Central and Eastern Europe Mid-Year 2023 Sovereign Outlook

Growth continues to face challenges amid downside economic risks

Sovereign and Public Sector, Scope Ratings GmbH, 25 July 2023

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

info@scoperatings.com | www.scoperatings.com | Bloomberg: RESP SCOP

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Scope Sovereign and Public Sector Ratings Group

Giacomo Barisone
Managing Director, Head of Sovereign and Public Sector
g.barisone@scoperatings.com

Alvise Lennkh-Yunus
Executive Director, Deputy Head
a.lennkh@scoperatings.com

Jakob Suwalski
Senior Director
j.suwalski@scoperatings.com

Julian Zimmermann
Associate Director
j.zimmermann@scoperatings.com

Dennis Shen
Senior Director
d.shen@scoperatings.com

Thomas Gillet
Director
t.gillet@scoperatings.com

Giulia Branz
Associate Director
g.branz@scoperatings.com

Brian Marly
Analyst
b.marly@scoperatings.com

Alessandra Poli
Analyst
a.poli@scoperatings.com

Executive Summary

Declines in energy prices have contributed to the gradual decrease in high headline inflation in the 11 EU countries in Central and Eastern Europe (CEE-11), but tight monetary policies and weak external demand have muted the economic recovery, with substantial risks to the downside for the rest of 2023. We expect growth in the CEE-11 region of around 1.7%, down from 4.4% in 2022. The recovery will pick up momentum by next year as inflationary pressures subside, with output growth rising to 2.5%, although growth will vary considerably by country (**Figure 1**). Outside of the EU, Türkiye's growth is to slow down, whereas the Ukrainian economy is anticipated to display above-consensus growth this year. Serbia is projected to experience moderate growth, while the robust recovery of the Georgian economy is continuing.

Figure 1: Real GDP growth, %

	Euro Area						Non-euro-area					Non-EU			
	Croatia	Estonia	Latvia	Lithuania	Slovakia	Slovenia	Bulgaria	Czech Rep.	Hungary	Poland	Romania	Georgia	Serbia	Türkiye	Ukraine
2022	6.3	(1.3)	2.8	1.9	1.7	5.7	3.4	2.5	4.6	5.4	4.7	10.2	2.3	5.6	(29.1)
2023E	2.4	(1.3)	1.5	(1.4)	1.4	1.3	1.6	0.2	0.1	2.5	3.0	7.5	2.0	2.7	4.0
2024F	2.0	2.3	1.8	2.4	2.0	2.4	3.0	2.8	2.5	2.0	4.1	6.1	3.0	3.0	2.5

Source: European Commission, IMF, Scope Ratings; see **Annex I** for full macroeconomic forecasts.

Sovereign rating adjustments and Outlook revisions amid the energy crisis and geopolitical tensions

- We downgraded several CEE sovereign issuers in the past six months, reflecting structural risks and the lingering impact from the energy and inflationary shocks in the CEE-11 region, which took their toll on real growth, public finances and economic resilience. We downgraded Hungary (to BBB), the Czech Republic (to AA-), and Poland (to A), and maintained a Negative Outlook for Slovakia (rated A+).
- We also revised downwards the Outlooks for Estonia (AA-/Negative), Latvia (A-/Stable), and Lithuania (A/Stable). These revisions reflect economic challenges and rising geopolitical tensions caused by Russia's 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. Similarly, we maintained the Negative Outlook on Türkiye's B- foreign-currency ratings due to long-standing uncertainties over economic and monetary governance and the vulnerability of the economy and public finances to balance-of-payments and other crises.

Key macro-economic themes in the CEE-11 region for 2023-24:

- **Growth outlook remains challenging.** High inflation, tight monetary policy and sluggish global demand are contributing to a subdued economic outlook. Smaller economies with a strong focus on energy-intensive manufacturing face greater downside risks stemming from the impact of weak external demand.
- **Inflation set to gradually decelerate.** Inflation in most CEE-11 economies will be running in the single digits by the end of this year. However, average inflation for 2023 in the region is still high at 11.8% compared with 13.9% last year. Looking ahead to 2024, we expect average inflation in CEE-11 to decline to 5.6%.
- **External deficits are improving but remain elevated.** The shock to the region's terms of trade from higher energy costs is gradually reversing while weak domestic demand is curtailing growth in imports. The average current account deficit for the CEE-11 region will narrow to 3.1% of GDP from 4.5% last year according to the IMF.
- **Fiscal sustainability in the region remains a concern.** CEE-11 governments continue to juggle the need to reduce budget deficits after Covid-19 in an uncertain economic context with support for strategic sectors and the need for greater energy, infrastructure and defence spending. The average budget deficit in the region will be little changed at 4.1% of GDP this year compared with 4.0% last year. Front-loaded debt issuance in the first months of 2023 has reduced refinancing risks for the year.
- **Flow of EU funds is critical.** Meeting milestones to allow for timely disbursements of EU funds is crucial for the region as this is the final year of the previous Multiannual Financial Framework (2014-2020). Delays or cuts in funding could limit policy flexibility and fiscal consolidation prospects, pressuring external finances. Concerns are highest in Hungary and Poland where unresolved disputes with the European Commission over the rule of law have delayed the roll out of EU funds.

Main themes for 2023

Rating adjustments and Outlook revisions amid the inflation crisis

The recent energy crisis has served as a stark reminder for the region to transition towards green energy sources and reduce dependence on fossil fuels. Due to the enduring adverse effects of the crisis, rating adjustments were made in the CEE-11 region, including downgrades in the first half of this year for Hungary (from BBB+/Negative to BBB/Stable), the Czech Republic (from AA/Negative to AA-/Stable), and Poland (from A+/Negative to A/Stable) while maintaining a Negative Outlook that was assigned on the A+ rating for Slovakia last year. These downgrades and previous Outlook revisions reflect common concerns regarding the economic outlook, inflationary pressures, fiscal metrics, and external vulnerabilities.

Specifically, the Czech Republic faces challenges arising from the Russia-Ukraine war, inflationary pressures, supply chain disruptions, and persistent budget deficits. Governance issues, disagreements with EU institutions, and uncertainties surrounding EU funding have significantly impacted Hungary's and Poland's ratings. Hungary's downgrade reflects a material deterioration in the near-term economic outlook, exchange rate volatility, and uncertainties related to EU fund disbursements. Poland's downgrade is a result of weakening governance institutions, disagreements over the rule of law, and concerns about underlying inflation.

Looking ahead, Hungary's and Poland's ratings face risks primarily due to institutional erosion and potential significant reductions or delays in the disbursement of EU funds, which could negatively impact policy flexibility, fiscal consolidation plans, and external finances. The Czech Republic’s ratings face a risk of higher inflation and persistent fiscal deficits exceeding expectations. The resolution of the Negative Outlook for Slovakia's ratings depends largely on the country's capacity to withstand external shocks, its growth prospects, fiscal consolidation efforts and the public debt trajectory. A key risk for Slovakia is a potential shift in policy priorities following early parliamentary elections in September 2023 that could undermine the reform agenda.

The Baltic countries of Estonia, Latvia, and Lithuania have also experienced Outlook revisions for their credit ratings, reflecting common challenges faced by their small, open economies heavily reliant on international trade, in navigating external crises and geopolitical tensions. The credit ratings of the three countries are, however, supported by their enhanced macroeconomic resilience and significant fiscal capacities. This reinforces our perspective of balanced risks currently for the ratings in the cases of Latvia and Lithuania.

The Outlook on Estonia's AA- ratings was revised from Stable to Negative due to prolonged effects of the cost-of-living crisis, geopolitical risk, and a weakening fiscal position. The Outlooks on Lithuania's A rating and Latvia’s A- rating were revised from Positive to Stable, reflecting a slow recovery and persistent effects of the cost-of-living crisis and heightened geopolitical risks on their economic and fiscal outlooks.

The Outlooks for Slovenia's A and Romania's BBB- ratings have remained Stable since the cost-of-living crisis. Romania's Stable Outlook 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 the companies have contracts with Gazprom, which reduces potential vulnerabilities associated with reliance on Russian gas imports. Slovenia's Stable Outlook reflects a wealthy and resilient economy, supported by ongoing diversification of its energy supplies and robust external performance. Following Croatia's upgrade from BBB-/Positive to BBB+/Stable in July 2022, the rating has been maintained at BBB+ due to Croatia’s euro area membership, reducing FX risks and increasing resilience against external shocks.

Bulgaria’s BBB+ ratings were affirmed on 21 July 2023, and the Outlook revised to Positive, from Stable. This was driven by expected progress on euro area accession, which would improve multiple rating-relevant areas, supported by the new government, alongside by sustained macro-economic stability.

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	Outlook Change, 28 Oct 2022
	Slovenia	A/Sta	Affirmation, 19 Aug 2022
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	First-time rating, 3 Jun 2022
	Türkiye	B-/Neg	Downgrade, 11 Mar 2023
	Ukraine	CC/Neg	Affirmation, 12 May 2023

*Foreign-currency issuer ratings.

Outside the European Union, we maintained the 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 on CCC domestic-debt ratings in local- and foreign-currency from Negative to Stable reflects a stronger focus in the coming years on domestic commercial-bank financing of the sovereign state, which reduces the likelihood of restructuring the domestic debt. We have also maintained the Negative Outlook on Türkiye’s rating, following the one-notch downgrade of the foreign-currency rating to B- in March 2022, reflecting deterioration of the nation's credit profile due to significant current account deficits, limited usable reserves, high inflation, inadequate economic governance and the likelihood of deeper balance of payment crises. Finally, the Stable Outlooks on Serbia's BB+ and Georgia's BB ratings have been maintained throughout the energy crisis.

The growth outlook continues to face significant challenges

In 2022, the CEE-11 region experienced strong average real GDP growth of 4.4% (weighted by GDP on purchasing power parity terms). However, there were noticeable indications of a slowdown towards the end of the year. Despite signs of a recovery, we anticipate subdued growth in the CEE-11 region for 2023 of 1.7%, an upside revision of 0.5pps relative to our projections in December 2022. Notably, positive revisions were made to the growth outlooks for Poland (from 1.5% to 2.5%) and Latvia (from -0.1% to 1.5%) compared to our previous forecasts. Lithuania (from 0.5% to -1.4%) and Estonia (from 0.8% to -1.3%) have experienced the most significant negative revisions in GDP growth forecasts for this year.

The subdued growth outlook in the CEE-11 region is attributed to factors such as elevated inflation, tight credit conditions, and weak external demand. Despite the decline in interbank and lending rates across most economies, we anticipate financial conditions will remain restrictive throughout 2023. For 2024, as inflationary pressures gradually subside, we expect stronger growth in the CEE-11 region of 2.5%.

The forecasted growth rates for individual economies within the CEE-11 region display notable variations, highlighting the diverse economic landscape across the region. In 2022, Estonia stood as the sole economy to undergo annual recession. Its GDP contracted by 1.3%, driven by a substantial decline in investment. However, Estonia had exceptional growth in 2021 (+8%), which was boosted by the one-off impact of a pension reform. Furthermore, during the second half of 2022, both the Czech Republic and Hungary experienced a mild recession, with Hungary continuing to exhibit negative quarter-on-quarter growth into early 2023.

Meanwhile, despite higher financing costs and tighter bank lending, the Polish economy demonstrated resilience last year, achieving growth of 5.1%. A strong carryover effect ought to contribute to projected growth of 2.5% this year, with growth in the latter half of this year helped by tax cuts implemented in 2022 alongside pre-election spending. Similarly, Croatia has exhibited robust economic performance, achieving a growth rate of 6.3% last year. This growth was mainly driven by strong consumption and high investment expenditures supported by euro area accession in January 2023. Due to a weaker global economic environment, a considerable growth slowdown is anticipated in 2023. Romania's projected GDP growth is set to reach 3% in 2023, followed by a further increase to 4.1% in 2024. An accelerated absorption of EU funds is expected to provide a solid foundation for the country's robust economic performance.

In contrast, the economies of the Czech Republic, Hungary, and Slovakia, which have a strong focus on energy-intensive manufacturing industries, face potential downside risks. These risks stem from the impact of weak external demand on their economies. The Czech Republic is expected to see modest growth of 0.2% in 2023, followed by a more robust growth of 2.4% in 2024. Hungary's growth forecast is 0.1% in 2023, increasing to 2.5% in 2024. While Hungary anticipates support for GDP growth through foreign direct investment and other private investment inflows, the arrival of EU funds, particularly those from the Recovery and Resilience Facility, is expected to be delayed until late 2023 or even 2024. Slovakia is projected to grow by 1.4% in 2023 and 2.0% in 2024. The growth in these countries will be supported by declines in energy costs. While stronger-than-expected external demand coupled with improved supply would boost GDP growth, the persistently tight labour market is set to contribute to the stickiness of core inflation and hence subdued real GDP growth.

Estonia and Lithuania are projected to experience full-year recessions in 2023, with estimated contractions of 1.3% and 1.4% respectively. This follows a weak performance in the first quarter of the year. High inflation has impacted households' disposable incomes, and savings accumulated during Covid-induced lockdowns have been depleted. With a gradual improvement in the economic outlook, supported by recovering external demand and private consumption, as well as increased investments under EU and government programmes, Estonia is expected to achieve GDP growth of 2.3% next year, while Lithuanian growth is expected to reach 2.4%.

Outside of the EU, growth in Serbia is anticipated to accelerate in the second half after a sluggish first half of the year as real incomes improve. We anticipate growth of 2.0% this year, followed by 3.0% next year. Georgia is expected to experience very strong growth of 7.5% in 2023. The economy has shown robust performance in recent years amid a boom in trade, capital and labour flows due to Russia's war in Ukraine.

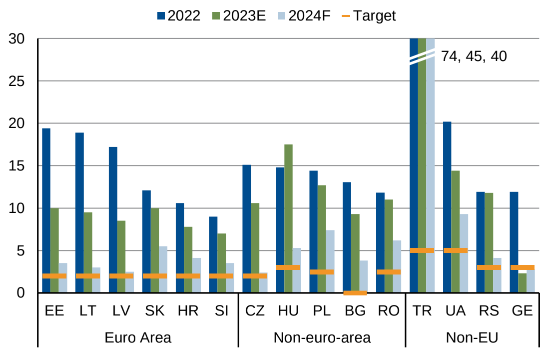
Ukraine has meanwhile faced exceptional economic challenges due to the war, resulting in a severe contraction of around 29% last year but we estimate growth of an above-consensus 4% for the economy in 2023. The projected 2023 growth in Türkiye has been revised down to 2.7% (from 3.0%) due to the economic impact of the earthquakes that occurred in February, along with tightening of credit conditions, following the recent rate hikes by the central bank to 17.5% this month from 8.5% pre-elections.

Inflation is to slow down, but unlikely to drop below targets this year

CEE-11 experienced an average headline inflation rate of 13.9% last year, which has been declining primarily due to the decrease in energy prices since the middle of last year. However, the dynamics of core inflation, which excludes the prices of food and energy, remain elevated, indicating that price pressures have broadened. We expect most countries in the CEE-11 region to achieve single-digit headline inflation rates by the end of this year. Nonetheless, the projected average headline inflation rate for 2023 in the region is 11.8%. Critically, we do not expect inflation to drop within the central bank objectives by the end of this year for any economy in the region.

Among the CEE-11, Croatia and Slovenia are expected to have the lowest inflation rates, with projections of average inflation of 7-8% (**Figure 2**) this year. On the other hand, Hungary is expected to experience the highest 2023 average inflation of 17.5%. This divergence in inflation across the region highlights varying economic conditions and policy reactions. For instance, inflation in Hungary is greatly influenced by the lasting effects of previous expansionary budget policies, the continued implementation of windfall taxes and other government interventions in pricing.

Figure 2: Headline inflation, annual average, %



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

The variance in rates of inflation across the region also highlights the importance of implementing effective price stability management tailored to each economy. The size of foreign-exchange reserve stocks helps to determine policy responses of non-euro-area central banks to high inflation. Central banks with large enough reserves, such as the Czech National Bank, have intervened in currency markets to control monetary conditions, while relieving some pressure for even more significant rate hikes. By contrast, Hungary's central bank, with comparatively low reserves, has needed to tighten monetary policy more aggressively.

As the central banks in non-euro area CEE economies began raising rates before the ECB and the Federal Reserve did, they prevented additional exchange-rate-related inflationary pressures on domestic price rises. Most CEE central banks have halted their rate-hike cycles. However, central banks are likely to maintain other quantitative policy tools to manage money supply and support their currencies, such as select macroprudential measures as per higher reserve requirements for banks.

The recent monetary policy decisions taken by central banks in Hungary, the Czech Republic, and Poland reflect differing approaches and considerations. In May, the **Hungarian National Bank** cut the one-day deposit rate by 100bps to 17%. In June, it was further lowered to 16%. This indicates a partial normalisation of rates, with potential for more easing in the future. Projections suggest gradual 100bp reductions at each of the coming meetings until the one-day deposit rate aligns with the 13% base rate by the September meeting. Following that, monthly 50bp reductions are expected, reaching 11.5% by the end of 2023 and 6.5% by the end of 2024. However, rate cuts might pause if the forint weakens significantly.

Meanwhile, the **Czech National Bank** has maintained a consistently hawkish policy stance, linking potential rate cuts to factors such as wage growth and other considerations. Recently, nominal wage growth fell below the central bank's 10% threshold. In its June meeting, the monetary policy committee nevertheless chose to keep rates unchanged, signalling a low likelihood of imminent rate cuts. The central bank stated that current circumstances rule out rate cuts, shifting the focus to maintaining current rates.

The **National Bank of Poland (NBP)** kept rates unchanged for the tenth time in a row in July (at a reference rate of 6.75%). The political influence of upcoming parliamentary elections and the modest decline in headline inflation imply an increased likelihood of a rate cut before the end of 2023. The NBP believes a single-digit inflation is possible by September.

Furthermore, the **National Bank of Romania** is seen keeping its key rate unchanged at 7% this year, before cuts to 5% by end-2024.

For Türkiye, we expect the inflation rate to remain persistently high throughout 2023, with an average of 45%. The **Central Bank of the Republic of Türkiye** is expected to hold rates at 17.5% for the remainder of this year before rates reach 20% by end-2024.

The **National Bank of Ukraine** is expected to cut rates to 20% by end-2023 before 15% by end-2024, while the **National Bank of Georgia** further cuts its cash rate to 9% by year-end 2023, before trimming to 7% by end-2024. Finally, the **National Bank of Serbia** is seen cutting to 6% by end-2023 before 4.5% by end-2024.

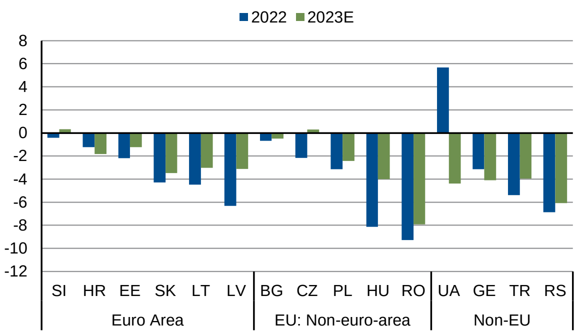
Large external deficits improve as energy prices ease

Recently high energy prices contributed to wider current-account deficits in the CEE region. CEE exports recovered since earlier this year. Key export leaders like the Czech Republic, Hungary, Poland, Slovakia, and Slovenia regained trade surpluses, while trade deficits narrowed in other CEE economies. However, foreign demand weakened in 2Q23, leading to a decline in new industrial orders and a contraction in industrial production, particularly in the Czech Republic, Hungary, Slovakia, and Slovenia. While certain global shocks, like supply-chain bottlenecks, have started to alleviate, they are unlikely to fully correct by the end of this year, exerting continued pressure on trade balances.

The terms of trade shock caused by higher energy costs is gradually reversing and weak domestic demand is likely to dampen the growth of imports. By the end of 2023, CEE-11 countries are expected to have higher gas inventories compared to in 2022, ranging from 60% to 85% of total capacity. Current storage levels of natural gas are adequate to meet consumption demands until year-end. As a result, the average current account balance for CEE-11 is expected to improve according to the IMF, declining from a deficit of 4.5% of GDP in 2022 to 3.1% this year.

In 2022, Romania, Hungary and Latvia recorded the highest current account deficits of 9.3%, 8.1%, and 6.3% of GDP, respectively. While Slovakia's and Hungary's current-account deficits were driven by their energy-intensive economies and exposures to supply-chain shocks, Romania's structurally high current-account deficit was due to robust domestic demand, escalating import prices, and outflows of primary income. Romania and Slovakia will continue to experience elevated current account deficits, which should be partly funded by high EU fund inflows. Hungary's current account deficit is to moderate to 4.0% of GDP this year.

Figure 3: Current Account Balances, % of GDP



Source: IMF forecasts, Scope Ratings

On the other hand, the Czech Republic and Slovenia should achieve current account surpluses this year, at around 0.3% of GDP each. Both economies observed current account surpluses in the first quarter of this year, primarily driven by the easing of energy prices.

Fiscal sustainability remains a concern

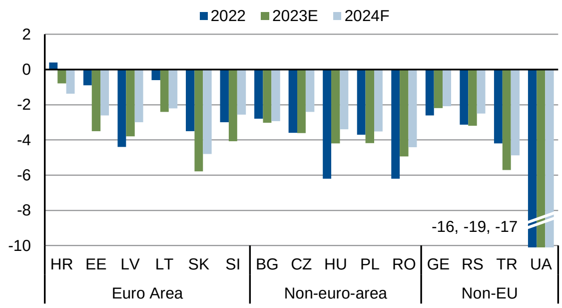
CEE-11 governments continue to navigate the challenge of fiscal prudence amid economic uncertainties, balancing support for key sectors, energy-related concerns, infrastructure investments, and defence needs. CEE-11 governments remain reluctant to reduce 2022 energy subsidies, impacting natural gas prices (Hungary, Slovakia), coal prices (Poland), and electricity tariffs (region-wide). Consequently, most CEE-11 governments have implemented limited fiscal adjustments for the current year, maintaining support for businesses and households despite declining inflation.

Primary balances are expected to deteriorate in most CEE countries in 2023. The average budget deficits for the CEE-11 region are projected to reach 4.1% of GDP in 2023, slightly higher than the 4.0% recorded last year, before gradually declining to 3.4% in 2024. There are potential risks in 2024 of the European Commission launching excessive deficit procedures (EDP) for Hungary, Poland, and Slovakia, along with a reassessment of the EDP initiated for Romania in 2020.

Investing in alternative energy infrastructure is a significant priority for CEE-11 governments in the medium term. This includes expanding storage facilities, developing new renewable energy sources, increasing nuclear generating capacity, and enhancing natural gas distribution networks. Additionally, defence spending has gained importance due to the ongoing war in Ukraine. For example, Poland aims to raise defence spending to over 3% of GDP in the upcoming year, compared to the planned 2.2% of GDP for 2022.

Hungary and Romania faced the highest budget deficits in 2022, both at 6.2% of GDP (**Figure 4**). In Hungary, where fiscal consolidation has been slower compared to in other countries in the region due to expansionary fiscal policies ahead of the 2022 elections, we expect a budget deficit of 4.2% of GDP in 2023. As for Romania, we forecast a budget deficit of 4.9% of GDP.

Figure 4: General Government Budget Balances, % of GDP

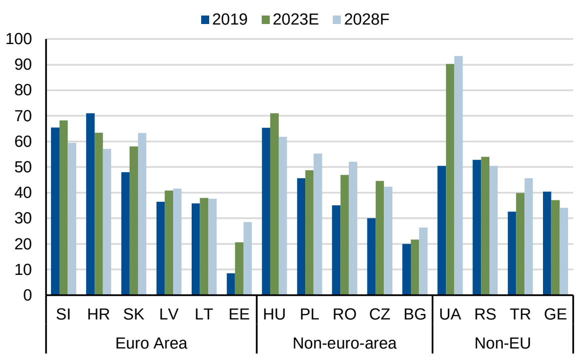


Source: IMF, Eurostat, Scope Ratings forecasts

However, the credit ratings of CEE-11 sovereigns are supported by moderate stocks of government debt (**Figure 5**) and improved debt profiles. By the end of 2022, only Croatia, Hungary, and Slovenia had general government gross debt exceeding the Maastricht threshold of 60% of GDP.

Front-loaded debt issuance this year has reduced risks of financing higher budget deficits for this year. In terms of year-to-date issuance, Romania has surpassed the planned net issuance for 2023 and Hungary and Slovakia have issued 85% and 60% respectively, of the planned net issuance for 2023. The decline of the risk premium (spread of 10-year government bonds to German Bunds) in euro-area CEE, which started at the beginning of this year, supported the high issuance volumes in the first half of this year, particularly for countries that experienced a significant widening of their risk premia before.

Figure 5: General government debt, % of GDP



Source: Eurostat, IMF, Scope Ratings forecasts

In the medium term, it is crucial to implement fiscal consolidation measures to effectively manage debt stocks and lower funding costs. This becomes especially relevant for countries facing additional uncertainties arising from upcoming parliamentary or presidential elections, as observed in Poland (late 2023), Romania (late 2024), and Slovakia (parliamentary, 30 September 2023). These electoral events might introduce uncertainties and potentially impact fiscal policies. The success of fiscal consolidation efforts will have a substantial influence on the long-term trajectory of sovereign ratings in the CEE region. Additionally, it is important to acknowledge the demographic shifts and ageing populations in most CEE countries, which pose long-term fiscal challenges.

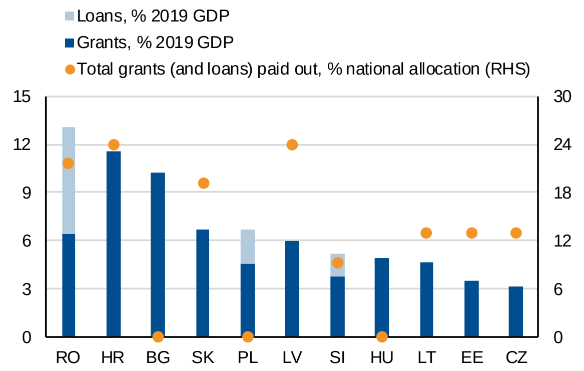
High inflows of EU funds scheduled for 2023, subject to governance risk

In 2023, the final year of the EU Multiannual Financial Framework for 2014-2020, allocated funds from the EU budget must be absorbed; otherwise, they are subject to cancellation. The flow of EU funds in 2023 is expected to be significant as the distribution of funds from the Recovery and Resilience Facility (RRF) also takes place alongside the conclusion of the 2014-20 Multiannual Financial Framework.

The RRF has a twofold purpose: addressing the immediate impacts of the pandemic and facilitating the green and digital transitions within the EU. A comparison between CEE countries and their Western counterparts reveals that CEE faces a greater task compared with its Western counterparts. This is evident in the allocation of funds through the RRF, where four out of the top ten EU countries with the highest allocations as a percentage of GDP are from the CEE-11 group. Croatia leads with the highest allocation of grants, amounting to 11% of its GDP. It is followed by Slovakia at 6.52%, Romania at 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. RRF disbursements have fallen short this year. The Czech Republic and Slovenia received their initial grants, and Slovakia received a second disbursement. Romania's pending request of EUR 3.2bn may be partially fulfilled with around EUR 2.7bn in August, conditional on implementing additional reforms. However, other EU-CEE countries are unlikely to access RRF funds in the current year.

Figure 6: CEE-11 national Recovery and Resilience Plan implementation progress



Source: European Parliamentary Research Service, Scope Ratings. Data as of 12 June 2023.

In contrast, Poland and Hungary have not met the necessary pre-conditions. The unresolved disputes concerning rule of law have raised concerns about their economic and fiscal outlooks. However, the dispute appears to be more entrenched in Hungary, where there have been frequent changes in government regulations that have led to deteriorating governance standards. Hungary's reforms are expected to be deemed insufficient by the European Commission for the first RRF tranche release. Meanwhile, reforms in Poland are likely to remain stalled by the Constitutional Tribunal until after forthcoming elections. The disputes between the EU and Hungary and Poland have also served as a potential harbinger for other CEE countries with comparatively higher institutional risk, such as Romania and Bulgaria. Any substantial delays or cuts in EU funding could result in reduced funding for planned investment projects, which might necessitate project cancellations or alternative sources of funding, with negative repercussions for policy flexibility, fiscal consolidation plans, government debt trajectories and the stability of external finances.

Annex I: 2022-24 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, %)*			Yield, local currency, 10-year (%)	CDS spread, USD, 5-year (bps)	EUR per local currency (% change)	Reserves (% of short-term external debt)
		2022	2023 (E)	2024 (F)	2022	2023 (E)	2024 (F)	2022	2023 (E)	2024 (F)	2022	2023 (E)	2024 (F)	2022	2023 (E)	2024 (F)	As of 23 Jul 2023		Since start-2023	2022
	EU CEE-11	**4.4**	**1.7**	**2.5**	**-4.0**	**-4.1**	**-3.4**				**13.9**	**11.8**	**5.6**							
Euro-area CEE	Slovakia	1.7	1.4	2.0	-3.5	-5.8	-4.8	59	58	59	12.1	10.0	5.5	2.00	4.00	3.75	3.6	37	-	-
	Slovenia	5.7	1.3	2.4	-3.0	-4.1	-2.6	70	68	66	9.0	7.0	3.5				3.2	36	-	-
	Lithuania	1.9	-1.4	2.4	-0.6	-2.4	-2.2	38	38	38	18.9	9.5	3.0				3.8	74	-	-
	Latvia	2.8	1.5	1.8	-4.4	-3.8	-3.0	41	41	42	17.2	8.5	2.5				3.9	73	-	-
	Estonia	-1.3	-1.3	2.3	-0.9	-3.5	-2.6	18	21	22	19.4	10.0	3.5				3.6	76	-	-
	Croatia	6.3	2.4	2.0	0.4	-0.8	-1.4	68	63	62	10.6	7.8	4.1				3.8	85	-	-
Non-euro-area EU CEE	Poland	5.4	2.5	2.0	-3.7	-4.2	-3.5	49	49	50	14.4	12.7	7.4	6.75	6.50	5.75	5.4	68	5.0%	108
	Romania	4.7	3.0	4.1	-6.2	-4.9	-4.4	47	47	47	11.8	11.0	6.2	6.75	7.00	5.00	6.9	171	0.3%	88
	Czech Republic	2.5	0.2	2.4	-3.6	-3.6	-2.4	44	45	43	15.1	10.6	2.4	7.00	6.00	4.50	4.0	34	0.2%	129
	Hungary	4.6	0.1	2.5	-6.2	-4.2	-3.4	73	71	68	14.8	17.5	5.3	13.00	11.50	6.50	6.4	158	5.4%	106
	Bulgaria	3.4	1.6	3.0	-2.8	-3.0	-2.9	23	22	23	13.1	9.3	3.8	1.30	3.30	2.30	4.3	115	0.0%	308
Non-EU emerging Europe	Türkiye	5.6	2.7	3.0	-4.2	-5.7	-4.9	31	40	41	73.8	45.0	40.0	9.00	17.50	20.00	18.0	441	-33.4%	59
	Ukraine	-29.1	4.0	2.5	-16.3	-19.1	-17.0	78	90	102	20.2	14.4	9.3	25.00	20.00	15.00	-	-	-5.0%	66
	Serbia	2.3	2.0	3.0	-3.1	-3.2	-2.5	55	54	53	11.9	11.8	4.1	5.00	6.00	4.50	6.1	226	0.1%	407
	Georgia	10.2	7.5	6.1	-2.6	-2.2	-2.1	40	37	37	11.9	2.3	2.8	11.00	9.00	7.00	7.9**	-	0.6%	136

Source: Scope Ratings, Macrobond, IMF, Eurostat, OECD, Bloomberg, national central banks and statistical offices; *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 displayed 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; **as of 18 July 2023 (primary market).

Annex II: Scope's CEE sovereign ratings

Figure 10. CEE long-term foreign-currency issuer ratings, as of 24 July 2023

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-/Negative
Lithuania	A/Stable	Poland	A/Stable	Ukraine	CC/Negative
Slovakia	A+/Negative	Romania	BBB-/Stable		
Slovenia	A/Stable				

Annex III: Recent research of CEE

Russia stuck in recession despite state spending; budget deficits points to longer-term weaknesses, 21 Jun

Türkiye's policy mix: will President Erdoğan's post-election pivot be sustained?, 20 Jun

Poland: Institutional deterioration and legal disputes with EU weaken credit standing, 13 Jun

Turkey: Erdoğan's re-election limits prospects for tackling economic challenges, unorthodox policies, 30 May

Turkey: close election outcome worsens long-running uncertainty over economic policy, 16 May

Policy reversal in Turkey, consolidation in Egypt crucial for coping with large external deficits, 20 Apr

Ukraine set for foreign debt restructuring next year; debt forgiveness likely medium term, 17 Apr

Poland: rule-of-law and monetary-policy weaknesses challenge ratings, 31 Mar

Romania: fiscal sustainability hinges on pension, tax reform as growth slows, 27 Mar

Managing public debt in the CEE-11: challenges, opportunities shift as borrowing costs rise, 16 Mar

Russia: financial strains set to grow as sanctions worsen structural weaknesses, 24 Feb

Georgia: robust economic performance, but geopolitical risks challenge outlook, 13 Feb

Bulgaria: high inflation, political stability key to timetable for euro accession, 9 Feb

Turkey: early election points to growing risk of future disruptive economic adjustment, 24 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), Türkiye (TR), Ukraine (UA), Serbia (RS), Georgia (GE).

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo
Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid
Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 94 91 66 2

Milan
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 8295 8254

Scope Ratings UK Limited

London
52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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