Economic & Financial Analysis

EM Economics & Strategy

Directional Economics CEEMEA

16 October 2024

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

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See team details at end of report

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Contents

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Summary

The countries of Central and Eastern Europe are quite rightly celebrated as having beaten the middle-income trap and evolved into high-income economies. Yet there is more work to be done. To converge on the income levels enjoyed by some of the core EU economies, the region can no longer mainly rely on cheap labour and an export-led growth model.

In this Autumn edition of Directional Economics, our Senior Economist in Poland, Michał Rubaszek and colleagues present a must-read article on this subject – looking at key development trends in Poland, Hungary, the Czech Republic, Romania and Turkey. These countries must avoid the mistakes made by Southern Europe a decade ago – where income gains were largely fuelled by debt and a construction boom. Today that region is further away from core EU income levels than it was in 2012.

Fortunately, our CEE countries in question have enjoyed income growth fuelled by FDI rather than debt. And the improvements in the quality of local institutions (which does matter for prosperity as just recognised by the Nobel committee), plus a well-educated labour force have delivered solid income gains.

To converge on core EU income levels, however, the CEE will need to do more. The priority, we identify, should be to focus on enhancing the productivity of scarce labour resources via innovation, automation and AI solutions, while assuring access to clean and affordable energy.

This can be done on the one hand through financial deepening, where an under-leveraged region can better develop banking and capital markets to help innovative and productive companies grow. It can also be done by the CEE countries twisting their decarbonisation challenge into an opportunity for productive investment-led growth. Please let us know what you think of our conclusions.

In terms of the outlook for the region, it is fair to say that growth has disappointed this year. The seizing up of the German industrial engine has certainly not helped, but it really has been the more cautious consumer and the higher savings rates that have weighed on domestic demand. At the same time investment trends have been poor.

Unlocking domestic demand is going to be the key challenge for 2025 and, in general, our economists expect growth rates to improve and certainly outperform a stagnant Eurozone next year. Helping these trends should be central banks delivering the final 50-100bp of their easing cycles, but also governments keeping fiscal policy looser than they should as the electoral calendar intensifies. Important elections in the region are seen every quarter for the next eighteen months.

Crucial to those investment trends for EU countries will be the ability to continue absorbing EU Cohesion funds and Recovery and Resilience Facility transfers. Here, Poland is preparing for a strong rise in public investments in 2025-26. Croatia and Romania are active users of EU money, while any improvement on access to EU funds by Hungary would be a positive surprise. In Ukraine, the war will continue to affect investment and severe energy deficits this coming winter will weigh on the economy.

Beyond the CEE4 and Ukraine, we expect Turkish authorities to stay the course with their disinflation policy. However, fiscal rather than monetary policy may have to do the heavy lifting now. And in the CIS space, fiscal policy is becoming easier and leading to upward revisions in CPI and policy rate trajectories.

As always, please take a look at our new set of quarterly and multi-year forecasts across the region, plus detailed analysis of the FX, rates, local and hard currency debt space.

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

Country summaries: CEE4

Czech Republic: Soft expansion with lower base rates

The Czech economic recovery is set to continue in the second half of the year despite the headwinds of lukewarm foreign demand from the main European trading partners. Continued solid wage growth in both nominal and real terms will provide enough fuel for household expenditure. That said, the dichotomy between sluggish manufacturing output and robust consumer spending has become even more pronounced. The labour market is expected to remain relatively tight with the continuing rebound, especially in the skilled labour segment. Core inflation is being driven by persistent price growth in services, while declining energy prices are likely to bring headline inflation close to the central bank's target early next year. Monetary policy easing is expected to carry on at a soft pace, with the fiscal stance becoming less constraining for growth in 2025 as compared to this year.

Hungary: Looking for bright spots

We hoped that 2024 would be the year of full recovery after years of polycrisis, but reality has disappointed us. This year is only the beginning of the healing process, as both consumer and business confidence (local and global) are limiting the Hungarian economy. While consumption is already on the rise, investments have fallen off a cliff. In the absence of import needs, net exports also remain a growth driver. The main silver lining is the tight labour market, which is also putting pressure on real wage growth. This, combined with normalisation of inflation and the turn to a year before the 2026 general election, brings many potential bright spots for GDP growth. However, the biggest threat could still be currency (in)stability and wage growth, which could spill over into inflation due to companies' heightened cost sensitivity. Against this backdrop, we are rather bearish on Hungarian assets for 2025-26.

Poland: Outperformance despite Eurozone stagnation

The Polish economy is recovering, driven by the highest real income growth in over 20 years. In 2025, investments from overdue RFF projects should restart, so the economy should continue to outperform the Eurozone and some CEE peers, despite German stagnation. Due to strong growth of labour costs, the NBP's fight to control inflation seems to lag others, leading to our and the central bank's sticky core inflation forecasts. The NBP can start cuts only in 2Q25, with a shallow 100bp easing cycle in 2025. While CEE peers and many DM central banks ease, the NBP's reluctance should help PLN. The 2025 budget assumes record borrowing needs, mostly covered by local savings. However, loose fiscal policy is a problem in many EMs and DMs, while Poland's sovereign credit risk seems contained, so we think POLGBs offer should attract some foreign capital, subject to the higher risk premium they can provide.

Romania: Buy time and hope for growth to come

While the twin deficits are anything but new to the country, most of the time Romania has had one thing to keep bad metrics in check: rapid growth. With growth fading, the fiscal problem only becomes bigger and more imminent. We expect a relatively slow-paced deficit reduction to start in 2025. Too abrupt tax hikes would impact the economy, but doing nothing is not an option. In the discussions with the European Commission (EC), the local officials are likely to play the 'Romania needs investments' card, hence the future government is expected to strike a fine balance between delivering some fiscal tightening while continuing the current investment cycle and not rushing into significant tax hikes. Some additional monetary easing being implemented while maintaining caution is likely to help as well.

Country summaries: Other Central & Eastern Europe

Bulgaria: Keep the economy on autopilot

Bulgaria's economy is progressing particularly well considering the challenges it faces. So far, it has absorbed only one RRF payment of €1.37bn. Meanwhile, protracted delays in the Climate Neutrality Plan adoption (a key reform for the country) have already led to the loss of 30% of the second RRF payment (€266m). A recent attempt by Parliament to ratify the plan failed due to the reportedly destabilising actions of Revival party MPs. Not all the funding is lost, though. Officials can still vote on the amendments by 20 October, a move that would also help the transition of workers from the energy and mining state-owned enterprises, which are in deep financial difficulties. With a snap election due on 27 October, the seventh in just over three years, only 38% of adults are set to vote according to a Trend poll, predicting little change to the structure of Parliament. We hold on to our view that euro adoption remains a matter for 2026.

Croatia: Keep the course

The euro adoption in 2023 seems to have unleashed a period of above expectations growth seconded by a prudent fiscal policy. These elements have been key to Croatia's 'A-' rating from both S&P and Fitch, a remarkable performance given that not more than six years ago Croatia was still rated 'junk'. With the country on track for a very strong RRF funds absorption while fiscal metrics are kept in check, it might not be the end of the road for more rating upgrades, though it is likely to take more than a year for any further upgrade to come. The presidential elections due in December 2024 have the potential to stir the waters to some extent. A re-election of the incumbent Milanović seems the most likely outcome. The government coalition looks solid under any scenario.

Serbia: Making deals with everyone

The Serbian economy is set to continue to perform well in the coming quarters. Growth has been above expectations so far this year, while inflation continued its downward trend. Moreover, the country is pursuing ambitious investment goals, with the EXPO 2027 event, the EC's New Growth Plan for the Western Balkans, and the IMF-agreed reforms taking centre stage. Furthermore, with debt and deficits also at reasonable levels, S&P lifted Serbia's rating to investment grade in early October. On the other hand, the country's geopolitical journey is less straightforward. Relations with Kosovo remain tense, Chinese FDIs have been advancing visibly and cooperation on the imposition of Russian sanctions is unlikely. That said, the Jadar lithium mining project – key in reducing the EU's reliance on Chinese-dominated mineral supply chains – bodes well for the alignment of EU-Serbia commercial interests.

Turkey: Programme remains on track

Economic activity has lost momentum driven by domestic demand, while annual inflation initiated a downtrend in June helped by a supportive base despite administrative price adjustments and continued pressure from the services group. Against this backdrop, the central bank (CBT) has maintained a tight policy stance and has introduced a series of macroprudential measures since the end of August with an aim of mopping up excess liquidity and maintaining the de-dollarization trend. Policy predictability and durability are key for the sustainability of the current performance. In this regard, Vice President Cevdet Yilmaz's statements in the release of the Medium Term Plan (MTP) are quite positive. He acknowledged a short-term trade-off between inflation and growth, and reiterated disinflation as the main policy priority with a signal for stronger support from fiscal policy for the disinflation process in 2025.

Country summaries: CIS

Armenia: Shifting to a lower gear

Economic activity is moderating as the momentum related to high-skilled immigration in 2022 and higher participation in the external trade is wearing off. The role of domestic drivers of financing activity, including local household savings, lending and state spending is increasing. Re-integration of refugees from Nagorno-Karabakh and continued tensions with Azerbaijan are likely to keep the fiscal deficit elevated, in line with our initial view at the start of last year. The resulting elevated CPI risks should limit the scope for monetary policy easing from current levels. The Armenian dram, which has so far avoided depreciation, may come under pressure on normalisation of the balance of payments, including the return to current account deficit and remittances inflow of around 5% of GDP. Meanwhile, potential easing in tensions with Azerbaijan could be supportive.

Azerbaijan: On a rebound

We maintain our constructive view on Azerbaijan for the near-term. While still sluggish on the core oil activity, Azerbaijan's economic growth is posting a recovery on the non-oil side, financed heavily by domestic credit and public expenditure. The resulting price pressures mean that the monetary policy easing cycle is most likely over. The country's fiscal and external reserves are ample, but the gradually eroding trade surplus and growing current account breakeven, if not addressed, could create some pressure on the manat's dollar peg in the coming years.

Kazakhstan: Higher rating, but more CPI and FX risks

Economic momentum has slowed owing to commodity sector and other cyclical factors, but the rest of the economy, especially consumer-focused, appears robust and well supported by lending and public spending. The budget policy is becoming more generous, and, at some point, the issue of the US$100+/bbl fiscal breakeven oil price will need to be addressed. For now, it has added to pro-inflationary risks and caused Kazakhstan's central bank (NBK) to signal that the end of the rate easing cycle is near. In the meantime, KZT depreciation risks seem to have materialised, but the challenges of the budget and balance of payments are likely to keep the tenge under pressure in the medium term.

Ukraine: Stable hryvnia, for now…

The hryvnia remains range-bound against the dollar since mid-July. This is likely to continue in the year end, as core central banks are gearing towards further monetary easing. Also, foreign aid helps to stabilize Ukraine's international reserves, allowing the NBU to stabilize the currency.

However, fundamentals behind the currency remain unsupportive, and uncertainty very high. The war continues to take toll on the economy, and the country has to cope with the energy deficit in the coming winter. Given heavy current account deficit and elevated inflation, the NBU is likely to allow for further gradual easing of the hryvnia, while stabilizing the currency as reserves allow. Even in the recent months NBU spent more than US$2.5bn monthly to shore up the currency against overall of US$40bn of reserves.

Uzbekistan: Watch out for CPI and FX trends

Uzbekistan continues to show a fast and well-diversified economic growth rate. Another positive is that the tariff-related spike in CPI was somewhat lower than expected, allowing an improvement in key rate easing expectations for the coming quarters. In addition, the soum depreciation rate slowed in 1H24, in line with our view, also helped by the strong gold market, but the pressure may increase in 2H24. Our concern for the medium term is the continued widening in the consolidated budget deficit which reached 7% of GDP for the four quarters ending March 2024. Like its CIS-4 peers, fiscal consolidation might come onto the agenda at some point.

ING main macroeconomic and financial forecasts

Real GDP (% YoY)

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Armenia	6.4	6.0	5.0	4.5	5.7	6.0	5.0
Azerbaijan	4.6	3.0	2.5	2.0	2.5	3.5	2.6
Bulgaria	2.1	2.3	2.6	2.9	3.1	2.3	3.1
Croatia	3.3	4.5	2.9	2.9	2.7	3.7	2.8
Czech Republic	0.6	1.6	1.9	2.1	2.3	1.1	2.2
Hungary	1.5	1.3	2.2	2.4	3.3	1.5	3.6
Kazakhstan	2.7	4.6	3.6	5.4	5.5	3.7	5.5
Poland	3.2	2.8	3.7	3.2	3.5	3.0	3.5
Romania	0.8	1.2	2.5	2.5	3.3	1.3	3.0
Serbia	4.0	3.4	3.5	3.9	4.2	3.8	4.1
Turkey	2.5	2.5	2.3	0.5	0.3	2.5	3.0
Ukraine	3.7	1.5	3.7	2.5	4.5	4.1	4.2
Uzbekistan	6.6	5.7	4.5	4.0	5.5	5.7	5.7
Eurozone*	0.6	0.4	-0.1	0.5	0.8	0.6	0.6
US*	3.0	2.7	1.8	0.5	0.5	2.7	1.4

*% QoQ annualised

Source: National sources, Refinitiv, ING estimates

Exchange rate (quarterly is eop, annual is avg)

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
USD/AMD	388	387	393	397	400	393	400
USD/AZN	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/BGN	1.96	1.96	1.96	1.96	1.96	1.96	1.96
EUR/HRK	-	-	-	-	-	-	-
EUR/CZK	24.80	25.10	25.00	24.90	24.90	25.10	24.80
EUR/HUF	395.2	397.2	395.0	400.0	408.0	393.2	402.0
USD/KZT	473	481	490	485	490	469	492
EUR/PLN	4.31	4.28	4.25	4.26	4.27	4.29	4.28
EUR/RON	4.98	4.98	4.98	4.98	5.02	4.98	5.02
EUR/RSD	108.4	106.45	106.44	106.41	106.41	117.11	116.95
USD/TRY	32.65	32.65	34.58	37.00	39.17	33.18	40.15
USD/UAH	43.40	46.00	45.30	45.70	45.70	43.90	45.80
USD/UZS	12,565	12,737	12,964	13,093	13,223	12,655	13,223
EUR/USD	1.08	1.12	1.10	1.10	1.10	1.10	1.10

*Quarterly data is eop, annual is average

Source: National sources, Refinitiv, ING estimates

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

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Armenia	0.8	0.6	2.3	4.5	3.9	0.4	3.4
Azerbaijan	1.1	3.5	4.5	3.5	4.9	2.2	4.3
Bulgaria	2.5	2.0	3.0	2.8	3.8	2.6	3.4
Croatia	2.5	2.5	2.9	3.0	3.0	3.0	2.8
Czech Republic	2.0	2.6	3.4	2.4	2.9	2.5	2.6
Hungary	3.7	3.0	4.6	3.7	4.4	3.8	4.0
Kazakhstan	8.4	8.3	8.2	7.8	7.9	8.6	7.4
Poland	4.9	4.7	6.0	5.3	3.9	3.6	4.6
Romania	4.8	4.3	4.2	3.4	4.1	5.4	3.8
Serbia	3.8	4.3	4.0	4.4	4.3	4.6	3.9
Turkey	71.6	71.6	49.4	43.3	33.3	58.2	28.8
Ukraine	3.8	7.0	8.5	9.0	8.5	5.9	7.7
Uzbekistan	10.6	10.2	10.4	11.0	8.5	9.7	9.1
Eurozone	2.5	2.2	1.9	2.0	1.9	2.3	2.0
US	3.2	2.6	2.4	2.0	1.7	2.9	1.9

Source: National sources, Refinitiv, ING estimates

Central Bank rate (%, eop)

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Armenia	8.00	7.50	7.25	7.25	7.25	7.25	7.00
Azerbaijan	7.25	7.25	7.25	7.25	7.25	7.25	7.25
Bulgaria	3.78	3.54	3.30	2.85	2.40	3.30	2.40
Croatia	3.75	3.50	3.25	2.75	2.25	3.25	2.25
Czech Republic	4.80	4.30	4.00	3.80	3.30	5.00	3.50
Hungary	7.00	6.50	6.25	6.25	5.50	6.25	5.25
Kazakhstan	14.50	14.25	14.00	13.50	13.00	14.00	12.00
Poland	5.75	5.75	5.75	5.75	5.50	5.75	4.75
Romania	7.00	6.50	6.50	6.25	6.00	6.50	5.50
Serbia	6.25	5.75	5.50	5.25	5.25	5.50	5.00
Turkey	50.00	50.00	50.00	47.50	40.00	47.50	27.50
Ukraine	13.00	13.00	13.00	13.00	13.00	13.00	11.00
Uzbekistan	14.00	13.50	13.50	13.50	13.00	13.50	12.50
Eurozone[1]	3.75	3.50	3.00	2.50	2.00	3.00	2.00
US[2]	5.50	5.00	4.50	4.75	4.00	4.50	3.50

[1] Depo Rate; [2] Upper level of 25bp range

Source: Refinitiv, ING estimates

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

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Armenia	9.7	9.7	n/a	n/a	n/a	n/a	n/a
Azerbaijan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Bulgaria	3.20	3.10	3.00	2.80	2.70	2.90	2.60
Croatia	3.65	3.15	3.10	2.90	2.80	3.10	2.70
Czech Republic	4.20	3.70	3.90	3.90	3.70	4.00	3.80
Hungary	6.82	6.16	6.25	6.45	6.65	6.35	6.62
Kazakhstan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Poland	5.74	5.4	5.67	6.01	6.08	5.65	5.97
Romania	6.90	6.65	6.50	6.30	6.30	6.60	6.10
Serbia	5.92	5.80	5.70	5.65	5.60	5.70	5.50
Turkey	28.28	28.28	28.40	25.60	20.49	27.44	20.06
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Uzbekistan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	2.60	2.10	2.00	2.10	2.20	2.00	2.00
US	4.40	3.80	3.70	3.90	4.00	3.70	4.75

Source: National sources, Refinitiv, ING estimates

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

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Armenia	8.8	8.3	n/a	n/a	n/a	n/a	n/a
Azerbaijan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Bulgaria	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Croatia	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Czech Republic	4.70	4.20	4.00	3.70	3.30	4.90	3.50
Hungary	6.89	6.32	6.05	5.95	5.30	7.23	5.47
Kazakhstan	12.20	10.40	13.50	13.20	12.70	12.90	12.10
Poland	5.85	5.85	5.90	5.87	5.53	5.87	5.45
Romania	6.01	5.55	5.55	5.30	5.05	5.81	5.05
Serbia	5.45	4.95	4.70	4.50	4.45	5.20	4.20
Turkey	49.79	49.79	48.88	43.28	37.48	46.78	33.97
Ukraine	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Uzbekistan	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Eurozone	3.70	3.40	2.90	2.40	2.00	3.20	2.10
US	3.70	3.40	2.90	2.40	2.00	3.20	2.10

Source: National sources, Refinitiv, ING estimates

CEE: Why beating the middle-income trap isn't enough

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Central and Eastern European countries have been praised for successfully escaping the middle-income trap and achieving the status of high-income countries. This success can be attributed to enhanced institutional quality, supported by EU accession, combined with a plentiful supply of well-educated labour. These factors have paved the way for an inflow of foreign capital, better resource allocation and spectacular productivity growth.

The next challenge for the region is to fully converge with EU average income standards. In this regard, the region faces several obstacles. The potential for further export-led growth based on strong cost competitiveness, which has been a key driver of CEE convergence, has reached its limits. Rising labour costs, unfavourable demographics and high energy prices are undermining cost competitiveness. In addition, CEE exports rely strongly on (weak) demand in core EU countries. We think these growth obstacles can be overcome if CEE countries continue to transform their economic structures. However, the risk is that they fall into the *incomplete convergence trap*, similar to the situation that Southern European countries experienced a decade ago.

In our opinion, escaping the *incomplete convergence trap* is possible but will be more difficult than the previous stage of development – reaching high-income status. The reason for this is that convergence so far has been achieved by capitalising on low hanging fruit, such as a more efficient use of high-quality labour force, changing bad governance policies into good ones, and the infusion of existing technologies from abroad. In turn, further growth will require changing good polices into the best ones, as well as creating new technologies and products. We emphasise the role of financial market deepening, allowing productive firms to grow, an entrepreneur-friendly environment, and innovation. We also underscore the need for investments in clean and reliable energy, which will be crucial for future growth in the face of environmental challenges. In our view, by addressing these issues, CEE countries can continue their journey towards full convergence with EU income standards and ensure their future prosperity.

Spectacular growth of CEE countries above the middle-income trap threshold

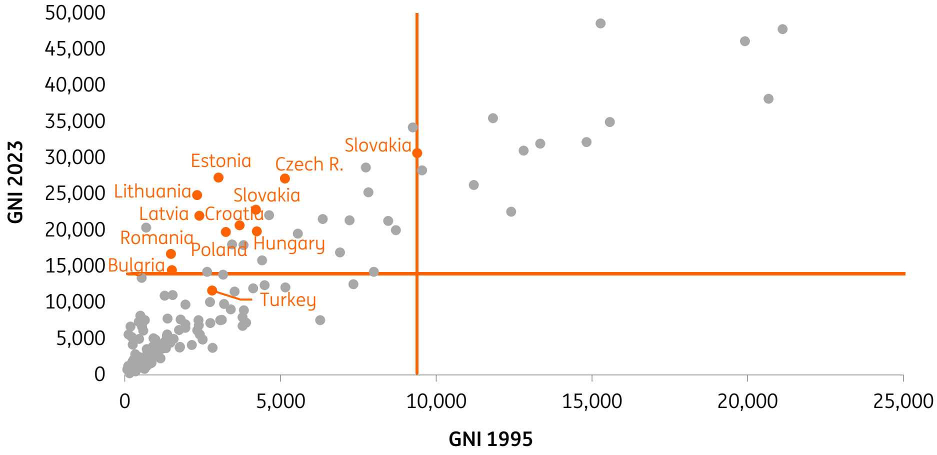
The middle-income trap is defined as a situation in which a country experiences a systematic growth slowdown, preventing it from achieving high-income status. This occurs because maintaining growth necessitates the continuous transformation of economic structures, a challenge that many countries find difficult to achieve.

CEE economies have managed to overcome this difficulty, standing out as rare examples of success.[1] The transition from central planning towards a market economy, supported by EU accession, has helped CEE countries to enhance the quality of institutions and attract foreign capital. This has resulted in better governance and resource allocation, which has unlocked the productivity of well-educated labour and, ultimately, brought prosperity.

Based on income classifications by the World Bank, in 2023, most CEE countries were well above the high-income threshold, defined as gross national income (GNI) per capita, of US$14,005, which was not the case in the mid-1990s (see Figure 1). The scale of this spectacular growth is well illustrated by GNI per capita changes in Central Europe and the Baltics, from US$3,137 in 1995 to US$20,342 in 2023.

[1] See World Bank Group, 2024, "The Middle-income trap", Washington.

Fig 1 **CEE escape from the middle-income trap: Gross national income comparison (US$)**

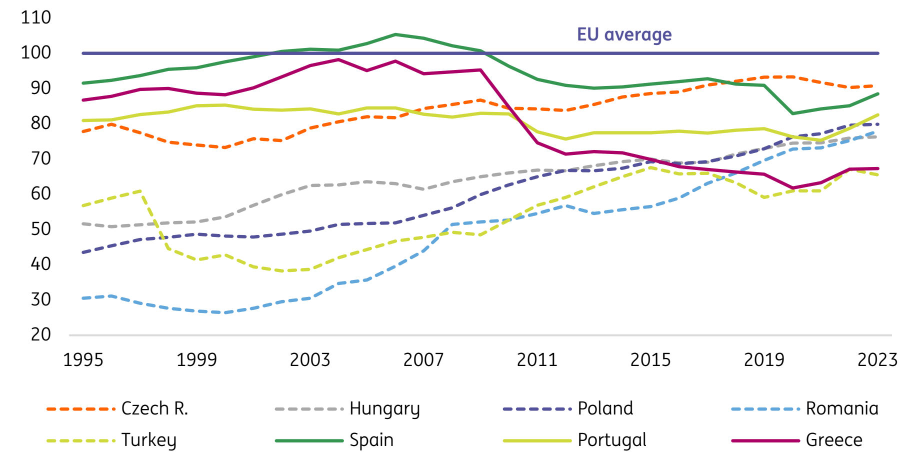


The orange lines indicate the threshold value between middle and higher income countries according to the World Bank income classifications (US$9,385 in 1995 and US$14,005 in 2023).
Source: World Bank, ING

Next challenge is to converge with the level of top EU economies

The next challenge for CEE countries, which is widely discussed in the context of economic development of the region, is defined in terms of full convergence with EU income standards. Figure 2 illustrates that the GDP per capita gap between CEE countries and the EU average has been gradually narrowing since 1995. In 2023 it amounted to just 9% in the Czech Republic, 20% in Poland, 22% in Romania, 24% in Hungary and 35% in Turkey. The figure also reveals that reaching full and lasting convergence cannot be taken for granted. Southern European countries were growing relatively fast until a decade ago but have subsequently experienced income divergence. They got stuck in what we call the incomplete convergence trap (ICT). In recent years, the Czech Republic has also experienced divergence rather than convergence of income. These developments raise questions about: (1) the risk that CEE countries repeat the experience of Southern Europe and get stuck in the ICT; and (2) the odds that they will continue their spectacular convergence with the average EU level.

Fig 2 **GDP per capita (current prices in Purchasing Power Standard, EU27=100)**



	1995	2023
Czech Republic	77.8	90.8
Hungary	51.6	76.3
Poland	43.5	79.9
Romania	30.5	77.9
Turkey	56.8	65.5
Spain	91.5	88.5
Portugal	80.9	82.5
Greece	86.7	67.3

Eurostat data (ticker: tec00114) for Romania and Turkey in 2023 indicates that GDP per capita was 80% and 73% of the EU average, respectively. Eurostat and AMECO data for other countries and years are the same.
Source: EC AMECO, ING

Figure 3 presents a broader picture on convergence by breaking down GDP per capita in Purchasing Power Standard along two dimensions. First, we can see that prices in CEE countries are lower than the average in the EU, which is especially true in Turkey and Romania. The distance to EU standards in terms of GDP per capita expressed in nominal terms is larger and amounts to 24% in the Czech Republic, 46% in Hungary, 47% in Poland, 55% in Romania and 68% in Turkey.

Fig 3 Convergence indicators for 2023

		Czech Republic	Hungary	Poland	Romania	Turkey	Spain	Portugal	Greece
GDP per capita	EU=100, Purchasing Power Standard	90.8	76.3	79.9	77.9	65.5	88.5	82.5	67.3
	EU=100, EUR	75.9	54.4	52.9	45.2	31.6	80.5	68.4	55.6
Price level	EU=100	83.6	71.3	66.2	58.0	48.2	91.0	82.9	82.6
GDP per worker	EU=100, Purchasing Power Standard	85.4	73.4	82.9	84.4	85.5	97.2	80.7	70.3
Hours per worker	*Hours/year*	*1,766*	*1,676*	*2,020*	*1,826*		*1,632*	*1,815*	*2,000*
GDP per hour	EU=100, Purchasing Power Standard	77.6	70.3	65.9	74.2		95.6	71.3	56.4
	Germany=100, Purchasing Power Standard	63.7	57.7	54.1	60.9		78.5	58.6	46.3

The average annual hours worked in the EU and Germany was 1,604 and 1,342, respectively.
Source: EC AMECO, ING

Second, Figure 3 also shows that working time in CEE countries is longer than in the EU. Indeed, the average annual hours per worker amounted to 1,604 in the EU and as much as 2,020 in Poland and 1,826 in Romania. This implies that the convergence of GDP per capita is partially reached via high labour intensity. The income gap measured by GDP per working hour is 22% in the Czech Republic, 26% in Romania, 30% in Hungary and 34% in Poland. On this income gap measure, the distance to Germany, the largest EU economy, is even greater as the average number of hours worked in Germany amounted to a mere 1,342 per worker.

Will CEE countries succeed in escaping the incomplete convergence trap experienced by Southern Europe? Let us start with the observation by Vukov[2] that the growth model of CEE countries (export-led) is different to the model in Southern Europe prior to the region's growth divergence (credit-led). The Southern Europe model put more emphasis on the development of domestic-oriented sectors (services and construction), whereas the current CEE model tends to preserve the industrial legacy from the communist era. In both strategies, growth is dependent on capital inflows from the core EU countries, as limited capital and technology pose similar challenges in the face of integration with the richer EU core. However, the type of capital inflows differs; it was largely credit in Southern Europe and Foreign Direct Investment (FDI) in the CEE region.

The differences in the growth model are illustrated in Figure 4, which compares the situation in Southern Europe in 2012 and the current situation in CEE. All analysed countries are net debtors on international capital markets, as their international investment position is negative. However, the stock of net FDI inflows to CEE countries is much higher compared to Southern Europe. By contrast, the level of non-FDI net foreign debt was substantial in Southern Europe in 2012 (close to 100% GDP), but almost negligible in CEE (close to zero in 2023). In fact, Poland and the Czech Republic recently became non-FDI net creditors.

Next, the table shows that the level of indebtedness in CEE countries in 2023 is much lower compared to what was observed in Southern Europe in 2012, both for public and private debt. In 2012, public debt in Southern Europe ranged from 90% to 162% of GDP, whereas in 2023 in CEE economies it stood at between 44% and 74% of GDP. Household debt in Southern Europe in 2012 was between 66% and 89% of GDP, whereas in CEE it is between 13% and 33% of GDP in 2023. For the corporate sector, the level of debt has ranged between 70% and 120% of GDP (Southern Europe, 2012) and between 28% and 56% of GDP (CEE, 2023).

[2] See detailed discussion in Vukov V., 2023. Growth models in Europe's Eastern and Southern peripheries: between national and EU politics. New Political Economy, 28(5), 832–848.

Fig 4 Economic indicators for Southern Europe and CEE countries

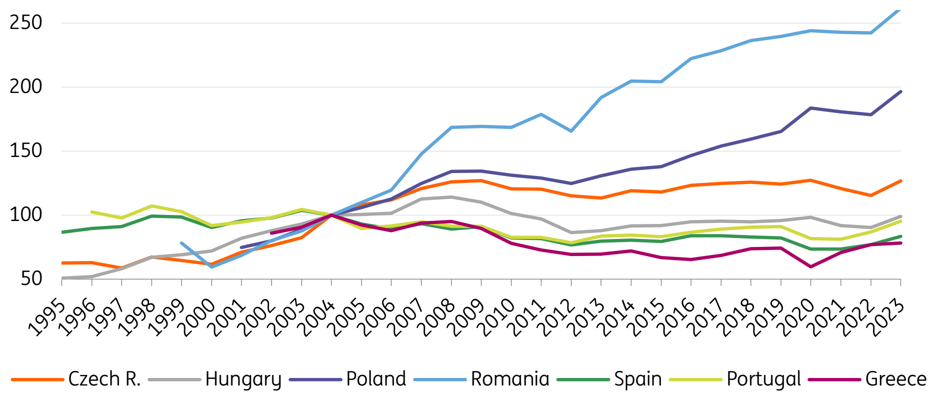
	Czech Republic	Hungary	Poland	Romania	Spain	Portugal	Greece
International investment position (net, % GDP)							
Total							
2004	-23.8	-85.5	-40.9	-29.8	-59.6	-65.8	-66.9
2012	-45.6	-91.7	-64.5	-64.6	-88.9	-119.3	-117.6
2023	-13.2	-43.2	-32.3	-39.8	-52.8	-72.5	-140.1
FDI							
2004	-38.9	-45.8	-26.6	-27.4	-20.8	-12.2	-5.6
2012	-55.5	-43.0	-34.5	-40.2	-2.2	-25.8	7.9
2023	-44.9	-32.7	-35.2	-33.8	-16.8	-43.7	-16.5
Non-FDI							
2004	15.1	-39.7	-14.3	-2.4	-38.8	-53.6	-61.3
2012	9.9	-48.7	-30	-24.4	-86.7	-93.5	-125.5
2023	31.7	-10.5	2.9	-6.0	-36.0	-28.8	-123.6
Gross debt (% GDP)							
Public debt							
2004	28.4	58.8	45.1	18.9	45.4	67.1	102.9
2012	44.2	78.2	54.8	35.4	90.0	129.0	162.0
2023	44.0	73.5	49.6	48.8	107.7	99.1	161.9
Households							
2004	13.8	19.9	13.2	6.3	62.9	75.7	28.9
2012	30.6	31.6	34.1	19.7	80.9	90.5	65.9
2023	32.6	16.8	23.4	12.5	46.5	55.2	41.7
Firms							
2004	39.2	50.9	28.1	27.2	75.5	88.4	45.0
2012	51.1	70.0	39.8	49.3	107.1	120.0	69.2
2023	43.4	55.5	33.4	27.9	64.7	75.0	54.6
Export of goods and services (% GDP)							
Total							
2004	56.9	59.6	34.2	25.7	25.4	27.7	20.7
2012	75.1	85.9	44.3	35.8	31.5	37.8	28.7
2023	69.0	81.2	57.8	39.1	39.0	47.4	44.9

Debt level data for the Czech Republic refers to 2022 data (in place of 2023).
Source: Eurostat, ING

The current situation in CEE differs from the situation in Southern Europe in 2012. The incomplete convergence trap experienced by the latter economies in 2012 might be related to the fact that at a high level of indebtedness, credit-led growth loses its allure, which limits the potential for further expansion[3]. The experience of Southern Europe from the past two decades also illustrates that excessive reliance on non-FDI foreign debt is risky, as this kind of capital is easy to reverse and the cost of servicing foreign debt might be weakly related to domestic economic conditions. In this context, the current level of indebtedness of CEE countries is low and creates ample space for capital deepening and growth through credit expansion.

[3] Debt accumulation of Southern Europe was supported by easy access to cheap credit following euro adoption, whereas the divergence started with the euro crisis, followed by austerity and deleveraging measures. This risk of a potential boom-bust cycle in the wake of euro adoption has been recognised by CEE policymakers.

Fig 5 Goods and service exports market share (2004=100)



Source: Eurostat, ING.

The experience of CEE economies with the export-based growth strategy fuelled by FDI inflow has been successful so far. Estimates by Hagemejer and Mućk[4] indicate that exports and participation in global value chains have been the major factor driving the convergence of the CEE countries with their advanced counterparts. The dominant role of exports in the CEE growth model is also illustrated by the numbers in the bottom panel of Figure 4. They show that the openness of CEE has increased over the past two decades so that it is now much higher compared to the openness of Southern European countries in 2012. In 2023, the export to GDP ratio was especially high in Hungary (81% of GDP) and the Czech Republic (69%). Figure 5 presents additional evidence on the strong role of exports in CEE growth. Since 2004, Romania and Poland have expanded their share in global trade, along with fast GDP per capita convergence. However, the export market share of the Czech Republic and Hungary has been relatively stable, which coincides with rather slow GDP convergence. This could indicate that export-led growth might have some limits, comparable to the credit-led growth framework applied in Southern Europe.

Challenges for CEE countries within export-led growth strategy

There are several challenges related to the export-led growth model of CEE countries, which are tied to the model's underlying assumptions. As indicated by Palley[5], within the export-led growth strategy, export expansion is supported by undervalued exchange rates and competitive wages, the transfer of foreign technologies, and partnerships between countries and multinational corporations. The success of this strategy depends on access to foreign technologies and markets, unlimited foreign demand and the availability of a well-educated labour force that can be hired at internationally competitive wages.

All the above conditions for successful export-led growth were observed in CEE countries in the mid-2000s, ie, at the time of EU enlargement. CEE countries were granted access to a large common EU market, the EU's institutional framework helped attract foreign capital and allowed for the transfer of foreign technologies, and there was an abundant well-educated workforce that could be hired at very attractive salaries. The wage gap was enormous; in 2004 hourly labour costs in manufacturing amounted to a mere €1.6 in Romania, €4.0 in Poland and €5.5 in the Czech Republic and Hungary, compared to €29.9 in Germany (see Figure 6).

[4] Hagemejer J., Mućk J., 2019. Export-led growth and its determinants: Evidence from Central and Eastern European countries. The World Economy 42, 1994–2025.

[5] Palley T., 2011. The Contradictions of Export-Led Growth: Public Policy Brief. Jerome Levy Economics Institute of Bard College, Public Policy Brief, No. 119119.

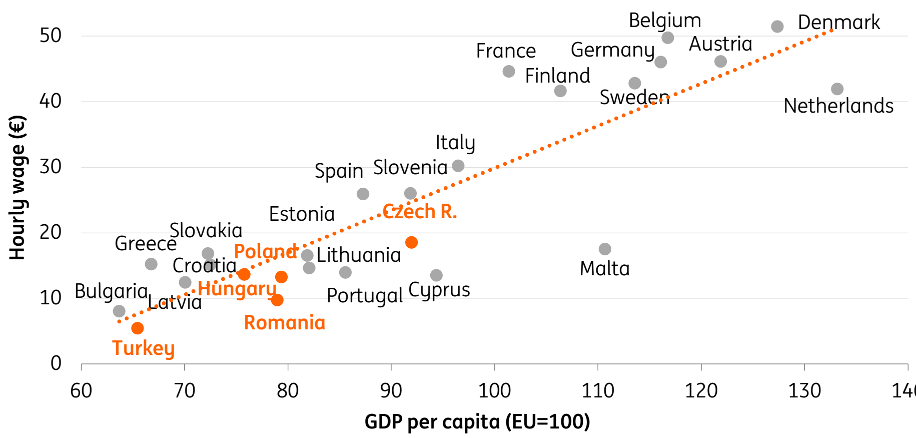
Fig 6 Hourly labour costs in manufacturing

	Level (€/h)						Germany=100	
	2004	2012	2016	2020	2023	1Q24	2004	1Q24
Czech Republic	5.5	9.7	10.2	14.3	18.5	18.4	18.4	38.6
Hungary	5.5	7.5	8.3	10.3	13.6	14.5	18.4	30.3
Poland	4.0	6.8	7.8	10.0	13.2	14.9	13.4	31.2
Romania	1.6	3.7	4.8	7.0	9.7	10.6	5.4	22.1
Turkey	-	5.4	6.1	3.8	5.4	6.7	-	14.1
Greece	13.9	15.5	15.1	14.3	15.2	15.6	46.5	32.7
Portugal	8.5	10.9	10.7	12.7	14.6	15.0	28.4	31.5
Spain	17.4	22.4	22.6	24.2	25.9	26.8	58.2	56.0
France	29.0	35.7	36.4	41.3	44.6	45.5	97.0	95.3
Germany	29.9	35.0	38.2	42.0	46.0	47.8	100.0	100.0

Total hourly labour costs in manufacturing are extrapolated using exchange rates and labour cost index
Source: Eurostat, ING

Currently, the level of wages in CEE3 countries (the Czech Republic, Hungary and Poland) constitutes the first challenge to the export-led growth model. Figure 6 shows that, for the past decade, labour costs in CEE3 have increased so much that their current levels are close to those observed in Southern European countries. Even though they remain attractive compared to Germany or France and are below values justified by the level of GDP per capita (see Figure 7), they became higher compared to other potential destinations of production, including Romania and Turkey. Indeed, this year, Poland has experienced several cases in which foreign-owned companies have decided to move their production to cheaper destinations.

Fig 7 Hourly wages and GDP per capita relationship (2023)



Source: Eurostat, ING

The second challenge for export-led growth in CEE3 is that for the past two decades there has been a substantial squeeze in labour availability. Figure 8 shows that the current activity rates in these economies are high and unemployment rates are at historically low levels. Consequently, employment rates are above 80%, close to the high German benchmark. This means that the availability of labour resources for developing new export capacity in CEE3 is limited. On top of that, ageing will make the labour scarcity problem more severe in the future. By 2030, the population aged 20-64 is projected to shrink by 2% in the Czech Republic and Hungary, and by 5% in Poland and Romania. The precondition of the successful export-led growth model related to an abundant availability of labour will therefore be difficult to meet. The situation in Romania and Turkey seems to be different as employment rates in these countries are lower, standing at 68% and 57%, respectively. Moreover, demographic projections for Turkey are more favourable than for the remaining CEE countries, as they point to a rising population.

Fig 8 Demographic and employment indicators and projections

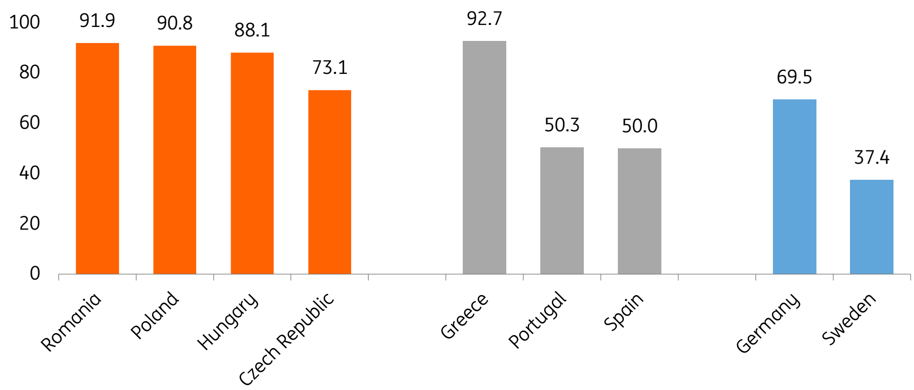
		Czech Republic	Hungary	Poland	Romania	Turkey	EU	Germany
Labour market participation (age group 20-64)								
Activity rate	2004	76.2	65.7	70.4	69.8		73.3	76.2
Unemployment		8.0	5.7	19.0	7.4		9.7	10.9
Employment rate		70.1	62.0	57.0	64.7		66.2	67.9
Activity rate	2023	83.8	84.0	80.1	72.5	63.1	80.0	83.6
Unemployment		2.5	4.0	2.8	5.2	9.3	5.8	3.0
Employment rate		81.7	80.7	77.9	68.7	57.3	75.3	81.1
Population projection (age group 20-64)								
% change vs 2023	2025	-0.1	-0.9	-2.0	-1.9	1.3	-0.4	-0.4
	2030	-1.9	-2.0	-5.2	-4.6	4.4	-2.3	-4.3
	2040	-5.6	-7.9	-9.8	-14.6		-6.5	-7.6
	2050	-11.0	-13.8	-20.1	-23.3	3.0	-10.6	-7.6

Source: Eurostat, Turkish Statistical Institute, ING

The third challenge to the export-led growth model is that its success depends on foreign demand. It is implicitly assumed that this is unlimited so any amount of production can be sold abroad. This assumption has been hard to satisfy in recent times, given the large economic size of all countries implementing an export-led growth strategy worldwide. The proximity and free access to the EU market is the key advantage of CEE countries compared to other export-oriented economies. This is reflected in the high share of EU countries in total exports of goods, which in 2023 amounted to 81.5% in the Czech Republic, 78.8% in Hungary, 74.6% in Poland and 72.6% in Romania. This means that future export dynamics, to a large extent, will depend on demand in the EU market, which at the current moment is uncertain. The challenges ahead for the European economy have been described in a recent Draghi report.[6]

The fourth challenge for the export-led growth strategy in CEE countries is related to the energy markets. Export-led growth needs to be underpinned by reliable access to cheap energy. Moreover, access to clean, low-carbon energy has gradually become increasingly important in recent years. Unfortunately, wholesale power prices in CEE countries are high. The average spot power price in 2024 in Romania, Poland and Hungary was around €90 per MWh and nearly €75 in the Czech Republic, slightly above the German level of €70, twice as high as in Spain and Portugal, and three times more than in Sweden, which enjoys the lowest electricity prices in Europe due to its unique natural resources and electricity mix (Figure 9). These price disparities are broadly unchanged in forward contracts for baseload electricity in 2025.

Fig 9 Wholesale electricity prices in selected European markets (€/MWh)

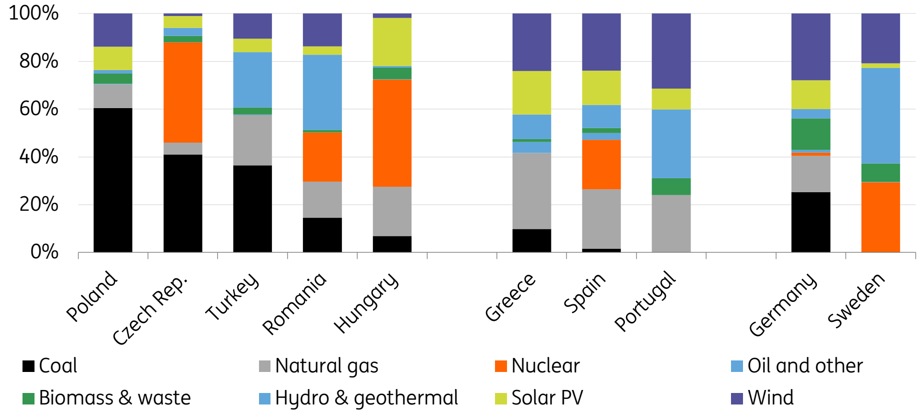


Average prices between January and August 2024.
Source: Ember

[6] European Commission, 2024. The future of European competitiveness.

As regards access to clean energy, in an ING report last year on [diverging carbon and commodity prices](), we discussed in detail the carbon intensity of the electricity mix. In Poland, around 60% of the electricity mix in 2023 was generated from coal, whereas in the Czech Republic and Turkey this share amounts to around 40% (Figure 10). In Romania and Hungary, the contribution of coal is much lower, but at the expense of a high share of natural gas. The energy mix in CEE countries is uncompetitive compared to Spain and Portugal, which are characterised by a relatively low use of fossil fuels, not to mention Sweden, where the electricity mix relies on nuclear power, hydro and wind.

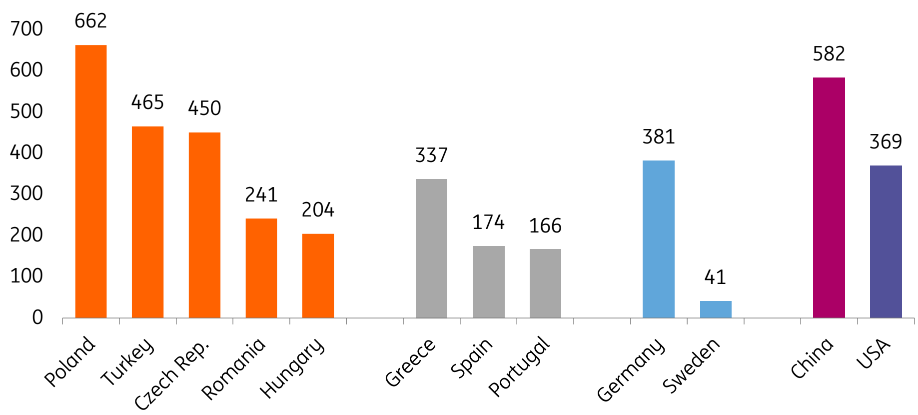
Fig 10 Electricity generation mix in selected European countries in 2023



Source: BNEF

This uncompetitive structure of energy sources in electricity generation is reflected in the high carbon intensity of electricity generation in CEE. Figure 11 shows that Poland, the Czech Republic and Turkey are producing brown energy, whereas the performance of Romania and Hungary is somewhat better. As regards the global perspective, carbon intensity of electricity in Germany is comparable to the US, and much lower than in China. However, the penalty for pollution in the EU and non-EU countries is different. In 2024, the average cost of emitting CO_2 in the EU was €65 per metric ton, while outside the EU, it was significantly lower. According to the Draghi report, the EU is also the only major region worldwide to have introduced a meaningful price for CO_2 emission. The report acknowledges that EU companies face electricity prices that are two to three times above those in the US. These high energy prices hinder CEE countries' comparative advantage in the production of exported goods and services, especially for extra-EU markets.

Fig 11 Carbon intensity of electricity in 2023 (gCO_2/kWh)



Source: Ember via https://ourworldindata.org/grapher/carbon-intensity-electricity?tab=tabl

Are CEE countries ready to fully converge to EU income levels?

We have discussed so far that, similar to credit-led growth, there are limits to the export-led convergence strategy. This claim can be related to the discussion in the academic literature, which indicates that financial deepening and better access to finance is supporting growth,[7] but the excessive accumulation of debt is harmful for the economy.[8] In the same vein, there are studies that show that international trade openness has a positive impact on growth until a certain threshold level, and thereafter the effect might be negative.[9] Therefore, there is non-negligible risk that CEE countries could fall into the incomplete convergence trap, similar to the experience of Southern Europe. In our view, this risk can be minimised if CEE countries continue their convergence by implementing policies focused predominantly on labour productivity, and at the same time invest in access to clean and sustainable energy.

We start by stating that sound passive policies, which promote an entrepreneur-friendly environment, are the fundamental factor for further productivity expansion. Effective institutions and regulations enhance investment, the infusion of existing technologies and innovation. Figure 12 shows that the quality of the business environment, measured by the Worldwide Governance Indicators (WGI), in all CEE countries except Turkey, is above the global median value of 50. The Czech Republic is the best performer with an average score of 80.6, slightly higher than in France (80.2) and slightly below the German benchmark of 88.4. The average scores of Poland (66.0), Hungary (62.7) and Romania (59.9) are well below the values of the core EU countries.

This illustrates that there is space for improvement in the quality of governance framework, where the space is the lowest for the Czech Republic and the highest for Turkey. In general, it can be stated that the institutional framework in CEE countries has been good enough to escape the MIT, but is lagging behind best practices, which (if unchanged) could limit growth in the future.

Fig 12 The quality of institutions proxied by Worldwide Governance Indicators

	Czech Republic	Hungary	Poland	Romania	Turkey	Spain	Portugal	Greece	France	Germany
Control of Corruption	74.5	51.4	68.4	55.7	34.9	75.0	75.9	56.6	85.4	95.8
Government Effectiveness	81.1	68.9	61.8	53.3	43.9	77.8	80.2	66.5	83.0	88.2
Political Stability	75.0	67.9	61.8	60.8	13.7	53.3	75.9	49.1	56.1	67.5
Regulatory Quality	88.7	64.6	74.5	63.7	43.4	75.9	75.0	67.5	85.4	92.5
Rule of Law	83.5	63.2	64.2	62.3	36.8	77.4	84.0	59.9	85.4	92.0
Voice and Accountability	80.7	59.9	65.2	63.8	23.2	79.7	89.9	76.8	86.0	94.7
Average	**80.6**	**62.7**	**66**	**59.9**	**32.6**	**73.2**	**80.1**	**62.7**	**80.2**	**88.4**

Data refers to 2022, based on WGI percentile ranking (0 - worst performer, 50 - median performer, 100 - best performer)
Source: World Bank Group, www.govindicators.org

Firm size-dependent regulations constitute a specific example of governance policies that are important for productivity. It is common to introduce policies protecting small businesses, which (unintentionally) limit the growth potential of the most productive companies. An innovative firm that creates value should be able to grow in size. But size-dependent policies, by providing incentives to remain small, keep productive firms smaller than they should be. These policies constitute an obstacle to innovation activity and productivity growth. Figure 13 shows that the size of firms in CEE countries is, on average, smaller than in the two core EU economies of France and Germany. It also shows that labour productivity (measured as value added per worker) of the largest companies is more than twice as high as those of the smallest ones. If the firm-size structure of companies in the CEE were the same as in Germany, it would help to

[7] Rajan R., Zingales L., 1998. Financial Dependence and Growth, American Economic Review 88: 559-586.
[8] Reinhart C., Rogoff K., 2010. Growth in a Time of Debt, American Economic Review 100: 573-578.
[9] Gupta R., Stander L., Vaona A., 2023. Openness and Growth: Is the Relationship Non-Linear?, International Journal of Finance & Economics 28: 3071-3099.

increase their productivity. Creating incentives for productive firms to expand and removing obstacles deterring productive firms from scaling up production could thereby provide an impetus for productivity increases in the region.

Fig 13 Firm size distribution and productivity by firm size

	Czech Republic	Hungary	Poland	Romania	EU	France	Germany
Share in employment (%, 2022)							
Below 10	32.7	41.2	37.1	32.3	30.3	29.6	19.2
From 10 to 49	17.5	17.5	16.0	19.2	18.9	14.9	21.4
From 50 to 249	18.2	13.9	14.3	17.1	15.4	11.3	17.2
250 and above	31.5	27.4	32.5	31.4	35.3	44.2	42.2
Value added per employed (€000, 2021)							
Below 10	20.5	14	14.1	13.9	38.5	50.1	57.4
From 10 to 49	30.1	26.9	25.3	22	51.3	58.8	56.1
From 50 to 249	38.8	34.1	33.3	24.2	67.0	68.0	65.9
250 and above	48.2	46.2	45.2	33.5	80.2	83.8	84.5
Average value added per employed	**34.3**	**27.9**	**28.8**	**23.4**	**60.1**	**68.3**	**70.0**
Average, with German size structure	**37.4**	**33.8**	**32.9**	**25.7**	**63.7**	**69.3**	**70.0**
% difference	*9.1*	*21.3*	*14.4*	*9.8*	*6.1*	*1.4*	*0.0*

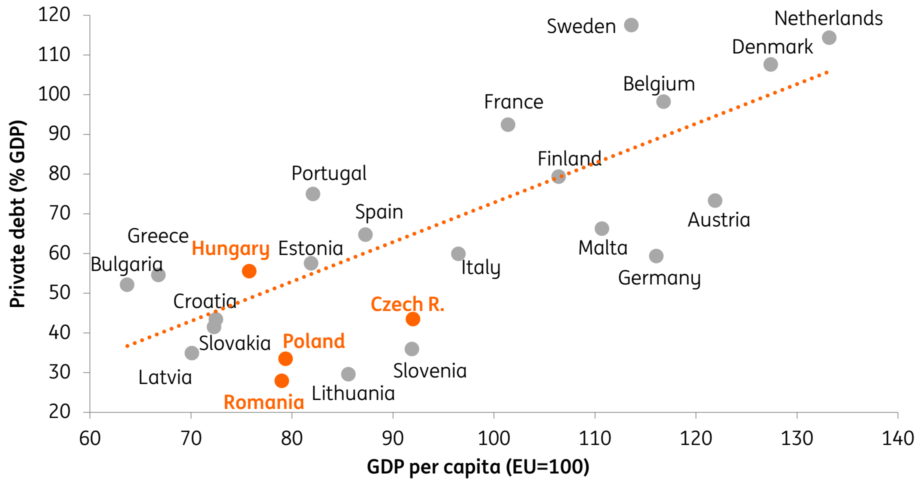
Source: Eurostat, ING calculations

Scaling up productive firms can be supported by financial market deepening, eg, by providing access to a wide range of capital and funding. Currently, the level of corporate debt in CEE is low, even if we control for the level of GDP *per capita* (Figure 14). This suggests that CEE countries are underleveraged and underutilise their potential. Financial deepening requires both further development of the banking industry and capital markets.

Strong empirical evidence, such as that in the influential study by Rajan and Zingales, shows that financial development not only correlates with economic growth but also drives growth and productivity increases. At their current stage of development, CEE countries need highly diversified sources of capital, including debt with longer maturities for long-term investment projects in green energy. They also need funding with a more diversified risk profile, supporting not only traditional sectors but also high-risk innovative startups. Indeed, external financing is crucial to commercialise and scale up innovative projects.

Still, the credit-led growth of Southern Europe was successful in the early years before the level of debt reached excessive levels. This means that greater courage in the use of external financing could give an extra boost to CEE economies. However, it is important not to repeat the mistakes of Southern Europe and to ensure that financial deepening supports the expansion of productive firms, especially those engaged in high risk-profile innovation activity, rather than just fuelling a housing market bubble.

Fig 14 The level of corporate debt and GDP per capita relationship (2023)



The level of debt is calculated as the sum of loans and debt instruments. In the case of missing data for 2023, figures for 2022 were taken.
Source: Eurostat, ING

The expansion of innovation activity in CEE countries is another crucial factor to escape the *incomplete convergence trap*, especially as the current level of CEE innovativeness is low. According to the European Commission's European Innovation Scoreboard (EIS), the overall performance of all CEE countries, apart from the Czech Republic, is well below the EU average. Figure 15 shows that CEE countries are classified as emerging (Turkey, Romania and Poland) or moderate innovators (Hungary and the Czech Republic).

Fig 15 European Innovation Scoreboard (EU=100, 2024)

	Czech R.	Hungary	Poland	Romania	Turkey	France	Germany
Summary Innovation Index	**90**	**71**	**66**	**34**	**52**	**104**	**112**
Human resources	75	48	72	27	60	136	94
Digitalization	94	87	80	93	39	110	86
Finance and support	84	81	62	20	62	142	95
Firm investments	115	70	62	14	48	89	141
Use of information technologies	95	79	99	29	33	78	115
Innovators (SME)	95	45	45	3	73	112	119
Employment impacts	102	60	59	9	30	107	127
Sales impacts	90	81	60	62	68	72	101
Environmental sustainability	94	70	60	48	43	109	115

Key: emerging (<70) innovators; moderate (70-100) innovators; strong (100-130) innovators; leading (>130) innovators

Source: European Commission, ING

The big advantage of the EIS is that it helps to identify specific areas in which a country performs strongly or poorly in terms of innovation activity. Figure 15 shows that the ICT sector (sections *digitalization* and *use of information technologies*) is relatively well developed in CEE, apart from Turkey. Among weaknesses, both the level of firm investment in innovation (*firm investments and innovators*) as well as government support for R&D (*finance and support*) are underperforming. The table also shows that in the areas of *human resources* and *environmental sustainability*, CEE countries are lagging behind other EU countries. The general picture that emerges from the EIS is that, in the past, CEE countries, apart from the Czech Republic, were more successful in adopting existing technologies than developing their innovation potential. At the current juncture, if growth through infusion has reached its limits, this would require a reorientation towards an innovation-supportive approach.

Fig 16 Projected electricity generation mix in CEE5 in 2030 compared to 2023 (% of total)

	Poland		Czech Republic		Turkey		Romania		Hungary	
	2023	2030	2023	2030	2023	2030	2023	2030	2023	2030
Coal	60	22	41	16	36	28	14	0	7	0
Nuclear	0	0	42	42	0	8	21	19	45	63
Renewables	29	56	12	38	42	43	50	59	27	30
Other (eg, gas)	10	22	5	5	21	21	15	22	21	8

Source: BNEF data for 2023, ING estimates based on the latest draft National Energy and Climate Plans for 2030.

Investment in clean energy is the next necessary condition to continue growth in the future, especially given the high carbon intensity of the current energy mix and evolving environmental policy. The available National Energy and Climate Plans (NECPs) envisage substantial decarbonisation of electricity generation. Figure 17 indicates that all countries from the region have opted for a power system decarbonisation strategy based on renewables and nuclear energy. Romania and Hungary are to phase out coal fully from their electricity mix by 2030, while the remaining countries are to reduce the share of coal significantly. Nonetheless, according to the official NECP from late 2023, Poland is to phase out coal only in 2049.

Fig 17 Energy-related EU funds through to 2030 (€m)

	Poland	Czech Republic	Hungary	Romania
Structural and cohesion funds, ERDF+CF	17,084	5,000	3,460	5,056
Recovery and Resilience Facility, RRF	27,450	2,628	5,440	7,050
Just Transition Fund allocation, JTF	3,847	1,640	261	2,100
Innovation Fund	313	20	2	
Modernization Fund	1,908	4,344	185	4,679
CEF-Energy	98	45		51
Total energy-related EU funds	**50,700**	**13,677**	**9,348**	**18,936**
Total as % of 2023 GDP	**6.80**	**4.30**	**4.80**	**5.80**
- distributed over 7 years to 2030	1.00	0.60	0.70	0.80
Memo:				
RRF grants	25,300	8,400	6,500	13,600
RRF loans	34,500	800	3,900	14,900
GDP in 2023	750,801	317,387	196,391	324,578

Hungary is still not able to access the RRF due to the *Rule of Law* condition. We see a non-negligible risk that the country will eventually not use RRF funds.
Source: EC's country fiches attached to Energy Union Report (2024), Eurostat data.

Decarbonisation of CEE economies will involve high investment, which constitutes both a challenge and an opportunity for further growth. Fortunately, there are EU funds available in the current decade to support energy-related investments in the EU member states, and CEE countries are significant beneficiaries. These funds come from the structural and cohesion funds and Recovery and Resilience Facility (RRF) grants and loans, supplemented by dedicated funds to coal regions from the Just Transition Fund, and other funds. In total, they add up to around €50 billion for Poland, €19 billion for Romania, €14 billion for the Czech Republic and €9 billion for Hungary (Figure 17). If expressed as a percentage of GDP in 2023, these amounts are equivalent to between 4.3% in the Czech Republic to 6.8% in Poland. If roughly divided into seven years, as most of these funds are available for disbursements through to 2029,[10] this means that they will amount to 0.6-1.0% of each country's GDP per year.

EU funds will help to finance the energy transition, though the scale of this support varies across CEE countries. In Hungary, where energy-related investment needs are relatively modest (thanks to the existing nuclear power plant and a low share of coal in the electricity mix), EU funding is likely to be a predominant source of financing.

[10] RRF grants need to be disbursed and accounted by mid-2026.

According to last year's National Energy and Climate Plan draft, the total investment over 2019-35 is estimated at HUF5,670bn (7.6% of GDP), which aligns closely to the projected inflow of EU funds for energy projects[11]. In Poland, where energy-related investment needs are relatively high (because of high share of coal in the electricity mix and plans to build nuclear power plants), EU funding is likely to constitute only a supportive source of financing. According to the latest estimates from the latest Polish NECP presentation, over 2021-30 required energy-related investment needs are estimated at PLN1,450bn (42.5% of GDP). This estimate includes both investments in power and heat supply (new capacity, grids, installations) and demand side investment in (electric) vehicles, heat sources in buildings, or industrial or agricultural installations. This means that EU funds are set to cover around 20% of energy related needs, while the rest has to be funded from own resources of firms and households or external debt. On the latter, there is a large spectrum of sustainable financing, including bank loans related to sustainability and capital market instruments, such as green or sustainable bonds.

Conclusions

1) **Central Eastern European countries are often depicted as successful examples of countries that have escaped the Middle-Income Trap.** By 2023, most CEE countries significantly surpassed the high-income threshold of US$14,005 GNI *per capita*. This success is related to the transition from a centrally-planned economy to a market economy and EU accession, and the improved institutional framework that facilitated the better utilisation of high-quality labour and attracted foreign investment.

2) **The next challenge for CEE countries is to fully converge with core EU income standards.** Achieving full and sustainable convergence cannot be taken for granted, as evidenced by the experience of Southern European countries. For the past decade, they have experienced income divergence and fallen into, what we call, the incomplete convergence trap.

3) The growth models of CEE (export-led) and Southern Europe (credit-led) are different. The incomplete convergence of Southern Europe can be attributed to the fact that, beyond a certain level of debt, credit-led growth loses its appeal. **The export-led strategy of CEE countries has been successful so far. However, the most recent experience of the Czech Republic indicates that the export-led convergence might stop.**

4) **There are reasons why an export-led strategy might not bring full convergence for CEE countries.** Export-led growth in the region relied on abundant labour resources, competitive wages and an infusion of foreign technologies. In an environment of scarce labour resources, rising wages and high energy prices, further expanding exports from already high levels may prove challenging.

5) **In order to limit the risk of falling into the incomplete convergence trap, CEE countries should focus on enhancing productivity of scarce resources: labour and environment.** This could be done by improving the business environment to scale up productive activity, through improved regulations and financial deepening. Specifically, a developed financial system (both banking sector and capital markets) helps productive and innovative companies to grow, which supports productivity and economic growth. Next, creating incentives for innovation activity will be crucial to continue the convergence. Lastly, CEE countries need to twist the decarbonisation

[11] A more ambitious With Additional Measures (WAM) scenario described in the forthcoming NECP update is expected to reveal higher investment needs, which will require financing from non-EU sources.

challenge into an opportunity of productive investment-led growth, based on diversified public-private financing.

6) To wrap up, **in our opinion, CEE countries can growth further, but this will require a reorientation of the growth model from one led by exports built on FDI inflows and cheap labour, to one focused on productivity based on financial deepening and innovation.** This reorientation seems to be less urgent in Romania, and the export-led strategy might continue to work successfully in Turkey in the near term. While export-led growth has been successful in the past, the future might require a more balanced approach that includes improved governance, innovation and good management of scarce resources.

CEE FX, rates and debt strategy

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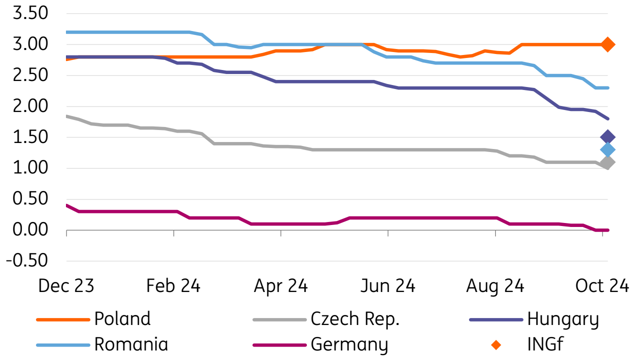
The focus is shifting from monetary policy to politics and fiscal consolidation. Most of the cutting cycle is done and the next steps by central bankers will be more fine-tuning. On the other hand, CEE countries have failed to deliver fiscal consolidation and the sustainability of public finances is coming back to the financial markets' attention. However, the election cycle will complicate any improvement, leaving the CEE region vulnerable. Disinflation has come to an end and we see inflation rebounding in some places, with local and global risks pointing more to the upside. The US presidential election is the biggest global issue for the CEE region and although the outcome itself may seem binary in its immediate impact on markets, the longer term impact will be more of a mixed bag depending on the details, but we are not as negative as market consensus.

As the year comes to an end, we see that some of the themes set for this year are running out of steam and the focus is shifting elsewhere. But at the same time, some topics carry over into the next year. The rate-cutting cycle is reaching a late stage in CEE and the big disinflationary cycle is behind us. Inflation is picking up in some places, the upside risks are starting to rise, but the market is willing to look through, and we are unlikely to start another inflation cycle, rather we will see bumps in the road. Market attention will increasingly turn to politics and fiscal consolidation. This, together with the weak economic recovery, are the two biggest stumbling blocks in the CEE region. We highlight three themes that we think will be the main drivers for markets in the CEE region over the next six months.

1) We believe the main focus will be the political cycle and fiscal policy while monetary policy remains in the background as any further easing will be more fine-tuning.
2) Inflation will continue to be a theme, but it's clear that the disinflationary phase is behind us and the picture is more mixed looking at the months ahead across the board, probably resulting in fewer downside surprises than we've been used to in recent months.
3) And, naturally, our final topic is the ubiquitous US presidential election, which market consensus sees as a risk to the CEE region, especially in the event of a Trump victory. The picture is perhaps more complicated than purely the outcome of the election and the scenario is not just a pure binary play.

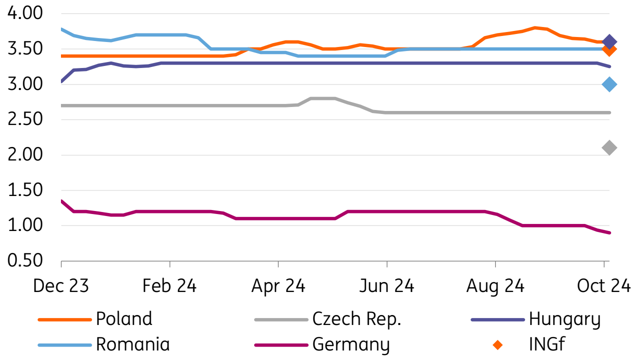
However, before we look at the detail, we need to look at the macro framework that lies ahead. According to economists, the narrative for this year was for significant economic recovery in the CEE region, however, a year ago we indicated that the risks were to the downside and we envisaged big disappointments in last quarters of the year. Our concern is that economists are running into the same trap with regards to next year and that the market will follow. We await the release of household savings and a kick-start of household demand. Although the latest numbers suggest some recovery, the outlook is not dazzling and at the same time global expectations are deteriorating. Our global team expects the German economy to shrink by -0.1% this year and grow 0.2% next year, below market expectations. And the outlook for the eurozone is similar, which will inevitably have an impact on growth in the CEE region as it cannot escape the global story. Therefore, we believe that expectations for next year are again too optimistic.

Fig 18 Consensus forecasts for 2024 GDP growth (%)



Source: Macrobond, ING

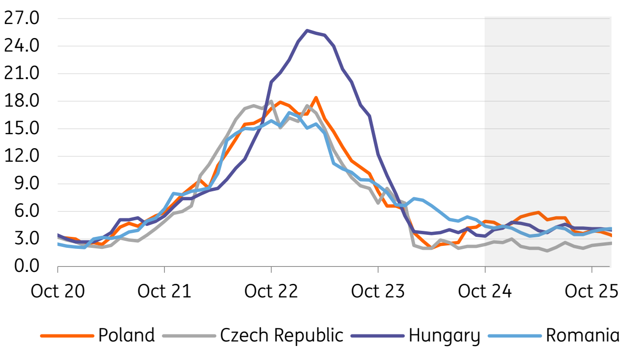
Fig 19 Consensus forecasts for 2025 GDP growth (%)



Source: Macrobond, ING

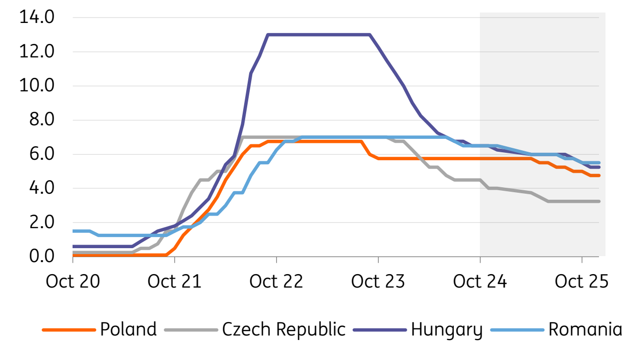
1 Politics has and will continue to affect, to some extent, essentially the entire CEE region, which will have an increasingly greater impact on fiscal policy. In Poland we will see a presidential election next May, which is basically a second round of the general election that took place last year, and the political atmosphere in the country remains heated. Already the state budget proposal for next year has been a negative surprise for the markets and we cannot expect any improvement on that front looking forward. The Czech Republic will hold general elections in October next year and an opposition victory seems like a baseline although it will be a tight race. While we do not expect a major reversal in fiscal consolidation, the new government may have a more relaxed bias, which may be more of an issue for the central bank than bond issuance itself. Hungary's general election will take place only in April 2026, but the election campaign seems to be starting now and the opposition is gaining momentum. In Romania, we expect general and presidential elections in November and December this year, with markets expecting fiscal consolidation after the elections, while this year's public finance deficit estimates are by far the highest in the CEE region. However, fiscal policy in the region is already stretched given the failure of fiscal consolidation this year with the exception of the Czech Republic. Moreover, fiscal policy and sustainability of public finances is becoming a global issue again with the US presidential election and the general election in France, which may soon translate into market thinking, finding CEE countries without a safeguard, where we see Romania as the most vulnerable with Poland and Hungary following. On the other hand, the Czech Republic can benefit from the work it has done on the fiscal side before.

Fig 20 Headline inflation forecast (%YoY)



Source: Macrobond, ING

Fig 21 Key policy rate forecast (%YoY)

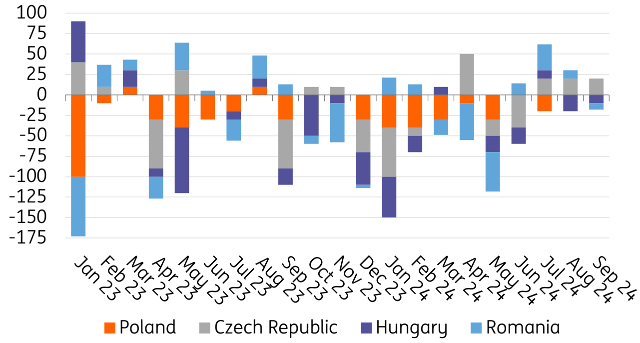


Source: Macrobond, ING

2 Inflation has clearly bottomed out in most countries in the CEE region and we are already seeing increases in some countries. For now, this seems to be more of a temporary move that markets are looking beyond and the consensus continues to see a return to the targets of central banks. However, the frequent downside surprises appear

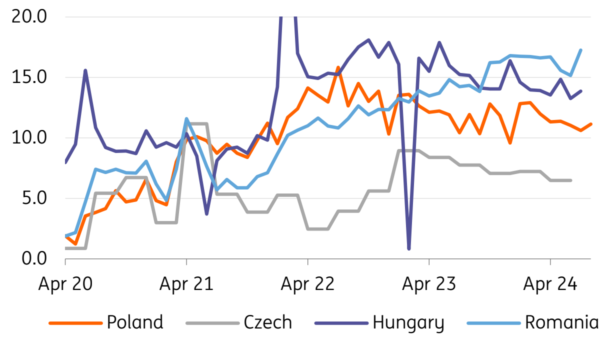
to be in the past and we are now seeing upside surprises in some cases. One explanation is the wild base effects of the past year and the jumps triggered by government measures or their removal. But there are other reasons as well. At a local level, service prices remain elevated, and it seems that pushing them down further will prove difficult, especially with persistent strong wage pressures. At a global level, we are also seeing a rebound in food prices and higher oil prices caused by geopolitical tensions. Thus, the upward inflation surprises may drive a hawkish tone from central banks and market sentiment in the coming months. Moreover, the room for monetary easing is narrowing and the next steps by central bankers in the region will be fine-tuning.

Fig 22 Headline inflation surprises vs consensus (ppt)



Source: Refinitiv, ING

Fig 23 Wage growth (YoY%)



Source: Macrobond, ING

3

The last topic is the US presidential election and not only the result and the immediate reaction of the markets but the longer term implications for the CEE region. Of course, the main channel of impact on the markets is EUR/USD. But later, the impact will rather depend on the policy towards Ukraine, NATO and global trade, which are key for CEE countries. The general market consensus is that a Trump victory would be negative and a Harris victory positive for the CEE region. However, as we showed in our US election guide for the FX market, the situation in the region has changed significantly from Trump's first term. CEE countries led by Poland are becoming leaders in defence spending and, within NATO, trade links with the US have grown significantly over the past few years and America has become a key partner for countries in the region. Moreover, on the political side, we can find more openness to Trump's policies among CEE leaders compared to leaders in Western Europe. In the event of some variant of an end to the Ukraine-Russia conflict, Poland and the Czech Republic in particular stand to benefit significantly economically from a Reconstruction Ukraine Project. Although the outcome of the US election and the immediate impact on markets may seem binary for the CEE region, we believe that, in the longer term, it will depend on the detail rather than the victory of one candidate or the other.

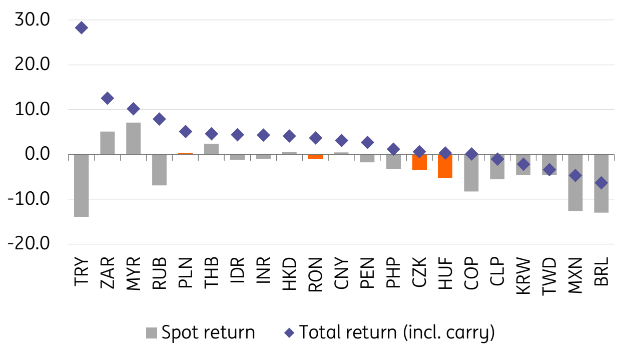
FX: The region has less to offer

The main benefit of CEE currencies in the form of carry is dissolving and, at the same time, the global story is not as dovish as it has seemed recently. Therefore, in relative terms, we believe the CEE has less to offer, which is not helped by the downside disappointment from the economic recovery. At the same time, local and global risks are rising. PLN remains a defensive option within the region. The CZK should retain central bank support. HUF is entering a more difficult period. RON remains firmly in the hands of the central bank.

CEE FX this year does not have an easy job. Central banks are delivering rate cuts well ahead of the global story, taking away the rate differential that has been their main benefit over the past year. At the same time, the economy is surprising on the negative side, and the stable current account surplus is one of the few positive news stories here. However, in the past month, geopolitical tensions and escalating conflict in the Middle

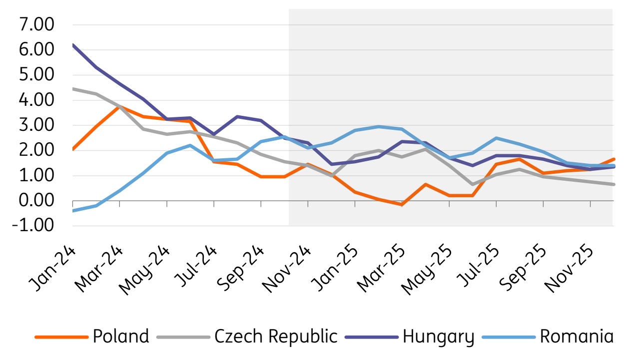
East have been added to the mix, putting the entire EM space under pressure. In addition, despite a bold start to the cutting cycle, the Fed may not be as dovish as we thought recently, again dampening expectations of an improvement in rates in relative terms. HUF and CZK are thus in losses YTD, reflecting the most aggressive cutting cycles and weak economies, and PLN maintains modest gains with a hawkish NBP and stronger economy on its side. This picture is likely to persist; PLN should remain supported/ protected by a strong economy and a relatively hawkish central bank compared to regional peers. However, even here we see market sentiment changing and optimism around PLN waning. Of course, room for further gains has diminished and heading into the presidential election the political and fiscal noise may be a negative for the currency. But still, PLN remains our favourite currency in the region and its relative value against CEE peers may be a good option if geopolitical tensions rise.

Fig 24 FX spot and total return (YTD, %)



Source: Macrobond, ING

Fig 25 Projected real policy rate (%)



Source: Macrobond, ING

The CZK is caught between two market views of the future. Our preferred option is a stronger CZK, thanks mainly to a hawkish central bank. The market in recent months has become accustomed to dovish expectations of CNB rate cuts, which were supposed to offset a weak economy heading into structural problems. However, we believe the CNB will stay on its hawkish trajectory and not deliver as many rate cuts as the market expects. At the same time, we see the rate differential as having the strongest impact on FX in the Czech Republic within the CEE region. Pickups in inflation could make a pause in the cutting cycle a real possibility. At the same time market positioning in rates is usually heavily received and any hawkish pivot by the central bank will be a boost for the CZK.

The HUF is entering a difficult period in the coming months. Although this year we were happy with a trading range of 392-400 EUR/HUF depending on inflation prints and NBH reaction, looking further out, the likely range moves up to 400-410. Although the geopolitical situation and global stress is more behind current HUF weakness, local reasons may come into play later. Fiscal policy and the election cycle is compounded by the change in central bank leadership next March, which the market sees as dovish. At the same time, HUF remains the most sensitive currency in the region to global stress. The HUF is thus likely to have more problems next year.

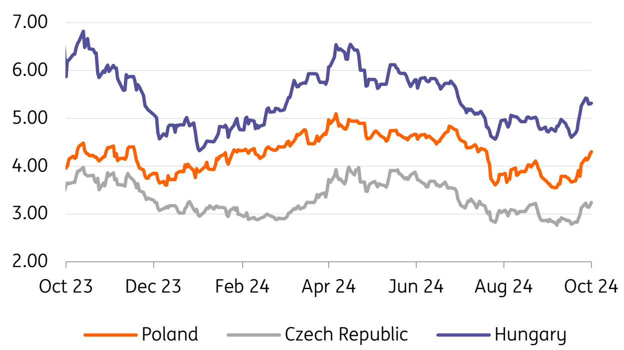
The RON has remained firmly attached to the EUR since the second half of last year, pegged in the 4.960-4.980 range, and it is hard to see any change in the near future. Volatility has fallen to freezing point plus carry has shrunk significantly due to rate cuts and tightening in FX implied yields. At the same time, the NBR's FX reserves continue to rise to record highs in nominal terms, guaranteeing the smooth running of the current FX regime. Banking sector excess liquidity also remains elevated, further pushing money market rates and FX implied yields lower, effectively easing monetary conditions. Thus, it seems any upward move in EUR/RON levels is again postponed. We expect EUR/RON to move above 5.00 in 25Q2, however, the central bank does not provide any forward guidance and timing will depend on other factors.

Rates: More space for steepening

The early-October sell-off left the IRS curve in the CEE region more fairly priced, especially at the short end. Although current valuations seem fair in PLN and CZK, HUF, as usual, shows the most mispricing. We believe the market would like to return to receiving rates across the region if global conditions allow. While the long end of the curve should be lower given neutral rates, higher core rates and fiscal policy will keep them higher, resulting in further steepening of curves in the region.

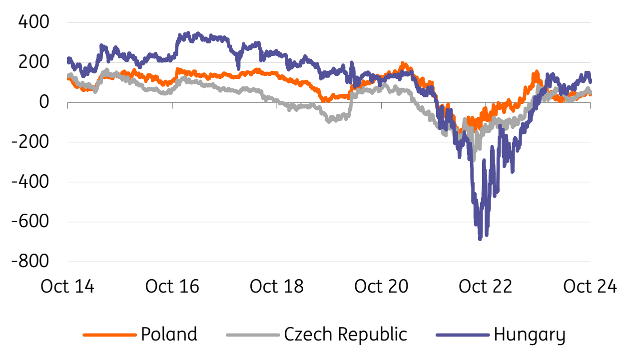
The early-October sell-off brought strong repricing across the CEE region. In our view, the excessive expectations on rate cuts in Poland and the Czech Republic were priced out while most expectations were removed in Hungary under EUR/HUF heading up. In Poland, the market is thus fully pricing in the first cut for March, which is still bold pricing in our view but realistic with 125bp for the whole of next year, not far from our economists' forecast of 100bp. In the Czech Republic, the market sees an almost fully priced chance for a rate cut in November but only 50% for December, where our economists see a pause, and a slightly higher probability for February. In Hungary, the market sees roughly only a 25% chance of a rate cut in October after an aggressive EUR/HUF move up, and a 40% chance for another meeting next year as well. Hungary again looks to us like the biggest misprice within the region. While understandably the central bank is turning more hawkish after the recent global volatility, the local picture has not changed much, and we also expect a dovish NBH shift after the March leadership change. The priced in terminal rate has returned to 5.25%. Thus, while PLN and CZK rates in front of the curve seem fairly priced in for now, we think HUF rates have the potential to return lower if the global situation calms down given that inflation continues to surprise to the downside, the only one within the CEE region. However, should the global situation allow, we believe the market would like to return to receiving front-end rates in PLN and CZK again as well, overshooting the terminal rate as we have seen in previous months.

Fig 26 Market implied terminal policy rate



Source: Eikon, ING

Fig 27 IRS 5y5y vs 1y1y spread in CEE



Source: Eikon, ING

The long ends of the curve in CEE are becoming more complicated, although current pricing would suggest further downside due to the distance from neutral rates. However, our bias for higher core rates and a negative view on fiscal policy in the region should keep the long ends higher. At the same time valuations suggest more room for curve steepening in most cases, which seems like the way we are looking going forwards.

Local currency debt: Loose fiscal policy in global headwinds

Loose fiscal policy and lack of consolidation is the biggest risk to CEE sovereign bonds. Bond issuance remains high, but in some countries we see an improvement compared to others. However, rising core rates and more attention from global markets will make the situation more complicated in the coming months.

As discussed in previous sections, fiscal policy has failed to deliver consolidation across the region with the exception of the Czech Republic. However, the world is moving towards the issue of sustainability of public finances, which we see as the biggest risk for sovereign bonds in the coming months amid a heavy election calendar in CEE. Already this year shows weak demand for bonds in Poland and Romania with bid/cover close to 1.0, while in the Czech Republic and Hungary demand remains strong in primary auctions (bid/cover above 2.0). However, there is little hope for improvement and risks tend to point to the downside, as seen in some outflows from foreign holders across the region this year.

In Poland, the government surprised markets negatively with a higher than expected budget deficit for next year and a lack of willingness to consolidate public finances. As a result, the issuance outlook for next year promises an even larger gross issuance of POLGBs than this year (up roughly 25%). Part of the reason for this is the consolidation of off-budget funds and the issuance of BGK, but the timing is not favourable and MinFin may have a hard time securing funding that will diversify into all possible sources according to market demand. However, we are already seeing weak market demand for durations while locals are focusing on short-end and belly. We thus expect a steepening of the POLGBs curve.

In the Czech Republic, the market has maintained a strong demand for CZGBs and surveys suggest that CZGBs have the largest overweight position in the CEE region. Similar to rates, we see risk in the bond space along with the IRS market for more CNB cuts, although this is too far away for us to have as a baseline. However, this view may drive CZGBs yields lower going forward, while the Czech Republic was the only country that was able to deliver materially lower issuance this year compared to last. On the other hand, the outlook for next year is worse due to higher redemptions despite further reduction in the state budget deficit.

In Hungary, this year's funding coverage was the smoothest across CEE peers, benefiting from the highest demand in the region's primary auctions. The government managed to improve the execution of the budget and reduce fiscal risk, while the debt agency frontloaded issuance, ending with lower supply by year-end. At the same time, the government projects deficit reduction for next year, on the other hand, the election risk is clear here. Still, HGBs offer high yields within CEE peers, high market demand and reduced borrowing needs, though split funding is unknown for now. The central bank is open to cutting rates if global tensions disappear, plus we can expect more cuts next year.

In Romania, bonds are the biggest underperformer this year within the CEE region, understandably due to the growing budget deficit. Although the market seems to have fully priced in this year's fiscal risk and is waiting for the consolidation announcement after the November/December elections, recent headlines suggest there may be more negative news. The political situation ahead of the election is also generating some noise. So we fear the situation may get a little worse before it gets better. In addition, current valuations against CEE peers suggest an expensive duration.

Hard currency sovereign debt: Wary of external shocks

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With hopes of a 'soft landing' scenario in the US still intact, the macro environment should remain relatively benign for EM sovereigns, which have shown remarkable resilience to the major shocks in recent years. We see potential for steady returns given the carry on offer despite fairly tight spreads, although risks are building in the runup to US elections, with geopolitics as always in focus.

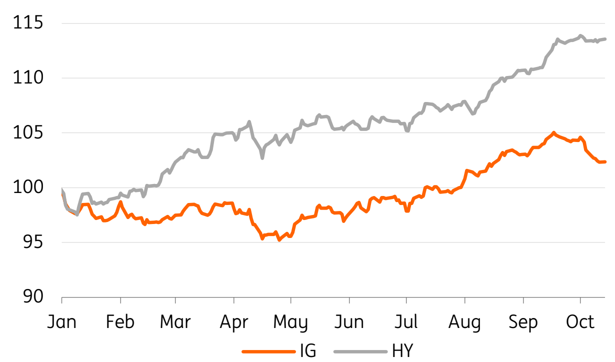
This year has seen a narrative of spread tightening in EM credit, amid further signs of resilience for the asset class. Total returns are positive for EM sovereigns this year, with HY names benefitting the most from the environment of spread tightening and generating over 10% YTD. Performance has been more mixed for IG names, with the volatility in core rates driving swings in total returns even as spreads there also continued to squeeze towards all time tights.

10Y UST yields have generally moved full circle, with the year though to May seeing a move higher as US data consistently beat expectations and showed signs of a major divergence with the rest of the world before easing expectations started to build through to September. More recently, 10Y UST yields have ticked back above 4% despite the realisation of September's 50bp cut, with US economic resilience remaining a theme in focus amid uncertainty over the scope of further easing.

With spreads still hovering near all-time tights for the 'core' index excluding CCC sovereigns and near post-Covid tights at the headline level, the scope for further significant compression has clearly diminished. Heading forward, we would need to see a continuation of the recent tentative signs of inflows into the asset class, while lower supply at the back end of this year should be a technical tailwind.

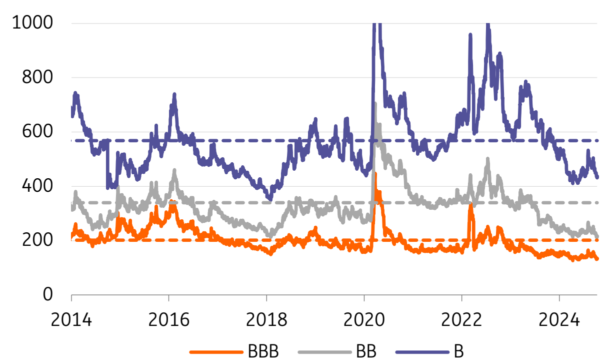
As a positive, all-in yields still look attractive for EM sovereigns, which should keep demand robust, including in the primary market. At the same time, the macro environment is still in a cycle of global monetary easing, while EM nations should increase their growth advantage over the developed world, meaning a fairly benign setup for EM sovereign credit. In terms of fundamentals, the global cycle has shifted towards rating upgrades outweighing downgrades, as fundamental improvements start to show in credit metrics.

Fig 28 Cumulative total returns YTD (EM USD sovereigns)



Source: ICE, Refinitiv, ING

Fig 29 EM sovereign spreads by rating (bp)



Source: ICE, Refinitiv, ING

Key themes

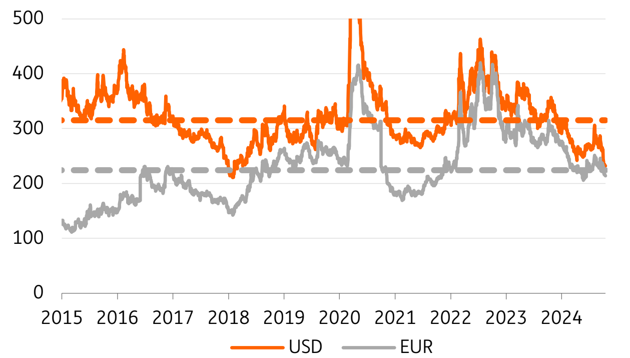
- **Waiting for elections.** US elections are set to be closely watched by EM investors, with key geopolitical hotspots such as Ukraine and the Middle East likely to be influenced by US foreign policy, along with questions around global trade and the more general economic outlook for US fiscal and rates. CEE sovereigns are wary of any potential change to the US stance on NATO, with some policy spillovers already starting to be seen in terms of commitments to greater military spending from the region. US elections are not the only ones in focus though, with investors hoping for signs of fiscal consolidation in **Romania** after their parliamentary and presidential votes, while **Bulgaria** needs to form a stable coalition to progress further towards euro adoption. Looking ahead to next year, the buildup to elections in **Hungary** and **Poland** could also start to play more of a role in keeping fiscal policy expansionary.

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

- **Diversification of funding sources continues.** Given the large funding needs for most CEE sovereigns, finding alternative financing sources outside of the traditional EUR and local currency markets has been key. Romania issued its debut samurai bond, Bulgaria and Montenegro came to the market in dollars, while even in the CIS region we saw a debut EUR issue for Uzbekistan. Outside of the bond market, North Macedonia has seen a loan from Hungary, and we could see official lending play a big part in the success of EM sovereigns, in particular in the EU periphery.

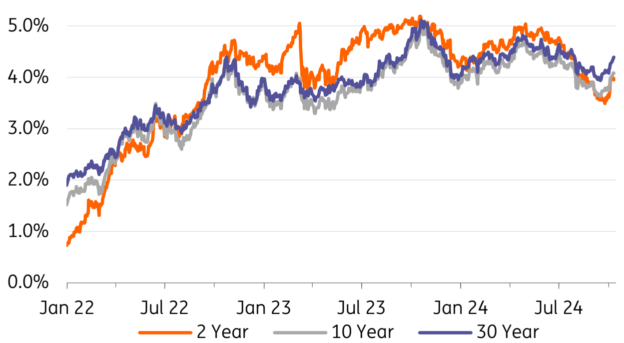
- **Geopolitics remains a global risk.** With tensions continuing to escalate in the Middle East, investors are wary of both direct impacts on the region, along with potential spillovers to the rest of the world that could come once again from the energy sector. Energy importers in CEE have recovered well from the gas shock in 2022 and are continuing to work on alternative sources of energy imports but could feel pressure from a spike in oil prices if there was a disruption to supplies from the Middle East, while naturally energy exporters Kazakhstan and Azerbaijan would be better placed.

Fig 30 EM sovereign spreads by currency & median (bp)



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

Fig 31 UST yields



Source: Macrobond, ING

CEE country views

(Moody's/S&P/Fitch rating; ↑=positive, ↓=negative outlook)

- **BGARIA** (Baa1/BBB↑/BBB↑): Given the upcoming elections and ongoing uncertainty over the ability to form a stable governing coalition, there remains the potential for some headline risk and weakness for Bulgaria's hard currency sovereign bonds in the near-term. Further delays to the expected timeline for euro adoption could drive some spread widening, although our medium-term conviction remains that eventual confirmation of eurozone entry should drive spread compression versus peers such as Croatia. Technical support for the EUR curve from regional demand has kept spreads well anchored this year.
- **CROATI** (Baa2↑/A-↑/A-): With solid and improving fundamentals, along with limited political risk, there is little for investors to be worried about in Croatia. Ratings have been on a consistent uptrend, and euro adoption has added a further catalyst for regional flows to continue, keeping a steady bid on the sovereign paper. At the same time, spread levels are tight, even versus higher-rated peer Poland, and eurozone peers in the Baltics, leaving limited room for upside. We would see CROATI now as a defensive play in the event of a general market risk-off move.
- **REPHUN** (Baa2/BBB-/BBB↓): The fiscal situation looks more positive for Hungary than CEE peers Romania and Poland in terms of expected supply pressure, with the government focused on maintaining a steady share of FX debt within the government stock. At the same time, this is likely to continue to be balanced by the ongoing headline risk around EU funds with no notable progress on unlocking more.
- **POLAND** (A2/A-/A-): Loose fiscal policy should mean further significant issuance needs in the Eurobond space for 2025, but other macro fundamentals are strong enough to ensure demand should remain robust, with solid growth momentum and comfortable external balance.
- **ROMANI** (Baa3/BBB-/BBB-): Concerns about the ongoing fiscal deterioration, along with election noise may continue to weigh on ROMANI sovereign credit. The focus for hard currency investors will likely remain on the huge Eurobond issuance from the country, having already seen over $18bn in sovereign issuance this year. The modest pace of fiscal consolidation will likely mean heavy supply again in 2025, while any further disappointments after the elections could bring ratings concerns back into focus. Valuations have cheapened up, in particular in the belly of the USD curve, with the May $34s widening versus most ratings and regional peers, including rising star Serbia. However, we would prefer to remain cautious at current levels, again waiting for some more concrete progress on the fiscal front and likely new issuance early in 2025.
- **SERBIA** (Ba2↑/BBB-/BB+↑): With strong fiscal performance compared to most CEE peers, Serbia has been rewarded with its first upgrade to IG and investors have been taking a similar view. Despite a lack of clear pathway towards easing tensions with Kosovo, the improving macro metrics have outweighed the political risk, with Serbia's dollar bonds now trading comfortably in IG territory and compressing towards the BBB-sovereign average. We see scope for the strong performance to continue as the other rating agencies catch up with S&P and robust macro performance continues to outshine CEE peers.
- **TURKEY** (B1↑/B+↑/BB-): Confidence in the improving macro situation is improving, along with expectations for the shift to orthodox monetary policy to be maintained. With inflation falling, the current account deficit narrowing, and expectations for fiscal tightening, fundamentals are clearly on the up, and credit ratings have been following, with Fitch moving to BB- and the other two main agencies on positive outlooks.

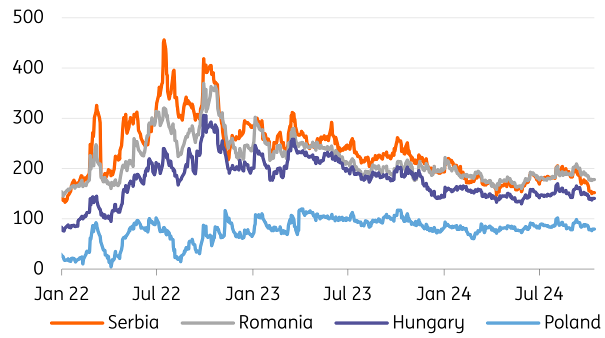
CIS country views

- **ARMEN** (Ba3/BB-/BB-): While macro fundamentals are generally normalising from the improvements seen in 2022, most metrics have stabilised at comfortable levels. Geopolitical risk from tensions with Azerbaijan remains a potential driver of volatility, although more recently some optimism has built about progress in improving relations at November's COP climate conference in Baku, meaning this is no longer a purely downside risk factor. Limited FX-reserve coverage and potential widening of the current account deficit are external vulnerabilities, but financing needs for commercial external debt are low outside of a small March 2025 (c.US$300m) Eurobond maturity.
- **AZERBJ** (Ba1↑/BB+/BBB-): Credit fundamentals are strong given the significant FX assets and limited external financing needs, despite expectations for a moderation in the twin surpluses. Ratings are on the path to IG, with Fitch upgrading to BBB- in July and Moody's on positive outlook, which should bring official ratings in line with market perception and pricing.
- **KAZAKS** (Baa1/BBB-/BBB). Some improvements in the external picture are balanced by modest fiscal weakening, leaving fundamentals overall fairly stable. We have seen a rating upgrade by Moody's, with all outlooks now stable and a composite rating of BBB, ranging across this tier (Baa1/BBB/BBB-). The long-awaited new issuance of 10-year USD bonds did bring about some weakness in the secondary curve, with spreads no longer as tight relative to ratings peers.

UZBEK (Ba3/BB-/BB-): In terms of fundamentals, Uzbekistan's strong balance sheet (low government debt and strong reserve coverage) is slightly weakened by widening twin deficits, although the sovereign remains in a comfortable position. We believe Eurobond supply is set to continue to finance the nation's investment needs on its development path, although refinancing needs are low until 2027.

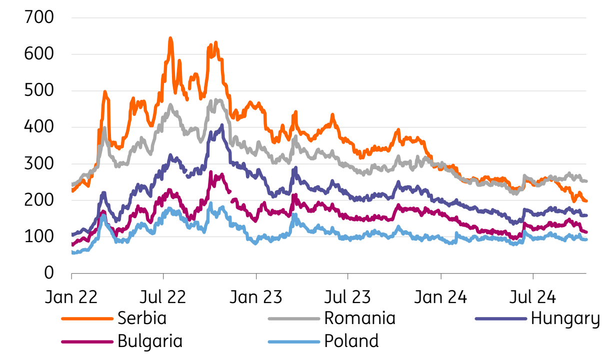
CEE and CIS relative value charts

Fig 32 CEE USD index spreads (bp)



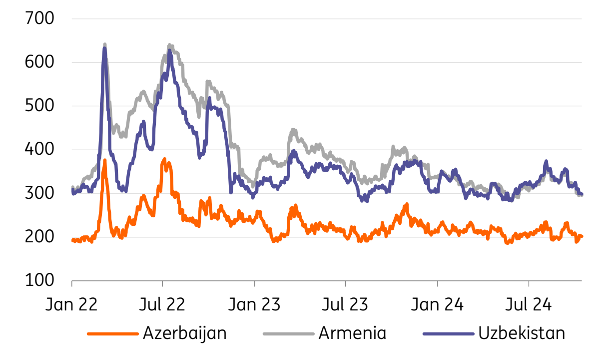
Source: ICE, Refinitiv, ING

Fig 33 CEE EUR index spreads (bp)



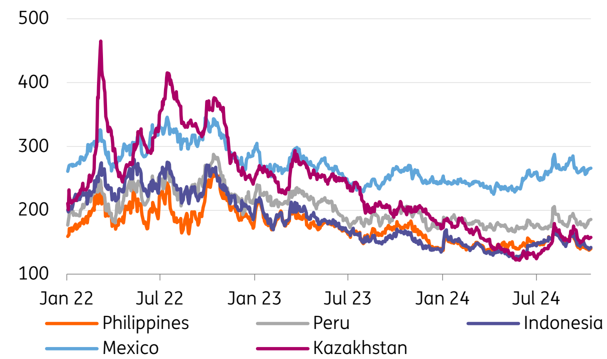
Source: ICE, Refinitiv, ING

Fig 34 CIS sovereign 10-year* spreads (bp)



Source: Refinitiv, ING; *AZERBJ 32s, ARMEN 31s, UZBEK 31s

Fig 35 Kazakhstan USD vs BBB sovereign spreads (bp)



Source: Refinitiv, ING; KAZAKS 44s/45s average vs maturity-matched bonds

Countries

Armenia

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	6.4	6.0	5.0	4.5	5.7	6.0	5.0
CPI (%YoY)*	0.8	0.6	2.3	4.5	3.9	0.4	3.4
Policy interest rate (eop, %)	8.00	7.50	7.25	7.25	7.25	7.25	7.00
3m interest rate (%)*	8.8	8.3	n/a	n/a	n/a	n/a	n/a
10yr yield (%)*	9.7	9.7	n/a	n/a	n/a	n/a	n/a
USD/AMD*	388	387	393	397	400	393	400
EUR/AMD*	415	431	432	436	441	428	441

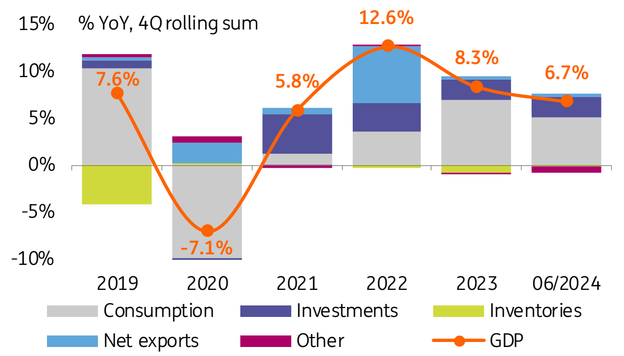
Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2029	S&P	BB-	BB-
Fiscal	Easing	Parliamentary: 2026	Moody's	Ba3	Ba3
Monetary	Tight	Local: n/a	Fitch	BB-	BB-

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

Country strategy: Shifting to a lower gear

Economic activity is moderating as the momentum related to high-skilled immigration in 2022 and higher participation in the external trade is wearing off. The role of domestic drivers of financing activity, including local household savings, lending and state spending is increasing. Re-integration of refugees from Nagorno-Karabakh and continued tensions with Azerbaijan are likely to keep the fiscal deficit elevated, in line with our initial view at the start of last year. The resulting elevated CPI risks should limit the scope for monetary policy easing from current levels. The Armenian dram, which has so far avoided depreciation, may come under pressure on normalisation of the balance of payments, including the return to current account deficit and remittances inflow of around 5% of GDP. Meanwhile, potential easing in tensions with Azerbaijan could be supportive.

GDP growth composition by usage

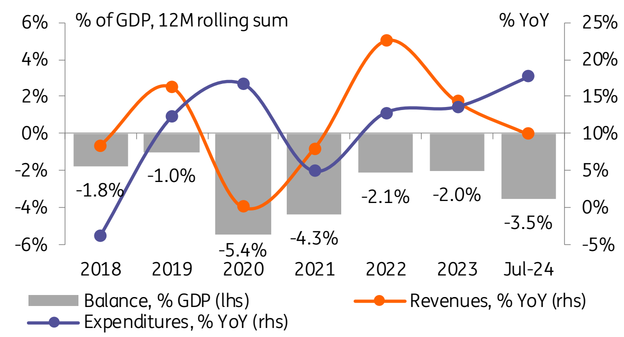


Source: National sources, CEIC, ING

Activity: Slowing down after the spike of 2022-23

Armenian GDP growth decelerated to 6.4% YoY in 2Q24 (or 6.7% YoY on a 4Q rolling basis) after a brief pick-up in 1Q24. From the output-based angle, the main drag came from the trade, transportation, hospitality and IT sectors, which were the primary drivers during the high-skilled immigration boom of 2022-23. Their contribution to GDP growth has dropped from 5.7-6.2ppt in 2022-23 to 3.7ppt currently, which is closer to the historical range of 2.0-2.5ppt. From the GDP usage angle, we note the material slowdown in real export growth from a 100% YoY spike in 1Q24 to 60% YoY in 2Q24 amid a similar slowdown in imports, suggesting still substantial but somewhat lower benefits from elevated foreign trade in the region. We see Armenia's GDP growth slowing to 6% this year and 4.5-5.0% in 2025-2026, ie, back to the historical norm.

Key parameters of the state budget

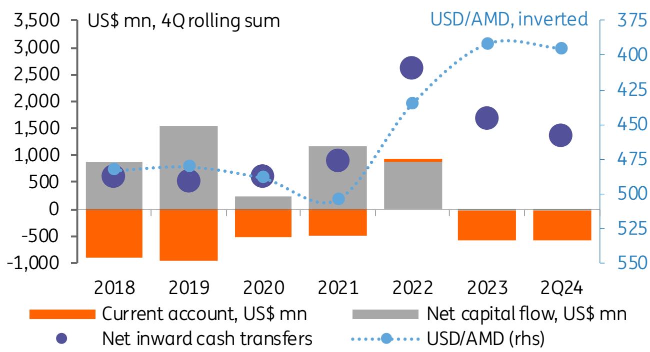


Source: National sources, CEIC, ING

Fiscal policy: Becoming expectedly more generous

The budget revenue side continues to underperform, while spending volumes keep growing due to still elevated military spending, higher social support and larger interest payments. Together, these lines accounted for 58% of the total and increased by 1.7ppt of GDP compared to year-end 2023. The budget deficit widened from c.2% of GDP in 2022-23 to 3.5%, and we do not exclude further widening to 4-5% of GDP in the next couple of years. A wider fiscal deficit puts a greater focus on Armenia's public debt. On the positive side, the external debt nearly halved to 25% of GDP compared to 2021 amid AMD appreciation, GDP growth and higher reliance on domestic borrowing, as local public debt doubled to AMD2.4tr. On the negative side, Armenian public finances remain exposed to AMD depreciation risks, which remain significant in our view.

Current account, remittances and Armenian dram (AMD)



Source: National sources, CEIC, ING

AMD: Remains overvalued relative to fundamentals

Armenia's trade deficit widened from US$1.5-2.0bn in 2020-21 to US$3-4bn (12M rolling basis) currently, reflecting largely domestic needs. This deficit is still being offset by a higher surplus of services, related to more active involvement in regional trade and the continued presence of foreign nationals in Armenia. At the same time, the current account balance has already returned to its normal deficit of -US$0.5-1.0bn, and we do not exclude further widening in the coming quarters. The nominal remittances remain elevated at around US$1.2bn pa (versus pre-2022 US$0.5-1.0bn pa). In real terms, the net remittances inflow is already back to the normal 5% of GDP vs the 2022 peak of 15%. Compared to the overall balance of payment fundamentals, the Armenian dram appears overvalued and vulnerable to depreciation risks, which, however, may be delayed if there is an easing of tensions with Azerbaijan.

Armenia

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	3.6	3.2	0.2	7.5	5.2	7.7	-7.2	5.8	12.6	8.3	6.0	5.0	4.5
Private consumption (%YoY)	1.6	-7.6	-2.1	13.7	4.9	11.5	-13.9	2.8	5.6	5.6	5.0	4.0	3.7
Government consumption (%YoY)	-1.2	4.7	-2.4	-2.1	-3.0	12.9	9.2	-6.2	-2.2	28.3	-5.0	7.0	5.0
Fixed investment (%YoY)	-2.2	2.5	-11.4	9.7	4.8	4.4	-1.5	23.6	14.0	10.1	7.0	4.5	5.0
Industrial production (%YoY)	1.5	5.2	6.5	12.3	4.2	9.0	-0.9	3.3	7.9	4.1	4.5	4.0	4.0
Unemployment rate (average, %)	17.6	18.5	18.0	17.8	19.0	18.3	18.2	15.5	13.5	12.6	12.5	12.3	12.2
Nominal GDP (AMDbn)	4829	5044	5067	5564	6017	6543	6182	6992	8501	9453	10063	10920	11819
Nominal GDP (€bn)	8.7	9.5	9.5	10.2	10.5	12.2	11.1	11.7	18.4	22.3	23.5	24.8	25.7
Nominal GDP (US$bn)	11.6	10.6	10.5	11.5	12.5	13.6	12.6	13.9	19.5	24.1	25.6	27.3	28.2
GDP per capita (US$)	3853	3512	3524	3869	4196	4597	4269	4685	6572	8053	8259	8796	9109
Gross domestic saving (% of GDP)	2.4	9.0	10.2	7.7	8.7	4.0	9.7	15.1	20.7	20.6	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	3.0	3.7	-1.4	1.0	2.5	1.4	1.2	7.2	8.6	2.0	0.4	3.4	3.6
CPI (year-end, %YoY)	4.6	-0.1	-1.4	2.6	1.8	0.7	3.7	7.7	8.3	-0.6	2.3	3.0	4.0
Wage rates (nominal, %YoY)	8.2	8.0	2.3	3.2	-11.4	5.6	4.0	7.4	15.3	14.7	9.0	5.0	4.0
Fiscal balance (% of GDP)													
Consolidated government balance	-1.9	-4.8	-5.5	-4.8	-1.6	-0.8	-5.1	-4.5	-2.2	-1.9	-4.0	-5.5	-5.6
Consolidated primary balance	-0.6	-3.3	-3.6	-2.6	0.7	1.6	-2.4	-2.0	0.1	0.7	-1.1	-2.4	-2.4
Total public debt	43.7	48.7	56.7	58.8	55.5	53.6	67.4	63.4	49.2	50.5	52.7	54.9	57.2
External balance													
Exports (US$bn)	1.7	1.6	1.9	2.4	2.7	3.4	2.7	3.3	5.7	8.6	14.7	13.2	11.2
Imports (US$bn)	3.8	2.8	2.9	3.8	4.5	5.1	4.1	4.8	7.6	11.2	16.7	15.1	12.8
Trade balance (US$bn)	-2.1	-1.2	-1.0	-1.4	-1.8	-1.7	-1.4	-1.5	-1.9	-2.5	-2.0	-1.8	-1.6
Trade balance (% of GDP)	-17.7	-11.2	-9.3	-12.2	-14.2	-12.6	-10.9	-10.8	-9.6	-10.4	-8.0	-6.7	-5.5
Current account balance (US$bn)	-0.9	-0.3	-0.1	-0.1	-0.9	-1.0	-0.5	-0.5	0.1	-0.6	-0.7	-0.9	-1.0
Current account balance (% of GDP)	-7.7	-2.7	-1.0	-1.3	-7.2	-7.1	-4.0	-3.5	0.3	-2.3	-2.7	-3.5	-3.6
Net FDI (US$bn)	0.4	0.2	0.3	0.2	0.3	0.2	0.1	0.3	0.9	0.5	0.3	0.2	0.3
Net FDI (% of GDP)	3.3	1.5	2.5	1.9	2.1	1.7	0.7	2.5	4.7	2.2	1.2	0.7	1.1
Current account balance plus FDI (% of GDP)	-4.5	-1.2	1.5	0.7	-5.1	-5.3	-3.3	-1.0	5.1	-0.1	-1.5	-2.7	-2.5
Foreign exchange reserves ex gold (US$bn)	1.5	1.8	2.2	2.3	2.3	2.8	2.6	3.2	4.1	3.6	3.7	3.8	3.9
Import cover (months of merchandise imports)	4.8	7.6	9.2	7.3	6.0	6.7	7.7	8.1	6.5	3.9	2.7	3.0	3.7
Debt indicators													
Gross external debt (US$bn)	8.5	8.9	10.0	10.5	10.9	12.4	12.9	13.8	15.3	15.5	16.0	17.0	18.0
Gross external debt (% of GDP)	73.5	84.5	94.4	91.3	87.7	90.9	102.1	99.8	78.2	64.2	62.4	62.2	63.6
Gross external debt (% of exports)	503	549	526	441	401	368	475	423	267	179	109	128	160
Lending to corporates/households (% of GDP)	41.6	38.3	40.3	42.7	46.2	49.6	60.4	51.2	44.7	48.9	49.5	50.6	51.7
Interest & exchange rates													
Central bank key rate (year-end, %)	8.50	8.75	6.25	6.00	6.00	5.50	5.25	7.75	10.75	9.25	7.25	7.00	7.00
Broad money supply (average, %YoY)	-3.5	5.2	24.8	28.9	13.2	21.5	14.8	12.8	13.4	22.1	15.0	12.0	10.0
3m interest rate (average, %)	7.50	12.09	8.56	6.11	6.02	5.83	5.44	7.10	10.00	10.75	n/a	n/a	n/a
3m interest rate spread over US$-Libor (ppt)	7.27	11.77	7.82	4.85	3.71	3.50	4.79	6.94	7.60	5.35	n/a	n/a	n/a
2yr yield (average, %)	8.93	13.30	11.15	7.68	7.04	6.80	6.17	8.22	10.62	11.05	n/a	n/a	n/a
10yr yield (average, %)	11.26	14.92	14.00	11.10	9.72	9.48	7.99	9.39	11.24	11.03	n/a	n/a	n/a
USD/AMD exchange rate (year-end)	475	484	484	484	484	480	523	480	394	405	393	408	429
USD/AMD exchange rate (average)	416	478	480	483	483	480	489	504	436	392	393	400	419
EUR/AMD exchange rate (year-end)	577	529	512	580	554	537	641	543	420	448	432	449	472
EUR/AMD exchange rate (average)	552	530	532	545	571	538	558	597	461	425	428	441	460
Brent oil price (annual average, US$/bbl)	99	54	45	55	72	64	43	71	99	82	81	72	70

Source: National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	7.4	6.4	6.6	6.4	6.0	5.0	4.5	5.7	4.3	5.5	5.0	4.0	3.5
CPI (eop, %YoY)	0.1	-0.6	-1.2	0.8	0.6	2.3	4.5	3.9	2.7	3.0	3.2	3.5	3.9
Central bank key rate (eop, %)	9.75	9.25	8.50	8.00	7.50	7.25	7.25	7.25	7.00	7.00	7.00	7.00	7.00
3m interest rate (eop, %)	10.36	10.27	8.95	8.77	8.35	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	10.17	10.77	9.65	9.69	9.72	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AMD exchange rate (eop)	396	404	393	388	387	393	397	400	404	408	413	419	424
EUR/AMD exchange rate (eop)	418	447	425	415	431	432	436	441	445	449	455	460	466

Source: National sources, ING estimates

Azerbaijan

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	4.6	3.0	2.5	2.0	2.5	3.5	2.6
CPI (%YoY)*	1.1	3.5	4.5	3.5	4.9	2.2	4.3
Policy interest rate (eop, %)	7.25	7.25	7.25	7.25	7.25	7.25	7.25
3m interest rate (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AZN*	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/AZN*	1.82	1.90	1.87	1.87	1.87	1.86	1.87

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2031	S&P	BB+	BB+
Fiscal	Easing	Parliamentary: 2025	Moody's	Ba1	Ba1
Monetary	Tight	Local: 2024	Fitch	BBB-	BBB-

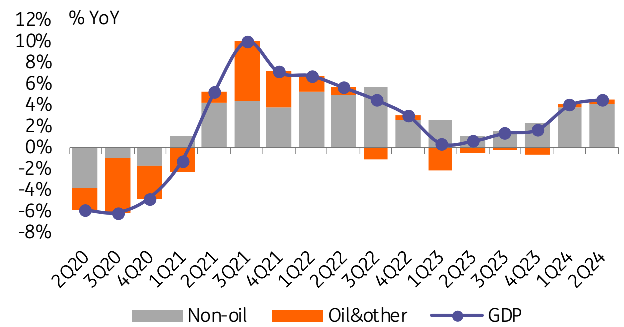
*Quarterly data is eop, annual is average

Source: National sources, ING estimates

Country strategy: On a rebound

We maintain our constructive view on Azerbaijan for the near-term. While still sluggish on the core oil activity, Azerbaijan's economic growth is posting a recovery on the non-oil side, financed heavily by domestic credit and public expenditure. The resulting price pressures mean that the monetary policy easing cycle is most likely over. The country's fiscal and external reserves are ample, but the gradually eroding trade surplus and growing current account breakeven, if not addressed, could create some pressure on the manat's dollar peg in the coming years.

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

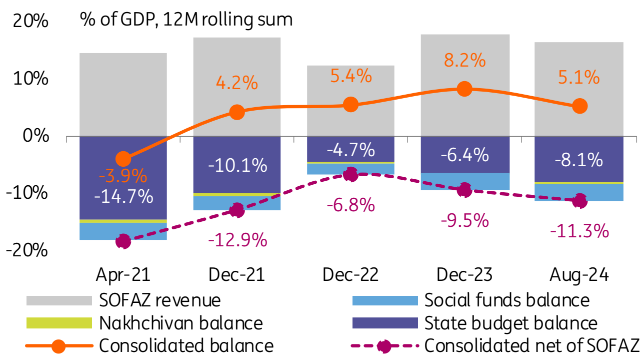


Source: National sources, CEIC, ING

Activity: Picking up thanks to non-fuel sectors

After a weak 1.1% GDP growth in 2023, Azerbaijan's economy is on a rebound, showing a 4.3% YoY GDP increase in 8M24, led by the 7.0% YoY spike in the value-added of the non-fuel sectors. Positive contributions from the construction, transport and retail-focused sectors suggest that, in addition, reconstruction of the recently re-integrated Nagorno-Karabakh, and bigger involvement in regional trade, the growth recovery is gaining a wider domestic base. The oil and gas sector, on the other hand, is stagnant, as the new projects, related to expanding hydrocarbon trade with the EU are so far only enough to offset the ageing of existing oil production infrastructure. We expect 3.5% GDP growth this year with possible moderation to 2-3% in the coming years.

Consolidated budget balance by components (% of GDP)

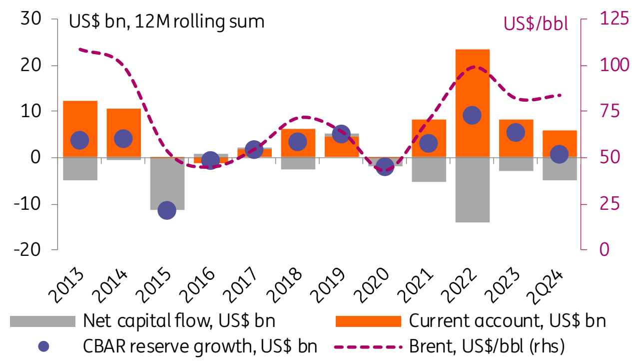


Source: National sources, CEIC, ING

Fiscal policy: More generous but still in surplus, so far

The consolidated budget is showing signs of easing. On the revenue side there is normalisation of oil revenue from a high of US$213m per US$1/bbl of Brent oil price last year to US$190m in the past 12 months, within the historical US$150-200m range amid declining volumes of production and exports. On the expenditure side there is a continued increase in spending, primarily in social support and defence, which is likely to continue given the country's priorities. The reconstruction of Nagorno-Karabakh, other investment projects and continued tensions with Armenia should keep the fiscal policy generous in the coming years. We see the consolidated surplus shrinking to 4% of GDP this year and to around zero by 2027, corresponding to an increase in the breakeven oil price from US$54 in 2023 to US$65-70/bbl in the next three years.

Balance of payments composition vs Brent oil price



Source: National sources, CEIC, ING

External balance: AZN dollar peg secure for now

The external balance continues to show signs of moderation following the strong 2022, when the current account surplus reached nearly 30% of GDP. Since then, the trade side has come under a double pressure of falling exports and growing imports. The exports side suffers from both moderation in oil prices and decline in export volumes, as fuel exports dropped from US$380m per US$1/bbl Brent in 2022 to a more normal US$280m during the four quarters ending in mid-2024. As a result of the narrowing current account and continued capital outflow, the central bank (CBAR) had to stop its accumulation of reserves for the first time since 2020. This is not a threat to the manat's eight-year long 1.7/US$ peg, but the increase of current account breakeven oil price to a multi-year high of US$63/bbl in a softer oil price context, if unaddressed, may become a watch factor for AZN depreciation in the coming years.

Azerbaijan

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	2.8	1.1	-3.1	0.2	1.5	2.5	-4.2	5.6	4.7	1.1	3.5	2.6	2.8
Real oil GDP (%YoY)	-2.9	0.6	0.1	-5.3	0.5	0.4	-6.5	1.4	-2.5	-2.3	0.0	1.5	1.5
Real non-oil GDP (%YoY)	6.9	1.1	-4.4	2.7	2	4	-2.9	7.1	9.0	3.7	5.0	4.0	4.5
Fixed investment (%YoY)	-1.7	-11.1	-21.7	2.8	-4.3	5.5	-7.3	-4.5	3.3	9.8	4.5	5.5	4.5
Industrial production (%YoY)	-0.7	2.5	-0.5	-3.5	1.5	1.8	-4.0	5.0	-1.1	-1.1	2.0	3.0	2.0
Unemployment rate (average, %)	4.9	5.0	5.0	5.0	4.9	4.9	6.4	6.4	5.8	5.6	5.5	5.5	5.5
Nominal GDP (AZNbn)	59.0	54.4	60.4	70.3	80.1	81.9	72.6	93.2	134.0	123.0	128.8	138.2	148.4
Nominal GDP (€bn)	56.6	47.8	34.2	36.2	39.9	43.0	37.4	46.3	74.7	66.9	69.2	73.9	79.4
Nominal GDP (US$bn)	75.2	53.0	37.9	40.9	47.1	48.2	42.7	54.8	78.8	72.4	75.8	81.3	87.3
GDP per capita (US$)	7,991	5,562	3,929	4,199	4,798	4,851	4,269	5,458	7,806	7,126	7,370	7,830	8,331
Gross domestic saving (% of GDP)	44	31	28	31	35	31	23	34	45	33	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	1.4	4.0	12.4	12.9	2.3	2.6	2.8	6.7	13.9	8.9	2.2	4.3	4.5
CPI (year-end, %YoY)	-0.2	7.6	15.7	7.9	1.6	2.3	2.6	12.0	14.4	2.1	4.5	3.5	5.6
Wage rates (nominal, %YoY)	4.6	5.0	7.0	5.7	3.0	16.6	11.4	3.4	14.7	11.2	2.2	4.3	4.5
Fiscal balance (% of GDP)													
Consolidated government balance	2.9	-5.3	0.3	-1.5	5.9	9.1	-6.5	4.2	6.0	8.2	3.8	1.2	0.6
Consolidated primary balance	4.3	-3.8	2.4	0.9	8.7	10.9	-4.4	6.3	6.5	8.6	4.3	1.7	1.1
Total public debt	8.5	18.0	20.6	22.5	18.7	17.7	21.3	26.3	17.3	18.4	16.9	18.4	21.1
External balance													
Exports (US$bn)	28.3	15.6	13.2	15.2	20.8	19.9	12.6	21.7	40.9	29.2	25.7	25.5	26.3
Imports (US$bn)	9.3	9.8	9.0	9.0	11.0	11.3	10.1	10.4	13.5	16.4	16.8	17.9	18.8
Trade balance (US$bn)	18.9	5.8	4.2	6.1	9.8	8.5	2.5	11.3	27.4	12.8	8.9	7.6	7.6
Trade balance (% of GDP)	25.2	11.0	11.1	15.0	20.9	17.7	5.9	20.6	34.7	17.7	11.8	9.3	8.7
Current account balance (US$bn)	10.4	-0.2	-1.4	1.7	6.1	4.4	-0.2	8.3	23.5	8.3	5.3	4.0	3.8
Current account balance (% of GDP)	13.9	-0.4	-3.6	4.1	12.8	9.1	-0.5	15.1	29.8	11.5	7.0	4.9	4.3
Net FDI (US$bn)	2.4	0.8	1.9	0.3	-0.8	-1.4	-0.8	-2.2	-5.1	-2.1	-2.0	-1.0	-1.0
Net FDI (% of GDP)	3.2	1.5	5.1	0.7	-1.7	-2.9	-1.8	-4.1	-6.5	-2.9	-2.6	-1.2	-1.1
Current account balance plus FDI (% of GDP)	17.1	1.1	1.5	4.9	11.1	6.2	-2.3	11.0	23.3	8.6	4.3	3.7	3.2
Foreign exchange reserves ex gold (US$bn)	15.3	7.7	7.3	7.0	6.7	7.1	7.8	8.3	10.8	13.7	14.2	14.7	15.0
Import cover (months of merchandise imports)	19.7	9.4	9.7	9.3	7.3	7.5	9.3	9.5	9.5	10.1	10.2	9.9	9.6
Debt indicators													
Gross external debt (US$bn)	12.1	13.3	14.6	15.4	16.6	16.5	16.5	15.6	15.3	16.8	17.3	17.8	18.3
Gross external debt (% of GDP)	16.1	25.2	38.6	37.8	35.2	34.3	38.6	28.5	19.4	23.2	22.8	21.9	20.9
Gross external debt (% of exports)	42.9	85.6	110.6	101.9	79.8	83.2	130.9	72.1	37.4	57.5	67.3	69.6	69.4
Lending to corporates/households (% of GDP)	31.4	40.0	27.2	16.7	16.3	18.7	20.0	18.4	15.1	19.5	19.7	19.7	19.7
Interest & exchange rates													
Central bank key rate (year-end, %)	3.50	3.00	15.00	15.00	9.75	7.50	6.25	7.25	8.25	8.00	7.25	7.25	7.75
Broad money supply (average, %YoY)	11.8	-1.3	-1.9	9.0	5.7	20.0	1.1	18.7	23.6	5.3	12.8	9.8	10.0
3m interest rate (Bakibor, average, %)	10.8	9.2	13.5	20.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
3m interest rate spread over US$-Euribor (ppt)	1057	884	1279	1936	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AZN exchange rate (year-end)	0.78	1.56	1.77	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70
USD/AZN exchange rate (average)	0.78	1.02	1.60	1.72	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/AZN exchange rate (year-end)	0.96	1.70	1.90	2.04	1.95	1.91	2.08	1.93	1.81	1.88	1.87	1.87	1.87
EUR/AZN exchange rate (average)	1.04	1.14	1.77	1.94	2.01	1.90	1.94	2.01	1.79	1.84	1.86	1.87	1.87
Brent oil price (annual average, US$/bbl)	99	54	45	55	72	64	43	71	99	82	81	72	70

Source: CEIC, National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	1.7	1.1	4.0	4.6	3.0	2.5	2.0	2.5	3.0	3.0	3.5	3.0	2.5
CPI (eop, %YoY)	5.1	2.1	4.8	1.1	3.5	4.5	3.5	4.9	3.7	3.5	5.6	4.4	5.0
Central bank key rate (eop, %)	9.00	8.00	7.50	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.50
3m interest rate (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/AZN exchange rate (eop)	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70
EUR/AZN exchange rate (eop)	1.80	1.88	1.83	1.82	1.90	1.87	1.87	1.87	1.87	1.87	1.87	1.87	1.87

Source: CEIC, National sources, ING estimates

Bulgaria

Valentin Tataru, Chief Economist | Stefan Posea, Economist

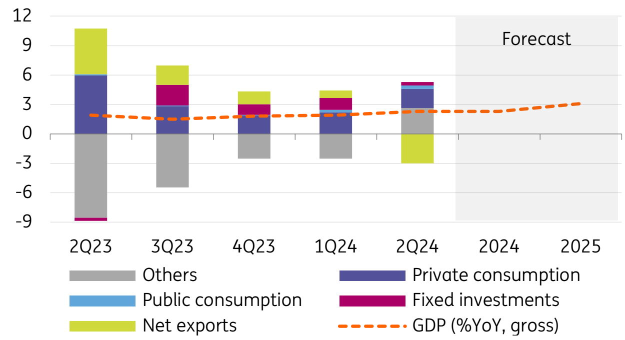
Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	2.1	2.3	2.6	2.9	3.1	2.3	3.1
CPI (%YoY)*	2.5	2.0	3.0	2.8	3.8	2.6	3.4
Policy interest rate (%)	3.78	3.54	3.30	2.85	2.40	3.30	2.40
10yr yield (%)*	3.20	3.10	3.00	2.80	2.70	2.90	2.60
USD/BGN	1.82	1.75	1.78	1.78	1.78	1.79	1.78
EUR/BGN	1.96	1.96	1.96	1.96	1.96	1.96	1.96

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2026	S&P	BBB	BBB
Fiscal	Loose	Parliamentary: 2024	Moody's	Baa1	Baa1
Monetary	Neutral	Local: 2027	Fitch	BBB	BBB

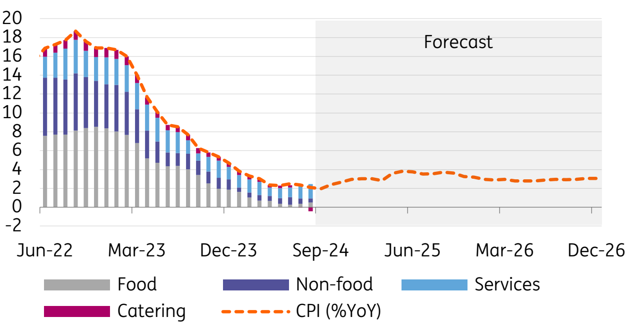
*Quarterly data is eop. Annual is average
Source: National sources. ING estimates

Real GDP (%YoY) and contributions (ppt)



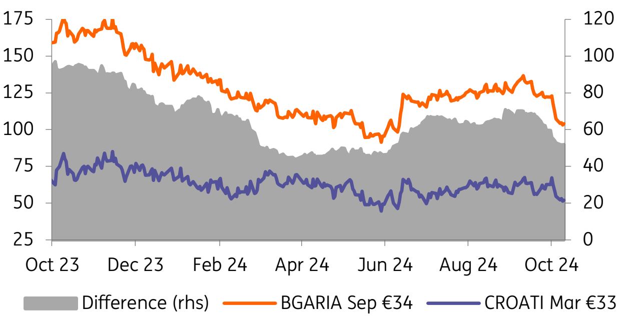
Source: NSI, ING

Inflation (%YoY) and main components (ppt)



Source: NSI, ING

BGARIA EUR credit spreads vs CROATI (bp)



Source: ICE, Refinitiv, ING

Country strategy: Keep the economy on autopilot

Bulgaria's economy is progressing particularly well considering the challenges it faces. So far, it has absorbed only one RRF payment of €1.37bn. Meanwhile, protracted delays in the Climate Neutrality Plan adoption (a key reform for the country) have already led to the loss of 30% of the second RRF payment (€266m). A recent attempt by Parliament to ratify the plan failed due to the reportedly destabilising actions of Revival party MPs. Not all the funding is lost, though. Officials can still vote on the amendments by 20 October, a move that would also help the transition of workers from the energy and mining state-owned enterprises, which are in deep financial difficulties. With a snap election due on 27 October, the seventh in just over three years, only 38% of adults are set to vote according to a Trend poll, predicting little change to the structure of Parliament. We hold on to our view that euro adoption remains a matter for 2026.

Internal demand is saving the day

Private consumption and fixed investments are set to remain the key growth engines, and we expect GDP growth to accelerate this year, despite the ongoing challenges. The drivers are the strong wage growth (17.1% YoY in 1H24), as well as the relatively robust design of the 2024 public investment budget, which was adjusted so that each project had own funding allocation and a designated state budget to oversee it. Net exports will reverse some of the gains, but mostly on account of weak external demand rather than excessive import pressures. The risk of further RRF funding losses and the absence of reforms in the energy sector due to the never-ending political issues, are key downside risks ahead.

Small reflationary pressures to reverse the recent gains

Inflation decelerated to 2.1% in August, cementing the disinflation trend. That said, we don't think there is room for complacency. Wages are rising aggressively and the pandemic VAT cuts are being reversed, providing upward potential, especially as consumers have their foot on the gas – retail sales ex-fuel are showing a 6.2% year-to-date growth. That said, unless a new government steps in soon, fiscal policy's room to boost demand will remain limited, which will also continue to weigh on FDIs. We pencil in a 3.0% year-end inflation, with balanced risks. In 2025, we expect inflation to average 3.4%, due to the upside pressures stemming from a higher burden on firms from both taxes and wages.

Eurozone entry remains a potential catalyst

Given the upcoming elections and ongoing uncertainty over the ability to form a stable governing coalition, there remains the potential for some headline risk and weakness for Bulgaria's hard currency sovereign bonds. Further delays to the expected timeline for euro adoption could drive some spread widening, although our medium-term conviction remains that eventual confirmation of eurozone entry should drive spread compression versus peers, such as Croatia.

James Wilson, EM Sovereign Strategist

Bulgaria

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	0.9	3.4	3.0	2.7	2.7	4.0	-4.0	7.7	3.9	1.8	2.3	3.1	3.2
Private consumption (%YoY)	1.4	2.8	2.2	2.6	3.7	6.0	-0.6	8.5	3.8	5.4	4.2	3.8	3.0
Government consumption (%YoY)	-0.1	1.8	2.2	4.3	5.3	2.0	8.3	0.4	5.5	-0.4	1.8	3.0	2.1
Investment (%YoY)	3.5	2.7	-6.6	3.2	5.4	4.5	0.6	-8.3	6.5	3.3	4.5	6.2	6.0
Industrial production (%YoY)	2.0	2.7	2.5	4.0	0.3	0.5	-6.3	10.1	12.8	-8.2	-4.0	2.2	3.0
Unemployment rate (eop, %)	11.4	9.0	7.7	6.7	5.7	5.3	6.3	4.6	4.0	4.3	4.2	4.3	4.4
Nominal GDP (BGNbn)	84.1	89.6	95.3	102.7	109.9	120.3	120.5	139.0	167.8	183.7	192.7	205.2	217.7
Nominal GDP (€bn)	43.0	45.8	48.7	52.5	56.2	61.5	61.6	71.1	85.8	93.9	98.5	104.9	111.3
Nominal GDP (US$bn)	56.8	50.4	53.6	59.9	65.7	68.9	70.9	83.9	90.1	101.4	107.4	115.4	122.5
GDP per capita (US$)	7,900	7,100	7,600	8,500	9,400	9,900	10,300	12,200	13,200	14,900	15,800	17,000	18,000
Gross domestic saving (% of GDP)	20.4	21.9	23.9	24.1	23.7	24.2	22.3	22.9	23.6	22.0	20.7	19.3	18.3
Prices													
CPI (average %YoY)	-1.4	-0.1	-0.8	2.1	2.8	3.1	1.7	3.3	15.3	9.7	2.6	3.4	2.9
CPI (year-end %YoY)	-0.9	-0.4	0.1	2.8	2.7	3.8	0.1	7.8	16.9	4.7	3.0	3.2	3.1
Wage rates (nominal %YoY)	2.4	7.9	7.0	10.5	7.4	12.0	8.6	12.0	13.7	14.5	16.5	7.0	7.0
Fiscal balance (% of GDP)													
Consolidated government balance	-5.4	-1.9	0.3	1.6	1.7	2.1	-3.8	-3.9	-2.9	-1.9	-2.8	-2.9	-2.0
Consolidated primary balance	-4.5	-0.9	1.2	2.4	2.4	2.7	-3.3	-3.5	-2.5	-1.4	-2.3	-2.4	-1.7
Total public debt	27.0	25.9	29.1	25.1	22.1	20.0	24.6	23.9	22.6	23.1	24.8	24.6	24.3
External balance													
Exports (€bn)	22.0	22.9	23.1	26.9	27.7	29.1	27.3	34.4	47.1	43.3	43.5	45.7	49.1
Imports (€bn)	26.1	26.3	24.1	27.7	30.4	32.0	29.2	37.3	52.2	47.0	48.8	51.2	53.8
Trade balance (€bn)	-4.1	-3.5	-1.0	-0.8	-2.7	-2.9	-1.9	-2.9	-5.1	-3.7	-5.3	-5.5	-4.7
Trade balance (% of GDP)	-9.5	-7.6	-2.0	-1.5	-4.8	-4.7	-3.2	-4.1	-6.0	-3.9	-5.4	-5.2	-4.2
Current account balance (€bn)	0.5	0.0	1.5	1.7	0.5	1.1	0.0	-1.2	-1.2	-0.3	0.6	0.5	0.5
Current account balance (% of GDP)	1.2	0.0	3.1	3.3	0.9	1.9	0.0	-1.7	-1.4	-0.3	0.6	0.5	0.4
Net FDI (€bn)	0.3	2.0	0.9	1.6	1.0	1.6	3.0	1.5	2.6	3.6	0.8	1.5	1.5
Net FDI (% of GDP)	-0.3	-4.1	-0.6	-1.3	-0.8	-1.2	-2.8	-1.3	-2.0	-3.9	-0.8	-1.4	-1.4
Current account balance plus FDI (% of GDP)	0.9	-4.1	2.5	2.0	0.2	0.6	-2.7	-3.0	-3.4	-4.1	-0.2	-1.0	-0.9
Foreign exchange reserves (€bn)	14.5	18.2	21.6	21.4	22.8	22.2	28.0	30.5	34.2	37.5	37.6	39.6	41.6
Import cover (months of merchandise imports)	6.7	8.3	10.8	9.3	9.0	8.3	11.5	9.8	7.9	9.6	9.2	9.3	9.3
Debt indicators													
Gross external debt (€bn)	39.3	36.7	38.1	37.7	37.2	37.7	39.3	41.2	44.2	45.4	45.9	46.8	47.7
Gross external debt (% of GDP)	91	80	78	72	66	61	64	58	52	48	47	45	43
Gross external debt (% of exports)	178	160	165	140	134	129	144	120	94	105	105	102	97
Lending to corporates/households (% of GDP)	59.2	54.8	52.0	49.8	50.4	49.6	51.5	48.3	44.9	43.8	42.9	44.2	45.6
Interest & exchange rates													
Base interest rate (year-end %)	0.02	0.01	0.00	0.00	0.00	0.00	0.00	0.00	1.30	3.60	3.30	2.40	2.40
Broad money supply (average %YoY)	1.1	8.8	7.6	7.7	8.8	9.9	10.9	10.7	13.2	8.7	8.9	9.3	9.8
3yr yield (average %)	1.59	1.03	0.36	0.08	-0.05	-0.20	0.05	-0.05	4.40	3.25	2.90	2.60	2.50
10yr yield (average %)	3.42	2.83	2.19	1.60	0.94	0.46	0.40	0.30	1.00	4.50	4.30	4.00	3.80
USD/BGN exchange rate (year-end)	1.62	1.79	1.86	1.63	1.70	1.75	1.60	1.72	1.83	1.78	1.78	1.78	1.78
USD/BGN exchange rate (average)	1.48	1.78	1.78	1.72	1.67	1.75	1.70	1.66	1.86	1.81	1.79	1.78	1.78
EUR/BGN exchange rate (year-end)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
EUR/BGN exchange rate (average)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96

Source: National sources. ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	1.5	1.8	1.9	2.1	2.3	2.6	2.9	3.1	3.2	3.2	3.0	3.1	3.1
CPI (eop. %YoY)	6.3	4.7	3.0	2.5	2.0	3.0	2.8	3.8	3.7	3.2	3.0	2.8	2.9
Base interest rate (eop. %)	3.53	3.80	3.80	3.78	3.54	3.3	2.85	2.6	2.6	2.6	2.5	2.5	2.5
3yr yield (eop. %)	3.25	3.25	3.20	3.30	3.10	3.00	2.80	2.70	2.60	2.60	2.50	2.50	2.50
USD/BGN exchange rate (eop)	1.79	1.85	1.78	1.81	1.75	1.78	1.78	1.78	1.78	1.78	1.78	1.78	1.78
EUR/BGN exchange rate (eop)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96

Source: National sources. ING estimates

Croatia

Valentin Tataru, Chief Economist | Stefan Posea, Economist

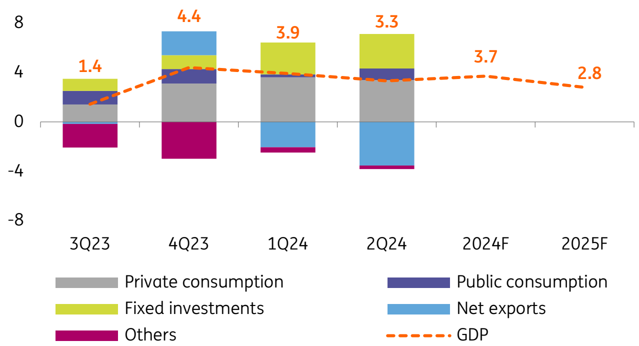
Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	3.3	4.5	2.9	2.9	2.7	3.7	2.8
HICP (%YoY)*	3.5	3.0	3.4	3.3	3.2	3.8	3.2
CPI (%YoY)	2.5	2.5	2.9	3.0	3.0	3.0	2.8
Key interest rate (eop,%)**	3.75	3.50	3.25	2.75	2.25	3.25	2.25
10yr yield (%)*	3.65	3.15	3.10	2.90	2.80	3.10	2.70

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

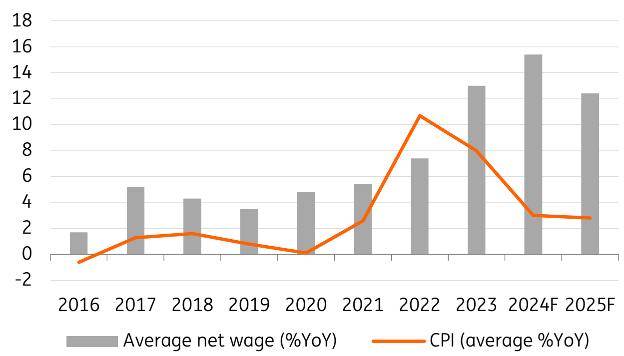
*Quarterly data is eop, annual is average **ECB rate starting 1 January 2023
Source: National sources, ING estimates

Real GDP (YoY%) and contributions (ppt)



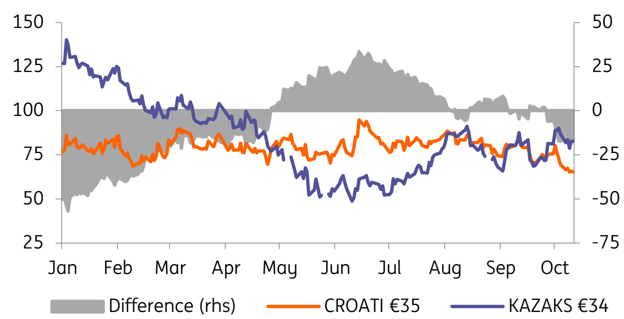
Source: Eurostat, ING

Wage hikes could stop the disinflation



Source: Eurostat, ING

CROATI EUR credit spreads vs KAZAKS (bp)



Source: ICE, Refinitiv, ING

Country strategy: Keep the course

The euro adoption in 2023 seems to have unleashed a period of above expectations growth seconded by a prudent fiscal policy. These elements have been key to Croatia's 'A-' rating from both S&P and Fitch, a remarkable performance given that not more than six years ago Croatia was still rated 'junk'. With the country on track for a very strong RRF funds absorption while fiscal metrics are kept in check, it might not be the end of the road for more rating upgrades, though it is likely to take more than a year for any further upgrade to come. The presidential elections due in December 2024 have the potential to stir the waters to some extent. A re-election of the incumbent Milanović seems the most likely outcome. The government coalition looks solid under any scenario.

A good year turning great

We expect GDP growth to accelerate to 3.7% in 2024, notably above the Eurozone average and Croatia's regional peers. Private consumption is shaping up for a very strong year, with retail sales real growth of 8.1% as of July, all underpinned by double-digit wage increases and relatively low inflation. A second growth engine in the short to medium term is coming from EU-funded investments, with Croatia having the second-highest share of EU funding-to-GDP share in the EU at around 24.0%. On the RRF alone, almost half of the total €10bn allocation has been received and we expect no significant hurdles in achieving the full absorption by the end of 2026. Once completed, the full RRF implementation is likely to generate a productivity boost and improve the country's growth potential.

Public wage reform boosting the deficit

The disinflationary trend continued largely unabated in 2024 as headline inflation dipped below 2.0% in August, a first since early 2021. However, with food price disinflation likely to have reached a bottom and service prices stubbornly high, it looks like August has been the low point of the cycle. We expect the CPI inflation to gradually return towards 3.0% by the end of the year and stabilise just below this level in the medium term. Public wage reforms implemented earlier this year resulted in a 1ppt higher budget deficit which has been revised higher to 2.6% of GDP. A gradual fading-out of energy subsidies and other support measures should bring the deficit closer to 2.0% in 2025 and below that in 2026, dependant however on the economy's performance during this investment cycle.

Sovereign credit: Little risk, little reward

With solid and improving fundamentals, along with limited political risk, there is little for investors to be worried about in Croatia. Ratings have been on a consistent uptrend, and euro adoption has added a further catalyst for regional flows to continue, keeping a steady bid on the sovereign paper. At the same time, spread levels are tight, even versus higher-rated peer Poland and eurozone peers in the Baltics.

James Wilson, EM Sovereign Strategist

Croatia

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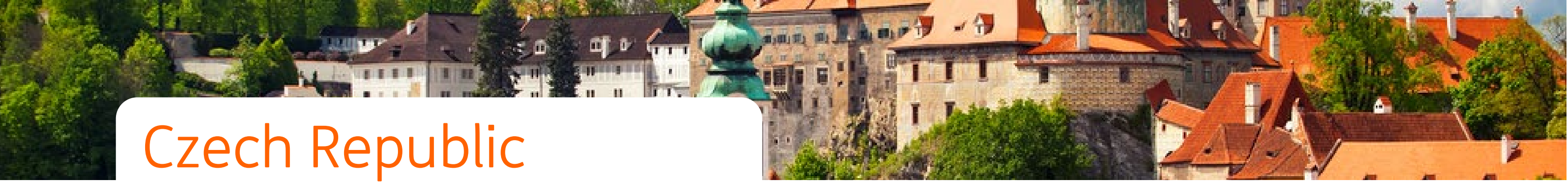
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	-0.3	2.5	3.6	3.4	3.0	3.4	-8.5	13.0	7.0	3.1	3.8	2.8	2.4
Private consumption (%YoY)	-2.5	0.4	3.2	3.2	3.4	4.1	-5.2	10.6	6.7	3.0	3.5	2.6	2.3
Government consumption (%YoY)	1.3	-0.4	1.1	2.1	2.2	2.8	3.5	3.1	2.7	6.6	5.2	2.9	2.5
Investment (%YoY)	-2.3	8.2	5.0	1.6	3.9	9.0	-5.0	6.6	0.1	4.2	5.9	4.0	3.1
Industrial production (%YoY)	1.1	2.5	4.8	1.9	-0.7	0.6	3.4	6.3	1.6	-0.2	-3.0	2.8	2.6
Unemployment rate (year-end, %)	17.8	16.0	13.5	10.5	8.1	6.6	9.0	6.7	7.0	6.4	5.8	5.5	5.4
Nominal GDP (€bn)	44.8	46.0	47.6	49.9	52.4	55.3	51.0	58.9	68.4	76.5	81.6	86.6	91.2
Nominal GDP (US$bn)	59	51	52	57	61	62	59	69	72	83	89	95	100
GDP per capita (US$)	14,000	12,000	12,600	13,800	15,000	15,200	14,700	17,800	18,400	21,200	22,900	24,600	26,100
Gross domestic saving (% of GDP)	17.6	19.8	21.2	21.6	21.8	22.0	16.9	19.9	20.6	20.1	20.1	20.3	20.8
Prices													
HICP (average, %YoY)	0.2	-0.3	-0.6	1.3	1.6	0.8	0.0	2.7	10.6	8.5	3.8	3.2	3.6
HICP (year-end, %YoY)	-0.1	-0.3	0.7	1.3	1.0	1.3	-0.3	5.2	12.7	5.4	3.4	3.4	3.7
CPI (average, %YoY)	-0.2	-0.5	-1.1	1.1	1.5	0.8	0.1	2.6	10.8	8.0	3.0	2.8	3.3
CPI (year-end, %YoY)	-0.5	-0.6	0.2	1.2	0.9	1.4	-0.7	5.5	13.1	4.5	2.9	2.5	3.8
Wage rates (net nominal, %YoY)	0.3	-3.4	2.5	5.3	4.3	3.5	4.7	5.4	7.3	13.0	14.5	12.4	10.0
Fiscal balance (% of GDP)													
Consolidated government balance	-5.2	-3.5	-1.0	0.6	-0.1	0.2	-7.2	-2.5	0.1	-0.7	-2.6	-2.3	-1.9
Consolidated primary balance	-1.8	-0.1	2.0	3.3	2.2	2.4	-5.3	-1.0	1.5	1.0	-1.4	-1.1	-0.8
Total public debt	83.4	82.8	79.1	76.0	72.6	70.4	86.1	77.5	67.8	63.0	59.7	58.9	58.3
External balance													
Exports (€bn)	10.4	11.5	12.3	14.0	14.5	15.2	14.9	18.4	24.1	22.9	23.8	24.8	25.8
Imports (€bn)	17.1	18.5	19.7	21.9	23.7	25.0	22.9	28.4	41.9	39.6	41.3	43.0	44.8
Trade balance (€bn)	-6.8	-7.0	-7.4	-7.9	-9.2	-9.8	-8.0	-10.0	-17.8	-16.7	-17.4	-18.2	-19.0
Trade balance (% of GDP)	-15.1	-15.1	-15.5	-15.8	-17.6	-17.7	-15.7	-17.0	-26.0	-21.8	-21.4	-21.0	-20.9
Current account balance (€bn)	0.2	1.6	1.1	1.8	0.9	1.6	-0.5	0.6	-1.9	0.8	0.8	0.8	1.0
Current account balance (% of GDP)	0.4	3.5	2.3	3.6	1.7	2.9	-1.5	1.0	-2.8	1.0	1.0	0.9	1.1
Net FDI (€bn)	-0.7	-0.2	-2.0	-1.1	-0.8	-3.4	-0.7	-3.0	-3.7	-1.5	-1.5	-1.5	-1.6
Net FDI (% of GDP)	-1.5	-0.4	-4.2	-2.2	-1.6	-6.2	-1.4	-5.1	-5.3	-1.9	-1.8	-1.8	-1.7
Current account balance plus FDI (% of GDP)	-1.1	3.1	-1.9	1.4	0.1	-3.4	-2.9	-4.1	-8.1	-0.9	-0.9	-0.9	-0.6
Foreign exchange reserves ex gold (€bn)	12.7	13.7	13.5	15.7	17.4	18.6	18.9	25.0	27.9	28.8	29.5	30.1	30.3
Import cover (months of merchandise imports)	8.9	8.9	8.2	8.6	8.8	8.9	9.9	10.6	8.0	8.7	8.6	8.4	8.1
Debt indicators													
Gross external debt (€bn)	49.5	48.6	45.1	43.9	42.8	40.6	41.3	47.2	49.8	56.9	65.0	67.0	70.6
Gross external debt (% of GDP)	110.6	105.8	94.6	88.0	81.7	73.4	81.0	80.2	72.8	74.4	79.7	77.4	77.4
Gross external debt (% of exports)	478	422	366	313	294	267	277	257	206	248	273	270	274
Lending to corporates/households (% of GDP)	69.2	65.2	60.3	56.5	54.7	53.3	61.0	53.8	51.0	49.1	50.8	50.2	50.4
Interest & exchange rates													
Central bank key rate (year-end, %)*	-0.20	-0.30	-0.40	-0.40	-0.40	-0.50	-0.50	-0.50	2.00	4.00	3.25	2.25	2.25
3yr yield (average, %)	3.15	2.60	1.70	1.20	0.70	0.15	0.15	0.10	3.00	2.95	3.15	3.00	2.85
10yr yield (average, %)	4.00	3.90	3.00	2.50	2.40	0.60	0.65	0.85	4.00	3.30	3.30	2.80	2.50
EUR/USD (average)	1.32	1.10	1.10	1.14	1.17	1.12	1.15	1.18	1.05	1.08	1.09	1.10	1.10
EUR/USD (end-period)	1.21	1.09	1.05	1.20	1.15	1.12	1.22	1.14	1.07	1.10	1.10	1.10	1.10

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

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	1.4	4.4	3.9	3.3	4.5	2.9	2.9	2.7	2.8	2.9	2.7	2.6	2.3
HICP (eop, %)	7.4	5.4	4.9	3.5	3.0	3.4	3.3	3.2	3.2	3.4	3.5	3.6	3.6
CPI (eop, %YoY)	6.7	4.5	4.1	2.5	2.5	2.9	3.0	3.0	2.6	2.5	2.8	3.4	3.5
Central bank deposit rate (eop, %)*	4.00	4.00	4.00	3.75	3.50	3.25	2.75	2.25	2.25	2.25	2.25	2.25	2.25
10yr yield (eop, %)	3.50	3.40	3.35	3.65	3.15	3.10	2.90	2.80	2.80	2.70	2.60	2.50	2.50

*ECB deposit rate as of 1 January 2023
Source: National sources, ING estimates



Czech Republic

David Havrlant, Chief Economist, Czech Republic

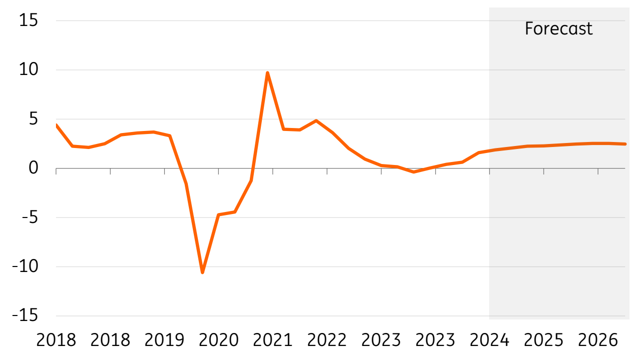
Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	0.6	1.6	1.9	2.1	2.3	1.1	2.2
CPI (%YoY)*	2.0	2.6	3.4	2.4	2.9	2.5	2.6
Policy interest rate (%)	4.8	4.3	4.0	3.8	3.3	5.0	3.5
3m interest rate (%)*	4.7	4.2	4.0	3.7	3.3	4.9	3.5
10yr yield (%)*	4.2	3.7	3.9	3.9	3.7	4.0	3.8
USD/CZK*	23.0	22.6	22.5	22.5	22.5	22.9	22.5
EUR/CZK*	24.8	25.1	25.0	24.9	24.9	25.1	24.8

Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2028	S&P	AA-	AA
Fiscal	Tighter	Parliamentary: 2025	Moody's	Aa3	Aa3
Monetary	Looser	Local: 2026	Fitch	AA-	AA-

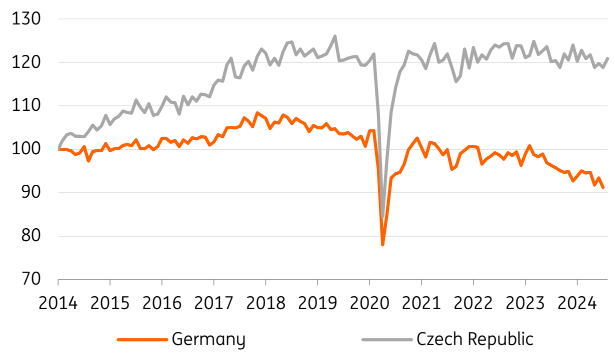
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

Real GDP recovers (%, ppt YoY)



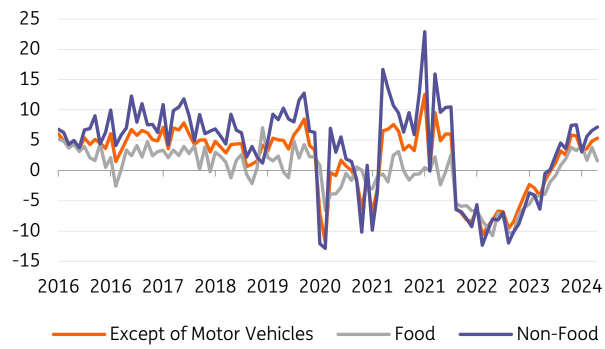
Source: CZSO, ING

Industrial output set for a downward trend (2014=100)



Source: Macrobond, ING

Real retail sales record robust expansion (%YoY)



Source: CZSO, ING

Country strategy: Soft expansion with lower base rates

The Czech economic recovery is set to continue in the second half of the year despite the headwinds of lukewarm foreign demand from the main European trading partners. Continued solid wage growth in both nominal and real terms will provide enough fuel for household expenditure. That said, the dichotomy between sluggish manufacturing output and robust consumer spending has become even more pronounced. The labour market is expected to remain relatively tight with the continuing rebound, especially in the skilled labour segment. Core inflation is being driven by persistent price growth in services, while declining energy prices are likely to bring headline inflation close to the central bank's target early next year. Monetary policy easing is expected to carry on at a soft pace, with the fiscal stance becoming less constraining for growth in 2025 as compared to this year.

Mounting challenges to global growth represent a risk

Economic recovery came into the spotlight after inflation had been broadly tamed. We expect the expansion to continue in the second half of the year, bringing full year economic growth to 1.1%. Both household and government consumption are set to contribute substantially to the rebound. Meanwhile, fixed investment will be a laggard due to the weak start to the year affected by the onset of the new EU funding period. Net exports are set to boost overall performance, but mainly on account of declining imports. Exports will grow only moderately this year as the leading European trading partners face challenges while tepid foreign demand is troublesome for the Czech export engine.

Czech industrial production has remained roughly flat since 2018, with the PMI survey pointing to lukewarm foreign demand as the main source of the trouble. Indeed, German manufacturing output has been trending down for more than six years, with recent news not indicating a turnaround any time soon. In particular, the automotive industry finds itself in a tough spot, with mounting regulations and too much red tape on one side and surging competition from China on the other.

Czech exporters are closely linked to the German car industry, with firms often owned or heavily invested in by auto manufacturers headquartered in the Western neighbour. However, the malaise seems to have dragged on for too long, and Czech firms report that they are looking for direct sales to customers overseas. Such a move might have limited scope and prove difficult to push through. However, an element of decoupling will be needed if things don't improve for German car manufacturers.

Consumer spending is set to drive the Czech recovery, with real retail sales expanding 5.3% annually in August, as household budgets benefit from solid nominal and real wage growth. The improving real income situation is reflected in a revival of the residential sector, which has seen a bottoming out of property prices. Higher spending should support the persistently elevated price growth of services and fuel core inflation, especially with rents likely to follow increasing property prices. Some unrelenting inflationary risks combined with a relatively tight labour market will contribute to a cautious approach to any further reduction of the restrictive monetary policy stance, in a scenario in which the economy is expanding below its potential and headline inflation is approaching the target early next year, dragged down by falling energy prices.

Czech Republic

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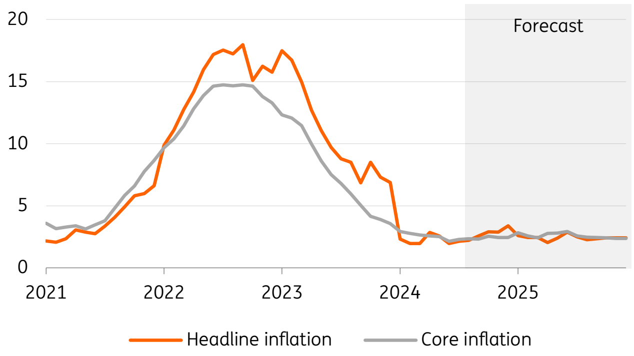
Core inflation set to remain elevated (% YoY)

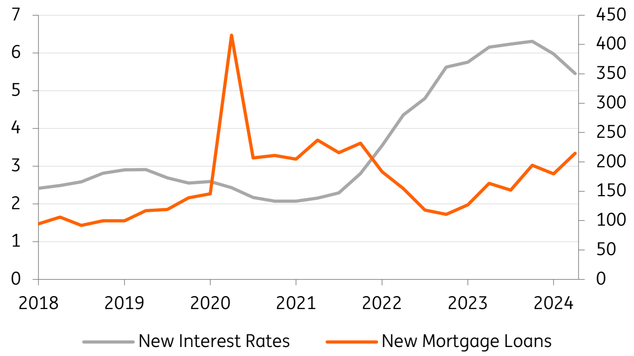


Source: CZSO, ING

Headline and core inflation to remain elevated

Headline inflation is expected to cross the 3% threshold in December or earlier, partially due to a low comparison base. A major electricity and natural gas distributor announced a reduction in end-prices for both, with a downward effect of 0.2ppt on the headline inflation early next year, helping it to get back to the CNB tolerance band. Core inflation is likely to remain elevated, driven by the stubborn price growth in the services sector and solid household spending. There is also a risk that the market and imputed rents will follow the renewed growth in property prices, resulting in potential for upward repricing in January.

New mortgage loans trend upwards (%, lhs, and CZKbn)

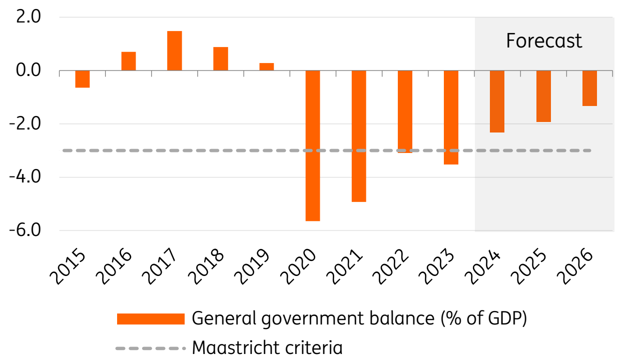


Source: Macrobond

Credit growth strengthens and property prices pick up

Credit demand continues on an upward trend, with new mortgage loans rising to levels seen during the buying spree of the pandemic years. The residential market is reviving despite the still elevated mortgage rates, which react slowly to any reduction in the base rate, representing a setback in the transmission of the monetary policy. The reviving demand is reflected in the bottoming out of residential prices, with house prices increasing across the country. That said, the amount of money in the economy and an overly strong credit dynamic represents a concern for policymakers when it comes to a further reduction in base rates.

Public finance balance (% of GDP)

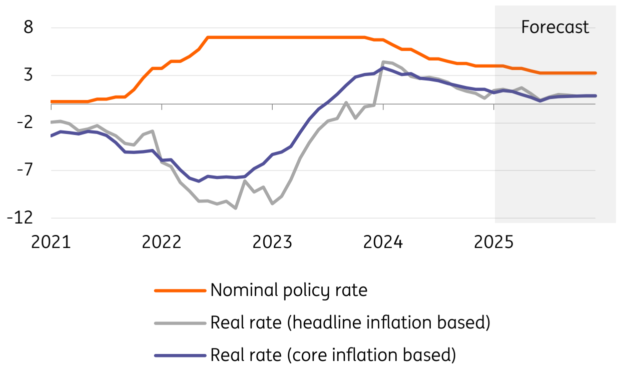


Source: MinFin, ING

Consolidation continues despite election risk next year

This is the first year of the fiscal consolidation package introduced by the government last year. The state budget performance shows that the government would have achieved the planned deficit this year without the impact of the flood damage. This will only be visible in the budget execution in the coming months but we believe it does not change the picture of the overall fiscal policy too much. For this year we expect a government deficit of 2.3% of GDP, including 0.2% of GDP related to flood spending. For next year, we expect a further decline to 1.9% of GDP, but there is upside risk given the general election in October. Although the deficit is expected to fall next year, MinFin has larger redemptions of CZGBs compared to this year, which will lead to a slight increase in issuance.

Nominal and real rates set to get lower (%)



Source: CNB, CZSO, ING

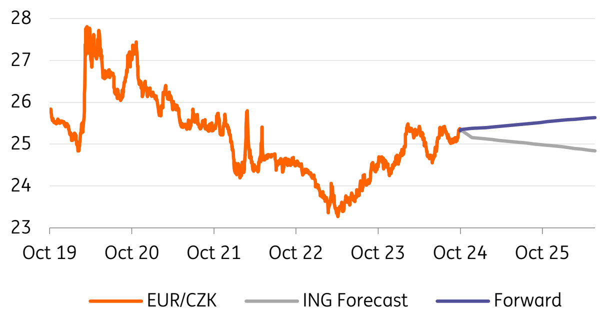
Both nominal and real rates are likely to move lower

We expect the central bank to go ahead with an additional soft cut in November, bringing the policy rate to 4%. For December we see a pause as the most likely outcome, giving the central bank an opportunity to wait and see January's inflation data, which is prone to more pronounced moves than in other months. Whether to cut or not to cut at the year end will be a close call, as not much forward guidance was provided, except that the easing could be terminated at any time. The question is whether a real interest rate below 1.5%, as measured by core inflation, is stringent enough to hold core inflation on a short leash, break the stubborn price growth in the services segment, and temper the accelerating credit growth. We see the base rate at 3.25% by mid-next year.

Czech Republic

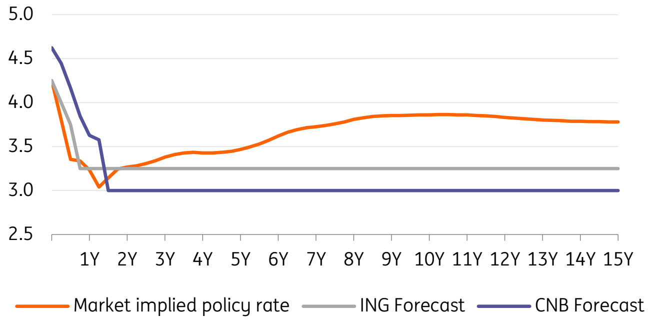
Strategy

FX – spot vs forward and INGF



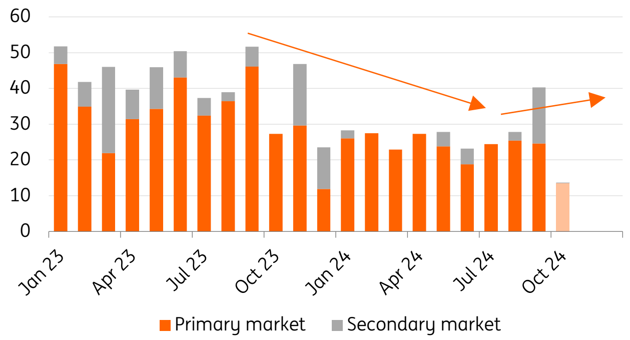
Source: Eikon, ING

Market implied policy rate vs CNB and ING forecast



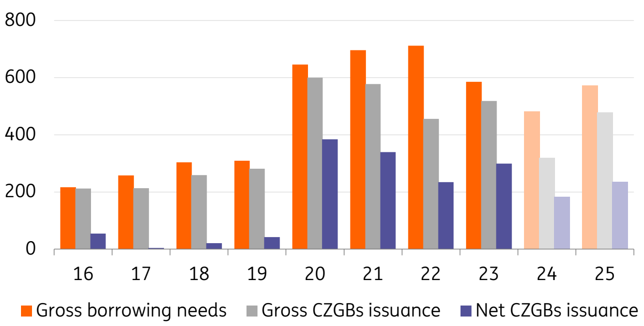
Source: Eikon, ING

CZGBs gross issuance (CZKbn)



Source: MinFin, ING

Ministry of Finance issuance activity (CZKbn)



Source: MinFin, ING

FX strategy

The koruna remains the least volatile currency in the CEE3 space and has confirmed its defensive position in the current global sell-off. EUR/CZK remains close to CNB forecasts and has escaped central bankers' attention. Although we remain positive on the CZK, the story could diverge either way over the coming months. Our preferred view is that the CZK will remain supported mainly by the CNB's hawkish policy and corrections in dovish bets on rate cuts in the market. On the other hand, the economy remains on the weak side, underperforming CEE peers. This may create pressure on the CZK especially through expectations of more rate cuts from the central bank in an attempt to support the economy.

However, we believe the CNB will remain on the hawkish side despite weak economic data and the risk of undershooting the inflation target for an extended period. Moreover, we believe the CNB is backed by fiscal consolidation heading into a period of global markets more focused on fiscal policy and its sustainability. Thus, the CZK may outperform CEE peers in the face of further global turbulence.

In the short term, we see CNB monetary policy and the US presidential election as the main drivers. If the CNB takes a break in the cutting cycle at the end of this year, it is likely to be a boost for the CZK. However, the uncertainty on both sides with a bias to a negative impact is the US election through the EUR/USD channel in particular. We see EUR/CZK heading towards 25.000 by the end of the year and range trading in the 24.500-25.000 range next year.

Fixed Income strategy

Receiving Czech rates tends to be the most popular trade within the CEE region this year, which usually leads to exuberant bets on CNB rate cuts versus our forecast. The recent sell-off has corrected some of these bets triggering heavy stop-losses. While the September terminal rate was priced in at 2.75%, it corrected to 3.10% in February. Similar to the CZK, the market is coming to a crossroads and the CNB will have to face questions about its hawkishness in light of weak economic numbers. We expect the market to be happy to return to the view of more rate cuts in the future, which may eventually materialise, but we see this risk later next year if at all. The road down will be very bumpy, as we have already seen several times this year with the significant repricing in March and August. Having said that, the IRS curve has further room to steepen although we are probably getting closer to the top as the CNB cutting cycle gets into the late phase.

CZGBs remain the largest OW for the market within the CEE region and nothing is likely to change that. The Czech Republic is the only country among peers that has delivered fiscal consolidation, pushing bond issuance down. The CNB is running the risk of more cuts in the future potentially unlocking more room for gains. On the other hand, MinFin faces higher redemptions next year, effectively leading to a higher CZGBs supply.

Czech Republic

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	2.2	5.0	2.5	5.3	2.8	3.5	-5.3	4.0	2.9	0.0	1.1	2.2	2.5
Private consumption (%YoY)	0.3	0.3	0.7	2.5	2.1	2.8	3.2	3.8	15.1	10.7	2.4	2.2	2.5
Government consumption (%YoY)	1.2	1.8	2.4	1.7	3.5	2.6	4.1	1.5	0.4	3.5	3.7	2.1	1.8
Investment (%YoY)	2.8	8.9	-2.1	3.1	8.9	7.4	-4.8	6.7	6.3	2.7	1.4	3.8	3.6
Industrial production (%YoY)	5.1	4.5	2.5	6.6	3.0	-0.5	-6.8	6.0	2.3	-0.8	-1.3	1.2	2.4
Unemployment rate (year-end, %)	6.1	5.0	4.0	2.9	2.1	2.1	3.2	2.3	2.3	2.7	2.8	2.8	2.7
Nominal GDP (CZKbn)	4,377	4,654	4,841	5,185	5,481	5,891	5,830	6,306	7,048	7,627	8,018	8,392	8,812
Nominal GDP (€bn)	159	171	179	197	214	230	220	246	287	318	320	338	359
Nominal GDP (US$bn)	211	189	198	222	252	257	251	291	302	344	350	374	394
GDP per capita (US$)	20,075	18,008	18,835	21,083	23,939	24,351	23,908	27,701	28,056	31,585	31,942	34,022	35,817
Gross domestic saving (% of GDP)	26.2	27.3	26.6	27.5	26.9	27.3	26.9	28.8	28.2	31.3	31.6	31.4	31.0
Prices													
CPI (average, %YoY)	0.3	0.3	0.7	2.5	2.1	2.8	3.2	3.8	15.1	10.7	2.5	2.4	2.4
CPI (year-end, %YoY)	0.1	0.0	2.0	2.4	2.0	3.2	2.3	6.6	15.8	6.9	3.4	2.4	2.3
Wage rates (nominal, %YoY)	2.9	3.2	4.4	6.8	8.1	7.9	4.6	5.8	4.3	8.0	7.2	6.0	6.2
Fiscal balance (% of GDP)													
Consolidated government balance	-2.1	-0.6	0.7	1.5	0.9	0.3	-5.6	-5.0	-3.1	-3.5	-2.3	-1.9	-1.3
Consolidated primary balance	-0.8	0.4	1.6	2.2	1.6	1.0	-4.9	-4.2	-2.0	-2.5	-1.2	-0.7	-0.1
Total public debt	41.5	39.5	36.2	33.8	31.7	29.6	36.9	40.7	42.5	42.4	45.1	45.9	46.2
External balance													
Exports (€bn)	126.5	135.4	142.1	156.8	166.6	168.4	149.4	166.5	182.8	192.7	186.8	194.4	204.1
Imports (€bn)	113.9	122.6	126.7	138.3	149.8	151.5	134.5	157.6	174.4	177.2	169.2	176.4	185.2
Trade balance (€bn)	10.0	10.1	13.5	15.0	13.0	14.0	14.7	9.1	3.1	16.0	13.8	13.8	15.1
Trade balance (% of GDP)	6.3	5.9	7.5	7.6	6.1	6.1	6.7	3.7	1.1	5.0	4.3	4.1	4.2
Current account balance (€bn)	0.3	0.8	3.2	3.0	0.8	0.8	3.9	-5.1	-13.5	1.0	3.2	2.7	3.1
Current account balance (% of GDP)	0.2	0.4	1.8	1.5	0.4	0.3	1.8	-2.1	-4.7	0.3	1.0	0.8	0.9
Net FDI (€bn)	-2.9	1.8	-6.9	-1.7	-2.0	-5.3	-5.6	-1.1	-3.4	-0.7	-0.7	-0.8	-1.6
Net FDI (% of GDP)	-1.8	1.1	-3.9	-0.9	-0.9	-2.3	-2.6	-0.5	-1.2	-0.2	-0.2	-0.2	-0.5
Current account balance plus FDI (% of GDP)	-2.6	2.6	-3.8	1.3	-1.2	-4.6	-1.8	-6.2	-16.8	0.3	2.5	1.9	1.5
Foreign exchange reserves ex gold (€bn)	45.2	58.7	81.3	119.7	124.8	132.1	134.3	148.6	128.9	138.3	140.1	142.3	144.4
Import cover (months of merchandise imports)	4.5	5.5	7.6	10.3	10.0	10.3	11.8	10.7	7.4	8.0	8.6	8.8	9.4
Debt indicators													
Gross external debt (€bn)	107	116	129	166	172	171	163	176	183	193	193	195	202
Gross external debt (% of GDP)	67.4	68.1	72.2	84.4	80.6	74.4	74.1	71.6	63.7	60.7	60.2	57.8	56.4
Gross external debt (% of exports)	85	86	91	106	103	101	109	106	100	100	103	100	99
Lending to corporates/households (% of GDP)	47.2	47.0	48.3	48.2	48.4	47.7	50.6	49.3	47.5	46.0	46.2	46.5	46.7
Interest & exchange rates													
Central bank key rate (year-end, %)	0.05	0.05	0.05	0.50	1.75	2.00	0.25	3.75	7.00	6.75	4.00	3.25	3.25
Broad money supply (average, %YoY)	6.4	8.5	6.8	9.3	5.5	7.1	10.5	7.3	5.6	8.3	6.9	7.2	7.6
3m interest rate (Pribor, average, %)	0.36	0.31	0.29	0.42	1.32	2.12	0.77	1.25	6.39	7.10	4.89	3.49	3.38
3m interest rate spread over Euribor (ppt)	0.15	0.33	0.55	0.75	1.64	2.48	1.20	1.79	6.04	3.67	1.29	0.89	1.08
2yr yield (average, %)	0.28	-0.09	-0.33	-0.17	1.03	1.43	0.36	1.51	5.35	5.12	3.82	3.74	3.80
10yr yield (average, %)	1.51	0.70	0.46	1.03	1.99	1.54	1.10	1.97	4.42	4.46	3.95	3.77	3.86
USD/CZK exchange rate (year-end)	22.46	24.82	25.65	21.69	22.70	22.94	21.62	22.32	22.91	22.44	22.50	22.41	22.33
USD/CZK exchange rate (average)	20.76	24.59	24.45	23.38	21.74	22.93	23.22	21.68	23.35	22.20	22.94	22.45	22.37
EUR/CZK exchange rate (year-end)	27.65	27.02	27.03	25.66	25.83	25.49	26.30	25.22	24.26	24.49	25.00	24.71	24.42
EUR/CZK exchange rate (average)	27.54	27.29	27.03	26.33	25.65	25.67	26.46	25.64	24.56	24.00	25.07	24.84	24.55

Source: National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	-0.4	0.0	0.4	0.6	1.6	1.9	2.1	2.3	2.3	2.4	2.5	2.5	2.5
CPI (eop, %YoY)	6.9	6.9	2.0	2.0	2.6	3.4	2.4	2.8	2.3	2.4	2.4	2.3	2.3
Central bank key rate (eop, %)	7.00	6.75	5.75	4.75	4.25	4.00	3.75	3.25	3.25	3.25	3.25	3.25	3.25
3m interest rate (eop, %)	7.10	6.77	5.61	4.71	4.20	3.95	3.70	3.25	3.30	3.30	3.35	3.35	3.40
10yr yield (eop, %)	4.77	3.75	4.00	4.18	3.74	3.85	3.85	3.70	3.75	3.75	3.80	3.85	3.90
USD/CZK exchange rate (eop)	22.85	22.44	23.27	23.03	22.62	22.50	22.48	22.45	22.43	22.41	22.39	22.37	22.35
EUR/CZK exchange rate (eop)	24.40	24.49	25.29	24.78	25.09	25.00	24.93	24.85	24.78	24.71	24.64	24.57	24.49

Source: National sources, ING estimates

Hungary

Péter Virovácz, Chief Economist, Hungary

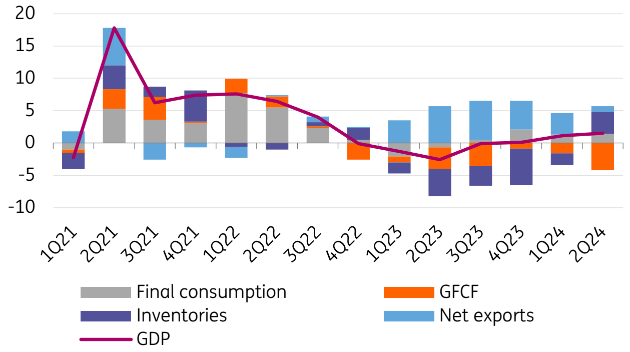
Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	1.5	1.3	2.2	2.4	3.3	1.5	3.6
CPI (%YoY)*	3.7	3.0	4.6	3.7	4.4	3.8	4.0
Policy interest rate (eop, %)	7.00	6.50	6.25	6.25	5.50	6.25	5.25
3m interest rate (%)*	6.89	6.32	6.05	5.95	5.30	7.23	5.47
10yr yield (%)*	6.82	6.16	6.25	6.45	6.65	6.35	6.62
USD/HUF*	368.9	354.6	359.1	363.6	370.9	360.7	365.5
EUR/HUF*	395.2	397.2	395.0	400.0	408.0	393.2	402.0

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

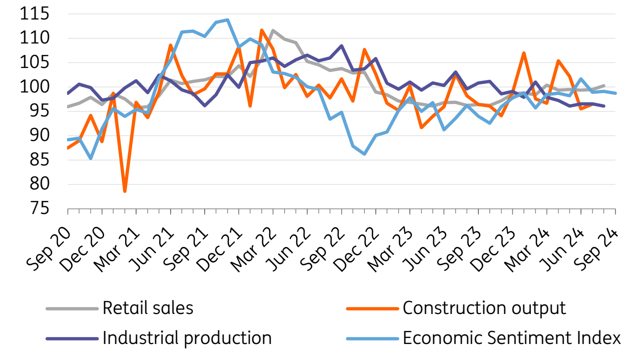
*Quarterly data is eop, annual is avg.
Source: National sources, ING estimates

Contribution to YoY GDP growth (ppt)



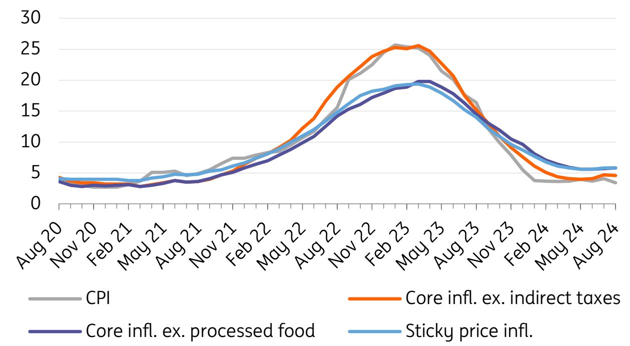
Source: Hungarian Central Statistical Office

Key activity indicators (swda; 2021 = 100%)



Source: Eurostat, Hungarian Central Statistical Office

Headline and underlying measures of inflation (%YoY)



Source: National Bank of Hungary

Country strategy: Looking for bright spots

We hoped that 2024 would be the year of full recovery after years of polycrisis, but reality has disappointed us. This year is only the beginning of the healing process, as both consumer and business confidence (local and global) are limiting the Hungarian economy. While consumption is already on the rise, investments have fallen off a cliff. In the absence of import needs, net exports also remain a growth driver. The main silver lining is the tight labour market, which is also putting pressure on real wage growth. This, combined with normalisation of inflation and the turn to a year before the 2026 general election, brings many potential bright spots for GDP growth. However, the biggest threat could still be currency (in)stability and wage growth, which could spill over into inflation due to companies' heightened cost sensitivity. Against this backdrop, we are rather bearish on Hungarian assets for 2025-26.

Macro digest

The Hungarian economy is once again experiencing some turbulence, as evidenced by the 0.2% quarterly contraction in the second quarter of 2024. The detailed data show that agriculture and industry were the main drags on the production side. In the first half of 2024, these two sectors are down by 3-4% YoY. A high base and bad weather are key for agriculture, and the lack of external and domestic demand remains a problem for manufacturing. Hopes for a quick recovery on the industrial side are very, very limited, with high stock levels and order books 27% lower than a year ago. Some 15% of firms are hoarding labour, hoping for a better future and unwilling to pull the trigger on labour rationalisation. This is keeping wage growth elevated, which eventually feeds through to demand for services, which were up by 2.2% YoY in January-June.

Against this backdrop, it is hardly surprising that consumption is rising (3.9% YoY in 1H24), which is certainly a cause for optimism. The big problem is sluggish investment. Gross fixed capital formation has collapsed by 12% YoY during the first half of this year as companies face much smaller order books and uncertainty about economic policy. The fiscal situation also warrants tight budget control, with public investment projects being postponed. Households have tended to save and rebuild their depleted reserves, taking advantage of the exceptional opportunities offered by retail bonds. The contribution of net exports has been positive, but it remains rather favourable for the wrong reasons: import demand is subdued, while exports are also weak, just not as much. We see GDP growth at 1.5% in 2024 and around 4.0% on average in 2025-2026, as we wait for consumer and business confidence to improve with the turn of the inventory cycle, new export capacity, pre-election government measures and a shift from saving to spending.

The era of sustained disinflation is over with headline inflation has been hovering between 3-4% YoY for the past 9 months. As in the region, the main driver of price pressure remains services, with an above 9% print. So, while the overall inflation outlook has improved recently, the structure of inflation remains an issue. We see year-end inflation rate in the 4.5-5.0% range, but not only on base effects. Fuel prices and FX volatility could push monthly repricing higher. The pro-inflationary fiscal measures will be reflected in the figures from the beginning of 2025. As companies' repricing frequency has increased since the pandemic, further cost shocks will be quickly passed on to consumers. We therefore see upside risks to our full-year forecasts. We project inflation averaging 3.8% this year and rising to around 4.0% in 2025, with a downward sloping inflation profile next year.

Hungary

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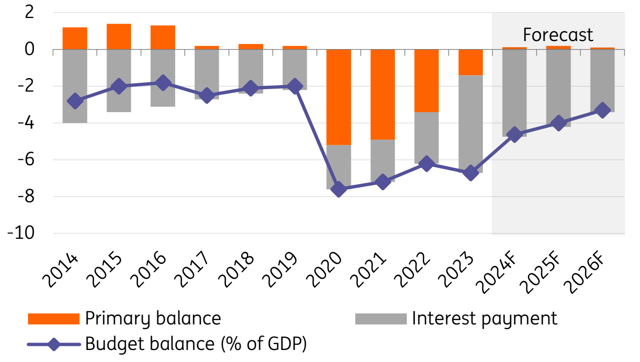
Budget and structural balance of general government (%)

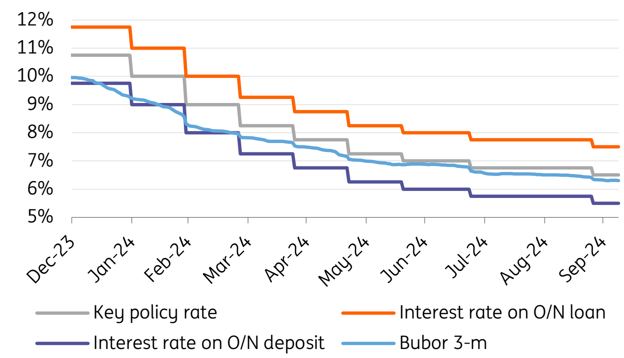


Source: AMECO, ING estimates

Fiscal policy to walk a tightrope in coming years

The ESA-based deficit target for 2024 is 4.5% of GDP, but based on our technical projection we still see a maximum slippage risk of around 0.5 pp. Of course, this could be reduced if VAT revenues continue to improve while the expenditure side remains tight. However, as we approach the 2026 general election cycle, the government is planning to restructure the budget to find a way for a pro-consumption and pro-investment fiscal stimulus. The plan will be revealed with the 2025 budget proposal in November. As a result, we expect a deficit of 4.0% of GDP next year, with the primary balance still close to zero. From a financing perspective, this would be entirely feasible as appetite for Hungarian retail and wholesale bonds remains strong. The only caveat is the lack of progress on the EU RRF money front, which carries a sovereign downgrade risk.

Benchmark policy rate and interest rate corridor

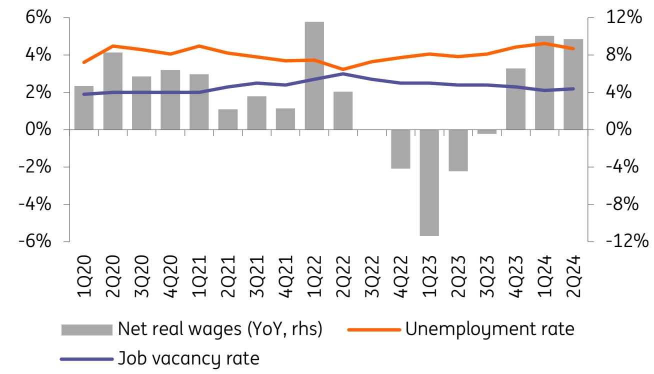


Source: National Bank of Hungary

Monetary easing continues if FX regains stability

The National Bank of Hungary is still solving market stability puzzles. With the latest geopolitical risk, the disorderly EUR/HUF move above 400 again urged the central bank to make a hawkish shift in the forward guidance via a verbal intervention. After halving the base rate in 12 months from 13.00% to 6.50% in September 2024, the room for manoeuvre tightened a lot. Against this backdrop, we see scope for one more 25bp easing in the fourth quarter. With so much uncertainty, both globally (geopolitics, major central banks' rate paths, etc.) and locally (changes in the Governing Council), it is hard to be very confident about the path of interest rates next year. We now expect at least as many cuts as the Fed/ECB deliver and see the local rate at the end of 2025 at 5.25%.

Unemployment, job vacancy rate and wage growth

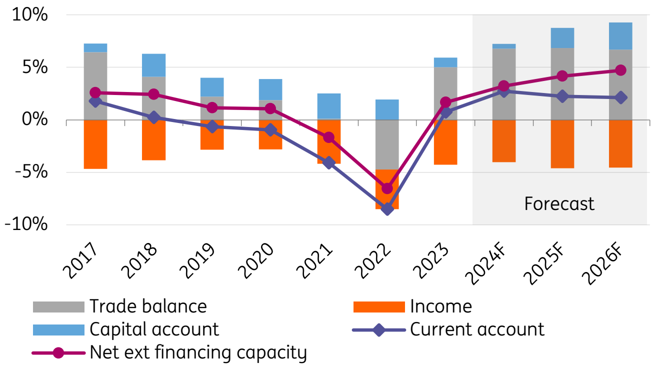


Source: Hungarian Central Statistical Office, ING estimates

Tight labour market remains a double-edged sword

The unemployment rate has been falling slowly over the year and was 4.2% in August. Details show that layoffs are likely to be among the low-paid and low-skilled, but even these workers can quickly find new jobs. With the labour market still tight, firms are likely to retain staff beyond their planned capacity, creating 'hidden' unemployment, as shown by the data on labour hoarding. This state of the labour market poses a twofold risk. On the one hand, there is a risk of long-term inflation with further upward pressure on wages. On the other hand, if economic activity fails to pick up, recessionary risks will increase as layoffs loom. Between these two extremes, we see the unemployment rate falling below 4% in 2025 and wage growth averaging close to 10% in 2025-2026.

Structure of the current account (% of GDP)



Source: National Bank of Hungary, ING estimates

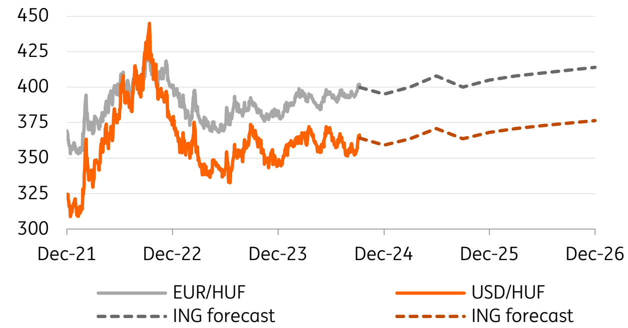
External balances are expected to remain resilient

The country's external balance has been one of the most positive surprises of the year and a clear bright spot. But it is all for the wrong reason. Imports are faltering because investment is exceptionally weak. Exports of goods are also constrained, affecting the need for imports (via spare parts and energy), while exports of services are doing well. We don't see a major shift in these processes and forecast a current account surplus of 2.7% of GDP in 2024. As investment recovers, consumption rises and newly built export capacities require more imports, the surplus could narrow somewhat, although we expect it to remain above 2% of GDP in the coming years. Our baseline macroeconomic projection assumes only the absorption of the EU funds made available so far.

Hungary

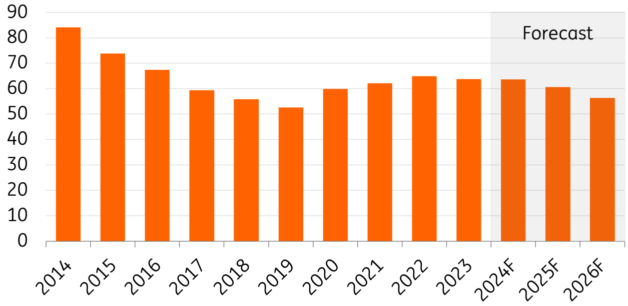
Strategy

FX – spot and INGF



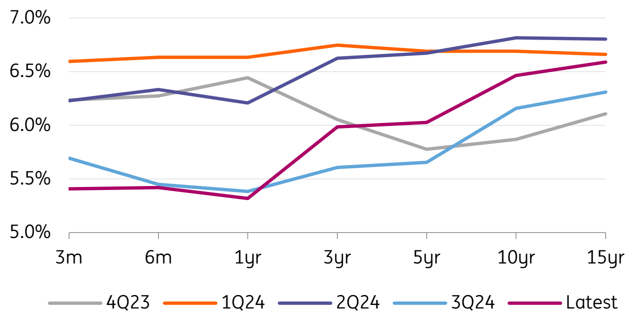
Source: National Bank of Hungary, ING estimates

Evolution of gross external debt (% of GDP)



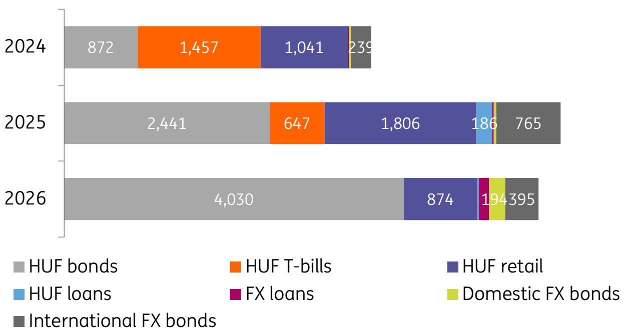
Source: National Bank of Hungary, ING estimates

Local curve (%)



Source: Government Debt Management Agency

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



Source: Government Debt Management Agency

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

The forint came under pressure during the recent global sell-off and broke the EUR/HUF 400 level for a few days in early October, the first time this year. A weaker forint also means a more hawkish central bank, which, as in the last two years, acts as a backstop for FX weakness. Although we continue to see the EUR/HUF 392-400 range as the main playing field for the rest of the year, opportunities are visibly deteriorating for HUF to move into the lower part of this range.

Geopolitical uncertainty, frequent global repricing and the upcoming US presidential election are not making things easier for HUF to return to stronger levels and the probability of journeys above EUR/HUF 400 are increasing. An NBH rate cut in October seems off the table given the current market volatility even though inflation continues to surprise to the downside. Although the market has outpriced almost all possibility of an October rate cut, a hawkish message from the central bank would be a boost for HUF.

In the medium term, however, we expect the rate cut discussion to return and, if conditions allow, the central bank has stated it will be happy to continue the cutting cycle. Moreover, the market sees the changes in NBH leadership as dovish, which could lead to a gradual weakening of the HUF next year with our forecast range shifting to EUR/HUF 400-410 as a result. We see the market already positioning itself in this direction, which will make life harder for HUF. Moreover, next year will also involve fiscal policy and election risk which additionally makes the HUF fragile looking ahead.

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

During the October sell-off, the market priced out roughly 75bp rate cuts in the HUF curve with the terminal rate moving from 4.50% to 5.25%. Although we see slower cuts on a one-year horizon, our forecast later moves below market expectations. The upward shift in the IRS and HGBs curve has raised the premium significantly over core and CEE peers and the market is showing interest in returning. Although the NBH is likely to delay further rate cuts, the direction is clear, supported by the downside surprise in CPI.

On the Eurobond front, the fiscal situation looks more positive for Hungary than CEE peers Romania and Poland in terms of expected supply pressure, with the government focused on maintaining a steady share of FX debt within the government stock. At the same time, this is likely to continue to be balanced by the ongoing headline risk around EU funds with no notable progress on unlocking more.

Hungary

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	4.3	3.7	2.4	4.1	5.6	5.1	-4.3	7.1	4.3	-0.9	1.5	3.6	4.4
Private consumption (%YoY)	2.3	3.7	4.2	4.9	4.1	4.7	-1.5	4.1	6.4	-0.7	4.1	4.6	4.8
Government consumption (%YoY)	8.9	1.3	0.5	3.8	4.3	9.6	4.2	2.8	0.7	3.9	0.5	4.3	1.5
Investment (%YoY)	12.4	4.8	-10.4	19.7	16.4	12.7	-7.3	5.7	0.9	-7.8	-9.2	4.7	4.4
Industrial production (%YoY)	7.7	7.4	0.9	4.6	3.5	5.6	-6.0	9.5	6.1	-5.5	-3.9	2.1	6.2
Unemployment rate (year-end, %)	6.9	5.7	4.1	3.5	3.3	2.9	4.2	3.8	3.8	4.2	4.3	3.9	3.6
Nominal GDP (HUFbn)	32,827	34,985	36,312	39,336	43,554	47,940	48,808	55,557	66,166	75,087	82,030	90,685	98,951
Nominal GDP (€bn)	106	113	117	127	137	147	139	155	169	197	209	226	241
Nominal GDP (US$bn)	139	124	129	146	161	165	161	180	178	213	227	248	265
GDP per capita (US$)	14,358	12,777	13,220	14,745	16,603	17,013	16,390	19,020	18,462	22,160	23,725	25,935	27,803
Gross domestic saving (% of GDP)	25.2	25.9	26.0	25.1	27.0	27.6	26.1	26.4	25.5	25.0	25.2	26.1	26.4
Prices													
CPI (average, %YoY)	-0.2	-0.1	0.4	2.4	2.8	3.4	3.3	5.1	14.5	17.6	3.8	4.0	3.2
CPI (year-end, %YoY)	-0.9	0.9	1.8	2.1	2.7	4.0	2.7	7.4	24.5	5.5	4.6	3.6	3.0
Wage rates (nominal, %YoY)	3.0	4.3	6.2	12.9	11.3	11.3	9.8	8.9	17.4	14.2	13.0	10.2	9.3
Fiscal balance (% of GDP)													
Consolidated government balance	-2.8	-2.0	-1.8	-2.5	-2.1	-2.0	-7.5	-7.1	-6.2	-6.7	-4.7	-4.0	-3.3
Consolidated primary balance	1.2	1.4	1.3	0.2	0.3	0.2	-5.2	-4.9	-3.4	-2.0	0.1	0.0	0.0
Total public debt	76.5	75.8	74.9	72.1	69.1	65.3	78.7	76.2	73.8	73.4	73.2	73.0	72.1
External balance													
Exports (€bn)	84.5	90.5	93.0	100.7	104.9	109.1	105.0	119.2	142.5	149.6	143.3	149.1	157.9
Imports (€bn)	78.2	81.9	83.3	92.6	99.3	104.8	99.4	117.6	151.7	140.6	130.8	135.1	143.3
Trade balance (€bn)	6.3	8.6	9.7	8.1	5.5	4.3	5.6	1.6	-9.1	9.0	12.6	14.0	14.6
Trade balance (% of GDP)	5.9	7.6	8.3	6.3	4.0	2.9	4.0	1.0	-5.4	4.6	6.0	6.2	6.1
Current account balance (€bn)	0.9	2.4	5.1	2.3	0.3	-0.9	-1.3	-6.3	-14.4	1.4	5.7	5.1	5.2
Current account balance (% of GDP)	0.8	2.2	4.4	1.8	0.2	-0.6	-0.9	-4.1	-8.5	0.7	2.7	2.2	2.1
Net FDI (€bn)	5.0	2.1	3.7	4.9	5.4	3.0	4.5	6.6	8.4	5.1	6.3	6.9	4.9
Net FDI (% of GDP)	4.7	1.9	3.2	3.9	3.9	2.0	3.3	4.2	5.0	2.6	3.0	3.1	2.0
Current account balance plus FDI (% of GDP)	5.6	4.1	7.5	5.7	4.2	1.4	2.3	0.2	-3.5	3.4	5.7	5.3	4.2
Foreign exchange reserves ex gold (€bn)	33.7	30.0	24.0	22.6	25.8	26.5	31.8	30.8	30.8	30.1	33.1	34.5	35.5
Import cover (months of merchandise imports)	5.2	4.4	3.5	2.9	3.1	3.0	3.8	3.1	2.4	2.6	3.0	3.1	3.0
Debt indicators													
Gross external debt (€bn)	89.4	83.2	78.6	75.5	76.2	77.5	83.2	96.3	109.6	125.3	132.8	136.6	136.0
Gross external debt (% of GDP)	84	74	67	59	56	53	60	62	65	64	64	61	56
Gross external debt (% of exports)	106	92	84	75	73	71	79	81	77	84	93	92	86
Lending to corporates/households (% of GDP)	41.1	33.8	32.1	31.3	31.2	32.1	35.8	35.5	33.2	30.2	29.7	29.6	28.8
Interest & exchange rates													
Central bank key rate (year-end, %)	2.10	1.35	0.90	0.90	0.90	0.90	0.60	2.40	13.00	10.75	6.25	5.25	4.25
Broad money supply (average, %YoY)	4.1	4.7	4.6	9.6	13.9	7.5	14.5	17.4	16.3	1.1	6.6	9.5	11.2
3m interest rate (Bubor, average, %)	2.41	1.61	0.99	0.15	0.12	0.19	0.69	1.45	9.96	14.30	7.23	5.47	4.60
3m interest rate spread over Euribor(ppt)	220	163	125	48	44	55	112	200	961	1087	363	287	230
3yr yield (average, %)	3.5	2.1	1.5	0.9	1.3	0.8	1.0	2.0	8.5	9.0	6.3	6.0	5.9
10yr yield (average, %)	4.8	3.4	3.1	3.0	3.0	2.5	2.2	3.1	7.6	7.5	6.4	6.6	6.9
USD/HUF exchange rate (year-end)	260.3	288.3	295.7	258.3	280.4	294.8	298.9	324.5	373.9	346.8	359.1	368.2	376.4
USD/HUF exchange rate (average)	236.6	282.3	281.6	269.5	270.9	291.1	304.0	308.2	372.2	352.4	360.7	365.5	372.7
EUR/HUF exchange rate (year-end)	314.9	313.1	311.0	310.1	321.5	330.5	365.1	369.0	400.3	382.8	395.0	405.0	414.0
EUR/HUF exchange rate (average)	308.7	309.9	311.5	309.2	318.9	325.4	351.2	358.5	391.3	382.0	393.2	402.0	410.0

Source: National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	-0.4	0.0	1.1	1.5	1.3	2.2	2.4	3.3	4.0	4.8	4.6	4.8	4.5
CPI (eop, %YoY)	12.2	5.5	3.6	3.7	3.0	4.6	3.7	4.4	4.0	3.6	3.3	3.1	3.1
Central bank key rate (eop, %)	13.00	10.75	8.25	7.00	6.50	6.25	6.25	5.50	5.25	5.25	5.00	4.75	4.50
3m interest rate (eop, %)	12.27	9.96	7.83	6.89	6.32	6.05	5.95	5.30	5.05	5.00	4.75	4.50	4.50
10yr yield (eop, %)	7.37	5.87	6.69	6.82	6.16	6.25	6.45	6.65	6.80	6.95	6.95	6.85	6.85
USD/HUF exchange rate (eop)	370.0	346.8	366.8	368.9	354.6	359.1	363.6	370.9	363.6	368.2	370.9	372.7	374.5
EUR/HUF exchange rate (eop)	391.3	382.8	395.8	395.2	397.2	395.0	400.0	408.0	400.0	405.0	408.0	410.0	412.0

Source: National sources, ING estimates

Kazakhstan

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	2.7	4.6	3.6	5.4	5.5	3.7	5.5
CPI (%YoY)*	8.4	8.3	8.2	7.8	7.9	8.6	7.4
Policy interest rate (%)	14.50	14.25	14.00	13.50	13.00	14.00	12.00
3m interest rate (%)*	12.2	10.4	13.5	13.2	12.7	12.9	12.1
10yr yield (%)*	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT*	473	481	490	485	490	469	492
EUR/KZT*	507	539	539	534	539	512	541

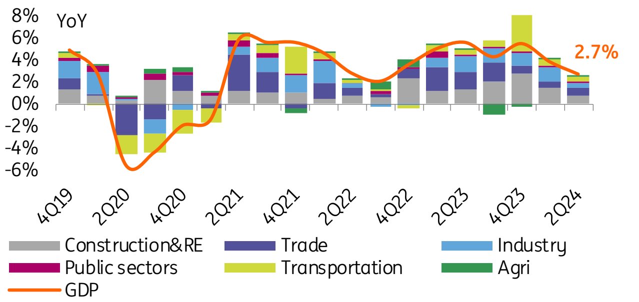
Macro trend		Political cycle	Ratings	FC	LC
Activity	-	Presidential: 2029	S&P	BBB-	BBB-
Fiscal	Easing	Parliamentary: 2028	Moody's	Baa1	Baa1
Monetary	Tight	Local: 2028	Fitch	BBB	BBB

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

Country strategy: Higher rating, but more CPI and FX risks

Economic momentum has slowed owing to commodity sector and other cyclical factors, but the rest of the economy, especially consumer-focused, appears robust and well supported by lending and public spending. The budget policy is becoming more generous, and, at some point, the issue of the US$100+/bbl fiscal breakeven oil price will need to be addressed. For now, it has added to pro-inflationary risks and caused Kazakhstan's central bank (NBK) to signal that the end of the rate easing cycle is near. In the meantime, KZT depreciation risks seem to have materialised, but the challenges of the budget and balance of payments are likely to keep the tenge under pressure in the medium term.

GDP growth and major contributors (%YoY)

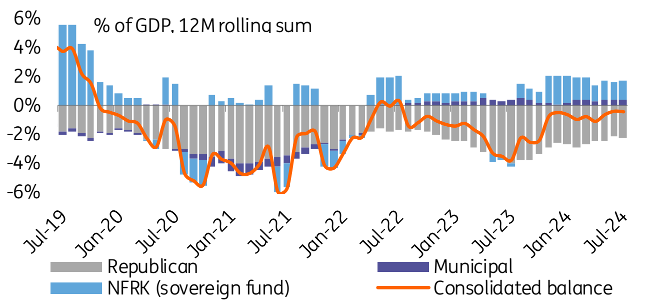


Source: National sources, CEIC, ING

Activity: Temporary slowdown, but fundamentals robust

GDP growth slowed to just 2.7% YoY in 2Q24, on the back of disappointing output in the commodity sector and slowdown in construction. Our initial growth expectations for 2024 are challenged and a 3.5-4.0% range appears more appropriate. A longer-term picture is not too grim. Consumption fundamentals are robust, with retail showing steady growth given an increase in employment, income growth, as well as fast retail lending. Meanwhile, non-oil industrial output is doing well, while the oil sector should improve next year if there is no delay with Tengiz or extra pressure from OPEC+. The continued fast growth in corporate as well as growing public spending appear accommodative. We therefore expect GDP growth to reverse to 4.5-5.5% in the next couple of years.

Consolidated budget balance by components

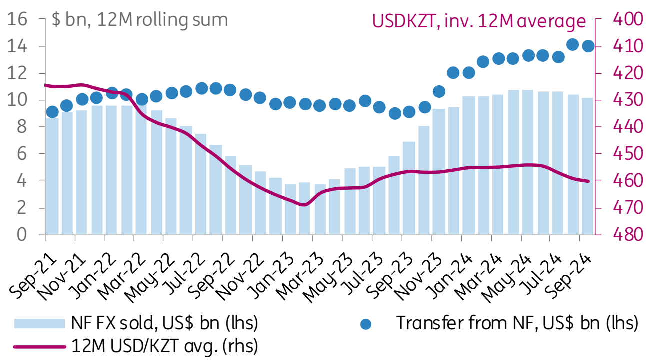


Source: National sources, CEIC, ING

Fiscal policy: More generosity than meets the eye

The headline data appears solid, but there are concerns. Flat consolidated revenues at around 21.2% of GDP are assured by the growing non-tax proceeds, mainly asset sales. The fuel revenues are weakening; proceeds per US$1/bbl of oil price declined from US$183m in 2022 to US$155m amid a sluggish oil sector. On expenditures, we see continued growth in spending on education, healthcare, social support, housing, sectoral investments and debt servicing, all leading to an increase of overall spending to 22.7% of GDP currently. While the consolidated deficit should remain within 0.5-1.5% of GDP, and stable at 2% of GDP at the republican level, it would suggest high fiscal breakeven oil prices of US$80-110/bbl – potentially raising the issue of fiscal consolidation in the longer run.

Key parameters of state FX interventions (US$bn)



Source: National sources, CEIC, ING

FX market: State capital flows still pivotal for KZT

The fiscal framework is KZT-supportive, as a further increase in the appetite for transfers out of the NFRK (which increased from US$12bn in 2023 to US$14bn in the 12m ending September 2024) may translate into higher FX sales by the state. Meanwhile, in the longer run, the state support to KZT should decline due to eventual fiscal consolidation and a declared inclination to reduce the role of oil savings in deficit financing in favour of higher debt accumulation. The negative effect on KZT could be hypothetically offset through higher non-resident participation in domestic public debt (recent increase in the sovereign rating by Moody's could be supportive of foreign appetite). We therefore would remain cautious on USD/KZT for the 2-3 year horizon and see it in a 480-500 range.

Kazakhstan

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	4.2	1.2	1.1	4.1	4.1	4.5	-2.5	4.3	3.2	5.1	3.7	5.5	4.5
Private consumption (%YoY)	1.1	1.8	1.2	1.5	6.1	6.1	-3.7	6.3	4.0	4.5	4.5	4.0	3.5
Government consumption (%YoY)	9.8	2.4	2.3	2.1	-14.1	15.5	12.8	-2.4	4.3	10.3	3.0	6.0	4.5
Investment (%YoY)	4.4	4.2	3.0	4.5	5.4	13.8	-0.2	2.6	3.8	20.7	3.0	6.0	4.5
Industrial production (%YoY)	0.3	-1.6	-1.1	7.3	4.4	-4.1	-0.5	3.6	1.1	4.3	3.5	5.0	4.0
Unemployment rate (average, %)	5.0	5.0	5.0	4.9	4.9	4.8	4.8	4.0	4.9	4.7	4.7	4.6	4.6
Nominal GDP (KZTbn)	39,676	40,884	46,971	54,379	61,820	69,533	70,649	83,952	103,766	119,808	132,237	149,864	166,431
Nominal GDP (€bn)	167	166	124	148	152	162	150	167	214	243	307	335	369
Nominal GDP (US$bn)	221	184	137	167	179	182	171	197	225	263	282	305	336
GDP per capita (US$)	12,807	10,511	7,715	9,248	9,813	9,813	9,122	10,371	11,477	13,194	14,014	15,005	16,289
Gross domestic saving (% of GDP)	41	35	34	37	40	39	34	37	40	n/a	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	6.7	6.6	14.7	7.4	6.0	5.2	6.8	8.0	14.9	14.8	8.6	7.4	6.3
CPI (year-end, %YoY)	7.4	13.6	8.5	7.1	5.3	5.4	7.5	8.4	20.3	9.8	8.2	6.5	6.1
Wage rates (nominal, %YoY)	10.9	4.1	13.4	5.5	7.9	14.8	14.0	17.5	23.1	24.1	11.9	11.2	9.5
Fiscal balance (% of GDP)													
Consolidated government balance	6.1	9.6	-4.4	-4.1	2.6	-0.4	-3.7	-4.3	-1.3	-0.5	-1.5	-1.1	-0.9
Consolidated primary balance	6.7	10.3	-3.3	-3.2	3.6	0.5	-2.6	-3.1	0.0	1.1	0.2	0.6	1.0
Total public debt	14.3	22.1	24.3	24.8	24.9	23.7	29.2	26.2	24.4	22.7	22.8	22.0	21.8
External balance													
Exports (US$bn)	70.1	41.6	37.0	49.5	59.0	59.5	44.1	65.8	85.6	80.2	80.2	82.8	83.1
Imports (US$bn)	42.5	33.9	26.6	31.0	35.0	41.1	38.1	41.6	50.6	60.4	59.7	61.5	63.3
Trade balance (US$bn)	27.7	7.7	10.5	18.5	24.0	18.4	6.0	24.2	35.0	19.9	20.5	21.3	19.7
Trade balance (% of GDP)	12.5	4.2	7.6	11.1	13.4	10.1	3.5	12.3	15.5	7.6	7.3	7.0	5.9
Current account balance (US$bn)	-2.9	-10.0	-7.0	-3.4	-1.8	-7.0	-11.1	-2.7	6.4	-9.0	-4.4	-5.3	-6.3
Current account balance (% of GDP)	-1.3	-5.4	-5.1	-2.1	-1.0	-3.9	-6.5	-1.4	2.9	-3.4	-1.6	-1.7	-1.9
Net FDI (US$bn)	4.7	3.3	13.7	3.8	5.0	5.9	5.9	1.9	8.0	2.4	4.0	3.0	2.0
Net FDI (% of GDP)	2.1	1.8	10.0	2.3	2.8	3.3	3.4	1.0	3.5	0.9	1.4	1.0	0.6
Current account balance plus FDI (% of GDP)	0.8	-3.6	4.9	0.2	1.8	-0.6	-3.0	-0.4	6.4	-2.5	-0.1	-0.7	-1.3
Foreign exchange reserves ex gold (US$bn)	29.2	27.9	29.7	31.0	30.9	29.0	35.6	34.4	35.1	35.9	37.9	38.9	39.9
Import cover (months of merchandise imports)	8.3	9.9	13.4	12.0	10.6	8.5	11.2	9.9	8.3	7.1	7.6	7.6	7.6
Debt indicators													
Gross external debt (US$bn)	157	153	164	167	160	160	164	164	161	164	168	173	178
Gross external debt (% of GDP)	71	83	119	100	89	88	96	83	71	62	60	57	53
Gross external debt (% of exports)	224	367	442	339	272	268	372	249	188	204	74	68	64
Lending to corporates/households (% of GDP)	31.4	31.0	27.1	23.4	21.2	19.9	20.7	22.0	23.9	24.9	25.4	25.4	25.4
Interest & exchange rates													
Central bank key rate (year-end, %)	5.50	16.00	12.00	10.25	9.25	9.25	9.00	9.75	16.75	15.75	14.00	12.00	10.50
Broad money supply (average, %YoY)	-8.2	8.0	46.2	7.5	7.1	11.0	19.2	24.1	18.0	16.8	12.0	11.0	10.0
3m interest rate (TONIA, average, %)	7.1	10.4	15.5	11.8	10.3	10.2	10.8	8.9	15.5	16.5	12.9	12.1	11.7
3m interest rate spread over US$-Euribor (ppt)	6.90	10.08	14.76	10.49	7.94	7.87	10.10	8.70	13.05	11.06	7.9	8.4	8.2
2yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT exchange rate (year-end)	182	339	333	332	384	381	421	432	463	455	490	500	500
USD/KZT exchange rate (average)	179	222	342	326	345	383	413	426	460	456	469	492	496
EUR/KZT exchange rate (year-end)	222	371	352	398	439	427	516	488	493	502	539	550	550
EUR/KZT exchange rate (average)	238	246	379	368	407	429	471	504	485	493	512	541	546
Brent oil price (annual average, US$/bbl)	99	54	45	55	72	64	43	71	99	82	81	72	70

Source: CEIC, National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	4.3	5.4	3.8	2.7	4.6	3.6	5.4	5.5	5.3	5.7	4.0	3.8	5.0
CPI (eop, %YoY)	11.8	9.8	9.1	8.4	8.3	8.2	7.8	7.9	7.0	6.5	6.4	6.3	6.2
Central bank key rate (eop, %)	16.50	15.75	14.75	14.50	14.25	14.00	13.50	13.00	12.50	12.00	11.50	11.00	10.75
3m interest rate (eop, %)	16.80	14.68	13.70	12.16	10.39	13.50	13.20	12.70	12.20	11.70	11.20	10.70	10.45
10yr yield (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/KZT exchange rate (eop)	478	456	447	473	481	490	485	490	495	500	495	490	495
EUR/KZT exchange rate (eop)	505	503	483	507	539	539	534	539	545	550	545	539	545

Source: CEIC, National sources, ING estimates

Poland

Rafał Benecki, Chief Economist, Poland

Forecast summary

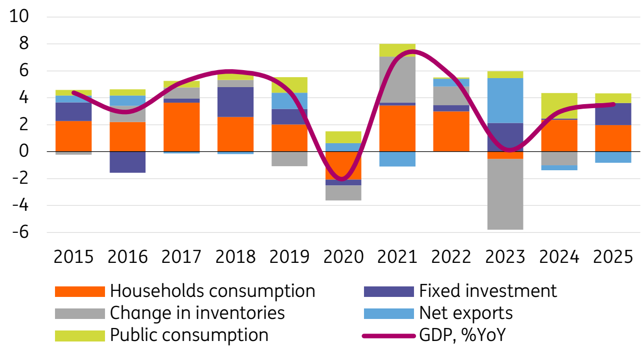
	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	3.2	2.8	3.7	3.2	3.5	3.0	3.5
CPI (%YoY)*	4.9	4.7	6.0	5.3	3.9	3.6	4.6
Policy interest rate (eop, %)	5.75	5.75	5.75	5.75	5.50	5.75	4.75
3m interest rate (%)*	5.85	5.85	5.90	5.87	5.53	5.87	5.45
10yr yield (%)*	5.74	5.4	5.67	6.01	6.08	5.65	5.97
USD/PLN*	4.03	3.82	3.86	3.87	3.88	3.93	3.89
EUR/PLN*	4.31	4.28	4.25	4.26	4.27	4.29	4.28

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

*Quarterly data is eop, annual is avg

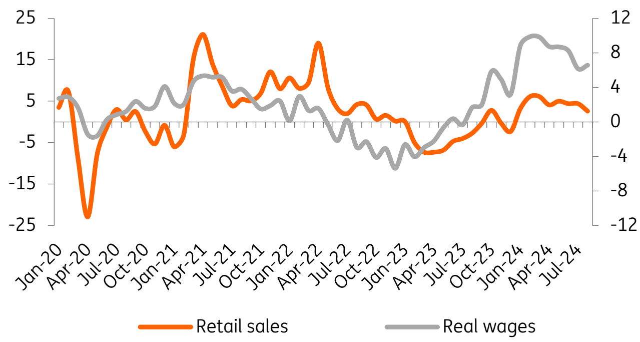
Source: National sources, ING estimates

GDP composition (%YoY)



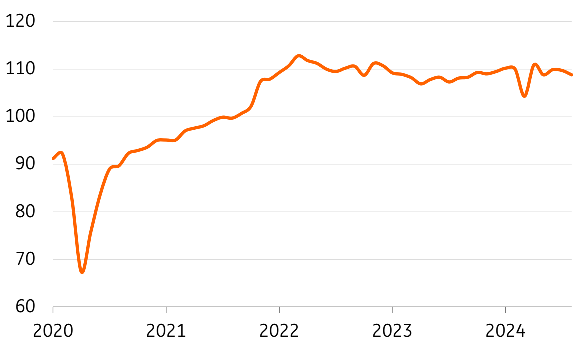
Source: Polish Statistical Office, ING forecast

Real wages in enterprises and retail sales (%YoY)



Source: Statistics Poland

Manufacturing, 2021=100, SA



Source: Statistics Poland

Country strategy: Outperformance despite EZ stagnation

The Polish economy is recovering, driven by the highest real income growth in over 20 years. In 2025, investments from overdue RFF projects should restart, so the economy should continue to outperform the Eurozone and some CEE peers, despite German stagnation. Due to strong growth of labour costs, the NBP's fight to control inflation seems to lag others, leading to our and the central bank's sticky core inflation forecasts. The NBP can start cuts only in 2Q25, with a shallow 100bp easing cycle in 2025. While CEE peers and many DM central banks ease, the NBP's reluctance should help PLN. The 2025 budget assumes record borrowing needs, mostly covered by local savings. However, loose fiscal policy is a problem in many EMs and DMs, while Poland's sovereign credit risk seems contained, so we think POLGBs offer should attract some foreign capital, subject to the higher risk premium they can provide.

NBP lagging with monetary easing as CPI is sticky

Economic recovery is continuing but remains uneven, particularly in terms of timing and structure. 1Q24 GDP data disappointed investors, but 2Q24 economic performance was stronger than expected. The external environment deteriorated in 3Q24 as the euro area showed renewed signs of weakness, the Chinese economy was shaky and the US labour market cooled. High-frequency data suggests that GDP growth in 3Q24 probably slid back below 3% YoY again. As for the structure of economic growth, it remains mainly driven by consumption due to the improvement in real disposable incomes following an easing in consumer inflation in 1H24 and continued double-digit wages growth. At the same time, manufacturing performance remained lacklustre and construction activity remained in the doldrums. Fixed investment bounced back in 2Q24 (2.7%YoY) after a decline in 1Q24 (-1.8%YoY) but given that investment outlays in mid-size and large enterprises continued nose-diving in 2Q24, we attribute the surprisingly strong reading to public spending on defence. We still believe that the improvement in real disposable incomes leaves enough room for both higher spending and savings rebuilding, but a persistently high propensity to save and an inflation rebound in 2H24 are expected to translate into slower consumption growth for the remainder of the year. Still, we stick to our forecast of 3% economic growth for 2024 and project it to accelerate to 3.5% in 2025 as fixed investment should rebound on investment led by the EU money (both cohesion funds and RRF).

Having reached local bottom at 2.0% YoY in March, headline inflation subsequently bounced back and is currently almost twice as high as the NBP target of 2.5% (4.9%YoY in September). Inflation was boosted by the partial withdrawal of measures protecting households from the high energy prices of the previous couple of years. Therefore, we see past inflation only now being unveiled in the headline figure. Since some protective measures remain in place in 2H24 (cap on electricity price, exception from the capacity fee), we may still see a jump in energy prices in 1Q25.

Since headline inflation remains on an upward trend in Poland and should peak in March 2025, and core CPI is also more sticky than for CEE peers (NBP core projection is 3.8-3.5% YoY for 2025-26, above the Czech Republic and even Hungary), the NBP is not following the global trend of monetary easing. Unless the relatively restrictive monetary policy increases and a widening of interest rate disparity leads to excessive firming of the PLN, the Polish MPC is likely to postpone rate cuts until Spring 2025. We expect the first 25bp rate cut in 2Q25 and believe rates may go down by 100bp next year.

Poland

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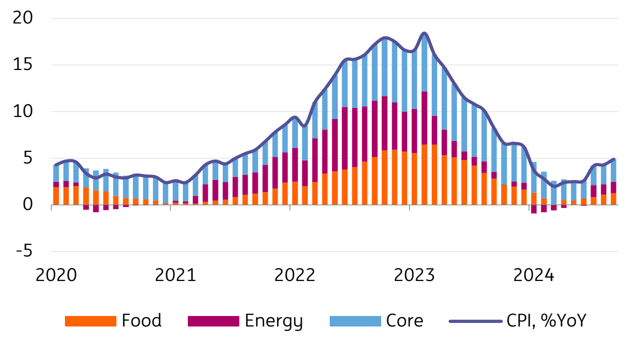
CPI inflation and its composition (%, percentage points)

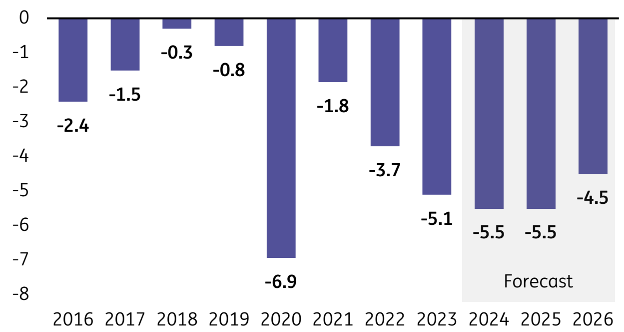


Source: Statistics Poland, ING forecast

Inflation high on energy and core

Headline inflation increased in July due to the partial normalisation of energy prices for households as some protective measures were removed and added 1.3ppt. Underlying inflation trends are also concerning. Core inflation is projected to run above 4% YoY in the coming months and its persistency is linked to the tight labour market, robust wages growth and buoyantly rising services prices. Poland is less advanced in containing inflation than other countries so the NBP is likely to lag behind other central banks in starting a monetary easing cycle. Still, headline inflation is projected to ease towards 3-3.5% YoY in 4Q25 so we see room for 100bp of monetary easing in 2025. In our view, the March 2025 NBP projection and expected turnaround in CPI after March 2025, will convince the MPC to start the easing cycle in 2Q25.

General government balance (% of GDP)

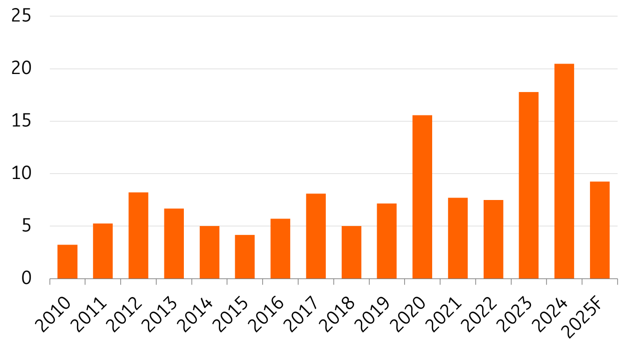


Source: Source: Eurostat, ING forecast

Authorities to opt for backloaded fiscal consolidation

Despite the excessive deficit procedure imposed on Poland in mid-2024, the 2025 draft budget remains expansionary. Authorities now expect the fiscal imbalance in 2024 to be wider than previously projected, increasing from 5.1% to 5.7% of GDP. The planned structural adjustment is minimal, around 0.2% of GDP. The government appears to be delaying significant adjustments and avoiding austerity measures in 2025, likely due to the upcoming presidential elections. The pursuit of multiple fiscal goals, such as increased spending on the military, healthcare and social programmes, may prove unsustainable and require future re-evaluation. We see adjustment in 2026, mainly based on cyclical improvement of revenues, such as closing the VAT gap, which should boost revenues a few quarters after GDP reaccelerates.

Minimum wage (%YoY)

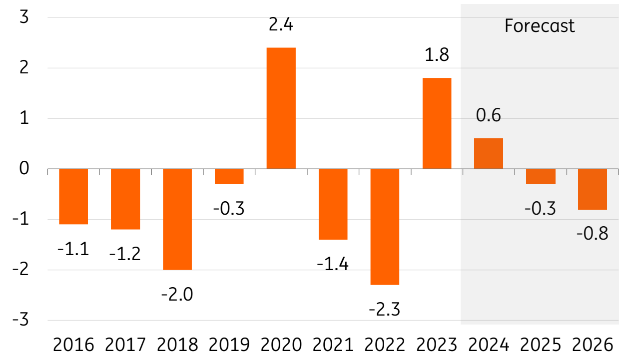


Source: Ministry of Finance

Wages growth should ease somewhat

Although wages continue rising at a double-digit pace, the rate of increase has slowed in recent months with a slight cooling of the labour market. In 2025, we project wage growth to moderate to a single-digit rate. First, the planned increase in minimum wage is set to be visibly lower than in the previous two years (8.5% vs 20% in 2024). Second, lower inflation in 2024 will reduce indexation of wages. Third, a deterioration in profitability of enterprises makes them less eager to hike renumeration, especially as labour cost is one of the top barriers in business surveys. In addition, a slight decline in employment may slightly reduce bargaining power of some workers. Overall, the labour market remains positive, with unemployment expected to stay near record lows due to limited labour supply from demographic factors and slowed immigration.

Current account balance (% of GDP)



Source: NBP, ING forecast

Poland's external remains strong but should moderate

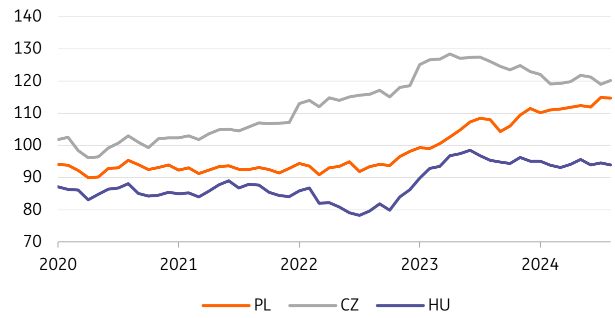
In the economically stagnant 2023, but with normalised imported energy commodity prices, Poland's external position posted a solid surplus of 1.8% of GDP after a deficit of 2.3% of GDP in 2022. As consumption demand has recovered in 2024 and external demand, especially from Germany, has remained subdued, the current account surplus is set to decline to 0.6% of GDP this year.

As Poland's GDP accelerates in 2025-26 supported by investments, and large deliveries of imported military equipment are continued, we project Poland's external current account position to reach a deficit of 0.3% of GDP in 2025 and 0.8% of GDP in 2026. Exports will be affected by slow growth in the Eurozone and a strong PLN while domestic demand supports imports.

Poland

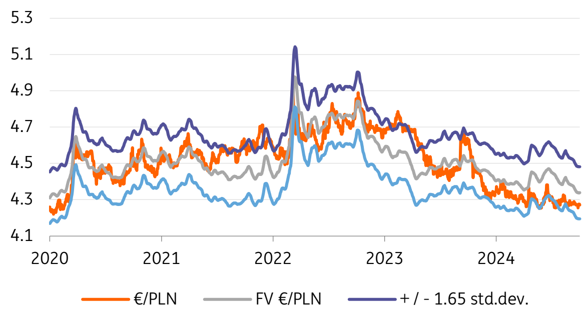
Strategy

CEE real effective exchange indices



An increase represents appreciation of CEE currency
Source: IMF

€/PLN – ING relative value model



Source: Macrobond, ING estimates

FX strategy

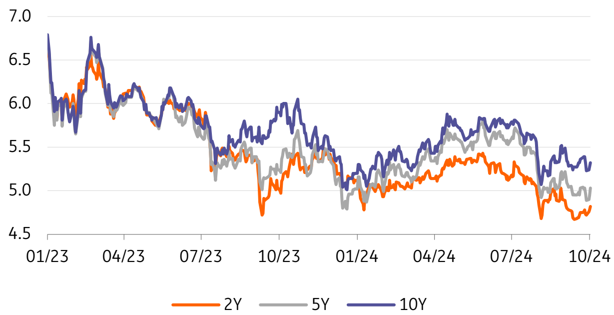
After an initial positive reaction to the Fed cut and the stimulus package in China, the €/PLN rate resumed range trading. We look for the currency to remain range-bound, until another wave of risk-on. With further rapid Fed and ECB easing around the corner, the general EM sentiment should remain at least mildly positive. The NBP is expected to lag other central banks in its delivery of cuts (given elevated inflation), which should help the zloty.

Our relative value model (gauging the zloty against other market variables, such as swaps) shows some more scope for potential €/PLN decline late this year. This chiefly reflects repricing of core central banks' policy easing paths, as the market positions for the NBP policy easing to remain aggressive.

In a supportive external environment we may see €/PLN re-testing this year's lows (at around 4.25). Fundamentally, the model shows scope for an even stronger move, to as low as 4.20, but it is unlikely to last long. Consequently, we lower our late-2024/early-2025 €/PLN path.

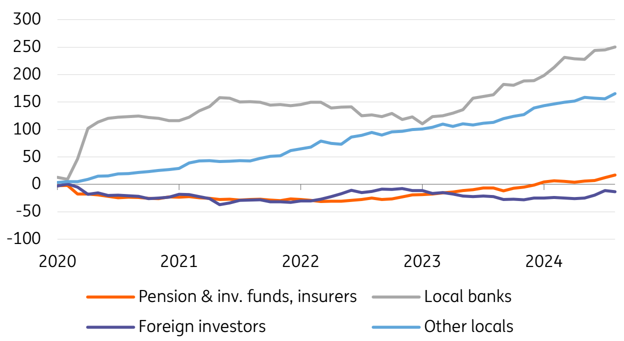
We see long-term prospects for the zloty as mixed. The government should retain the option to stabilise the zloty for multiple quarters, choosing whether EU funds are converted into PLN on the market or via the NBP. This should, to a large extent, offset risks for the zloty after the NBP starts to catch up with core central banks with its policy easing.

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



Source: Macrobond

Structure of POLGBs holders; change since January 2022



Source: MinFin

Fixed income strategy

July brought some foreign demand for POLGBs, likely on the back of global repricing in response to the Fed and ECB easing paths. Still, local investors should remain the government's key funders. Record-high 2025 borrowing needs make it a risky prospect for foreigners to approach the market just yet on a larger scale. At the same time, the government has been relatively slow in starting new EU co-financed projects, so corporate credit recovery should be lacklustre. This suggests a further build-up in over liquidity in the banking sector, so we expect solid local demand for POLGBs at the year end, also supported by redemptions.

As high issuance starts to pour in, 2025 should be the test for the market. However loose fiscal policy is a problem in many emerging and developed markets, while Poland's sovereign credit risk seems limited and the economy should again outperform the rest of the EU with strong GDP in 2024-25. So we think, POLGBs should attract more foreign capital than in recent years, but that will require higher spreads against the core market yield curves. With emerging and developed market easing cycles accelerating, a higher premium in POLGBs may bring some foreign inflow.

When it comes to the short end of the curve, Poland is in a different situation to core and other CEE peers given its sticky core inflation. But easing elsewhere should maintain firm cut expectations and the MPC is unlikely to sway the market away from pricing out a relatively aggressive NBP easing path anytime soon, so we do not look for major short end changes.

Poland

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	3.8	4.4	3.0	5.1	5.9	4.5	-2.0	6.9	5.6	0.2	3.0	3.5	3.8
Private consumption (%YoY)	3.4	3.8	3.6	6.3	4.4	3.5	-3.6	6.2	5.4	-1.0	4.2	3.5	3.9
Government consumption (%YoY)	4.0	2.4	2.0	2.7	3.5	6.5	4.9	5.0	0.5	2.8	10.1	3.6	3.0
Investment (%YoY)	11.7	6.9	-7.6	1.6	12.6	6.2	-2.3	1.2	2.7	13.1	0.5	9.5	9.2
Industrial production (%YoY)	4.1	6.0	3.6	6.2	5.4	5.1	-1.9	14.7	9.1	-1.9	1.3	3.2	4.2
Unemployment rate (year-end, %)	11.4	9.7	8.2	6.6	5.8	5.2	6.8	5.8	5.2	5.1	5.1	4.9	4.7
Nominal GDP (PLNbn)	1,701	1,798	1,853	1,983	2,127	2,288	2,338	2,631	3,075	3,410	3,630	3,936	4,211
Nominal GDP (€bn)	406	430	425	465	499	532	527	576	656	751	846	920	975
Nominal GDP (US$bn)	538	477	470	525	589	596	599	682	689	812	924	1,012	1,072
GDP per capita (US$)	14,005	12,405	12,231	13,661	15,320	15,528	15,628	17,863	18,226	21,527	24,558	26,962	28,617
Gross domestic saving (% of GDP)	21.4	23.1	23.2	22.9	23.5	24.2	24.4	25.1	23.9	24.1	21.9	22.2	22.3
Prices													
CPI (average, %YoY)	0.0	-0.9	-0.6	2.0	1.6	2.3	3.4	5.1	14.4	11.4	3.6	4.6	3.0
CPI (year-end, %YoY)	-1.0	-0.5	0.8	2.1	1.1	3.4	2.4	8.6	16.6	6.2	4.7	3.1	3.6
Wage rates (nominal, %YoY)	3.8	3.5	4.1	5.6	7.1	6.6	4.8	8.6	12.9	12.7	14.1	8.0	6.5
Fiscal balance (% of GDP)													
Consolidated government balance	-3.7	-2.6	-2.4	-1.5	-0.2	-0.7	-6.9	-1.8	-3.4	-5.1	-5.5	-5.5	-4.5
Consolidated primary balance	-1.7	-0.8	-0.7	0.1	1.2	0.6	-5.6	-0.7	-1.9	-3.0	-3.3	-3.1	-2.4
Total public debt	51.4	51.3	54.5	50.8	48.7	45.7	57.2	53.6	49.2	49.6	55.1	59.4	61.8
External balance													
Exports (€bn)	152.8	164.0	169.2	191.2	205.2	220.3	220.5	263.6	324.3	335.6	342.2	366.8	386.5
Imports (€bn)	160.7	166.2	170.6	196.0	216.4	224.7	213.6	271.3	346.3	330.8	349.5	383.0	408.9
Trade balance (€bn)	-7.9	-2.1	-1.3	-4.8	-11.3	-4.4	7.0	-7.7	-22.0	4.7	-7.3	-16.2	-22.4
Trade balance (% of GDP)	-1.9	-0.5	-0.3	-1/0	-2.3	-0.8	1.3	-1.3	-3.4	0.6	-0.8	-1.6	-2.1
Current account balance (€bn)	-11.9	-5.7	-4.5	-5.5	-9.9	-1.4	12.6	-7.8	-14.9	13.5	6.0	-3.0	-8.2
Current account balance (% of GDP)	-2.9	-1.3	-1.1	-1.2	-2.0	-0.3	2.4	-1.4	-2.3	1.8	0.6	-0.3	-0.8
Net FDI (€bn)	10.6	9.7	3.5	7.5	14.7	12.1	13.3	23.1	27.2	18.1	14.8	18.8	22.3
Net FDI (% of GDP)	2.6	2.3	0.8	1.6	2.9	2.3	2.5	4.0	4.2	2.4	1.6	1.9	2.1
Current account balance plus FDI (% of GDP)	-0.3	0.9	-0.2	0.4	1.0	2.0	4.9	2.7	1.9	4.2	2.3	1.6	1.3
Foreign exchange reserves (€bn)	82.6	86.9	108.1	94.6	102.3	114.5	125.6	146.6	156.5	175.4	201.5	216.2	234.9
Import cover (months of merchandise imports)	6.2	6.3	7.6	5.8	5.7	6.1	7.1	6.5	5.4	6.4	6.9	6.8	6.9
Debt indicators													
Gross external debt (€bn)	294.1	304.2	321.8	320.3	317.9	317.3	307.9	324.0	352.1	387.9	418.9	430.2	443.5
Gross external debt (% of GDP)	72.5	70.7	75.7	68.8	63.7	59.6	58.5	56.3	53.7	51.5	49.5	46.8	45.5
Gross external debt (% of exports)	192.4	185.5	190.1	167.5	154.9	144.0	139.6	122.9	108.6	115.6	122	117	115
Lending to corporates & households (% of GDP)	56.7	57.2	58.1	56.2	56.3	55.0	54.0	50.5	43.8	39.5	38.5	36.4	35.5
Interest & exchange rates													
Central bank key rate (year-end, %)	2.00	1.50	1.50	1.50	1.50	1.50	0.10	1.75	6.75	5.75	5.75	4.75	4.25
Broad money supply (average, %YoY)	6.5	8.4	10.2	6.1	7.0	9.5	14.9	10.6	7.1	7.5	7.5	7.9	7.8
3m interest rate (WIBOR, average, %)	2.51	1.75	1.70	1.73	1.71	1.72	0.66	0.55	6.04	6.53	5.87	5.45	4.53
3m interest rate spread over EURIBOR (ppt)	230	177	196	206	203	208	109	110	569	310	227	285	223
2yr yield (average, %)	2.48	1.73	1.66	1.89	1.59	1.57	0.53	0.83	6.33	5.67	5.28	4.88	4.55
10yr yield (average, %)	3.52	2.71	3.05	3.44	3.22	2.38	1.52	1.95	6.11	5.83	5.65	5.97	5.63
USD/PLN exchange rate (year-end)	3.51	3.90	4.18	3.48	3.76	3.80	3.76	4.06	4.40	3.94	3.86	3.91	3.95
USD/PLN exchange rate (average)	3.16	3.77	3.94	3.78	3.61	3.84	3.90	3.86	4.46	4.20	3.93	3.89	3.93
EUR/PLN exchange rate (year-end)	4.26	4.26	4.42	4.17	4.30	4.26	4.61	4.60	4.69	4.35	4.25	4.30	4.33
EUR/PLN exchange rate (average)	4.19	4.18	4.36	4.26	4.26	4.30	4.44	4.57	4.69	4.54	4.29	4.28	4.32

Source: National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	0.5	1.0	2.0	3.2	2.8	3.7	3.2	3.1	3.3	4.1	4.1	3.5	3.4
CPI (eop, %YoY)	8.2	6.2	2.0	2.6	4.9	4.7	6.0	5.3	3.9	3.1	3.0	3.0	2.9
Central bank key rate (eop, %)	6.00	5.75	5.75	5.75	5.75	5.75	5.75	5.50	5.00	4.75	4.50	4.25	4.25
3m interest rate (eop, %)	5.77	5.88	5.88	5.85	5.85	5.90	5.87	5.53	5.12	4.95	4.62	4.45	4.45
10yr yield (eop, %)	5.91	5.20	5.43	5.74	5.40	5.67	6.01	6.08	5.96	5.91	5.72	5.51	5.55
USD/PLN exchange rate (eop)	4.37	3.94	3.99	4.03	3.82	3.86	3.87	3.88	3.90	3.91	3.92	3.93	3.94
EUR/PLN exchange rate (eop)	4.64	4.35	4.30	4.31	4.28	4.25	4.26	4.27	4.29	4.30	4.31	4.32	4.33

Source: National sources, ING estimates

Romania

Valentin Tataru, Chief Economist | Stefan Posea, Economist

Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	0.8	1.2	2.5	2.5	3.3	1.3	3.0
CPI (%YoY)*	4.8	4.3	4.2	3.4	4.1	5.4	3.8
Policy interest rate (eop, %)	7.00	6.50	6.50	6.25	6.00	6.50	5.50
3m interest rate (%)*	6.01	5.55	5.55	5.30	5.05	5.81	5.05
10yr yield (%)*	6.90	6.65	6.50	6.30	6.30	6.60	6.10
USD/RON*	4.61	4.53	4.56	4.56	4.60	4.57	4.57
EUR/RON*	4.98	4.98	4.98	4.98	5.02	4.98	5.02

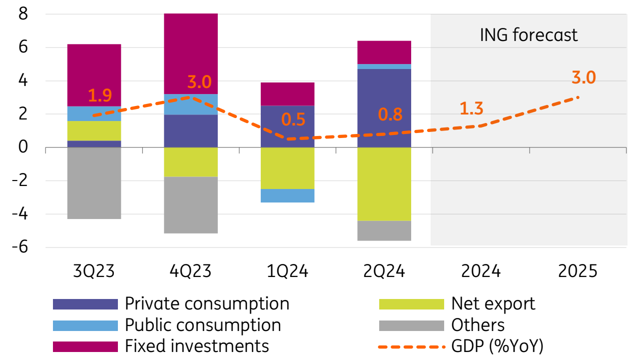
Macro trend		Political cycle	Ratings	FC	LC
Activity	Slowing	Presidential: Dec 2024	S&P	BBB-	BBB-
Fiscal	Loose	Parliament: Dec 2024	Moody's	Baa3	Baa3
Monetary	Restrictive	Local: 2028	Fitch	BBB-	BBB-

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

Country strategy: Buy time and hope for growth to come

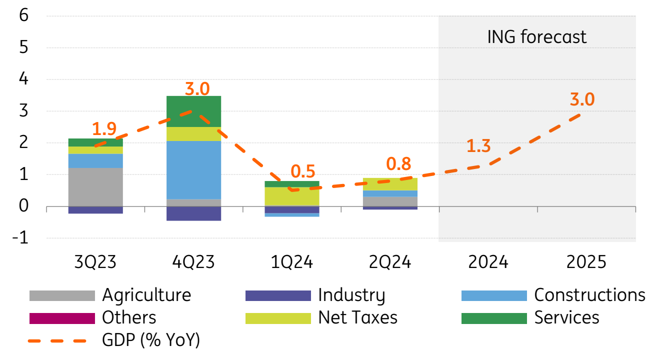
While the twin deficits are anything but new to the country, most of the time Romania has had one thing to keep bad metrics in check: rapid growth. With growth fading, the fiscal problem only becomes bigger and more imminent. We expect a relatively slow-paced deficit reduction to start in 2025. Too abrupt tax hikes would impact the economy, but doing nothing is not an option. In the discussions with the European Commission (EC), the local officials are likely to play the 'Romania needs investments' card, hence the future government is expected to strike a fine balance between delivering some fiscal tightening while continuing the current investment cycle and not rushing into significant tax hikes. Some additional monetary easing being implemented while maintaining caution is likely to help as well.

GDP (YoY%) and components (ppt)



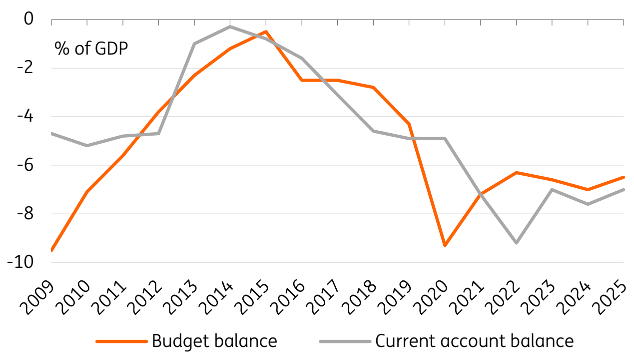
Source: NIS, ING

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



Source: NIS, ING

Twin deficits remain the main headache for policy makers



Source: NIS, ING

Slower growth exposes the high deficits

The economy expanded by 0.7% in the first half of 2024, well below most expectations and slightly decoupled from the high-frequency data. Essentially, internal demand came up quite strongly and investments remained robust as well, but most of these gains seem to have been lost in higher imports, while the external demand for Romania's exports has been marginally declining.

Crunching the numbers a bit, we see that the advance in wages remained eye-catchingly strong at around 14.0%, with public sector wage growth flirting with the 20.0% level. Consumers did not waste much time acting on their increased real income, visible in the 3.7ppt that private consumption added to the 0.7% GDP growth in 1H24. Add to this 1.4ppt from the still resilient fixed capital formation and one might ask what could have stopped Romania from posting one of the highest semestrial growth rates ever. While there are several reasons for that, most of them revolve around the issue of domestic supply not being able to match domestic demand. With Romania posting a trade deficit in pretty much all major economic sectors, it is clear that a large part of the growth generated by internal demand is dissipated into imports. To add insult to injury, many of the investment projects that are underway are likely to have contributed to higher imports as well (through the acquisition of construction machines, building materials, etc) and even some of the wages gained in these activities are leaving the country given the growing levels of imported labour force into Romania. In numbers, imports subtracted 2.0ppt from growth. The external demand hasn't helped either, as exports subtracted 1.5ppt from the 0.7% growth. All said, 1H24 provided a somewhat bleak growth picture. We expect some quickening in the second half of 2024 to take full year growth to 1.3%. For 2025 and 2026 we maintain our 3.0% GDP growth estimates and, in general, we signal that Romania might have - prematurely? - transitioned to a lower growth regime of 3.0-3.5% rather than the 4.0% and more that had been easily achieved in previous years.

On the monetary policy front, the National Bank of Romania (NBR) is likely to continue with rate cuts into 2025, taking the key rate from the current 6.50% to an estimate of 5.50% by the year-end. This would bring the deposit facility (the effective policy rate) to 4.50% and the front end of the curve closer to that level. Key to the rates path will be the impact of the fiscal consolidation plan for growth and inflation. For now, we tend to think that the measures will tilt towards being more supportive for the disinflationary process rather than for growth, hence allowing for more monetary easing.

Romania

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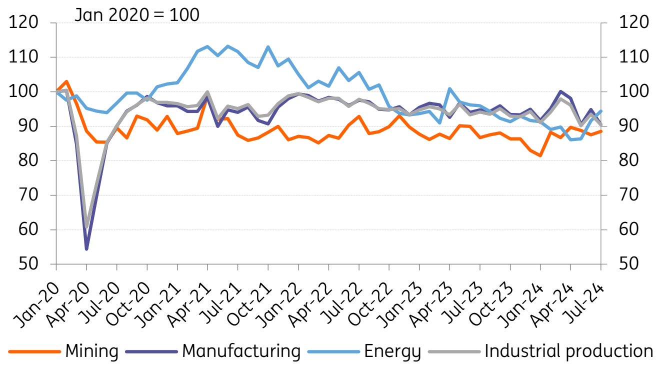
Industrial output remains below pre-pandemic levels

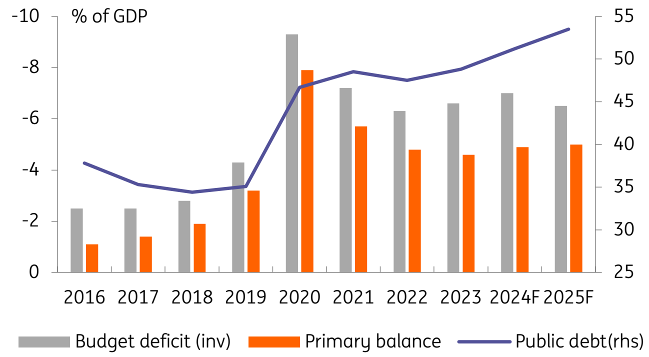


Source: NSI, ING

Structural weakness likely to persist

Industrial production continued to weaken this year, resuming the longer contractionary trend. Despite some signs of recovery in early 2024, the latest data confirms a decline, with year-to-date output down 1.4% at July mainly due to the manufacturing sector. While some order books showed temporary improvements earlier in the year, recent confidence indicators point to more pessimistic expectations, with further declines in inventories and cautious productions expectations. Given that Germany's structural challenges are unlikely to go away anytime soon, any meaningful rebound of local industrial output is likely to remain rather muted in the near term.

No end in sight for the EDP procedure

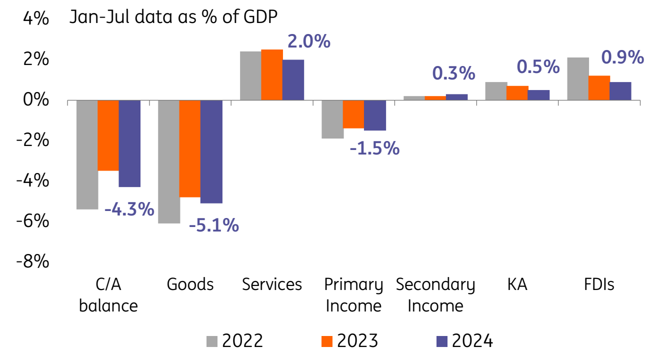


Source: MFin, ING

Fiscal slippage barely contained

The budget deficit looks set to remain the big macro headache for years to come in Romania. As of September, it reportedly reached 5.5% of GDP making our previous 7.0% forecast for 2024 to look quite optimistic. We have therefore revised it to 8.0% of GDP. Starting 2025, the new government is likely to enter into a 4-to-7 year agreement with the EC to reduce the deficit below 3.0% of GDP by the end of the agreement. A 7-year plan (the most likely choice for Romania) will allow a more gradual reduction of the deficit but will also cover another electoral cycle. We believe that the upcoming government's focus will be to deliver on the targets for the first 2-3 years, this way restoring some of the lost credibility in Romania's willingness to tackle the deficit issue. Given the weak starting point of this year, a 7.0% of GDP budget deficit in 2025 looks like a mildly optimistic scenario.

Current account remains under pressure

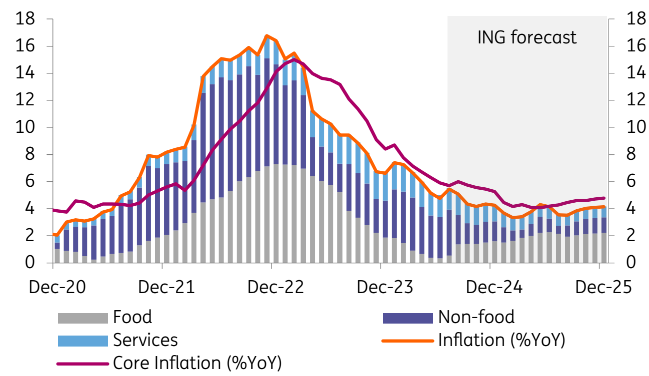


Source: NBR, ING

Strong consumption fuels imports again

The current account has started to re-widen again in 2024, as the fiscal stance remained loose, stimulating demand, and the better terms of trade which helped in 2023 have not helped again this year. The trade balance remains the main culprit as it looks to be heading towards -9.0-10.0% of GDP this year, with virtually all the main economic sectors experiencing a trade deficit. Moreover, the services surplus has started to diminish as well, most likely due to lower activity in the transportation and IT sectors. These developments are likely to push the current account deficit towards the 7.5-8.0% area by the end of 2024, with little prospects of a trend reversal given that the weak external demand looks set to continue while domestically we still see robust real wage gains.

Inflation (YoY%) and main components (ppt)



Source: NIS, ING

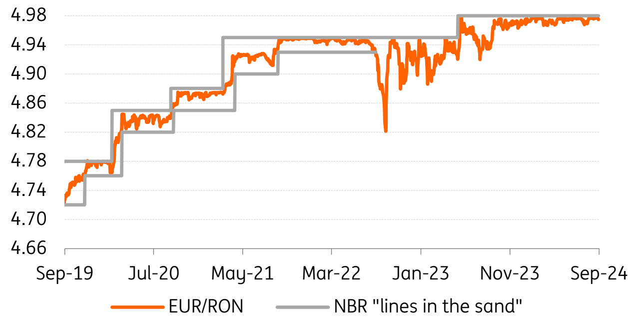
Inflation progress: far from calling it a win yet

Inflation looks bound to safely enter below the 5.0% level together with the September print and should continue descending to below 4.0% in 1Q25, only to come back to around 4.0% in the second half of the year. Through our entire forecast horizon, core inflation is likely to stay above the headline as services inflation looks set to remain stubbornly high. The fiscal consolidation plan will be key to the inflation outlook in 2025 as we look for a mix of measures that will impact prices and consumption. For now, we tend to think that the measures will tilt towards being more supportive for the disinflationary process rather than for growth, hence allowing for more monetary easing. All said, we expect 100bp of rate cuts in 2025, taking the key rate to 5.50% by year-end.

Romania

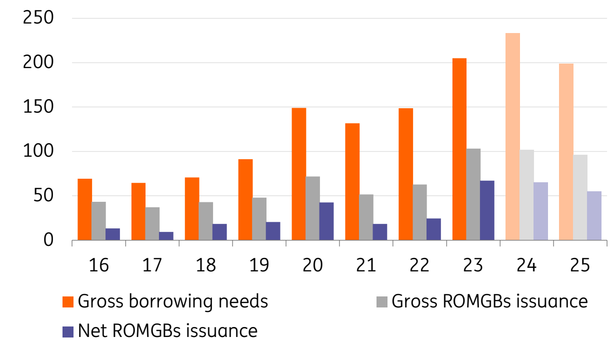
Strategy

Tightly managed floating



Source: Refinitiv, ING estimates

Borrowing needs and ROMGBs issuance



Source: MinFin, ING estimates

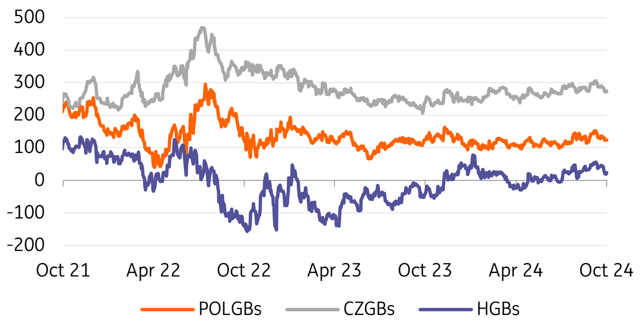
FX strategy *(with Frantisek Taborsky, EMEA FX & FI Strategist)*

EUR/RON has remained unchanged since the second half of last year, pegged in the 4.960-4.980 range, and it is hard to see any reason for change in the near future. Volatility has fallen to the freezing point plus carry has shrunk significantly due to rate cuts and tightening in FX implied yields. At the same time, NBR's FX reserves continue to rise to record highs in nominal terms, guaranteeing the smooth running of the current FX regime. Banking sector excess liquidity also remains elevated, further pushing money market rates and FX implied yields lower, effectively easing monetary conditions.

Thus, it seems that any upwards move in the EUR/RON level is again postponed. Inflation remains the number one priority for the central bank and loose fiscal policy creates a major risk to monetary policy. Romania's problem of having the highest current account deficit within the CEE peer group will thus have to wait a little longer while financing looks covered.

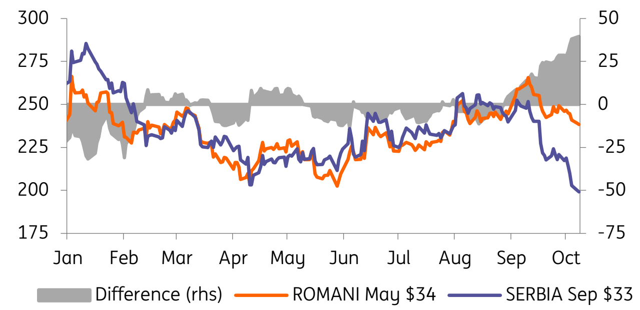
We expect EUR/RON to move above 5.00 in 2Q25, however, the central bank does not provide any forward guidance and timing will depend on other factors.

10y ROMGBs spreads vs CEE3 (bp)



Source: Refinitiv, ING

ROMANI $34 vs SERBIA $33 (bp)



Source: Refinitiv, ING

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

ROMGBs remain a major underperformer within the CEE region. The 10yr yield spread vs peers widened in September to its highest level since last November. We think the market is pricing in a public finance deficit in the range of 7-8% of GDP for this year, so there is still room for negative surprises and the political noise ahead of the election does not suggest sentiment improvement. Thus, we are waiting for some progress on the fiscal side after the November election, which should attract demand for duration.

Concerns about the ongoing fiscal deterioration, along with election noise may also continue to weigh on ROMANI sovereign credit. The focus for hard currency investors is likely to remain on the huge Eurobond issuance from the country, having already seen over US$18bn in sovereign issuance this year. The modest pace of fiscal consolidation is likely to mean heavy supply again in 2025, while any further disappointments after the elections could bring ratings concerns back into focus.

Romania

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	4.1	3.2	2.9	8.2	6.0	3.9	-3.7	5.7	4.1	2.1	1.3	3.0	3.0
Private consumption (%YoY)	3.5	5.8	6.4	11.7	9.4	3.3	-3.9	7.5	5.8	2.8	4.6	2.9	3.0
Government consumption (%YoY)	0.0	1.3	-9.5	11.5	-0.8	6.4	2.0	0.4	-3.3	6.0	2.5	1.6	1.7
Investment (%YoY)	5.4	7.7	-2.2	5.5	0.0	12.6	1.1	2.9	5.9	14.4	5.5	6.2	6.9
Industrial production (%YoY)	6.2	2.7	3.1	8.6	5.0	-2.6	-9.2	6.5	0.9	-2.5	-1.9	2.4	2.8
Unemployment rate (year-end, %)	6.8	6.8	5.9	5.7	4.2	3.9	5.0	5.6	5.6	5.6	5.5	5.4	5.3
Nominal GDP (RONbn)	669	713	752	852	959	1064	1056	1182	1401	1606	1734	1855	1983
Nominal GDP (€bn)	150	160	167	186	206	224	218	240	283	324	348	369	390
Nominal GDP (US$bn)	199	176	184	213	241	251	249	283	297	350	380	406	429
GDP per capita (US$)	10,000	8,900	9,400	10,800	12,400	12,900	12,900	14,800	15,600	18,400	20,000	21,400	22,700
Gross domestic saving (% of GDP)	24.6	24.7	22.7	21.4	20.0	20.2	20.2	20.6	20.4	20.9	21.0	21.0	21.0
Prices													
CPI (average, %YoY)	1.1	-0.6	-1.6	1.3	4.6	3.8	2.6	5.1	13.8	10.5	5.4	3.8	3.9
CPI (year-end, %YoY)	0.8	-0.9	-0.5	3.3	3.3	4.0	2.1	8.2	16.4	6.6	4.2	4.1	3.6
Wage rates (nominal, %YoY)	5.2	8.3	13.0	14.2	13.1	14.9	6.7	7.1	12.2	15.4	13.0	7.0	6.0
Fiscal balance (% of GDP)													
Consolidated government balance	-1.2	-0.5	-2.5	-2.5	-2.8	-4.3	-9.3	-7.2	-6.3	-6.6	-8.0	-7.0	-6.5
Consolidated primary balance	0.6	1.0	-1.1	-1.4	-1.9	-3.2	-7.9	-5.7	-4.8	-4.6	-6.3	-5.3	-4.5
Total public debt	39.1	37.7	37.8	35.3	34.4	35.1	46.7	48.5	47.5	48.8	52.9	53.7	54.5
External balance													
Exports (€bn)	52.5	54.6	57.4	62.6	67.7	69.0	62.2	74.7	91.9	93.1	94.5	100.6	108.1
Imports (€bn)	58.5	63.0	67.4	75.6	82.8	86.3	80.6	98.4	126.0	122.0	125.6	131.4	139.7
Trade balance (€bn)	-6.1	-8.4	-10.0	-13.0	-15.1	-17.3	-18.4	-23.7	-34.1	-28.9	-31.1	-30.8	-31.6
Trade balance (% of GDP)	-4.0	-5.2	-6.0	-7.0	-7.3	-7.7	-8.4	-9.9	-12.0	-8.9	-8.6	-8.4	-8.1
Current account balance (€bn)	-0.4	-1.3	-2.7	-5.8	-9.5	-10.9	-10.9	-17.4	-26.0	-22.6	-24.5	-26.0	-26.0
Current account balance (% of GDP)	-0.3	-0.8	-1.6	-3.1	-4.6	-4.9	-5.0	-7.3	-9.2	-7.0	-7.7	-7.0	-6.7
Net FDI (€bn)	2.7	2.9	4.8	4.8	4.9	4.8	2.9	8.8	8.8	6.6	7.1	8.7	9.2
Net FDI (% of GDP)	1.8	1.8	2.9	2.6	2.4	2.1	1.3	3.7	3.1	2.0	2.0	2.3	2.4
Current account balance plus FDI (% of GDP)	1.5	1.0	1.3	-0.5	-2.2	-2.7	-3.7	-3.6	-6.1	-5.0	-4.7	-4.7	-4.3
Foreign exchange reserves ex gold (€bn)	32.2	32.2	33.0	32.3	31.8	31.7	36.2	37.1	43.2	56.4	62.0	66.9	71.0
Import cover (months of merchandise imports)	6.6	6.1	5.9	5.1	4.6	4.4	5.4	4.5	4.1	5.5	5.7	5.8	5.8
Debt indicators													
Gross external debt (€bn)	97.2	94.7	94.3	97.4	99.8	109.8	126.8	136.6	143.9	170.0	183.6	196.5	210.0
Gross external debt (% of GDP)	65	59	56	52	48	49	58	57	51	53	53	53	54
Gross external debt (% of exports)	185	173	164	155	147	159	204	183	157	183	183	183	182
Lending to corporates/households (% of GDP)	31.0	29.9	28.5	26.5	25.4	24.5	25.7	26.5	24.7	23.2	24.7	24.9	25.4
Interest & exchange rates													
Central bank key rate (year-end, %)	4.00	2.75	1.75	1.75	1.75	2.50	1.50	1.75	6.75	7.00	6.50	5.50	4.50
Broad money supply (average, %YoY)	4.1	6.8	7.8	11.4	8.8	10.9	15.3	15.8	6.8	10.7	11.0	10.0	8.0
3m interest rate (Robor average, %)	2.54	1.40	0.89	1.15	2.80	3.15	2.38	1.82	6.19	6.68	5.81	5.05	4.65
3m interest rate spread over Euribor (ppt)	2.3	1.4	1.2	1.5	3.1	3.5	2.8	2.4	5.8	3.2	2.7	2.7	2.2
3yr yield (average, %)	3.3	1.9	1.5	1.9	3.7	3.7	3.3	2.9	7.2	6.5	6.3	5.7	5.2
10yr yield (average, %)	4.6	3.5	3.3	3.9	4.7	4.5	3.9	4.0	7.6	6.9	6.6	6.1	5.6
USD/RON exchange rate (year-end)	3.70	4.15	4.32	3.88	4.06	4.27	3.97	4.34	4.62	4.53	4.56	4.62	4.67
USD/RON exchange rate (average)	3.37	4.04	4.08	4.01	3.98	4.24	4.24	4.18	4.71	4.59	4.57	4.57	4.63
EUR/RON exchange rate (year-end)	4.48	4.52	4.54	4.66	4.66	4.78	4.87	4.95	4.94	4.97	4.98	5.05	5.12
EUR/RON exchange rate (average)	4.44	4.45	4.49	4.57	4.65	4.75	4.84	4.93	4.95	4.96	4.98	5.02	5.09

Source: National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q23	3Q26F
Real GDP (%YoY)	1.9	3.0	0.5	0.8	1.2	2.5	2.5	3.3	2.9	3.0	3.2	3.0	2.9
CPI (eop, %YoY)	8.8	6.6	6.6	4.8	4.3	4.2	3.4	4.1	3.8	4.1	4.2	4.1	4.0
Central bank key rate (eop, %)	7.00	7.00	7.00	7.00	6.50	6.50	6.25	6.00	5.75	5.50	5.25	5.00	4.75
3m interest rate (eop, %)	6.40	6.22	6.06	6.01	5.55	5.55	5.30	5.05	4.80	4.55	4.30	5.05	3.80
10yr yield (eop, %)	6.95	6.40	6.55	6.90	6.65	6.50	6.30	6.30	6.10	5.80	5.70	5.60	5.50
USD/RON exchange rate (eop)	4.69	4.52	4.61	4.61	4.53	4.56	4.56	4.60	4.62	4.62	4.62	4.64	4.64
EUR/RON exchange rate (eop)	4.97	4.97	4.98	4.98	4.98	4.98	4.98	5.02	5.02	5.05	5.05	5.10	5.10

Source: National sources, ING estimates

Serbia

Valentin Tataru, Chief Economist | Stefan Posea, Economist

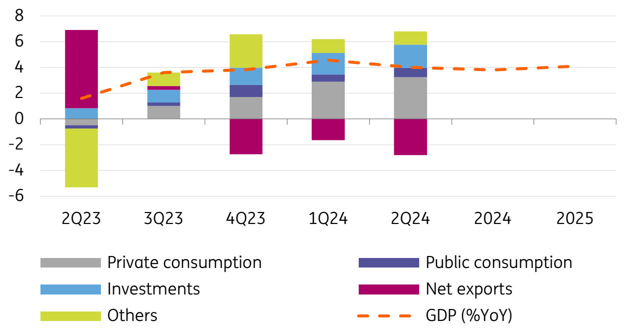
Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	4.0	3.4	3.5	3.9	4.2	3.8	4.1
CPI (%YoY)*	3.8	4.3	4.0	4.4	4.3	4.6	3.9
Policy interest rate (eop, %)	6.25	5.75	5.50	5.25	5.25	5.50	5.00
3m interest rate (eop, %)	5.45	4.95	4.70	4.50	4.45	5.20	4.20
10yr yield (eop, %)	5.92	5.80	5.70	5.65	5.60	5.70	5.50
USD/RSD (avg, ann)	117.1	117.09	117.08	117.05	117.05	107.4	106.4
EUR/RSD) avg, ann)	108.4	106.45	106.44	106.41	106.41	117.11	116.95

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

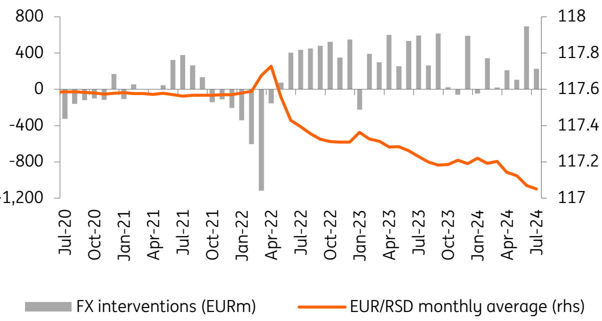
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

Real GDP (%YoY) and contributions (ppt)



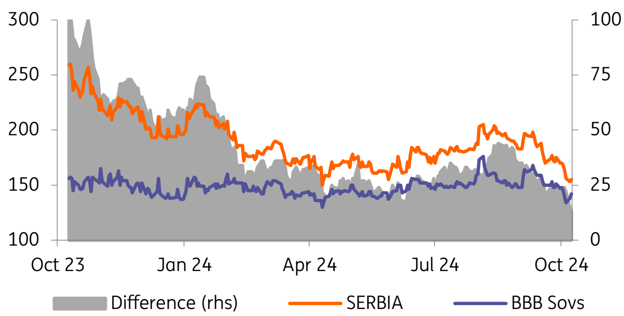
Source: Eurostat, ING

FX stability remains the main policy tool



Source: NBS, ING

SERBIA USD credit spreads vs BBB sovereigns (bp)



Source: ICE, Refinitiv, ING

Country strategy: Making deals with everyone

The Serbian economy is set to continue to perform well in the coming quarters. Growth has been above expectations so far in 2024, while inflation continued its downward trend. Moreover, the country is pursuing ambitious investment goals, with the EXPO 2027 event, the EC's New Growth Plan for the Western Balkans, and the IMF-agreed reforms taking centre stage. Furthermore, with debt and deficits also at reasonable levels, S&P lifted Serbia's rating to investment grade in early October. On the other hand, the country's geopolitical journey is less straightforward. Relations with Kosovo remain tense, Chinese FDIs have been advancing visibly and cooperation on the imposition of Russian sanctions is unlikely. That said, the Jadar lithium mining project – key in reducing the EU's reliance on Chinese-dominated mineral supply chains – bodes well for the alignment of EU-Serbia commercial interests.

Growth prospects look solid

Activity advanced through the first half of 2024 on a strong footing. Private and public consumption, as well as investments, grew at a solid pace. That said, imports outpaced exports, fuelled by double-digit wage growth. Overall, we expect a 3.8% GDP expansion in 2024, with downside risks amid a stronger base effect driven by the upward revision of 2023 GDP. Lower interest rates and a more expansionary fiscal stance – amid the large investment needs – will stimulate activity and productivity. In numbers, EXPO 2027 is valued at around €17.8bn (23% of the estimated 2024 GDP) and will be spread across 323 projects across the country. What's more, subject to EU-agreed reforms, Serbia will also benefit from its share in the New Growth Plan for the Western Balkans (2024-2027) of €1.5bn.

Inflation to moderate further and FX stability to persist

Price pressures stood at 4.3% in August, remaining in the upper range of the target, while the central bank has so far eased policy by 75bp since June (cutting from 6.50% to 5.75%). Our view is that demand pressures stemming from solid growth and income rises will continue to keep inflation in check. We forecast a gradual disinflation trend ahead and expect price pressures to stabilise slightly above the midpoint of the target, at 3.5%, through the medium term. We expect one more 25bp cut this year, taking the key rate to 5.50%. On FX, we continue to see stability ahead. Gross FX reserves reached a record high of €28.2bn in August as the NBS has been continually buying EUR to mute the dinar appreciation pressures.

Sovereign credit: Macro improvement tops political tensions

With strong fiscal performance compared to most CEE peers, Serbia has been rewarded with its first upgrade to IG and investors have been taking a similar view. Despite a lack of clear pathway towards easing tensions with Kosovo, the improving macro metrics have outweighed the political risk, with Serbia's dollar bonds now trading comfortably in IG territory and compressing towards the BBB-sovereign average. We see scope for the strong performance to continue as the other rating agencies catch up with S&P and robust macro performance continues to outshine CEE peers.

James Wilson, EM Sovereign Strategist

Serbia

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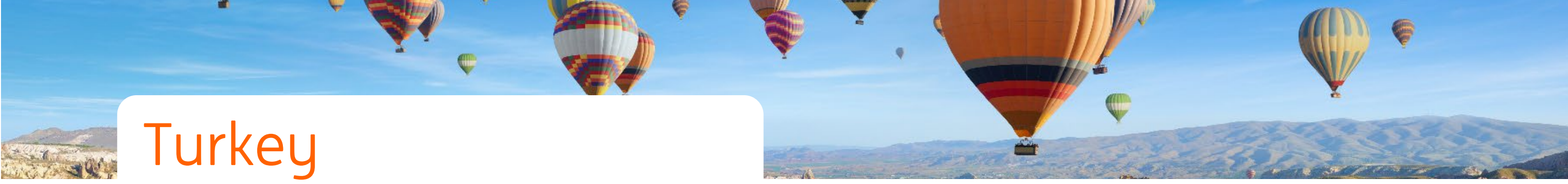
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	-1.6	1.8	3.3	2.1	4.5	4.3	-0.9	7.7	2.5	2.5	3.8	4.1	4.2
Private consumption (%YoY)	-0.1	-0.6	1.9	2.2	3.1	3.7	-1.9	7.8	4.0	0.8	3.1	3.3	3.4
Government consumption (%YoY)	0.9	-3.7	0.0	2.9	3.7	1.9	2.8	4.1	0.4	0.3	1.6	0.9	1.5
Investment (%YoY)	-3.4	6.2	5.1	6.6	17.5	17.2	-1.9	15.7	1.9	3.9	5.2	4.8	4.4
Industrial production (%YoY)	-7.3	7.3	5.2	3.9	1.3	0.3	0.4	6.4	1.6	2.4	4.0	3.2	3.0
Unemployment rate (average, %)	20.6	18.9	16.4	14.5	13.7	11.2	9.7	11.1	9.5	9.4	8.6	8.6	8.5
Nominal GDP (RSDbn)	4,161	4,315	4,528	4,761	5,073	5,422	5,504	6,272	7,098	8,150	8,805	9,509	10,232
Nominal GDP (€bn)	34.4	35.5	36.7	40.2	42.9	46.1	46.8	53.3	60.5	69.6	75.2	81.3	87.5
Nominal GDP (US$bn)	47.3	50.8	50.8	43.5	45.4	51.5	53.8	62.9	63.4	75.1	82.0	89.4	96.2
GDP per capita (US$)	6,700	7,200	7,300	6,200	6,500	7,500	7,800	9,300	9,500	11,300	12,400	13,800	14,800
Gross domestic saving (% of GDP)	8.4	11.6	13.3	13.0	14.0	15.2	15.9	17.2	15.5	16.9	15.7	14.5	13.4
Prices													
CPI (average, %YoY)	2.1	1.4	1.1	3.1	2.0	1.9	1.6	4.1	11.9	12.5	4.6	3.9	3.4
CPI (year-end, %YoY)	1.8	1.6	1.5	3.0	2.0	1.9	1.3	7.9	15.1	7.6	4.0	3.4	3.5
Wage rates (nominal, %YoY)	1.4	-0.2	3.7	4.0	3.7	10.6	9.4	9.6	13.8	14.8	12.0	10.0	8.8
Fiscal balance (% of GDP)													
Consolidated government balance	-6.2	-3.5	-1.2	1.1	0.6	-0.2	-8.0	-4.1	-3.2	-2.2	-2.9	-2.3	-2.0
Consolidated primary balance	-3.5	-0.4	1.7	3.6	2.8	1.8	-6.1	-2.5	-1.8	-0.5	-1.3	-0.6	-0.4
Total public debt	67.5	71.2	68.7	58.6	54.4	52.8	60.0	57.1	55.6	52.3	51.8	50.1	49.8
External balance													
Exports (€bn)	11.2	12.0	13.5	15.1	16.4	17.7	17.1	21.9	27.6	28.6	29.7	30.8	31.9
Imports (€bn)	15.2	16.1	17.1	19.5	22.1	24.1	23.1	28.9	39.0	36.9	39.8	43.0	46.5
Trade balance (€bn)	-4.0	-4.0	-3.6	-4.4	-5.7	-6.4	-5.9	-7.1	-11.4	-8.2	-10.1	-12.2	-14.5
Trade balance (% of GDP)	-11.7	-11.4	-9.9	-11.0	-13.2	-13.9	-12.7	-13.3	-18.9	-11.8	-13.5	-15.0	-16.6
Current account balance (€bn)	-2.0	-1.2	-1.1	-2.1	-2.1	-3.2	-1.9	-2.3	-4.2	-1.8	-2.5	-2.7	-2.7
Current account balance (% of GDP)	-5.8	-3.5	-2.9	-5.1	-4.8	-6.9	-4.1	-4.2	-6.9	-2.6	-3.3	-3.3	-3.1
Net FDI (€bn)	1.2	1.8	1.9	2.4	3.2	3.6	2.9	3.7	4.3	4.2	4.4	4.5	4.7
Net FDI (% of GDP)	3.6	5.1	5.2	6.0	7.4	7.7	6.3	6.9	7.2	6.0	5.8	5.6	5.4
Current account balance plus FDI (% of GDP)	-2.2	1.6	2.2	0.9	2.5	0.8	2.2	2.6	0.3	3.4	2.5	2.3	2.3
Foreign exchange reserves ex gold (€bn)	9.9	10.4	10.2	10.0	11.3	13.4	13.5	16.5	19.4	24.9	30.0	29.0	30.0
Import cover (months of merchandise imports)	7.8	7.7	7.2	6.1	6.1	6.7	7.0	6.8	6.0	8.1	9.0	8.1	7.7
Debt indicators													
Gross external debt (€bn)	25.7	26.2	26.5	25.5	26.7	28.3	30.8	36.5	41.9	45.4	46.5	47.7	48.9
Gross external debt (% of GDP)	74.7	73.9	72.2	63.5	62.1	61.3	65.8	68.4	69.2	65.3	61.9	58.7	55.9
Gross external debt (% of exports)	230	218	197	169	163	160	180	167	152	159	157	155	153
Lending to corporates/households (% of GDP)	40.8	40.6	40.9	40.3	41.4	42.0	45.5	43.4	40.3	35.8	37.2	38.7	40.3
Interest & exchange rates													
Central bank key rate (year-end, %)	8.00	4.50	4.00	3.50	3.00	2.25	1.00	1.00	5.00	6.50	5.50	5.00	4.50
Broad money supply (average, %YoY)	7.6	6.6	11.6	3.6	14.5	8.4	18.1	13.3	6.9	12.7	12.0	8.0	10.0
3m interest rate (Belibor, year-end, %)	9.85	3.83	3.47	3.12	3.03	1.64	0.90	0.94	4.95	5.70	4.70	4.20	3.70
3m interest rate spread over Euribor (ppt)	9.7	3.9	3.8	3.4	3.3	2.0	1.3	1.5	4.5	2.3	1.5	1.9	1.4
3yr yield (year-end, %)	n/a	n/a	n/a	n/a	n/a	3.2	2.1	2.4	6.0	5.8	4.50	4.40	4.30
10yr yield (year-end, %)	n/a	n/a	n/a	n/a	4.8	4.0	3.1	3.6	7.0	6.3	5.70	5.50	5.50
USD/RSD exchange rate (year-end)	86.2	83.1	99.5	111.2	117.1	105.0	96.4	103.1	109.6	106.5	106.4	106.4	106.3
USD/RSD exchange rate (average)	88.0	84.9	89.1	109.4	111.8	105.2	102.3	99.6	111.9	108.6	107.4	106.4	106.3
EUR/RSD exchange rate (year-end)	121.0	121.6	123.5	118.5	118.2	117.6	117.6	117.6	117.3	117.2	117.05	117.00	116.90
EUR/RSD exchange rate (average)	117.4	120.8	123.2	121.3	118.3	117.8	117.6	117.6	117.5	117.3	117.11	117.03	116.95

Source: National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	3.6	3.8	4.6	4.0	3.4	3.5	3.9	4.2	4.1	4.2	4.3	4.2	4.3
CPI (eop, %YoY)	10.2	7.6	5.0	3.8	4.3	4.0	4.4	4.3	3.5	3.4	3.4	3.4	3.5
Central bank key rate (eop, %)	6.50	6.50	6.50	6.25	5.75	5.50	5.25	5.25	5.25	5.00	4.75	4.75	4.75
3m interest rate (eop, %)	5.70	5.70	5.70	5.45	4.95	4.70	4.50	4.45	4.30	4.20	3.95	3.90	3.90
10yr yield (eop, %)	6.50	6.30	6.20	5.92	5.80	5.70	5.65	5.60	5.60	5.50	5.45	5.45	5.40
USD/RSD exchange rate (eop)	117.20	117.17	117.19	117.1	117.09	117.08	117.05	117.05	117.05	117.10	116.99	116.95	117.05
EUR/RSD exchange rate (eop)	110.57	106.52	108.51	108.4	106.45	106.44	106.41	106.41	106.41	106.45	106.35	106.32	106.41

Source: National sources, ING estimates



Turkey

Muhammet Mercan, Chief Economist, Turkey

Forecast summary

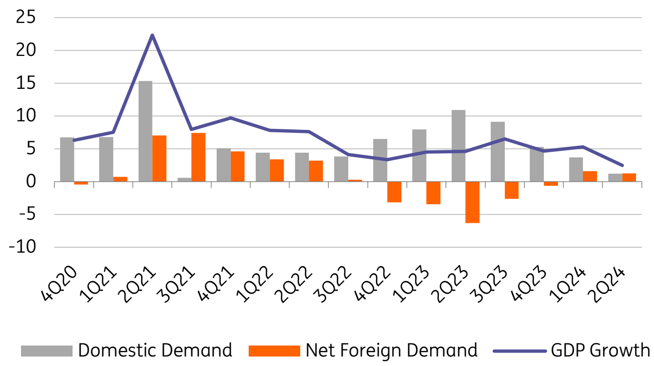
	2Q24	2Q24	3Q24	4Q24F	1Q25F	2024F	2025F
Real GDP (% YoY)	2.5	2.5	2.3	0.5	0.3	2.5	3.0
CPI (% YoY)*	71.6	71.6	49.4	43.3	33.3	58.2	28.8
Policy interest rate (eop, %)	50.00	50.00	50.00	47.50	40.00	47.50	27.50
3m interest rate (%)*	49.79	49.79	48.88	43.28	37.48	46.78	33.97
10yr yield (%)*	28.28	28.28	28.40	25.60	20.49	27.44	20.06
USD/TRY*	32.65	32.65	34.58	37.00	39.17	33.18	40.15
EUR/TRY*	35.05	36.57	38.04	40.70	43.09	36.29	44.16

Macro trend		Political cycle	Ratings	FC	LC
Activity	-	Presidential: May 2028	S&P	B+	B+
Fiscal	Loose	Parliamentary: May 2028	Moody's	B1	B1
Monetary	Tight	Local: Mar-29	Fitch	BB-	BB-

*Quarterly data is eop, annual is average

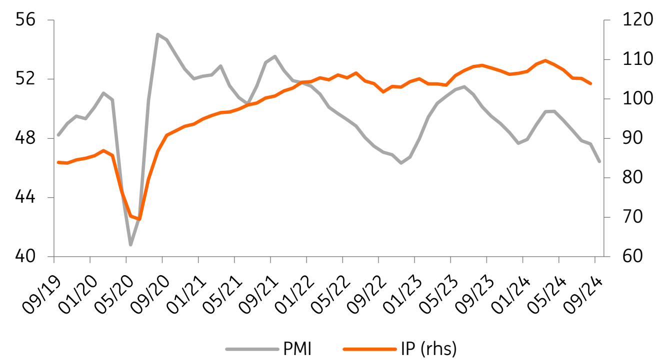
Source: National sources, ING estimates

GDP growth (%YoY)



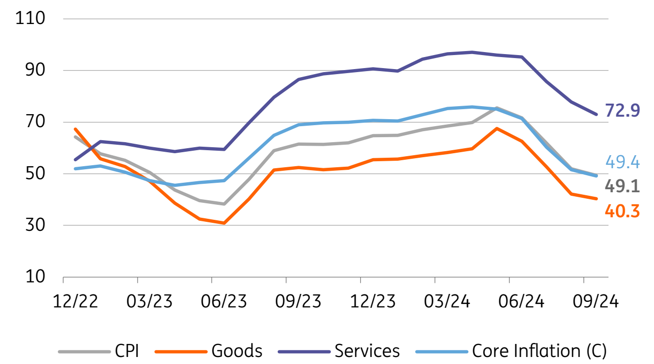
Source: TurkStat, ING Bank

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



Source: ICI, TurkStat, ING Bank

Inflation (%YoY)



Source: TurkStat, ING Bank

Country strategy: Programme remains on track

Economic activity has lost momentum driven by domestic demand, while annual inflation initiated a downtrend in June helped by a supportive base despite administrative price adjustments and continued pressure from the services group. Against this backdrop, the central bank (CBT) has maintained a tight policy stance and has introduced a series of macroprudential measures since the end of August with an aim of mopping up excess liquidity and maintaining the de-dollarization trend. Policy predictability and durability are key for the sustainability of the current performance. In this regard, Vice President Cevdet Yilmaz's statements in the release of the Medium Term Plan (MTP) are quite positive. He acknowledged a short-term trade-off between inflation and growth, and reiterated disinflation as the main policy priority with a signal for stronger support from fiscal policy for the disinflation process in 2025.

Macro digest

2Q24 GDP growth came in at 2.5% on a year-on-year basis, well below market consensus (3.2%), largely driven by domestic demand. Meanwhile, TurkStat revised the 1Q24 GDP expansion down from 5.7% to 5.3% and 2023 growth up from 4.5% to 5.1%. Accordingly, 1H24 GDP growth stood at 3.8% while downward forces are at play in 2H24. The 2Q24 performance equates to a barely positive quarter-on-quarter growth rate at 0.1% after seasonal adjustments. This shows a significant momentum loss in comparison to a relatively modest reading in 1Q24 at 1.4%. Decelerating sequential performance is attributable to investments and net exports turning negative and declining supportive impact of government spending. Overall, following the CBT's policy actions with the surge in loan demand in the run-up to the local elections (including an unexpected rate hike in March and moves to control both TRY and FX lending growth and sterilise the liquidity in the system), economic activity has lost momentum driven by domestic demand. On the other hand, private consumption, which has been the main driver of growth in recent quarters, grew slightly on a sequential basis and reached a new historical high. For 2H24, there are signals of additional weakness in domestic demand, as tightening financial conditions, slowing real wage growth and a likely increase in the unemployment rate point to a further slowdown in economic activity. We see 2.5% GDP growth in 2024.

The annual inflation figure has maintained its declining trend falling from 52.0% a month ago to 49.4%, given the continuing favourable base effect, while the pace of decline lost momentum with no respite in services inflation. Cumulative inflation in the first nine months of this year reached 35.9% vs the 38.0% CBT forecast for the whole year (with a forecast range of 34-42%). Regarding the underlying trend, the September headline figure, on a seasonally adjusted basis, recorded a slight sequential decline, while the 3Q24 average came in above 3% vs the CBT guidance of a decline to around 2.5%. The elevated underlying trend is attributable to services which showed no meaningful signs of improvement yet, despite a gradual moderation in goods group pricing pressures recently. The downtrend is likely to continue as the lagged effects of monetary tightening on credit and domestic demand and the continued real appreciation of the TRY are likely to be factors that will keep the underlying inflation trend on a downward path over the remainder of this year. However, the September data implies that the 2024 outcome could be above the CBT's forecast range, while we expect slightly above of 43%. Additionally, odds for a rate cut in November have declined significantly with the September print unless we see a significant positive surprise in October inflation.

Turkey

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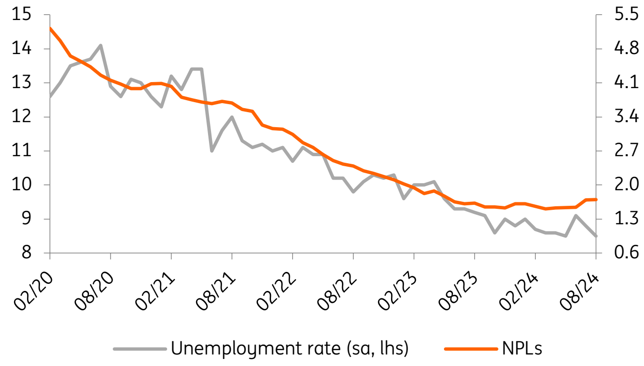
Unemployment vs NPLs (%)

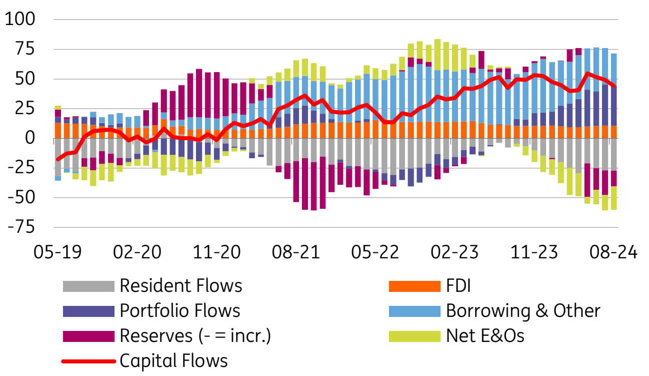


Source: TurkStat, BRSA, ING Bank

Headline unemployment still resilient

Based on the seasonally adjusted results, the unemployment rate hit its lowest level since 2012, at 8.5% in May, while labour force participation has remained close to the highest level in the current series. Following a temporary spike in June, the data releases after that show a recovery and return to 8.5% in August, implying a resilience despite moderation in the activity. However, broadly defined unemployment rates, particularly the composite measure of labour underutilisation (sum of time-related underemployment, unemployment, and potential labour force) hint at strains in the labour market as the indicator, which was below 20% before the pandemic, is now above of 27% (sa). On the activity side, early indicators hint that the momentum continues to soften. Given this backdrop, unemployment is likely to start rising from these levels.

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

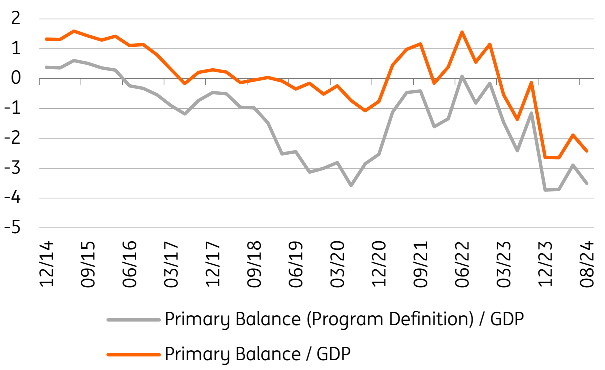


Source: CBT, ING Bank

Current account (c/a) on a narrowing course

The 12M rolling c/a deficit that was around 6% of GDP after the Presidential elections last year, has narrowed to c.0.9% in August 2024 with the improving energy bill, normalisation in gold imports, growth in tourism receipts and lower consumer imports, while revision in the services income data has also contributed. During this period, despite significant real TRY appreciation feeding into competitiveness concerns, exports have remained resilient. The c/a is likely to remain benign as the impact of CBT actions on the balancing of demand factors will be supportive. On the capital account, the portfolio flows and higher rollover ratios support the flows. But, given continuing unidentified outflows, the CBT's year-to-date reserve accumulation has been modest with a decline in the first four months of US$25.1bn, despite a strong performance since May.

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

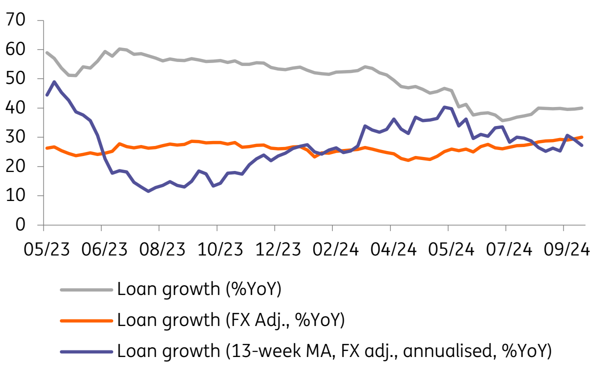


Source: Ministry of Treasury and Finance, ING Bank

Additional fiscal tightening likely

The new Medium-Term Programme forecasts a central government budget deficit at 4.9% of GDP in 2024 (down from 6.4%), 3.1% in 2025 and looks for a steady improvement thereafter narrowing to 2.5% by end-2027. The government signals fiscal prudence as it plans to achieve budget targets for next year via spending cuts of as much as 1.5% of GDP and expanding tax income by 0.9% of GDP. Simsek explicitly pointed out that fiscal policy would provide very strong support to disinflation, implying less reliance on inflationary administered price hikes and tax hikes. Based on the latest figures, the 12M rolling deficit is 5.1% of GDP. The current performance and packages introduced in recent months seem to be insufficient in terms of limiting the budget deficit this year. Given this, we may see other steps on the revenues or expenditures side.

Banking sector volume expansion



Source: BRSA, ING Bank

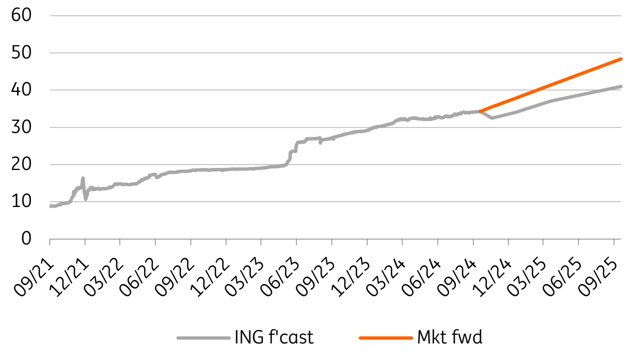
Action from the CBT and BRSA

In the banking sector, higher rates and tighter conditions lead to a pick-up in NPL formation. This is particularly visible on the retail side as the retail credit card (CC) NPL ratio moved up from 1.3% to 2.7% at end-2023. There has also been a gradual increase in retail CC lending momentum since July. Both the CBT and BRSA have announced actions to address these issues. The CBT's move is expected to have a tightening impact on CC lending to high-income individuals as it will differentiate interest rates for CCs based on outstanding balances. The BRSA has introduced regulation allowing restructuring of CC debt over up to 60 months and targets an easing of NPL pressures. Before that, the BRSA also normalised risk weights applied to retail loans and housing loans, down from more prudent risk weights compared to international minimum standards.

Turkey

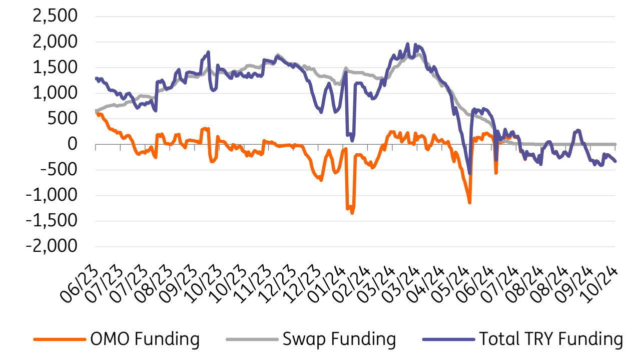
Strategy

FX – spot vs forward and INGF



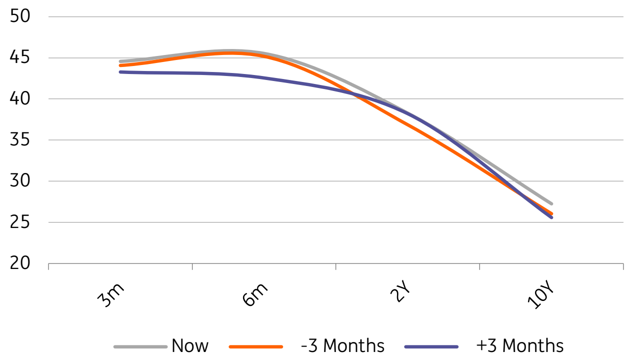
Source: Refinitiv, ING estimates

CBT funding (TRYbn)



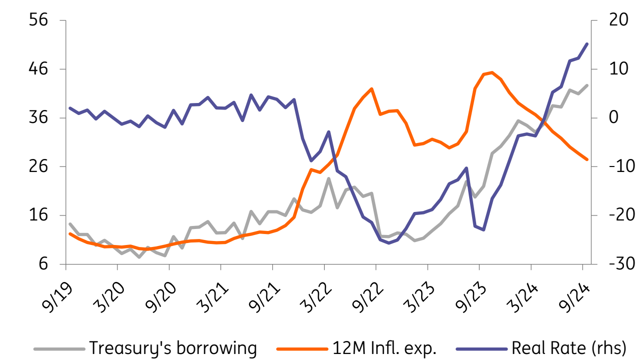
Source: CBT, ING Bank

Yield curve (%)



Source: Refinitiv, ING estimates

Real interest rate (%)



Source: Treasury, CBT, ING Bank

FX strategy

In the latest rate setting meeting, the CBT reiterated that the tight monetary stance would lead to: (1) a decline in the underlying trend of monthly inflation by moderating domestic demand; (2) real appreciation in TRY; and (3) improvement in inflation expectations. The bank also expected an improvement in services inflation to occur in 4Q24, while removing an explicit reference to high and sticky services inflation as a source of inflationary risk. Additionally, it repeated its forward guidance to keep a tight monetary stance until there is a significant and sustained decline in the underlying trend of monthly inflation, and inflation expectations converge towards the forecast range, but it has toned down its reaction if there were to be a deterioration in the inflation outlook. These changes hint that the CBT is cautiously setting the scene for rate cuts. Given that a relatively stable currency and normalisation in domestic demand should support a decline in the underlying inflation trend over the remainder of this year, we continue to see room to cut in December or January, depending on the data, though the upside surprise in the latest inflation figure shows continuing pressures and implies a delay in the start of the rate cut cycle. The de-dollarization trend has resumed following the CBT actions in August as these moves have eased the possible depreciation pressure on the TRY from Turkish residents because of accelerated FX-protected deposit (KKM) unwinds. Given this backdrop, the CBT has recovered its FX reserves losses in September, following the pressure in August, thanks to reviving foreign appetite and a resumption of de-dollarization among residents. Global financial conditions are likely to be supportive for foreign inflows as the Fed has started its easing cycle with 50bp cut in September.

Fixed Income strategy

Based on the September inflation rate of 49.4%, the ex-post real policy rate finally turned positive and is even as high as c.15% if we annualise the policy rate. The ex-ante real policy rate, on the other hand, is around 22.5% (vs 12M inflation expectations at 27.5%). Despite the improvement in the macro-financial outlook, Treasury borrowing rates remain quite high given the monetary tightening and the easing of bank obligations to purchase government securities. On the supply side, there are increasing efforts to control the budget deficit as the government announced spending cuts and revenue raisers since May. Domestic debt rollover rate stood at 120.1% on a year-to-date basis, though monthly rollovers have remained above 140% in recent months except in September. Given that the Treasury's TRY deposits at the CBT are around TRY450bn on average in 2024 so far, the Treasury seems to be helping the CBT in sterilisation of the liquidity. After large inflows following the local elections, foreign appetite showed signs of some weakness until recently. In fact, foreigners' bond purchases, at US$11.3bn between end-March and mid-June, dropped to a mere US$1.6bn in the subsequent weeks until early September. However, there have been signs of a reacceleration as we have seen US$4.4bn in foreign purchases over the past four weeks. Accordingly, despite fluctuations in appetite, foreign investors have maintained interest with their share in local debt at 8.8% at the end of August, up from less than 1% in November 2023. The weight of TURKGBs also continues to gradually increase within the GBI-EM index, which should ensure steady inflows from abroad regardless of market conditions. Overall, borrowing rates have remained close to peak recently, while foreign appetite and timing of the easing cycle remain key for the evolution of bond yields ahead.

Turkey

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (% YoY)	4.9	6.1	3.3	7.5	3.0	0.8	1.9	11.4	5.5	5.1	2.5	3.0	4.0
Private consumption (% YoY)	3.1	5.3	3.8	5.9	0.7	1.5	3.2	15.4	18.9	13.6	2.6	3.5	4.1
Government consumption (% YoY)	3.1	3.9	9.5	5.0	5.9	3.9	2.2	3.0	4.2	2.4	2.7	1.0	1.1
Investment (% YoY)	4.9	9.3	2.2	8.3	0.1	-12.5	7.3	7.2	1.3	8.4	0.8	2.1	3.1
Industrial production (% YoY)	5.7	5.8	3.4	9.0	1.3	-0.5	1.6	17.5	4.4	1.6	1.3	2.4	3.2
Unemployment rate (year-end, %)	9.9	10.3	10.9	10.9	10.9	13.7	13.1	12.0	10.5	9.4	9.3	10.5	10.2
Nominal GDP (TRYbn)	2,055	2,351	2,627	3,134	3,761	4,318	5,049	7,256	15,012	26,546	43,874	58,294	71,606
Nominal GDP (€bn)	681	707	779	763	664	677	623	671	849	1014	1209	1320	1407
Nominal GDP (US$bn)	937	856	867	861	775	761	712	788	900	1096	1322	1452	1548
GDP per capita (US$)	12,178	11,085	10,964	10,696	9,792	9,213	8,536	9,369	10,589	12,843	15,586	17,183	21,004
Gross domestic saving (% of GDP)	24.9	25.2	26.0	26.0	26.8	25.8	26.4	30.5	30.0	27.5	29.8	30.9	29.8
Prices													
CPI (average, % YoY)	8.9	7.7	7.8	11.1	16.3	15.2	12.3	19.6	72.3	53.9	58.2	28.8	19.9
CPI (year-end, % YoY)	8.2	8.8	8.5	11.9	20.3	11.8	14.6	36.1	64.3	64.8	43.3	24.6	16.7
Wage rates (nominal, % YoY)	15.5	18.1	20.5	13.3	15.8	18.4	6.9	39.5	88.1	113.5	84.4	32.2	22.2
Fiscal balance (% of GDP)													
Consolidated government balance	-1.1	-1.0	-1.1	-1.5	-1.9	-2.8	-3.4	-2.6	-0.9	-5.2	-5.0	-3.2	-3.0
Consolidated primary balance	1.3	1.3	0.8	0.3	0.0	-0.5	-0.8	-0.2	1.1	-2.6	-2.3	0.1	0.9
Total public debt	28.3	27.2	27.7	27.8	29.9	32.4	39.4	40.4	30.8	34.4	25.2	25.4	25.9
External balance													
Exports (US$bn)	173.3	154.9	152.6	169.2	178.9	182.2	168.4	224.7	253.4	251.0	260.7	278.4	292.0
Imports (US$bn)	239.9	203.9	192.6	227.8	219.7	199.0	206.3	254.0	343.0	337.9	317.7	342.0	357.5
Trade balance (US$bn)	-66.6	-49.0	-39.9	-58.6	-40.8	-16.8	-37.9	-29.3	-89.6	-86.9	-57.0	-63.6	-65.4
Trade balance (% of GDP)	-7.1	-5.7	-4.6	-6.8	-5.3	-2.2	-5.3	-3.7	-10.0	-7.9	-4.3	-4.4	-4.2
Current account balance (US$bn)	-38.8	-27.3	-26.8	-40.6	-20.7	6.8	-35.5	-7.2	-49.1	-45.0	-15.3	-19.4	-22.6
Current account balance (% of GDP)	-4.1	-3.2	-3.1	-4.7	-2.7	0.9	-5.0	-0.9	-5.5	-4.1	-1.2	-1.3	-1.5
Net FDI (US$bn)	13.3	19.3	13.9	11.1	13.0	9.3	7.8	13.3	13.7	10.6	11.3	13.4	16.1
Net FDI (% of GDP)	1.4	2.3	1.6	1.3	1.7	1.2	1.1	1.7	1.5	1.0	0.9	0.9	1.0
Current account balance plus FDI (% of GDP)	-2.7	-0.9	-1.5	-3.4	-1.0	2.1	-3.9	0.8	-3.9	-3.1	-0.3	-0.4	-0.4
Foreign exchange reserves ex gold (US$bn)	106.3	95.7	92.1	84.1	72.0	81.2	50.0	72.6	82.9	92.8	94.8	111.4	126.1
Import cover (months of merchandise imports)	5.3	5.6	5.7	4.4	3.9	4.9	2.9	3.4	2.9	3.3	3.6		4.2
Debt indicators													
Gross external debt (US$bn)	416.4	402.9	406.3	451.1	426.3	414.3	428.4	435.2	456.7	512.0	515.9	517.5	516.6
Gross external debt (% of GDP)	44	47	47	52	55	54	60	55	51	47	39	36	33
Gross external debt (% of exports)	240	260	266	267	238	227	254	194	180	204	198	186	177
Lending to corporates/households (% of GDP)	60.2	63.1	65.9	66.8	63.6	61.4	70.7	67.4	50.4	43.8	36.3	34.4	33.9
Interest & exchange rates													
Central bank key rate (year-end, %)	8.25	7.50	8.00	8.00	24.00	12.00	17.00	14.00	9.00	42.50	47.50	27.50	20.00
Broad money supply (average, % YoY)	11.9	17.1	18.3	15.7	19.1	26.1	36.0	53.6	60.7	66.5	66.3	33.9	23.8
3m interest rate (TRLibor, average, %)	8.6	9.9	8.9	11.6	19.1	18.8	11.0	18.0	15.7	20.5	46.8	34.0	20.5
3m interest rate spread over US$-Libor(ppt)	837	960	812	1029	1671	1684	1071	1794	1225	1512	4164	3037	1700
2yr yield (average, %)	9.2	9.8	9.7	11.8	18.9	17.2	11.9	18.5	19.2	21.1	42.0	30.6	22.9
10yr yield (average, %)	9.3	9.4	10.1	11.0	15.8	15.5	12.7	18.2	17.6	18.4	27.4	20.1	16.6
USD/TRY exchange rate (year-end)	2.32	2.92	3.53	3.79	5.29	5.95	7.43	13.32	18.69	29.48	36.00	43.00	49.00
USD/TRY exchange rate (average)	2.19	2.75	3.03	3.64	4.85	5.67	7.09	9.20	16.68	24.22	33.18	40.15	46.25
EUR/TRY exchange rate (year-end)	2.81	3.17	3.70	4.55	6.05	6.67	9.08	15.14	20.00	32.54	39.60	47.30	53.90
EUR/TRY exchange rate (average)	3.02	3.33	3.37	4.11	5.66	6.37	8.11	10.81	17.68	26.17	36.29	44.16	50.88
Brent oil price (annual average, US$/bbl)	99.35	52.08	43.31	54.13	71.17	64.72	41.80	71.25	99.25	82.25	82.25	77.25	74.75

Source: National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (% YoY)	6.5	4.6	5.3	2.5	2.3	0.5	0.3	3.0	3.6	4.5	4.5	4.2	3.8
CPI (eop, % YoY)	61.5	64.8	68.5	71.6	49.4	43.3	33.3	29.4	24.6	24.6	22.6	20.0	18.4
Central bank key rate (eop, %)	30.00	42.50	50.00	50.00	50.00	47.50	40.00	32.50	30.00	27.50	25.00	22.50	22.50
3m interest rate (eop, %)	22.82	38.61	50.58	49.79	48.88	43.28	37.48	33.20	30.56	29.12	25.53	22.89	22.37
10yr yield (eop, %)	27.15	25.06	26.82	28.28	28.40	25.60	20.49	19.55	18.31	17.66	17.21	16.79	16.42
USD/TRY exchange rate (eop)	27.37	29.48	32.35	32.65	34.58	37.00	39.17	41.03	42.63	44.00	45.50	47.00	48.50
EUR/TRY exchange rate (eop)	28.95	32.54	34.92	35.05	38.73	40.70	43.09	45.14	46.89	48.40	50.05	51.70	53.35

Source: National sources, ING estimates

Ukraine

Leszek Kąsek, Senior Economist, Ukraine

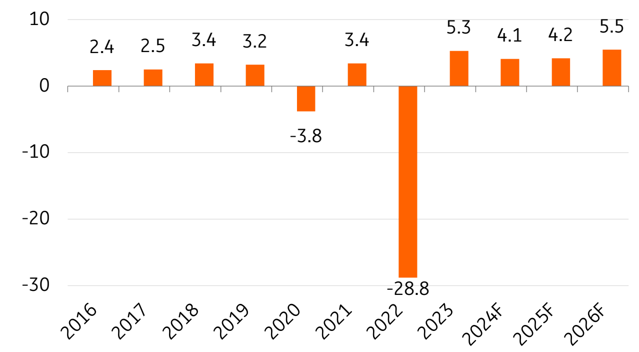
Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	3.7	1.5	3.7	2.5	4.5	4.1	4.2
CPI (%YoY)*	3.8	7.0	8.5	9.0	8.5	5.9	7.7
Policy interest rate (eop, %)	13.0	13.0	13.0	13.0	13.0	13.0	11.0
USD/UAH*	40.5	41.2	41.2	41.5	41.5	40.3	41.6
EUR/UAH*	43.4	46.0	45.3	45.7	45.7	43.9	45.8

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

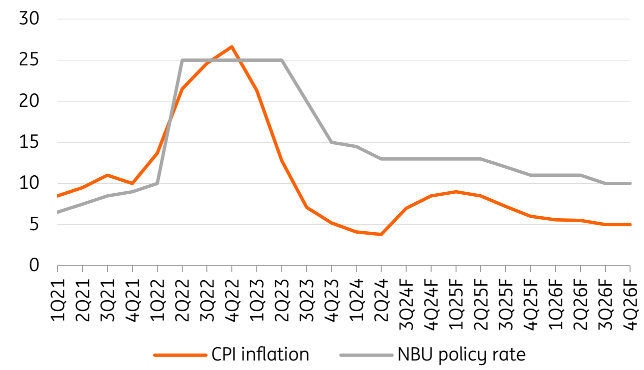
*Quarterly data is eop, annual is average
Source: National sources, ING estimates

GDP growth (%)



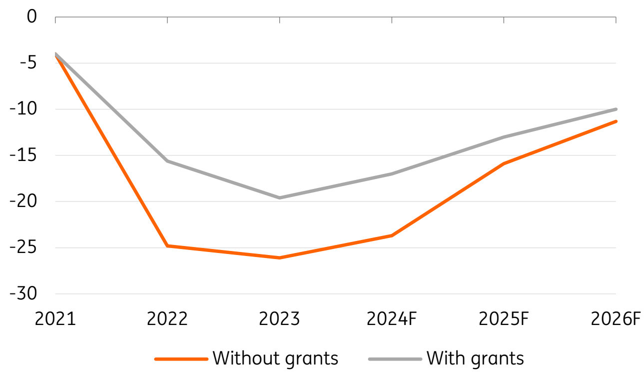
Source: NSI, ING

Inflation and NBU policy rate (%)



Source: NBU, ING

Fiscal balance, with and without grants, % of GDP



Source: Ministry of Finance, NBU, IMF, ING

Country strategy: Stable hryvnia, for now…

The hryvnia remains range-bound against the dollar since mid-July. This is likely to continue in the year end, as core central banks are gearing towards further monetary easing. Also, foreign aid helps to stabilize Ukraine's international reserves, allowing the NBU to stabilize the currency.

However, fundamentals behind the currency remain unsupportive, and uncertainty very high. The war continues to take toll on the economy, and the country has to cope with the energy deficit in the coming winter. Given heavy current account deficit and elevated inflation, the NBU is likely to allow for further gradual easing of the hryvnia, while stabilizing the currency as reserves allow. Even in the recent months NBU spent more than US$2.5bn monthly to shore up the currency against overall of US$40bn of reserves.

The war hurts and weighs on economic fundamentals

The Russian full-scale war in Ukraine continues. Around 20% of Ukraine's territory is occupied, and 6-7 million Ukrainians remain refugees abroad. Defence absorbs a half of budget spending. The aggressor made some military advances in Donbas in the recent months, while Ukraine entered into the Russian Kursk region. As energy infrastructure was targeted, the damages have devastating impact on people and the economy. The IEA estimates that Ukraine lost 2/3 of its pre-war power capacity and its reconstruction would cost US$30bn. Winter season electricity gap is of 30%. Real GDP reached a 6.5%YoY growth in 1Q 2024, but it slowed down recently because of energy and trade disruptions and high uncertainty.

Disinflation trend discontinued and NBU's rates stabilized

Last year, Ukraine benefited from the reversal of the global supply chain disruptions and energy and food prices shocks, and the disinflation trend continued to May 2024 (CPI at 3.3%YoY) but was reverted in June. This enabled a series of interest rates cuts from 25% in late-2022 to 15% in late-2023, and 13% in June 2024. However, in the recent months inflation picked up on the back of hikes regulatory tariffs on energy and increases in indirect taxes, while the central bank has kept the interest rates unchanged. Because global central banks, in particular the ECB and more recently the Fed, entered the easing cycle we do not expect the NBU to adjust rates to rising inflation in the coming months but rather keep them higher for longer, before resuming gradual cuts in late in 2H25.

Ukraine remains heavily dependent on foreign aid

Foreign aid, both grants and loans, helped Ukraine cover huge fiscal and external imbalances caused by the war, its timely and predictable mobilization is indispensable. According to the NBU, foreign financial aid is to halve in the medium term from US$43bn in 2023 to around US$21bn in 2025-26. This requires improved tax compliance. In 2023, the fiscal balance inc. grants (of around 7% of GDP) amounted to 18% of GDP. It is projected to narrow gradually to about 15% of GDP in 2024 and decline further in the medium term, while the public debt is to rise. In 2025, the country may get loans based on profits from the frozen Russian assets. The external current account deficit is set to widen from around 5% of GDP in 2023 to 6% of GDP in 2024, and stabilise in the medium term.

Ukraine

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	-6.6	-9.8	2.4	2.5	3.4	3.2	-3.8	3.4	-28.8	5.3	4.1	4.2	5.5
Private consumption (%YoY)	-8.3	-20.7	2.1	7.7	8.8	10.9	1.7	4.7	-16.8	5.5	3.5	5.0	6.1
Government consumption (%YoY)	1.1	1.7	-0.5	2.4	0.2	-13.6	-0.7	0.1	12.5	2.6	2.5	2.0	1.0
Investment (%YoY)	-24.0	-9.2	20.4	18.8	14.3	11.7	-21.3	8.1	-18.6	5.8	4.0	7.0	10.5
Industrial production (%YoY)	-10.1	-13.0	2.8	0.4	3.0	-0.5	-4.0	3.5	-42.8	5.0	4.0	5.0	7.0
Unemployment rate (year-end, %)	10.6	9.5	9.7	9.9	9.3	8.5	9.0	9.8	24.5	19.6	15.4	13.5	11.5
Nominal GDP (UAHbn)	1,587	1,989	2,385	2,983	3,561	3,975	4,090	5,451	5,239	6,538	7,419	8,573	9,830
Nominal GDP (€bn)	101	82	84	99	111	137	133	169	154	165	169	187	213
Nominal GDP (US$bn)	133	91	93	112	131	154	152	200	162	179	184	206	234
GDP per capita (US$)	3,100	2,117	2,200	2,600	3,050	3,600	3,400	4,200	3,700	3,900	4,500	5,100	5,100
Gross national saving (% of GDP)	9.9	13.3	14.8	12.3	15.3	12.2	12.2	12.5	17.0	10.0	10.9	11.3	12.5
Prices													
CPI (average, %YoY)	12.1	48.5	14.9	14.5	11.0	7.9	2.7	9.3	20.1	13.4	5.9	7.7	5.5
CPI (year-end, %YoY)	24.9	43.3	12.4	13.7	9.8	4.1	5.0	10.0	26.6	5.2	8.5	6.0	5.0
Wage rates (nominal, %YoY)	6.1	21.1	23.3	37.0	24.8	18.4	10.4	20.9	6.0	17.4	16.1	14.5	10.0
Fiscal balance (% of GDP)													
Consolidated government balance	-4.5	-1.6	-2.3	-1.4	-2.0	-2.2	-5.9	-4.0	-15.6	-19.6	-17.0	-13.0	-10.0
Consolidated primary balance	-1.5	2.8	1.9	2.4	1.2	1.0	-3.0	-1.1	-12.5	-15.7	-11.3	-8.6	-5.8
Total public debt	69.4	79.0	80.9	71.8	60.9	50.2	60.4	48.9	78.5	82.9	94.1	102.7	106.5
External balance													
Exports (US$bn)	50.6	35.4	33.6	39.7	43.3	46.1	45.1	63.1	40.9	34.7	41.1	43.0	48.5
Imports ((US$bn)	57.7	38.9	40.5	49.4	56.1	60.4	52.0	69.8	55.6	63.5	68.9	75.2	82.4
Trade balance (US$bn)	-7.1	-3.5	-6.9	-9.7	-12.7	-14.3	-6.9	-6.7	-14.7	-28.8	-27.8	-32.2	-33.9
Trade balance (% of GDP)	-5.4	-3.8	-7.4	-8.6	-9.7	-9.3	-4.5	-3.4	-9.1	-16.1	-15.1	-15.6	-14.5
Current account balance (US$bn)	-4.6	5.0	-1.9	-3.5	-6.4	-4.1	5.3	-3.9	8.0	-9.6	-10.6	-13.2	-13.2
Current account balance (% of GDP)	-3.5	5.5	-2.0	-3.1	-4.9	-2.7	3.5	-1.9	4.9	-5.3	-5.8	-6.4	-5.6
Net FDI (US$bn)	0.3	-0.2	4.0	3.4	4.9	5.2	-0.1	7.5	0.2	4.4	3.8	5.0	8.0
Net FDI (% of GDP)	0.2	-0.3	4.2	3.1	3.7	3.4	0.0	3.8	0.1	2.5	2.1	2.4	3.4
Current account balance plus FDI (% of GDP)	-3.2	5.3	2.2	0.0	-1.2	0.7	3.4	1.8	5.1	-2.9	-3.7	-4.0	-2.2
Foreign exchange reserves (US$bn)	10.0	13.2	15.3	18.9	17.7	25.3	29.1	30.9	28.5	40.5	40.0	41.0	42.0
Import cover (months of merchandise imports)	2.1	4.1	4.5	4.6	3.8	5.0	6.7	5.3	6.2	7.7	7.0	6.5	6.1
Debt indicators													
Gross external debt (US$bn)	125.3	117.7	112.5	115.5	114.7	121.7	125.7	129.7	131.0	161.5	171.5	191.5	211.0
Gross external debt (% of GDP)	94.1	129.5	120.6	103.0	87.7	79.1	82.9	64.9	81.1	90.4	93.2	92.9	90.2
Gross external debt (% of exports)	247.9	332.3	335.2	290.9	264.6	264.1	278.4	205.6	320.2	465.5	417.4	445.4	435.1
Lending to corporates/households (% of GDP)	62.4	48.4	41.3	33.7	29.8	24.5	23.1	21.6	23.6	18.2	17.8	19.5	20.5
Interest & exchange rates													
Central bank key rate (year-end, %)	14.0	22.0	14.0	14.5	18.0	13.5	6.0	9.0	25.0	15.0	13.0	11.0	10.0
Broad money supply (average, %YoY)	5.3	3.9	10.9	9.6	5.7	12.6	28.6	12.0	20.8	23.0	13.0	10.0	10.0
2yr yield (average, %)	17.9	18.9	19.4	15.7	17.8	17.2	13.0	12.5	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UAH exchange rate (year-end)	15.8	24.0	27.2	28.1	27.7	23.7	28.3	27.3	36.6	38.0	41.2	42.0	42.0
USD/UAH exchange rate (average)	11.9	21.9	25.6	26.6	27.2	25.8	27.0	27.3	32.4	36.6	40.3	41.6	42.0
EUR/UAH exchange rate (year-end)	19.2	26.2	28.4	33.5	31.7	26.4	34.7	30.9	39.0	42.2	45.3	46.2	46.2
EUR/UAH exchange rate (average)	15.7	24.3	28.3	30.0	32.1	28.9	30.8	32.3	34.1	39.5	43.9	45.8	46.2

Source: National sources, IMF, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	9.6	4.7	6.5	3.7	1.5	3.7	2.5	4.5	5.0	5.5	5.0	5.4	5.5
CPI (eop, %YoY)	7.1	5.2	4.1	3.8	7.0	8.5	9.0	8.5	7.2	6.0	5.6	5.5	5.0
Central bank key rate (eop, %)	20.0	15.0	14.5	13.0	13.0	13.0	13.0	13.0	12.0	11.0	11.0	11.0	10.0
USD/UAH exchange rate (eop)	36.6	38.0	39.2	40.5	41.2	41.2	41.5	41.5	41.7	42.0	42.0	42.0	42.0
EUR/UAH exchange rate (eop)	38.6	42.2	42.4	43.4	46.0	45.3	45.7	45.7	45.9	46.2	46.2	46.2	46.2

Source: NBU, Ukrstat, Macrobond, ING estimates

Uzbekistan

Dmitry Dolgin, Chief Economist, CIS

Forecast summary

	2Q24	3Q24F	4Q24F	1Q25F	2Q25F	2024F	2025F
Real GDP (%YoY)	6.6	5.7	4.5	4.0	5.5	5.7	5.7
CPI (%YoY)*	10.6	10.2	10.4	11.0	8.5	9.7	9.1
Policy interest rate (eop, %)	14.00	13.50	13.50	13.50	13.00	13.50	12.50
USD/UZS*	12,565	12,737	12,964	13,093	13,223	12,655	13,223
EUR/UZS*	13,467	14,198	14,260	14,403	14,545	13,794	14,545

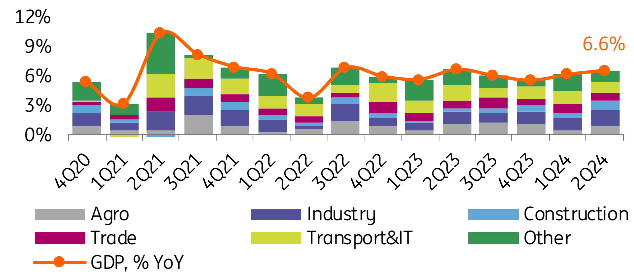
Macro trend		Political cycle	Ratings	FC	LC
Activity	+	Presidential: 2030	S&P	BB-	BB-
Fiscal	Easing	Parliamentary: 2024	Moody's	Ba3	Ba3
Monetary	Neutral	Local: n/a	Fitch	BB-	BB-

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

Country strategy: Watch out for CPI and FX trends

Uzbekistan continues to show a fast and well-diversified economic growth rate. Another positive is that the tariff-related spike in CPI was somewhat lower than expected, allowing an improvement in key rate easing expectations for the coming quarters. In addition, the soum depreciation rate slowed in 1H24, in line with our view, also helped by the strong gold market, but the pressure may increase in 2H24. Our concern for the medium term is the continued widening in the consolidated budget deficit which reached 7% of GDP for the four quarters ending March 2024. Like its CIS-4 peers, fiscal consolidation might come onto the agenda at some point.

GDP growth by sectors

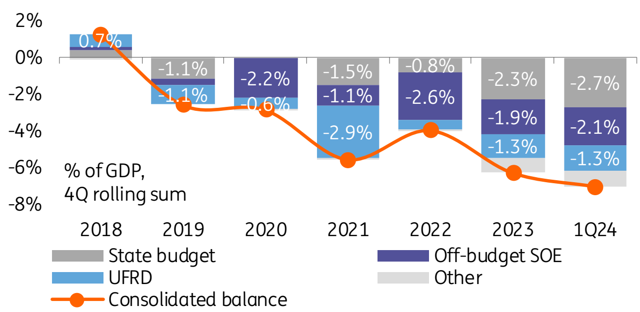


Source: National sources, CEIC, ING

Activity: Robust and broad-based for now

GDP accelerated for the second quarter in a row, with 2Q24 posting a 6.6% YoY increase on stronger industrial output. The most recent leading indicators of industry, including a decline in the electricity output and slowdown in corporate lending growth to 9% YoY, suggest a potential softening in 2H24, but the overall corporate mood should remain well supported by the state's investment-friendly approach. Consumption trends appear generally positive, however, the recent spike in household tariffs and cooling in retail lending growth from 47% YoY in 2023 to 30% YoY as of mid-2024 suggest that the momentum in retail trade might slow in the coming quarters, with the state budget being the only steady real income support factor. In any case, we see GDP growth remaining in a high range of 5.5-6.0% this year, as well as in 2025-26.

Consolidated budget balance by components (% GDP)

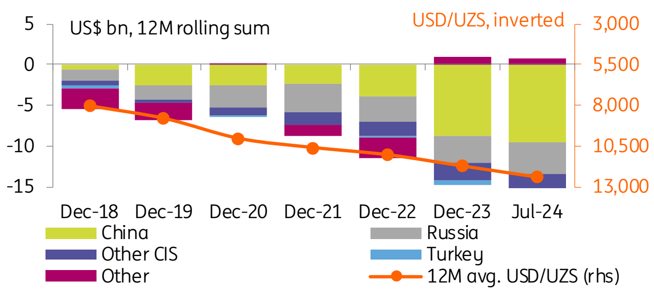


Source: National sources, CEIC, ING

Fiscal policy: Radical easing on the way

The consolidated budget is showing a wider deficit. At the state level, the deficit increased from 0.8% of GDP in 2022 to 2.7% in the four quarters ending in March 2024, while at the consolidated level the widening was from 3.9% to 7.0% of GDP. At the state level, the key contributors to expenditure growth include social and investment spending. At the consolidated level, the state-owned enterprise (SOE) spending is proving sticky, at around 10% of GDP, and is outperforming the revenue. As a result, we expect the consolidated budget deficit to remain in an elevated range of 4-6% GDP for 2024-26. This means more pressure on the liquid FX savings in the sovereign fund (UFRD), already under 10% of GDP. This could serve as an incentive to proceed with the privatisation programme.

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



Source: National sources, CEIC, ING

External balance: Pressure on USZ resumed

Improvement in the export dynamics has somewhat slowed the pace of USZ depreciation in 1H24, in line with our expectations. At the same time, the broader balance of trade picture at the beginning of 2H24 is pointing to a renewed pressure, as 12m rolling exports have slowed down to just 1% YoY as of July, while imports continued growing at around 18% YoY. As a result, the current account deficit is likely to remain at around US$7-8bn in 2024-25, with state and private capital inflows only partially covering the gap and exerting further pressure on USZ. We continue to expect the pace of USD/USZ to slow to around 2-4% in the medium term, but this year it should be around 5% YoY (to 12,900-13,000), in our view.

Uzbekistan

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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024F	2025F	2026F
Activity													
Real GDP (%YoY)	6.9	7.2	5.9	4.4	5.5	6.0	2.0	7.4	5.7	6.0	5.7	5.7	5.5
Real oil GDP (%YoY)	8.7	11.9	8.3	4.2	7.0	5.6	0.3	11.7	11.1	6.1	5.0	4.7	4.0
Real non-oil GDP (%YoY)	8.4	6.7	2.7	1.5	4.8	5.7	1.4	3.1	3.5	1.4	5.0	4.0	3.0
Investment (%YoY)	9.8	9.4	4.1	19.4	29.9	38.1	-4.4	2.9	0.2	22.1	7.0	8.0	7.0
Industrial production (%YoY)	4.5	5.3	5.4	5.2	10.8	6.6	0.7	8.8	5.3	6.0	7.0	5.5	5.0
Unemployment rate (year-end, %)	5.2	5.2	5.2	5.4	9.3	9.1	11.1	9.8	8.9	8.4	8.0	7.5	7.0
Nominal GDP (UZStr)	187	221	255	317	427	533	606	738	897	1,067	1,237	1,426	1,609
Nominal GDP (€bn)	60.9	77.6	77.9	54.1	44.6	53.8	52.7	58.8	77.1	84.0	89.7	98.1	106.9
Nominal GDP (US$bn)	80.9	86.2	86.2	61.9	52.5	60.1	60.2	69.6	81.2	90.9	97.7	107.9	117.6
GDP per capita (US$)	2,628	2,754	2,705	2,152	1,781	2,004	1,941	2,215	2,527	2,790	2,612	2,829	3,028
Gross domestic saving (% of GDP)	23.4	21.5	19.6	23.2	24.6	24.3	25.0	23.6	22.4	24.1	n/a	n/a	n/a
Prices													
CPI (average, %YoY)	9.3	8.8	8.1	13.9	17.5	14.5	12.9	10.8	11.4	10.0	9.7	9.1	6.9
CPI (year-end, %YoY)	10.4	7.6	9.8	18.8	14.3	15.2	11.2	10.0	12.3	8.8	10.4	8.0	6.1
Wage rates (nominal, %YoY)	n/a	n/a	n/a	n/a	25.0	27.5	15.0	20.3	20.8	17.2	18.7	15.1	11.9
Fiscal balance (% of GDP)													
Consolidated government balance	1.9	-0.3	0.7	1.2	1.3	-2.5	-2.8	-5.5	-3.9	-6.2	-6.0	-5.3	-4.7
Consolidated primary balance	1.9	-0.3	0.7	1.3	1.4	-2.2	-2.3	-4.8	-3.2	-5.5	-5.3	-4.5	-3.9
Total public debt	6.1	10.0	8.2	19.4	19.4	28.3	37.1	35.3	33.9	36.3	37.5	38.6	39.5
External balance													
Exports (US$bn)	10.6	9.5	8.6	10.2	11.4	13.9	12.8	14.1	16.6	19.6	21.2	22.5	23.6
Imports (US$bn)	13.5	11.6	11.0	12.4	18.3	21.2	19.0	22.9	28.3	34.5	36.5	38.4	40.3
Trade balance (US$bn)	-3.0	-2.1	-2.4	-2.2	-6.9	-7.3	-6.2	-8.8	-11.7	-14.9	-15.4	-15.9	-16.7
Trade balance (% of GDP)	-3.7	-2.4	-2.8	-3.6	-13.0	-12.1	-10.3	-12.6	-14.4	-16.3	-15.7	-14.8	-14.2
Current account balance (US$bn)	2.1	0.9	0.2	1.5	-3.6	-3.4	-3.0	-4.9	-2.8	-7.8	-7.4	-7.9	-7.7
Current account balance (% of GDP)	2.6	1.0	0.2	2.4	-6.8	-5.6	-5.0	-7.0	-3.5	-8.6	-7.5	-7.3	-6.6
Net FDI (US$bn)	0.8	1.0	1.7	1.8	0.6	2.3	1.7	2.3	2.7	2.1	2.6	3.1	3.7
Net FDI (% of GDP)	1.0	1.2	1.9	2.9	1.2	3.8	2.9	3.3	3.3	2.4	2.6	2.9	3.2
Current account balance plus FDI (% of GDP)	3.6	2.2	2.2	5.3	-5.6	-1.8	-2.2	-3.8	-0.2	-6.2	-4.9	-4.5	-3.4
Foreign exchange reserves ex gold (US$bn)	24.1	24.3	26.4	28.1	27.1	29.2	34.9	35.1	35.8	34.6	33.1	32.6	32.1
Import cover (months of merch. imports)	21.4	25.2	28.7	27.2	17.8	16.5	22.0	18.4	15.2	12.0	10.9	10.2	9.6
Debt indicators													
Gross external debt (US$bn)	11.6	13.4	14.6	15.6	17.1	24.3	33.3	43.2	51.7	60.6	67.6	72.6	77.6
Gross external debt (% of GDP)	14.3	15.6	17.0	25.1	32.3	40.3	55.3	62.1	63.7	66.7	69.2	67.3	66.0
Gross external debt (% of exports)	109.9	141.3	169.2	153.3	150.0	174.6	259.7	305.4	310.5	309.1	319.2	323.4	329.2
Lending to corporates/households (% of GDP)	n/a	n/a	20.6	34.8	39.2	38.9	45.2	43.7	43.0	42.7	43.1	43.9	44.7
Interest & exchange rates													
Central bank key rate (year-end, %)	10.00	9.00	9.00	14.00	16.00	16.00	14.00	14.00	15.00	14.00	13.50	12.50	11.00
Broad money supply (average, %YoY)	15.7	24.3	23.5	40.2	14.1	13.9	17.7	29.7	30.2	12.2	16.1	15.7	13.6
3m interest rate (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
3m interest rate spread over US$-Euribor (ppt)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (average, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UZS exchange rate (year-end)	2,422	2,791	3,225	8,120	8,404	9,506	10,466	10,818	11,229	12,346	12,964	13,482	13,887
USD/UZS exchange rate (average)	2,310	2,569	2,965	5,126	8,133	8,861	10,055	10,614	11,046	11,733	12,655	13,223	13,684
EUR/UZS exchange rate (year-end)	2,931	3,030	3,393	9,745	9,563	10,657	12,787	12,303	12,022	13,648	14,260	14,830	15,275
EUR/UZS exchange rate (average)	3,066	2,851	3,280	5,869	9,573	9,895	11,493	12,548	11,627	12,693	13,794	14,545	15,053
Brent oil price (annual average, US$/bbl)	99	54	45	55	72	64	43	71	99	82	81	72	70

Source: National sources, ING estimates

Quarterly forecasts

	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24F	1Q25F	2Q25F	3Q25F	4Q25F	1Q26F	2Q26F	3Q26F
Real GDP (%YoY)	6.0	5.6	6.2	6.6	5.7	4.5	4.0	5.5	6.5	6.7	6.5	6.0	5.0
CPI (eop, %YoY)	9.2	8.8	8.0	10.6	10.2	10.4	11.0	8.5	7.9	8.0	7.9	6.8	6.5
Central bank key rate (eop, %)	14.00	14.00	14.00	14.00	13.50	13.50	13.50	13.00	13.00	12.50	12.50	12.00	11.50
3m interest rate (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
10yr yield (eop, %)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
USD/UZS exchange rate (eop)	12,184	12,346	12,615	12,565	12,737	12,964	13,093	13,223	13,353	13,482	13,583	13,684	13,786
EUR/UZS exchange rate (eop)	12,897	13,648	13,611	13,467	14,198	14,260	14,403	14,545	14,688	14,830	14,942	15,053	15,164

Source: National sources, ING estimates

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