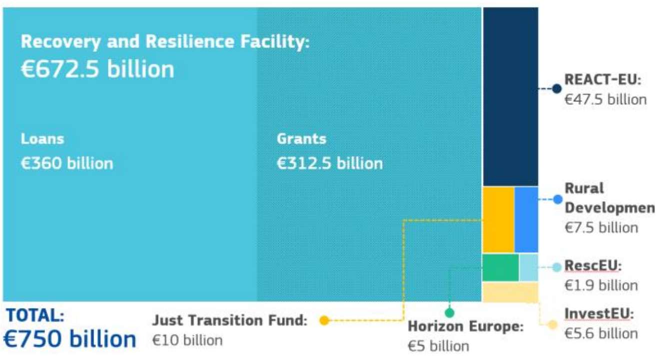


Source: CNB, ING

Credit activity muted except housing loans

New housing loans became a surprising element last year, reaching a record-high in 2020 and increasing by 34% YoY. Administrative measures, such as cancellation of the 4% transaction tax, abolition of income limits by the CNB (both DSTI and DTI) and relaxation of the LTV limit, contributed to the increase. Growth in mortgages reached 8% and was the only segment to show strong growth, while the volume of consumer loans stagnated YoY as well as loans to non-financial corporations. After the debt holiday, which ended in October 2020, non-performing loans increased only slightly, to 4.2% for corporates, 5.2% for consumer and 1.1% for housing loans. The overall banking sector credit portfolio increased from 2.4% to 2.8% over the year, which remains low from an historical context.

Next generation EU



Source: European Commission

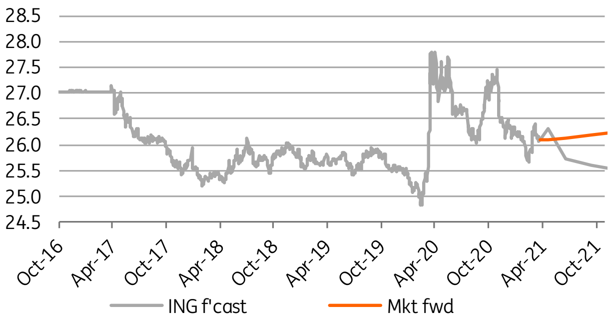
EU funds inflow intensifies due to recovery facility

The next generation EU fund of €750bn consists of a Recovery and Resilience Facility (RRF) of €672.5bn intended to help EU countries to overcome the negative consequences of the Covid crisis. The Czech Republic will receive €7.1bn (3% of GDP) in the form of grants, while a loans facility is not planned to be used by the government. Withdrawing money will be possible after the National Recovery Plan is finalised (deadline end-April). With approval of the EU, 13% of pre-financing might come to the Czech Rep at the end of summer. The rest will be tapped according to fulfilled plans in years ahead. Though the RRF lasts only until 2023, money can be tapped until 2026. 27% of funds in the Czech Rep recovery plan is allocated to digitalisation (minimum demanded 20%) according to the latest available draft.

Czech Republic

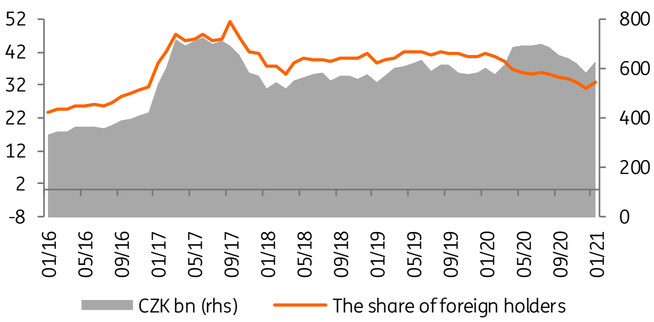
Strategy

FX – spot vs forward and INGF



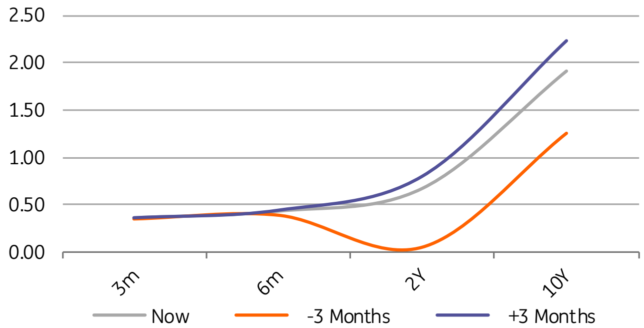
Source: Eikon, ING

Foreign holders of CZGB (%)



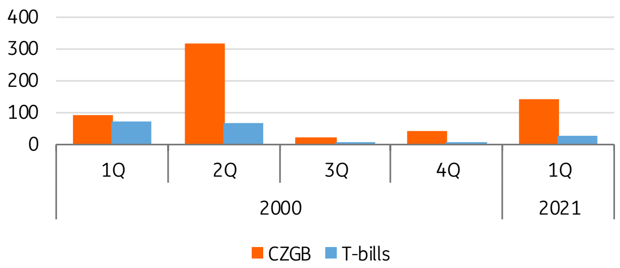
Source: CZSO, ING Bank

Local curve (%)



Source: Eikon, ING

Ministry of Finance issuance activity in 2020-21 (CZK bn)



Source: ING, CNB, MinFin

FX strategy *(with Petr Krpata, Chief EMEA FX and IR Strategist)*

Despite the latest CZK weakness (exaggerated by positioning and, in our view, not overly relevant political comments), the currency remains our top CEE pick. The CNB is still pointing to hikes this year (despite the domestic coronavirus situation) and the currency should eventually receive support from the most fundamentally hawkish central bank in the region (we expect 50bp tightening in 4Q21 and three more 25bp hikes next year).

Importantly, unlike its regional peers, the CNB does not lean against currency strength, with stronger CZK being the CNB's base case and one of the tools to tighten the monetary conditions this year and next. Note that the CNB forecast pencils in EUR/CZK at 25.40 by 4Q this year. Should CZK fail to strengthen in 2Q, the case for a more pronounced CNB tightening will build and, in turn, strengthen CZK.

Compared to the pre-pandemic period, CZK now benefits from the tailwind of the current account surplus. We expect the surplus to remain meaningful this year – around 2% of GDP – largely due to the ongoing partial CNB ban on the dividend payments of local commercial banks.

The non-negligible CZK positioning (the by-product of the FX floor exit) remains the key risk to long CZK positions – as has been evident during the periods of risk aversion in past years, with CZK overacting on the downside as heavy longs have been squeezed.

Czech Republic

Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (% YoY)	2.3	1.8	-0.7	0.0	2.3	5.5	2.5	5.4	3.2	2.2	-5.6	3.1	4.1
Private consumption (% YoY)	1.3	0.4	-1.1	0.9	1.4	3.9	3.7	4.0	3.3	2.9	-5.2	2.9	2.5
Government consumption (% YoY)	0.8	-3.5	-1.9	2.4	1.0	1.8	2.5	1.8	3.8	2.2	2.9	1.7	1.2
Investment (% YoY)	0.2	1.1	-3.2	-2.1	3.3	9.8	-3.1	5.1	10.0	2.2	-8.5	2.7	4.5
Industrial production (% YoY)	8.6	6.1	-0.7	0.1	5.0	4.3	3.6	6.5	3.2	-0.1	-7.2	5.5	3.5
Unemployment rate (year-end, %)	6.9	6.5	7.0	6.8	5.8	4.5	3.5	2.3	2.2	2.0	3.1	3.4	3.3
Nominal GDP (CZKbn)	3,989	4,058	4,088	4,142	4,345	4,627	4,795	5,117	5,416	5,751	5,652	5,990	6,341
Nominal GDP (€bn)	158	165	163	160	158	170	177	194	211	224	214	232	251
Nominal GDP (US$bn)	209	230	209	212	210	188	196	218	249	251	243	286	312
GDP per capita (US$)	19,868	21,870	19,881	20,167	19,925	17,873	18,570	20,623	23,457	23,545	22,793	26,729	29,085
Gross domestic saving (% of GDP)	30.2	31.0	31.2	30.6	32.0	33.1	32.5	33.7	33.4	33.1	31.2	31.6	33.5
Prices													
CPI (average, % YoY)	1.5	1.9	3.3	1.4	0.4	0.3	0.7	2.5	2.1	2.8	3.2	2.5	1.8
CPI (year-end, % YoY)	2.3	2.4	2.4	1.4	0.1	0.1	2.0	2.4	2.0	3.2	2.3	2.9	1.9
Wage rates (nominal, % YoY)	2.2	2.5	2.5	-0.1	2.9	3.2	4.4	6.7	8.2	6.4	4.4	2.8	3.5
Fiscal balance (% of GDP)													
Consolidated government balance	-4.2	-2.7	-3.9	-1.3	-2.1	-0.6	0.7	1.5	0.9	0.3	-6.0	-7.7	-4.6
Consolidated primary balance	-3.1	-1.4	-2.5	0.1	-0.6	0.4	1.5	2.3	1.6	1.0	-5.3	-6.9	-3.8
Total public debt	37.1	39.8	44.2	44.4	41.9	39.7	36.6	34.2	32.0	30.2	35.4	41.8	45.1
External balance													
Exports (€bn)	87	99	104	103	110	116	118	129	136	139	130	139	146
Imports (€bn)	85	96	100	97	102	109	109	119	129	130	119	127	130
Trade balance (€bn)	1.6	3.1	4.9	6.5	8.0	6.9	9.6	9.8	7.9	9.3	10.8	12.1	16.0
Trade balance (% of GDP)	1.0	1.9	3.0	4.1	5.1	4.0	5.4	5.0	3.7	4.2	5.1	5.2	6.4
Current account balance (€bn)	-5.7	-3.5	-2.5	-0.8	0.3	0.7	3.2	2.9	1.0	0.7	7.8	5.0	-1.6
Current account balance (% of GDP)	-3.6	-2.1	-1.6	-0.5	0.2	0.4	1.8	1.5	0.5	0.3	3.7	2.2	-0.6
Net FDI (€bn)	3.8	1.9	4.8	-0.3	2.9	-1.8	6.9	1.7	2.0	5.3	2.7	2.5	2.8
Net FDI (% of GDP)	2.4	1.1	3.0	-0.2	1.9	-1.1	3.9	0.9	0.9	2.4	1.3	1.1	1.1
Current account balance plus FDI (% of GDP)	-1.2	-1.0	1.4	-0.7	2.0	-0.7	5.7	2.4	1.4	2.7	4.9	3.2	0.5
Foreign exchange reserves ex gold (€bn)	32	31	34	41	45	60	81	123	125	133	136	136	139
Import cover (months of merchandise imports)	4.4	3.8	4.1	5.1	5.3	6.6	8.9	12.4	11.6	12.3	13.6	12.9	12.8
Debt indicators													
Gross external debt (€bn)	86	90	97	100	106	115	129	171	172	173	165	168	171
Gross external debt (% of GDP)	55	54	60	62	67	68	73	88	81	77	77	72	68
Gross external debt (% of exports)	99	90	93	97	96	100	109	132	126	124	127	121	117
Lending to corporates/households (% of GDP)	45.3	47.4	48.1	49.4	48.4	48.5	49.9	49.8	50.3	49.8	53.4	52.1	50.4
Interest & exchange rates													
Central bank key rate (year-end, %)	0.75	0.75	0.05	0.05	0.05	0.05	0.05	0.50	1.75	2.00	0.25	0.75	1.50
Broad money supply (average, % YoY)	1.5	2.1	5.6	4.7	5.4	7.9	8.6	9.5	5.3	6.9	9.8	10.1	7.0
3m interest rate (Pribor, average, %)	1.3	1.2	1.0	0.5	0.4	0.3	0.3	0.4	1.3	2.1	0.9	0.4	1.2
3m interest rate spread over Euribor (ppt)	51	-15	36	23	17	33	54	73	158	247	130	93	169
2yr yield (average, %)	1.7	1.6	1.0	0.3	0.3	-0.1	-0.3	-0.2	1.1	1.5	0.6	0.9	1.1
10yr yield (average, %)	3.9	3.8	2.9	2.1	1.6	0.7	0.5	1.0	2.0	1.6	1.2	2.1	2.5
USD/CZK exchange rate (year-end)	18.7	19.8	19.0	19.9	22.9	24.9	25.7	21.3	22.4	22.7	21.5	19.9	20.5
USD/CZK exchange rate (average)	19.1	17.7	19.6	19.5	20.7	24.6	24.4	23.4	21.7	22.9	23.2	20.9	20.3
EUR/CZK exchange rate (year-end)	25.0	25.6	25.1	27.3	27.7	27.0	27.0	25.5	25.7	25.4	26.2	25.5	25.0
EUR/CZK exchange rate (average)	25.3	24.6	25.1	25.9	27.5	27.3	27.0	26.4	25.6	25.7	26.5	25.8	25.3

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (% YoY)	2.0	-1.8	-10.8	-4.9	-4.7	-2.1	8.3	2.9	3.3	4.8	4.6	3.5	3.3
CPI (eop, % YoY)	3.2	3.4	3.3	3.2	2.3	2.4	2.4	2.5	2.9	2.2	1.7	2.0	1.9
Central bank key rate (eop, %)	2.00	1.00	0.25	0.25	0.25	0.25	0.25	0.25	0.75	1.00	1.00	1.25	1.50
3m interest rate (eop, %)	2.2	1.0	0.3	0.4	0.4	0.4	0.4	0.4	0.9	1.2	1.2	1.4	1.7
10yr yield (eop, %)	1.6	1.5	0.8	0.9	1.3	2.0	2.3	2.4	2.5	2.5	2.5	2.6	2.6
USD/CZK exchange rate (eop)	22.7	24.8	23.7	23.1	21.5	22.1	21.1	20.5	19.9	19.8	20.2	20.5	20.5
EUR/CZK exchange rate (eop)	25.4	27.4	26.7	27.1	26.2	26.1	25.7	25.6	25.5	25.4	25.3	25.2	25.0

Source: National sources, ING estimates

Hungary

Péter Virovácz, Chief Economist, Hungary

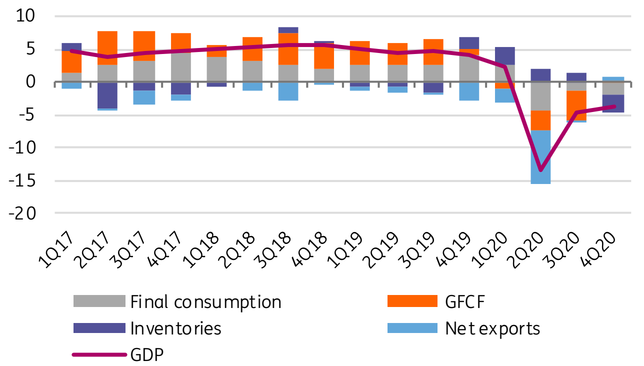
Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (%YoY)	-3.6	-5.0	15.6	5.5	5.6	5.4	6.0
CPI (%YoY)*	2.7	3.4	4.6	4.2	4.0	4.0	2.8
Policy interest rate (eop, %)	0.60	0.60	0.60	0.60	0.60	0.60	0.60
3m interest rate (%)*	0.75	0.77	1.20	1.20	1.00	1.04	1.00
10yr yield (%)*	2.08	2.85	3.00	3.00	3.10	2.81	3.20
USD/HUF*	297.4	309.3	295.1	292.0	289.1	296.3	300.0
EUR/HUF*	362.6	365.0	360.0	365.0	370.0	364.5	375.0

Macro Trend		Political Cycle	Ratings	FC	LC
Activity	▲	Presidential: 2022	S&P	BBB	BBB
Fiscal	Loose	Parliamentary: 2022	Moody's	Baa3	Baa3
Monetary	Loose	Local: 2024	Fitch	BBB	BBB

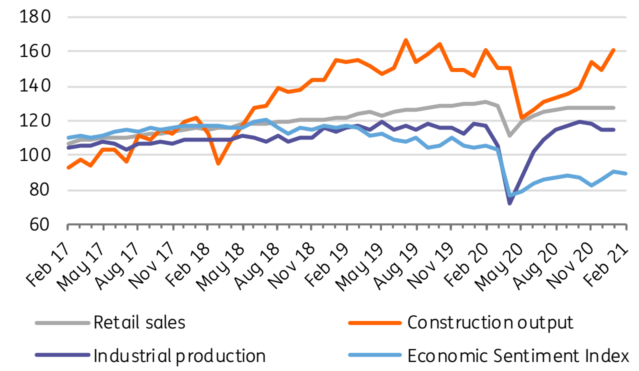
*Quarterly data is eop, annual is avg Source: National sources, ING estimates

Contribution to YoY GDP growth (ppt)



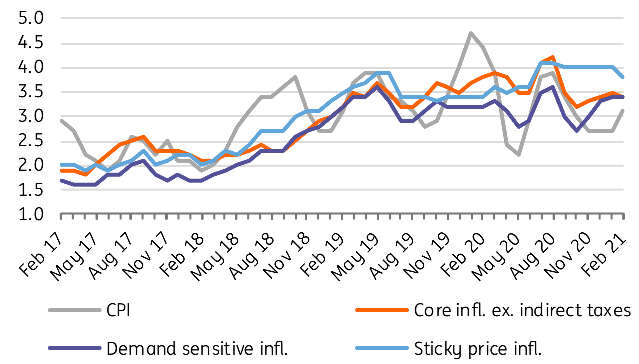
Source: Hungarian Central Statistical Office

Key activity indicators (swda; 2015 = 100%)



Source: Eurostat, Hungarian Central Statistical Office

Headline and underlying measures of inflation (% YoY)



Source: National Bank of Hungary

Country strategy

Following 4.6% YoY GDP growth in 2019, the Hungarian economy saw a 5% YoY recession in 2020 as a result of the Covid-19 pandemic. This was a better-than-expected outcome, mainly spurred by export and investment activities. The atypically high fiscal deficit last year helped reduce damage in the labour market, while central bank moves alleviated the credit risks. Despite a third wave hitting in 1Q21, we see a 5.4% YoY rebound in economic activity for the year. Financial markets will focus on inflation, which we expect to average 4% YoY in 2021 due to supply side issues and energy price shocks. That could reignite underperformance of the forint, pushing the NBH to hike the 1-week deposit rate. As parliamentary elections are due in 2022, effective fiscal consolidation won't start this year.

Macro digest

Hungarian GDP shrank by 5% on a yearly basis in 2020. The pandemic and related containment measures not only rewrote the record books in several ways but resulted in a torn economy. Although value added of services dipped 'only' 4.8% YoY, in-person activities had a tougher outcome. The hospitality sector saw a 32% YoY drop, while the IT sector closed the year with 6% YoY growth. Construction faced structural issues during the year, while industry had already returned to its pre-crisis level by the end of the year.

On the final use side, volume of consumption took a severe hit, ending with a 2.5% YoY drop in 2020 as real disposable incomes shrank due to the increased unemployment rate and higher share of part-time jobs. Uncertainty pushed precautionary savings higher among households, but corporates decided to accelerate forwards, ramping up investment activity during the second half of the year, having a higher gross fixed capital formation in 4Q than a year ago.

Due to the strong fourth quarter GDP performance, the carry-over effect in 2021 could be 2.2%, a record high. On top of that, we see significant growth potential in the economy this year despite the third wave of Covid-19 bringing a new round of tighter containment measures. The projected 5.4% YoY GDP growth will be mainly driven by domestic demand. Consumption will rebound on pent-up demand of households, while government consumption remains elevated as there is a general election in the Spring of 2022. The latter will push public investments higher too, especially with the expected run-up of EU projects via the RRF facility. Investment activity will be supported via low interest rates, housing and lending programmes too for both households and corporates. All of these will carry over into 2022 with further support from net exports, translating into a 6% year-on-year GDP growth, on our forecasts.

Headline inflation has started to pick up during the first months of 2021. In the meantime, core CPI has remained elevated, hovering just above the top of the target range. Low base, rising oil prices and 're-opening' inflation might push the year-on-year CPI up further, to 5% in May, and keep the core reading above 4% YoY. The third wave of Covid-19 with its stricter lockdown measures could mean further disruption in the supply side, translating into an even higher supply-demand mismatch than we thought earlier. This will dampen competitiveness mainly in in-person activities, lifting the pricing power of sellers. This could mean an average of 4% headline inflation in 2021. We see the supply side and energy price shocks as temporary, so expect inflation to reach the 3% target again by early 2022 and to post a 2.8% average during that year.

Hungary

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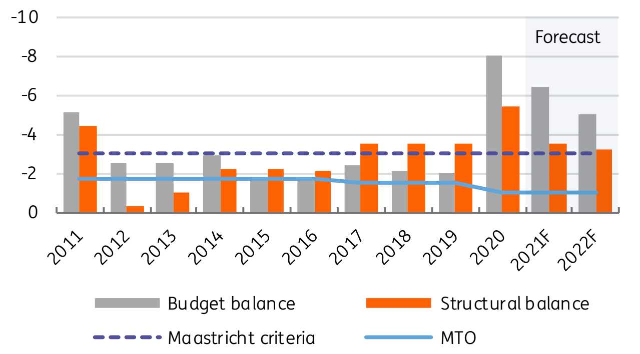
Budget and structural balance of general government (%)

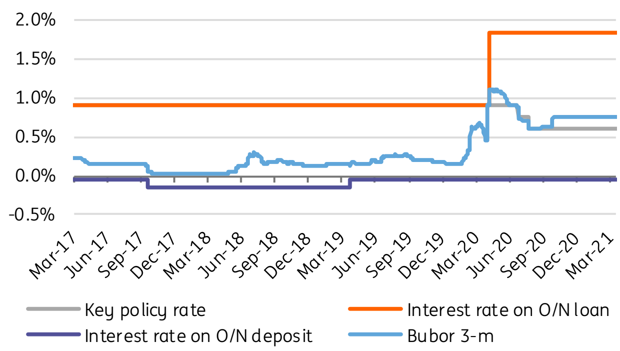


Source: AMECO, National Bank of Hungary, ING estimates

Fiscal consolidation starts in small steps

The government set a 6.5% deficit-to-GDP goal this year, after registering a 10-year high 8.1% shortfall in 2020. The crisis also erased a decade of progress in debt reduction. After a 65.4% debt-to-GDP ratio, we saw an 81% debt level in 2020. The consolidation will be slow, based on the government's projection, so the focus will remain on helping the economy to push for improvement in fiscal metrics. It hardly comes as a surprise knowing that 2022 is an election year. Last year's extra issuances in HGBs and REPHUNs paved the way for positive fiscal impetus this year without putting too much pressure on the wholesale bond market. The majority of this year's shortfall will be spent on public investment projects, part of this being EU-project related spending.

Benchmark policy rate and interest rate corridor

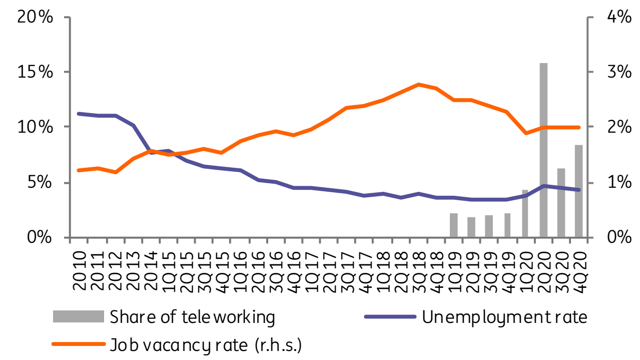


Source: National Bank of Hungary

The central bank is in a delicate situation

The National Bank of Hungary's monetary policy for a high-pressure economy translated into persistently high underlying inflation by 2020. This has left the central bank in a delicate situation; inflation is elevated, rates are low, so HUF is vulnerable. Any FX weakness will add to the inflation pressure, meaning tightening might be needed. On the other hand, any premature tightening could suffocate the fragile economic rebound. We see the central bank trying to sit out this year's storm where CPI could be 4% on average. An upward adjustment in the 1-week deposit rate might be needed before the reopening triggers a global risk-on mood, weakening the dollar and helping EM FX, including the forint. Effective monetary policy consolidation might start after the general election at the earliest.

Unemployment, job vacancy and telework

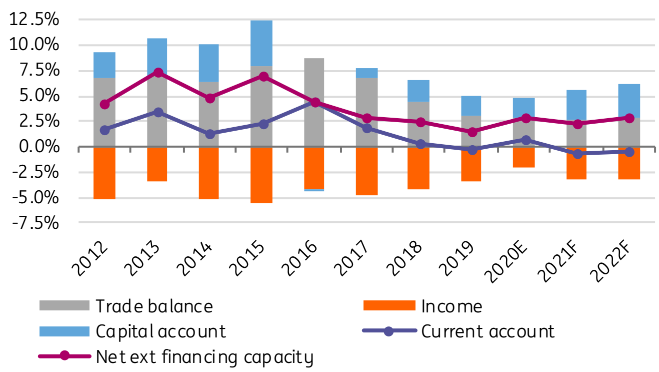


Source: Hungarian Central Statistical Office

Labour market is challenged by the latest Covid-19 wave

For the labour market, 2020 was quite a mixed year. The average wage growth was 9.7%, as a legacy of the previous year's labour shortage and the 8% hike in minimum wage. The unemployment rate peaked at 5.1% in June 2020 before it started to drop. The second wave, however, had pushed it back to 5% by January this year. With that Hungary is still among the best performers in terms of the labour market, due to the strong starting point, fiscal support and the quick spread of the working-from-home concept. Looking forwards, the third wave and new round of lockdowns might have a strong impact on the job market, especially in-person services. The unemployment rate could move higher only temporarily, but this would keep the wage growth low (around 4.5%) in 2021.

Structure of the current account (% of GDP)



Source: Government Debt Management Agency, ING

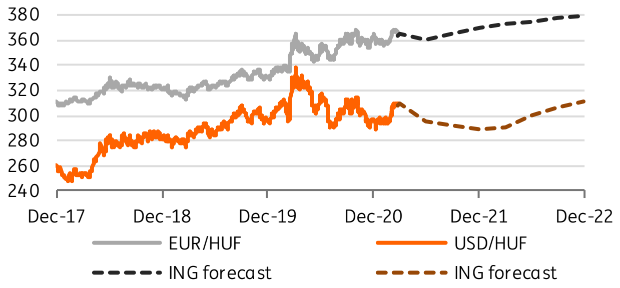
Current account's move into surplus is only temporary

After nine years in surplus, the current account dropped into deficit in 2019 but was back in surplus in 2020. The balance of goods improved significantly on the depleted domestic demand due to the Covid-19 crisis. The absence of tourism cut the surplus in services to its lowest level since 2013. With this, the trade account balance eventually became worse than a year ago. So, the most important factor behind the improving current account balance was primary and secondary incomes. As we expect a strong economic rebound in 2021-22 driven by domestic demand (with high import ratio), the current account balance should drop back into negative. Ongoing export related FDI developments and improving tourism, however, should cut the 0.7% of GDP current account deficit to 0.4% by 2022.

Hungary

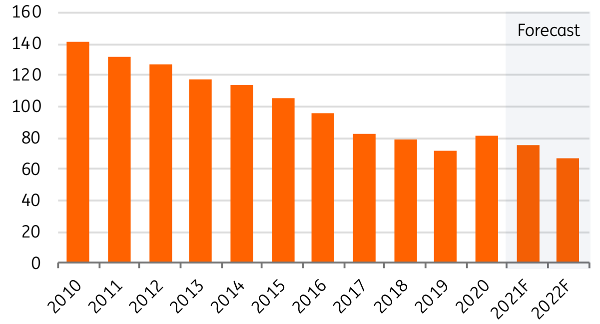
Strategy

FX – spot and INGF



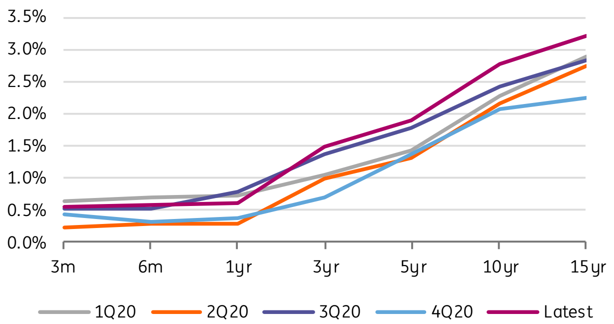
Source: National Bank of Hungary, ING estimates

Evolution of gross external debt (% of GDP)



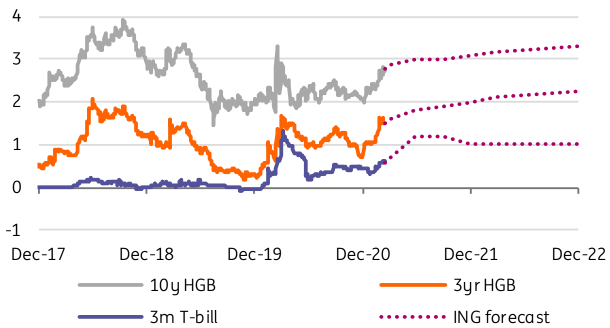
Source: National Bank of Hungary, ING estimates

Local curve (%)



Source: Government Debt Management Agency

Rates – spot and INGF



Source: Government Debt Management Agency, ING estimates

FX strategy *(with Petr Krpata, Chief EMEA FX and IR Strategist)*

The upcoming spike in Hungarian CPI (to 5% expected in April and May) will depress the HUF real rate and weigh on the currency. While this is likely to eventually lead to emergency rate hikes, the hikes will need to be preceded by the FX weakness. EUR/HUF 370 is an important level to watch, but we are not 100% convinced that this is a line in the sand per se given that HUF weakness of past weeks was in large part caused by external, not domestic, drivers (UST sell-off). Only once the EUR/HUF decline becomes more disorderly, is a policy response likely, in our view.

Unlike its free-floating CEE peers (CZK, PLN), the Hungarian current account position will return to deficit this year. This remains a clear negative for the forint, putting downside pressure on the currency. We therefor expect EUR/HUF to start flirting with the 370 level in 2Q21 and, coupled with the inflation data deterioration, this should eventually cause a reactive tightening by the NBH, in turn stabilising the HUF throughout the summer.

However, the more stable HUF is going to be, the more likely it is that the NBH eventually reverses the FX stabilising hikes (as was the case last year) in turn taking a degree of protection away from the currency. Hence, we look for more HUF weakness later this year as the NBH reverses the prior hikes (likely in 4Q21).

Hungary forecasts

Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (%YoY)	1.1	1.9	-1.4	1.9	4.2	3.8	2.1	4.3	5.4	4.6	-5.0	5.4	6.0
Private consumption (%YoY)	-1.2	0.8	-2.4	-0.2	2.5	3.7	4.8	4.7	4.8	4.6	-2.5	5.5	6.4
Government consumption (%YoY)	2.3	0.1	0.0	6.0	9.8	1.1	0.3	3.5	1.8	4.7	2.0	3.4	3.7
Investment (%YoY)	-9.5	-1.3	-3.0	9.8	12.2	4.9	-10.6	19.7	16.4	12.2	-7.3	8.5	10.0
Industrial production (%YoY)	10.6	5.6	-1.8	1.1	7.7	7.4	0.9	4.6	3.5	5.6	-6.1	13.5	7.0
Unemployment rate (year-end, %)	10.9	10.8	10.7	9.2	7.2	6.2	4.5	3.8	3.6	3.4	4.2	4.0	3.6
Nominal GDP (HUFbn)	27,431	28,502	28,920	30,291	32,742	34,937	36,167	39,233	43,347	47,514	47,605	52,684	58,637
Nominal GDP (€bn)	100	102	100	102	106	113	116	127	136	146	136	145	156
Nominal GDP (US$bn)	132	142	128	135	141	125	129	143	160	163	155	178	195
GDP per capita (US$)	13,179	14,224	12,935	13,687	14,272	12,701	13,094	14,615	16,408	16,730	15,856	18,308	20,182
Gross domestic saving (% of GDP)	20.9	21.0	20.9	24.4	24.6	25.7	25.8	25.2	27.2	27.8	26.7	24.7	25.2
Prices													
CPI (average, %YoY)	4.9	3.9	5.7	1.7	-0.2	-0.1	0.4	2.4	2.8	3.4	3.3	4.0	2.8
CPI (year-end, %YoY)	4.7	4.1	5.0	0.4	-0.9	0.9	1.8	2.1	2.7	4.0	2.7	4.0	2.8
Wage rates (nominal, %YoY)	1.3	5.2	4.7	3.4	3.0	4.3	6.1	12.9	11.3	11.4	9.7	4.5	9.0
Fiscal balance (% of GDP)													
Consolidated government balance	-4.5	-5.2	-2.5	-2.5	-2.9	-1.9	-1.8	-2.4	-2.1	-2.1	-8.1	-6.5	-5.0
Consolidated primary balance	-0.3	-1.1	2.2	1.9	1.2	1.4	1.3	0.2	0.2	0.2	-6.5	-3.7	-3.0
Total public debt	80.2	80.4	78.4	77.4	76.7	75.8	74.9	72.2	69.1	65.5	81.0	78.6	74.6
External balance													
Exports (€bn)	71.4	80.0	80.0	81.3	84.5	90.5	93.0	100.7	104.9	109.1	104.5	112.3	120.6
Imports (€bn)	65.9	72.9	73.3	74.7	78.2	81.9	83.3	92.6	99.3	104.8	98.7	107.1	114.8
Trade balance (€bn)	5.5	7.1	6.7	6.6	6.3	8.6	9.7	8.1	5.5	4.3	5.8	5.3	5.7
Trade balance (% of GDP)	5.5	6.9	6.7	6.4	5.9	7.6	8.4	6.4	4.1	3.0	4.3	3.6	3.7
Current account balance (€bn)	0.3	0.6	1.6	3.6	1.3	2.6	5.2	2.5	0.4	-0.7	0.1	-1.0	-0.7
Current account balance (% of GDP)	0.3	0.6	1.6	3.5	1.2	2.3	4.5	2.0	0.3	-0.5	0.1	-0.7	-0.4
Net FDI (€bn)	1.4	1.7	4.1	2.1	5.1	2.3	3.9	5.1	5.5	2.9	2.3	4.1	5.0
Net FDI (% of GDP)	1.4	1.7	4.1	2.0	4.9	2.0	3.3	4.0	4.1	2.0	1.7	2.8	3.2
Current account balance plus FDI (% of GDP)	1.6	2.3	5.7	5.5	6.0	4.4	7.8	6.0	4.4	1.5	1.8	2.1	2.7
Foreign exchange reserves ex gold (€bn)	32.3	35.1	31.8	32.6	33.7	30.0	24.0	22.6	25.8	26.5	31.8	29.6	28.5
Import cover (months of merchandise imports)	5.9	5.8	5.2	5.2	5.2	4.4	3.5	2.9	3.1	3.0	3.9	3.3	3.0
Debt indicators													
Gross external debt (€bn)	140.5	135.3	127.6	119.8	121.0	119.3	110.9	105.6	108.0	105.7	110.9	107.9	107.0
Gross external debt (% of GDP)	141	133	128	117	114	106	96	83	79	72	82	75	68
Gross external debt (% of exports)	197	169	160	147	143	132	119	105	103	97	106	96	89
Lending to corporates/households (% of GDP)	58.9	57.0	48.9	44.7	41.2	33.8	32.3	31.4	31.4	32.4	36.7	37.1	36.9
Interest & exchange rates													
Central bank key rate (year-end, %)	5.75	7.00	5.75	3.00	2.10	1.35	0.90	0.90	0.90	0.90	0.60	0.60	0.60
Broad money supply (average, %YoY)	2.8	2.5	-1.3	4.1	4.1	4.7	4.6	9.6	13.9	7.5	14.5	12.0	7.9
3m interest rate (Bubor, average, %)	5.50	6.19	7.00	4.32	2.41	1.61	0.99	0.15	0.12	0.19	0.70	1.04	1.00
3m interest rate spread over Euribor(ppt)	470	485	636	409	222	163	124	47	43	54	114	154	145
3yr yield (average, %)	6.7	7.0	7.5	4.8	3.6	2.1	1.5	0.9	1.3	0.8	1.0	1.6	2.0
10yr yield (average, %)	7.3	7.6	7.9	5.9	4.8	3.4	3.1	3.0	3.1	2.5	2.2	2.8	3.2
USD/HUF exchange rate (year-end)	208.7	240.7	220.9	215.7	259.1	286.6	293.7	258.8	280.9	294.7	297.4	289.1	311.5
USD/HUF exchange rate (average)	208.2	200.9	225.4	223.7	232.5	279.5	281.4	274.3	270.3	290.7	307.9	296.3	300.0
EUR/HUF exchange rate (year-end)	278.8	311.1	291.3	296.9	314.9	313.1	311.0	310.1	321.5	330.5	365.1	370.0	380.0
EUR/HUF exchange rate (average)	275.4	279.2	289.4	296.9	308.7	309.9	311.5	309.2	318.9	325.4	351.2	364.5	375.0

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (%YoY)	4.2	2.3	-13.4	-4.6	-3.6	-5.0	15.6	5.5	5.6	8.2	5.6	5.3	4.8
CPI (eop, %YoY)	4.0	3.9	2.9	3.4	2.7	3.4	4.6	4.2	4.0	2.9	2.6	2.7	2.8
Central bank key rate (eop, %)	0.90	0.90	0.75	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
3m interest rate (eop, %)	0.16	0.46	0.74	0.77	0.75	0.77	1.20	1.20	1.00	1.00	1.00	1.00	1.00
10yr yield (eop, %)	2.06	2.75	2.21	2.43	2.08	2.85	3.00	3.00	3.10	3.15	3.20	3.25	3.30
USD/HUF exchange rate (eop)	294.7	327.1	317.8	311.4	297.4	309.3	295.1	292.0	289.1	291.0	300.0	306.9	311.5
EUR/HUF exchange rate (eop)	331.0	360.7	354.5	363.5	362.6	365.0	360.0	365.0	370.0	372.5	375.0	377.5	380.0

Source: National sources, ING estimates

Kazakhstan

Dmitry Dolgin, Chief Economist, Russia & CIS

Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (%YoY)	-2.2	0.8	3.1	3.1	2.4	3.2	3.7
CPI (%YoY)*	7.5	7.0	6.5	6.3	6.1	6.7	6.1
Policy interest rate (%)	9.00	9.00	9.00	9.00	9.00	9.00	9.25
3m interest rate (%)*	10.00	10.00	10.00	10.00	10.00	10.00	10.05
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT*	421	423	416	416	413	418	412
EUR/KZT*	515	499	508	519	529	514	516

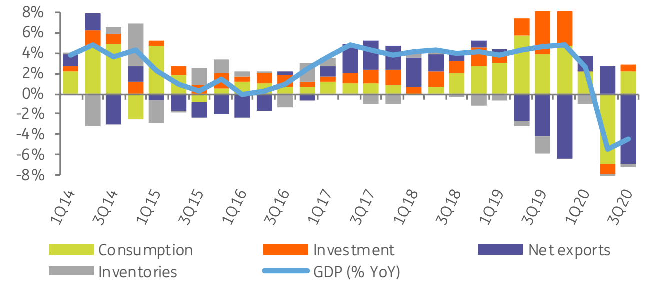
Macro Trend		Political Cycle	Ratings	FC	LC
Activity	▲	Presidential: 2024	S&P	BBB-	BBB-
Fiscal	Easing	Parliamentary: 2026	Moody's	Baa3	Baa3
Monetary	Neutral	Local:	Fitch	BBB	BBB

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

Country strategy

The economic recovery in Kazakhstan is ongoing but pressured by extended lockdowns, low vaccination rates, and by limited room for recovery in oil output this year. The good news is that despite the fiscal stimulus of 9% of GDP in 2020, the government preserved its financial strengths and, given the recovery in the oil price, we see room for a softer-than-expected approach to spending this year, which may provide an additional boost to growth. High oil prices should reinforce the position of the budget and tenge, allowing for better resilience against any global negativity, however the capital account transparency is a watch factor. Despite the relatively stable tenge, CPI in Kazakhstan is facing elevated risks, in line with global trends, which suggests no further room for monetary easing.

GDP growth and major contributors (% YoY)

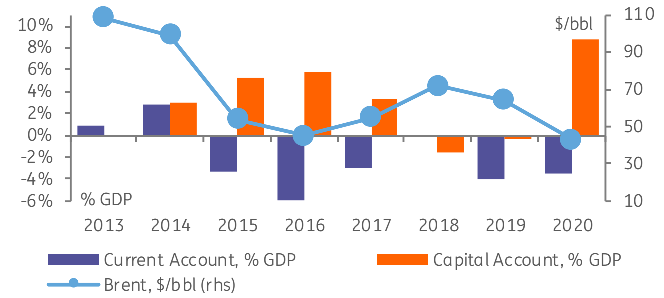


Source: CEIC, ING

Pace of GDP recovery is limited by Covid-19 risk

GDP dropped 2.6% YoY in 2020, underperforming our expectations due to prolonged lockdown measures. Oil industry output decreased by 5.4% versus 2019 because of the OPEC+ restrictions and low demand, and for this year we do not expect material recovery. This year we expect GDP growth of 3.2% YoY on catch-up effects, but a higher rate would be challenging given muted activity in 1Q21 on severe weather conditions and quarantine restrictions amid extremely low vaccination rates. Meanwhile, the country's strong fiscal position could be used for additional stimulus. While the current fiscal plan guides for consolidation, the higher-than-expected oil price environment allows for additional spending within 3% of GDP.

Balance of payments and oil price

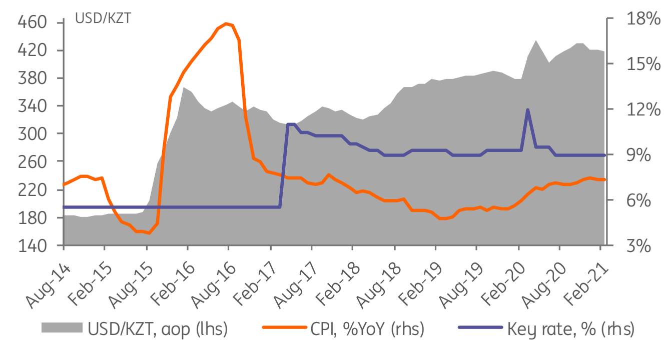


Source: CEIC, ING

BoP benefit from high oil price

The current account deficit narrowed to 3.5% of GDP in 2020 versus 4.0% in 2019, as the drop in oil prices was offset by imports, a decline in the profit repatriation by foreign producers and US$1.3 bn in legal awards. Net capital inflow totalled 8.7% of GDP, represented by the reduction in foreign assets by the government, which however was largely offset by grey outflows (errors and omissions) by the private sector. Given the US$9/bbl upgrade in ING's 2021 oil price forecast, we see Kazakhstan's current account deficit narrowing to -1.8% of GDP in 2021 even despite the restrained oil output and exports. The capital account remains the main source of uncertainty for Kazakhstan's balance of payments.

USD/KZT, CPI and NBK rate (%)



Source: CEIC, ING

CPI risks are obstacles to monetary easing

Given the strengthening of the current account and that the high KZT oil price of 26.9thousand/bbl is comfortable for the budget, USD/KZT insulation from the global core rate negativity appears relatively high, allowing us to expect KZT stability within the 410-420 range. Meanwhile, despite a stable tenge, local CPI picked up to 7.4% YoY in February 2021, responding to global agro price trends and negative developments in the global non-food supply chain. Most of the price pick up is temporary, and we expect CPI to return to the 6.0-6.5% YoY range by the end of 2021. However, this still means CPI above the NBK target range of 4.0-6.0%. This suggests that the NBK's monetary stance should remain at least unchanged in 2021, with a view to tightening in 2022.

Kazakhstan

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Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (%YoY)	7.3	7.4	4.8	6.0	4.2	1.2	1.1	4.1	4.1	4.5	-2.6	3.2	3.7
Private consumption (%YoY)	11.8	12.0	10.1	10.6	1.1	1.8	1.2	1.2	6.1	6.1	-5.0	3.5	3.9
Government consumption (%YoY)	2.7	11.9	13.5	1.7	9.8	2.4	2.3	1.9	-14.1	15.5	13.9	1.7	2.1
Investment (%YoY)	-3.0	2.9	4.1	6.9	4.2	3.7	2.0	5.8	17.5	8.5	-3.0	3.1	2.2
Industrial production (%YoY)	9.6	3.8	0.7	2.5	0.3	-1.6	-1.1	7.3	4.4	4.1	-0.7	2.5	3.1
Unemployment rate (year-end, %)	5.8	5.4	5.3	5.2	5.1	4.9	5.0	4.9	4.8	4.8	6.1	4.9	4.8
Nominal GDP (KZTbn)	21,816	28,243	31,015	35,999	39,676	40,884	46,971	54,379	61,820	69,533	70,134	77,246	84,963
Nominal GDP (€bn)	112	145	157	171	177	116	133	138	146	163	137	150	165
Nominal GDP (US$bn)	148	191	206	234	218	127	141	163	166	181	167	185	206
GDP per capita (US$)	9,106	11,580	12,309	13,726	12,612	7,207	7,893	9,014	9,076	9,764	9,350	10,226	11,248
Gross domestic saving (% of GDP)	43.8	47.3	43.5	39.9	40.8	34.6	33.8	36.9	39.6	38.9	38.0	39.5	40.2
Prices													
CPI (average, %YoY)	15.3	16.0	12.5	7.8	10.9	4.1	13.4	5.5	6.0	5.2	6.8	6.7	6.1
CPI (year-end, %YoY)	7.8	7.4	6.0	4.8	7.4	13.6	8.5	7.1	5.3	5.4	7.5	6.1	6.0
Wage rates (nominal, %YoY)	15.3	16.0	12.5	7.8	10.9	4.1	13.4	5.5	7.9	14.8	13.8	5.3	5.6
Fiscal balance (% of GDP)													
Consolidated government balance	8.0	9.9	8.3	7.6	6.1	9.6	-4.4	-4.1	2.6	-0.4	-3.7	-0.8	-0.6
Consolidated primary balance	8.4	10.4	8.7	8.1	6.7	10.3	-3.3	-3.2	3.6	0.5	-2.6	0.1	0.2
Total public debt	14.4	11.6	12.3	12.3	14.3	22.1	24.4	25.4	26.4	24.4	29.6	27.4	28.3
External balance													
Exports (US$bn)	60.3	84.3	86.4	84.7	79.5	46.0	36.7	48.5	61.1	58.1	46.9	58.2	64.9
Imports (US$bn)	31.1	36.9	46.4	48.8	41.3	30.6	25.4	29.6	33.7	39.7	38.1	38.0	41.8
Trade balance (US$bn)	29.1	47.4	40.1	35.9	38.2	15.4	11.4	18.9	27.5	18.4	8.9	20.2	23.2
Trade balance (% of GDP)	19.7	24.8	19.4	15.4	17.5	12.2	8.1	11.6	16.5	10.1	5.3	10.9	11.2
Current account balance (US$bn)	1.4	10.2	2.2	2.0	6.1	-6.0	-8.1	-5.1	-0.1	-7.2	-5.9	-3.4	-4.5
Current account balance (% of GDP)	0.9	5.3	1.1	0.8	2.8	-4.7	-5.8	-3.1	-0.1	-4.0	-3.5	-1.8	-2.2
Net FDI (US$bn)	3.7	8.6	11.9	8.0	4.7	3.3	13.7	3.8	4.7	5.4	4.9	3.7	4.0
Net FDI (% of GDP)	2.5	4.5	5.7	3.4	2.1	2.6	9.8	2.3	2.8	3.0	2.9	2.0	1.9
Current account balance plus FDI (% of GDP)	3.4	9.8	6.8	4.3	4.9	-2.2	4.0	-0.8	2.7	-1.0	-0.6	0.2	-0.3
Foreign exchange reserves ex gold (US$bn)	25.2	25.2	22.1	19.2	21.8	20.3	20.1	18.5	16.5	10.1	12.1	12.0	13.2
Import cover (months of merchandise imports)	9.7	8.2	5.7	4.7	6.3	8.0	9.5	7.5	5.9	3.0	3.8	3.8	3.8
Debt indicators													
Gross external debt (US$bn)	118.2	125.3	136.9	150.0	157.1	153.0	163.3	167.2	159.8	158.6	163.0	168.0	170.0
Gross external debt (% of GDP)	80	66	66	64	72	121	116	103	96	88	98	91	82
Gross external debt (% of exports)	196	149	158	177	198	333	445	345	261	273	347	289	262
Lending to corporates/households (% of GDP)	34.8	31.1	32.1	31.4	30.5	31.0	27.1	24.4	25.5	24.5	26.1	25.7	25.1
Interest & exchange rates													
Central bank key rate (year-end, %)	7.00	7.50	5.50	5.50	5.50	16.00	12.00	10.25	9.25	9.25	9.00	9.00	9.25
Broad money supply (average, %YoY)	13.3	15.0	7.9	10.2	10.4	33.8	15.6	-1.7	7.0	2.4	16.9	-0.8	5.0
3m interest rate (KazPrime, average, %)	4.07	1.77	2.50	6.50	7.13	10.40	15.50	11.75	10.25	10.20	10.75	10.00	10.05
3m interest rate spread over US$-Libor (ppt)	372	140	210	624	688	1003	1472	1038	780	798	1020	972	975
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)	147	148	151	154	182	339	333	332	384	381	420.7	413	412
USD/KZT exchange rate (average)	147	148	150	154	182	323	334	334	372	384	421	418	412
EUR/KZT exchange rate (year-end)	195	192	199	211	222	371	352	398	439	427	516	529	503
EUR/KZT exchange rate (average)	195	195	197	211	224	351	352	395	423	426	511	514	515
Brent oil price (annual average, US$/bbl)	80	111	112	109	99	54	45	55	72	64	43	65	70

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (%YoY)	4.9	2.7	-5.6	-4.4	-2.2	0.8	3.1	3.1	2.4	2.6	3.0	3.8	4.6
CPI (eop, %YoY)	5.4	6.4	7.0	7.0	7.5	7.0	6.5	6.3	6.1	6.1	6.1	6.0	6.0
Central bank key rate (eop, %)	9.3	12.0	9.5	9.0	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.25
3m interest rate (eop, %)	10.3	13.0	10.5	10.0	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.25
10yr yield (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT exchange rate (eop)	381	448	404	430	420.7	423	416	416	413	413	412	410	412
EUR/KZT exchange rate (eop)	427	493	454	504	515	499	508	519	529	529	515	505	503

Source: National sources, ING estimates

Poland

Rafał Benecki, Chief Economist, Poland

Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (%YoY)	-2.8	-2.3	9.6	4.4	6.1	4.5	5.0
CPI (%YoY)*	2.4	2.8	3.5	3.5	4.0	3.4	3.4
Policy interest rate (eop, %)	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3m interest rate (%)*	0.21	0.21	0.22	0.23	0.25	0.23	0.25
10yr yield (%)*	1.24	1.55	1.70	1.75	1.80	1.62	1.89
USD/PLN*	3.76	3.94	3.70	3.56	3.44	3.67	3.55
EUR/PLN*	4.61	4.65	4.52	4.45	4.40	4.51	4.44

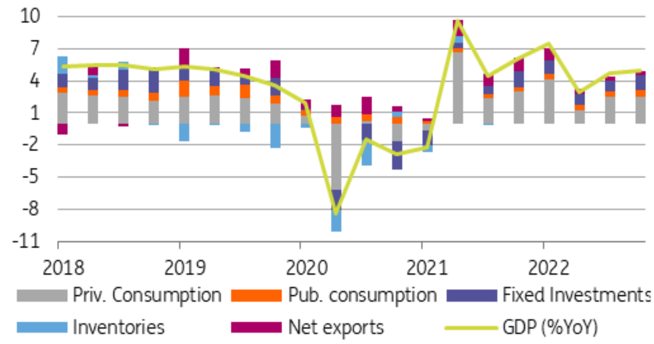
Macro Trend		Political Cycle	Ratings	FC	LC
Activity		Presidential: 2025	S&P	A-	A
Fiscal	Loose	Parliamentary: 2023	Moody's	A2	A2
Monetary	Neutral	Local: 2022	Fitch	A-	A-

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

Country strategy

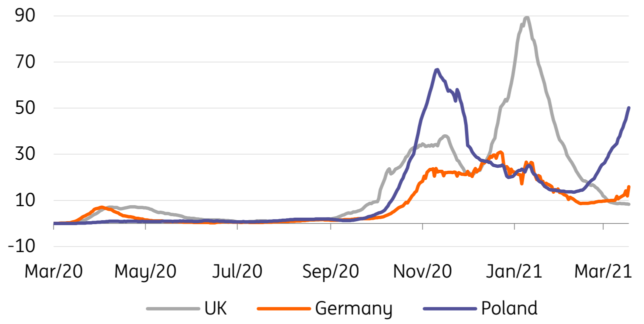
The ongoing EM market tensions may provide an opportunity to take fundamentally-backed positions for 2H21. This is particularly the case for the zloty, affected by both EM sentiment and NBP FX interventions from late-2020. We expect a strong domestic macro story, particularly a current account surplus. On the external side, an expected rise in €/US$ should trigger capital inflow towards CEE. A dovish NBP policy stance will offset those only partially.

GDP structure (%YoY)



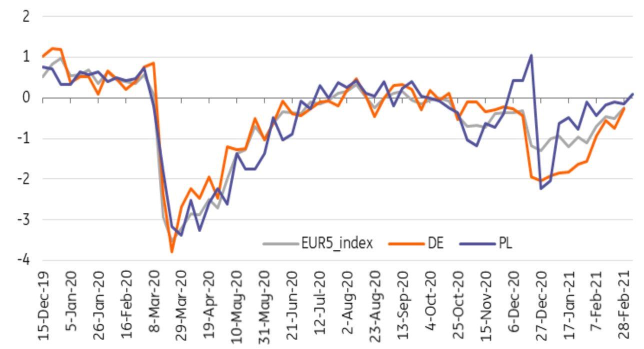
Source: GUS, ING

New daily Covid-19 cases per 100,000 citizens, 7-day avg



Source: ING

ING WAI, indices of current economic activity (normalised)



Source: ING calculations based on JHU data

Macro digest

Covid-related restrictions are likely to affect economic activity at least into early 2Q21. Poland experienced a substantial rise in new Covid-19 cases (currently around 50 per 100,000, more than double the number in January) and the pace of vaccinations remains slow (just above EU average). The government reintroduced safety measures that had been lifted earlier this year. The course of the pandemic in Poland seems to be the biggest risk now. In a negative scenario, we see a risk of downward revisions to our macroeconomic forecasts.

Nonetheless, the Polish economy appears increasingly resilient to the pandemic. In 4Q20, the number of Covid-19 cases was much higher than in the Spring, while administrative restrictions associated with this second wave of the pandemic were a quarter to a half less onerous. But the quarter-on-quarter contraction of GDP in 4Q20 was only a 1/13 of that in 2Q20. Our ING high-frequency index also indicates that, after a slowdown at the turn of the year, activity has been gradually improving despite prolonged lockdowns.

Given the still high risk profile potential of the current third wave of the pandemic, we have a conservative growth forecast for 1Q21. But the vaccination is expected to accelerate significantly in 2Q21. This should gradually unlock the economy and bring a rebound in consumption. The expected rebound in global GDP should boost Poland's manufacturing sector taking into account its high geographic and product diversification relative to the region.

A bigger concern may be delays in deliveries and problems with the availability of raw materials reported. Companies have managed to cope with this so far, but it generates cost pressure, which can push up the prices of finished goods. Disturbances in supply chains are visible not only in Poland but also in other economies, including the US. As consumption demand is expected to rebound, companies are likely to pass on the rising costs to consumers. This means that the expected recovery will be accompanied by higher inflation, as we assume in our forecasts.

The local political situation may come into focus in the coming quarters. Support for the ruling PiS has fallen over the course of the pandemic from 41% in early January to 34% currently, according to aggregator eWybory. Cracks in the coalition may encourage PiS to attempt to again boost its support via fiscal spending. The media has presented supposed leaks, suggesting a costly increase of the tax-free quota. This might allow PiS to push for early elections, aiming for a single party government (dropping junior partner Solidarna Polska). Currently, polls show PiS remains well ahead of any opposition party, but likely not enough for a comfortable election bid.

Poland

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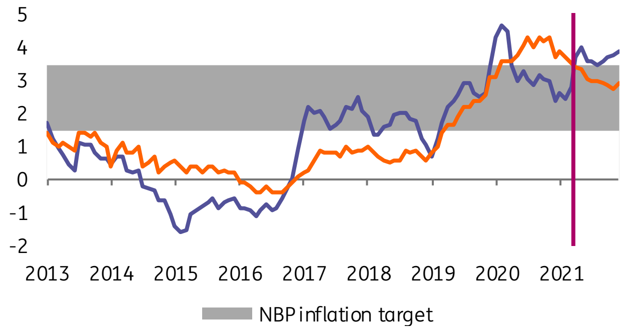
CPI (headline and core) against the NBP inflation target



Source: NBP, GUS, ING

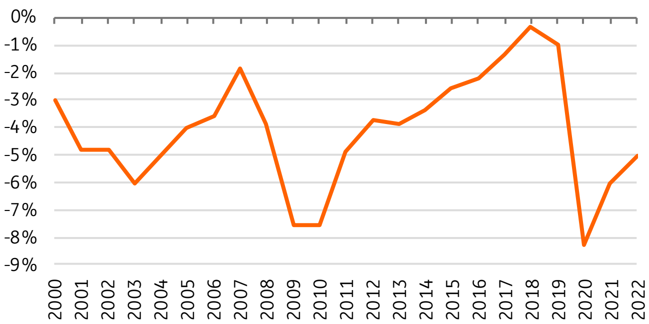
Elevated CPI does not change our view on flat rates

CPI fell from 2.6% in January to 2.4% YoY in February, but core CPI remained high at 3.7% (3.9% in January).

We expect core inflation to decelerate, but only to a moderate extent. Lagged effects of the recession should be compensated by price pressures in global supply chains. The low base for food and fuel prices will keep up the pressure over the coming months. We expect a consumption-driven growth. Hence, we estimate average CPI inflation of 3.4% in Poland in 2021-22.

Our elevated forecast does not change our approach indicating that the central bank should keep rates unchanged until the term end - for the MPC in 1H22 and for Governor Glapiński in June 2022.

The deficit of general government (% of GDP)



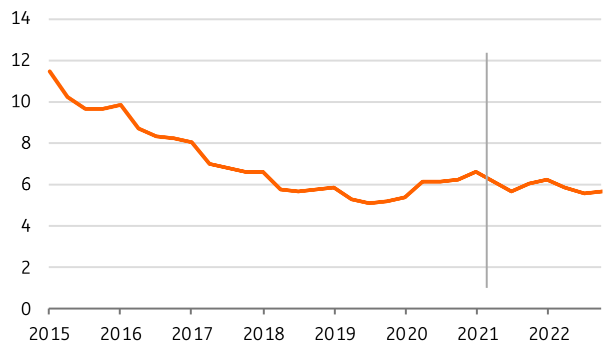
Source: Ministry of Finance, ING forecast

Deficits in 2021 and 2022 will remain elevated

Budget performance in 2020 was better than expected with the deficit of general government reaching around 8% of GDP compared with 12% assumed in the budget bill. However, the prolonged period of the pandemic (due to lacklustre vaccination progress) has forced us to revise our 2021 deficit forecast of general government from 5% of GDP to 6%.

We also revise our forecast for the 2022 deficit from 3.5% of GDP to 5%. The government has signalled plans for a significant loosening of fiscal policy. The details are not yet available, but we believe a raising of tax-free personal allowance (income with 0% PIT) is likely, as well as additional benefits to retirees.

Registered unemployment in Poland (% of labor force)



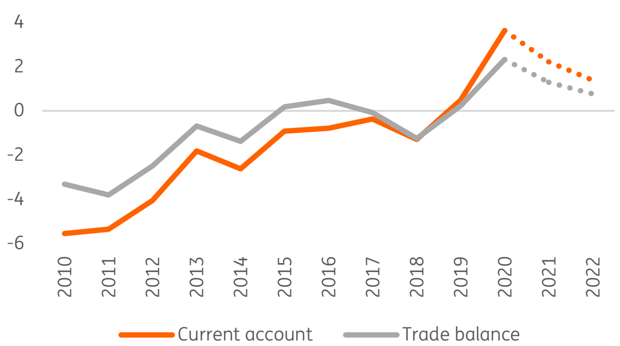
Source: Polish Statistical Office, ING forecast

Polish labour market resilient despite economic downturn

The labour market in Poland has not suffered significantly during the pandemic. Unemployment rose by c.1ppt to 6.5% in January 2021. The generous anti-crisis measures provided by the government following the first wave of the pandemic came with job protection clauses.

On the other hand, the recovery of employment and wages has been relatively slow so far. Companies are holding back recruitment as diminishing numbers of job offers show. Moreover, in January the statistical office revised down the size of the enterprise sector (unlike in previous years). This suggests there is trouble among SMEs. In our opinion, employment and wages will lag behind a recovery in economic activity.

Current account and trade balances (% of GDP)



Source: NBP, ING forecasts

Record-high current account surplus to moderate in 2021

In 2020, Poland reached a record-high current account surplus of 3.6% of GDP and a surplus in merchandise trade of 2.3% of GDP. In the pandemic year, net exports mitigated the GDP loss. Manufacturing benefited from a shift of consumer demand from unrealised demand for services, heavily affected by lockdowns.

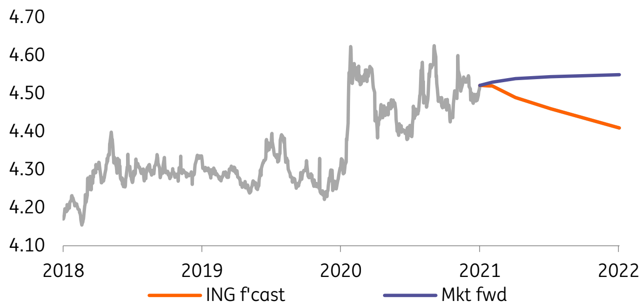
Late 2020, trade turnover got an additional boost due to Brexit as the UK is one of Poland's main trading partners.

Both trade and current account surpluses are to moderate in 2021 due to an expected revival of import-intensive investment demand and rising import bills for oil, both due to higher volume and global prices. Export growth should remain solid driven by durable consumer goods, including batteries for electric cars, car parts and vehicles.

Poland

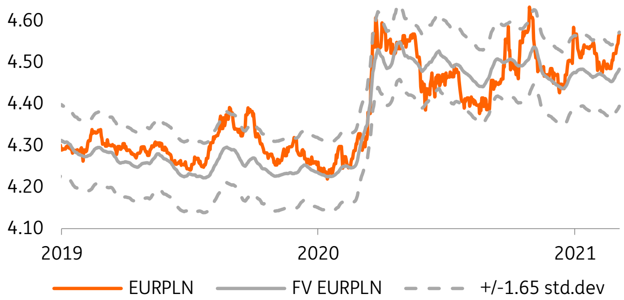
Strategy

FX – spot vs forward and INGF



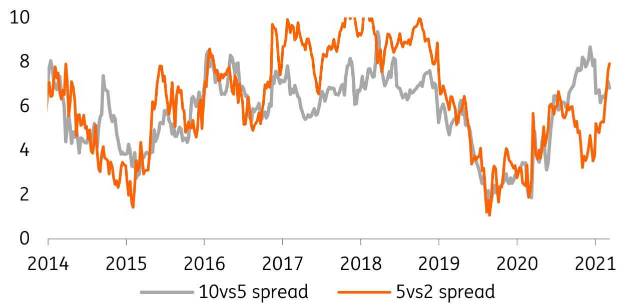
Source: Macrobond, ING forecasts

€/PLN – ING relative value model



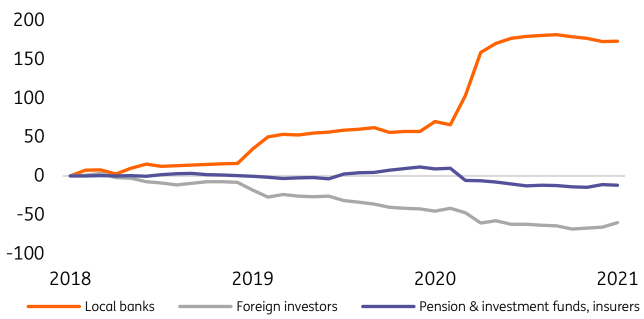
Source: Macrobond, ING estimates

Local curve (%)



Source: Macrobond

Structure of POLGBs holders – change since Jan-18



Source: MinFin

FX strategy

The NBP's policy stance stands in contrast to many other EM central banks, even among CEEs. This makes the zloty one of the prime targets for depreciation in the EM space. Moreover, Bloomberg reports significant FX option positions opened ahead of the Supreme Court ruling on FX mortgages in April. Delta hedging on FX option positions likely contributed to the €/PLN rise in March.

This may offer an opportunity to enter a short €/PLN position, looking for a decline in 2H21. Our relative value model (gauging €/PLN value based on other market variables, such as swaps) suggests an equilibrium level around 4.45. Anything above 4.55 denotes significant undervaluation. For details see the chart on the left (*€/PLN - ING relative value model*). Our long-term fundamental estimates (based on current account, labour productivity, etc) indicate a fair value level around 4.30-4.40.

In 2H21, we expect the zloty to revert back to appreciation despite the NBP's policy stance. Primarily, we anticipate Poland to retain a solid (even if smaller compared to 2020) current account surplus. This differentiates Poland from other CEE economies, which are all in C/A deficit. Moreover, the anticipated rise in €/US$ typically attracts capital inflow to CEEs.

The NBP is likely to continue verbal FX interventions against the zloty, possibly entering the market. However, the central bank announced it won't introduce an FX intervention level (as in the Czech Republic). Given our expectations of elevated inflation and GDP recovery ahead, rate cuts are not an option. Hence, we see the NBP only delaying the €/PLN decline.

Poland forecasts

Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (%YoY)	3.6	5.0	1.6	1.4	3.3	4.2	3.1	4.8	5.4	4.5	-2.8	4.5	5.0
Private consumption (%YoY)	2.5	3.3	0.8	0.3	2.6	3.8	3.9	4.8	4.3	4.0	-3.0	5.0	4.5
Government consumption (%YoY)	3.3	-1.8	-0.4	2.2	4.0	2.1	2.2	2.6	3.5	6.4	3.2	1.7	1.7
Investment (%YoY)	0.0	8.8	-1.8	-1.1	10.0	6.1	-8.2	4.0	9.4	7.2	-8.4	2.3	7.2
Industrial production (%YoY)	11.1	6.8	1.4	2.4	3.5	4.8	2.9	6.5	6.0	4.3	-1.0	5.5	6.0
Unemployment rate (year-end, %)	12.4	12.5	13.4	13.4	11.4	9.7	8.2	6.6	5.8	5.2	6.2	6.1	5.7
Nominal GDP (PLNbn)	1,447	1,565	1,623	1,647	1,711	1,801	1,863	1,990	2,122	2,272	2,268	2,405	2,528
Nominal GDP (€bn)	362	380	388	392	409	431	427	468	498	529	510	534	569
Nominal GDP (US$bn)	480	528	498	521	542	478	473	527	587	592	582	670	711
GDP per capita (US$)	12,501	13,806	13,102	13,743	14,315	12,557	12,420	13,879	15,483	15,636	15,349	17,826	19,215
Gross domestic saving (% of GDP)	14.9	16.1	17.4	19.8	19.9	23.2	23.5	24.1	23.4	25.8	24.7	25.6	24.4
Prices													
CPI (average, %YoY)	2.6	4.3	3.7	0.9	0.0	-0.9	-0.6	2.0	1.7	2.3	3.4	3.4	3.4
CPI (year-end, %YoY)	3.1	4.6	2.4	0.7	-1.0	-0.5	0.8	2.1	1.1	3.4	2.4	4.0	3.4
Wage rates (nominal, %YoY)	3.6	4.9	3.5	2.6	3.8	3.5	4.1	5.7	7.1	6.6	4.8	5.3	6.0
Fiscal balance (% of GDP)													
Consolidated government balance	-7.4	-5.0	-3.8	-4.2	-3.6	-2.6	-2.4	-1.5	-0.2	-0.7	-8.0	-6.0	-5.0
Consolidated primary balance	-4.9	-2.3	-1.1	-1.7	-1.7	-0.9	-0.7	0.1	1.2	0.6	-7.5	-4.5	-3.5
Total public debt	53.5	54.7	54.4	56.5	51.1	51.3	54.2	50.6	48.8	45.9	57.3	60.9	61.5
External balance													
Exports (€bn)	118.2	132.3	140.5	147.5	157.0	171.4	177.5	202.0	217.0	232.9	232.4	244.2	260.6
Imports (€bn)	130.2	146.8	150.1	150.2	162.6	170.6	175.5	202.4	223.3	231.7	220.7	237.2	256.2
Trade balance (€bn)	-12.0	-14.5	-9.7	-2.7	-5.6	0.8	2.0	-0.4	-6.2	1.2	11.7	7.0	4.4
Trade balance (% of GDP)	-3.3	-3.8	-2.5	-0.7	-1.4	0.2	0.5	-0.1	-1.2	0.2	2.3	1.3	0.8
Current account balance (€bn)	-20.1	-20.4	-15.7	-7.1	-10.7	-3.9	-3.4	-1.7	-6.4	2.6	18.4	12.0	7.9
Current account balance (% of GDP)	-5.5	-5.4	-4.0	-1.8	-2.6	-0.9	-0.8	-0.4	-1.3	0.5	3.6	2.2	1.4
Net FDI (€bn)	6.5	9.8	4.7	3.2	9.8	9.1	3.9	6.7	12.8	8.5	5.1	6.6	7.5
Net FDI (% of GDP)	1.8	2.6	1.2	0.8	2.4	2.1	0.9	1.4	2.6	1.6	1.0	1.2	1.3
Current account balance plus FDI (% of GDP)	-3.8	-2.8	-2.8	-1.0	-0.2	1.2	0.1	1.1	1.3	2.1	4.6	3.5	2.7
Foreign exchange reserves (€bn)	70.0	75.6	82.5	77.0	82.7	87.2	108.5	94.5	102.2	114.3	125.6	130.6	132.8
Import cover (months of merchandise imports)	6.4	6.2	6.6	6.2	6.1	6.1	7.4	5.6	5.5	5.9	6.8	6.6	6.2
Debt indicators													
Gross external debt (€bn)	239.0	250.9	279.7	278.9	293.5	303.1	321.3	319.7	316.7	315.7	300.7	293.7	288.0
Gross external debt (% of GDP)	66.0	66.1	72.1	71.1	71.8	70.4	75.2	68.4	63.6	59.7	58.9	54.6	50.3
Gross external debt (% of exports)	202	190	199	189	187	177	181	158	146	136	129	120	110
Lending to corporates & households (% of GDP)	52.4	55.1	53.7	54.9	56.3	57.2	57.8	56.0	56.5	56.4	59.7	58.8	60.0
Interest & exchange rates													
Central bank key rate (year-end, %)	3.50	4.50	4.25	2.50	2.00	1.50	1.50	1.50	1.50	1.50	0.10	0.10	0.10
Broad money supply (average, %YoY)	8.8	12.5	4.5	6.2	8.2	9.1	9.6	4.6	9.2	9.3	7.0	8.2	8.2
3m interest rate (WIBOR, average, %)	3.93	4.58	4.87	2.98	2.49	1.74	1.70	1.73	1.71	1.72	0.60	0.23	0.25
3m interest rate spread over EURIBOR (ppt)	313	324	423	275	230	176	195	205	202	207	104	73	70
2yr yield (average, %)	4.77	4.82	4.23	3.01	2.45	1.70	1.67	1.88	1.56	1.56	0.43	0.08	0.20
10yr yield (average, %)	5.80	5.98	4.94	4.09	3.46	2.69	3.08	3.46	3.20	2.42	1.49	1.62	1.89
USD/PLN exchange rate (year-end)	2.96	3.42	3.10	3.01	3.51	3.90	4.18	3.48	3.76	3.80	3.76	3.44	3.66
USD/PLN exchange rate (average)	3.02	2.96	3.26	3.16	3.16	3.77	3.94	3.78	3.61	3.84	3.90	3.67	3.55
EUR/PLN exchange rate (year-end)	3.98	4.46	4.07	4.15	4.27	4.26	4.41	4.18	4.30	4.26	4.56	4.40	4.47
EUR/PLN exchange rate (average)	3.99	4.12	4.18	4.20	4.19	4.18	4.36	4.26	4.26	4.30	4.44	4.51	4.44

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (%YoY)	3.6	1.9	-8.4	-1.5	-2.8	-2.3	9.6	4.4	6.1	7.5	3.0	4.7	4.9
CPI (eop, %YoY)	3.3	4.5	3.3	3.2	2.4	2.8	3.5	3.5	4.0	3.6	3.4	3.4	3.4
Central bank key rate (eop, %)	1.50	1.00	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3m interest rate (eop, %)	1.71	1.17	0.26	0.22	0.21	0.21	0.22	0.23	0.25	0.25	0.25	0.25	0.25
10yr yield (eop, %)	2.12	1.68	1.39	1.31	1.24	1.55	1.70	1.75	1.80	1.85	1.90	1.93	1.95
USD/PLN exchange rate (eop)	3.80	4.15	3.98	3.87	3.76	3.94	3.70	3.56	3.44	3.45	3.55	3.62	3.66
EUR/PLN exchange rate (eop)	4.26	4.55	4.47	4.53	4.56	4.65	4.52	4.45	4.40	4.42	4.44	4.45	4.47

Source: National sources, ING estimates

Romania

Valentin Tataru, Economist, Bucharest

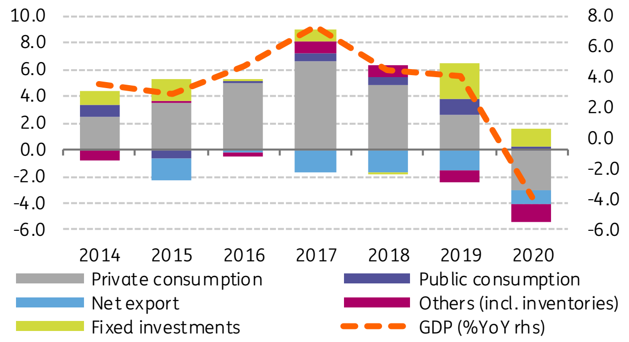
Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (%YoY)	-1.4	-1.8	12.4	7.5	3.9	5.5	5.0
CPI (%YoY)*	2.1	3.1	2.8	2.7	3.3	3.0	2.8
Policy interest rate (eop, %)	1.50	1.25	1.25	1.25	1.25	1.25	1.75
3m interest rate (%)*	2.40	1.70	1.70	1.70	1.70	1.70	1.85
10yr yield (%)*	2.90	3.00	2.90	3.00	3.00	3.00	3.00
USD/RON*	3.99	4.14	4.01	3.94	3.84	3.98	3.94
EUR/RON*	4.88	4.89	4.89	4.92	4.92	4.89	4.92

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

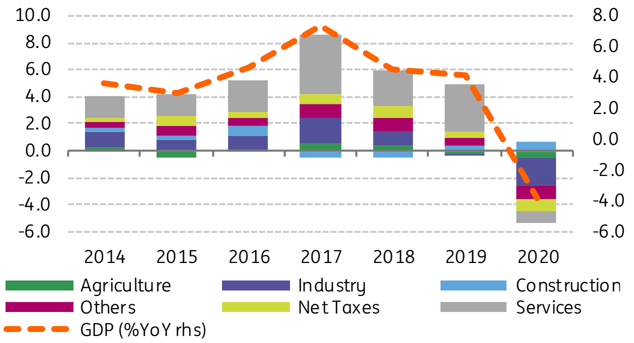
*Quarterly data is eop, annual is avg Source: National sources, ING estimates

GDP (YoY%) and components (ppt)



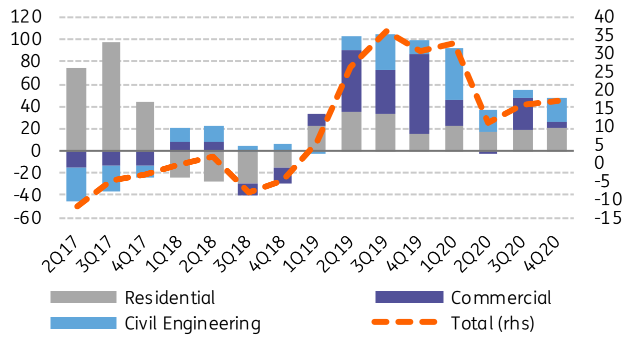
Source: NIS, ING

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



Source: NIS, ING

Construction sector booming (YoY% growth)



Source: NIS, ING

Country strategy: no excuses this time

With elections concluded and the next electoral clash not until 2024, policymakers have a unique window of opportunity to do the right things. At heart, problems revolve around the fiscal consolidation process which should start this year. Along with this, we are increasingly anxious about Romania's external imbalances – namely the trade deficit and, by extension, the current account deficit, both of which expanded with the economic slump in 2020. These developments challenge the generally accepted idea that Romania's external deficits are largely driven by the fiscal deficit. While this could be the root cause, we suspect as well fundamental competitiveness issues for the real economy. That said, we remain quite upbeat in our outlook and revert to our belief that GDP growth will save the day again.

Macro digest

Despite not benefitting from the same marginal fiscal impulse as most of its Central and Eastern European peers, the Romanian economy confirmed its much-improved resilience to shocks. 4Q20 flash GDP printed a whopping 5.3% expansion versus the third quarter and a 1.5% contraction compared to 4Q19. For 2020, the contraction was 3.9%. Subtracting the contribution from agriculture, the contraction would have been even milder, ie, around -3.3%. Due to the significant carryover effect created by the fourth quarter growth, the outlook for 2021 GDP is shaping up to be much better. Looking beyond statistical effects, we believe that the prospects of seeing the economy back to pre-crisis levels as early as the third quarter of 2021 are good. Of course, a lot depends on the epidemiological developments and the pace of vaccination which, of late, seems to be going in the right direction.

On the supply side, the main drag (-2ppt) came from industrial production, a sector that was not developing well before the crisis and the lockdown has only accentuated its fall. While base effects and reopening could lead to some positive numbers for industry in 2021, we remain rather downbeat on the sector's prospects, particularly in the first half of 2021.

The shining star of 2020 was undoubtedly the construction sector which expanded by almost 20% versus 2019. The bulk of the growth came from the civil engineering side which accelerated by 23% on the back of historically high public infrastructure investments. Given the official target for investment spending to reach new historical highs over the next couple of years as well, we are upbeat in our estimates regarding the construction sector outlook. In our view, the construction sector will remain one of the most vibrant economic sectors in the years to come. The government is likely to favour civil works (motorways, schools, hospitals) via the Recovery and Resilience Plan while in the private sector residential construction is likely to outpace commercial.

On the demand side, it will mainly be down to private consumption to take the lead and support growth in 2021, although recent restrictive measures adopted with the third wave of Covid-19 might dampen sentiment once again. Our 5.5% GDP growth forecast for 2021 therefore assumes a relatively anaemic growth (if any at all) in the first quarter of 2021, followed by a reinvigoration of economic activity in late-2Q21 and an acceleration thereafter. This assumes a normal agricultural year, an anticipated recovery in the Eurozone economies and a vaccination campaign that will achieve official estimates of herd immunity in 3Q21.

Romania

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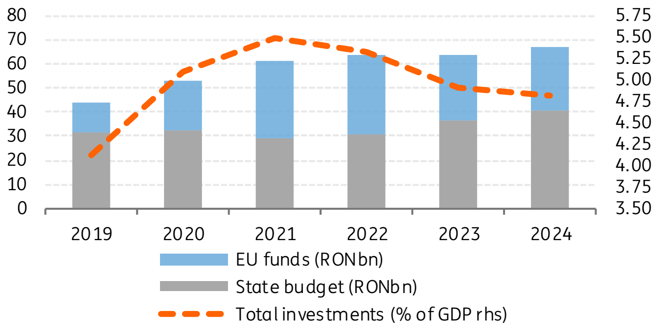
Scheduled public investments for 2021-2024

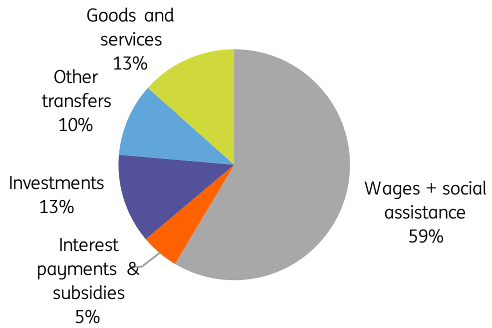


Source: Ministry of Finance, ING

Investment prospects dependent on EU funds

Particularly constrained by the high share of rigid spending over the past few years, Romania's 2021 budget plans incorporate a 15.8% increase in investment spending, to take the investment-to-GDP ratio to around 5.5% - a new historical high. The multi-annual investment proposals focus on improved EU funds absorption which is seen as 'a central element of budget sustainability'. While a focus on EU funds is certainly welcome, the projections underline a relatively high dependence on EU money for Romania's investment projects (which are also crucial -partly- for balancing the current account). It also suggests that if projected EU-financed investments do not materialise, the country could swiftly move from historical highs to historical lows in terms of the investments-to-GDP ratio.

Budget spending breakdown in 2020 (% of total expenses)

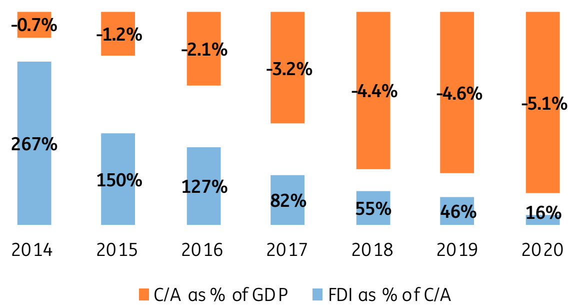


Source: Ministry of Finance, ING

Small steps in the right direction

At 9.8% of GDP in 2020, Romania posted one of the largest budget deficits in the CEE, while it offered one of the lowest levels of fiscal support to the economy due to the very weak starting point at end-2019. For 2021 the government targets a cash deficit of 7.16% of GDP, with most near-term adjustments resulting from a partial unwind of the pandemic response measures. With a look towards 2024, we are slightly baffled by the official forecasts that see a relatively constant share of revenues in GDP (at around 31%), which effectively means that most of the fiscal correction will come from the expenditure side. That said, we believe the adjustment pace strikes a realistic balance between the need to preserve support for the economy while bringing the deficit closer to acceptable levels.

Current account (C/A) deficit is far from correcting



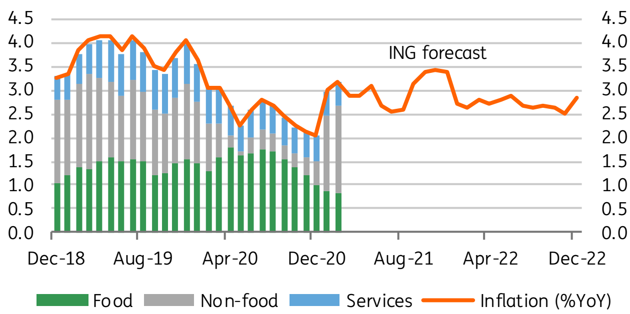
Source: NBR, ING

Widening during a year of economic contraction

Rarely heard of during years of economic contraction, Romania's C/A deficit has widened in 2020 to -5.1% of GDP from -4.5% a year earlier. This was mainly due to exports shrinking faster than imports. The financing structure of the C/A has also deteriorated, with FDIs representing a mere 16% of the C/A deficit in 2020.

In the short-to-medium term, we are not necessarily concerned regarding the financing side of the C/A deficit due to better prospects for FDIs and, crucially, inflows from the NextGen EU. It is the structural nature of the C/A deficit that could give rise to upset - and 2020 developments certainly have not helped. Add on top the prospects for another year of relatively overvalued leu and the odds for the C/A deficit to rebalance remain rather distant.

Inflation (YoY%) and main components (ppt)



Source: NIS, ING

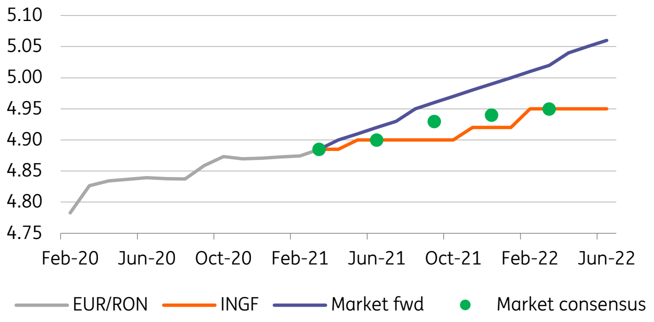
Inflation revised higher but still within the target range

The annual inflation rate reached 3.2% in February 2021, prompting us to revise our 2021 average inflation forecast from 2.7% to 3.0% and the year-end from 3.0% to 3.3%. We revised 2022 inflation upwards as well, from 2.5% to 2.8%, both for the annual average and year-end. This broadly matches newly revised NBR projections which see inflation at 3.4% for December 2021 and 2.8% for December 2022. The risk balance to our base case seems mildly tilted to the upside as the rapidly closing output gap could exert more significant demand-side pressures, alongside a general increase in international prices for agricultural products. A 're-opening' inflation in the service sector could also act on the upside but for now we do not expect significant price pressures in this area.

Romania

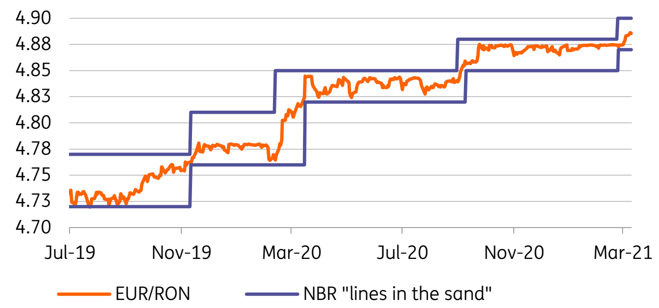
Strategy

FX – spot vs forward and INGF



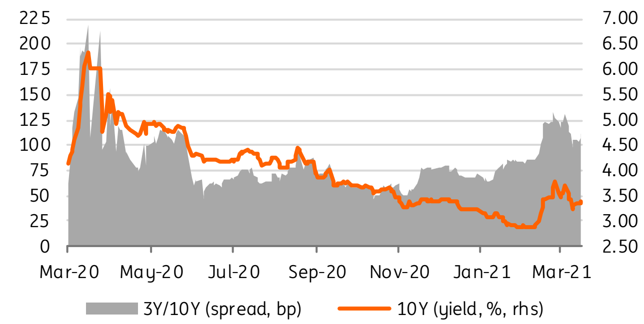
Source: Refinitiv, ING

The same tight grip on the EUR/RON



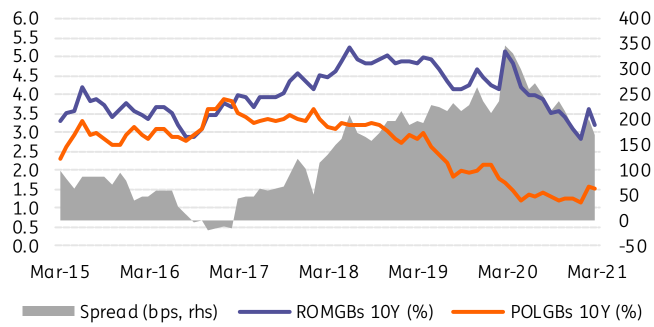
Source: NBR, ING

Local bond curve (%)



Source: Refinitiv, ING

ROMGBs spread over POLGBs



Source: Refinitiv, ING

FX strategy

2020 was another year which underlined the FX-centred reaction function of the NBR. The Romanian leu remained one of the most stable currencies in the region, likely on the back of historically high FX interventions. We have little reason to believe that 2021 will be any different in terms of policy choices. Although as of mid-March 2021 the leu has lost some 0.3% compared to end-2020 (which is insignificant by pretty much any standards but rather relevant for the local market), the trading pattern is already starting to resemble that of 2020, which should translate into a prolonged period of stability after the minor upward tick for the pair. As in 2020, maintaining currency stability will have a blurred impact on the central bank's FX reserves due to the Ministry of Finance's Eurobond issuance (which we estimate to reach €7.5bn in 2021) and, coming on top versus 2020, the likely increased absorption of EU funds - in particular front-loaded payments from the NextGen EU. We do not expect prolonged episodes of abnormally high carry rates to occur as often as in the past, although short-lived spikes to contain FX pressures are always possible. We believe that the NBR will try to maintain quasi-neutral liquidity conditions (if anything, small surpluses might be tolerated) which will allow for a swifter reaction should pressures emerge.

Since the weak fundamentals given by the large twin deficits will not disappear soon, we stress that the medium-term prospects continue to point towards a nominal weakening of the leu. We maintain our 2021 year-end forecast for EUR/RON at 4.92, with an upward tick towards the 4.95-5.00 area in subsequent years.

Romania forecasts

Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (%YoY)	-3.9	1.9	2.0	3.8	3.6	3.0	4.7	7.3	4.5	4.2	-3.9	5.5	5.0
Private consumption (%YoY)	-4.6	1.5	1.8	0.5	4.6	5.8	8.2	9.8	10.1	6.0	-3.8	4.0	5.0
Government consumption (%YoY)	-1.6	-1.2	7.4	-1.6	6.1	-3.8	0.0	4.4	3.3	6.0	2.3	2.0	1.5
Investment (%YoY)	-2.8	6.1	3.1	-5.9	3.8	7.0	-0.1	3.5	2.5	-2.6	5.6	7.0	6.0
Industrial production (%YoY)	4.9	8.1	3.0	7.7	6.4	2.7	3.1	8.7	4.4	-3.2	-9.1	3.0	3.0
Unemployment rate (year-end, %)	7.0	7.1	6.9	7.0	6.8	6.8	5.9	5.0	4.2	3.9	5.0	5.0	4.6
Nominal GDP (RONbn)	529	559	592	635	670	712	764	858	952	1,060	1,054	1,120	1,220
Nominal GDP (€bn)	126	132	133	144	151	160	170	188	205	223	222	229	249
Nominal GDP (US$bn)	166	185	171	191	199	176	187	214	241	248	258	289	319
GDP per capita (US$)	8,200	9,200	8,500	9,600	10,000	8,900	9,500	10,900	12,400	12,800	13,400	15,000	16,700
Gross domestic saving (% of GDP)	20.7	22.3	21.8	24.8	24.2	24.5	22.4	21.0	19.4	19.1	20.1	21.8	21.8
Prices													
CPI (average, %YoY)	6.1	5.8	3.3	4.0	1.1	-0.6	-1.6	1.3	4.6	3.8	2.6	3.0	2.8
CPI (year-end, %YoY)	8.0	3.1	5.0	1.6	0.8	-0.9	-0.5	3.3	3.3	4.0	2.1	3.3	2.8
Wage rates (nominal, %YoY)	2.5	5.0	5.0	5.0	5.3	8.4	13.0	14.2	13.1	14.9	6.7	4.0	5.0
Fiscal balance (% of GDP)													
Consolidated government balance	-6.9	-5.4	-3.7	-2.1	-1.2	-0.6	-2.6	-2.6	-2.9	-4.4	-9.8	-7.3	-5.8
Consolidated primary balance	-5.4	-3.8	-1.9	-0.3	0.5	1.0	-1.1	-1.4	-1.8	-3.2	-8.6	-7.2	-5.7
Total public debt	29.6	34.0	37.1	37.6	39.2	37.8	37.4	35.1	34.7	35.3	47.3	53.9	54.5
External balance													
Exports (€bn)	37.4	45.3	45.0	49.6	52.5	54.6	57.4	62.6	67.4	68.7	56.8	68.0	72.0
Imports (€bn)	46.9	54.9	54.6	55.3	58.6	63.0	67.4	75.6	82.8	86.2	76.1	87.0	91.0
Trade balance (€bn)	-9.5	-9.7	-9.6	-5.8	-6.1	-8.4	-10.0	-13.0	-15.4	-17.6	-19.3	-19.0	-19.0
Trade balance (% of GDP)	-7.5	-7.3	-7.2	-4.0	-4.0	-5.2	-5.9	-6.9	-7.5	-7.9	-8.7	-8.3	-7.6
Current account balance (€bn)	-6.4	-6.6	-6.4	-1.5	-1.0	-2.0	-3.6	-6.0	-9.2	-10.2	-11.3	-11.4	-11.4
Current account balance (% of GDP)	-5.1	-5.0	-4.8	-1.1	-0.7	-1.2	-2.1	-3.2	-4.5	-4.6	-5.1	-5.0	-4.6
Net FDI (€bn)	2.3	1.7	2.6	2.9	2.7	3.0	4.5	4.9	5.0	5.3	1.7	2.4	3.2
Net FDI (% of GDP)	1.8	1.3	1.9	2.0	1.8	1.8	2.7	2.6	2.4	2.4	0.8	1.0	1.3
Current account balance plus FDI (% of GDP)	-3.3	-3.7	-2.9	1.0	1.1	0.6	0.6	-0.6	-2.0	-2.2	-4.2	-3.8	-2.7
Foreign exchange reserves ex gold (€bn)	32.4	33.2	31.2	32.5	32.2	32.2	34.2	33.5	33.1	32.9	37.4	38.8	40.1
Import cover (months of merchandise imports)	8.3	7.2	6.9	7.1	6.6	6.1	6.1	5.3	4.8	4.6	5.9	5.4	5.3
Debt indicators													
Gross external debt (€bn)	93.6	99.9	100.9	98.1	94.7	92.1	92.9	97.4	99.8	109.8	125.5	132.0	135.0
Gross external debt (% of GDP)	75	75	72	69	63	57	54	51	48	48	56	58	54
Gross external debt (% of exports)	250	221	224	198	180	169	162	156	148	160	221	194	188
Lending to corporates/households (% of GDP)	39.2	39.2	39.5	37.9	34.3	31.7	30.5	28.9	27.2	26.7	26.3	26.2	26.5
Interest & exchange rates													
Central bank key rate (year-end, %)	8.00	6.25	6.00	5.25	4.00	2.75	1.75	1.75	1.75	2.50	1.50	1.25	1.75
Broad money supply (average, %YoY)	8.2	6.2	6.2	7.9	4.1	6.8	7.8	11.4	11.1	9.3	15.3	9.1	10.2
3m interest rate (Robor average, %)	6.75	5.82	5.34	4.22	2.54	1.40	0.89	1.15	2.80	3.15	2.40	1.70	1.85
3m interest rate spread over Euribor (ppt)	5.9	4.4	4.8	4.0	2.3	1.4	1.2	1.5	3.1	3.5	2.8	2.2	2.5
3yr yield (average, %)	7.4	7.2	6.3	4.8	3.3	1.9	1.5	1.9	3.7	3.7	3.4	2.3	2.5
10yr yield (average, %)	7.2	7.4	6.7	5.3	4.6	3.5	3.3	3.9	4.7	4.5	4.0	3.0	3.0
USD/RON exchange rate (year-end)	3.22	3.32	3.36	3.27	3.70	4.15	4.32	3.88	4.06	4.27	4.35	3.84	4.06
USD/RON exchange rate (average)	3.19	3.03	3.45	3.32	3.37	4.04	4.08	4.01	3.94	4.27	4.17	3.98	3.94
EUR/RON exchange rate (year-end)	4.28	4.32	4.43	4.48	4.48	4.52	4.54	4.66	4.66	4.78	4.87	4.92	4.95
EUR/RON exchange rate (average)	4.21	4.24	4.46	4.42	4.44	4.45	4.49	4.57	4.65	4.75	4.84	4.89	4.92

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (%YoY)	4.7	2.4	-10.0	-5.6	-1.4	-1.8	12.4	7.5	3.9	4.7	5.1	5.1	5.2
CPI (eop, %YoY)	4.0	3.0	2.6	2.5	2.1	3.1	2.8	2.7	3.3	2.8	2.9	2.7	2.8
Central bank key rate (eop, %)	2.50	2.00	1.75	1.50	1.50	1.25	1.25	1.25	1.25	1.25	1.25	1.50	1.75
3m interest rate (eop, %)	3.20	2.55	2.20	2.10	2.40	1.70	1.70	1.70	1.70	1.75	1.75	1.85	2.00
10yr yield (eop, %)	4.50	5.15	4.00	3.45	2.90	3.00	2.90	3.00	3.00	3.10	3.20	3.25	3.25
USD/RON exchange rate (eop)	4.27	4.39	4.28	4.15	3.99	4.14	4.01	3.94	3.84	3.87	3.96	4.02	4.06
EUR/RON exchange rate (eop)	4.78	4.83	4.84	4.86	4.88	4.89	4.89	4.92	4.92	4.95	4.95	4.95	4.95

Source: National sources, ING estimates

Russia

Dmitry Dolgin, Chief Economist, Russia & CIS

Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (%YoY)	-2.0	-0.5	6.0	3.0	1.5	2.5	2.2
CPI (%YoY)*	4.9	5.7	5.3	5.3	4.2	5.1	4.1
Policy interest rate (eop, %)	4.25	4.50	4.75	5.00	5.00	5.00	5.25
3m interest rate (%)*	4.92	4.85	5.00	5.30	5.30	5.10	5.40
10yr yield (%)*	6.27	6.70	6.50	6.30	6.20	6.40	6.30
USD/RUB*	73.90	73.00	72.00	75.00	73.00	73.38	73.60
EUR/RUB*	90.70	86.14	87.84	93.75	93.44	90.25	92.00

Macro Trend		Political Cycle	Ratings	FC	LC
Activity	▲	Presidential: Mar-24	S&P	BBB-	BBB
Fiscal	Neutral	Parliamentary: Sep-21	Moody's	Baa3	Baa3
Monetary	Tightening	Local: 2021	Fitch	BBB	BBB

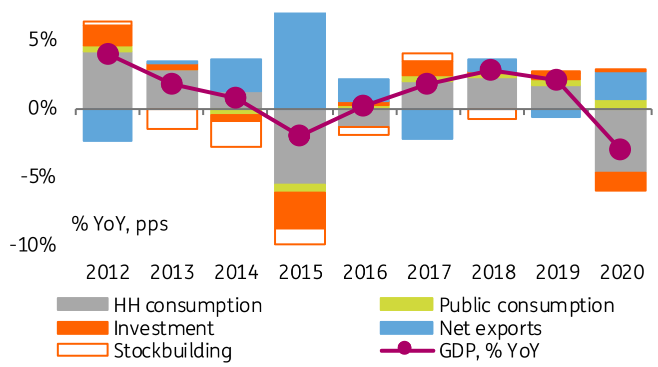
*Quarterly data is eop, annual is avg. Source: National sources, ING estimates

Country strategy

Russian GDP dropped defensively by 3.1% in 2020, in line with our expectations, and managed to preserve its macro strength, which is now helped by the oil price rally. But the economic recovery is challenged by the weak household income trend, low appetite for corporate investment and a likely tightening in the monetary policy stance throughout 2021.

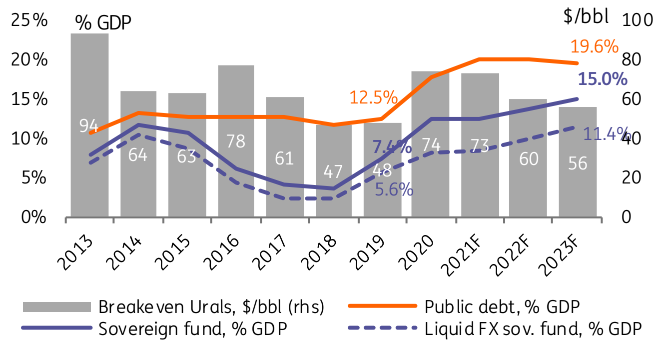
Russia's macro advantages should somewhat mitigate the negative effect of global bond market nervousness and help rouble and OFZ justify our constructive view. However, the Russia-specific weaknesses related to slow growth, susceptibility to higher CPI, and foreign policy challenges are a traditional set of risks to our view.

GDP and key contributors (% YoY, ppt)



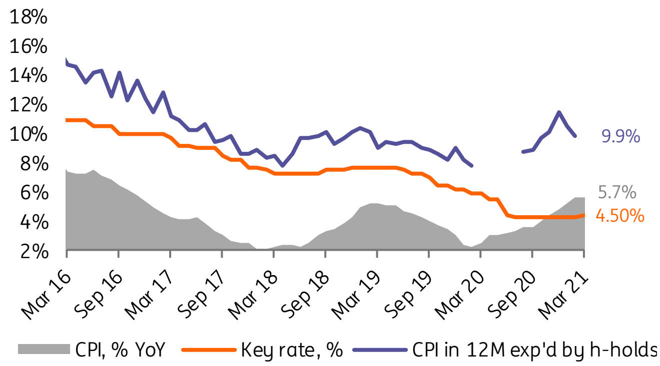
Source: Rosstat, ING

Fiscal policy – consolidation ahead



Source: Finance Ministry, ING

Monetary policy – scope for easing exhausted



Source: Bank of Russia, Rosstat, ING

Macro digest

Russian GDP dropped by 3.1% in 2020, faring relatively well thanks to budget support, a small services segment, and lack of prior overheating (which has prevented a destocking). Meanwhile, fixed investment appears under persistent pressure as, following the 6.2% YoY drop in 2020, its level is now 21.2% of GDP, the lowest reading since 2007 and below the 25% of GDP targeted by the government. A material increase in investment demand would require expectations of a long-term consumer recovery; however, consumers are downbeat as a result of lower employment and weak income, which slid by over 10% since 2013 and is now lower than ten years ago. Exports should post a recovery versus 2H20 given the expected easing in the OPEC+ constraints, but the overall volumes are more likely to remain flat versus FY20.

The government's ability to boost local demand with conventional tools is largely exhausted as, following the 4% of GDP fiscal support in 2020, the consolidated expenditures are already at elevated levels close to 39% of GDP, driven by both socially focused and other spending. With budget-breakeven Urals at a high US$74/bbl level (US$83/bbl net of one-off proceeds in 2020) the fiscal room for extra direct spending is limited to around 1% of GDP, in our view, to be disbursed around the time of the September Parliamentary elections. Assuming that and an expected Urals price of US$63/bbl in 2021, we see the federal budget deficit narrowing to 1.2% of GDP this year, with a somewhat wider deficit at the consolidated level. Due to excess borrowing in 2020 and better-than-expected non-fuel revenue collection, the 2021 net borrowing programme should be limited to RUB2.2tr, keeping pubic debt under 20% of GDP, while a higher-than-expected oil price could lead to an increase of around US$25bn in the National Wealth Fund's liquid FX portion to 8.0-8.5% of GDP.

The room for monetary support is exhausted. Higher-than-expected CPI in 1Q21, driven by food and non-food segments and supported by upward pressure from producer inflation – means CPI is likely to exceed the CBR's target and reach 4.0-4.5% in 2021. CPI should gradually decelerate from its 1Q21 peak of 5.8%, staying above 5.0% until October, but dropping rapidly in 4Q21 and 1Q22 (to below 4.0%) thanks to the high base effect. The global reflation and potential softening in the local fiscal stance ahead of parliamentary elections this September pose upward risks to CPI. The beginning of the key rate hike cycle will be brought forward from 2022 to 2021, with 5.0% seen by the year-end. We see the central bank's base case of 3-4% GDP growth this year as optimistic. The CBR's ability to tighten the real rate will be determined by the pace of economic recovery and tightening expectations from Russia's EM/commodity peers.

Russia

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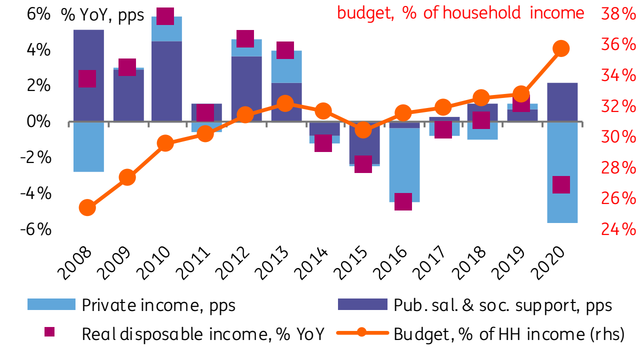
Key indicators of the Russian income trend

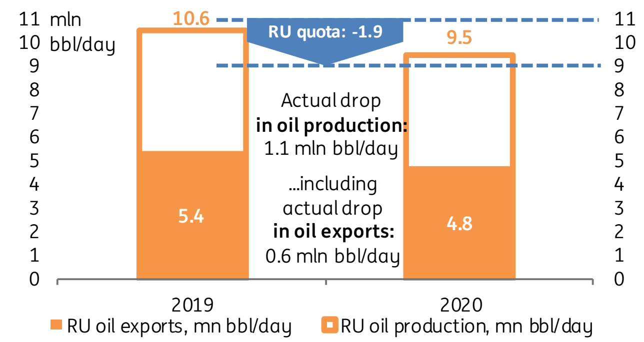


Source: Rosstat, Finance Ministry, ING

Households – income pressured; fiscal tools limited

Our key concern regarding the consumer trend is related to income. The 3.5% drop in the real disposable income in 2020 was entirely due to the 7.5% YoY drop in the private sector (including private sector salaries and other forms of income) and somewhat dampened by a 3.2% YoY increase in public sector salaries, pensions and other social benefits. As a result, the share of household income directly dependent on the budget has increased to the historical high of 36% in 2020, up from 33% in 2019 and 22% in 2006. Meanwhile, fiscal room for additional social support appears limited, with the 2020 enlarged budget spending at a post 2009 high of 39% of GDP, and household income support measures at an historical high of 22% GDP.

Russian oil production and exports

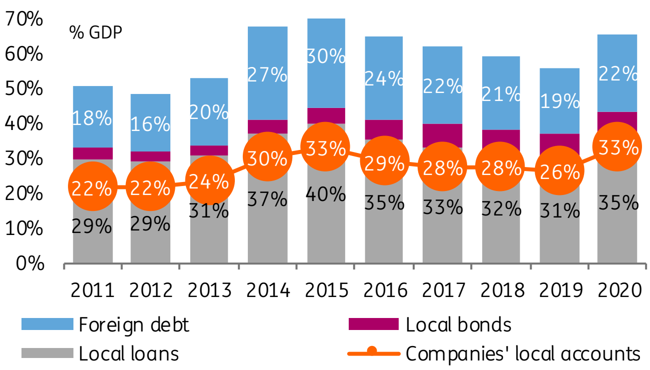


Source: OPEC, Bank of Russia, media, ING

Recovery in volumes to offset potential price correction

In 2020, Russia lowered the average oil production by 1.1mbpd, with half of that amount realised through exports. This seems smaller than the indicated cut of 1.9mbpd, as the reference production level ahead of the cut was higher than actual. Currently, Russia is fully compliant with the OPEC+ restrictions. Oil exports, which dropped to multi-year lows of 4.4mbpd in 2H20, should recover closer to the historical average of 5.0mbpd by 4Q20, and some further catch-up increase in 2022 should be expected. Given ING's view on oil, the Urals price forecast is US$63/bbl in 2021, giving US$110bn in annual oil exports assuming 4.8mbpd. Each 0.2mbpd increase in annual export volumes from that level lowers the required oil price by US$2.0-2.5/bbl without any damage to expected oil exports.

Corporate debt and local accounts

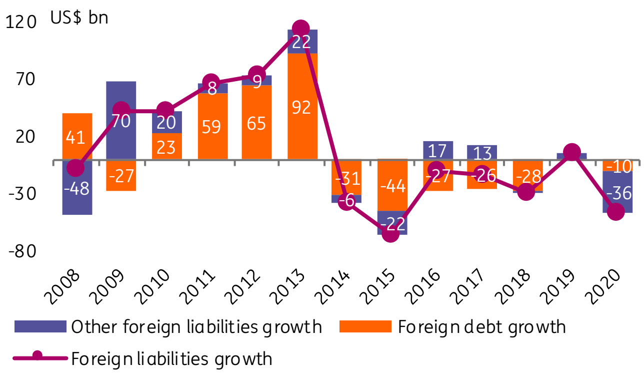


Source: Bank of Russia, ING

Corporate debt burden remains moderate amid low capex

Russian corporate debt was moderate at 66% of GDP in 2020 (up from 56% of GDP in 2019 due to GDP drop) with scope for foreign debt accumulation limited due to sanctions. Local debt is 43% of GDP, predominantly to banks, with loan book growth of 3-6% YoY in 9M20, accelerating to low double-digits in 4Q20. So far, corporate loan growth has been driven by working capital needs and replacement of foreign debt. Capex activity has been low, pushing corporates to accumulate RUB and FX on local bank accounts. Local corporate accounts were up from 26% to 33% of GDP in 2020, dollarization slightly up from 31% to 35% throughout the year, but with growth seen in both RUB and FX segments. On the plus side, the share of RUB corporate loans was more-or-less stable at 72%, with NPLs under control at 7.8% in 2020 (down from 7.9% in 2019).

Annual change of the corporate foreign liabilities



Source: Bank of Russia, ING

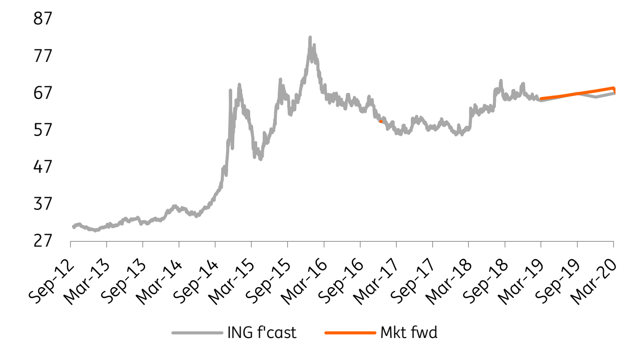
In 2020, equity investments fell the most since 2008

In 2020, the composition of the net private capital outflow from Russia changed materially. If earlier it was assured by the accumulation of foreign assets, a sign of low local investment demand, in 2020, foreign debt redemption contributed to only 23% of the outflow. The US$36bn drop in non-debt foreign liabilities (equity FDI and portfolio investments into banks and non-financial corporates), the largest since 2008, was the key pressure factor for Russia's capital account in 2020. On the positive side, such drops are symptomatic of crisis years (2008, 2014-15), and the equity support from abroad historically tends to recover in the aftermath of a crisis. At the same time, the revision of double taxation treaties with countries accounting for around 50% of Russia's stock of FDI, is clouding the outlook for 2021.

Russia

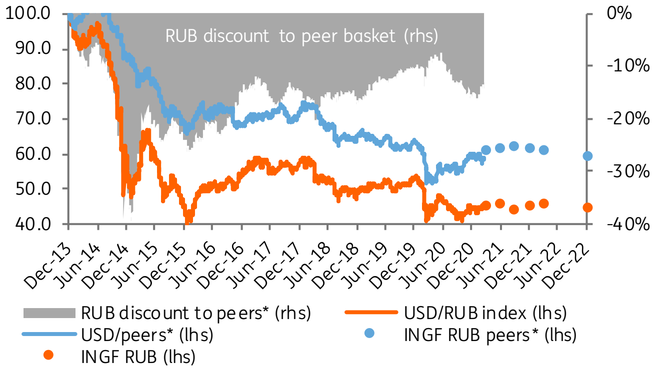
Strategy

FX – spot vs forward and INGF



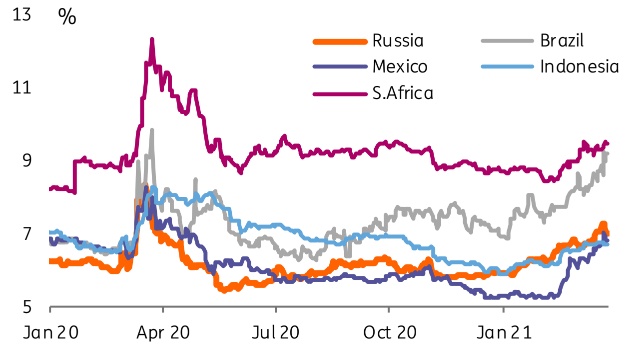
Source: Refinitiv, ING

USD/RUB performance vs its peer group*



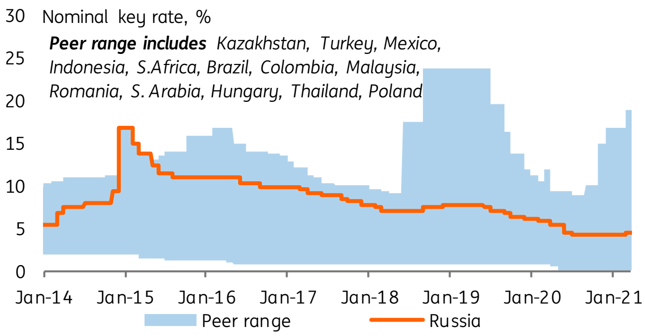
*EW FX basket of ZAR, BRL, TRL, MXN, MYR, NOK, COP; Source: Refinitiv, ING

Yield on 10-year local currency state bonds, by country



Source: Refinitiv, ING

Russian nominal key rate versus peer range



Source: Bank of Russia, Refinitiv, ING

FX strategy

ING upgraded its oil price forecasts for 2021 by around US$9/bbl, to give a Urals price assumption of US$63/bbl versus our previous call of US$54/bbl. According to our calculations, that means a material US$25bn increase in the annual current account forecast to US$70bn for 2021. Meanwhile, the budget will be the key beneficiary of this increase, as more than half of the extra current account (US$15bn) will be sterilised by the FX purchases under the fiscal rule, as we now see annual FX interventions at US$25bn this year (potentially reduced by US$4-5bn if there are investments from NWF into local projects). The remaining US$10-15bn of extra current account is subject to risks of elevated private capital outflows.

While failing to have a direct positive effect on the rouble, it may help insulate it from additional external volatility through reinforced macro stability perceptions. The total foreign debt of 32% of GDP, public debt of under 20% of GDP, liquid FX savings in the sovereign fund at 8% of GDP, expected current account surplus of 4.5% of GDP combined with FX underperformance in 2H20 (see chart USD/RUB performance vs its peer group) should make the rouble less vulnerable to global volatility associated with the US Treasury sell-off than most of its emerging market peers. At the same time, higher oil prices are unlikely to insulate the rouble from the pre-existing Russia-specific challenges, including foreign policy uncertainty (the recent US sanctions were a relief but the risk of further tightening has not been removed) and private capital outflows stemming from low local confidence.

We therefore maintain our cautiously constructive expectations of USD/RUB 73.0 by end-1Q21 and 72.0 by mid-year, though several risks suggest a widening in the range to 70-75.

Russia forecasts

Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (%YoY)	4.5	4.3	4.0	1.8	0.7	-2.0	0.2	1.8	2.8	2.0	-3.1	2.5	2.2
Private consumption (%YoY)	5.5	6.8	7.6	5.1	2.1	-9.5	-2.6	3.7	4.3	3.2	-8.6	4.0	2.0
Government consumption (%YoY)	-1.5	1.4	2.2	0.1	-2.5	-3.6	1.4	2.5	1.3	2.4	4.0	0.0	1.0
Investment (%YoY)	5.9	9.1	6.2	1.9	-2.1	-10.6	1.3	4.7	0.6	1.5	-6.2	3.0	1.0
Industrial production (%YoY)	7.3	5.0	3.4	0.4	1.7	-0.8	2.2	2.1	2.9	2.4	-2.9	3.0	2.0
Unemployment rate (year-end, %)	7.0	6.0	5.5	5.5	5.2	5.6	5.5	5.2	4.8	4.6	5.9	5.5	5.3
Nominal GDP (RUBbn)	46,309	60,114	68,103	72,986	79,030	83,087	85,616	91,843	103,862	109,193	106,607	114,946	121,939
Nominal GDP (€bn)	1,149	1,471	1,705	1,725	1,557	1,226	1,153	1,394	1,405	1,506	1,294	1,274	1,325
Nominal GDP (US$bn)	1,525	2,046	2,191	2,292	2,059	1,363	1,277	1,574	1,657	1,687	1,478	1,567	1,657
GDP per capita (US$)	10,675	14,312	15,356	16,064	14,411	9,503	8,919	10,745	11,271	11,493	10,093	10,693	11,317
Gross domestic saving (% of GDP)	29.8	32.0	30.6	28.2	28.2	29.6	28.3	28.9	33.0	31.3	29.5	n/a	n/a
Prices													
CPI (average, %YoY)	6.9	8.4	5.1	6.8	7.8	15.5	7.1	3.7	2.9	4.5	3.4	5.1	4.1
CPI (year-end, %YoY)	8.8	6.1	6.6	6.5	11.4	12.9	5.4	2.5	4.3	3.0	4.9	4.2	4.5
Wage rates (nominal, %YoY)	12.8	11.7	16.4	9.3	8.3	4.2	7.8	7.3	11.6	9.5	6.0	6.1	6.4
Fiscal balance (% of GDP)													
Consolidated government balance	-3.4	1.4	0.4	-1.2	-1.1	-3.4	-3.7	-1.5	2.9	1.9	-4.0	-2.2	-0.7
Consolidated primary balance	5.6	2.8	1.0	-0.5	-0.4	-3.0	-3.2	-0.6	3.8	2.7	-3.2	-1.2	0.8
Total public debt	7.3	8.8	9.7	10.8	13.4	12.8	12.8	12.9	11.7	12.5	17.7	20.1	20.1
External balance													
Exports (US$bn)	392.7	515.4	527.4	521.8	496.8	341.4	281.7	352.9	443.9	419.9	331.7	402.5	413.4
Imports (US$bn)	245.7	318.6	335.8	341.3	307.9	193.0	191.5	238.4	248.9	254.6	239.7	260.7	279.0
Trade balance (US$bn)	147	197	192	181	189	148	90	115	195	165	92	142	134
Trade balance (% of GDP)	9.6	9.6	8.7	7.9	9.2	10.9	7.1	7.3	11.8	9.8	6.2	9.1	8.1
Current account balance (US$bn)	67	97	71	33	58	68	24	32	116	65	32	70	56
Current account balance (% of GDP)	4.4	4.8	3.3	1.5	2.8	5.0	1.9	2.0	7.0	3.8	2.2	4.5	3.4
Net FDI (US$bn)	-9	-12	2	-17	-35	-15	10	-8	-23	10.1	-5.0	-10.0	-10.0
Net FDI (% of GDP)	-0.6	-0.6	0.1	-0.8	-1.7	-1.1	0.8	-0.5	-1.4	0.6	-0.3	-0.6	-0.6
Current account balance plus FDI (% of GDP)	3.8	4.2	3.3	0.7	1.1	3.9	2.7	1.5	5.6	4.4	1.9	3.8	2.8
Foreign exchange reserves ex gold (US$bn)	443	454	487	470	339	320	318	356	382	444	457	489	526
Import cover (months of merchandise imports)	22	17	17	17	13	20	20	18	18	21	23	23	23
Debt indicators													
Gross external debt (US$bn)	489	539	636	729	600	518	512	518	454	491	470	484	485
Gross external debt (% of GDP)	32.0	26.3	29.0	31.8	29.1	38.0	40.1	32.9	27.4	29.1	31.8	30.9	29.3
Gross external debt (% of exports)	124	105	121	140	121	152	182	147	102	117	142	120	117
Lending to corporates/households (% of GDP)	39.2	38.7	40.7	46.1	53.4	54.9	51.1	50.1	50.3	51.9	53.6	58.4	56.9
Interest & exchange rates													
Central bank key rate (year-end, %)	5.00	5.25	5.50	5.50	17.00	11.00	10.00	7.75	7.75	6.25	4.25	5.00	5.25
Broad money supply (average, %YoY)	23.6	20.3	16.9	16.4	12.7	18.8	10.4	3.4	9.7	7.9	13.5	11.0	11.0
3m interest rate (Mosprime, average, %)	4.1	5.5	7.2	6.9	10.5	13.8	11.2	9.3	7.8	7.8	5.4	5.1	5.4
3m interest rate spread over US$-Libor (ppt)	372	512	675	664	1025	1343	1045	814	530	555	483	478	505
2yr yield (average, %)	5.9	6.7	6.8	6.2	9.2	11.5	9.2	7.9	7.2	6.9	4.9	5.1	5.0
10yr yield (average, %)	7.6	8.6	8.0	7.5	9.6	11.1	8.8	7.8	8.0	7.5	6.3	6.4	6.3
USD/RUB exchange rate (year-end)	30.48	32.20	30.37	32.73	56.26	72.88	60.66	57.60	69.47	61.91	73.88	73.00	74.00
USD/RUB exchange rate (average)	30.37	29.38	31.09	31.84	38.38	60.94	67.06	58.34	62.67	64.74	72.10	73.38	73.6
EUR/RUB exchange rate (year-end)	40.33	41.67	40.23	44.97	68.34	79.70	63.81	68.87	79.46	69.34	90.68	93.44	90.28
EUR/RUB exchange rate (average)	40.30	40.88	39.95	42.30	50.77	67.76	74.26	65.87	73.93	72.51	82.39	90.25	92.00
Brent oil price (annual average, US$/bbl)	80	111	112	109	100	54	45	55	72	64.3	42.9	64.5	69.5

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (%YoY)	2.1	1.6	-8.0	-3.4	-2.0	-0.5	6.0	3.0	1.5	2.5	0.0	3.0	3.3
CPI (eop, %YoY)	3.0	2.5	3.2	3.7	4.9	5.7	5.3	5.3	4.2	3.9	3.9	4.2	4.5
Central bank key rate (eop, %)	6.25	6.00	4.50	4.25	4.25	4.50	4.75	5.00	5.00	5.00	5.00	5.00	5.25
3m interest rate (eop, %)	6.5	6.7	4.9	4.6	4.9	4.9	5.0	5.3	5.3	5.3	5.3	5.3	5.6
10yr yield (eop, %)	6.41	6.83	6.05	6.42	6.27	6.70	6.50	6.30	6.20	6.10	6.10	6.30	6.75
USD/RUB exchange rate (eop)	61.9	77.7	70.0	79.7	73.9	73.00	72.00	75.00	73.00	72.00	73.00	76.00	74.00
EUR/RUB exchange rate (eop)	69.3	85.7	78.7	93.0	90.7	86.14	87.84	93.75	93.44	92.16	91.25	93.48	90.28

Source: National sources, ING estimates

Serbia

Valentin Tataru, Economist, Bucharest

Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (%YoY)	-1.0	0.4	12.0	5.4	4.7	5.5	5.0
CPI (%YoY)*	1.3	1.4	1.7	2.0	2.3	1.9	2.3
Policy interest rate (eop, %)	1.00	1.00	1.00	1.00	1.00	1.00	1.50
3m interest rate (%)*	0.90	0.90	0.95	1.00	1.05	0.90	1.20
10yr yield (%)*	3.10	2.50	2.65	2.75	2.85	2.75	3.00
USD/RSD*	96.4	99.7	96.4	94.1	91.8	95.6	94.0
EUR/RSD*	117.6	117.6	117.6	117.6	117.5	117.6	117.6

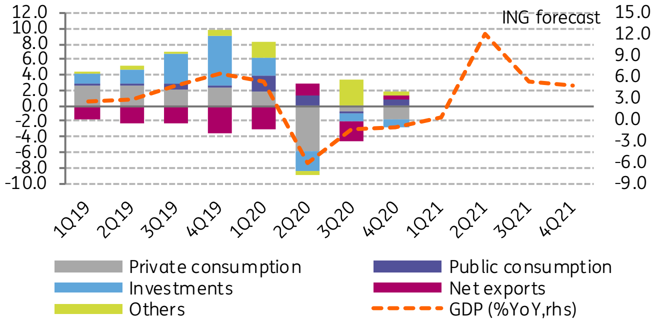
Macro Trend		Political Cycle	Ratings	FC	LC
Activity		Presidential: 2022	S&P	BB+	BB+
Fiscal	Loose	Parliamentary: 2024	Moody's	Ba2	Ba2
Monetary	Loose	Local: 2024	Fitch	BB+	BB+

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

Country strategy: resuming the rapid growth

Having navigated a complicated 2020 in an impressively resilient manner, the Serbian economy looks on track to outperform (again) most - if not all - European economies in 2021. In achieving this, a few elements will need to align (and we think they will): a narrower but still sufficiently loose fiscal gap, a successful vaccine rollout, on-hold (hence stimulative) monetary policy and a restoration of external demand. On the downside, there seems to be little progress with the EU in opening new negotiation chapters while the prospects of early elections in 2022 could derail the reforms in the SOE sector and the related privatisation process. On the ratings front, we maintain our view that Serbia has a reasonable prospect of achieving investment grade by the end of 2022.

Real GDP (%YoY) and contributions (ppt)

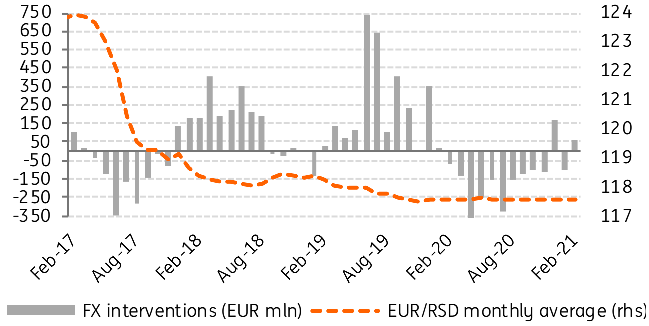


Source: Eurostat, ING

On track to close the output gap in 2Q21

The combined monetary and fiscal response (that amounted to some 12% of GDP) limited the economic contraction to 1.0% in 2020. For 2021, the implementation of the newly announced fiscal package of around 4.0% of GDP (including direct one-off payments of €60 to citizens above 18 years old and €50 for pensioners) will be key to maintain the growth momentum but could also lead to a budget gap way higher than the official 3.0% of GDP estimate and even higher than our 3.5% forecast. Public investments are planned to reach historical highs of 5.5% of GDP in 2021, but key to achieving a GDP growth in the 5-6% range will be the recovery of private consumption.

FX stability at its best

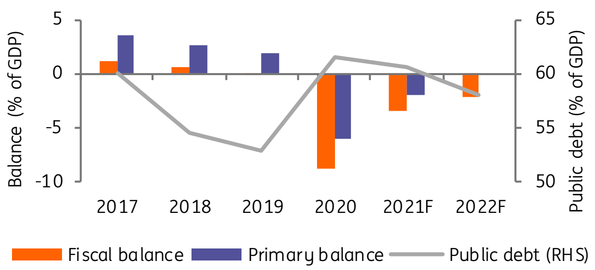


Source: NBS, ING

The end of a long easing cycle

Faced with an inflation that remains benign but nevertheless on the rise, the NBS is likely to leave its key rate unchanged at 1.00% for the rest of 2021. Monetary policy should remain FX-centred, as the 'relative stability of the exchange rate' is repeatedly brought forward in the central bank's communication. For now, the inflation outlook appears fairly contained within the lower half of the 1.5-4.5% tolerance band. We remain slightly wary about the demand-side pressures which could surprise the policymakers given the context of direct fiscal stimuli and the approaching elections. Hence, while still safely within target, we believe that inflation will stay on the rise in 2022 as well, triggering a short-lived tightening cycle.

Government debt and fiscal balance (% of GDP)



Source: National sources, ING estimates

Serbia forecasts

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Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (%YoY)	0.7	2.0	-0.7	2.9	-1.6	1.8	3.3	2.0	4.4	4.1	-1.1	5.5	5.0
Private consumption (%YoY)	-0.6	1.4	-1.7	-1.7	-0.1	-0.3	1.2	1.9	3.1	2.4	-0.3	3.5	6.5
Government consumption (%YoY)	-0.1	1.6	0.4	-2.1	1.0	-3.8	1.2	3.3	3.7	3.0	12.9	3.5	2.5
Investment (%YoY)	-6.5	4.7	13.9	-12.0	-3.4	4.9	5.3	7.0	18.3	15.7	-4.7	13.0	8.0
Industrial production (%YoY)	1.3	2.5	-2.2	5.5	-6.5	8.4	4.7	3.5	1.3	0.2	0.2	3.3	2.0
Unemployment rate (average, %)	17.4	20.0	24.4	23.1	22.1	17.7	15.3	13.5	12.7	10.3	9.0	8.0	7.5
Nominal GDP (RSDbn)	3,251	3,612	3,810	4,121	4,161	4,315	4,528	4,761	5,073	5,418	5,474	5,900	6,300
Nominal GDP (€bn)	30.8	34.5	33.5	35.9	34.4	35.5	36.7	40.2	42.9	46.1	46.6	50.2	53.6
Nominal GDP (US$bn)	48.1	46.0	52.1	46.8	49.0	48.4	41.4	42.6	50.6	51.0	54.0	63.2	68.6
GDP per capita (US$)	6,600	6,400	7,300	6,600	6,900	6,900	5,900	6,100	7,300	7,400	7,800	9,200	9,900
Gross domestic saving (% of GDP)	5.4	5.5	5.5	9.2	8.5	11.6	13.1	13.0	14.2	14.8	14.3	15.2	15.4
Prices													
CPI (average, %YoY)	6.1	11.1	7.3	7.7	2.1	1.4	1.1	3.1	2.0	1.9	1.5	1.9	2.3
CPI (year-end, %YoY)	10.2	7.0	12.2	2.2	1.8	1.6	1.5	3.0	2.0	1.9	1.3	2.3	2.5
Wage rates (nominal, %YoY)	7.5	11.2	9.0	6.2	1.4	-0.2	3.7	1.5	6.5	10.6	9.4	10.0	8.0
Fiscal balance (% of GDP)													
Consolidated government balance	-4.3	-4.5	-6.4	-5.1	-6.2	-3.5	-1.2	1.1	0.6	-0.2	-8.9	-3.5	-2.2
Consolidated primary balance	-3.4	-3.4	-4.7	-3.0	-3.5	-0.5	1.7	3.6	2.7	1.8	-6.1	-2.0	0.0
Total public debt	48.9	43.5	54.3	56.7	65.4	70.7	68.5	60.1	54.4	52.9	61.5	60.5	58.0
External balance													
Exports (€bn)	7.4	8.5	8.8	11.1	11.1	12.0	13.4	14.7	15.5	17.5	17.0	18.4	19.9
Imports (€bn)	12.6	14.3	14.7	15.5	15.4	16.4	17.3	19.8	21.9	24.0	23.0	25.0	27.2
Trade balance (€bn)	-5.2	-5.8	-5.9	-4.4	-4.3	-4.3	-3.9	-5.2	-6.3	-6.4	-6.0	-6.6	-7.3
Trade balance (% of GDP)	-17.0	-16.8	-17.5	-12.2	-12.4	-12.2	-10.6	-12.9	-14.8	-14.0	-12.9	-13.1	-13.5
Current account balance (€bn)	-2.0	-3.7	-3.7	-2.1	-2.0	-1.2	-1.1	-2.1	-2.1	-3.2	-2.0	-2.6	-2.8
Current account balance (% of GDP)	-6.5	-10.7	-11.0	-5.8	-5.8	-3.4	-3.0	-5.2	-4.9	-6.9	-4.3	-5.2	-5.2
Net FDI (€bn)	1.1	3.3	0.8	1.3	1.2	2.0	1.9	2.4	3.2	3.6	2.9	3.6	3.0
Net FDI (% of GDP)	3.6	9.6	2.4	3.6	3.5	5.6	5.2	6.0	7.5	7.8	6.2	7.2	5.6
Current account balance plus FDI (% of GDP)	-2.9	-1.2	-8.7	-2.2	-2.3	2.3	2.2	0.7	2.6	0.9	1.9	2.0	0.4
Foreign exchange reserves ex gold (€bn)	11.2	12.3	11.4	11.6	11.1	11.2	11.1	10.4	12.2	13.6	13.8	14.7	15.9
Import cover (months of merchandise imports)	10.7	10.4	9.3	9.0	8.6	8.2	7.7	6.3	6.7	6.8	7.2	7.1	7.0
Debt indicators													
Gross external debt (€bn)	23.8	24.1	25.6	25.6	25.7	26.2	26.5	25.5	26.7	28.3	30.5	31.0	31.3
Gross external debt (% of GDP)	77.2	69.9	76.5	71.3	74.7	73.9	72.2	63.5	62.1	61.3	65.5	61.8	58.4
Gross external debt (% of exports)	322	285	290	231	230	218	197	174	172	161	179	168	157
Lending to corporates/households (% of GDP)	40.0	47.2	44.8	46.5	41.0	40.8	40.6	40.9	40.3	41.5	45.7	49.2	50.3
Interest & exchange rates													
Central bank key rate (year-end, %)	11.50	9.75	11.25	9.50	8.00	4.50	4.00	3.50	3.00	2.25	1.00	1.00	1.50
Broad money supply (average, %YoY)	19.7	6.6	14.7	5.6	5.9	5.8	9.2	8.0	7.3	12.4	15.5	14.0	12.2
3m interest rate (Belibor, average, %)	10.75	12.85	11.66	10.13	8.25	6.08	3.43	3.40	2.96	2.50	1.18	0.90	1.20
3m interest rate spread over Euribor (ppt)	10.0	11.5	11.0	9.9	8.1	6.1	3.7	3.7	3.3	2.9	1.6	1.4	1.7
3yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	3.20	2.10	2.00	2.50
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	4.80	4.00	3.10	2.75	3.00
USD/RSD exchange rate (year-end)	62.9	66.7	79.3	80.9	86.2	83.1	99.5	111.2	117.1	102.3	105.0	91.8	96.1
USD/RSD exchange rate (average)	55.8	67.6	78.6	73.1	88.0	84.9	89.1	109.4	111.8	105.2	101.4	95.6	94.0
EUR/RSD exchange rate (year-end)	105.5	104.6	113.7	114.6	121.0	121.6	123.5	118.5	118.2	117.6	117.6	117.6	117.5
EUR/RSD exchange rate (average)	103.5	102.0	113.6	113.1	117.4	120.8	123.2	121.3	118.3	117.8	117.6	117.6	117.6

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (%YoY)	6.3	5.2	-6.3	-1.4	-1.0	0.4	12.0	5.4	4.7	4.8	5.0	5.0	5.1
CPI (eop, %YoY)	1.9	1.3	1.6	1.8	1.3	1.4	1.7	2.0	2.3	2.3	2.3	2.2	2.5
Central bank key rate (eop, %)	2.25	1.75	1.25	1.25	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.50	1.50
3m interest rate (eop, %)	1.65	1.35	1.05	1.00	0.90	0.90	0.95	1.00	1.05	1.25	1.25	1.50	1.50
10yr yield (eop, %)	2.90	3.00	3.15	3.15	3.10	2.50	2.65	2.75	2.85	3.00	3.00	3.00	3.00
USD/RSD exchange rate (eop)	105.0	106.9	105.0	100.5	96.4	99.7	96.4	94.1	91.8	91.8	94.0	95.4	96.1
EUR/RSD exchange rate (eop)	117.6	117.6	117.6	117.6	117.6	117.6	117.6	117.6	117.5	117.5	117.5	117.4	117.3

Source: National sources, ING estimates

Turkey

Muhammet Mercan, Chief Economist, Istanbul

Forecast summary

	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (% YoY)	5.9	2.6	10.6	3.5	3.9	5.0	4.5
CPI (% YoY)*	14.6	15.8	14.6	14.0	11.5	14.3	10.5
Policy interest rate (eop, %)	17.00	19.00	19.00	19.00	16.00	16.00	12.00
3m interest rate (%)*	15.59	17.01	17.01	16.88	15.47	16.30	13.34
10yr yield (%)*	12.90	14.22	13.93	13.82	13.63	13.84	13.11
USD/TRY*	7.43	7.30	7.40	7.60	7.80	7.49	8.18
EUR/TRY*	9.08	8.61	9.03	9.50	9.98	9.18	10.24

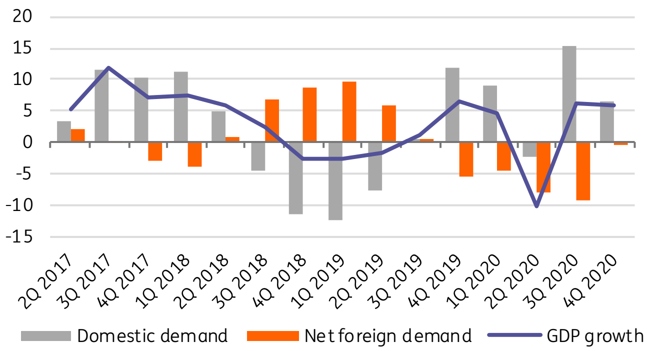
Macro Trend		Political Cycle	Ratings	FC	LC
Activity	▼	Presidential: June 2023	S&P	B+	BB-
Fiscal	Neutral	Parliamentary: June 2023	Moody's	B2	B2
Monetary	Tighter	Local: March 2024	Fitch	BB-	BB-

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

Country strategy

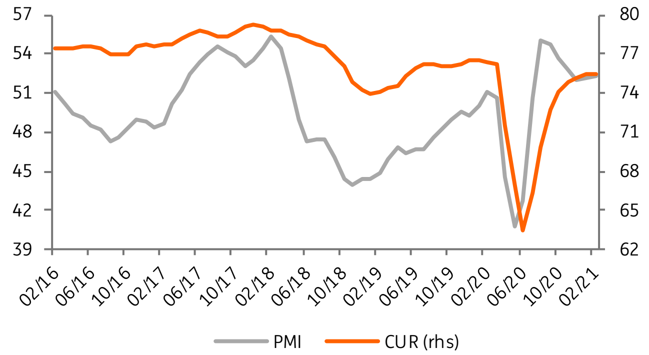
The pandemic turned out to have a lesser impact on Turkey than on many other countries, with its supportive policy mix leading to a deterioration of inflation and external imbalances. The risk premium has also increased with accelerating dollarization and capital outflows last year. Policymakers responded with a number of positive steps to restore macroeconomic stability, while these efforts have been more evident on the monetary front. With the CBT's rate hikes along with the simplification of the policy framework, investor sentiment recovered, though the recent change in governorship has increased market uncertainty over the future path of policy rates and the monetary framework. With further guidance from the CBT, we will revisit our forecasts.

GDP growth (% YoY)



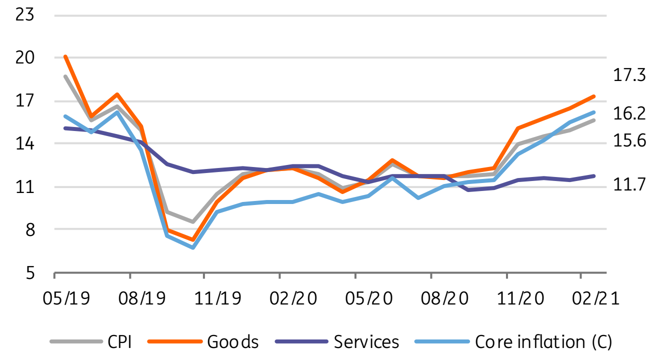
Source: TurkStat, ING

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



Source: ICI, TurkStat, ING

Inflation (% YoY)



Source: TurkStat, ING

Macro digest

In the pandemic year, GDP expansion was strong at 1.8%, recording one of the best performances among the major EM countries, vs 0.9% in 2019 and well above of the government's 0.3% projection. While losing some momentum in comparison to 3Q, the 4Q growth at 5.9% was still buoyant as evidenced earlier by high frequency economic activity indicators. In the sectoral breakdown, all sectors with the exception of construction have lifted the headline growth showing continuation of a broad-based recovery. Among the positive drivers, industry was again the biggest contributor followed by services, which was surprising given the return of pandemic-control restrictions in early-November. All in all, the data showed continuation of a rebound from the pandemic-induced recession despite the revival of quarantine measures with the second wave of the Covid-19 pandemic. Despite some moderation versus 3Q, 4Q GDP performance remained strong driven by private consumption, gross fixed capital formation and government expenditures while the contributions from net exports and inventory were in negative territory. The latest activity indicators hint at a strong start to this year and the carry over effect from last year should keep yearly growth high, though the pace of activity is likely to lose momentum given significant policy tightening by the BRSA and CBT moves along with ongoing uncertainty related to the pandemic and pace of vaccinations.

Recent CPI data confirms still challenging inflation dynamics with demand conditions, elevated services inflation, a recent uptrend in commodity prices and supply constraints during the pandemic. Accordingly, the annual figure has followed a strong uptrend since November and reached 15.6% at the latest, while core inflation stood at 16.2%. As an indicator for underlying price dynamics, the diffusion index has remained high showing the extent of pricing pressures, despite some moderation lately. The Domestic Producer Price Index (D-PPI), on the other hand, exceeded 27% with a sharp uptrend since last May on the back of the impact of exchange rate developments last year but also recent pressure on commodity prices and strong base effects. The outlook indicates significant producer-price-driven cost pressures on the inflation outlook. Inflation is likely to peak in April though upside risks continue given a likely recovery in pandemic-led weak demand conditions in certain groups with normalisation process, ie, clothing, possibility of tax adjustments and still high inflation expectations. Importantly, a strong uptrend in commodity prices that started in the last quarter of 2020 is likely to create challenges by further weighing on input costs, and hence inflation outlook.

Turkey

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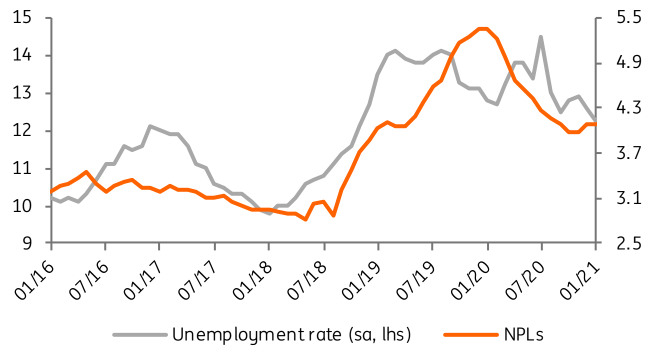
Unemployment vs NPLs (%)

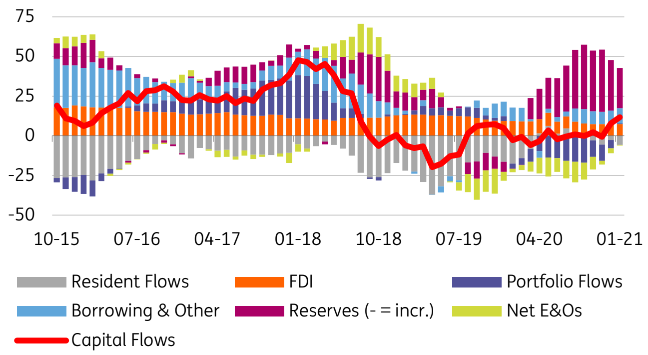


Source: TurkStat, BRSA, ING

Recovery in employment despite pandemic restrictions

Labour force statistics that were published as 3-month moving averages until this year started to be announced as independent monthly estimates from January. The first monthly data of 2021 defied relatively cautious expectations with a sharp drop in the unemployment rate despite pandemic-control restrictions that were revived in November. The improvement is mainly driven by an unexpected jump in agriculture employment, along with a strong recovery in services job creation. However, the broad definition of unemployment shows a continued strain in the labour market, indicating that protection of households remains a pressing issue for policymakers. The labour market could be further challenged by the longer tightening being signalled under the current policy framework.

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

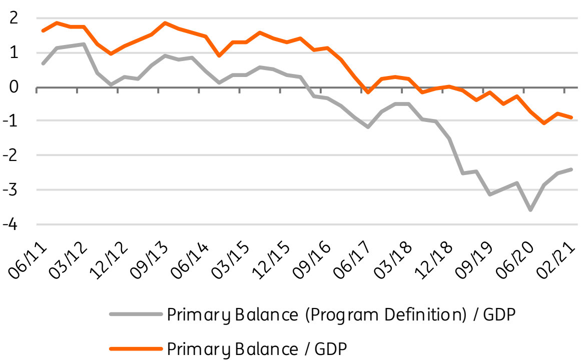


Source: CBT, ING

Signals of direction change in current account

The current account deficit is expected to narrow in 2021 thanks to normalisation efforts, a mean reversion in the gold deficit and a recovery in tourism showing initial signs of improvement in January. However, a rise in import prices could significantly limit the pace of recovery and, depending on the extent of the commodity prices uptrend, a continuation of tight credit policy and demand control would become even more important for the external outlook. On the capital account, flows should strengthen to boost reserves given relatively demanding external debt payments. Since the policy shift in November, we have seen inflows thanks to: (1) increasing portfolio flows with interest of foreign investors in local government debt; and (2) Treasury eurobond issuances at US$8.25bn since October.

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

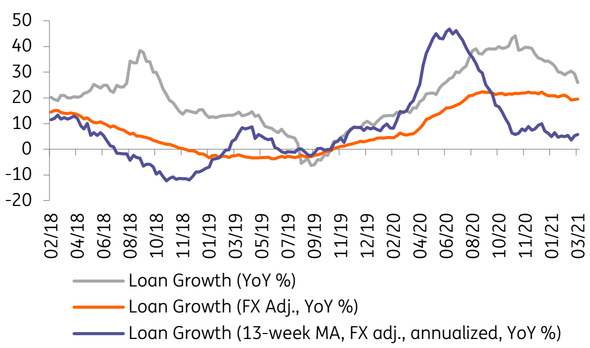


Source: Ministry of Treasury and Finance, ING

More prudence on the fiscal side

While there is a need for supportive policy on the fiscal side under the pandemic conditions, efforts are expected to focus on better management of non-interest spending and contingent liabilities. Given this backdrop, the Ministry of Finance has signalled support in the disinflation efforts, cutting the budget deficit target from 4.3% of GDP to 3.5% in 2021. The central administration budget in the first two months of the year was impacted by the absence of profit transfers from the CBT that were carried out in January last year instead of April, though we saw: (1) strength in tax collection, up by 27.7% YoY, with resilient domestic demand; and (2) muted 4.9% YoY nominal growth in primary spending. Interest expenditure, on the other hand, surged by 29% YoY on the back of higher borrowing increasingly in the short term with higher rates.

Banking sector volume expansion



Source: BRSA, ING

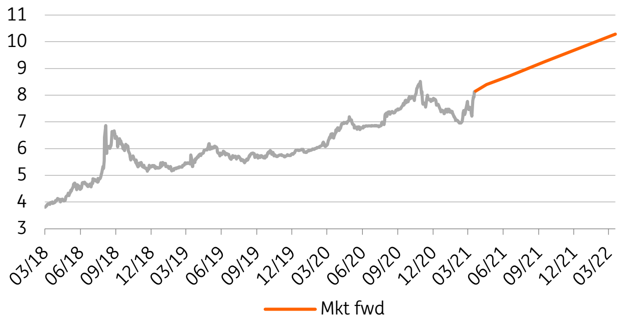
Reacceleration signals in lending attracts attention

Given the strong association between credit growth and the current account balance, policymakers have targeted to fix external imbalances with a slowdown in credit expansion. This should also contribute to ease exchange rate pressures as well as the inflation rate. Normalisation in lending has been more apparent lately as growth of the 13-week moving average FX adjusted lending volume returned to single digits in late 2020, after peaking at 140% for TRY commercial loans in mid-May, and 125% in mid-August for consumer loans. However, retail lending expansion is still strong for non-state banks with the same measure above 20%. In the March MPC, the CBT also expressed concern about some reacceleration signals in lending that lost significant momentum in recent months.

Turkey

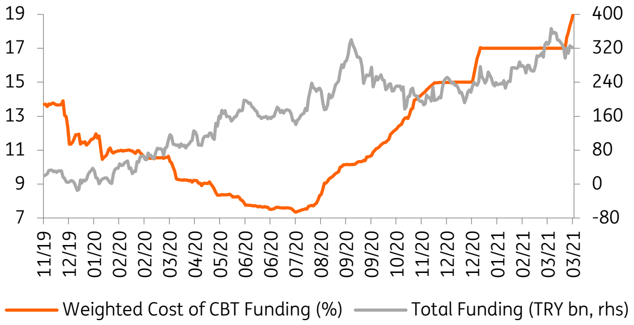
Strategy

FX – spot vs forward



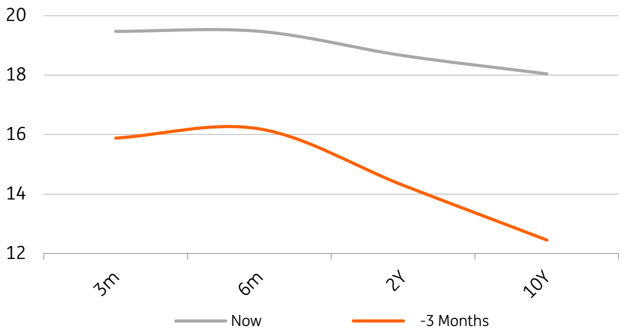
Source: Bloomberg, ING estimates

CBT funding



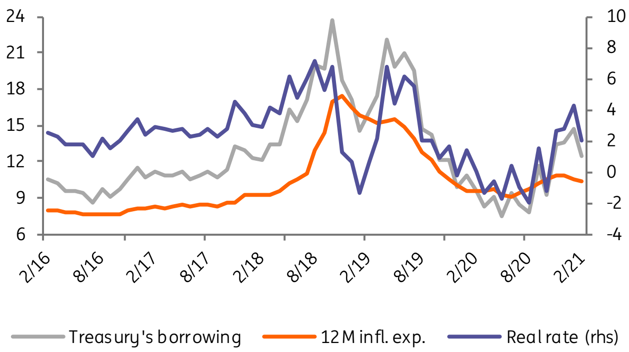
Source: CBT, ING

Local curve (%)



Source: Bloomberg, ING estimates

Real interest rate (%)



Source: Treasury, CBT, ING

FX strategy

A number of factors have been supportive for the TRY until recently: (1) the CBT's cautious approach and forward guidance to keep the current real rate buffer in place so as to ease inflationary pressures; (2) the highest nominal and risk adjusted carry for the TRY in the EM FX space; (3) one of the cheapest EM currencies based on ING REER terms from a fundamental perspective; (4) given concerns about level of FX reserves, a need for caution before reducing the restrictive policy stance; and (5) better C/A outlook with the deficit set to reduce in coming months.

While the new governor's initial messages not signalling policy change or immediate rate moves, and meanwhile adhering to the main objective of achieving a permanent fall in inflation, a concrete guidance as to future economic policy and monetary stance should help recover the TRY outlook.

Going forward: (1) although the CBT currently pursues a restrictive policy stance, a likely reversal would take away some support from the currency; (2) while Turkey's current account position is likely to improve versus 2020 due to a mean reversion in the gold deficit and a recovery in tourism, it is expected to remain in deficit, and commodity prices and any shift in local policy mix should pose downside risks for this year; and (3) persistently high CPI in double digits this year should impact on TRY performance.

Turkey forecasts

Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (% YoY)	8.4	11.2	4.8	8.5	4.9	6.1	3.3	7.5	3.0	0.9	1.8	5.0	4.5
Private consumption (% YoY)	11.0	12.2	3.2	7.6	3.1	5.2	3.7	5.9	0.5	1.5	3.2	4.0	4.8
Government consumption (% YoY)	1.7	1.1	6.8	8.0	3.1	3.9	9.5	5.0	6.6	4.4	2.3	-1.9	-0.7
Investment (% YoY)	22.0	23.7	2.9	14.2	4.9	9.3	2.2	8.3	-0.3	-12.4	6.5	4.5	5.0
Industrial production (% YoY)	13.7	14.7	4.2	7.2	5.7	5.8	3.4	9.0	1.3	-0.5	1.6	13.3	3.9
Unemployment rate (year-end, %)	11.1	9.1	8.4	9.0	9.9	10.3	10.9	10.9	10.9	13.7	13.1	12.6	12.1
Nominal GDP (TRYbn)	1,168	1,405	1,581	1,823	2,055	2,351	2,627	3,134	3,758	4,320	5,048	5,800	6,709
Nominal GDP (€bn)	541	624	684	717	681	707	779	763	664	678	623	632	655
Nominal GDP (US$bn)	775	834	885	946	937	856	867	861	774	761	712	774	820
GDP per capita (US$)	10,629	11,289	11,675	12,582	12,178	11,085	10,964	10,696	9,792	9,213	8,534	9,201	9,637
Gross domestic saving (% of GDP)	24.7	29.1	26.2	27.8	27.0	26.5	26.0	26.0	26.7	25.7	28.2	27.2	27.0
Prices													
CPI (average, % YoY)	8.6	6.5	8.9	7.5	8.9	7.7	7.8	11.1	16.3	15.2	12.3	14.3	10.5
CPI (year-end, % YoY)	6.4	10.4	6.2	7.4	8.2	8.8	8.5	11.9	20.3	11.8	14.6	11.5	9.5
Wage rates (nominal, % YoY)	5.8	7.5	9.7	10.9	10.1	13.8	21.9	9.2	18.4	25.5	14.1	20.3	13.3
Fiscal balance (% of GDP)													
Consolidated government balance	-3.4	-1.3	-1.9	-1.0	-1.1	-1.0	-1.1	-1.5	-1.9	-2.8	-3.4	-4.2	-3.5
Consolidated primary balance	0.7	1.7	1.2	1.7	1.3	1.3	0.8	0.3	0.0	-0.5	-0.8	-1.0	-0.4
Total public debt	39.7	36.2	32.4	31.2	28.5	27.4	28.0	28.0	30.2	33.1	35.9	37.0	36.2
External balance													
Exports (US$bn)	121.0	142.4	161.9	167.4	173.3	154.9	152.6	169.2	178.9	182.2	168.4	194.7	209.2
Imports (US$bn)	177.3	231.6	227.3	249.3	239.9	203.9	192.6	227.8	219.7	199.0	206.3	228.6	244.7
Trade balance (US$bn)	-56.3	-89.2	-65.4	-81.9	-66.6	-49.0	-39.9	-58.6	-40.8	-16.8	-37.8	-33.9	-35.5
Trade balance (% of GDP)	-7.3	-10.7	-7.4	-8.7	-7.1	-5.7	-4.6	-6.8	-5.3	-2.2	-5.3	-4.4	-4.3
Current account balance (US$bn)	-44.6	-74.4	-48.0	-55.9	-38.8	-27.3	-26.8	-40.6	-20.7	6.8	-36.8	-24.2	-20.8
Current account balance (% of GDP)	-5.8	-8.9	-5.4	-5.9	-4.1	-3.2	-3.1	-4.7	-2.7	0.9	-5.2	-3.1	-2.5
Net FDI (US$bn)	9.1	16.2	13.7	13.6	13.3	19.3	13.9	11.1	13.0	9.3	7.8	9.5	10.8
Net FDI (% of GDP)	1.2	1.9	1.6	1.4	1.4	2.3	1.6	1.3	1.7	1.2	1.1	1.2	1.3
Current account balance plus FDI (% of GDP)	-4.6	-7.0	-3.9	-4.5	-2.7	-0.9	-1.5	-3.4	-1.0	2.1	-4.1	-1.9	-1.2
Foreign exchange reserves ex gold (US$bn)	80.7	78.3	100.3	112.0	106.3	95.7	92.1	84.1	72.0	81.2	51.6	58.0	69.2
Import cover (months of merchandise imports)	5.5	4.1	5.3	5.4	5.3	5.6	5.7	4.4	3.9	4.9	3.0	3.0	3.4
Debt indicators													
Gross external debt (US$bn)	291.2	304.8	341.5	394.5	406.9	399.2	408.1	453.8	442.6	434.2	441.1	455.8	465.9
Gross external debt (% of GDP)	38	37	39	42	43	47	47	53	57	57	62	59	57
Gross external debt (% of exports)	241	214	211	236	235	258	267	268	247	238	262	234	223
Lending to corporates/households (% of GDP)	45.4	48.8	50.3	57.7	60.2	63.1	66.0	66.9	63.7	61.4	70.4	69.7	70.3
Interest & exchange rates													
Central bank key rate (year-end, %)	6.50	5.75	5.50	4.50	8.25	7.50	8.00	8.00	24.00	12.00	17.00	16.00	12.00
Broad money supply (average, % YoY)	19.1	14.8	10.2	22.2	11.9	17.1	18.3	15.7	19.1	26.1	36.0	15.9	16.7
3m interest rate (TRLibor, average, %)	7.4	8.3	8.9	6.1	8.6	9.9	8.9	11.6	19.1	18.8	11.0	16.3	13.3
3m interest rate spread over US$-Libor(ppt)	718	796	836	581	837	960	812	1029	1671	1684	1071	1605	1309
2yr yield (average, %)	8.4	9.1	8.1	7.6	9.2	9.8	9.7	11.8	18.9	17.2	11.9	15.7	13.5
10yr yield (average, %)	9.8	9.6	8.6	8.3	9.3	9.4	10.1	11.0	15.8	15.5	12.7	13.8	13.1
USD/TRY exchange rate (year-end)	1.55	1.91	1.78	2.13	2.32	2.92	3.53	3.79	5.29	5.95	7.43	7.80	8.50
USD/TRY exchange rate (average)	1.51	1.68	1.79	1.93	2.19	2.75	3.03	3.64	4.85	5.67	7.09	7.49	8.18
EUR/TRY exchange rate (year-end)	2.07	2.47	2.35	2.93	2.81	3.17	3.70	4.55	6.05	6.67	9.08	9.98	10.37
EUR/TRY exchange rate (average)	2.16	2.25	2.31	2.54	3.02	3.33	3.37	4.11	5.66	6.37	8.11	9.18	10.24
Brent oil price (annual average, US$/bbl)	79.86	112.08	112.40	109.55	99.35	52.08	43.31	54.75	71.75	64.00	43.20	64.50	69.50

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (% YoY)	6.4	4.5	-10.3	6.3	5.9	2.6	10.6	3.5	3.9	4.9	5.0	4.4	4.0
CPI (eop, % YoY)	11.8	11.9	12.6	11.7	14.6	15.8	14.6	14.0	11.5	11.3	10.6	10.1	9.5
Central bank key rate (eop, %)	12.00	9.75	8.25	10.25	17.00	19.00	19.00	19.00	16.00	15.00	14.00	13.00	12.00
3m interest rate (eop, %)	10.67	10.58	8.30	10.95	15.59	17.0	17.0	16.9	15.5	13.8	13.1	12.8	12.0
10yr yield (eop, %)	12.21	13.55	11.83	13.23	12.90	14.22	13.9	13.8	13.6	13.4	13.1	12.5	12.2
USD/TRY exchange rate (eop)	5.95	6.61	6.85	7.72	7.43	7.30	7.40	7.60	7.80	7.98	8.15	8.33	8.50
EUR/TRY exchange rate (eop)	6.67	7.30	7.70	9.05	9.08	8.61	9.03	9.50	9.98	10.21	10.19	10.24	10.37

Source: National sources, ING estimates

Ukraine

Karol Pogorzelski, Leszek Kąsek, Economists, Warsaw

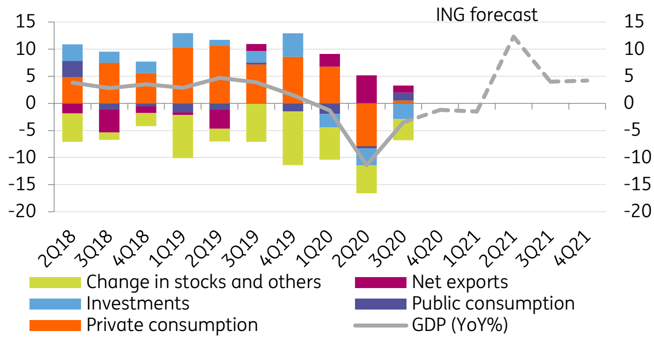
Forecast summary

	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F	2021F	2022F
Real GDP (%YoY)	-1.2	-1.5	12.3	4.0	4.2	4.8	4.1
CPI (%YoY)*	5.0	7.5	8.0	8.0	7.5	7.8	6.3
Policy interest rate (eop, %)	6.0	6.5	6.5	6.8	6.8	6.8	6.8
USD/UAH*	28.4	27.8	28.2	28.1	28.0	28.0	27.7
EUR/UAH*	35.0	32.8	34.4	35.1	35.8	34.5	34.5

Macro Trend		Political Cycle	Ratings	FC	LC
Activity	▲	Presidential: 2024	S&P	B	B
Fiscal	Loose	Parliamentary: 2023	Moody's	B3	B3
Monetary	Neutral	Local: 2024	Fitch	B	B

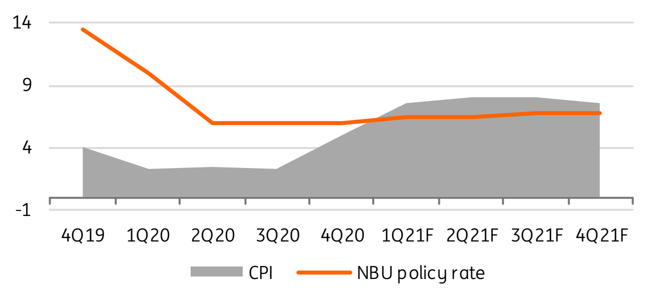
*Quarterly data is eop, annual is avg Source: National sources, ING estimates

GDP (YoY%) and components (ppt)



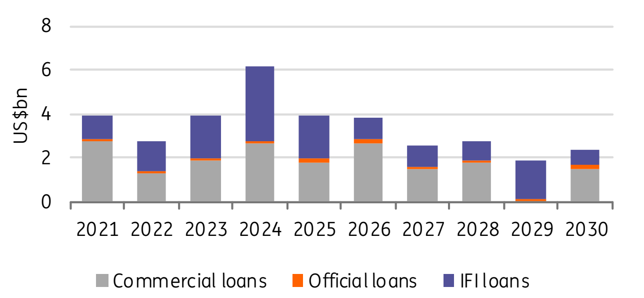
Source: NSI, ING

Inflation and NBU policy rate



Source: NBU, ING

Government external debt repayment profile (US$bn)



Source: Ministry of Finance, ING

Country strategy: leaning to international bond markets

Given that Ukraine will probably draw another tranche from the IMF later in 2021, and conclude the US$5bn programme with less than US$3bn in withdrawals, the country will need to lean more on international markets. Recently, these markets became even more volatile than usual on the back of the reflation story in the US. This is very evident in Ukraine as CPI accelerated to 7.5% YoY and the NBU demonstrated its reliability and unexpectedly hiked the rates in early March 2021 despite rising Covid-19 contagions and regional lockdowns, and the slow pace of vaccinations. Growth is to rebound, driven by industry. In politics, the ruling party is increasingly fragmented in Parliament, and President Zelenskiy is struggling to maintain a reform course despite pressures and a vested interest.

A global shift from services to industry supports growth

The GDP contraction of 4.4% in the pandemic year 2020 was milder than we projected in November and much shallower than feared in the Spring. The economy fared relatively well in 4Q20 and shrank by 1.5% YoY compared to -3.5% in 3Q and -11.4% in 2Q. This is despite economics restrictions introduced during the late-Autumn wave of the pandemic. This resilience can be associated with a global shift in demand from services, suffering from the various lockdown measures, to industry, not to mention agriculture, which have been less exposed to restrictions. Recently, also, commodity prices have trended upwards, which favours Ukrainian export specialisations. We expect GDP to expand to above 4% in 2021-22.

The NBU is reacting to higher and accelerating inflation

With the March 2021 hike of the main policy rate from 6% to 6.5%, the NBU ended the easing cycle to support the economy during the pandemic. The inflation rate accelerated from 2.3% at the end of 1Q20 to 5.0% in 4Q20 and 7.5% in February 2021 (driven by food and fuel prices), which is well above the NBU's inflation target of 5% with a ±1ppt band. The acceleration of inflation and double-digit growth in nominal wages required a prompt monetary policy reaction to contain the second-round lockdown effects. In our baseline scenario, the key rate is projected to be hiked by only 0.25ppt in 2021 as inflationary pressure should gradually fade.

Ukraine forecasts

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Annual forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021F	2022F
Activity													
Real GDP (%YoY)	4.1	5.5	0.2	0.0	-6.6	-9.8	2.4	2.5	3.4	3.2	-4.4	4.8	4.1
Private consumption (%YoY)	7.0	15.7	8.4	6.9	-8.3	-20.7	2.1	7.7	8.8	11.9	-3.6	7.0	5.1
Government consumption (%YoY)	4.2	-2.9	4.5	-0.9	1.1	1.7	-0.5	2.4	0.2	2.4	-3.9	4.1	2.5
Investment (%YoY)	3.2	8.5	5.0	-8.4	-24.0	-9.2	20.4	18.8	15.3	13.8	-14.0	12.0	7.2
Industrial production (%YoY)	12.2	8.0	-0.7	-4.3	-10.1	-13.0	2.8	0.4	3.0	-0.5	-6.5	3.5	1.9
Unemployment rate (year-end, %)	8.4	8.2	8.0	7.6	10.6	9.5	9.7	9.9	9.3	8.7	9.3	8.4	8.2
Nominal GDP (UAHbn)	1,079	1,300	1,405	1,465	1,587	1,989	2,385	2,983	3,559	3,975	4,086	4,712	5,213
Nominal GDP (€bn)	103	116	136	138	101	83	85	98	111	139	127	136	151
Nominal GDP (US$bn)	137	163	176	183	133	91	93	112	131	153	148	168	188
GDP per capita (US$)	3,000	3,665	3,900	4,000	3,100	2,100	2,200	2,600	3,100	3,700	3,520	3,750	3,970
Gross domestic saving (% of GDP)	16.8	15.8	13.1	9.3	9.9	13.3	14.8	12.3	13.4	13.8	13.9	14.1	14.3
Prices													
CPI (average, %YoY)	9.4	8.0	0.6	-0.3	12.1	48.5	14.9	14.5	11.0	7.9	3.0	7.8	6.3
CPI (year-end, %YoY)	9.1	4.6	-0.2	0.5	24.9	43.3	12.4	13.7	9.8	4.1	5.0	7.5	5.5
Wage rates (nominal, %YoY)	17.7	17.5	14.9	8.0	6.1	21.1	23.3	37.0	24.8	18.5	10.2	15.0	8.0
Fiscal balance (% of GDP)													
Consolidated government balance	-6.7	-2.6	-4.1	-4.3	-4.5	-1.6	-2.3	-1.4	-1.9	-2.2	-5.5	-4.8	-3.5
Consolidated primary balance	-5.1	-0.7	-2.2	-1.8	-1.5	2.8	1.9	2.4	1.2	0.9	-2.1	-1.6	-0.2
Total public debt	40.1	36.4	36.7	39.9	69.4	79.0	80.9	71.8	60.9	50.3	62.8	64.2	65.0
External balance													
Exports (US$bn)	51.5	68.5	68.5	64.3	54.2	37.9	36.4	43.3	47.3	50.0	43.0	49.0	51.0
Imports ({US$bn)	60.9	82.6	84.6	76.8	54.3	36.3	39.2	49.6	57.2	60.7	48.0	55.0	59.0
Trade balance (US$bn)	-9.4	-14.1	-16.1	-12.5	-0.1	1.6	-2.8	-6.3	-9.9	-10.7	-5.0	-6.0	-8.0
Trade balance (% of GDP)	-9.2	-12.1	-11.8	-9.0	-0.1	1.9	-3.4	-6.4	-8.9	-7.7	-3.4	-3.6	-4.2
Current account balance (US$bn)	-3.0	-10.2	-14.3	-16.5	-4.6	1.6	-1.3	-3.5	-6.4	-7.1	6.6	-1.9	-4.5
Current account balance (% of GDP)	-2.9	-8.8	-10.5	-12.0	-4.5	2.0	-1.6	-3.6	-5.8	-5.1	4.5	-1.1	-2.4
Net FDI (US$bn)	5.8	7.0	7.2	4.1	0.3	3.0	3.3	3.6	4.4	5.2	-2.0	1.8	2.6
Net FDI (% of GDP)	5.6	6.0	5.3	3.0	0.3	3.6	3.9	3.7	4.0	3.8	-1.6	1.4	2.0
Current account balance plus FDI (% of GDP)	2.7	-2.8	-5.2	-9.0	-4.2	5.6	2.3	0.1	-1.8	-1.3	2.9	0.3	-0.4
Foreign exchange reserves ex gold (US$bn)	33.3	31.8	24.5	20.4	7.5	13.3	15.5	18.8	20.8	25.3	29.0	31.7	32.0
Import cover (months of merchandise imports)	6.6	4.6	3.5	3.2	1.7	4.4	4.7	4.5	4.4	5.0	7.3	6.9	6.5
Debt indicators													
Gross external debt (US$bn)	117.3	126.2	134.6	142.1	125.3	117.7	112.5	115.5	114.7	121.7	124.0	127.0	130.0
Gross external debt (% of GDP)	85.9	77.7	76.6	77.6	94.0	129.0	120.8	103.0	87.7	79.3	83.9	75.5	69.0
Gross external debt (% of exports)	227.8	184.2	196.5	221.0	231.2	310.6	309.1	266.7	242.5	243.4	288.4	259.2	254.9
Lending to corporates/households (% of GDP)	65.8	59.8	56.4	60.4	62.4	48.4	41.3	33.7	29.8	24.1	24.7	24.5	24.0
Interest & exchange rates													
Central bank key rate (year-end, %)	7.8	7.8	7.5	6.5	14.0	22.0	14.0	14.5	18.0	13.5	6.0	6.8	6.8
Broad money supply (average, %YoY)	22.7	14.7	12.8	17.6	5.3	3.9	10.9	9.6	5.7	12.6	28.7	13.5	12.0
2yr yield (average, %)	n/a	12.5	20.0	13.9	17.9	18.9	19.4	15.7	17.8	17.2	13.0	12.5	12.0
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UAH exchange rate (year-end)	8.0	8.0	8.0	8.0	15.8	24.0	27.2	28.1	27.7	23.6	28.4	28.0	27.5
USD/UAH exchange rate (average)	7.9	8.0	8.0	8.0	11.9	21.8	25.6	26.6	27.2	25.9	27.7	28.0	27.7
EUR/UAH exchange rate (year-end)	10.6	10.4	10.6	11.0	19.1	26.2	28.6	33.7	31.8	26.4	35.0	35.8	33.6
EUR/UAH exchange rate (average)	10.5	11.2	10.3	10.6	15.7	24.0	28.1	30.3	32.1	28.7	32.1	34.5	34.5

Source: National sources, ING estimates

Quarterly forecasts

	4Q19	1Q20	2Q20	3Q20	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F	1Q22F	2Q22F	3Q22F	4Q22F
Real GDP (%YoY)	1.5	-1.3	-11.4	-3.5	-1.2	-1.5	12.3	4.0	4.2	4.6	3.7	4.2	4.0
CPI (eop, %YoY)	4.1	2.3	2.4	2.3	5.0	7.5	8.0	8.0	7.5	7.0	6.5	6.0	5.5
Central bank key rate (eop, %)	13.5	10.0	6.0	6.0	6.0	6.5	6.5	6.8	6.8	6.8	6.8	6.8	6.8
USD/UAH exchange rate (eop)	23.6	28.0	26.7	27.5	28.4	27.8	28.2	28.1	28.0	27.9	27.8	27.6	27.5
EUR/UAH exchange rate (eop)	26.5	30.0	30.0	33.3	35.0	32.8	34.4	35.1	35.8	35.7	34.7	34.0	33.6

Source: NBU, Ukrstat, Macrobond, ING estimates

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