# July 2022 Central and Eastern Europe Mid-Year Sovereign Outlook

High inflation, slower growth, wider external and fiscal deficits, disruptions to supply chains and Russian energy supplies to increase credit risks

Sovereign and Public Sector, Scope Ratings GmbH, 26 July 2022

EU CEE-11: Poland I Czech Republic I Hungary I Slovakia I Romania I Bulgaria I Croatia I Slovenia I Lithuania I Latvia I Estonia
Non-EU CEE: Russia I Turkey I Ukraine I Serbia I Georgia

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# Executive summary

The Russia-Ukraine war represents a significant exogenous shock for countries in central and eastern Europe (CEE), due to their geographies and close economic ties with Russia and Ukraine. In addition to a humanitarian crisis, the war in Ukraine has intensified sovereign credit challenges for CEE countries in 2022 and beyond. Dangers are multiple, ranging from higher and more persistent inflationary pressure to slower economic growth to widening external and fiscal deficits to disruptions of supply chains and of Russian energy supplies.

External security risks for the region, with many countries bordering Russia and/or Ukraine, have increased. However, EU CEE countries' NATO memberships reduce likelihood that the conflict spills over to their borders. Security guarantees are based upon NATO's Article 5, which states that if one member of the alliance is attacked, other members will consider this as an attack against all and come to that country's defence. All NATO-member CEE countries have frequently restated their commitments to Article 5.

The decoupling of the Russian economy from the West alongside international sanctions pose significant adverse economic consequences for Russia long run but will not come absent collateral damage for other CEE economies near-to-medium term. Inflation will accelerate and growth will slow from Q2 of this year on. Russia and Ukraine will record deep recessions this year. By contrast, positive calendar-year growth will continue within the remainder of the region under our baseline economic scenario – for the CEE countries of the EU (CEE-11), Georgia, Serbia and Turkey – despite significant slowdown.

The impact of the conflict on growth will prove severe in third and fourth quarters of this year, gradually decrease by the end of the year, but linger well into 2023, via three main channels:

1) Higher prices of energy, food and other commodities near term pushing up inflation, squeezing household and corporate budgets, and placing further strain upon external-sector and government finances. Most CEE economies are net energy importers and heavily exposed to elevated and highly volatile European gas and crude oil prices.

2) Supply-chain and trade disruptions, reflecting western sanctions on Russia, but also strategic retaliatory measures of Russia, cause shortages of key inputs and create logistical bottlenecks, such as lengthy delivery times, contributing to considerably higher input prices. EU plans to shed its dependence on Russian energy could hit government budgetary performance medium run as energy-sector investment increases.

3) Increased financial-market volatility is another danger given less resilient investor sentiment and risk the Federal Reserve and ECB tighten faster, resulting in capital outflows from emerging economies, higher financing costs and exchange-rate volatility.

See **Annex I** for our full macroeconomic forecasts for CEE.

# Main economic themes entering H2 2022

## Russia, Ukraine in deep recession; crisis risk in Turkey, rest of CEE has shown resilience but slowdown ahead

In Russia, severe international sanctions will result in a deep contraction this year, of 10.5% (**Figure 1, next page**) – the steepest output decline since 1994 – followed by stagnation in 2023. We expect a so-called "L-shaped recovery", when an economy enters severe recession followed by a prolonged period of weak or no growth. We see sanctions remaining in place for years while assuming no change in the political regime of Russia over a foreseeable future.

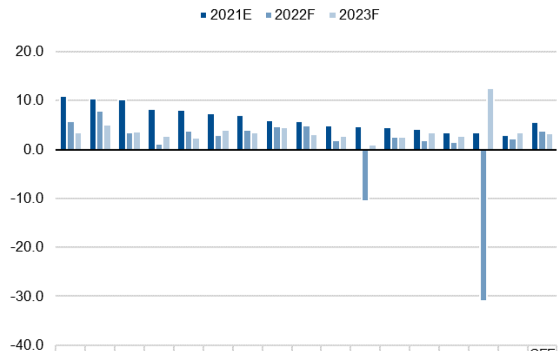
Russia's economic decoupling from the West and subsequent competitive disadvantage as far as innovation and technological advancement will result in lesser productivity growth, affecting real incomes. Important non-extractive industries – such as machinery and electrical equipment, computers, automobiles, pharmaceuticals – rely upon imported components. The share of foreign value-added exceeds 50% in such Russian industries, with around half of this coming from the EU, the US, the UK, Canada and Japan, much of which cannot easily be replaced by imports from China or domestic alternatives. In lieu of significant restructuring of its economy, Russia's medium-run growth potential will moderate to 1-1.5% a year, from 1.5-2.0% before the full-scale war.

Ukraine's economy faces a 31% contraction in 2022 as a result of the war. Uncertainty around performance of the Ukrainian economy is huge, but we assume output partially rebounds by 12.5% in 2023 as activity recovers in regions where the conflict has eased. Output next year would potentially remain circa 22% below 2021 levels, however – an indication of the scale of the reconstruction task at hand. Severe decline of output and extreme geopolitical uncertainty place enormous strain on debt sustainability. Debt-to-GDP will rise, climbing to around 89% in 2022 from 48.9% at end-2021. Ukraine's challenges in meeting a significant near- and long-run shortfall in financing requirements have (prudently) resulted in a government consent solicitation for the restructuring of Eurobond debt and GDP-linked securities. This, however, resulted in revision of Ukraine's foreign-currency long-term ratings to C last Friday.

In Turkey, poor economic governance is making high inflation worse and adding to risks for the country's external sector, increasing possibility of full financial crisis – factors which underpinned our decision to downgrade Turkey's foreign-currency ratings to B- while maintaining a Negative credit Outlook. The war in Ukraine and its impact on the Black Sea region is furthermore stressing the Turkish economy and currency particularly as central banks of advanced economies tighten monetary policies.

Under our baseline scenario, the Turkish economy grows by 5.8% in 2022 and 3.5% in 2023. A lira savings scheme announced in December is unlikely to prove sustainable long run or prevent severe currency crisis. The scheme is gradually sacrificing one of Turkey's most important credit strengths – a healthy sovereign balance sheet – to temporarily slow depreciation of the lira while the central bank maintains an overly accommodative monetary policy.

**Figure 1: Real GDP growth rates*, %**




| | TR | GE | HR | EE | SI | RS | HU | RO | PL | LT | RU | LV | BG | CZ | UA | SK | CEE-11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2021E | 11.0 | 10.4 | 10.2 | 8.2 | 8.1 | 7.4 | 7.1 | 5.9 | 5.8 | 4.9 | 4.8 | 4.5 | 4.2 | 3.5 | 3.4 | 3.0 | 5.6 |
| 2022F | 5.8 | 8.0 | 3.5 | 1.2 | 3.9 | 3.0 | 4.0 | 4.8 | 4.9 | 1.8 | -10. | 2.5 | 1.8 | 1.6 | -31 | 2.2 | 3.8 |
| 2023F | 3.5 | 5.0 | 3.7 | 2.7 | 2.5 | 4.0 | 3.4 | 4.5 | 3.1 | 2.8 | 1.0 | 2.5 | 3.5 | 2.7 | 12.5 | 3.4 | 3.3 |

Source: European Commission, IMF, Scope Ratings forecasts; *sorted by estimated rate of 2021 growth; full forecasts available via **Annex I**

In CEE-11, full-year growth will average 3.8% this year before 3.3% in 2023, supporting Stable rating Outlooks for most sovereigns of the bloc. Economic growth of Hungary and Romania in Q1 2022 surprised on the upside, of 8% and 6.4%, respectively, compared with the same quarter of last year. Poland's economy grew 9.2% with the largest contribution from inventories (+7.7pps). Underlying growth momentum in Q1 2022 supports economic resilience moving ahead.

However, Q1 reflected mostly a cyclical economic acceleration, with growth slowing significantly since and will continue to slow due to knock-on effects of the war in Ukraine. Some economies could be in technical recession in the second half of this year. The sharp rise of inventories in Q1 is set to reverse over the remainder of 2022. Leading indicators, such as manufacturing purchasing managers' indices, display significant contraction in production and new orders, while investment will suffer due to rising interest rates and tendencies of businesses to delay investment under such conditions.

A measured recovery in growth is foreseen by next year, provided supply chains recover, supporting exports and inward foreign direct investment (FDI). However, due to a weaker starting point, average annual growth for 2023 will prove more moderate than in 2022 for many economies. Should slowdown of growth be more prolonged or deeper than currently expected, this could hold adverse implications for the credit quality of CEE-11 sovereigns.

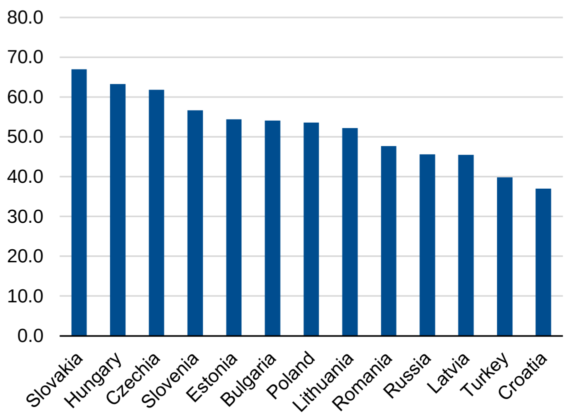
In other parts of CEE, governments of Serbia and Georgia face a difficult task in balancing their relations with Russia with economic and institutional convergence with the EU, and absent jeopardising future reforms and investor confidence. Despite increased economic uncertainties and geopolitical risks, both countries' medium-run annual growth prospects remain sturdy – of 4-4.5% for Serbia and 5% for Georgia.

## Prolonged supply-chain disruptions hit exporting sectors

The Covid-19 crisis resulted in supply-chain disruptions currently exacerbated by Russia's war in the Ukraine as well as by renewed pandemic-related economic restrictions in China. Such disruptions are likely to continue until the end of this year if not longer. Together with elevated consumer and producer prices and logistical bottlenecks, this weighs upon global trade over coming quarters and restrains regional recovery.

Countries with more open economic structures are especially vulnerable to supply-side disruption. Exports of manufactured goods play a significant role in many CEE economies for which manufacturers themselves are dependent upon imported components. The global value chain participation rate – the share of foreign-made inputs and domestically-produced inputs used in third countries' exports as a share of gross national exports – is the highest in Slovakia, followed by in Hungary and the Czech Republic. Meanwhile, Croatia has the lowest exposure (**Figure 2**).

**Figure 2: Global value chain participation rates***



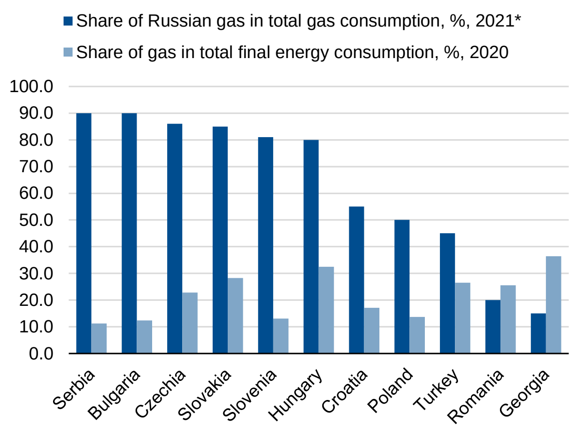

Source: WTO; *foreign inputs and domestically produced inputs used in third countries' exports, % of total exports, 2018

Direct trade with Russia, Ukraine and Belarus (which is under international economic sanctions alongside Russia) are not overly significant for the largest CEE-11 economies – amounting to between 5-6.5% of GDP in total in 2021 for Poland, Hungary and the Czech Republic. Still, shortages of some key inputs for these countries – energy, metals and other commodities – and complications associated with indirect trade channels could severely disrupt industrial production, and, if prolonged, impair macroeconomic conditions.

The EU's oil embargo significantly increases the risk Russia will expand economic retaliation against EU CEE member states, possibly via further limiting or halting energy supplies before an EU boycott of Russian energy imports assumes its full effect – as Russia already has started vis-à-vis some European countries. Russia is the most important supplier of natural gas to Europe, benefitting from windfall gains as the war and sanctions have brought soaring energy prices. The temporary exemption for the Druzhba pipeline illustrates a difficulty for the EU in finding consistent approaches when individual member states are dependent upon Russian energy.

Czech Republic, Slovakia, Slovenia and Hungary rely on Russia for above 80% of their gas consumption (**Figure 3**). An abrupt and prolonged suspension of Russian gas would reduce near-term economic growth and exports and exacerbate inflationary pressure. Still, several CEE countries accelerated initiatives for replacement of Russian gas well before escalation of the war and will benefit from such further infrastructure being close to completion. Lithuania abandoned all Russian energy imports in May. Poland is planning to replace Russian gas with imports from Norway via the Baltic Pipe, which will be operationalised by end-2022 with a capacity of circa 10 billion cubic meters (bcm) annually. This would completely substitute Poland's annual Russian gas imports of 10bcm, or about 50% of its aggregate domestic use.

**Figure 3: Exposure to Russian gas disruptions**



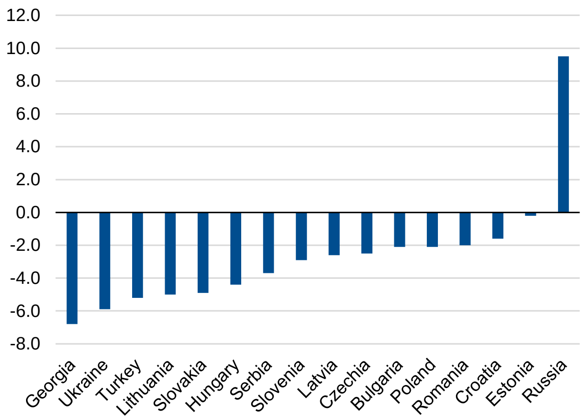

Source: Federal Customs Service of Russia, Gazprom, Eurostat, International Energy Agency, national governments and statistical offices; *or latest data from before 2021

Finally, the war in Ukraine has disrupted Europe's automotive industries, which rely on manufacturers in Ukraine for cable harnesses and other important parts. Parts shortages weigh currently on recovery in Slovakia and the Czech Republic. Energy-intensive manufacturing industries with complex value chains, such as automotive sectors, play a huge role in these economies. Success of Ukrainian suppliers in maintaining output despite the war or relocating production to other locations, such as to North Africa, limit medium-run disruption for Ukraine.

## Surging commodity prices stress external vulnerabilities

Energy and other commodity prices have surged since intensification of the war. Georgia, Ukraine, Turkey, Slovakia, Hungary and Serbia are among the most exposed to soaring energy prices as significant net energy importers (**Figure 4**). Russia and Ukraine account for around 90% of Turkey's and Georgia's wheat imports (including meslin, HS 1001), while this dependence is low for the remainder of the region (e.g., Bulgaria: 12%). Most Russian and Ukrainian wheat is transported via ports on the Black Sea and Sea of Azov where the war has severely compromised sea freight.

**Figure 4: Energy trade balance*, % of GDP, 2021**




Source: UN Comtrade, Scope Ratings; *Energy trade is based on HS chapter-27; data correspond to 2020 for Russia, Bulgaria

Commodity prices are expected to remain volatile with possibility for further substantive upside, contributing to deterioration of external positions of CEE-11 economies. Poland and Hungary's current-account deficits are seen widening to above 4% and around 5% of GDP respectively for 2022, from deficits of below 1% and around 3% of GDP in 2021.

Deteriorating external balances place downside pressure on the value of regional currencies, even as central banks raise rates. Since the start of the year, the Polish zloty and Hungarian forint have depreciated by over 3% and over 7%, respectively, against the euro. This could add to pressure on foreign-exchange reserves. As an example, the National Bank of Serbia sold a net EUR 1.8bn since the Ukraine conflict's escalation to protect dinar. Still, forex reserves of most CEE-11 economies are presently sufficient to bridge a period of excessive market volatility, in most cases fully covering external debt maturing over the next year. In addition, the ECB's euro liquidity lines granted to Polish and Hungarian central banks via new swap and extended repo facilities – of EUR 10bn and EUR 4bn, respectively – support their external sectors, reducing risk amid currency sell-offs.

Steady EU budget transfers under the Multiannual Financial Framework and Recovery and Resilience Facility (RRF) alongside FDI inflow have compensated for low levels of national savings and enhanced the external financing capacities of CEE-11 economies. Outside of the EU, Serbia and Georgia, where current-account deficits will be around double-digits as a ratio to GDP this year, might require further recourse to debt-creating flows to finance said deficits.

Ukraine and Turkey's forex reserves, meanwhile, are increasingly inadequate, increasing risk of more severe balance-of-payment crises. In addition, with Turkey's weak monetary policy framework due to political interference, its forex reserves and lira exchange rate are likely to remain under near constant pressure, as financial assistance from the IMF remains off the table for the government.

As regards Russia, we assay recovery of rouble to be unsustainable and partly artificial based on capital controls introduced by the central bank. From 2023, an EU boycott of Russian oil will imply considerable costs for the Russian energy sector and real economy as far as rouble convertibility.

## Higher-for-longer inflation creates uncertainties

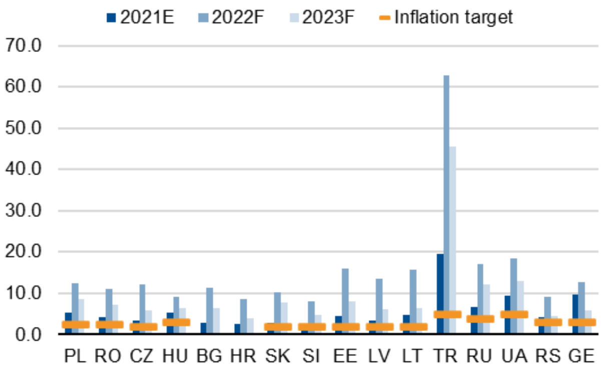
Inflation has soared across CEE and a peak of YoY inflation rates still lies ahead of us. Our baseline forecast is for higher and more persistent inflation as compared with our expectations before the escalation of the war in Ukraine. Average inflation rates will average above 10% for CEE-11, as well as in Georgia, nearly 10% in Serbia, nearly 20% in Russia and Ukraine, and above 60% in Turkey in 2022 (**Figure 5**). Supply-side drivers are largely to blame, namely rises of energy and food prices intensified by the war and resulting sanctions and countersanctions. However, core inflation has as well risen, reflecting underlying demand pressures and effects of higher energy on manufacturing input and non-oil import prices. Ukraine and Russia signed an agreement last week aimed at releasing millions of tons of grain through Ukraine's Black Sea ports that, if implemented, would mark an important step toward the shoring up of global food supplies and easing some of the inflation impetus.

Nevertheless, surging inflation is driving monetary tightening and higher interest rates across the region. Further rate hikes are expected from central banks of the region, before central banks such as those of Poland, Hungary and the Czech Republic start reversals of rate increases by 2023 as elevated inflation cools. Macroeconomic conditions put central banks in a difficult spot. They need to manage higher inflation and anchor inflation expectations without jeopardising already weakening economic conditions and further pushing up significant debt-servicing costs. Furthermore, they have hardly any control over inflation effects from supply-side factors.

Moreover, monetary conditions of CEE economies are expected to tighten due to expected further increases of *ECB and Federal Reserve* interest rates and these economies' substantive shares of public- and private-sector debt denominated in foreign currency (especially in euro).

For central banks of Russia and Ukraine, key factors during the war also reflect the value of their respective currencies and forex flows, which are under the heavy momentary influence of capital controls. Ukraine devalued its temporary *fixed* exchange rate 25% against the US dollar on 21 July. Conversely, in Turkey, a series of rate cuts in 2021 (while other central banks were tightening) makes the economy more vulnerable to further lira depreciation, higher inflation and capital outflows – ahead of elections due by 2023.

**Figure 5: Inflation forecast, year-on-year, %**




Source: Central banks, European Commission, IMF and Scope Ratings forecasts; HICP for EU CEE member states, CPI for non-EU CEE economies

Under our baseline expectations, inflation abates gradually as we conclude 2022 and over the run of 2023, reflecting a moderation of international prices of food and energy, and assuming gradual easing of supply-chain and transportation bottlenecks related to Covid-19 and the Russia-Ukraine conflict, alongside easing of demand-side pull on inflation from initial post-Covid reopening rebounds.

Conversely, should prolonged supply-side bottlenecks worsen and/or further rises of commodity prices trigger further rises of inflation expectations, central banks could face pressure to tighten policies more substantively. This will be increasingly difficult to do absent severely damaging economic recoveries and swelling the interest costs of new debt – with potential credit-negative implications for highly indebted sovereigns, including those of the region. Furthermore, tight labour markets could translate to overcapacity problems further driving higher inflation, as labour shortages become more pronounced despite improvements of inward migration for many nations over recent years. Most countries have limited spare human capital, such is the case for Czech Republic, Poland, Slovakia and Romania. Turkey is the only country of the region with an abundant supply of labour.

## Re-emergence of fiscal vulnerabilities due to tighter financing conditions

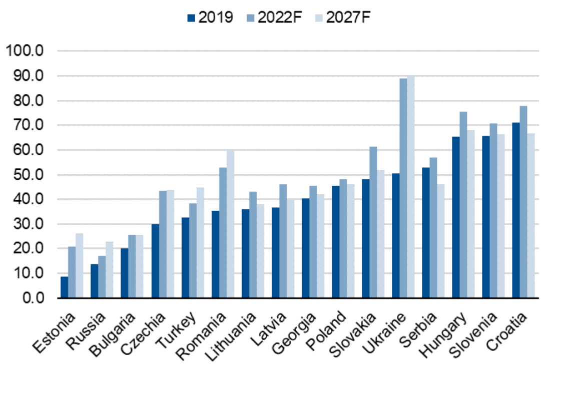
Public debt accumulated over the Covid-19 crisis raised longer-run fiscal vulnerabilities, with a higher volume of debt needing to be rolled over presenting latent risk that has crystallised under a presently higher interest-rate environment. The recent increase of debt-financing costs adds to underlying budgetary vulnerabilities and represents a limitation for fiscal consolidation, particularly for highly indebted non-euro-area CEE governments, which do not benefit as much from the ECB's market support – such as a recently unveiled 'Transmission Protection Instrument'.

Governments need to provide support to households and businesses to address the costs of inflation, which widens fiscal deficits, adding further pressure on public accounts post-Covid. Medium run, pressure on public finances will rise as governments spend on constructing alternative energy infrastructures, from storage facilities to new renewables and nuclear generating capacity and natural gas distribution networks.

We appraise general government deficits of 2022 of between 1.5% of GDP in Russia to a high of 7.5% of GDP for Romania and near 20% of GDP in Ukraine. Next year, deficits of the region will remain significant – 3.8% of GDP (after 4.7% of GDP in 2022) for the CEE-11, 3.9% of GDP in Russia and around 18.5% of GDP in Ukraine as it reconstructs the nation.

As a result, Romania's public debt will continue rising to 53% of GDP by 2022 (**Figure 6**), from around 35% as of 2019. However, for many other CEE countries covered by Scope, including Poland and Hungary, debt ratios have declined since 2020, due both to strong real economic recoveries as well as elevated inflation.

**Figure 6: General government debt trends**




Source: IMF World Economic Outlook April 2022 and Scope Ratings forecasts

However, governments need to demonstrate renewed commitments to budgetary consolidation, especially in countries with other stress factors or sources of uncertainty or forthcoming elections, such as Turkey, Bulgaria, Poland, Hungary, Romania and Georgia. Success in the consolidation of government finances will support the determination of trajectories of their sovereign ratings.

For many CEE economies, further development of domestic capital markets, including of capacity of domestic investment sectors to absorb longer-dated government debt issuance, is crucial to easing future funding stress. In Hungary and Romania, as an example, gross government financing requirements are running around an estimated >15% of GDP in 2022 – a level above which emerging market sovereign borrowers are considered as under "high scrutiny" by the IMF. Enhancing domestic capital markets could help finance such elevated borrowing needs.

The market capitalisation to GDP of the most developed CEE capital market, that of Poland, is still only circa a half of an EU average. Shifts in international capital flows present an opportunity for CEE economies to attract fresh groups of investors to domestic capital markets and deepen said markets. As an example, CEE-11 countries are well positioned to attract investment linked to a growing environment, social and governance (ESG) community, given EU strategic focus upon sustainable economic growth and manners to fund such growth. Countries with stable legal systems and robust rule of law are the most likely to benefit from such ESG-linked investment.

National savings as a ratio of GDP of Poland, Romania and Slovakia unfortunately remain low, of close to 20% of GDP (the EU average being 25%), impeding capital-market development and increasing reliance on foreign savings.

In Turkey, state-owned banks hold adequate liquidity to support financing of government deficits and state foreign-currency requirements over an immediate future. However, rising government debt and a fast-devaluing lira increasingly limit the banking system's room for manoeuvre.

In Russia, default on foreign debt last month presents limited near-term financial implications as high energy revenues help the state to finance itself for now. Russia's access to foreign markets is mostly closed anyhow for the indefinite future. In the longer run, default restricts Russia's financing flexibility and is another blow to investor confidence, which is likely to further discourage foreign investment that Russia badly needs. The default complicates debt payments and borrowing by the private sector, whose external debt is about four times that of the Russian state.

In the Ukraine, war has brought substantive short-run financing shortfalls – with annual gross government financing requirements of circa 37.5% of GDP for 2022 before remaining above 20% over 2023-26. Circumscribed market access, higher local borrowing rates after the NBU's recent rate increase and monetary financing reflects an unsustainable funding backdrop –

highlighting increasing fiscal and balance-of-payment crisis risks absent acceleration of international assistance and/or an earlier conclusion of the war.

## Sovereign ratings: CEE rating actions in 2022, and outlook moving ahead

An abrupt deceleration of global growth amid war in Ukraine and associated further supply-chain disruption, further rises of inflation and risk reversal in financial markets as central banks tighten set a stage for sovereign credit risk of CEE entering the second half of the year.

Before Russia's full-scale invasion of Ukraine on 24 February, we held a Negative Outlook on three issuers of CEE: Ukraine, Turkey and Poland as compared with three borrowers on Positive (Outlook): Lithuania, Latvia and Croatia. Turkey's foreign-currency issuer ratings have since been further downgraded to B- in March, with maintenance of Negative Outlook. Ukraine was downgraded to CCC and placed under review in March. This review was concluded in June and the Outlook was assigned as Negative. This was before further downgrade of foreign-currency ratings of Ukraine to C on 22 July upon solicitation of debt restructuring. We downgraded Russia's credit ratings in three stages from BBB+ to C, before becoming the first EU credit rating agency to withdraw Russia's credit ratings in March. A first-time sovereign rating of BB+ was assigned to Serbia in June, with Stable Outlook. Marked deterioration of growth and elevated reliance on Russian energy, moreover, drove Outlook revision to Negative for the Czech Republic's AA ratings earlier this month, while Croatia's ratings were upgraded to BBB+/Stable upon forthcoming euro accession. **Annex II, Figure 8** summarises rating actions since February.

As such, presently, 11 of Scope's 15 publicly rated sovereigns of CEE are investment-grade rated with four rated sub investment-grade (Turkey, Ukraine, Serbia, Georgia). Three borrowers are on Negative Outlook while two are presently on Positive (Outlook). **Annex II, Figure 7** provides a summary of outstanding CEE sovereign ratings.

Policy responses targeting sustained recovery, while addressing macro-financial imbalances and anchoring medium-run budget and inflation expectations will prove crucial for credit assessments of CEE sovereign states over the remainder of 2022 and beyond.

# Country outlooks

## Visegrád countries

### Poland (A+/Negative): EU approval of recovery plan lowers immediate risks to funding; governance risks continue

We expect Polish real GDP to grow 4.9% this year (revised up 0.8pps from a 4.1% forecast entering this year) before slowing to 3.1% in 2023 (revised down from 3.7%). Poland is less exposed to disruption of global supply chains compared with the remainder of the Visegrád Group because of a large and diversified economy and diversified gas supply infrastructure, which support the credit ratings. We see public debt moderating to 45% of GDP by 2023, from a peak of 57% in 2020. However, the economy's low savings and shortages of skilled workers deepen reliance upon external resources, with risk of making growth less sustainable. Inflation will remain a near-term challenge, set to average 12.5% (HICP) for this year. The National Bank of Poland is likely to further tighten monetary policies as real interest rates remain deeply negative, even as it approaches the conclusion of its hike cycle.

Poland's weak governance – manifested in state policies to subvert the rule of law and weaken independence of the judiciary – remains a source of discord with the European Union, calling into question Poland's access to EU funding and underscoring a Negative Outlook. This is despite EU endorsement of Poland's EUR 35.4bn (EUR 23.9bn in grants and EUR 11.5bn in loans) recovery and resilience plan, which curtails immediate funding risk. The rule-of-law conditionality mechanism introduced to the EU multiannual budget is a relevant risk for Poland's forward-looking economic outlook. A failure to fulfil EU conditions on improvement of the rule of law could result in further financial sanctions and fresh delays of EU financing, adversely impacting growth, the trajectory of public finances as well as reliability of contingent EU support under adverse market scenarios.

### Czech Republic (AA/Negative): credible macroeconomic policies, but exposure to external risk is a challenge

The war in Ukraine and associated supply-chain disruptions are a drag upon Czech Republic's export-driven economy, particularly on its automotive industry, which accounts for around 10% of the aggregate economy. Dependence on Russian energy (85% of Czech gas being imported from Russia) coupled with high economic integration in global supply chains are core constraints for near-term economic growth and inflation. We expect output to increase only 1.6% in 2022 before 2.7% for 2023. We do not expect the Czech National Bank to tighten much further, but more persistent inflation – with average inflation seen topping 12% in 2022 – will delay future monetary easing.

A record of robust macroeconomic policy making underpins AA credit ratings, despite revision of the Outlook to Negative earlier this month. This policy-making record has anchored a competitive and industrialised economic base as well as high levels of employment, which, alongside expectation of continuing FDI inflow, support medium-run economic growth. Despite looser-than-expected fiscal policies near term to accommodate for Ukraine-war-related economic consequences, we anticipate government to contain outsized rises of government debt medium run. Debt is seen further rising to 45% of GDP in 2023. The government will likely focus on how to enhance EU and

NATO integration processes absent undertaking major changes of economic policies.

### Hungary (BBB+/Stable): further delays of EU funding risks ratings outlook

The Hungarian government needs to address rising budgetary pressure as the economy is set to slow amid rising inflation. We foresee growth of 4.0% in 2022 before 3.4% in 2023. Inflation is expected to average 9.2% this year, even assuming dampening effects of caps on food and fuel prices. The National Bank of Hungary might be forced to tighten further this year, also given recent weakening of forint. Hungary's sizeable subsidies to cushion the economy from high energy prices are expected to hold the fiscal deficit around an elevated 5.6% of GDP in 2022 and public debt at 76% of GDP by end-2022. This debt ratio remains among the highest of CEE-11 and represents a credit challenge, reducing space for further discretionary spending. An expected robust underlying growth rate over years ahead, assuming supply chains recover, supporting exports and FDI, ought to facilitate gradual further decrease of the public debt ratio, to 68% of GDP by 2027.

Strained relations with the EU, however, risk further delays of the disbursement of EU funding, with such funding vital to supporting recovery without having to resort to additional state borrowing. Long-run risks to economic competitiveness, such as structural employment gaps and the public sector's predominance across many sectors, weigh on macroeconomic sustainability. These factors could lower Hungary's growth outlook and damage fiscal and external balances, challenging the ratings outlook.

### Slovakia (A+/Stable): positive fiscal dynamics at risk from energy crisis and weaker reform momentum

Slovakia's small, open economy is highly vulnerable to supply-chain disruption and energy shortages, and particularly to a sudden stop of Russian gas, as Russia accounts for 85% of Slovak gas consumption. Still, gas storage facilities enable the government to meet domestic demand through H1 2023 and mitigate short-run risks for households and corporates.

We expect output growth of 2.2% in 2022 (down from 3.0% in 2021) before 3.4% in 2023. Resumed inflows of FDI especially to the automotive industry (which accounts for around 12% of GDP) ought to underpin said recovery together with EU funding to diversify energy supplies and support green transition. Public debt is seen decreasing to 61.4% of GDP in 2022, due to inflationary pressure (among the highest of the euro area) and lower fiscal deficits, before stabilising around 50-55% of GDP medium run. The ECB holds nearly half of outstanding Slovak government securities, which mitigates refinancing risk as the ECB reinvests maturing securities over a forthcoming period. Still, the full implementation of recent reform of the fiscal framework and introduction of pension reform are crucial to improving long-run fiscal sustainability given a rapidly-ageing population.

## Southeast Europe

### Romania (BBB-/Stable): ratings outlook hinges on fiscal prudence, maintaining EU funding

After robust growth of 5.9% in 2021, Romania's economy is forecast to grow around 4.8% in 2022 and 4.5% in 2023 as supply-chain bottlenecks affect its trade balance and investment outlook. Inflation will average around 11% this year and the current-account deficit is expected to widen to 8% of GDP this year (from 7% of GDP in 2021) on higher prices for fuel and agricultural commodities.

The slowdown of growth represents a challenge for government fiscal plans to reduce the budget deficit to under 3% of GDP by 2024 (we do not expect the deficit to fall under 3% of GDP over our forecast horizon to 2027). For now, disbursement of EU funding via the RRF, which requires no co-financing, is partly compensating for budgetary deterioration. In 2022, Romania plans to receive EUR 6bn in RRF monies, equivalent to around 2.5% of GDP.

However, the government faces a difficult task of passing and implementing pension reforms by 2023 and increasing tax revenue by at least 2.5pps of GDP by 2025. Meeting such objectives is important to guaranteeing a steady inflow of RRF financing, of EUR 29.2bn (12% of 2021 GDP) over 2021-2026, in addition to EU structural funds of around EUR 50bn (21% of 2021 GDP) for 2021-2027. Reception of EU funds is vital for supporting Romania's credit-rating outlook.

Romania's credit outlook hinges furthermore on credibility of authorities' reform agenda and fiscal-consolidation programme. Should lawmakers fail to maintain a stable government implementing credible fiscal and economic reforms as envisioned under the Recovery and Resilience Plan, this would present greater risk to Romania's investment-grade ratings.

### Bulgaria (BBB+/Stable): institutional reform, stable government key for smooth euro-area accession, ratings outlook

The fall of the government in Sofia after a no-confidence vote in June creates political instability, which is negative for economic recovery and could affect a timetable for euro-area accession.

Russia's halting of gas supplies raises risk of energy shortages, given relatively low levels of gas stored, until new supply arrangements are finalised. However, gas makes up a relatively small share of Bulgaria's final energy consumption (12%), somewhat reducing the immediate adverse growth impact. We forecast Bulgaria's output to grow 1.8% and inflation to average above 11% in 2022.

As political parties negotiate to form a new government, reforms – such as those required to make the most of crucial EU funding – are likely to take a backseat. Political instability could extend into next year, with the possibility that only another election breaks the deadlock. Critical factors to watch moving ahead include stability of any new government and its policy choices, including as regards tackling corruption and judicial independence, and developing the institutional capacity required for more effective spending of EU funding. A continuity of reform will prove vital for boosting Bulgaria's growth potential to more than a current (estimated) 2.75% a year and meeting a sought 1 January 2024 target date for accession to the euro area. We do not expect political instability to affect the low level of government debt and prudent fiscal policy framework – key credit strengths underpinning BBB+ investment-grade credit ratings.

### Croatia (BBB+/Stable): euro-area entry by 2023 underscored rating upgrade

The upgrade of Croatia's ratings to BBB+/Stable from BBB-/Positive on 15 July 2022 reflected recent formalisation of entrance to the euro area on 1 January 2023 and forthcoming adoption of euro as local currency, with multiple credit-positive implications through the future circulation of a global reserve currency, strengthened governance institutions via said accession and strengthened flexibility of monetary policies. The replacement of the Croatian kuna with euro will significantly curtail foreign-currency risk in an euroised economy, banking system and public debt stock. The fact that Croatia stands ready to join the euro area already next year underlines authorities' commitment to reform. However, economic disruptions due to Covid-19 and Russia's full-scale invasion of Ukraine are credit constraints that have driven up inflation and caused budgetary deterioration.

Other credit challenges reflect an elevated government debt burden, projected around 76.5% of GDP at end-2022. Furthermore, raising modest medium-run growth potential, estimated around 3% annually, is a challenge despite a relatively low income level with GDP per capita of around half the euro-area average. Croatia's economic structure and composition of the tradeable sector and energy mix point towards lower direct exposure to repercussions of the war in Ukraine than that of regional economic peers, while its high reliance on tourism increases sensitivity to potentially recurring Covid-19 travel restrictions and external-sector shocks.

### Slovenia (A/Stable): Fiscal, external buffers support the ratings; demographics cloud the outlook

The Stable Outlook of Slovenia balances downside credit risks from the war in Ukraine and medium-run fiscal and growth challenges against anticipated reduction of fiscal deficits and public debt ratios. The economy's heavy reliance on energy imports from Russia (almost all gas and around 10-15% of oil and petroleum derive from Russia) makes the economy exposed to a sudden stop or full embargo of Russian energy, although gradual diversification of gas supplies with European as well as non-European partners mitigates those risks to a degree. We forecast growth to decelerate to 3.9% in 2022 (from 8.1% in 2021) before 2.5% growth in 2023. Public debt is set to decline from 79.8% of GDP in 2020 to around 65-70% of GDP medium run. Disbursements from the EU RRF should support said declining debt trend as incentives for structural reform including of pensions counter long-run ageing-related spending pressures. Significant cash cushions ought to mitigate risks surrounding higher long-term bond yields. We expect the current account to remain in surplus over 2022-23 due to a resilient exporting sector, although it would remain under pre-Covid-19 levels because of higher energy costs and stepped-up investment in green and digital transitions.

## EU: Baltic states

### Lithuania (A/Positive): strengthened resilience of the economy supports ratings

Following no *annual* contraction during pandemic-crisis peaks of 2020 – reflecting enhanced resilience of the economy – output rebounded strongly in 2021, posting 4.9% growth. We forecast growth to slow to 1.8% in 2022 due to adverse repercussions connected to the war in Ukraine. Private consumption is affected by elevated inflation, the latter projected to average nearly 16% this year, while ongoing supply-chain bottlenecks weigh on exports and investment. However, we do not expect the war to present a more permanent impact on the economy. Exports of goods of national origin to Russia are modest, of around 1.7% of aggregate exports in 2021, while Russia was the source of 12% of imports of goods, most of which reflected fuel, oil and associated products.

We do not anticipate seismic energy disruption after Lithuania halted all Russian energy importing since May. The Lithuanian as well as Baltic natural gas transmission systems have already been connected with Polish and EU systems, while connection of Baltic states' and continental Europe's electricity networks is planned for completion by 2025, with a possibility of earlier synchronisation. Implementation of strategic public-infrastructure investment projects on the back of the country's strong historical absorption of EU funds will drive balanced medium-run growth, estimated at 2.5-3% annually. The government's proven ability to consolidate public finances ought to support the reduction of government debt to around 43% of GDP by 2022. However, an ageing population, rising pension obligations and a still-sizeable shadow economy remain constraints to outlooks of growth and public finances.

### Latvia (A-/Positive): fiscal prudence, reduction of financial-sector risk support Positive Outlook

We forecast real growth to slow to 2.5% in 2022 and 2023 for Latvia, from 4.5% in 2021. Rising commodity prices dampen real household disposable income, with full-year 2022 inflation of an elevated 13.5% anticipated. At the same time, we see the Latvian economy and public finances remaining resilient to high inflation and economic consequences of the Russia-Ukraine war, recognising a backdrop of sizeable budgetary cushions and improved external finances. We foresee solid growth medium run, estimated at 2.5% annually. This growth will benefit from sizeable inflows of EU funding and investments under the flagship infrastructure initiative, Rail Baltica, which will connect the Baltic region with the European rail network via Poland by 2030.

Despite political fragmentation, we expect comparative policy continuity after elections later in 2022. This includes continued commitment to prudent fiscal management after elections, which ought to ensure the debt ratio stabilises over 2022-23 and a gradual drop thereafter. Financial-sector risk has subsided with diminishing reliance of Latvian banks upon non-resident deposits, achieved absent materially adversely affecting banking-system liquidity. However, moderate productivity growth and net emigration, the latter albeit moderating, remain constraints for long-run economic growth and the health of public finances.

### Estonia (AA-/Stable): solid public finances, but demographics and green transition reflect challenges

Sound institutions, coherent policy making and prudent fiscal management have maintained Estonian public debt at low levels. General government debt of an estimated 21% of GDP in 2022 remains the lowest of CEE-11 even if set to continue gradually rising over the medium run. A favourable investment environment and digital transformation of the economy – exemplified via attraction of investment of >EUR 1bn via Volkswagen for automotive software development (although with a small direct impact on output, given a large import component) – demonstrate a robust economy and support a medium-run growth outlook.

Risks to the credit ratings associate with unfavourable demographics, which, besides constraining labour-market supply, also burden the pensions system, as well recognising a current low level of pension payments. Still, Estonia has benefitted from net immigration since 2015, mitigating labour shortages of some sectors. The transition required to meet EU carbon-neutrality objectives appears challenging, however, in view of importance of the country's oil shale sector. The sector accounted for 40% of electricity production in 2020, although down from 76% in 2018.

## CIS+ – Russia, Ukraine and Georgia

### Russia (WD): sanctions widen disconnect between rouble and the real economy

The Russian rouble's fortunes are increasingly disconnected from health of the Russian economy due to western sanctions. Over 1H 2022, the current-account surplus surged to USD 138.5bn, surpassing its full-year surplus of 2021 of USD 120.3bn. The EU's oil embargo will hit foreign-currency inflows in 2023, however, with material implications for value of rouble. While efforts of the Central Bank of Russia to ease capital flight and stabilise local markets via capital controls are working near term, they come at the cost of tighter financial conditions than before the escalation of the war given elevated credit spreads and low liquidity. The central bank cut rates a further 150bps last Friday to 8% amid a strong currency, cooling inflation and a weak economy – a fifth rate cut of this year, taking the key rate to under levels from when the full-scale invasion began.

Transforming Russia's economic model to sustain greater economic isolation will require more than simply protecting the value of rouble. More profound reform is needed to wean the economy off reliance on the oil and gas sector. Such reforms are politically costly, however, as they require reducing the state's role in the economy. Instead, the state's footprint in the economy is likely to further increase from ongoing nationalisations of impacted businesses in sectors from which foreign investors are leaving.

In the oil sector, because of lowered drilling activities, in part from an absence of foreign technologies, Russia may not return to pre-February levels of crude production over the next years. Nevertheless, relative importance of energy revenues in the budget will further increase: over the first four months of 2022 alone, Russia's federal budget collected 50% of a planned RUB 9.5trn (or USD 132bn) in oil and gas revenue.

In the longer run, an EU boycott of Russian oil is likely to imply significant costs for the energy sector and real economy as far as rouble convertibility. This is despite Russia's expectation of bypassing an EU ban on insuring maritime oil deliveries to third countries by using state guarantees and increasing re-exports. A sizeable share of Russian crude exported to India is re-exported, including to the United States and Europe, as refined oil products. A complete replacement of the European market for Russian energy exports is out of reach any time soon due to significant transport and logistical constraints, even if China's and India's oil imports from Russia have increased significantly over the recent months. While Asian independent refiners may be attracted by Russian oil at discounted pricings, state-owned commodity traders may be less so due to concerns around secondary sanctions.

### Ukraine (C/Under Review): ratings under review upon solicitation of debt-service suspension

We revised Ukraine's foreign-currency ratings to C (to one notch from default), from CCC, and placed said foreign-currency ratings under review for a developing outcome on 22 July. This decision reflected a prudent consent solicitation of the government for the restructuring of Eurobond debt and GDP-linked securities, alongside reflecting the further weakening of Ukraine's external-sector resilience. At this stage, it remains unclear the full degree of support from creditors for presented restructuring terms, however – even recognising significant international commitment to assist Ukraine and early indications of explicit backing from a representative group of the largest debt holders. The government seeks agreement with bondholders by 15 August 2022. Under any scenario bondholders do not agree to changes, Ukraine plans to continue the servicing of its foreign debt. Given significant international goodwill for Ukraine, there is likelihood, moreover, of longer-run debt forgiveness to address possible solvency challenges.

The foreign-currency issuer ratings could be revised to a selective default credit rating within the forthcoming period should negotiations conclude successfully in distressed debt restructuring. Meanwhile, Ukraine's *local-currency* long-term ratings were left unchanged in July at CCC and Negative Outlook.

The National Bank of Ukraine (NBU)'s foreign-currency reserves eased to USD 19.4bn last month – above highly at-risk levels at this stage but having declined from peaks of USD 29.4bn as of December 2021. The pace of such declines has accelerated as the central bank attempts to defend hryvnia while supporting funding of a USD 5-7bn monthly state financing gap. This has raised balance-of-payment risks.

The NBU's 15pp rate increase last month has reintroduced a positive real policy rate, even after inflation further rose to 21.5% YoY in June, with the NBU hoping the rate hike eases forex, reserve and dollarisation pressure. A further hike(s) of rates might be necessary, however, to defend value of hryvnia and ease financial-system risk. The official hryvnia exchange was devalued 25% against dollar on 21 July, resulting in significant convergence with the unofficial hryvnia rate.

After estimated output growth of 3.4% in 2021, Ukraine's economy is expected to face a severe 31% (revised up from -37.5%) economic contraction during 2022, prior to rebound of output in 2023 of circa 12.5%. The conflict's escalation and decline of output have seen reversal of a strong pre-2022 declining trajectory of government debt and placed substantive strain on an outlook as regards long-run debt sustainability. Under a baseline economic scenario, assumptions are for a headline budget deficit of 19.7% of GDP this year, rising from a pre-crisis 4.0% deficit of 2019, followed by an average general government deficit of 14.9% over 2023-27. The general government debt ratio might reach 89.1% of GDP in 2022, from 48.9% in 2021, prior to concluding a forecast horizon (to 2027) around 90%.

Ukraine's credit ratings are supported by very significant international financial support. However, Ukraine has recently relied overly heavily upon monetary financing via the NBU – amounting to USD 7.7bn financed via the central bank of an aggregate USD 24.6bn raised by government since escalation of the war through 21 July 2022. An overly significant share of financing has furthermore been in the form of loan financing, requiring greater international commitments via grant allocations moving ahead.

### Georgia (BB/Stable): solid growth prospects despite political polarisation

The Stable Outlook reflects our view that Georgia's credible policy framework and strong access to donor financing lower risk to its macro-financial stability and anchor foreign-currency reserve stocks. The economy holds potential to grow around 5% annually, underpinned by capacity to draw FDI. We expect the government to remain committed to growth-oriented, business-friendly reforms and fiscal discipline medium run, supported by sound institutional engagement with the IMF, EU and other supranational organisations. While Ukraine and Moldova were granted candidature status for EU accession in June, Georgia was granted a "European perspective" – e.g., candidacy only upon meeting specified institutional and governance targets.

Elevated polarisation between ruling Georgian Dream and the largest opposition group, United National Movement, during aftermath of a severe political crisis that followed 2020 parliamentary elections hinders implementation of reform and impacts the investment environment. We expect geopolitical risks with Russia to persist with relation to unresolved conflicts in South Ossetia and Abkhazia. Aside from Ukraine, we consider Georgia as the most geopolitically at-risk country of our rated sovereign universe to Russian aggression – challenging the credit outlook.

## Rest of Emerging Europe: Turkey and Serbia

### Turkey (B-/Negative): ongoing credit deterioration, with 2023 elections on horizon

We downgraded ratings of Turkey by one notch to B-/Negative (foreign currency) and B/Negative (local currency) on 11 March, on basis of unsustainable economic policies and the risk of a deeper balance of payments and financial crisis.

Inflation rose to fresh post-2002 highs of 78.6% in June, the highest since the 1990s. A consequential real policy rate of -64.6% represents the lowest by far of any emerging market but, since 2021, Turkish monetary authorities have become numb to inflation data due to political interference.

The lira has fallen 54% in value since September 2021 highs. However, we consider a rate hike in 2022 as unlikely. Instead, unsustainable policy making has been adopted against forex sell-off pressures, intended to encourage resident sector investment and savings in domestic currency. However, such regulations are unlikely over the long run to prevent a severe currency crisis, and instead will encourage macro imbalances to accrue such as distortions of lira value and forex flexibility, strengthening the sovereign-bank nexus, exacerbating economy-wide shortages of foreign currency while undercutting fiscal strengths.

The possibility of a more severe economic crisis is likely to interact with institutional and political challenges ahead of scheduled 2023 presidential and parliamentary elections. We consider it unlikely that President Recep Tayyip Erdoğan relinquishes power easily after any elections. At the same time, there exist upside scenarios after elections of ultimate change of government and policy direction, after a phase of instability. As such, elections could either reinforce (our baseline) or, possibly, reverse the credit trajectory of Turkey.

Due to stronger-than-anticipated economic data and acceleration of lira lending to 56% YoY by June, we revise up our short-run growth expectation to 5.8% for 2022 (from 3.6% as of our April 2022 estimate), before slowdown to 3.5% in 2023. Turkey's external-sector vulnerabilities, including net FX reserves at a record low of around USD 60bn alongside weakening of the current account, raise vulnerabilities under a scenario of deeper economic and institutional crises.

### Serbia (BB+/Stable): growth momentum, policy discipline reduce risk of macro instability

On 3 June, we assigned Serbia a first-time rating of BB+ with Stable Outlook, accounting for disciplined policy making, which is seen sustaining a relatively stable dinar and adequate forex reserves. After projected growth of 3% for 2022, growth is expected to stabilise at around 4% by 2023, roughly equal to an economic potential rate of growth of circa 4%-4.5% over the medium run.

The EU embargo of Russian oil could have a material adverse economic impact, as Serbia relies on supplies transported via EU countries, including via Croatia. Serbia imports almost 90% of its gas and 60% of its oil from Russia. We forecast average headline inflation of around 9% YoY in 2022, with the current-account deficit widening to nearly double-digits as a ratio to GDP this year from 4.4% of GDP in 2021, mainly due to an impact of higher energy and other commodity prices.

The government faces a difficult task in balancing its relations with Russia – given reliance on energy imports from Russia, including a recent three-year gas deal, with the nation's other political objectives – such as economic and institutional convergence with the European Union. Broader normalisation of relations between Serbia and Kosovo, a precondition for EU accession for which a date is likely to be delayed considerably from a planned 2025, remains a longer-run challenge.

## Annex I: 2022-23 macroeconomic outlook

| | Country/region | Real GDP growth (%, average) | | | General government balance (% of GDP) | | | General government debt (EOP, % of GDP) | | | Inflation, year-on-year (%, average)* | | | Policy rate (%)** | | | Yield, local currency, 10-year (%) | CDS spread, USD, 1-year (bps) | Δ in EUR per local currency (%) | Reserves (% of short-term external debt)*** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2021 (E) | 2022 (F) | 2023 (F) | 2021 (E) | 2022 (F) | 2023 (F) | 2021 (E) | 2022 (F) | 2023 (F) | 2021 (E) | 2022 (F) | 2023 (F) | Current | 2022 (EOP) | 2023 (EOP) | Current | Current | Since start-2022 | 2022 (EOP, F) |
| | **EU CEE-11** | 5.6 | 3.8 | 3.3 | -4.4 | -4.7 | -3.8 | | | | 4.3 | 11.6 | 7.2 | | | | | | | |
| **Euro-area CEE** | **Slovakia** | 3.0 | 2.2 | 3.4 | -6.2 | -4.9 | -3.1 | 63 | 61 | 56 | 2.8 | 10.2 | 7.6 | 0.00 | 1.00 | 1.50 | 1.9 | 31 | - | - |
| | **Slovenia** | 8.1 | 3.9 | 2.5 | -5.2 | -4.9 | -4.6 | 75 | 71 | 70 | 2.0 | 8.1 | 4.8 | 0.00 | 1.00 | 1.50 | 2.1 | 30 | - | - |
| | **Lithuania** | 4.9 | 1.8 | 2.8 | -3.0 | -4.4 | -2.7 | 43 | 43 | 42 | 4.6 | 15.8 | 6.5 | 0.00 | 1.00 | 1.50 | 2.7 | 57 | - | - |
| | **Latvia** | 4.5 | 2.5 | 2.5 | -7.3 | -7.0 | -3.5 | 45 | 46 | 46 | 3.3 | 13.5 | 6.0 | 0.00 | 1.00 | 1.50 | 2.4 | 55 | - | - |
| | **Estonia** | 8.2 | 1.2 | 2.7 | -2.4 | -4.4 | -3.7 | 18 | 21 | 23 | 4.5 | 16.0 | 8.0 | 0.00 | 1.00 | 1.50 | 2.6 | 27 | - | - |
| **Non-euro-area EU CEE** | **Poland** | 5.8 | 4.9 | 3.1 | -1.9 | -3.2 | -3.2 | 54 | 48 | 45 | 5.2 | 12.5 | 8.5 | 6.50 | 7.00 | 6.00 | 5.8 | 91 | -3.2 | 100 |
| | **Romania** | 5.9 | 4.8 | 4.5 | -7.5 | -7.5 | -5.5 | 49 | 53 | 55 | 4.1 | 11.1 | 7.1 | 4.75 | 5.50 | 5.00 | 8.7 | 179 | 0.3 | 83 |
| | **Czech Republic** | 3.3 | 1.6 | 2.7 | -5.9 | -4.5 | -3.8 | 42 | 44 | 45 | 3.3 | 11.7 | 5.7 | 7.00 | 7.00 | 6.00 | 4.3 | 23 | 1.4 | 145***** |
| | **Hungary** | 7.1 | 4.0 | 3.4 | -6.8 | -5.6 | -4.8 | 77 | 76 | 75 | 5.2 | 9.5 | 6.4 | 9.75 | 10.75 | 7.75 | 8.2 | 120 | -7.3 | 178 |
| | **Bulgaria** | 4.2 | 1.8 | 3.5 | -4.1 | -4.8 | -2.6 | 25 | 25 | 27 | 2.9 | 11.4 | 6.3 | 0.00 | 0.00 | 0.00 | 2.9 | 73 | 0.0 | 327 |
| | **Croatia** | 10.2 | 3.5 | 3.7 | -2.9 | -2.8 | -2.5 | 80 | 77 | 74 | 2.7 | 8.8 | 4.0 | 0.05 | 0.05 | - | 3.2 | 63 | -0.1 | 149 |
| **Non-EU emerging Europe** | **Russia** | 4.8 | -10.5 | 1.0 | 0.7 | -1.5 | -3.9 | 17 | 17 | 20 | 6.7 | 16.0 | 12.0 | 8.00 | 8.00 | 7.00 | 9.1 | - | 45.5 | 444 |
| | **Turkey** | 11.0 | 5.8 | 3.5 | -3.3 | -2.3 | -2.7 | 42 | 38 | 39 | 19.4 | 64.0 | 45.6 | 14.00 | 14.00 | 14.00 | 16.7 | 911 | -15.8 | 44 |
| | **Ukraine** | 3.4 | -31.0 | 12.5 | -4.0 | -19.7 | -18.5 | 49 | 89 | 85 | 9.3 | 18.5 | 13.0 | 25.00 | 30.00 | 20.00 | 39.4 | 31595 | -17.0 | 66 |
| | **Serbia** | 7.4 | 3.0 | 4.0 | -4.1 | -3.5 | -2.0 | 57 | 57 | 55 | 4.1 | 9.0 | 4.5 | 2.75 | 3.50 | 3.00 | 7.0 | 142 | 0.1 | 300 |
| | **Georgia** | 10.4 | 8.0 | 5.0 | -6.0 | -3.9 | -2.6 | 49 | 46 | 45 | 9.6 | 12.7 | 6.0 | 11.00 | 11.50 | 10.50 | 10.0**** | - | 23.0 | 92 |

Source: Scope Ratings, Macrobond, IMF, Eurostat, OECD, Bloomberg, Refinitiv Eikon, national central banks and statistical offices; *HICP for EU CEE economies, CPI for non-EU CEE countries; **deposit facility rate of the ECB for euro-area CEE economies; yield on 7-day National Bank of Poland money market bills for Poland; 2-week repo rate displayed for the Czech Republic; interest rate on minimum reserves for Hungary; 1-week repo rate for Romania, Russia and Turkey; base rate for Bulgaria; rate on regular operations for Croatia; 1-week refinancing rate for Georgia; key policy rate for Ukraine, Serbia ***coverage of short-term external debt plus long-term external debt maturing in one year or less, an IMF adequacy threshold for this ratio is above 100%, data from IMF Assessing Reserve Adequacy; Russia's data include its sanctioned reserves ****as of 19 July (primary market); *****Scope estimate.

# Annex II: Scope's CEE sovereign ratings & 2022 rating actions

**Figure 7. CEE long-term foreign-currency issuer ratings, as of 22 July 2022**

| Central and Eastern Europe EU member states (CEE-11) | | | | Non-EU CEE | |
|---|---|---|---|---|---|
| *Euro area* | | *Non-euro-area EU* | | | |
| Estonia | AA-/Stable | Bulgaria | BBB+/Stable | Georgia | BB/Stable |
| Latvia | A-/Positive | Croatia | BBB+/Stable | Russia | WD |
| Lithuania | A/Positive | Czech Rep. | AA/Negative | Serbia | BB+/Stable |
| Slovakia | A+/Stable | Hungary | BBB+/Stable | Turkey | B-/Negative |
| Slovenia | A/Stable | Poland | A+/Negative | Ukraine | C/Under Review |
| | | Romania | BBB-/Stable | | |

**Figure 8. Scope's CEE sovereign rating actions in 2022, through 22 July 2022**

| Date | Sovereign | Rating action | Rating & Outlook* |
|---|---|---|---|
| 22 July | Ukraine | Downgrade/ Under review | C/Developing |
| 15 July | Croatia | Upgrade/ Outlook change | BBB+/Stable |
| 8 July | Czech Republic | Affirmation/ Outlook change | AA/Negative |
| 17 June | Ukraine | Confirmation/Outlook assignment | CCC/Negative |
| 3 June | Serbia | First-time rating | BB+/Stable |
| 17 March | Russia | Withdrawal | WD |
| 11 March | Turkey | Downgrade | B-/Negative |
| 10 March | Russia | Downgrade/ Under review | C/Developing |
| 4 March | Russia | Downgrade/ Under review | CCC/Review for downgrade |
| 1 March | Russia | Downgrade/ Under review | BB+/Review for downgrade |
| 1 March | Ukraine | Downgrade/ Under review | CCC/Developing |
| 28 January | Croatia | Affirmation/ Outlook change | BBB-/Positive |
| 28 January | Ukraine | First-time rating | B/Negative |
| 21 January | Czech Republic | Affirmation | AA/Stable |
| 14 January | Poland | Affirmation/ Outlook change | A+/Negative |
| 14 January | Latvia | Affirmation/ Outlook change | A-/Positive |

*Foreign-currency long-term issuer ratings only.

## Annex III: Additional research of CEE

Bulgaria: no-confidence vote increases early election risk, restricts capacity for reform, 22 Jun

Serbia: growth momentum, policy discipline cushion economic blows from war in Ukraine, 13 Jun

Southern and eastern European countries set to receive most EU funds in 2021-27, 7 Jun

Russian oil embargo: Europe faces manageable cost squeeze; Russia's long-term growth outlook worsens, 2 Jun

Ukraine: war-torn economy to shrink 40% in 2022; daunting financing, reconstruction task ahead, 24 May

Russia: tougher sanctions widen disconnect between rouble and economy, increasing retaliation risk, 10 May

EU's oil embargo proposal strikes delicate balance; Hungary risks further isolation, 6 May

Russian gas stoppages stress EU's political unity and economic outlook, accelerate Russian gas exit, 2 May

Russia-Ukraine crisis: CEE, Egypt, Turkey pay economic price for trade, energy, tourism ties, 26 Apr

Romania: credit outlook hinges on fiscal prudence, deploying EU funds amid slow growth, inflation, 22 Apr

Russia: record current account surplus disguises longer-term impact of sanctions, 21 Apr

Central and eastern Europe: growth slows, inflation rises from war in Ukraine; ECB, EU cushion blow, 12 Apr

Hungary: Orbán's re-election prompts greater isolation risks; negative for credit outlook, 11 Apr

Bulgaria: exposure to Russia, Ukraine is a drag on growth; rating upside depends on euro progress, 28 Mar

Russian demand for rouble payments for gas further complicates EU-Russia energy stand-off, 25 Mar

Limiting Russian oil and gas imports: Europe's delicate balancing act, 25 Mar

Russia's economy to shrink significantly in 2022 due to war in Ukraine, sanctions, 15 Mar

Russia-Ukraine war raises stagflation risk for sovereign, corporate credit quality, 10 Mar

Further Russian conflict escalation could pressure Ukraine sovereign credit rating, 22 Feb

Russia: credit risk hinges on design of any tougher sanctions, 18 Feb

Poland's rule-of-law dispute with the EU challenges long-run credit outlook, 17 Feb

Europe's difficult balancing act: managing the energy transition amid a geopolitical crisis, 3 Feb

Russia's assertive foreign policy threatens longer-term economic and reform outlook, 20 Jan

## Country abbreviations

Slovakia (SK), Slovenia (SI), Estonia (EE), Latvia (LV), Lithuania (LT), Poland (PL), Romania (RO), Czech Republic (CZ), Hungary (HU), Bulgaria (BG), Croatia (HR), Russia (RU), Turkey (TR), Ukraine (UA), Serbia (RS), Georgia (GE).

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