SCOPE Scope Ratings

Central and Eastern Europe 2024 Sovereign Outlook

Recovering growth, diverging fiscal paths, and persistent geopolitical risks

Sovereign and Public Sector, Scope Ratings, 17 January 2024

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

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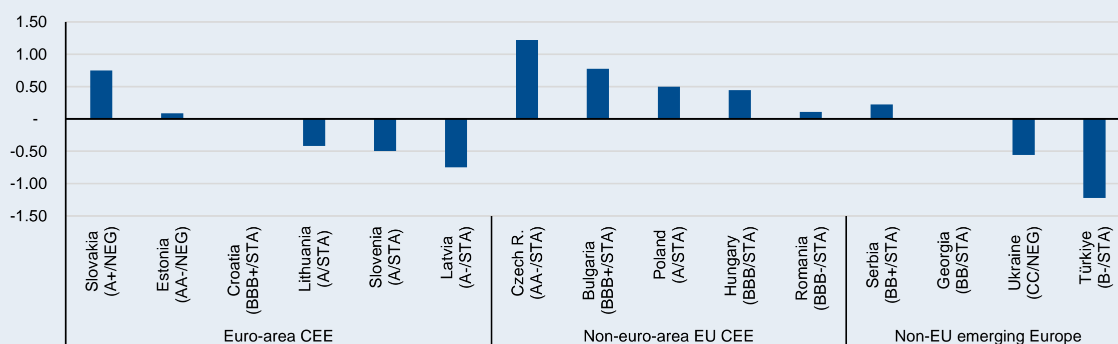
Executive Summary

Risk balance to ratings and Outlooks broadly neutral for 2024, after negative adjustments in 2023:

- The risk balance for ratings on CEE-11 sovereigns is broadly neutral in 2024, following multiple downward rating actions in 2023. The war in Ukraine increased the region's geopolitical risk premium. This is compounded by the energy shock and concerns around fiscal and external accounts.
- We downgraded Hungary (to BBB), the Czech Republic (to AA-), and Poland (to A), and maintained a Negative Outlook for Slovakia (rated A+) in 2023, reflecting structural economic risks and the impact from the cost-of-living shock on growth, public finances and economic resilience.
- We revised down the Outlooks for Estonia (AA-/Negative), Latvia (A-/Stable) and Lithuania (A/Stable), reflecting economic challenges and geopolitical tensions caused by the war in Ukraine.
- Outside of the EU, we maintained a Negative Outlook on Ukraine's CC foreign-debt ratings, reflecting our expectation of external debt restructuring by mid-2024. In January 2024, we revised the Negative Outlook on Türkiye's B- foreign-currency long-term ratings to Stable due to more conventional monetary policy supporting progressive rebalancing of the economy.

Figure 1: Scope's sovereign ratings in the CEE region

versus the US agency average* (notches)



** Average of S&P, Moody's and Fitch Ratings. Based on alpha-numeric conversion on a 20-point scale from AAA (20) to D (1) with US agency ratings adjusted to the Scope rating scale. Pos/Neg Outlooks are treated with a +/-0.33 adjustment. Credit Watch positive/negative with a +/-0.67 adjustment. Foreign-currency long-term issuer ratings, 12 Jan 2024.*

Key macroeconomic themes in the CEE-11 region for 2024:

- **Projected growth improvement amid downside risks.** We expect real GDP growth to rise to 2.5% in 2024, rebounding from 2023's expected 0.7%, and to 3.0% in 2025. This is driven by lower inflation and higher real wages, supporting private demand, while growth contributions of exports are limited due to weak external demand.
- **Inflation to decelerate.** For the CEE-11 region, we forecast inflation at 4.6% in 2024, down from an expected 11.2% in 2023. Strong nominal wage growth signals risks tied to a wage-price spiral.
- **External deficits remain stable.** The terms-of-trade shock is gradually reversing, constraining import growth amid lower domestic demand and sufficient natural gas reserves. However, export performance continues to lag. We expect the current account balance for the CEE-11 region to hover around -1% of GDP in 2024, similar to 2023.
- **Fiscal outlooks remain challenging**. CEE-11 governments are balancing the task of reducing budget deficits with providing support to strategic sectors and boosting spending on energy, infrastructure and defence. The regional budget deficit is expected to decline to 4.5% of GDP this year, down from 4.9% in 2023. The rise in interest payments in 2024, notably for sovereigns with substantial borrowing needs and shorter debt durations compounds the challenge of managing persistent budget deficits.
- **Flow of EU funds is critical**. Governance risks could affect the disbursement of EU funds, which are vital for CEE-EU nations. Blocked funds in Poland and Hungary due to rule of law issues are curbing the economic recovery. The Covid-19 pandemic and conflict in Ukraine intensified the importance of EU funds while higher policy rates in CEE countries compared with the euro area have complicated market-based financing.

Main themes for 2024

Risk balance broadly neutral for CEE sovereigns, after downward adjustments in 2023

The adverse effects of the inflation crisis prompted rating adjustments and Outlook revisions in the CEE-11 region in 2023. Conversely, the success of fiscal consolidation efforts and the impact of monetary policy normalisation is key for the trajectory of our sovereign ratings in the CEE region.

Table 1: Ratings and latest rating actions

	Country	Rating*	Latest Action
Euro area	Croatia	BBB+/Sta	Affirmation, 26 May 2023
	Estonia	AA-/Neg	Outlook Change, 12 May 2023
	Latvia	A-/Sta	Outlook Change, 28 Apr 2023
	Lithuania	A/Sta	Outlook Change, 28 Apr 2023
	Slovakia	A+/Neg	Affirmation, 6 Oct 2023
	Slovenia	A/Sta	Affirmation, 28 July 2023
EU: Non-euro-area	Bulgaria	BBB+/Pos	Outlook Change, 21 Jul 2023
	Czech R.	AA-/Sta	Downgrade, 26 May 2023
	Hungary	BBB/Sta	Downgrade, 24 Feb 2023
	Poland	A/Sta	Downgrade, 2 Jun 2023
	Romania	BBB-/Sta	Affirmation, 17 Mar 2023
Non-EU	Georgia	BB/Sta	Affirmation, 27 Jan 2023
	Serbia	BB+/Sta	Affirmation, 27 October 2023
	Türkiye	B-/Sta	Outlook Change, 12 Jan 2024
	Ukraine	CC/Neg	Affirmation, 12 May 2023

Foreign-currency issuer ratings and rating Outlooks.

In the euro area, **the Baltic countries**' rating Outlooks were revised downwards during the first half of 2023. These adjustments were primarily driven by common challenges faced by the small, trade-dependent economies in navigating external headwinds and geopolitical tensions. Lithuania's A rating and Latvia's A- rating saw their Outlooks revised from Positive to Stable. This shift reflected a sluggish recovery and the sustained impact of the cost-of-living crisis and heightened geopolitical risks on their economic and fiscal outlooks. Additionally, we revised the Outlook to Negative on Estonia's ratings to AA-/Negative to account for the prolonged effects of the cost-of-living crisis on the country's economic fundamentals as well as for the deterioration of its fiscal trajectory.

Slovakia's Negative Outlook was affirmed in 2023, driven by risks tied to an uncertain policy framework and the ongoing diversification of the country's energy supply away from Russian fossil fuels. Slovakia's small, open economy with high exposure to external demand and global value chains could also face challenges due to fragile external demand from European trading partners. Slovakia's fiscal outlook remains vulnerable to potential delays in deficit reduction despite a robust fiscal framework. Following legislative elections in September, the rating trajectory will mainly depend on the government's ability to advance fiscal consolidation to contain the rise in general government debt.

Following our upgrade of **Croatia**'s rating from BBB-/Positive to BBB+/Stable in July 2022, the rating has remained steady at BBB+. This stability is attributed to Croatia's inclusion in the euro area, which mitigates foreign exchange risks and enhances resilience against external shocks. Furthermore, Croatia's growth in 2023 was also strongly supported by its thriving tourism sector, which played a pivotal role in contributing to its sustained economic development.

The outlook for **Slovenia**'s A rating has remained Stable throughout the Covid pandemic and cost of living crisis, supported by a wealthy and resilient economy, diversification of energy supply and robust external performance. Additionally, contrary to most CEE-11 countries, Slovenia (similar to Croatia) stands out with a dynamic tourism industry that benefited from the strong season that prevailed across Europe. This enhanced external resilience contributed to macroeconomic stability. Yet, Slovenia was adversely impacted by the severe floods and landslides of August 2023. The impact on GDP growth prospects is moderate, but fiscal consolidation has been delayed by the reconstruction efforts of flood-affected areas.

All non-euro area countries within the CEE region except for Romania underwent rating adjustments or Outlook revisions in 2023.

Hungary's rating was downgraded from BBB+/Negative to BBB/Stable, the **Czech Republic** from AA/Negative to AA-/Stable, and **Poland** from A+/Negative to A/Stable. These changes, combined with earlier rating Outlook revisions, indicate shared concerns regarding economic prospects, inflationary pressures, fiscal performance, and external vulnerabilities. Specifically, the Czech Republic is dealing with challenges arising from the Russia-Ukraine war, inflationary pressures, disruptions in supply chains, and persistent budget deficits. Governance issues, disagreements with EU institutions, and uncertainties surrounding EU funding have notably impacted the ratings of Hungary and Poland. The new REPowerEU initiative is pivotal for Poland and Hungary, allowing them immediate pre-financing access. Yet, the European Commission has stipulated that further disbursements for these nations hinge on achieving crucial "super milestones". We expect that EU funds allocated in the 2021-2027 Multiannual Financial Framework and the Recovery and Resilience Facility (RRF) will maintain their current levels without substantial reductions. However, the pace of disbursement is expected to remain prolonged, and ultimate absorption is likely to be meaningfully affected.

In contrast to these negative rating actions, **Bulgaria**'s BBB+ ratings were affirmed on July 21, 2023, with the Outlook revised to Positive from Stable. This adjustment reflects our expectation of the country's euro area accession, which should enhance various credit-relevant drivers. The support from the new government and sustained macroeconomic stability also contributed to this favourable revision.

The Outlook for **Romania**'s BBB- ratings has remained Stable since October 2018. This assessment balances structural budget deficits and high current-account deficits with moderate government debt and the benefits of EU membership. Additionally, Romania has one of the least dependent economies of the region on Russian gas as neither the Romanian state nor companies have contracts with Gazprom, which reduces potential vulnerabilities associated with reliance on Russian gas imports.

Outside the European Union, we maintained a Negative Outlook on **Ukraine**'s CC foreign-debt ratings, reflecting our baseline of a second external debt restructuring by mid-2024. The revision of the Outlook in May 2023 on CCC domestic-debt ratings in local and foreign-currency from Negative to Stable reflects a stronger focus since 2023 on domestic commercial bank financing of the sovereign, which reduces the likelihood of domestic debt restructuring.

The Stable Outlook on **Georgia**'s BB ratings has been maintained throughout the energy crisis, supported by a stronger-than-anticipated economic recovery and a favourable sovereign debt profile owed largely to official-sector creditors. However, challenges persist, due to heightened geopolitical risks, domestic institutional concerns, and susceptibility to external shocks attributed to the economy's small size and reliance upon external funding.

Scope's affirmation of **Serbia**'s BB+/Stable ratings highlights certain credit strengths, such as a well-established macroeconomic policy framework and sound fiscal policies leading to a moderate public debt burden. However, the rating faces substantial challenges, including significant net external debt with structural current account deficits and a high prevalence of foreign currency, especially euros, in the financial sector. Institutional weaknesses are complicating Serbia's EU membership aspirations. Prolonged political risks could threaten Serbia's macro-financial stability in 2024.

Finally, we recently affirmed **Türkiye**'s foreign-currency long-term rating at B- and revised the Outlook to Stable from Negative. This rating action was driven by the recent shift towards a more conventional monetary policy supporting progressive rebalancing of the economy following President Recep Tayyip Erdoğan's re-election for a five-year term in May 2023. Policy measures taken by the central bank and the Ministry of Finance and Treasury, including significant policy rate hikes and simplification of prudential regulations, improved institutional credibility and effectiveness. A sustained track record of orthodox economic and monetary policies would support resilience to external shocks and lowers the likelihood of deeper balance-of-payments and/or financial crisis. However, a sharper than expected economic slowdown may test the durability of the current economic management.

Projected growth improvement amid lingering downside risks

We expect a rebound in growth for the CEE-EU 11 region, reaching 2.5% in 2024 from an estimated 0.7% last year. In 2025, we forecast an acceleration in economic growth, averaging 3.0% across the CEE-EU region. **Table 2** summarises our country-level growth projections.

Table 2: Real GDP forecasts, %-change YoY

		2023 (E)	2024 (F)	2025 (F)
Euro Area	Croatia	2.4	2.0	2.6
	Estonia	(2.5)	2.0	2.7
	Latvia	(0.1)	2.2	2.9
	Lithuania	(0.5)	2.4	3.2
	Slovakia	1.4	1.9	2.3
	Slovenia	1.3	2.2	2.7
Non-euro-area	Bulgaria	2.1	2.4	2.7
	Czech R.	(0.4)	1.6	2.8
	Hungary	(0.6)	2.4	3.1
	Poland	0.5	2.9	3.0
	Romania	2.0	3.0	3.4
Non-EU	Georgia	6.7	4.7	5.0
	Serbia	2.0	3.0	3.5
	Türkiye	4.1	3.3	3.5
	Ukraine	5.5	4.0	5.0

Source: Scope Ratings forecasts

Subdued growth last year can be attributed to several factors, including elevated inflation, tight credit conditions, and weakened external demand. For 2024, our forecasts identify **private consumption as a primary growth driver** and indicate a rebound in domestic demand across the CEE-EU region, bolstered by declining inflation, rising household purchasing power thanks to accelerated growth in real wages, and gradually more accommodative financial conditions.

Weak investment also characterised growth in CEE-EU in 2023, but as inflation slows, we expect base effects to support some capital expenditure resurgence in the region this year, which should bolster private consumption in 2025. Yet, potential fiscal tightening might offset this. Additionally, the region's transition into a new EU funding cycle presents potential challenges for investment activity.

Weak external demand, including the potential for a protracted global economic slowdown, is likely to remain a key headwind. We expect contributions from net exports to overall growth in the CEE-11 region are unlikely to substantially support GDP growth this year. Sluggish euro area economies, particularly Germany's performance as a main trading partner to CEE countries, remains a challenge. This is due to the region's deep integration and reliance on Western capital and economies, and the industrial sector's

vulnerability to supply chain disruptions, especially in the **automotive sector**, which is a key employment and growth driver in Slovakia, the Czech Republic and Hungary.

However, the proportion of car exports varies, with Slovakia and the Czech Republic showing high export value. Hungary's and Slovakia's strategic investments in electric vehicle (EV) battery factories have notably positioned the countries well in the global automotive industry due to the substantial difference in cost structure between EVs and traditional vehicles, with a major share of EV production expenses attributed to battery costs.

Our forecast growth rates for individual economies within the CEE-11 region display notable variations, highlighting the diverse economic landscape across the region.

In the euro area, **the Baltic countries** experienced a recession in 2023 amid high inflation and adverse external conditions, related to weak demand from Scandinavia and Germany. This led to a downturn in goods exports, which, alongside tighter funding conditions, weighed on private investment. Estonia experienced the sharpest contraction (estimated at - 2.5%), driven by weak private demand and exports, which were only marginally offset by higher government spending. Latvia (-0.1%) and Lithuania (-0.5%) faced similar headwinds and experienced mild recessions. We anticipate growth in the Baltic countries will align with that of CEE-EU this year. Slowing inflation, the full-scale commencement of RRF-funded investments, and a more favourable external environment should drive a gradual recovery in domestic demand. We forecast real growth will rebound to 2.4% in Lithuania, 2.2% in Latvia, and 2.0% in Estonia this year.

Croatia experienced robust economic growth in 2023 (estimated at 2.4%), driven by strong domestic consumption, a successful tourism season, and increased investment following euro area accession in January 2023. However, we expect a slowdown to 2.0% in 2024.

Similarly, we expect **Slovenia**'s GDP to grow by 2.2% this year, up from 1.3% in 2023. Domestic economic activity will be supported by private consumption benefiting from the decline in inflation. Investments are also expected to drive higher growth rates due to the reconstruction of flood-affected areas and the disbursement of EU funds.

Slovakia's GDP is projected to grow by 1.9% in 2024, up from 1.4% in 2023, due to a more accommodative fiscal stance introduced by the three-party coalition government led by Prime Minister Fico. However, high (albeit declining) inflation rates are expected to continue weighing on disposable incomes. The rebound in GDP growth will also be hindered by still-high dependence on external demand amid sluggish European growth and the ongoing energy supply diversification from Russia fossil fuels. Growing uncertainty on the disbursement of EU funds may also restrain investments.

Bulgaria is projected to achieve a growth rate of 2.4% this year, with an anticipated increase to 2.7% in 2025. Growth will be bolstered by factors such as moderating inflation and a swifter absorption of EU funds. Moreover, the continued influx of EU funds has the potential to further stimulate investment.

The economy of **Hungary**, centred on energy-intensive manufacturing, saw a GDP contraction of 0.6% in 2023. We project 2024 GDP growth of 2.4%, contingent on the release of EU funds, which will drive accelerated growth of 2.9% in 2025, fuelled by substantial FDI. Our forecast assumes that EU funds allocated in the 2021-2027 multiannual financial framework and the RRF will maintain their current levels without substantial reductions. However, the pace of disbursement is expected to remain slow.

After the **Polish** economy weakened markedly in 2023 (to an estimate of 0.5% growth), we see real growth improving to 2.9% this year, as household consumption and business investment recover amid decelerating inflation. Still, risks to the growth outlook include an inflation jump should anti-inflationary measures be withdrawn, still-comparatively tight financing conditions as official rates stay on hold and sluggish external demand. Growth should converge towards a medium-run potential of 3% by 2025, implying continued income convergence towards EU averages.

The **Czech Republic** experienced -0.4% GDP contraction in 2023. We project a moderate recovery with 1.6% growth in 2024, followed by a rebound to 2.8% in 2025, lagging other countries in the region. Weakening foreign demand is a key downside risk to our forecast. While stronger-than-expected external demand coupled with improved supply would support GDP growth, the persistently tight labour market is set to contribute to the stickiness of core inflation.

Romania's projected GDP growth is set to reach 3.0% in 2024, followed by a further increase to 3.4% in 2025. An accelerated absorption of EU funds is expected to provide a solid foundation for the country's robust economic performance.

Outside of the EU, **Georgia** is expected to experience strong growth of 4.7% in 2024, roughly aligning with the nation's medium-run growth potential, driven by tourism and increased financial inflows. The economy has shown robust performance in recent years amid the Covid-19 recovery alongside a jump in trade, and capital and labour inflows due to Russia's war in Ukraine.

Ukraine has faced exceptional economic challenges due to the war, resulting in a severe contraction of around 29% in 2022. We have estimated growth of an above-consensus 5.5% in 2023 and forecast 4.0% for 2024. Our forecasts assume a protracted war.

Growth in **Serbia** is expected to accelerate as real incomes improve to 3.0% this year, followed by 3.5% next year.

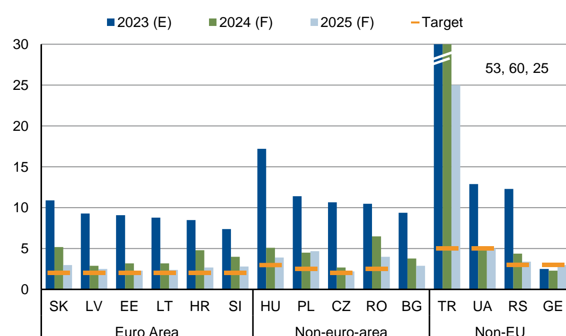
We forecast 2024 growth in **Türkiye** of 3.3%, as the economy adapts to a more restrictive policy mix. More stringent financing conditions are causing a slowdown in credit expansion and consumption, yet the depreciation of the lira supports exports. GDP is expected to grow by 3.5% in 2025 as more conventional policies support the gradual rebalancing of the economy and foster foreign investor confidence. This trajectory follows 4.1% growth in 2023, attributed in part to post-earthquake reconstruction efforts and pre-election expenditure.

Most central banks to cut rates as inflation eases gradually

We forecast the CEE-11 will see an average headline inflation rate of 4.6% in 2024, down from an expected 11.2% last year. Disinflation, supported largely by external factors, was robust throughout 2023. However, robust nominal wage growth in the CEE-11 region is primarily driven by the tight labour market and still elevated inflation, indicating potential risks associated with a wage-price spiral.

The inflation scenario differs among CEE countries. **Within the euro area**, Latvia is expected to have the lowest inflation rate, with a projection of 2.9% (**Figure 2**) this year. Conversely, Slovakia is expected to experience the highest average inflation of 5.2% in 2024.

Figure 2: Headline inflation, annual average, %



Source: National central banks, Eurostat, IMF, Scope Ratings forecasts

Within non-euro area CEE economies, we estimate the Czech Republic will have the lowest inflation at 2.7%, while Romania is forecast to have the highest at 6.5%. This divergence in inflation highlights varying economic conditions and policies. For instance, inflation in Hungary averaged 17.2% in 2023 and has been driven by the lasting effects of previous expansionary budget policies, the continued implementation of windfall taxes and other government interventions in pricing. Inflation is forecast to go down to 5.1% this year in Hungary.

The Czech, Hungarian, Polish, and Romanian central banks underwent balance-sheet expansions in recent years, heightening their sensitivity to FX and interest-rate developments. The Czech and Hungarian central banks also experienced some capital erosion due to interest payments on higher liabilities and limited asset returns, driven by low yields on long-term investments and high interest paid on excess liquidity. Romania's central bank is facing the lowest effects due to its less aggressive tightening.

In the last quarter in 2023, major global central banks held their rates steady. Nevertheless, **Poland** adjusted down its rates in September and October 2023 pre-elections, although it has left them unchanged since then. The **Czech** and **Romanian central banks** kept their rates unchanged throughout the period. We anticipate that the **Hungarian** central will gradually adjust its policy rate to 7% by end-2024. The Czech central bank appears cautious, despite expectations for inflation to align with targets swiftly. We expect the central bank to cut its rates to 4.0% by the end of this year. We forecast the National Bank of Poland to cut its rate moderately to 5.5% by the end of this year. The National Bank of Romania may reduce rates to 5.75% in 2024, contingent on fiscal policy adjustments. A robust labour market and still-high inflation might delay monetary easing until mid-2024.

Outside the EU, in **Türkiye**, the inflation rate persisted at a high level throughout 2023, averaging 53.4%. Inflation is expected to increase to 60% in 2024 as the lira continues to depreciate. On that basis, the Turkish central bank is expected to maintain restrictive funding conditions to ensure price stability, with the main policy rate projected to increase from 42.5% as of end-2023 to 45.0% at the end of 2024, before declining at 40.0% by the end of 2025.

The **National Bank of Ukraine** reduced rates to 15% by the end of 2023 and is projected to further cut to 10% by the end of 2024. The National Bank of Georgia cut its cash rate to 9.5% by the end of 2023, with additional cuts expected to 8% by the end of 2024.

The **National Bank of Serbia** is forecast to lower its rate to 5.25% by the conclusion of 2024, down from 6.5% at the end of 2023.

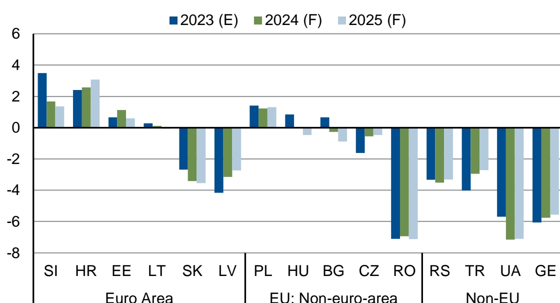
External deficits broadly stable after reversal of terms-of-trade shock

Throughout 2023, current-account deficits in most CEE countries declined, driven by a reversal of the terms-of-trade shock and a shift in the private sector towards net savings. Romania (estimated at 7.1% of GDP) and Latvia (4.2%) recorded the highest current account deficits in 2023 (**Figure 3**), owing to varying factors such as energy-intensive economies, supply-chain vulnerabilities, robust domestic demand, and rising import prices. In Hungary, the external position significantly improved, with the current account likely to achieve a surplus in 2023 after a notable 8% of GDP

deficit in 2022. Reduced imports, particularly in fuel and consumer goods, contributed to a shift in the balance of goods while exports, particularly vehicles and transport equipment, have shown growth.

In 2024, we expect that the reversal of the energy-induced terms-of-trade shock will moderate import growth in the CEE-11 region due to weakened domestic demand. Adequate natural gas storage levels for winter consumption further contribute to this trend. We expect the average current account balance for CEE-11 economies to remain broadly stable at around -1% of GDP. Romania and Slovakia are expected to maintain relatively high current account deficits in 2024, offset by substantial EU fund inflows. Conversely, Croatia (2.6% of GDP), Slovenia (1.7%) and Poland (1.2%) should achieve the largest current account surpluses.

Figure 3: Current account balances, % of GDP



Source: IMF World Economic Outlook forecasts for Ukraine and Georgia, European Commission AMECO forecasts for others, Scope Ratings

Investments were postponed last year because of tightened financial conditions and primarily relied on reinvested profits and debt flows due to relatively lower borrowing costs in the euro area compared to CEE. In 2024, we anticipate that EU transfers and FDI will significantly enhance the sustainability of external deficit financing in the region. Countries with substantial pipelines of new FDI projects include Hungary and Poland. Nonetheless, trade balances will remain affected by still-high (albeit declining) gas prices, particularly in energy-intensive sectors and by currency appreciation, as input and labour costs rise sharply. An oil price shock, especially if the conflict in the Middle East were to intensify, would disproportionately impact larger importers like landlocked CEE countries, some of which being still reliant on Russian fuels.

Diverging interest costs, high investment needs drive fiscal paths

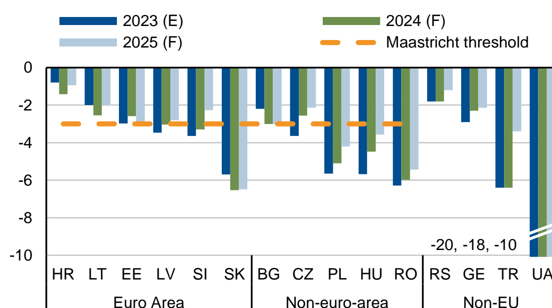
Fiscal policies across CEE-11 countries reflect varied deficits, with certain countries demonstrating relatively expansionary fiscal stances, resulting in elevated budget deficits in 2024: Slovakia (6.5% of GDP), Romania (6.0%), Poland (5.1%), and Hungary (4.5%). We see limited potential for deficits to be reduced to Maastricht limits of 3% of GDP by 2025 (**Figure 4**).

Within the euro area, Croatia's fiscal deficit is seen rising to a still-moderate 1.4% of GDP this year, from an estimated 0.8% of GDP in 2023, before moderating to 0.9% of GDP in 2025. After reaching 3.6% of GDP this year, Slovenia's fiscal deficit is expected to gradually moderate to 2.3% by 2025. In Estonia and Latvia, the general government deficit is expected to improve to 2.6% and 3.0% of GDP in 2024, respectively (down 0.4pps and 0.5pps from the previous year), before widening somewhat in 2025, all the while remaining below the 3% threshold. Lithuania's fiscal balance is seen increasing to 2.5% of GDP this year (up 0.5pps from 2023), before reverting to 2.0% in 2025. In contrast, Slovakia's budget deficit is predicted to widen to 6.5% of GDP in 2024 and 2025, from 5.7% in 2023.

Among non-euro CEE countries, Hungary's deficit is expected to decrease to 4.5% this year and further to 3.6% by 2025. Poland's deficit is expected to gradually decline from 5.6% in 2023 to 4.2% in 2025, and Romania's from 6.3% in 2023 to 5.4% by 2025. Czech Republic and Bulgaria exhibited more moderate deficits in 2023 and are projected to maintain this trajectory, with the Czech Republic's budget deficit decreasing to 2.0% in 2025 and Bulgaria's stagnating at around 3.0%.

The EU's revised fiscal rules discount debt interest costs in the period 2025-2027 for the application of an Excessive Deficit Procedure. Still, the re-introduction of the Excessive Deficit Procedure (EDP) in spring 2024 may identify Slovakia, Romania (currently under an EDP), Poland and Hungary.

Figure 4: General government budget balances, % of GDP



N.B. Central government balance for Türkiye and Ukraine. Source: IMF, Eurostat, Scope Ratings forecasts.

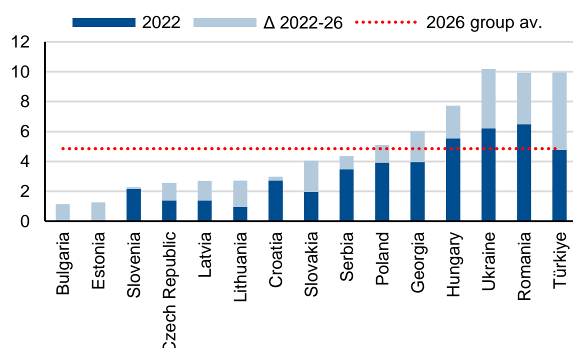
The continued provision of post-pandemic support to households and the management of repercussions from the 2022 energy shock by several CEE governments are pivotal factors contributing to sustained high budget deficits. These measures, such as subsidies and increased pension commitments are a strain on non-discretionary public spending.

In 2024, increasing borrowing costs will exacerbate the challenge of handling ongoing budget deficits, especially in countries with high borrowing requirements and shorter debt durations (**Figure 5**).

The burden of net interest payments is projected to rise in the CEE-11 region, increasing from an average of 2.4% of government revenue in 2022 to an estimated 2.9% in 2023 and to 3.3% in 2024, gradually reaching 3.9% by 2026. The most substantial interest burden is

expected to fall on Romania, reaching 9.9% of revenue by 2026, while Hungary will likely follow with 7.7% of government revenues allocated for interest payments. Front-loaded debt issuance last year has reduced the risks of financing higher budget deficits. The absence of additional rate hikes by the ECB and Fed contributed to the decrease in longer-term rates in CEE. Further declines in yields are anticipated throughout 2024.

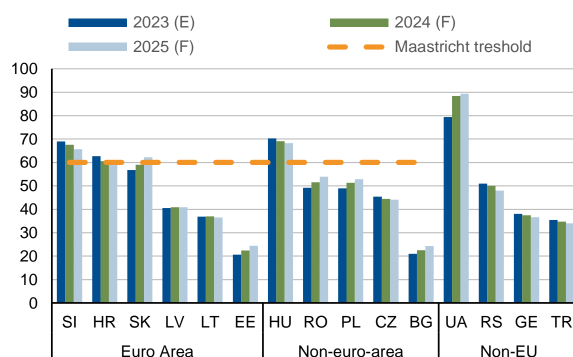
Figure 5: Net interest payments, % of revenue



Source: IMF, Scope Ratings forecasts

Simultaneously, there is a pressing need for substantial investments in alternative energy infrastructure within the CEE-11. This includes measures to expand storage facilities, develop new renewable energy sources, bolster nuclear generating capacity, and expand natural gas distribution networks. The heightened significance of defence spending due to the war in Ukraine adds another dimension to fiscal considerations for these countries.

Figure 6: General government debt, % of GDP



Source: Eurostat, IMF, Scope Ratings forecasts

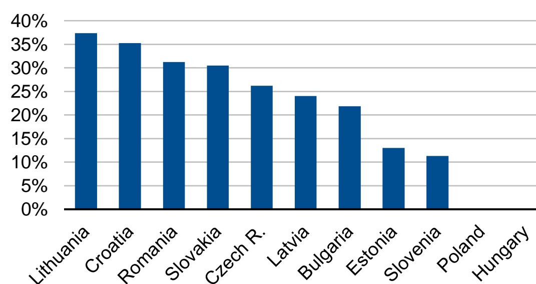
Amid these economic and geopolitical dynamics, the demographic shifts and ageing populations across most CEE countries pose long-term fiscal challenges. In the medium term, countries will have to implement fiscal consolidation measures to effectively manage debt stocks and lower funding costs. The credit ratings of CEE-11 sovereigns are supported by moderate stocks of government debt (**Figure 6**) and improved debt profiles. By the end of 2023, only Croatia, Hungary, and Slovenia had general government gross debt exceeding the Maastricht threshold of 60% of GDP. We expect a modest downward path of debt-to-GDP levels in the region, due to the persistent deficits but recovering GDP growth.

Substantial EU financial support, subject to governance risk

EU funds have been crucial for CEE-EU countries, supporting public investments, fostering growth, and ensuring steady foreign currency inflows, typically amounting to 2%-3% of GDP annually from the EU's structural and cohesion funds. In the CEE region, governments differ in their reliance on EU funds. However, the recent impacts of the Covid-19 pandemic and the war in Ukraine have heightened their importance as CEE central banks have raised policy rates to levels higher than in the euro area, making market-based financing more challenging. The combined EU financial support to member states through the structural and cohesion funds of the 2021-2027 multi-year budget, the RRF, and the recent introduction of the REPowerEU plan to reduce reliance on Russian energy represents substantial financial inflows for CEE-EU sovereigns.

Compared to their Western counterparts, except Spain (A-/Stable) and Italy (BBB+/Stable), CEE countries face a greater task. This is because four of the top 10 EU countries with the highest allocation of RRF funds as a percentage of GDP are from CEE-11. Croatia leads with the highest allocation of grants, amounting to 11% of its GDP. It is followed by Slovakia and Romania at around 6%, and Poland at 4%. The allocations and projected GDP growth indicate the significance of the RRF for CEE countries, but the varying commitments and capacities of administrations across the region present challenges in implementing the agreed milestones and linked disbursements of funds (see **Figure 7**).

Figure 7: CEE-11 RRF implementation progress, % of funds paid out



Source: NGEU Tracker, Scope Ratings

In **Hungary**, judicial reforms were enacted last year, resulting in the release of EUR 10.2bn of Cohesion funds. Despite advancements in judicial reform, around EUR 12bn in funding remains withheld until the RRF's 'super milestones' are fully implemented. Remaining concerns related to rule of law issues under the budget conditionality mechanism include areas such as public procurement, conflict of interest, the fight against corruption, and public interest trusts. Full compliance

with these milestones is yet to be achieved, resulting in the withholding of payment requests.

Further significant delays in accessing EU funds could lead to increased bond issuance, potentially resulting in higher interest payments due to prevailing elevated rates. We expect that the forthcoming EU parliamentary elections scheduled for June 2024 could emerge as a critical factor in unlocking certain EU funds, potentially influencing the resolution of outstanding issues related to the disbursement of EU funds in Hungary.

In **Poland**, both the RRF and EU Cohesion funds are currently withheld due to lingering rule-of-law concerns. We expect the new government to restore a degree of EU funding access. However, governing under the Tusk government faces challenges. The three-way coalition's unity faces negotiations on sensitive topics like abortion and LGBT rights, potentially affecting coalition stability and policy-making effectiveness. Meanwhile, the opposition Law and Justice (PiS) maintains considerable influence, with PiS-appointed judges, President Andrzej Duda, and central-bank governor Adam Glapiński remaining in significant positions of influence, posing obstacles for the incoming government's objectives. The short-term political polarisation and long-run governance uncertainties remain challenges. Moreover, Poland's ongoing distribution of EU funds from the '2014-20 EU financial period' may encounter some uncertainty in the coming months. This is due to the expected depletion of the '2014-20' EU budget, combined with the untapped 'new' EU budget, due to rule-of-law issues. Failure to promptly address rule-of-law concerns might lead to a pause in disbursements from the 'new' budget in 2024. Judicial reforms serve as critical "super milestones" for the RRF, which has seen suspension of its payments until judicial-independence concerns are resolved.

Outside the EU, **Serbia** held early parliamentary elections in 2023. Compared to the 2022 elections, pro-EU parties gained more parliamentary seats. The country's EU accession hinges on improved relations with Kosovo, a key obstacle that has seen minimal progress over the past two years. Finally, several countries in the region are scheduled to conduct elections this year (**Figure 8**). Croatia and Romania face a significant election year, featuring European, local, general, and presidential elections.

Figure 8: Election schedule 2024

Country	Election Type
Croatia	Parliament (July), President (December)
Hungary	Local (June)
Poland	Local (April)
Romania	Local (September), President (November-December), Parliament (December)
Slovakia	Presidential (March, April)
Türkiye	Local (March)

Annex I: 2023-25 macroeconomic outlook

	Country/region	Real GDP growth (annual average, %)			General government balance (% of GDP)*			General government debt (EOP, % of GDP)			Headline inflation (annual average, %)**			Policy rate (EOP, %)***			Unemployment rate (annual average, %)			EUR per local currency (% change)	Reserves (% of short-term external debt)
		2023 (E)	2024 (F)	2025 (F)	2023 (E)	2024 (F)	2025 (F)	2023 (E)	2024 (F)	2025 (F)	2023 (E)	2024 (F)	2025 (F)	2023	2024 (F)	2025 (F)	2023 (E)	2024 (F)	2025 (F)	31 Dec vs 1 Jan 2023	2023
	EU CEE-11	**0.7**	**2.5**	**3.0**	**-4.9**	**-4.5**	**-3.9**				**11.2**	**4.6**	**3.8**								
Euro-area CEE	**Slovakia**	1.4	1.9	2.3	-5.7	-6.5	-6.5	56.8	59.1	62.3	10.9	5.2	3.0	4.00	3.50	2.50	5.9	5.9	5.8		
	Slovenia	1.3	2.2	2.7	-3.6	-3.3	-2.3	69.0	67.5	65.7	7.4	4.0	2.8				3.6	3.6	3.5		
	Lithuania	-0.5	2.4	3.2	-2.0	-2.5	-2.0	36.8	36.9	36.5	8.8	3.2	2.4				6.8	7.0	6.6		
	Latvia	-0.1	2.2	2.9	-3.5	-3.0	-2.8	40.5	40.9	40.9	9.3	2.9	2.5				7.0	6.7	6.5		
	Estonia	-2.5	2.0	2.7	-3.0	-2.6	-2.9	20.6	22.4	24.4	9.1	3.2	2.3				7.0	7.0	6.8		
	Croatia	2.4	2.0	2.6	-0.8	-1.4	-0.9	62.7	60.6	58.9	8.5	4.8	2.7				6.6	6.5	6.2		
Non-euro-area EU CEE	**Poland**	0.5	2.9	3.0	-5.6	-5.1	-4.2	49.0	51.3	52.9	11.4	4.5	4.7	5.75	5.50	4.75	2.8	2.8	2.8	7.9%	115
	Romania	2.0	3.0	3.4	-6.3	-6.0	-5.4	49.2	51.6	53.9	10.5	6.5	4.0	7.00	5.75	5.25	5.5	5.3	5.2	-0.5%	93
	Czech Republic	-0.4	1.6	2.8	-3.6	-2.6	-2.1	45.4	44.4	44.1	10.7	2.7	2.2	7.00	4.00	3.00	2.7	2.7	2.6	-2.5%	129
	Hungary	-0.6	2.4	3.1	-5.7	-4.5	-3.6	70.2	69.1	68.2	17.2	5.1	3.9	10.75	7.00	5.00	4.1	4.0	3.8	4.7%	120
	Bulgaria	2.1	2.4	2.7	-2.2	-3.0	-3.0	21.0	22.5	24.3	9.4	3.8	2.9	3.80	3.55	3.00	4.4	4.4	4.4	0.0%	319
Non-EU emerging Europe	**Türkiye**	4.1	3.3	3.5	-6.4	-6.4	-3.4	35.5	34.7	34.1	53.4	60.0	25.0	42.50	45.00	40.00	9.5	10.5	11.5	-38.9%	44
	Ukraine	5.5	4.0	5.0	-19.6	-17.5	-10.1	79.4	88.4	89.3	12.9	4.9	5.0	15.00	10.00	10.00	n/a	n/a	n/a	-7.7%	62
	Serbia	2.0	3.0	3.5	-1.8	-1.8	-1.2	51.0	50.0	48.0	12.3	4.4	3.4	6.50	5.25	4.00	9.7	9.1	8.7	0.1%	374
	Georgia	6.7	4.7	5.0	-2.9	-2.3	-2.1	38.1	37.5	36.6	2.5	2.3	3.0	9.50	8.00	7.00	16.5	16.0	16.0	-3.1%	126

Source: Scope Ratings, Macrobond, IMF, Eurostat, OECD, national central banks and statistical offices

* Central government balance for Türkiye and Ukraine.

** HICP headline inflation for euro-area member states; otherwise, CPI headline inflation.

*** Deposit facility rate of the ECB for euro-area CEE economies; yield on the 7-day National Bank of Poland money market bills for Poland; 2-week repo rate for the Czech Republic; interest rate on minimum reserves shown for Hungary; 1-week repo rate for Romania and Türkiye; base rate for Bulgaria; 1-week refinancing rate for Georgia; key policy rate for Ukraine, Serbia.

Annex II: Scope's CEE sovereign ratings

Figure 10. CEE long-term foreign-currency issuer ratings, as of 15 January 2024

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

Annex III: Recent research of CEE

2024 Sovereign Outlook, 15 Dec 2023

EU sovereign debt: climate but especially demographics present important long-term risk, 20 Nov 2023

Poland: pivotal elections bring a pro-European coalition back to the fore, 19 Oct 2023

Hamas attacks test Israel's economic resilience; adds risk to regional stability, global growth, 10 Oct 2023

Türkiye to pursue policy shift with large rate hike but hefty inflation challenge remains, 21 Jun 2023

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), Türkiye (TR), Ukraine (UA), Serbia (RS), Georgia (GE).

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