UniCredit

# CEE Quarterly

Macro Research
Strategy Research
Credit Research

**"Demand resilience sapped by economic and geopolitical shocks"**

3Q 2022

**"Your Leading Banking Partner in Central and Eastern Europe"**

Bank Austria Member of UniCredit

HypoVereinsbank Member of UniCredit

UniCredit Bank

UniCredit Bank Banja Luka

UniCredit Bulbank

Zagrebačka banka UniCredit Group

# Contents


4 **Demand resilience sapped by economic and geopolitical shocks**
16 **When the lights go out: oil and gas vulnerability in CEE**
29 **CEE and the global food crisis: higher prices, no shortages**
42 **CEE Strategy: Inflation and growth risks collide**
93 **Acronyms and abbreviations used in the CEE Quarterly**

**COUNTRIES**

49 **Bulgaria**: Higher-for-longer inflation to keep GDP growth subdued
53 **Croatia**: Euro adoption to shield against rising risks
57 **Czechia**: Crossing the pain threshold
61 **Hungary**: The fiscal conundrum
65 **Poland**: Pre-election largesse to hamper disinflation
69 **Romania**: A blurred outlook
73 **Slovakia**: Shocks all around
75 **Slovenia**: Headwinds to growth

**EU CANDITATES AND OTHER COUNTRIES**

77 **Bosnia and Herzegovina**: Economic challenges likely to be pushed aside by upcoming elections
79 **North Macedonia** gets closer to starting the EU accession process
81 **Russia:** First shock weathered, next one in sight
85 **Serbia:** Rising downside risks
89 **Turkey:** Policy inertia leads to larger imbalances



**Marco Valli**, Global Head of Research, Chief European Economist (UniCredit Bank, Milan)
+39 02 8862-0537; marco.valli@unicredit.eu

**Dan Bucşa**, Chief CEE Economist (UniCredit Bank, London)
+44 207 826-7954, dan.bucsa@unicredit.eu

**Artem Arkhipov**, Head of Macroeconomic Analysis and Research Russia (UniCredit Russia)
+7 495 258-7258 ext. -7558, artem.arkhipov@unicredit.ru

**Gökçe Çelik**, Senior CEE Economist (UniCredit Bank, London)
+ 44 207 826-6077, gokce.celik@unicredit.eu

**Ariel Chernyy**, Economist, Macroeconomic Analysis and Research Russia (UniCredit Russia)
+7 495 258-7258 ext. 7562; ariel.chernyy@unicredit.ru

**Hrvoje Dolenec,** Chief Economist (Zagrebačka banka)
+385 1 6006-678, hrvoje.dolenec@unicreditgroup.zaba.hr

**Dr. Ágnes Halász**, Chief Economist, Head of Economics and Strategic Analysis Hungary (UniCredit Hungary)
+36 1 301-1907, agnes.halasz@unicreditgroup.hu

**Ľubomír Koršňák**, Chief Economist (UniCredit Bank Czech Republic and Slovakia)
+42 12 4950-2427, lubomir.korsnak@unicreditgroup.sk

**Elia Lattuga**, Deputy Head of Strategy Research (UniCredit Bank, Milan)
+39 028862 0538, elia.lattuga@unicredit.eu

**Mauro Giorgio Marrano**, Senior CEE Economist (UniCredit Bank, Vienna)
+43 50505-82712, mauro.giorgiomarrano@unicredit.de

**Anca Maria Negrescu**, Senior Economist Romania (UniCredit Bank Romania)
+40 21 200-1377, anca.negrescu@unicredit.ro

**Kristofor Pavlov**, Chief Economist (UniCredit Bulbank)
+359 2 923-2192, kristofor.pavlov@unicreditgroup.bg

**Pavel Sobíšek**, Chief Economist (UniCredit Bank Czech Republic and Slovakia)
**+420 955 960-716,** pavel.sobisek@unicreditgroup.cz



**Published on 29 June 2022**

**Marco Valli**
Global Head of Research
Chief European Economist
Piazza Gae Aulenti, 4 - Tower C
I-20154 Milan

**Imprint:**
**UniCredit Bank AG**
UniCredit Research
Am Eisbach 4
D-80538 Munich

**Supplier identification:**
www.unicreditresearch.eu

# Demand resilience sapped by economic and geopolitical shocks

**Dan Bucsa**
Chief CEE Economist
(UniCredit Bank, London)
+44 207 826-7954
dan.bucsa@unicredit.eu

- The Russia-Ukraine conflict is likely to be protracted, with long-term economic and political consequences in CEE.
- Supply shocks spurred on inflation in 2Q22 and are likely to continue to do so by increasing food and energy prices in 2022 and 2023.
- In our baseline scenario, the EU will reduce its dependence on Russian gas by two thirds compared to 2021 and to Russian oil by 90% before year-end, in line with plans. In this scenario, we expect the EU-CEE[1] economies to grow on average by 3.6% in 2022 and 2.6% in 2023, with the Western Balkans lagging. Turkey could grow by 4.4% in 2022 and 3.3% in 2023. In Russia, the economy could shrink by around 10% this year and stall next year.
- In a negative scenario, in which deliveries of Russian oil and gas stop suddenly, before the EU finds alternative energy sources, CEE could undergo a very negative growth shock in the first few quarters due to impaired production and falling exports, with its magnitude estimated at between -9pp in Turkey and Romania and -13pp in Slovakia and Slovenia.
- The biggest direct impact from a lack of Russian energy imports would be in Hungary and Slovakia, followed by Bulgaria, Czechia and Serbia.
- If the EU fails to reduce oil and gas purchases from Russia in line with plans, economic growth would be higher than in our baseline scenario, especially in Central Europe.
- Inflation is likely to peak between August and December in most CEE countries, with the exception of Hungary and Poland, where the peak could be postponed to 2023. Inflation is expected to remain well above targets in 2023. There is a risk that fiscal profligacy might fuel inflation in most CEE countries.
- We expect central banks to end rate hikes in the autumn at around 9.5% in Hungary, 7% in Poland and Czechia, 6% in Romania and 4% in Serbia. The scope for rate cuts in 2023 is very limited, with the CNB and the NBH most likely to cut. The CBR could cut the policy rate to 8% in 2022 and 7% in 2023. The CBRT might hike in 2023 if there is a change in government.
- We expect FX interventions to be a suboptimal offset for insufficient rate hikes.
- The protracted Russia-Ukraine conflict is testing hawkishness in the EU and the rule of law in CEE. In our view, the main political risks are: **1.** political instability and more populist policies in Poland; **2.** the lack of an overhaul of the energy strategy in Hungary; **3.** stalling reforms in Czechia, Romania and Slovakia; **4.** political volatility and wider economic imbalances in Turkey and **5.** lower long-term growth and deindustrialization in Russia.
- The EU should act more proactively to foster reforms in the Balkans and around the Black Sea, offering the prospect of a customs union and a common energy policy to candidate countries.

**Russia-Ukraine conflict likely to be protracted**

More than four months after Russia invaded Ukraine, peace looks unlikely in the short term. The human, economic and technological costs for the two countries, especially Ukraine, reduce the likelihood of a rapidly mediated deal, especially if a solution includes a redrawing of internationally recognized borders. Even if peace were reached soon, sanctions against

[1]EU-CEE refers to CEE countries that are members of the EU: Bulgaria, Croatia, Czechia, Hungary, Poland, Romania, Slovakia and Slovenia.

Russia could be kept in place to ensure that it complies with new treaties and covers some of the losses inflicted on Ukraine.

Given the uncertain timeline of the conflict and potential economic consequences, the EU moved to reduce its dependency on Russian oil and gas, aiming to cut 90% of oil and oil product imports from Russia by the end of the year (imports shipped and piped through Druzhba North) and two thirds of gas deliveries.

## 1. Supply shocks will continue in 2022-23

**Gas inflows from Russia are down by two thirds in the EU…**

Data from Bruegel[2] show that the EU reduced its gas imports from Russia by a third in the first five months of the year, with a further decline of one third prompted by cuts to deliveries via Nord Stream I, presumably because of late maintenance work affected by Western sanctions (Chart 1). If the EU complies with its own targets, current flows are close to what they should be for the rest of the year. They are enough to replenish storage during the summer, but would be insufficient in colder months. Besides Nord Stream I, deliveries through other pipelines have fallen significantly: they stopped altogether on the Yamal pipeline after Russia halted sales to Poland; they are running at less than third of capacity on the pipelines that cross Ukraine; and they have almost halved on Turkstream following the end of Russian gas exports to Bulgaria.

CEE replaced some of the missing gas with more expensive LNG[3] and Poland will also benefit from a new pipeline linking it to Norway, due to come online in October or November. However, there is limited capacity to reverse flows on pipelines linking EU-CEE to Western Europe and this means that CEE (and especially landlocked Central Europe) is particularly vulnerable to a further reduction in gas deliveries from Russia. In the article “When the lights go out” on pages 16-28, we show that CEE may not avoid rationing gas consumption if imports from Russia stop altogether before the winter. Landlocked Hungary, Slovakia and Czechia are particularly vulnerable, with such a shock likely to push these countries into a deep recession.

**…while oil shipments remain higher than in 2021**

In contrast, oil shipments from Russia to the EU increased by 10% in the first five months of the year compared to 5M21[4] (Chart 2), with most going to Western Europe and the Mediterranean.

**THE EU ON ITS WAY TO REDUCING GAS IMPORTS BUT NOT OIL IMPORTS FROM RUSSIA**

**Chart 1: Russian gas flows are down by two thirds vs. 2021**

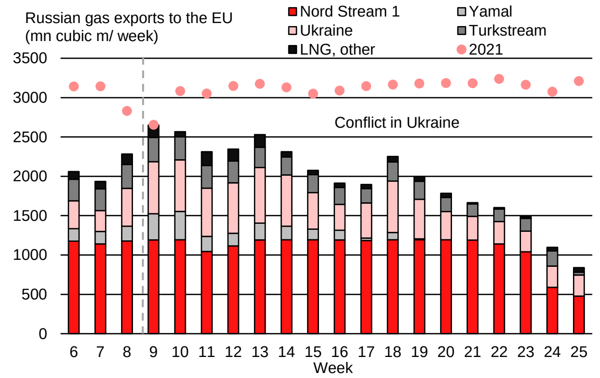
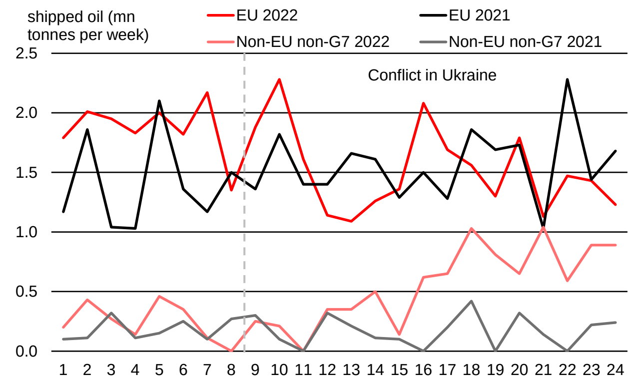



**Chart 2: YTD, EU imports of Russian oil are higher than in 2021**




Source: Bruegel, Entsog, UniCredit Research

[2] European natural gas imports | Bruegel
[3] There are six LNG terminals in CEE: one in Croatia, one in Poland and four in Turkey. Terminals in Lithuania and Italy are used to deliver gas to CEE countries.
[4] Russian crude oil tracker | Bruegel

In CEE, the main shipments of Russian oil were to Bulgaria, Romania and Turkey. Besides the landlocked countries in Central Europe, Bulgaria and Serbia are the most exposed countries in CEE to oil deliveries from Russia, as the main producers and exporters of fuel in the two countries are Russian owned.

**Russia-Ukraine conflict fuels supply shocks**

So far, the economic consequences of the war has mostly seen in higher inflation. There are several transmission channels:

**Staggered food shock…**

**…likely to further increase prices in 2022-23**

1. **Higher food prices**. While the EU is self-sufficient in most food staples embargoed by Russia and currently sold in much lower quantities by Ukraine[5], global food prices are likely to rise further, spilling over into domestic food prices throughout CEE. In the article "CEE and the food crisis: higher prices, no shortages" on pages 29-38, we discuss CEE's exposure to the global food crisis. We estimate the impact of a 10% increase in global food prices on headline inflation in CEE at 0.1-2pp within a year (Chart 3). Shocks to food supply and prices are likely to be staggered. First, lower exports from Russia and Ukraine, coupled with trade restrictions imposed by other exporters, could raise global food prices and threaten food security in Africa, the Middle East and Southeast Asia. Crop forecasts suggest that the world grain output could be lower than last year even excluding Russia and Ukraine. Second, energy and fertilizer prices are expected to rise, threatening output in 2023 and 2024, and pushing production costs higher along food supply chains.

**Lower supply and higher prices of fuel**

2. **Higher fuel prices**. We expect most benchmark oil prices to exceed USD 120/bbl while the EU moves away from Russian oil, forcing international flows of oil and fuel to be rerouted. The EU's decision to cut oil and oil-products shipped from Russia leaves the EU needing to replace up to 2.3mn barrels a day of mainly Urals blend with other types of oil. Some European oil refiners expect to reduce production by 10-20% while switching from Urals. The shock is larger in diesel prices than in gasoline prices because Russia is a main source of diesel for EU countries.

   Countries that will continue to import from Russia will not be allowed to sell oil products in other European countries due to the price advantage, further adding to disruptions.

3. **Higher gas prices**. The increase in global prices and their unlikely return to pre-2021 levels have two main consequences:

**Gas prices need to be increased further**

   1. CEE governments will have to increase regulated gas prices for households or bear the cost of subsidies. While international gas prices expressed in local currency have risen by 240-2770% since January 2010[6], retail gas prices did not rise at all in Hungary and increased by between 13% and 430% in the other countries. This gap will have to be narrowed either through price increases (inflation) or subsidies (budget deficits). Even if actual import prices increased by less than prices on the TTF exchange expressed in local currency[7], energy subsidies would probably exceed 0.5% of GDP in all CEE countries, be close to 2% of GDP in Hungary, Poland and Turkey. These subsidies will hamper the expected fiscal adjustment, especially for countries such as Hungary with high public debt that need to run primary surpluses to support their current sovereign ratings. Thus, we expect governments to increase electricity and gas prices gradually. This is valid even in Poland, where the government is preparing for elections, and Hungary, where the government has vowed to maintain low energy prices.

[5] One exception is sunflower oil.
[6] Using the Dutch benchmark computed at the Title Transfer Facility (TTF).
[7] In CEE, this is especially true for Hungary, Serbia and Turkey.

2. CEE companies are facing a rapid increase in production costs, since most of them have not hedged commodity exposure. In the more energy-intensive sectors[8], many companies have reduced or shut down their operations.

**SUPPLY SHOCKS ARE FAR FROM OVER**

**Chart 3: International food prices will fuel inflation in CEE**

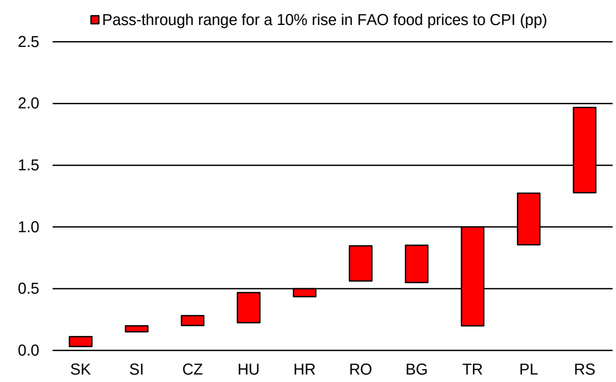
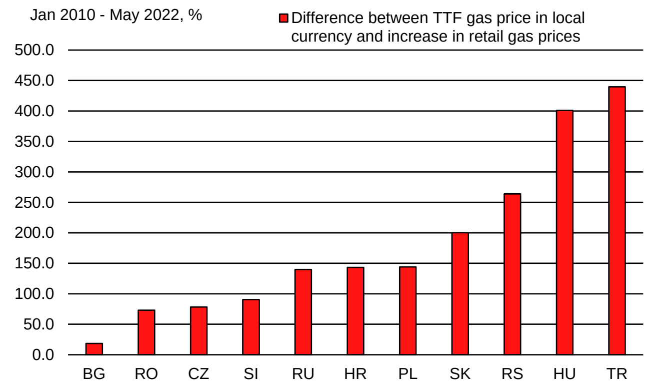



**Chart 4: Retail gas prices remain well below market prices**




Source: Eurostat, national statistical offices, FAO, Bloomberg, UniCredit Research

**Strong demand is fueling inflation in CEE**

While central banks have blamed inflation on supply shocks, strong demand has been pushing inflation higher in 2021-22. In fact, consumer demand accelerated in the first part of 2022, as households rushed to spend and borrow ahead of expected price and interest-rate increases. This is evident in strong consumption numbers for 1Q22 and retail sales for 5M22, but also in new lending figures. As a result, the precautionary savings accumulated during the pandemic have been spent in Poland, Bulgaria, Slovakia and Romania.

1Q22 GDP numbers show that gross operating surpluses increased faster than GDP in Turkey, Romania, Bulgaria and Croatia (Chart 5). This would not be possible without strong demand validating these price increases that outpace costs. Hungary is the only country where the share of labor in GDP increased in 1Q22.

From here on, private consumption is likely to grow at a slower pace due to higher food costs and energy bills, a high share of hand-to-mouth consumers (over 45%) and higher debt repayments for borrowers.

**Inflation could peak in 2022…**

As base effects become larger, we expect inflation to peak, first in countries that did not impose many price caps or cut indirect taxes. Thus, inflation could peak first in Czechia and Romania (August, at above 16% and 15%, respectively) and then in Serbia (September, at above 12%) and Turkey (October, at above 100%). In Hungary, inflation could peak in February 2023 at above 17% if price caps are removed at the start of next year and gas prices increase by around 20%. If price caps and tax cuts are maintained until 2024, we expect inflation to peak in December 2022 at over 13% and then remain well above target in 2023-24. In Poland, another increase in gas and energy prices at the start of 2023 would push the inflation peak to around 16.6% in February 2023.

**…and miss targets again in 2023**

Inflation is also likely to miss targets by large margin in 2023 (Chart 6). Poland and Hungary are in danger of double-digit inflation in December 2023 if they remove price caps and reverse tax cuts before the end of next year. Thus, postponing the return to normal tax rates and market prices could damage inflation expectations in the long term.

[8] Chemicals (especially nitrates and fertilizers), metals, metal products, products dependant on gas derivates (ad-blue, glass, carbon dioxide for the food industry).

We expect core inflation to range more widely than headline inflation and to be lowest in Serbia and highest in Turkey, where inflation expectations will remain unanchored, with Poland and Hungary ranking second and third highest due to the strength of their labor markets.

**STRONG DEMAND IS BOOSTING INFLATION**

**Chart 5: Fast rise in gross operating surpluses suggests demand is underpinning price increases**

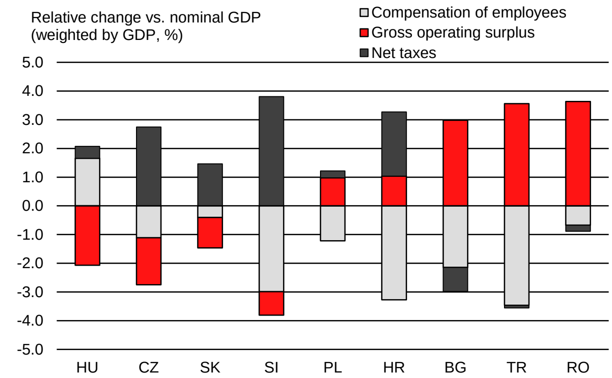
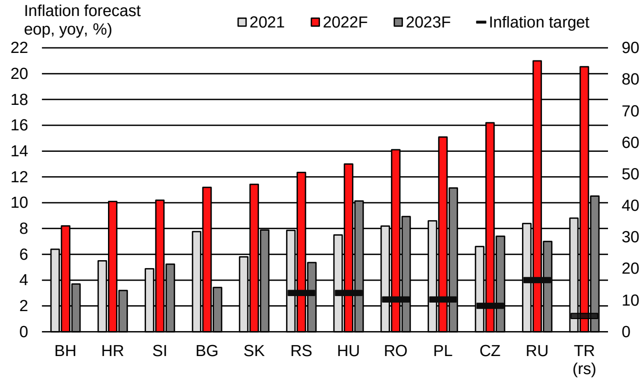



**Chart 6: Inflation above 10% in most countries in 2022, 2023 targets likely to be missed**




Source: statistical offices, UNCTAD, UniCredit Research

**Labor markets are likely to remain tight**

The strength of labor markets will determine how quickly consumption and core inflation cool off. Vacancies are falling throughout CEE, but they remain very high in Central Europe (Chart 7), where we see the risk of a wage-price spiral. This is especially true for Hungary, where bargaining is leading to double-digit wage growth, and increasingly for Poland. In the other countries, the risks are confined mostly to the construction sector and leisure services, where employment did not recover to pre-pandemic levels and wages are the lowest in the economy. Economic immigration from Asia is covering some labor demand, with refugees from Ukraine having a limited impact[9]. Thus, even if economic activity slows, Bulgaria and Czechia are the only EU-CEE countries expected to see unemployment increase next year. Unemployment might rise in Turkey next year if economic growth falls below potential, as we expect. In Russia, the structural shock affecting the economy led to the unemployment rate and vacancies falling at the same time. Many firms reduced pay and introduced part-time work to avoid layoffs, but potential disruptions in the non-energy part of the economy could have an impact on employment and wages. The subsidiaries of many multinational companies that left Russia will struggle to produce and export, and may need government support to pay wages and maintain employment at current levels.

**Fiscal policy will fuel inflation**

At the same time, governments will try to soften the landing by capping consumer prices, offering subsidies and spending more on handouts to households. As a result, the fiscal adjustment is likely to slow in 2022 compared to last year, although Poland is the only EU-CEE country that has managed to return to pre-pandemic deficits in 2021. In Bulgaria, Croatia and Poland, as well as Bosnia and Herzegovina and Turkey, budget deficits are expected to widen in 2022 compared to 2021, with fiscal impulses turning positive (Chart 8).

CEE governments are facing a trade-off between capping energy and food prices and higher budget deficits and inflation. Price caps cannot be pursued for long because the wedge between domestic energy prices and external ones is continuing to widen.

[9] Please see the country sections for details.

LABOR MARKETS AND FISCAL POLICY WILL FUEL HOUSEHOLD INCOME

Chart 7: Most CEE companies are struggling to find employees

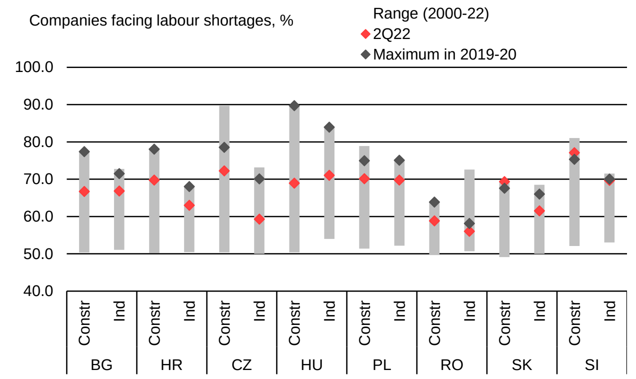
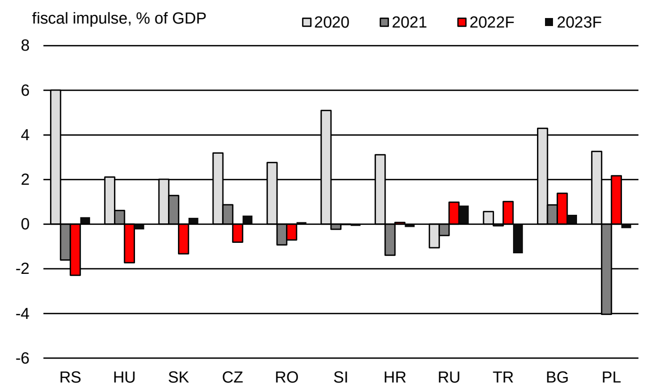



Chart 8: Fiscal consolidation is stopping in half of CEE countries




Source: statistical offices, Eurostat, UniCredit Research

## 2. Three economic scenarios shaped by oil and gas availability

**Economic outlook depends on flows of oil and gas from Russia**

We see three potential scenarios for economic growth in 2022-23:

1. In our baseline scenario, we assume that oil and gas imports from Russia will be reduced by the end of the year in line with current plans, by 90% and two thirds, respectively. In this scenario, we expect CEE countries to struggle to replace Russian energy sources, which would amplify the negative impact of supply-chain bottlenecks and would raise the risk of energy consumption being rationed during the coming winter. Economic growth could slow in EU-CEE from 5.6% in 2021 to 3.6% in 2022 (Chart 9) and 2.6% in 2023. The risk of a technical recession next winter is high, with the weak carryover into 2023 leading to lower average growth even if global trade improves in 2H23. We expect the EU to ease access to NGEU funds if this risk materializes. In this scenario, economic growth is likely to slow in the Western Balkans as well, even if governments increase spending to mitigate external shocks.

**Risk of technical recession next winter and rationing if the EU walks the talk**

   We expect growth to slow in Turkey to 4.4% in 2022 and to 3.3% in 2023. Below-potential growth next year would be explained either by poor access to foreign capital or by much tighter real monetary conditions.

   We expect the Russian economy to shrink by around 10% this year and to stall in 2023 as import substitution is likely to be incomplete and lead to a productivity shock that will affect potential growth in the medium term.

**Recession in CEE if oil and gas imports from Russia end abruptly**

2. In our second scenario, oil and gas imports from Russia end abruptly. If Europe does not ensure alternative supplies before the shock materializes, we expect GDP in CEE to drop by more than 10pp in the first few quarters (Chart 10). Except for Romania, the largest gas producer in CEE, countries have gas inventories for 3-5 months in Central Europe and at most a month in the Balkans. Due to high dependency on gas for heavy industry and car manufacturing, we expect a very large shock in production and exports throughout EU-CEE. Even if the EU finds mitigating solutions, CEE countries and their main trading partners (Germany, Italy and Austria) would probably undergo a recession. This is true even if the EU expands common borrowing and spending to help governments partly mitigate the shock.

   Turkey enjoys a higher degree of energy autonomy than EU-CEE, but its economy could be hit by both lower external demand and the fallout from Western sanctions on Russia that could affect industry and tourism.

In this scenario, Russia could undergo a double-digit decline in GDP and could see its available FX reserves reduced to very low levels in around twelve months.

### GDP OUTLOOK SHAPED BY OIL AND GAS FLOWS

**Chart 9: 2022 GDP growth driven mostly by consumption**

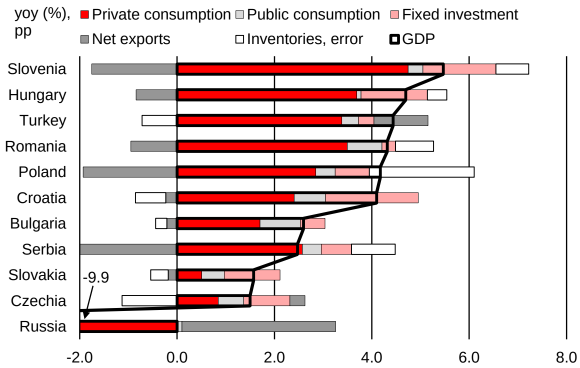
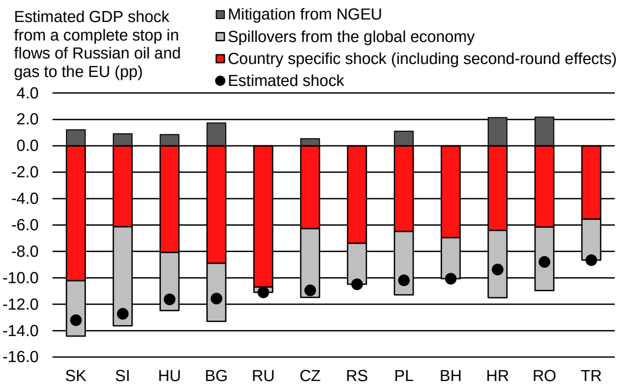



**Chart 10: Deep GDP contraction throughout CEE if oil and gas imports from Russia stop abruptly, with no alternative supplies**




Source: statistical offices, Eurostat, UniCredit Research

**Hungary, Slovakia, Bulgaria and Czechia more at risk from sudden stop in energy imports**

Table 1 shows an updated heatmap that links CEE's dependencies on Russia. Hungary, Slovakia, Bulgaria and Czechia stand out as the CEE countries most at risk. The situation could be also difficult in Serbia and Republika Srpska, where Russian companies control a large part of the energy sector.

3. In our third scenario, the EU fails to walk the talk and imports from Russia remain large beyond the end of this year. In this situation, our growth forecasts are too pessimistic, especially for Central Europe. Czechia, Hungary and Slovakia would see larger upgrades than countries that are likely to comply more strictly with sanctions (the Baltics, Croatia, Poland, Romania and Slovenia).

### TABLE 1: CEE IS VERY VULNERABLE TO A SUDDEN STOP IN OIL AND GAS FLOWS FROM RUSSIA

| | BG | BH | CZ | HR | HU | PL | RO | SK | SI | RS | TR |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Trade exposure[1]** | MEDIUM | MEDIUM | MEDIUM | LOW | MEDIUM | MEDIUM | LOW | MEDIUM | LOW | MEDIUM | MEDIUM |
| **Oil & gas dependency[2]** | HIGH | LOW | HIGH | MEDIUM | HIGH | MEDIUM | MEDIUM | HIGH | HIGH | HIGH | MEDIUM |
| **Financial exposure[3]** | NONE | NONE | LOW | NONE | NONE | NONE | NONE | NONE | NONE | NONE | NONE |
| **Economic – energy[4]** | HIGH | HIGH | LOW | NONE | MEDIUM | LOW | LOW | NONE | NONE | HIGH | MEDIUM |
| **Economic – other[5]** | MEDIUM | LOW | MEDIUM | LOW | MEDIUM | LOW | MEDIUM | NONE | NONE | LOW | MEDIUM |

[1] Trade exposure: MEDIUM: >1% of GDP, LOW: <1% of GDP
[2] Share of oil and gas from Russia in total available energy (net of exports), adjusted for industry dependency: HIGH (20-50%), MEDIUM (10-20%), LOW (0-10%)
[3] Financial exposure: Russian-owned banks and financial institutions
[4] Economy – energy: share of Russian-owned/controlled companies in fuel, gas (production, distribution), heating, nuclear-power generation
[5] Economy – other: Russian-owned companies in metals, mining, telecom, manufacturing; Russian-owned housing; reliance on Russian tourists

Source: statistical offices, UniCredit Research

**Wider C/A deficits in CEE…**

Since the beginning of the energy shock in the second half of 2021, trade balances have deteriorated in CEE. The external shortfall is continuing to widen due to persistent supply-chain bottlenecks, additional ones brought about by sanctions on Russia and a rising energy bill. As the EU pivots away from Russian oil, gas and coal, the energy bill could rise further, especially during the next winter. With the addition of larger budget deficits and lower savings rates in the private sector, C/A deficits are expected to widen to their highest levels since the global financial crisis. With many greenfield projects on hold because of impaired supply chains, reinvested profits and intercompany lending will account for most FDI. On a more optimistic note, EU-CEE stands to receive more EU funds, with flows from the 2021-27 EU budget expected to pick up this year and next. However, disbursements from the Recovery and Resilience Facility (RRF) are late for all countries because EU-CEE governments fell behind in implementing the reform agendas upon which RRF flows are conditional.

**…and more external borrowing by the private sector.**

Where extended basic balances are turning negative, the private sector is filling the funding gap by borrowing from abroad, taking advantage of lower interest rates in the eurozone. Non-financial companies are leading the way.

## 3. Monetary policy: disinflation requires demand destruction

**Accelerating inflation momentum forces more hikes…**

Since 2H21, CEE central banks have pushed their inflation forecasts gradually higher. We believe they will have to take them higher still. At the time of writing, Central European central banks are talking about slowing the pace of rate hikes and approaching the end of tightening, although inflation momentum is still accelerating following the implementation of sanctions on Russia and global disruptions to the supply of energy and food (Chart 11).

**…at least until October.**

Mindful of slower economic growth ahead, Central European central banks seem to be targeting a timeline for rate hikes (with an end around October or November, when they expect inflation to peak), rather than a certain level of maximum interest rates. Even so, the NBH is the only central bank that signaled its readiness to push the 1W deposit rate and the key rate above 7%, a move that was probably prompted by HUF depreciation. In contrast, NBP President Adam Glapiński and incoming CNB Governor Aleš Michl have spoken of the narrowing scope for higher interest rates, while the NBR and the NBS are intentionally lagging their regional peers.

To discuss where policy rates should be taken, it is worth reviewing what central bankers can achieve at this stage by tightening further.

**FX interventions are suboptimal**

First, they can prevent currencies from depreciating more. Hawkish communication has been sufficient for the outgoing majority in the Czech MPC, but not for the Hungarian one. For the first time on record, all CEE central banks that set their own interest rates have vowed to intervene in FX markets if currencies come under pressure. The NBR and the NBS are defending levels, rather than ranges, having moved from crawling bands to outright pegs. The CNB is comparing EUR-CZK to its forecast and could try to curb major deviations between the two. The NBH has hinted that EUR-HUF should not be above 390, although it failed so far to defend the 400 threshold. Representatives of the NBP and the Polish government have said that the PLN is heavily undervalued above 4.80 against the EUR.

The best the CBRT can hope for is gradual depreciation, with the TRY losing 21% against the USD since the start of the year, despite the central bank having spent around USD 43bn on FX interventions in the first five months of the year. Unable to raise interest rates, the CBRT resorted to large FX interventions and quasi-capital controls designed to extract as much foreign currency as possible from the private sector.

The CBR is gradually unfreezing the FX market. The RUB is heavily overvalued at current levels, but the central bank might try to prevent sharp depreciation in 2022 to cap the FX pass-through to inflation and cheapen imports for an economy that is trying to substitute purchases from the West. Gradual easing of the CBR's capital controls, rate cuts, lower exports and higher imports going forward might allow the RUB to depreciate towards year-end, remaining overvalued this year when accounting for the productivity shock.

Since all CEE central banks are ready to intervene if currencies depreciate too much compared to their expectations, timid hikes are the suboptimal choice for several reasons:

1. They deplete FX reserves if interventions are needed whenever markets are unhappy with the size of rate hikes. This is an issue especially in Hungary, but also in Romania and Serbia (despite higher moral suasion and, thus, more efficient interventions in the latter two countries).

2. They take short-term market interest rates to levels that would be comparable to those reached if rate hikes were larger. In fact, implied interest rates can easily spike into double digits if depreciation pressure mounts.

3. They lead to more interest-rate volatility. In combination with volatile exchange rates, this reduces investor appetite for local-currency bonds at a time when appetite for EM bonds is unstable and most CEE governments are falling behind their issuance plans.

**Financial conditions must tighten more to curb lending**

Second, central banks can tighten real monetary and financial conditions, leading to a slowdown in new lending and a reduction in demand pressure on prices. So far, results are mixed. In Czechia, there are tentative signs that lending is slowing in annual terms. In Hungary, mortgage loans are still supported by subsidized lending schemes, especially the green mortgage bonds whose cost is fixed at 2.5% and becomes even more appealing as the policy rate rises. Tweaking accepted real-estate collateral under the program does little to slow the pace of new lending. In Poland, corporate loans are on a very sharp uptrend, only partly explained by base effects, whereas households' appetite for mortgages is little changed. In Romania, only new consumer loans were falling in 2Q22 compared to 1Q22.

In Turkey, loans are affected by the central bank's quasi-capital controls, but deeply negative real interest rates, to which the CBRT is adding some sweeteners for exporters, are rising rapidly (albeit below inflation).

In Russia, financial conditions tightened after the invasion of Ukraine and the CBR takes this into account when deciding to cut rates. Uncertainty about future economic activity is likely to hamper lending, even at negative real interest rates.

In EU-CEE and Turkey, it is difficult to imagine a return to inflation targets while avoiding demand destruction. With fiscal policy loosening or remaining too lax in most CEE countries, central banks will have to increase interest rates further. However, we expect them to become more concerned with economic activity, which is likely to cut the tightening cycle short.

**We expect rate hikes to end at 9.5% in Hungary, 7% in Poland and Czechia,…**

Given the strength of core inflation and fiscal largesse, both the NBH and the NBP would need to lift interest rates into double digits to increase the chances of inflation falling back to target by 2024. Neither is likely to do that, unless inflationary shocks multiply and risk appetite falls further. That said, we see the NBH ending rate hikes very close to 10%, at 9.5%, while the NBP might reduce the pace of rate increases to arrive at 7% by October (Chart 12). At the time of writing, this is in line with what FRAs are pricing in, but markets could raise their expectations if inflation continues to surprise on the upside and/or risk appetite for EM declines further amid Fed and ECB hikes. The scope for cuts is limited in 2023, in our view (to 6.5% in Hungary and 6% in Poland), especially if the two governments decide to remove the price caps imposed in 2022, keeping inflation above 10% at the end of next year. While the market is no longer pricing in additional rate hikes in Czechia, a dovish turn by the new MPC majority would probably be punished by investors, which might take EUR-CZK above 26 and force a U-turn. Instead, we expect the MPC to cautiously test the market and remain on hold until 2H23, when it could cut to 5%.

**…6% in Romania…**

We expect the NBR to increase the policy rate to 6% by October, to sterilize liquidity and intervene in the FX market whenever there is pressure on the RON. As a result, short-term rates in Romania could be comparable to those in Central Europe in times of stress and are likely to be more volatile than in neighboring countries. So far, FX interventions and international bond redemptions have been covered by EU transfers and sovereign issuance abroad. The NBR might break the tight peg it has been running in 2022 by allowing EUR-RON to move into a 5.00-5.10 range in 1Q23.

**…and 4% in Serbia.**

In Serbia, the central bank will try to end rate hikes as soon as possible (potentially already at 4%) but this is dependent on weaker depreciation pressure. The NBS cannot maintain the current pace of FX interventions, with FX reserves falling by EUR 2.9bn (almost 15%) in the first five months of the year. Even though part of the decline is explained by the private sector switching from RSD to EUR, which may not happen again to the same extent, the RSD is likely to suffer during episodes of poor risk appetite for EM financial assets.

Neither the NBR, nor the NBS will be able to cut rates in 2023, even if core inflation is lower than for the other inflation targeters in CEE.

**Hikes are possible in Turkey if the opposition wins elections**

We expect the CBRT to keep rates on hold until after next year's elections, with more quasi-capital controls introduced to slow TRY depreciation. Thereafter, a potential change in the governing majority may lead to sharp hikes and a return to orthodox economic policies that could make Turkey one of the best performers in EM. If monetary policy remains unchanged after the elections, we expect tighter capital controls, but we do not see an end to depreciation as the country will struggle to fund its C/A deficit.

**We expect the CBR to cut to 8% in 2022 and 7% in 2023**

The CBR might cut its policy rate to 8% in 2022 and 7% in 2023. The Russian central bank expects sanctions to have a bigger impact on the economy in 2H22 and beyond, once inventories run out and the scope for import substitution is tested in earnest. The CBR is also mindful of demand recovering sooner than supply and pushing inflation higher, even if the economy is operating at a much lower level of activity than before the start of the Russia - Ukraine conflict. Potential RUB depreciation would slow disinflation as well, although the CBR seems confident that inflation can return to the 4% target by 2024.

**MONETARY POLICY HAS TO TIGHTEN FURTHER**

**Chart 11: Inflation momentum is accelerating throughout CEE**

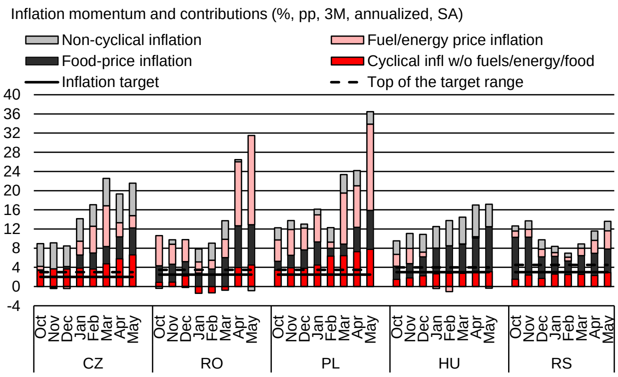
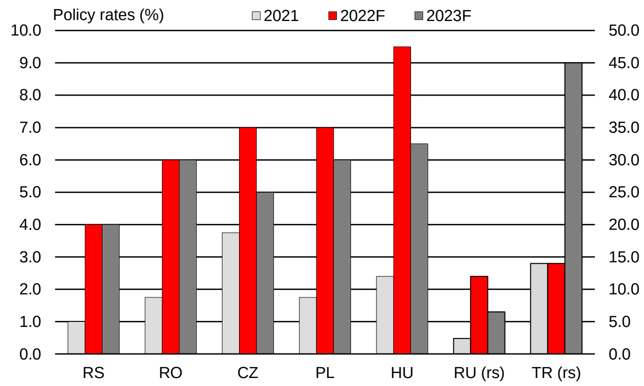



**Chart 12: More rate hikes in 2022, a few cuts in 2023**




Source: statistical offices, central banks, Eurostat, UniCredit Research

## 4. Conflict tests hawkishness in the EU and rule of law in CEE

In its attempt to support Ukraine, Europe faces the choice between much lower growth or even a recession to reduce Russia's oil and gas revenues and a longer war with unpredictable consequences for the continent.

**A dovish EU core threatens EU-CEE allegiance to the union**

Most EU-CEE governments seem willing to incur the economic costs, as they are on the hawkish flank of the EU. This is not the case in Western Europe, especially in Germany and France, which are arguing for negotiations with Russia and are perceived in EU-CEE as failing to provide leadership when Europe needs it most[10]. The consequences could be severe in terms of EU-CEE's allegiance to the European project, with NATO gaining (even more) prominence. Dovish EU leadership could lead to Brussels exerting looser control over how EU-CEE and the Western Balkans are abiding by rule-of-law principles and watering

[10] Ukraine war: Where's Europe's leadership in crisis with Russia? - BBC News

down criteria for disbursing EU funds. Poland's access to NGEU is proof in point. Hungary is likely to be next, concluding an agreement on NGEU money later this year, despite the geopolitical divide between Budapest and Brussels having yet to close.

**Turmoil in CEE politics, more economic populism**

Regional turmoil is also seeping into domestic politics, which also need to handle disgruntled voters, unhappy with high inflation and the uncertain economic outlook. The result is a volatile political environment, more economic and social populism, and stalling reforms.

**Unstable political environment leads to less efficient economic policies in Poland**

1. Poland's standing in the EU has never been more prominent, with a Law and Justice (PiS) government in power. At the same time, domestic political turmoil is also rising, with disagreements inside the PiS mounting as the economic outlook darkens. Prime Minister Mateusz Morawiecki, who has probably handled the economic fallout from the pandemic better than any of his CEE peers, is seeing his authority challenged amid declining living standards. With elections 16 months away, economic policies are increasingly dominated by populist handouts and short-term fixes, a poor omen for the health of public finances in the next election cycle.

**Hungary may be forced to change its energy strategy…**

**…and draw closer to the EU.**

2. In Hungary, the ruling Fidesz won a clear victory in April's parliamentary elections. While this offered a great opportunity to reset Hungary's economic priorities, Prime Minister Viktor Orbán is increasingly at odds with his EU colleagues when it comes to economic ties to Russia. According to our analysis, Hungary is the most dependent country in Europe on Russian energy. As a landlocked country with eastern neighbors who favor severing trade relationships with Russia, Hungary is in dire need of a new energy strategy. Otherwise, the country risks the deepest recession on record if oil and gas flows from Russia stop abruptly. Hungary's regional agenda has also been thwarted by its perceived support for Russia, with Visegrád peers, especially Poland, disagreeing with Mr. Orbán's foreign policy. With Janez Janša having lost parliamentary elections in Slovenia, Mr. Orbán has no obvious ally who could oppose an Article 7 vote in the European Council.

**Political crisis in Bulgaria threatens euro adoption in 2024**

3. Bulgaria's political crisis bundles diverging views on Russia with an impasse in reforms and a lack of communication among the main political players. Another round of elections would probably lead to another fragmented parliament, threatening the country's fiscal discipline and its planned euro adoption in 2024.

**Stalling reforms in Czechia, Slovakia and Romania**

4. In Czechia, Romania and Slovakia, the Russia-Ukraine conflict has caused reforms to stall. This is threatening the medium-term economic outlook, while also fueling current macroeconomic disequilibria. Another victim could be RRF-funded investment, which requires reforms to unlock funding. This is despite all three countries badly needing investment in energy to reduce their dependency on imports from Russia.

**Turkish politics are increasingly noisy, at home and abroad**

5. In Turkey, the ruling People's Alliance (formed by the Justice and Development Party, AKP, and the National Movement Party, MHP) is running behind the opposition Nation Alliance in opinion polls. Turkish voters face a further loss of purchasing power and we see little scope of a turnaround in policies and support for the government. This increases the risk of political noise at home and abroad, with President Recep Tayyip Erdoğan's rhetoric turning to potential incursions into Syria and vetoing the NATO accession of Sweden and Finland. At the same time, lack of capital inflows pushed Mr. Erdoğan closer to former foes like Saudi Arabia's Mohammed bin Sultan.

**Import substitution is lagging in Russia**

6. Russian attempts to substitute imports look to be facing difficulty, with exports from friendly countries such as China and Western allies such as South Korea and Taiwan falling in annual terms (Chart 14). This is threatening a potential recovery by impairing domestic supply and might force Russian authorities to make concessions in favor of friendly and non-aligned countries. As a result, Russia's trade surpluses could be undermined in the

short term, while what the CBR called “reversed industrialization”[11] is a threat in the long term.

**Balkan and Black-Sea countries should be part of the EU’s customs union and common energy policy**

7. In better news, Ukraine and Moldova were offered candidate status for EU accession, while negotiations with North Macedonia and Albania could be unblocked if Bulgaria withdraws a veto on the former’s negotiations (a majority of members of parliament wish so). However, the road to full EU accession remains long. In our view, the best these countries can hope for in the coming decade is a customs union with the EU, as we have argued in previous editions of the *CEE Quarterly*. This is also the case for Serbia and Montenegro, while Bosnia-Herzegovina and Georgia need to implement additional reforms before starting the negotiation process. In addition, Ukraine will need financial and logistical help in its postwar reconstruction. It is paramount for the stability of the region that the EU keep all these countries close and offer them economic incentives in exchange for reforms. Their energy security should also be a European priority given long-term geopolitical rifts. A more proactive and farther-reaching EU foreign policy in the Balkans and the Black Sea could be beneficial for longer-term stability in Europe.

**POLITICAL UNCERTAINTY BEGETS ECONOMIC VOLATILITY**

**Chart 13: Polls show declining approval for the ruling AKP and MHP in Turkey**

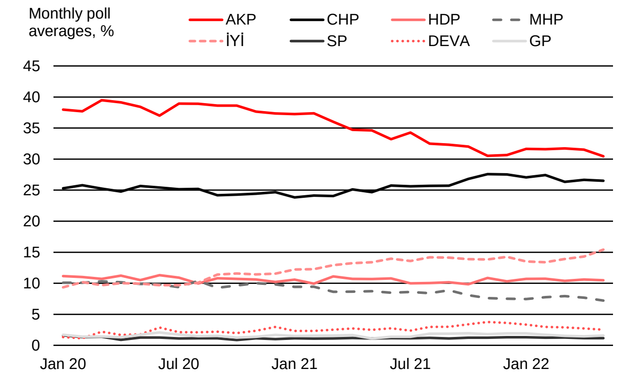



**Chart 14: Russian imports from both friendly and sanction-observing countries are falling**


Source: pollsters, Bloomberg, UniCredit Research

[11] https://www.cbr.ru/Collection/Collection/File/40953/bulletin_22-02.pdf

# When the lights go out: oil and gas vulnerability in CEE

**Mauro Giorgio Marrano**, Senior CEE Economist (UniCredit Bank, Vienna)
+43 50505-82712
mauro.giorgiomarrano@unicredit.de

**Dan Bucsa**
Chief CEE Economist
(UniCredit Bank, London)
+44 207 826-7954
dan.bucsa@unicredit.eu

- Oil and gas account for over half of final energy consumption in CEE, exceeding 60% in Turkey and averaging 56% in EU-CEE[12] and 50% in the Western Balkans[13].
- Gas is used more than oil in EU-CEE and Turkey, while oil is more relevant in the Western Balkans.
- CEE imports most of its oil and gas. There is significant production only in Albania (oil) and Romania (gas and oil).
- CEE is almost fully dependent on gas imports from Russia. Turkey is the main exception.
- In EU-CEE (except for Croatia) and Serbia, Russian oil accounts for 40-100% of imported crude oil. Petroleum products are imported mainly from the EU, which partly represents indirect exposure to Russia.
- Gas accounts for 30% of total energy consumption in CEE industry, being the largest single source of energy. In Albania and Montenegro, oil is more important.
- In EU-CEE, heavy industry and car production are very reliant on gas, highlighting the risk to production and exports if imports from Russia stop.
- Services and households in EU-CEE and Turkey are dependent on gas imports, while CEE transport companies rely on imported oil.
- A stop in oil and gas deliveries from Russia would affect EU-CEE much more than the Western Balkans, with the effect on Turkey being somewhere in between.
- Hungary and Slovakia are the most at risk from a halt to imports of Russian oil and gas, followed by Bulgaria and Czechia.
- Short-term solutions to move away from Russian oil and gas should target lower consumption, increased efficiency and a common EU platform for purchasing energy products.

[12] Bulgaria, Croatia, Czechia, Hungary, Poland, Romania, Slovakia and Slovenia – all EU members.
[13] Albania, Bosnia-Herzegovina, Montenegro, North Macedonia and Serbia.

## Methodological notes

**The conflict in Ukraine has increased the focus on energy dependency**

The conflict between Russia and Ukraine has increased the focus on Europe's dependency on oil and gas imports. Significant increases in prices, disruptions in Russian exports and the risk of sudden stops in energy flows threaten economic activity at a time when the post-COVID recovery in the eurozone is still incomplete and subject to increasing downside risks.

**Focus on the importance of natural oil and gas in EU-CEE, the Western Balkans and Turkey**

In this note we look at the importance of oil and gas and the exposure to imports from Russia in CEE, which we divide into three subregions: EU-CEE, the Western Balkans and Turkey. We also include the euro area[14] for comparison.

We consider three aspects: **1.** The overall importance of natural oil and gas for the economy, **2.** Dependency on energy imports from Russia and **3.** The use of oil and gas and the vulnerability of various sectors.

**We look at 2019 to avoid distortions related to the pandemic**

We have based our analysis on the Eurostat energy database and have looked at data for 2019 because data for 2020 and 2021 are likely to have been distorted by the pandemic. In recent months, countries have started to shift away from Russian energy and reduce their overall dependency on oil and gas. However, we believe that our analysis still provides a relevant assessment of the role that oil and gas plays in the energy balance and therefore also of the challenges associated with shifting away from Russian exports.

In this note, gas is defined as natural gas plus manufactured gas, including LNG[15]. The general oil category includes petroleum products[16], with crude oil and diesel forming the lion's share of CEE imports.

An important feature of the data is that transit quantities are excluded in both exports and imports. This holds for all products except electricity and heat, where transit quantities appear in both imports and exports where applicable, but they constitute a small proportion of the whole.

In line with the methodology on transit, imports by partner country show the country where the product originated. For example, Russia exports gas to Serbia through Hungary and Bulgaria and the data, correctly, show that the trading partner for Serbia is Russia.

Our analysis considers energy flows as presented in Eurostat Sankey diagrams[17]. It therefore looks at the complete energy process: from the available energy from production and imports, through transformation, to final energy consumption.

**Available energy is a good proxy for the size of an economy**

To assess the importance of oil and gas for an economy, we look at the energy flows as shares of total available energy. While energy intensity varies somewhat across countries, total energy is overall proportional to GDP; therefore these shares allow comparison across countries

[14] Euro area data include intra-euro area trade.

[15] According to the Eurostat definition, natural gas comprises gases occurring in underground deposits, whether liquefied or gaseous, consisting mainly of methane, independent of the extraction method. It includes liquified natural gas (LNG) and compressed natural gas (CNG). Manufactured gas is gas produced from other energy sources including in gas works gas, coke oven gas, blast furnace gas and other recovered gases. It typically represents a small portion of total gas.

[16] This includes crude oil, other primary oil, motor gasoline, gas oil and diesel oil, Kerosene-type jet fuel, fuel oil and other petroleum products.

[17] Sankey diagrams for energy balance – Statistics Explained (europa.eu)

# 1. Oil and gas: the main energy source in CEE

**Oil and gas account for most of the energy used in CEE**

Chart 1 shows that oil and gas account for most of the energy available from all sources[18] in CEE and the eurozone. The exceptions are Bulgaria, Poland and Czechia in EU-CEE, and Serbia, Montenegro and Bosnia-Herzegovina in the Western Balkans. These are countries with significant domestic production of coal (all of them excluding Albania), renewables (mostly hydro power produced in mountainous Albania, Montenegro and Bosnia-Herzegovina) and nuclear energy, which in the chart below is included in “other” (Bulgaria, Czechia, Hungary, Romania, Slovenia).

Excluding exports[19], the overall picture does not change significantly (Chart 2). The shares of oil and gas in available energy are a bit smaller, especially in EU-CEE and Albania, but they still range between 40% and 65% in most countries.

**Oil is more important than gas in the energy mix**

Oil is more important than gas in the energy mix in most CEE countries. Its share in available energy exceeds 30% everywhere but in Czechia and Bosnia-Herzegovina. Albania stands out, with a share of 60%, the only CEE country where domestic production of oil has a large share in energy generation.

**The importance of gas varies significantly across countries**

The importance of gas in the energy mix varies significantly across countries. Gas is more relevant in EU-CEE and Turkey (average share of 23%), and less so in the Balkans (average share of 5%). Hungary stands out with a share of total available energy of over 40%, but the share of exports is also high at around 15% of available energy.

**CHART 1: SOURCES OF AVAILABLE ENERGY**

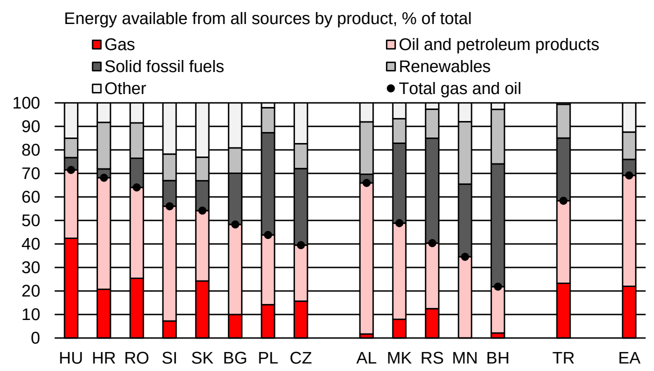
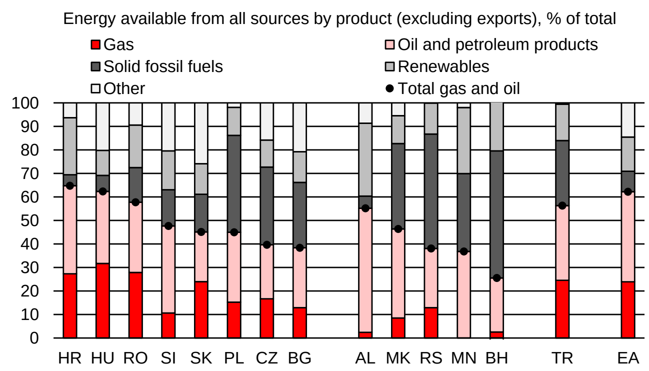



**CHART 2: AVAILABLE ENERGY EXCLUDING EXPORTS**




Source: Eurostat, UniCredit Research

## 1.1. CEE: Oil and natural gas are almost entirely imported

Energy imports exceed two thirds of available energy in Hungary, Slovakia, Slovenia and Croatia. The situation is similar in Turkey and the euro area (Chart 3).

**CEE’s energy imports consist almost entirely of oil and gas**

**Significant production of oil and gas only in Romania and**

CEE’s energy imports consist almost entirely of oil and gas, while the main sources of energy produced in CEE are solid fossil fuels, renewables and nuclear energy (Chart 4). The only two CEE countries with significant production of oil and gas are Romania (gas and, to a lesser extent, oil) and Albania (oil). Croatia ranks a distant third, with limited production of

[18] Available energy from all sources is defined as the sum of domestic production, imports, stock draw, and a small statistical difference. It is the amount of available energy before exports, transformation and consumption. In other words, it is the amount of energy required by the economy for its overall functioning.
[19] The available energy excluding exports (called gross available energy) represents the quantity of energy necessary to satisfy domestic energy demand and it is an important aggregate. In the reminder of this section, however, we will focus on available energy from all sources, the aggregate which includes exports. We believe it gives a better indication of the overall importance of these commodities and is more suitable for some of the comparisons.

**Albania**

both oil and gas. In Romania and Albania, local production accounts for roughly 30% of total available energy, a share comparable with that of imports of oil and gas.

**Gas is piped and shipped to six LNG terminals**

Besides imports from Russia (discussed below), CEE receives gas through pipelines connecting it to Germany and Austria (mostly Russian) and Italy. A new pipeline linking Poland to Norway will start operation this summer. CEE benefits from six LNG terminals, one each in Poland and Croatia, and four in Turkey. CEE countries can access gas from LNG terminals in Lithuania and Italy. A new terminal under construction in Greece will be used by the country's Balkan neighbors.

**Oil is shipped and piped**

Russian oil arrives in CEE through pipelines and by ship at several CEE ports, the largest quantities landing at Constanta in Romania, Gdansk in Poland and Burgas in Bulgaria. Trieste in Italy and Butinge in Lithuania are also used to deliver oil and oil products to the Balkans and Poland, respectively.

**CHART 3: CEE IMPORTS MOST OIL AND GAS**

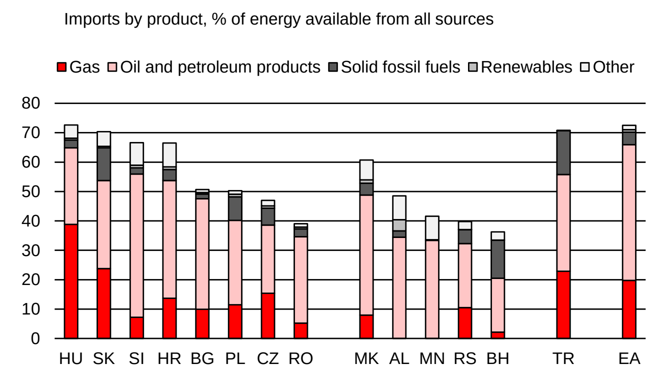
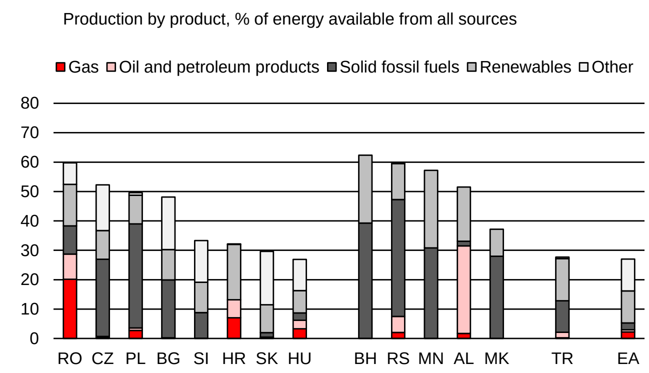



**CHART 4: COAL AND HYDRO DOMINATE PRODUCTION**




Source: Eurostat, UniCredit Research

## 1.2. CEE: no immediate alternative to fossil fuels

**CEE has few short-term energy alternatives to fossil fuels**

CEE has few short-term energy alternatives to fossil fuels. Wind power in CEE is limited to the narrow corridors between mountain ranges, with the best area being the Black Sea coast in Bulgaria and Romania. At the same time, long and wet winters reduce the appeal of solar energy, although solar panels can still be used to heat water. Hydro power can damage fragile ecosystems, as has happened on the Danube and its main tributaries in the Balkans.

**Nuclear power the most valid option**

Nuclear power remains the most valid option, with CEE countries wanting to install small modular reactors (SMR), cheaper and more versatile than conventional reactors, although with similar issues of waste disposal[20]. The first SMR, using previously untested US technology, should be ready by 2028 in Romania. Other countries wanting to implement this technology are Czechia and Poland. Meanwhile, CEE countries have not given up the idea of further developing large nuclear reactors. Bulgaria wishes to expand the Belene nuclear power plant, although political infighting has delayed the project. Czechia plans to expand its nuclear power plant at Temelín and to replace the existing reactors at Dukovany, its other plant. Hungary is doubling the capacity of its Paks nuclear power plant with help from Rosatom (Russia's state atomic energy corporation, which is not sanctioned). However, more than 60% of its suppliers are in Russia and wide sanctions on trade with dual-use goods could affect the project, completion of which is due in 2030. Romania is planning to expand further its Cernavodă nuclear power plant, but successive governments have switched from

[20] Nuclear waste from small modular reactors | PNAS

Canadian to Chinese and back to Western technology. Moreover, the operating company, Nuclearelectrica, remains a cash cow for Romanian governments and, as a result, the expansion could take longer than the SMR project in Doicești. Slovenia and Croatia want to expand their joint venture in Krško (in Slovenia) with a second reactor. The capacity at Slovakia's Mochovce nuclear power plant will double with the addition of two reactors this year and next.

**NGEU could be used for green transition**

The large share of fossil fuels in energy sources could be addressed in EU-CEE by using NextGenerationEU (NGEU) funds[21]. The green transition is important because fossil fuels could remain expensive for years, while the price of green certificates might increase further. This is a critical issue in Poland and Czechia, the two EU-CEE countries that are the most reliant on coal. Since 2021, expensive energy has driven producer prices higher throughout the region and cost competitiveness in the tradable sector could be further affected. High dependency on coal in the Western Balkans will be more difficult to tackle due to lack of funding. This increases the vulnerability to changes in energy flows in landlocked countries like Serbia and North Macedonia, but also in Bosnia-Herzegovina.

**Short-term solutions should target energy efficiency and pooled market power**

The faster solutions suggested in the European Commission's REPower EU strategy include reducing consumption (both industrial and residential), reducing energy losses by using better cladding, heat pumps and adapting consumption to peaks in energy generation[22]. A team of economists and energy specialists[23] suggested a common EU Energy Platform for purchasing natural gas, LNG and hydrogen, which would allow the EU to use its market power in order to target larger contracts and better prices.

# 2. CEE: oil and gas imports from Russia

## 2.1. Gas: almost fully dependent on Russia

**Gas imports from EU countries is typically of Russian gas**

Assessing the dependency on Russian gas requires data adjustments. While Eurostat data exclude transit, the share of gas imports from Russia appears to be underestimated for some countries (Romania, Slovenia, Croatia, and, to a lesser extent, Poland). These countries have a large share of gas imports from EU countries like Germany, Austria, Hungary, Slovenia and Bulgaria. Based on available information, we estimate that most of these imports are Russian gas, due to the limited scope to reverse flows on pipelines coming from Western Europe. These imports are probably not registered as Russian in Eurostat statistics due to methodological aspects. For example, the gas might be stored locally and then re-exported.

**Most CEE countries import 100% of their gas from Russia**

Chart 5 shows that Russia's share in total gas imports is close to 100% in most countries. The exceptions are Bulgaria, where 20% of gas comes from Greece, Poland, where 13% is from Qatar and 5% from the United States (both LNG), and Turkey, where 65% of the gas comes from other producers including Azerbaijan and Iran (via pipeline), Algeria, Qatar, Nigeria and the United States (mostly through the aforementioned LNG terminals).

**Four pipelines linking Russia with Western Europe**

CEE imports gas from Russia mainly through four pipelines:

1. The Yamal pipeline crosses Belarus and Poland and ends in Germany. It has not been used at all since Russia decided to end gas deliveries to Poland.

2. The pipelines crossing Ukraine and branching out into Poland, Slovakia, Hungary, Romania and Moldova. These pipelines are still used at around a third of their capacity, despite the conflict raging on in Eastern Ukraine. The flow is equivalent to

[21] For an analysis on the European Commission's plan on how the EU can eliminate its dependency on Russian fossil fuels please see Tagliapietra, S. (2022) *REPowerEU: will EU countries really make it work?*, Bruegel Blog, 18 May
[22] REPowerEU (europa.eu)
[23] Boltz, W., K.D. Borchardt, T. Deschuyteneer, J. Pisani-Ferry, L. Hancher, F. Lévêque, B. McWilliams, A Ockenfels, S. Tagliapietra and G. Zachmann (2022) *How to make the EU Energy Platform an effective emergency tool*, *Policy Contribution* 10/2022, Bruegel

a quarter of the EU's imports of Russian gas since Russia invaded Ukraine[24].

3. TurkStream links Russia to the European part of Turkey and then continues to Bulgaria, Serbia, Hungary and Austria. Deliveries on this pipeline fell by around a third after Russia stopped selling gas to Bulgaria. Bulgaria threatened to withhold gas from the flow to Serbia and Hungary if contracts are not observed by Gazprom.

4. Nord Stream 1 crosses the Baltic Sea from the Gulf of Finland to Northern Germany. Until two weeks ago, this pipeline was used close to full capacity. In early June, Russia started to reduce flows on Nord Stream 1, claiming delays in maintenance works by German company Siemens. However, Russia could pump gas to Germany through alternative routes if it wanted to maintain flow, especially through the Yamal pipeline. EU-CEE receives gas from Nord Stream 1 via Germany and Austria.

Since the start of the Russia-Ukraine conflict, EU's gas imports from Russia have fallen by a third compared to the same period last year. The EU's target to reduce deliveries from its eastern neighbor by another third before year-end would require flows on Nord Stream 1 to remain well below capacity. In the week ending 20 June, Russian gas exports to the EU represented 36% of the flow from 2021's 24$^{th}$ week.

## 2.2. Oil: direct and indirect exposure to Russia is large

**Imports of oil consists mainly of crude oil and diesel products**

To assess CEE's dependency on Russian oil, it is useful to first look at the structure of imports of oil and petroleum products (Chart 6). The main imports are crude oil and diesel. Countries with a high share of imports of crude oil are typically those with significant refining capacities in EU-CEE, Turkey and Serbia. Slovenia and the Western Balkans (excluding Serbia) import mainly diesel and other oil-derived product (Chart 6).

**CHART 5: CEE IS RELIANT ON RUSSIA FOR NATURAL GAS**

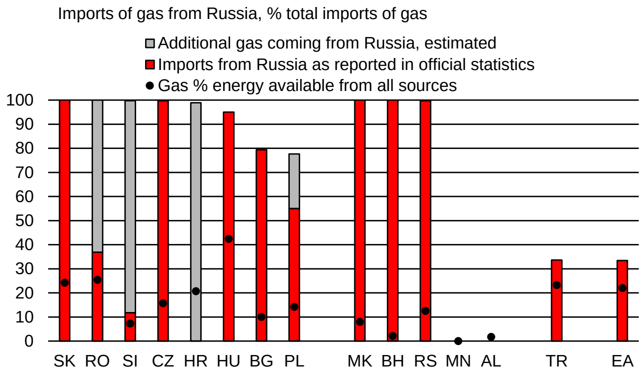
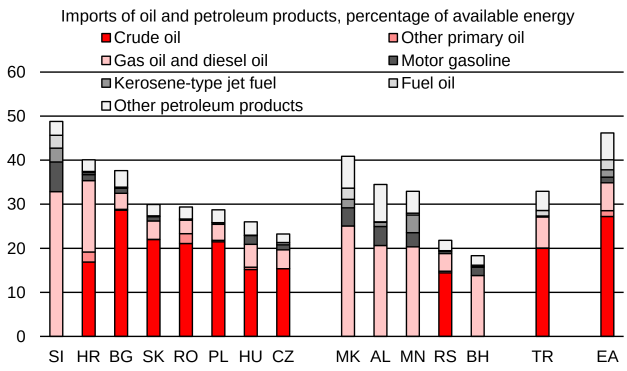



**CHART 6: CRUDE AND DIESEL DOMINATE OIL IMPORTS**




Source: Eurostat, UniCredit Research

**Russian oil arrives in CEE via pipelines and three ports**

We focus on crude oil and diesel to identify CEE's dependency on imports from Russia. Russian oil arrives in CEE countries via the Druzhba pipelines or shipped to CEE ports. Druzhba North crosses Belarus into Poland and Germany, while Druzhba South links Russia to Slovakia and Hungary via Ukraine. The EU's pledge to stop oil imports through Druzhba North will leave just Druzhba South as a source of imports for landlocked countries in Central Europe (Czechia, Hungary and Slovakia).

...

The largest oil and diesel shipments from Russia to CEE land in Constanța and Burgas[25] from the Russian terminal at Novorossiysk in the Black Sea and in Gdańsk from the Ust-Luga

[24] European natural gas imports | Bruegel

and Primorsk terminals close to St Petersburg. Of the three countries, Bulgaria is the most dependent on oil imports from Russia because the largest fuel producer in the country, located in Burgas and owned by Russia's Lukoil, accounts for 90% of Bulgaria's exports and consumption of fuels. The refinery can also use crude oil from countries other than Russia

**Most crude oil comes from Russia**

**Most diesel products come from the EU, in part indirectly from Russia**

The share of imports of crude oil from Russia is high in most countries, except for Croatia and Turkey (Chart 7).For diesel products the picture is more complex. Only Poland, Romania, Bulgaria and Turkey report a high share of imports from Russia. However, these are countries in which oil products make up a small share of total oil imports. The main trading partners of most countries are in the EU. This could imply, at least in part, indirect exposure to Russia, given that the euro area imports 20% of its crude oil from Russia.

**EU-CEE, Serbia and Turkey are more dependent on Russian energy than the Western Balkans**

Summing up, Chart 8 shows direct imports of oil and gas from Russia and potential indirect imports of oil products[26] (through imports from the EU) in percent of total available energy. Overall, EU-CEE, Serbia and Turkey are more dependent on imports from Russia than the Western Balkans. Hungary and Slovakia stand out, having the highest dependency, followed by Bulgaria, Poland and Czechia.

**CHART 7: CEE VERY DEPENDENT ON RUSSIAN CRUDE OIL**

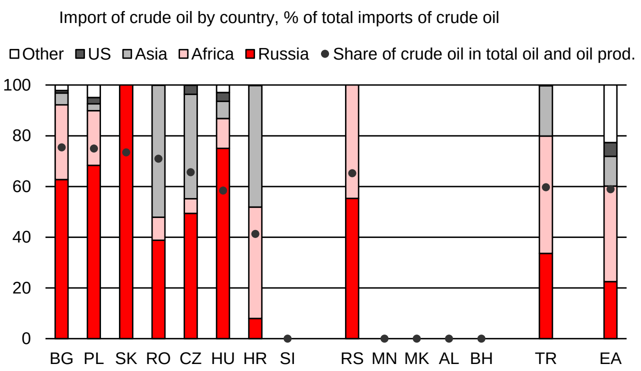
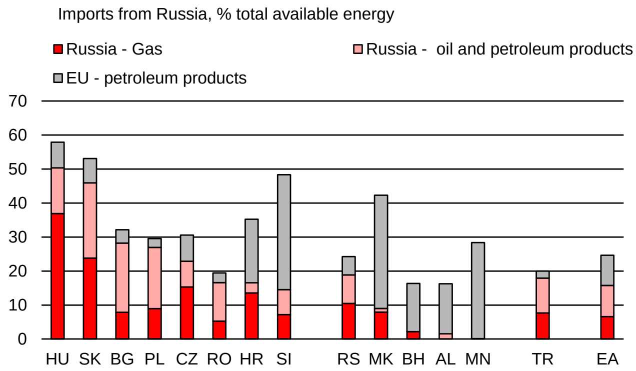



**CHART 8: DIRECT AND INDIRECT IMPORTS FROM RUSSIA**




Source: Eurostat, UniCredit Research

## 2.3. Replacing Russian energy – a tall order for CEE

**Moving away from Russian crude oil to other types of oil could cause disruptions to refineries…**

Moving away from Russian crude oil, which is mostly medium light and medium sour, to oil from other sources with different features in terms of density and sulfur content, could cause disruptions to refineries as they would need to adapt to the type of oil. Some Central European companies estimate output declines of 10-20% if they need to adapt their refining capacities, which will require time and investment. Moving from Urals to Brent is easier as the latter is lighter and sweeter, while moving from Urals to Arabian heavy (the oil most widely available in the Middle East) would be more difficult.

**…especially in EU-CEE, Serbia and Turkey**

Countries with larger refining capacity are more exposed to such disruptions. Chart 9 shows that EU-CEE, Serbia and Turkey refine most of the oil used in their energy mix, while Chart 10 shows that CEE countries export fuels that represent more than 10% of available energy.

[25] Russian crude oil tracker | Bruegel
[26] It is unlikely that all of CEE's fuel imports from the EU are produced using Russian oil.

**CEE countries were not prepared to diversify away from Russian energy sources**

Before Russia invaded Ukraine, no CEE country had considered diversifying away from Russian energy sources. This was evident when Croatia built its LNG terminal on the island of Krk and struggled to attract orders from neighboring countries to fund the construction. Bulgaria and Romania delayed the extraction of gas from the Black Sea until the potential external partners packed their bags and headed for the Eastern Mediterranean. In June, gas extraction started in Romania's Black Sea waters, with a potential output of one billion cubic meters (bcm) per year, roughly 10% of Romania's gas consumption (although some of it can be exported). At this rate, the well would be depleted in ten years. Larger projects are delayed due to proximity to Snake Island, which remains disputed by the Russian and Ukrainian armies.

Russia's invasion of Ukraine and higher prices make alternative energy sources more palatable in CEE. However, the gradual rearrangement of global supply corridors for oil and gas hamper CEE's search for alternative energy sources in the short term

**CHART 9: IMPORANCE OF OIL REFINING ACTIVITY IN CEE**

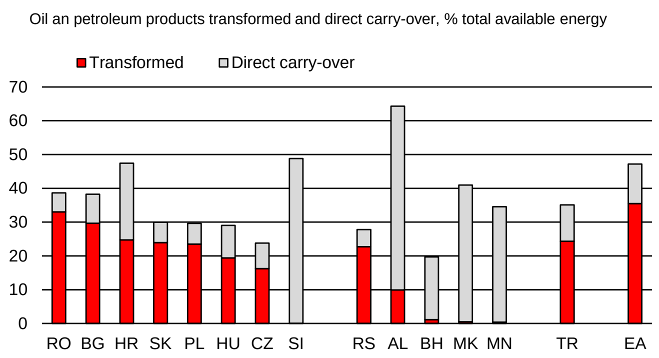
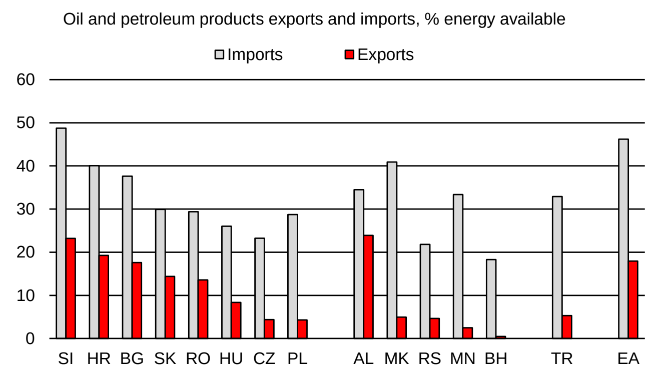



**CHART 10: CEE'S FUEL EXPORTS ARE LARGE**




Source: Eurostat, UniCredit Research

Only Albania and Romania can increase their domestic production of oil, and oil and gas, respectively, but the increase would not replace imports from Russia. Bulgaria and Turkey could also extract gas from the Black Sea, although the latter is eyeing the much larger undersea fields in the Mediterranean.

**Shifting away from Russian energy will take time and significant investment**

In the short term, the new Norway-Poland pipeline, to be opened this autumn, and the Greek LNG terminal, to be completed next year, offer the most important direct alternatives to Russian imports. Other potential sources are:

1. Flow reversals on pipelines linking Eastern and Western Europe. The flow is normally east to west. Reversal would require big investment, not only in Central Europe but also Western European interconnectivity over the Pyrenees and the Alps. Both will take years.
2. Larger flows from the Caspian basin (Azerbaijan, Kazakhstan, Turkmenistan) via Turkey. The Southern Gas Corridor could be expanded to include deliveries from Uzbekistan and Iran.
3. Gas pipelines from the Eastern Mediterranean basin. Large gas reserves discovered in this region bode well for Europe's gas security. However, territorial water disputes, especially between Turkey and Greece, could delay such projects. Israel, Cyprus and Greece reached an agreement to build a pipeline, but the Biden administration poured cold water on the project in the hope that Turkey and Egypt will also be included. Being close to Europe but remote from Russia, this would be the most feasible option for Europe and CEE to purchase large quantities of gas.

4. Shale gas has been touted as a source of energy throughout Eastern Europe, particularly in Ukraine, Poland and Romania. Geological hindrances and local opposition have so far sidelined such projects. We see shale as unlikely to help reduce dependency on Russian gas.

**EU energy security must include the Western Balkans, Moldova and Ukraine**

In a shifting geopolitical landscape, the EU's energy security framework must include countries in the Western Balkans, as well as Moldova and Ukraine. This is paramount to reduce energy dependence on Russia and Russia's political influence. If countries such as Serbia, Moldova and Ukraine remain dependent on Russian energy, their cooperation with the EU and additional reforms to help strengthen the rule of law and improve institutional quality will be hindered. The task might be easier in the Western Balkans and Moldova, which have very small economies, but not in Ukraine. There, widespread destruction has added to energy inefficiency, dependence on energy-intensive sectors (heavy industry, chemicals) and territorial spread.

With limited alternatives to imports of Russian energy in the short term, CEE must contemplate reducing its energy consumption and, as seems increasingly likely, consumption rationing over the winter. To assess these risks, we look into how CEE uses oil and gas in its energy mix.

## 3. CEE: oil and gas power tradables, households

**Oil and gas are mostly used for final energy consumption**

Around 70% of natural gas and 40% of oil produced and imported in CEE are used directly. The remaining gas is transformed into electricity and heat, while crude oil is refined into petroleum products. Part of the energy is lost during transformation.

The oil and gas available directly and after transformation have three main destinations: **1**. final energy consumption; **2.** exports; and **3.** other uses, which include consumption of the energy branch, non-energy consumption (for example in the chemicals industry), international maritime bunkers, international aviation and storage. Table 1 shows the breakdown of oil and gas used for these three purposes[27]. On average, 60% of oil and gas is used for final energy consumption, although for oil the share differs significantly across countries

**Table 1: Energy available after transformation by usage, %**

| | Gas* | | | Oil | | |
|---|---|---|---|---|---|---|
| | Exports | Final energy consumption | Other | Exports | Final energy consumption | Other |
| **BG** | 0 | 83 | 17 | 47 | 39 | 14 |
| **CZ** | 0 | 81 | 19 | 18 | 55 | 26 |
| **HR** | 3 | 66 | 31 | 40 | 48 | 12 |
| **HU** | 37 | 41 | 22 | 29 | 51 | 20 |
| **PL** | 6 | 64 | 29 | 15 | 69 | 17 |
| **RO** | 0 | 76 | 24 | 35 | 51 | 14 |
| **SI** | 0 | 99 | 1 | 48 | 44 | 8 |
| **SK** | 0 | 57 | 43 | 47 | 39 | 14 |
| **MN** | 0 | 0 | 0 | 7 | 77 | 15 |
| **MK** | 0 | 99 | 1 | 12 | 79 | 9 |
| **AL** | 0 | 11 | 89 | 38 | 51 | 11 |
| **RS** | 0 | 69 | 31 | 18 | 62 | 20 |
| **BH** | 0 | 64 | 36 | 2 | 89 | 9 |
| **TR** | 2 | 89 | 9 | 15 | 62 | 23 |
| **EA** | 17 | 71 | 13 | 39 | 38 | 23 |
| **CEE avg.** | 3 | 64 | 25 | 27 | 58 | 15 |

* Includes also electrcity and heat generated using gas    Souce: Eurostat, UniCredit Research

27 Gas also includes the electricity and heat produced using gas, which we estimate to be a small portion of total gas.

## 3.1. Limited gas exports, significant exports of oil products

Chart 11 shows that gas exports are very limited, with the exception of Hungary, which has the highest ratio of stored gas to domestic consumption of gas in CEE (Chart 11).

**Gas exports are limited**

Oil exports are important in most EU-CEE countries and Albania but are still much lower than imports (Chart 10). This is explained by oil refiners having extended networks in the region and selling their products in neighboring countries.

**Oil exports are important in EU-CEE and Albania**

This raises an important issue of competition in view of the EU's target to phase out purchases of oil shipped to EU ports and piped on Druzhba North from Russia before the end of this year. With Czechia, Hungary and Slovakia being allowed to continue purchases of oil through the Druzhba South pipeline, oil refiners in the three countries would benefit from a competitive advantage as they continue to purchase Urals oil from Russia at a discount of USD 20-40/bbl (a 15-30% discount to Brent). As a result, the EU is likely to limit exports from exempted countries to neighboring countries, which would mostly affect Mol, the Hungarian oil company that is refining oil products in both Hungary and Slovakia. Thus, such companies could find the competitive advantage of purchase oil from Russia being heavily affected by export caps.

**Sanctions on Russia will cap fuel exports from Czechia, Hungary and Slovakia**

## 3.2. Households, industry and services dependent on gas, transport dependent on oil

Chart 12 shows oil and gas as a share of final energy consumption, exceeding 50% in almost every case. Once more, oil is important for all countries, while gas is more important for EU-CEE and Turkey.

**CHART 11: HUNGARY IS THE ONLY SIGNIFICANT GAS EXPORTER**

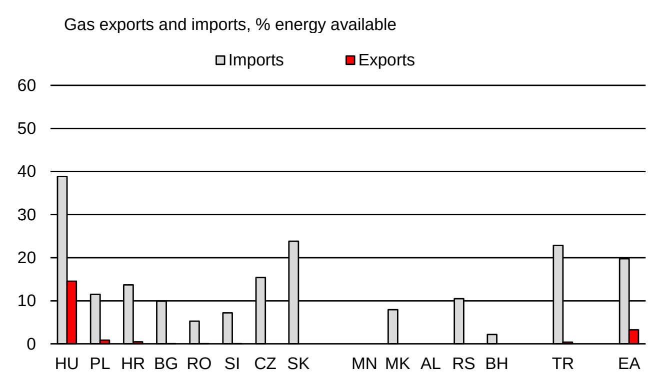
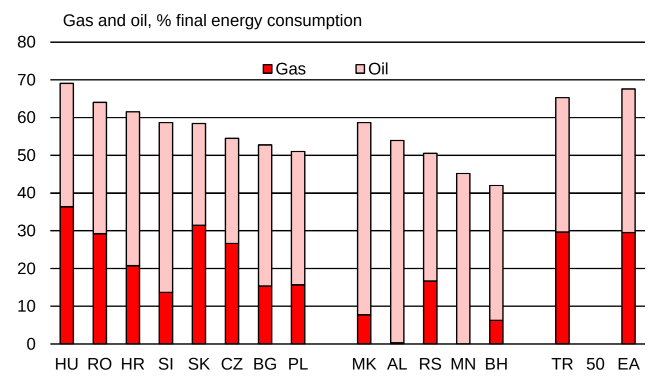



**CHART 12: OIL AND GAS: 50% OF ENERGY CONSUMPTION**




Note: in chart 12 gas includes also heat and electricity produced with gas. Source: Eurostat, UniCredit Research

Charts 14-17 show energy consumption for the various sectors by product.

**CEE industry heavily reliant on gas**

Gas accounts for around 30% of the energy used in industry, except in Albania, Montenegro and North Macedonia, where oil is more important. The sectors most exposed are iron and steel, chemicals, non-metallic minerals and food.

**Transport sector uses mainly oil**

The transport sector uses almost exclusively oil and petroleum products as sources of energy.

**Households' and services' dependency on gas varies across countries**

Households' dependency on gas varies across countries. At over 20%, it is high in most of EU-CEE and Turkey, while lower in the Western Balkans. Hungary, Slovakia, Romania and Turkey stand out. Households use gas mainly for heating and hot water. Dependency on oil is low.

For the services sector, the dependency on gas is similar to that of households, while oil is not very important except in Albania and North Macedonia.

**CHART 14: INDUSTRY - ENERGY CONSUMPTION**

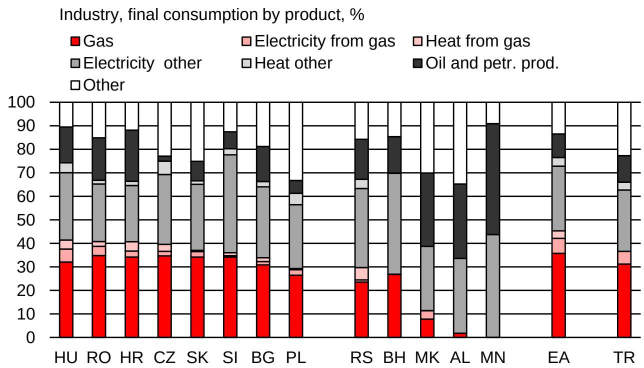



**CHART 15: TRANSPORT - ENERGY CONSUMPTION**

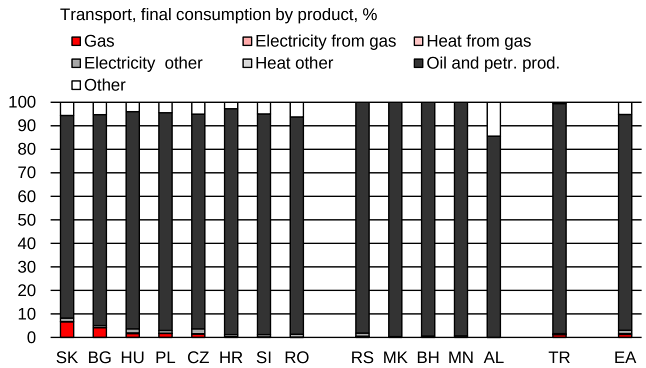



**CHART 16: SERVICES - ENERGY CONSUMPTION**

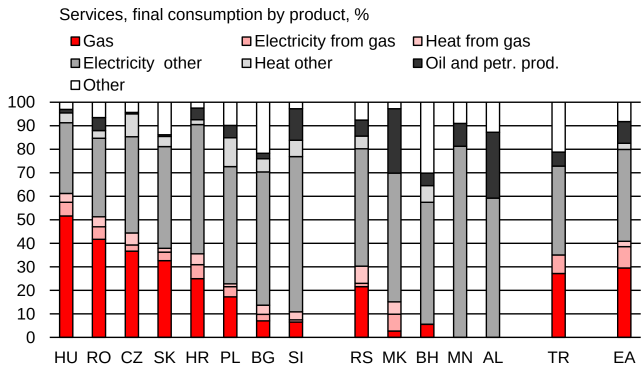
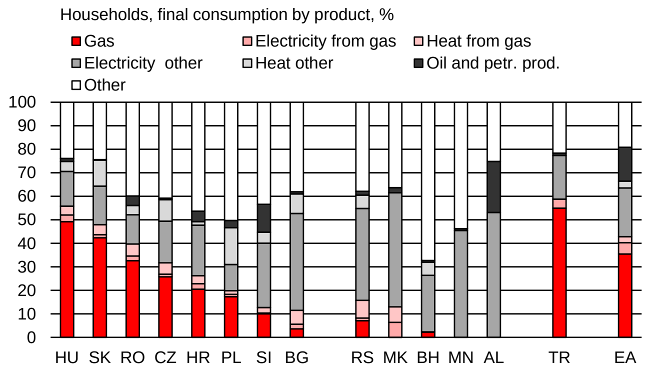



**CHART 17: HOUSEHOLDS - ENERGY CONSUMPTION**




Source: Eurostat, UniCredit Research

**Most industrial sectors in EU-CEE are highly dependent on gas**

Severing Russian gas deliveries is likely to disrupt industry and exports in EU-CEE, with a potentially significant impact on economic growth, employment and government spending. Table 2 shows that most industrial sectors in EU-CEE are highly dependent on gas, in particular heavy industry. A halt in gas deliveries from Russia could lead to supply shortages in industry in all EU-CEE countries, with Slovakia, Slovenia, Bulgaria, Czechia and Romania most exposed. Turkey, Serbia and Bosnia-Herzegovina face similar risks. Car manufacturing is a heavy gas user in Czechia and Slovakia and, to a lesser extent, in Romania, Hungary and Poland. With more than a third of energy used to produce cars coming from gas in all these countries, finding alternative energy sources could prove impossible in the event of a sudden halt in imports from Russia.

Gas accounts for three quarters of energy used in chemical production in Croatia and a third in Romania. Chemicals are less energy intensive than heavy industry, but they are very important for domestic consumption (fertilizers, rubber, pharma) and exports. Some chemical producers in CEE (nitrates) have already stopped producing due to very high gas prices and this is likely to boost imports of fertilizers and affect the 2023 harvest.

Protracted issues with high prices and/or gas shortages would probably require governments to support this strategic sector. The eurozone faces similar risks, with the EU's fertilizer imports rising sharply.

**Western Balkans are more dependent on oil, except for Serbia**

In EU-CEE, industry is much less dependent on oil than on gas, with few exceptions. In the Western Balkans, industry is more dependent on oil, except for Serbia.

**Table 2: Dependency on gas and oil in total energy consumption by industry, %**

| | BG | | CZ | | HR | | HU | | PL | | RO | | SI | | SK | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Gas | Oil | Gas | Oil | Gas | Oil | Gas | Oil | Gas | Oil | Gas | Oil | Gas | Oil | Gas | Oil |
| Mining | 12 | 3 | 56 | 2 | 4 | 45 | 9 | 60 | 9 | 19 | 3 | 35 | 19 | 12 | 79 | 10 |
| Iron and steel | 45 | 0 | 45 | 0 | 28 | 0 | 43 | 0 | 55 | 0 | 39 | 0 | 51 | 1 | 54 | 0 |
| Non-ferreous metals | 27 | 9 | 57 | 0 | 51 | 6 | 66 | 1 | 43 | 2 | 33 | 0 | 27 | 1 | 12 | 0 |
| Minerals | 46 | 12 | 44 | 1 | 25 | 31 | 34 | 18 | 36 | 3 | 28 | 32 | 37 | 15 | 24 | 11 |
| Machinery | 29 | 4 | 34 | 1 | 30 | 8 | 40 | 2 | 30 | 4 | 40 | 3 | 30 | 7 | 34 | 1 |
| Transport eq. | 33 | 3 | 37 | 0 | 30 | 8 | 30 | 0 | 27 | 3 | 40 | 3 | 36 | 4 | 39 | 5 |
| Chemicals | 27 | 34 | 26 | 6 | 75 | 1 | 23 | 28 | 12 | 14 | 35 | 34 | 28 | 2 | 27 | 48 |
| Food | 35 | 4 | 47 | 1 | 50 | 9 | 47 | 2 | 38 | 3 | 54 | 8 | 44 | 11 | 54 | 1 |
| Paper and printing | 20 | 0 | 16 | 0 | 59 | 4 | 20 | 1 | 13 | 2 | 53 | 1 | 45 | 1 | 12 | 0 |
| Wood | 11 | 1 | 8 | 2 | 2 | 2 | 6 | 7 | 4 | 2 | 7 | 5 | 0 | 5 | 14 | 0 |
| Construction | 32 | 36 | 36 | 28 | 0 | 94 | 17 | 63 | 12 | 28 | 21 | 66 | 21 | 60 | 60 | 0 |
| Textiles | 26 | 2 | 40 | 1 | 39 | 6 | 48 | 0 | 39 | 4 | 62 | 1 | 31 | 7 | 50 | 0 |
| Other | 18 | 2 | 23 | 1 | 16 | 6 | 32 | 2 | 19 | 2 | 12 | 4 | 29 | 4 | 35 | 0 |

| | MN | | MK | | AL | | RS | | BH | | TR | | EA | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Gas | Oil | Gas | Oil | Gas | Oil | Gas | Oil | Gas | Oil | Gas | Oil | Gas | Oil |
| Mining | 0 | 95 | 0 | 49 | 0 | 0 | 0 | 50 | 0 | 65 | 33 | 24 | 26 | 26 |
| Iron and steel | 0 | 42 | 11 | 25 | 0 | 10 | 46 | 0 | 66 | 0 | 38 | 0 | 48 | 1 |
| Non-ferreous metals | 0 | 5 | 0 | 52 | 0 | 5 | 25 | 6 | 23 | 2 | 32 | 1 | 37 | 4 |
| Minerals | 0 | 84 | 2 | 31 | 0 | 36 | 18 | 49 | 2 | 32 | 19 | 38 | 40 | 18 |
| Machinery | 0 | 63 | 1 | 29 | - | - | 14 | 7 | 0 | 23 | 37 | 4 | 35 | 6 |
| Transport eq. | - | - | 21 | 22 | - | - | 24 | 5 | 2 | 43 | 51 | 2 | 31 | 2 |
| Chemicals | 0 | 38 | 9 | 21 | 0 | 56 | 21 | 11 | 9 | 19 | 49 | 0 | 38 | 14 |
| Food | 0 | 51 | 14 | 41 | 13 | 36 | 22 | 10 | 16 | 30 | 42 | 1 | 47 | 5 |
| Paper and printing | 0 | 50 | 24 | 24 | 0 | 28 | 31 | 2 | 1 | 28 | 26 | 1 | 24 | 2 |
| Wood | 0 | 88 | 0 | 13 | 0 | 0 | 4 | 6 | 4 | 10 | 8 | 2 | 7 | 2 |
| Construction | - | - | 0 | 86 | 0 | 6 | 0 | 44 | 0 | 73 | 45 | 2 | 23 | 54 |
| Textiles | 0 | 67 | 1 | 39 | 0 | 20 | 17 | 8 | 11 | 28 | 30 | 1 | 48 | 4 |
| Other | 0 | 86 | 3 | 9 | 0 | 40 | 20 | 4 | 0 | 5 | 30 | 2 | 20 | 5 |

Dependency

High: above 20%

Medium: between 10% and 20%

Low: below 10%

Source: Eurostat, UniCredit Research

## 4. Heatmap

The following heatmap aggregates CEE countries' vulnerability to oil and gas.

The first section shows oil and gas as a share of energy consumption. All CEE countries are vulnerable, having a share of close to or above 50%.

The second section shows oil and gas exports. Disruptions to oil and gas flows would affect exports more in Croatia, Bulgaria and Slovenia.

The third section shows the dependency on imports from Russia. Hungary and Slovakia stand out, followed by Bulgaria and Poland.

Overall, Hungary stands out as the CEE country most exposed to a halt in oil and gas imports from Russia, followed by Slovakia. Czechia is at risk due to its industry being more reliant on gas, while Bulgaria is more dependent on oil. Generally, stopping oil and gas deliveries from Russia would affect EU-CEE much more than the Western Balkans, with Turkey ranked in between.

**Table 3: Heatmap**

| | **Importance of gas and oil on final energy consumption** | | | **Importance of gas and oil exports** | | | **Dependency on Russia** | | |
|---|---|---|---|---|---|---|---|---|---|
| | Final consumption of product % total final energy consumption* | | | Exports of product as % of available energy | | | Imports from Russia as % of available energy | | |
| | Gas & oil | Gas | Oil | Gas & oil | Gas | Oil | Gas & oil | Gas | Oil |
| **BG** | 53 | 15 | 37 | 18 | 0 | 18 | 28 | 8 | 20 |
| **CZ** | 54 | 27 | 28 | 4 | 0 | 4 | 23 | 15 | 8 |
| **HR** | 62 | 21 | 41 | 20 | 0 | 19 | 17 | 14 | 3 |
| **HU** | 69 | 36 | 33 | 23 | 15 | 8 | 50 | 37 | 13 |
| **PL** | 51 | 16 | 35 | 5 | 1 | 4 | 27 | 9 | 18 |
| **RO** | 64 | 29 | 35 | 14 | 0 | 14 | 17 | 5 | 11 |
| **SI** | 59 | 14 | 45 | 23 | 0 | 23 | 15 | 7 | 7 |
| **SK** | 58 | 31 | 27 | 14 | 0 | 14 | 46 | 24 | 22 |
| **MN** | 45 | 0 | 45 | 3 | 0 | 3 | 0 | 0 | 0 |
| **MK** | 59 | 8 | 51 | 5 | 0 | 5 | 9 | 8 | 1 |
| **AL** | 54 | 0 | 54 | 24 | 0 | 24 | 2 | 0 | 2 |
| **RS** | 51 | 17 | 34 | 5 | 0 | 5 | 19 | 10 | 8 |
| **BH** | 42 | 6 | 36 | 0 | 0 | 0 | 2 | 2 | 0 |
| **TR** | 65 | 30 | 36 | 6 | 0 | 5 | 18 | 8 | 10 |
| **EA** | 68 | 30 | 38 | 21 | 3 | 18 | 16 | 7 | 9 |
| | Note: * gas includes also heat and electricity produced with gas. Source: Eurostat, UniCredit Research | | | | | | | | |
| **Legend** | | | | | | | | | |
| High – above: | 50 | 25 | 25 | 50 | 25 | 25 | 25 | 12.5 | 12.5 |
| Medium – upper limit: | 50 | 25 | 25 | 50 | 25 | 25 | 25 | 12.5 | 12.5 |
| Medium – lower limit: | 20 | 10 | 10 | 20 | 10 | 10 | 10 | 5 | 5 |
| Low – below: | 20 | 10 | 10 | 20 | 10 | 10 | 10 | 5 | 5 |

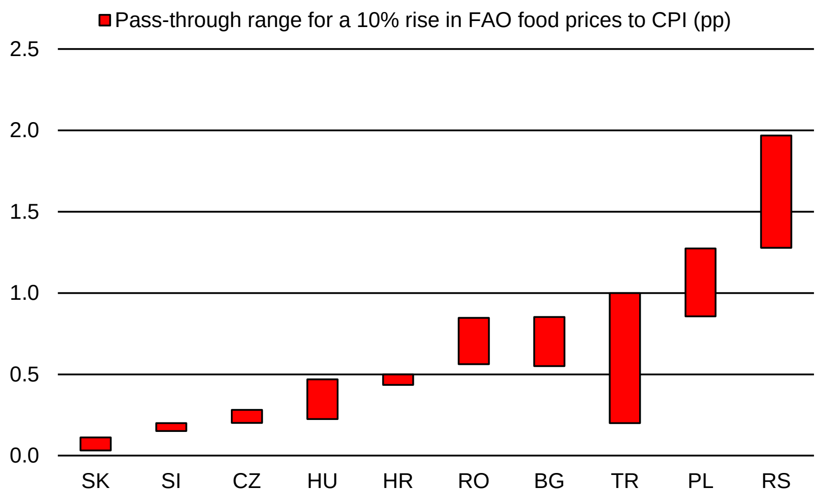
## CEE and the global food crisis: higher prices, no shortages

**Gökçe Çelik**, Senior CEE Economist (UniCredit Bank, London)
+ 44 207 826-6077
gokce.celik@unicredit.eu

**Dan Bucsa**
Chief CEE Economist
(UniCredit Bank, London)
+44 207 826-7954
dan.bucsa@unicredit.eu

- We expect a staggered global food crisis: 1. a supply shortage in 2022 coming from the Russia-Ukraine conflict and export restrictions and 2. a lower harvest in 2023 due to higher fuel and fertilizer costs.
- Elevated food prices might jeopardize inflation expectations in CEE, postponing the return of headline inflation to target. This could force CEE central banks to maintain high interest rates in 2023.
- CEE countries are not at risk of food shortages, as the bulk of their trade deficits with fresh and processed food is with the EU.
- Next year's harvest could be affected because CEE countries are dependent on imports of fertilizers from Russia and the EU.
- The pass-through from global food prices to domestic consumer prices is large in CEE countries, either directly or via producer prices.

**INTERNATIONAL FOOD PRICES HAVE A LARGE IMPACT ON INFLATION IN CEE**




**The Russia-Ukraine conflict has intensified global food security risks**

Global food security risks started to increase even before the Russia-Ukraine conflict due to supply-chain disruptions and rising energy and fertilizer prices. However, risks have intensified recently as this conflict has led not only to higher prices in the main food categories (primarily cereals, seeds and vegetable oil) but has also triggered restrictions on a wide range of food exports by large producers. This could result in food shortages, especially in countries that are highly dependent on imported food, such as those in Africa, the Middle East and Asia.

**Two-stage shock in food supply and prices…**

We expect a staggered shock in food supply and prices, with two distinct phases:

1. In 2022, supply shocks are likely to push prices higher if this year's harvest fails to cover demand from importing countries. The main supply shocks are expected to come from low exports from Ukraine if a Russian maritime blockade continues, export restrictions

imposed by several large exporters of food and a smaller harvest globally due to weather conditions and other disruptions.

2. High fuel and fertilizer costs will affect harvests in 2023 and 2024 by reducing cultivated land and yields and by driving some small producers out of business, especially in EM. This shock will add to this year's likely incapacity to replenish inventories and efficiently distribute agricultural commodities among countries. While the price shock could be smaller than this year, we expect food to become even more expensive in 2023.

**…has been underestimated by CEE central banks…**

In this note, we analyze CEE countries' exposure to food security risks through trade links and rising prices. This is important because we believe that CEE central banks have tended to underestimate the length and strength of the current food crisis. While the first phase of the shock seems to be at least partly reflected in central banks' forecasts, next year's is not. Most CEE central banks expect food-price inflation to return close to target in 2023, which we think is very optimistic.

**…at the risk of having to keep interest rates higher for longer**

While the food crisis is a supply shock that will affect disposable income, especially among low-income households, it also threatens inflation expectations, which in CEE are mostly anchored to food and fuel prices. Given tight labor market conditions, rising inflation expectations might lead to a wage-price spiral. Even if this is avoided, central banks might have to delay rate cuts until the shock weakens enough for inflation and wage expectations to stabilize and for headline inflation to fall back close to target ranges.

## 1. Low risk of food shortages in CEE, at least in 2022-23

**EU-CEE countries are net exporters of cereals, seeds and oils…**

EU-CEE countries run trade surpluses for the three major food subgroups currently exposed to the largest global supply shocks: cereals, oil seeds and cooking oil (Chart 1). Slovenia is an exception, as the country's 0.2% surplus with the rest of the EU is offset by a deficit with the rest of the world, which is mostly with Serbia. Poland and Romania are the third and fourth largest producers of cereals in the EU, after France and Germany. Romania is also the EU's top producer of sunflowers, followed by Hungary and Bulgaria. While the EU is dependent on Ukraine for 87% of its sunflower oil imports, in CEE, Poland, Slovakia, Slovenia and Croatia are net importers, with Ukraine's share in sunflower oil imports at 44% for Poland and 22% for Slovakia. In contrast, Bulgaria, Hungary and Romania are net exporters of sunflower oil.

**…but net importers of fresh and processed food, mostly from the EU**

All EU-CEE countries but Hungary and Poland are net importers of fresh food (meat, dairy, vegetable, fruit) and processed food. However, the largest part of these trade deficits is with other EU countries (Chart 2).

**Turkey runs trade deficits for cereals, seeds and oil**

Among non-EU countries, Turkey and Serbia have trade surpluses with food. Turkey is running trade deficits with Russia, Ukraine, Brazil and Malaysia for cereals, oil seeds and, to a lesser extent, oil. While Turkey is often mentioned as being very dependent on wheat imports (8.2mn tons in 2021), their decline might be partly mitigated by reducing exports of flour and wheat products, such as pasta. Turkey's imports of wheat amounted to USD 2.4bn in 2021, but its trade deficit with wheat and wheat products (flour and pasta) amounted to just USD 0.7bn.

North Macedonia and Bosnia-Herzegovina are net importers of all the major food sub-groups. Their largest provider is Serbia, followed by the EU.

**We do not expect food shortages in CEE in 2022-23**

As long as the EU's food production remains close to current levels, we expect no food shortages in CEE until the next harvest. Thus, the first phase of the food crisis could have a limited impact on CEE countries. That said, EU-CEE countries might have to contribute alongside other EU countries to respond to food shortages in North Africa and the Middle East.

## CEE FOOD TRADE BALANCE

Chart 1: Overall food balances

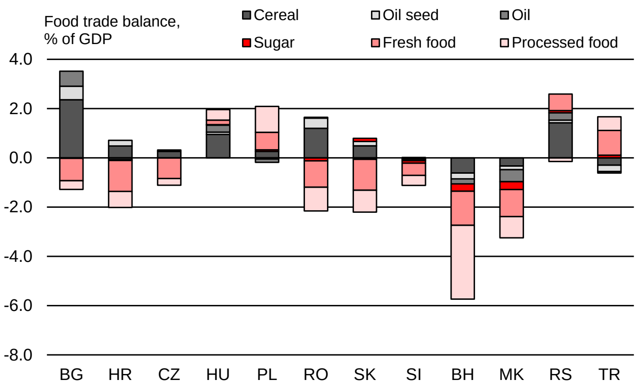
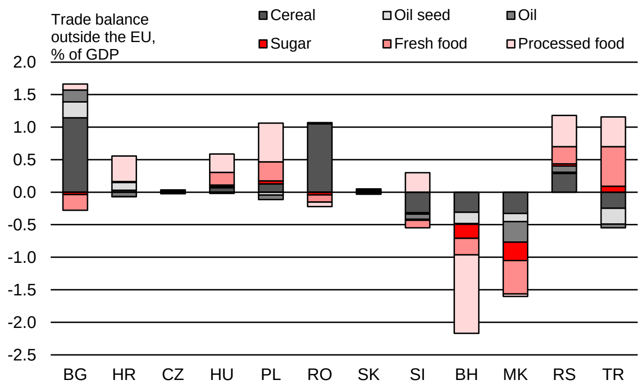



Chart 2: Trade balance with non-EU countries




Source: Eurostat, Haver, UniCredit Research

**CEE countries rely on fertilizer imports…**

To gauge the potential extent of next year's phase of the food crisis, we looked at trade balances with fertilizers, given their essential role in agricultural production and in food manufacturers. Most CEE countries remain net importers of fertilizers, with Romania and Hungary running the highest deficits, at 0.3% and 0.2% of GDP respectively (Chart 3). Importantly, regardless of CEE countries' trade balance with fertilizers, Russia has been a major provider, accounting for more than half of the fertilizer imports of Serbia; around a quarter of Poland's, Slovenia's and North Macedonia's; 13% of Bulgaria's and 10% of Romania's and Hungary's (Chart 4). Across CEE, imports of fertilizers are rising quickly and are likely to far exceed those of 2021. In Bulgaria, Poland and Romania, Russia's share of overall fertilizer imports increased in the first quarter of this year.

**…with Russia being a major provider**

**Fertilizer imports are rising in the EU, while production is falling**

Several CEE producers[28] have ceased or reduced production due to elevated costs, as they have hedged only part (or nothing) of their large commodity exposure. Moreover, given that CEE countries also import fertilizers from EU, the latter's exposure to fertilizer restrictions should also be considered. The EU is also ramping up its fertilizer imports, and an EU-wide purchasing program might be needed if disruptions in production and trade persist in 2023, threatening the 2024 harvest as well.

[28] In Romania, Azomures restarted production at reduced capacity, following a cease in production during December-April. Petrokemija announced a temporary shutdown at its plant in Croatia. Hungary's sole artificial fertilizer producer, Nitrogenmuvek, suspended its production of ammonia in March. Western European fertilizer producers' operations are also subject to disruptions. In March, Yara temporarily curtailed its ammonia and urea production at two of its plants, located in France and Italy.

**CEE COUNTRIES ARE DEPENDENT ON IMPORTS OF FERTILIZERS**

Chart 3: Fertilizer trade

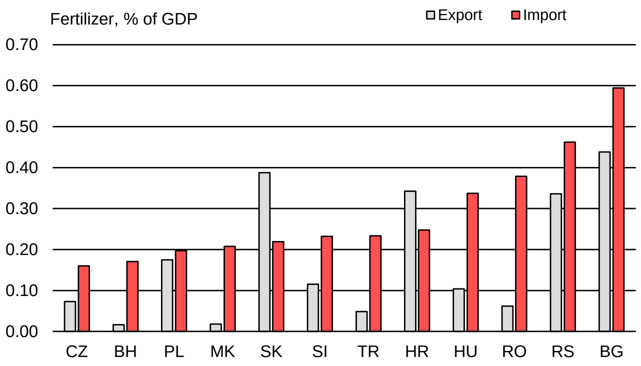
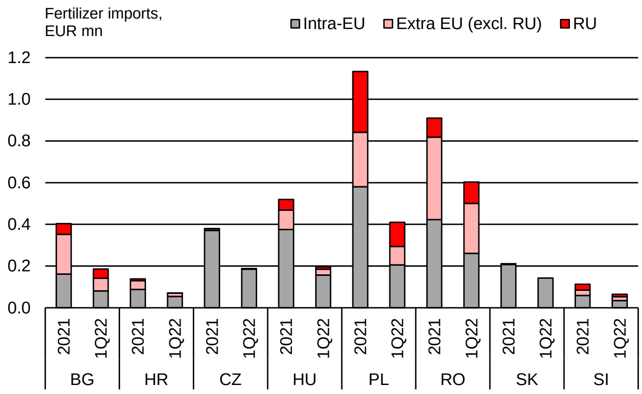



Chart 4: Fertilizer imports




Source: Eurostat, UniCredit Research

## 2. Food supply: disruptions lead to trade restrictions

**Restrictions on food trade are larger than they were during previous stress periods**

An abrupt rise in agricultural commodity and fertilizer prices has triggered trade restrictions, as several governments have rushed to prevent shortages. Importantly, in terms of the number of restrictions and the volume of goods/calories affected, current restrictions are larger than they were in both 2020 and 2008 (Chart 5). Consequently, while fertilizer prices have reached 2008 levels, food prices have exceeded them (Chart 6).

**RESTRICTIONS ON FOOD AND FERTILIZERS ARE ADDING TO PRICE PRESSURES**

Chart 5: Restrictions on food exports

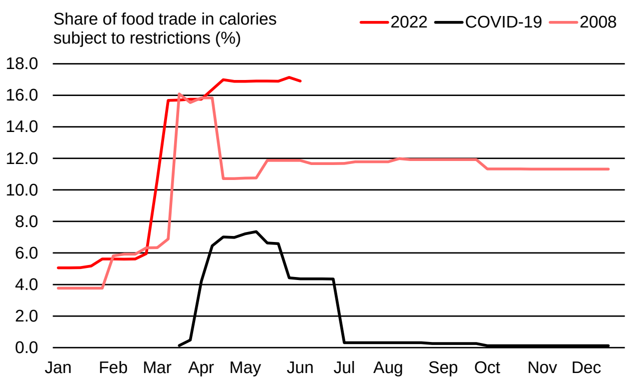
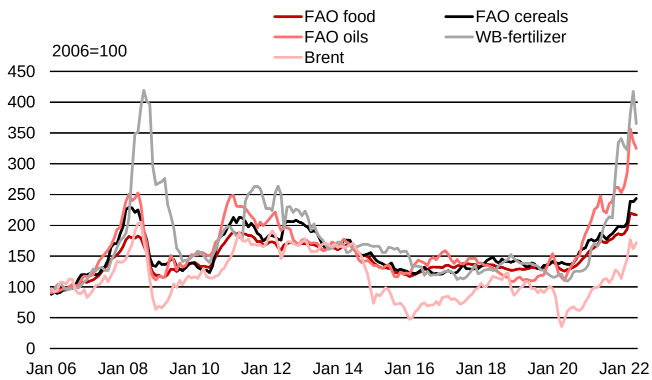



Chart 6: Global food, fertilizer and energy prices




Source: *Food and Fertilizer Restrictions Tracker* by David Laborde[29], FAO,UniCredit Research

[29]Food & Fertilizer Export Restrictions Tracker | Tableau Public

**Ukraine's exports have been curtailed by Russia's blockade in the Black Sea …**

The bulk of restrictions are on exports of cereals, seeds and vegetable oil, as well as on products using these commodities. Other restrictions cover exports of sugar, meat and vegetables. Restrictions were imposed mainly by Russia, Ukraine, India and Indonesia. Some of these export caps have been eased. Ukraine has lifted an export-licensing requirement on maize and oil, but its incapacity to export through its Black Sea ports remains an unresolved issue.

**…and logistical shortcomings are related to railway transport**

According to recent statements by Ukrainian officials, some 20-25mn tons of grains are blocked within the country. These need to be exported before this summer's harvest, expected in August. In the absence of seaborne transport, such a task is daunting due to logistical shortcomings and volume limitations associated with railway transport to Poland and Romania. In addition, grain loading facilities in Romania's port of Constanța are fully utilized and are expected to be further strained later this year by Romania's own exports of grains. Turkey's recent attempt to negotiate with Russia a naval corridor for Ukrainian exports failed because it would require Ukraine to remove mines from its territorial waters. Ukraine is reluctant to do so without further security guarantees[30]. Russia is asking for sanctions to be lifted on exports of grains and fertilizers before agreeing to a trade corridor.

**Serbia has eased the export ban on wheat and flour**

Within CEE, Hungary, Serbia and Turkey also imposed restrictions on the export of several food items after Russia invaded Ukraine. Serbia eased restrictions on 20 April, from outright bans on exports of wheat, maize and sunflower oil to monthly export quotas, while removing all restrictions on flour exports from 11 May onward.

**TABLE 1: RESTRICTIONS ON FOOD EXPORTS**

| | Grain | Seed, oil | Other food | Fertilizers |
|---|---|---|---|---|
| Russia | + | + | + | + |
| Ukraine | + | + | + | + |
| Algeria | + | + | + | |
| Argentina | | + | + | |
| Azerbaijan | + | + | + | |
| Burkina Faso | + | | | |
| Belarus | + | + | | |
| Cameroon | + | + | | |
| China | | | | + |
| Egypt | + | + | + | |
| Ghana | + | | | |
| India | + | | + | + |
| Indonesia | | + | | |
| Iran | | | + | |
| Kazakhstan | | + | + | |
| Kosovo | + | + | + | |
| Kuwait | + | + | + | |
| Kyrgyzstan | + | + | + | + |
| Lebanon | + | | + | |
| Malaysia | | | + | |
| Pakistan | | | + | |
| Serbia | + | + | | |
| South Korea | | | | + |
| Tunisia | | | + | |
| Turkey | + | + | + | |
| Vietnam | | | | + |

Source: *Food and Fertilizer Restrictions Tracker* by David Laborde, UniCredit Research

[30] Turkish team to discuss Black Sea grain corridor in Russia this week -sources | Reuters

**Fertilizer restrictions by Russia and Belarus could affect CEE both directly and via fertilizer imports from the EU…**

The CEE's exposure to food export restrictions is limited to Russia and Ukraine and looks manageable if potential shortages are dealt with at the EU level. However, the negative impact of these will likely come from higher prices for agricultural commodities. Moreover, export bans are not limited to food. Restrictions on fertilizer trade could prove challenging for the region, given that most CEE countries rely on imports.

**As Russia and Belarus account for 40% of fertilizer imports to the EU**

Russia and Belarus, which restricted exports of fertilizers and are also subject to sanctions by the EU, were the source of roughly 40% of the EU's fertilizer imports in 2021. These two countries' share of the EU's potash imports was around 55%. Unlike other types of fertilizers, the EU produces little potash and, therefore, will probably have to switch to other providers, such as Canada, Israel and Jordan. Even if alternative producers have the capacity to fill the gap, the switch could imply additional costs for importers.

## 3. CEE countries are not immune to a staggered price shock

We expect food prices in CEE to be pushed higher in both phases of the food crisis:

1. In the first phase, trade restrictions could further lift prices this year, especially if the 2022 harvest fails to cover demand from importing countries. We expect disruptions to mostly affect importing countries in North Africa and the Middle East.

**2022 harvest is likely to add to price pressure**

   This year's predicted output is unlikely to alleviate price pressure. In its May report, the EU's Monitoring Agricultural Resources (MARS) Unit slightly lowered its 2022 crop yield expectations compared to previous estimates, noting that rain deficits have been affecting winter crops, especially in Bulgaria, Romania, Ukraine and France. According to its latest forecasts, 2022 crop yields will remain above the average of the past five years while being lower than last year's output for most cereals (Chart 7).

   In Turkey, crop yields are expected to be above their average amounts of the past few years and last year. Delays to crop development due to cold winters are a source of concern, as it might expose crops to heat stress, according to the MARS Unit.

**Higher fuel and fertilizer prices could affect sowing and yields in the next couple of years**

2. In the second phase of the shock, higher fuel and fertilizer costs could affect the 2023 harvest. This shock could be large in CEE, where small farms have a higher share of arable land than in the eurozone. Despite the sharp rise in food prices, farmers' production costs have increased faster, which has led to a decline in the real output prices of food[31]. Unless food prices catch up or input prices decline, farmers might opt to **1**. plant less land; **2**. to use fewer fertilizers and pesticides, which would lead to lower yields; or **3**. rotate crops from grains to cultures that need less fertilizers, such as soybeans. Thus, governments might have to increase subsidies in 2022 to prevent not only another round of fast price increases but also to ensure food security going forward.

**The EU expects the 2023 harvest to be better than that of 2022…**

   The European Commission projects a limited rise, of 0.2%, in the EU's grain production in 2023, assuming 4% higher wheat production and a 1.2% decline in coarse grains (barley, rye, corn). Oil-seed production is expected to rise by 6.3% compared to this year.

**…but global wheat and maize production could decline in 2023**

   In its June report, the UN's Food and Agriculture Organization (FAO) forecasted that global wheat production in 2023 will decrease by 0.8% compared to this year, with Ukraine and India driving the decline. The production of coarse grains in 2023 was also expected to decline by 0.6% yoy, mainly due to lower maize production in the US and

[31] The real output price of food is calculated by the FAO by deflating the FAO food price index with the net global input price index (net-GIPI). The net-GIPI index consists of energy, fertilizer and pesticide prices. For details, see *Food Outlook – Biannual Report on Global Food Markets*.

**Supply risks might lead to further rise in food prices in CEE**

Ukraine. The US Department of Agriculture (USDA) forecasts hint at similar trends for wheat and coarse grain production for next year, albeit with a larger decline of -1.5% yoy in the latter (Chart 8). Moreover, the USDA forecast that oilseed production would increase by 8% next year as higher soybean and rapeseed output for biofuels is expected to offset the decline in sunflower output.

While these declines do not look large, they would come on the heels of 2022, which was plagued by supply disruptions and the pandemic, which made it more difficult for governments and companies to build foodstuff inventories. Thus, even a small decline in global and CEE production could push food prices higher in 2023.

**LOWER WHEAT AND GRAIN PRODUCTION NEXT YEAR**

Chart 7: Crop-yield forecasts for CEE

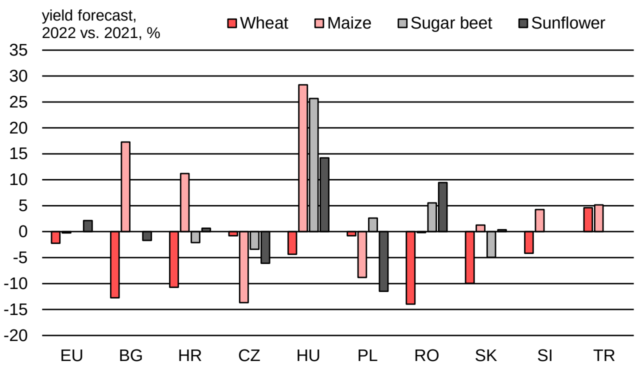
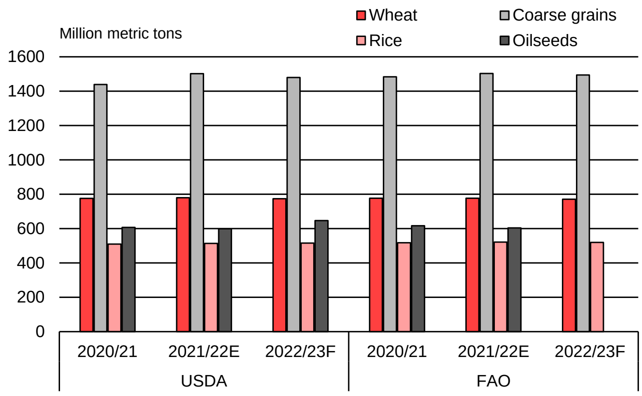



Chart 8: Production forecasts




Source: EU-MARS, USDA, FAO, UniCredit Research

## 4. CEE: the large impact of food prices on inflation

**CEE countries are subject to price shocks…**

Although CEE countries' direct exposure to international restrictions on food exports is limited, neither producers nor consumers are immune to the global price shocks affecting agricultural commodities, fertilizers and energy. Despite lagging the increase in total producer prices, the rise in food-producer prices has surpassed previous peaks (in 2008 or 2011) in most CEE countries (Chart 9). Consumer food prices have increased faster than headline consumer price inflation, despite tax cuts and several price caps being implemented by CEE governments (Chart 10).

## PRODUCER AND CONSUMER PRICES

Chart 9: Producer price inflation for foodstuff is accelerating

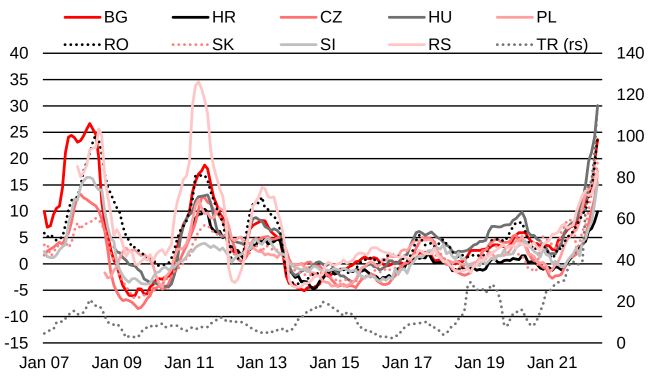
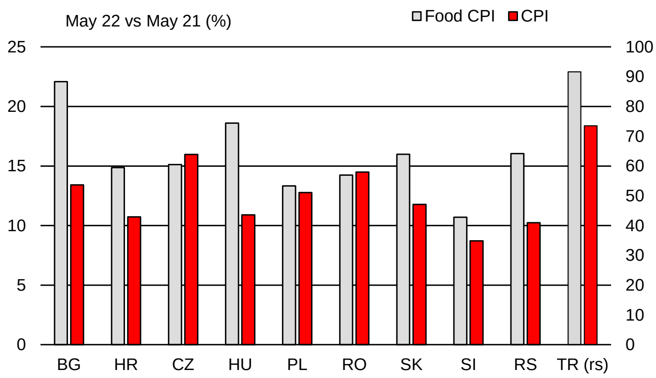



Chart 10: Consumer food prices outpace headline inflation




Source: national statistical offices, Haver, UniCredit Research

**… as the pass-through from global food prices to consumer food prices is large**

According to our estimates, the pass-through from global food prices (measured by the FAO food price index) to food producer prices is sizable for most CEE countries (Table 2). In addition, the pass-through from food producer prices to consumer prices is also high, suggesting that food producers tend to fully reflect higher production costs in selling prices within a year. In Bulgaria and Croatia international food prices have a direct and significant impact on consumer prices, in addition to the impact through PPI.

Considering both the direct impact on consumer food prices (where it is statistically significant) and their indirect impact through food producer prices, our estimates suggest that a 1pp shock to global food prices adds 0.6pp to consumer food inflation in Serbia; 0.5pp in Poland; 0.3pp in Romania and Bulgaria, and 0.2pp in Hungary and Czechia.

**TABLE 2: PASS THROUGH FROM INTERNATIONAL FOOD PRICES (2011-21)[32]**

| Pass-through to food_PPI | | | | | | Pass-through to food_CPI | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | FAOFOOD | Brent | TTF | USD-CEE | Period of max impact | | Food_PPI | FAOFOOD | USD-CEE | Brent | TTF | Period of max impact |
| BG | 27% | 3% | | 22% | 12 | BG | 45% | 15% | 22% | | | 12 |
| HR | 23% | 5% | | 25% | 12 | HR | 35% | 11% | 12% | | | 12 |
| CZ | 22% | 2% | | | 12 | CZ | 72% | | | | | 12 |
| HU | 28% | 11% | | 25% | 12 | HU | 87% | | | | | 12 |
| PL | 52% | | | 48% | 12 | PL | 92% | | | | | 12 |
| RO | 36% | 7% | | 52% | 12 | RO | 71% | | 12% | | | 12 |
| SK | 14% | | 3% | | 12 | SK | 39% | | | | | 12 |
| SI | 26% | | 3% | 39% | 12 | SI | 14% | 6% | | | 1% | 12 |
| RS | 56% | | | 62% | 12 | RS | 75% | 21% | 25% | | | 12 |
| TR | 45% | | | 35% | 12 | TR[33] | 83% | | 41% | | | 12 |

Source: national statistical offices, FAO, Haver, Bloomberg, UniCredit Research

[32] The table shows the maximum impulse responses of food-PPI and food-CPI to a 1pp shock in the explanatory variables within a year using vector autoregressive (VAR) and vector error correction models (VEC). The explanatory variables for food-PPI are international food price index (FAOFOOD), oil (Brent) and natural gas (TTF) prices and exchange rates (USD-CEE). Food-CPI models also include the food-PPI as an explanatory variable. Our sample includes monthly data from January 2011 to December 2021. Figures in red indicate that the coefficient is not statistically significant at a 95% confidence level.
[33]For Turkey, the pass-through to consumer food prices is calculated using the pass through to processed and unprocessed consumer food prices separately.

**The current pass-through from global food prices is higher than its long-term average**

We reran the models by restricting the sample period to 2011-19 (instead of 2011-21) to check for the impact of the pandemic. The estimated pass-through to both producer and consumer food prices was smaller before COVID-19 affected production and supply chains (Table 3). However, the responsiveness of producer and consumer food prices to international food prices might have increased for a longer time, given the magnitude and the nature of the current shock. Moreover, the pass-through from international food prices to producer food prices peaks early[34], taking longer in the post-COVID-19 period. Therefore, we consider estimations for the restricted sample as a lower bound for the pass-through, while the estimates for the full sample form the upper bound.

**TABLE 3: PASS THROUGHB FROM INTERNATIONAL FOOD PRICES (2011-19)**

| Pass-through to food_PPI | | | | | | Pass-through to food_CPI | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | FAOFOOD | Brent | TTF | USD-CEE | Period of max impact | | Food_PPI | FAOFOOD | USD-CEE | Brent | TTF | Period of max impact |
| BG | 13% | 4% | | 22% | 5 | BG | 35% | 13% | 18% | | | 9 |
| HR | 24% | 3% | | 36% | 12 | HR | 23% | 11% | 9% | | | 12 |
| CZ | 21% | 3% | | | 12 | CZ | 54% | | | | | 12 |
| HU | 13% | 5% | | 10% | 6 | HU | 88% | | | | | 12 |
| PL | 30% | | | 25% | 12 | PL | 98% | | | | | 12 |
| RO | 24% | 4% | | 28% | 4 | RO | 71% | | 12% | | | 12 |
| SK | 4% | | -1% | | 8 | SK | 43% | | | | | 12 |
| SI | 7% | 4% | | 20% | 12 | SI | 3% | 9% | | | 2% | 7 |
| RS | 30% | | | 58% | 12 | RS | 75% | 18% | 21% | | | 12 |
| TR | 21% | | | 31% | 12 | TR | 41% | | 34% | | | 4 |

Source: national statistical offices, FAO, Haver, Bloomberg, UniCredit Research

With international prices rising by around 30% yoy, their impact on consumer price inflation in CEE could amount to 0.5-1.5pp, even before accounting for country-specific factors. The notable exceptions are eurozone members Slovakia and Slovenia, where the pass-through is smaller. Further increases in global food prices brought about high fuel and fertilizer prices, and trade disruptions would reinforce the inflationary shock.

Turkey is a special case due to the strong cointegration between CPI and the exchange rate, which reduces the estimated impact of other variables (such as international food prices) on CPI. Moreover, Turkey produces most of the food consumed domestically and the high volatility of unprocessed food prices might make it more difficult to pin down the impact from international prices on consumer prices, ultimately reducing the estimated pass-through. A vector autoregression including Turkish CPI, USD-TRY and FAO food prices leads to a larger pass-through of around 0.9pp for a 10% increase in FAO food prices even for the shorter timespan (2011-2019). However, we do not use this larger number because the methodology is not comparable to the one used for the other countries.

[34] In the first four months in Romania, in five months in Bulgaria, in six months in Hungary, and in eight months in Slovakia

TABLE 4: PASS THROUGH FROM A 10PP RISE IN INTERNATIONAL FOOD PRICES TO CPI

| | 2011-21 | | | 2011-19 | | | Range |
|---|---|---|---|---|---|---|---|
| | Pass through to food_CPI (pp) | Food weight in the basket (%) | Pass through to CPI (pp) | Pass through to food_CPI (pp) | Food weight in the basket (%) | Pass through to CPI (pp) | Pass through to CPI (pp) |
| BG | 2.7 | 31.5 | 0.9 | 1.7 | 31.5 | 0.5 | 0.5 - 0.9 |
| HR | 1.9 | 25.9 | 0.5 | 1.7 | 25.9 | 0.4 | 0.4 - 0.5 |
| CZ | 1.6 | 17.8 | 0.3 | 1.1 | 17.8 | 0.2 | 0.2 - 0.3 |
| HU | 2.4 | 19.4 | 0.5 | 1.2 | 19.4 | 0.2 | 0.2 - 0.5 |
| PL | 4.8 | 26.6 | 1.3 | 3.2 | 26.6 | 0.9 | 0.9 - 1.3 |
| RO | 2.6 | 33.0 | 0.8 | 1.7 | 33.0 | 0.6 | 0.6 - 0.8 |
| SK | 0.5 | 20.5 | 0.1 | 0.2 | 20.5 | 0.0 | 0 - 0.1 |
| SI | 0.9 | 16.6 | 0.2 | 0.9 | 16.6 | 0.2 | 0.2 - 0.2 |
| RS | 6.3 | 31.3 | 2.0 | 4.1 | 31.3 | 1.3 | 1.3 - 2.0 |
| TR | 3.8 | 25.3 | 1.0 | 0.9 | 25.3 | 0.2 | 0.2 - 1.0 |

Source: UniCredit Research

Another leg of food price increases in 2023 could keep headline inflation elevated for longer in CEE, given the large share of the food in the consumer baskets.

The large pass-through from global and domestic producer prices for food to consumer prices means that CEE inflation could remain high in 2022-23 and will likely miss targets also next year. The combined shock of higher prices, lower purchasing power and tighter monetary conditions could weigh on growth in CEE, even if the direct impact of the global food crisis is very limited. That said, CEE is likely to fare better than other EM regions, especially in Africa and Asia, where food shortages and high prices could lead to political instability, which, in turn, would further add to the resulting economic shock.

## OUR GLOBAL FORECAST

| | GDP growth, % | | | CPI (Avg), % | | | Policy interest rate**, % | | | 10Y bond yield (EoP), % | | | Exchange rate (LC vs.USD) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2021 | 2022F | 2023F | 2021 | 2022F | 2023F | 2021 | 2022F | 2023F | 2021 | 2022F | 2023F | 2021 | 2022F | 2023F |
| Eurozone | 5.3 | 2.8 | 1.3 | 2.6 | 7.5 | 2.7 | -0.50 | 0.75 | 1.25 | | | | 1.13 | 1.06 | 1.12 |
| Germany* | 2.9* | 1.6* | 1.8* | 3.1 | 7.5 | 3.7 | - | - | - | -0.18 | 1.75 | 1.35 | | | |
| France | 6.8 | 2.4 | 1.4 | 1.6 | 5.2 | 3.3 | - | - | - | | | | | | |
| Italy | 6.6 | 2.9 | 1.1 | 1.9 | 6.4 | 2.3 | - | - | - | 1.17 | 3.75 | 3.10 | | | |
| UK | 7.4 | 3.4 | 0.6 | 2.6 | 8.4 | 3.9 | 0.25 | 1.50 | 1.50 | | | | 1.35 | 1.18 | 1.15 |
| USA | 5.7 | 2.4 | 1.3 | 4.7 | 8.3 | 3.4 | 0.25 | 3.50 | 3.25 | 1.51 | 3.50 | 3.00 | | | |
| Oil price, USD/bbl | | | | | | | | | | | | | 78 | 118 | 100 |

* Non-wda figures. Adjusted for working days: 2.9% (2021), 1.7% (2022) and 2.0% (2023). **Deposit rate for ECB

## THE OUTLOOK AT A GLANCE

| Real GDP (% change) | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|
| EU-CEE | -3.8 | 5.6 | 3.6 | 2.5 |
| Bulgaria | -4.4 | 4.2 | 2.7 | 2.0 |
| Czechia | -5.8 | 3.3 | 1.5 | 0.9 |
| Hungary | -4.5 | 7.1 | 4.6 | 2.8 |
| Poland | -2.2 | 6.0 | 4.2 | 2.8 |
| Romania | -3.7 | 5.9 | 4.3 | 2.8 |
| Croatia | -8.1 | 10.2 | 4.1 | 3.3 |
| Russia | -2.7 | 4.7 | -9.9 | 0.7 |
| Serbia | -0.9 | 7.4 | 2.5 | 3.0 |
| Turkey | 1.8 | 11.0 | 4.4 | 3.3 |

| CPI EoP (% change) | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|
| EU-CEE | 2.0 | 7.6 | 14.2 | 9.2 |
| Bulgaria | 0.1 | 7.8 | 12.3 | 6.1 |
| Czechia | 2.3 | 6.6 | 16.2 | 7.4 |
| Hungary | 2.7 | 7.4 | 13.2 | 10.8 |
| Poland | 2.4 | 8.6 | 15.1 | 11.1 |
| Romania | 2.1 | 8.2 | 14.1 | 8.9 |
| Croatia | -0.7 | 5.5 | 10.1 | 3.2 |
| Russia | 4.9 | 8.4 | 21.0 | 7.0 |
| Serbia | 1.3 | 7.9 | 12.3 | 5.4 |
| Turkey | 14.6 | 36.0 | 84.0 | 43.0 |

| C/A balance (% GDP) | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|
| EU-CEE | 0.8 | -1.7 | -4.0 | -3.7 |
| Bulgaria | -0.1 | -0.4 | -2.9 | -2.1 |
| Czechia | 2.0 | -0.8 | -4.0 | -3.3 |
| Hungary | -1.0 | -2.9 | -5.9 | -5.0 |
| Poland | 2.9 | -0.6 | -2.1 | -2.5 |
| Romania | -5.0 | -7.1 | -8.7 | -8.0 |
| Croatia | -0.1 | 3.4 | 1.1 | -1.0 |
| Russia | 2.4 | 6.9 | 7.1 | 7.4 |
| Serbia | -4.1 | -4.4 | -7.0 | -6.5 |
| Turkey | -5.0 | -1.7 | -5.6 | -3.5 |

| Extended basic balance (% GDP) | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|
| EU-CEE | 4.2 | 2.3 | -0.1 | 0.0 |
| Bulgaria | 5.8 | 2.4 | -0.4 | 0.7 |
| Czechia | 5.1 | -0.3 | -2.9 | -1.9 |
| Hungary | 2.9 | 1.3 | -1.9 | -1.1 |
| Poland | 7.3 | 4.6 | 2.3 | 1.6 |
| Romania | -2.2 | -1.8 | -3.3 | -2.8 |
| Croatia | 3.4 | 10.8 | 6.0 | 4.2 |
| Russia | 2.7 | 5.5 | 4.5 | 4.9 |
| Serbia | 2.2 | 2.4 | -2.0 | -1.6 |
| Turkey | -4.4 | -0.8 | -4.7 | -2.8 |

| External debt (% GDP) | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|
| EU-CEE | 76.3 | 74.1 | 68.6 | 65.0 |
| Bulgaria | 64.9 | 61.8 | 53.8 | 49.4 |
| Czechia | 75.9 | 73.1 | 67.1 | 67.7 |
| Hungary | 149.5 | 153.9 | 141.1 | 128.4 |
| Poland | 62.4 | 53.9 | 48.9 | 44.3 |
| Romania | 42.7 | 44.9 | 43.9 | 44.5 |
| Croatia | 79.8 | 77.9 | 71.9 | 69.1 |
| Russia | 29.4 | 28.1 | 20.2 | 19.6 |
| Serbia | 65.8 | 63.0 | 61.8 | 58.5 |
| Turkey | 60.4 | 54.9 | 58.8 | 47.6 |

| General gov't balance (% GDP) | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|
| EU-CEE | -7.0 | -4.5 | -4.9 | -4.2 |
| Bulgaria | -4.0 | -4.1 | -5.3 | -3.5 |
| Czechia | -5.8 | -5.9 | -5.0 | -4.0 |
| Hungary | -7.8 | -6.8 | -5.2 | -4.1 |
| Poland | -6.9 | -1.9 | -4.0 | -4.0 |
| Romania | -9.4 | -7.7 | -7.1 | -5.3 |
| Croatia | -7.3 | -2.9 | -3.3 | -2.6 |
| Russia | -3.8 | 0.4 | -2.0 | -2.1 |
| Serbia | -8.0 | -4.1 | -3.0 | -1.5 |
| Turkey | -5.2 | -3.9 | -5.2 | -4.2 |

| Gov't debt (% GDP) | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|
| EU-CEE | 55.3 | 54.4 | 52.7 | 52.2 |
| Bulgaria | 24.1 | 24.5 | 24.6 | 25.3 |
| Czechia | 37.7 | 41.9 | 43.3 | 44.1 |
| Hungary | 79.6 | 76.8 | 74.6 | 74.0 |
| Poland | 57.1 | 53.8 | 50.3 | 49.1 |
| Romania | 47.2 | 48.8 | 49.6 | 50.4 |
| Croatia | 87.3 | 79.8 | 75.4 | 72.8 |
| Russia | 18.3 | 16.6 | 14.8 | 17.1 |
| Serbia | 57.8 | 57.1 | 54.4 | 52.1 |
| Turkey | 39.7 | 42.0 | 41.7 | 36.9 |

| Policy rate (%) | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|
| EU-CEE | | | | |
| Bulgaria | - | - | - | - |
| Czechia | 0.25 | 3.75 | 7.00 | 5.00 |
| Hungary | 0.60 | 2.40 | 9.50 | 6.50 |
| Poland | 0.10 | 1.75 | 7.00 | 6.00 |
| Romania | 1.50 | 1.75 | 6.00 | 6.00 |
| Croatia | | | | |
| Russia | 4.25 | 8.50 | 8.00 | 7.00 |
| Serbia | 1.00 | 1.00 | 4.00 | 4.00 |
| Turkey | 17.00 | 14.00 | 14.00 | 45.00 |

| FX vs. EUR (EoP) | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|
| EU-CEE | | | | |
| Bulgaria | 1.96 | 1.96 | 1.96 | 1.96 |
| Czechia | 26.2 | 24.9 | 24.9 | 25.0 |
| Hungary | 365 | 369 | 395 | 400 |
| Poland | 4.61 | 4.60 | 4.75 | 4.80 |
| Romania | 4.87 | 4.95 | 4.98 | 5.06 |
| Croatia | 7.54 | 7.52 | 7.53 | EUR |
| Russia | 90.7 | 84.1 | 87.2 | 112.0 |
| Serbia | 117.6 | 117.6 | 117.6 | 118.2 |
| Turkey | 9.1 | 15.1 | 23.3 | 20.7 |

Source: National statistical agencies, central banks, UniCredit Research

### EM VULNERABILITY HEATMAP

| | BG | CZ | HR | HU | PL | RO | RS | RU | SK | TR | UA | MX | BR | CL | SA | ID | IN | CN | AG |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **External Liquidity** | | | | | | | | | | | | | | | | | | | |
| Current account (% of GDP) | -1.4 | -2.7 | 3.4 | -4.9 | -2.2 | -2.8 | -6.9 | 8.7 | -4.7 | -3.1 | 0.0 | -0.2 | -1.6 | -7.3 | 3.2 | 0.4 | -1.2 | 1.8 | 0.8 |
| Extended Basic Balance (% of GDP) | 1.6 | -0.1 | 10.7 | -0.8 | 3.2 | -1.8 | -0.8 | 4.4 | 1.8 | -2.2 | 1.3 | 2.2 | 0.5 | -7.4 | 12.3 | 1.8 | 0.0 | 2.9 | 1.4 |
| FX Reserves coverage (months of imports) | 7.6 | 11.1 | 9.6 | 2.6 | 4.2 | 3.7 | 5.4 | 14.8 | - | 2.2 | 3.7 | 4.2 | 12.0 | 4.9 | 5.5 | 6.4 | 8.8 | 12.2 | 6.5 |
| External Debt (excl.ICL, % of GDP)* | 38.5 | 70.7 | 62.0 | 62.6 | 40.1 | 38.5 | 61.3 | 19.7 | 120.3 | 54.3 | 64.6 | 33.1 | 41.7 | 76.4 | 38.2 | 33.8 | 19.9 | 14.9 | 52.5 |
| Short-term debt (% of GDP) | 22.3 | 40.1 | 25.0 | 18.2 | 9.4 | 7.1 | 4.2 | 4.0 | 68.6 | 16.5 | 8.1 | 3.5 | 5.0 | 8.5 | 6.4 | 4.1 | 7.3 | 7.9 | 8.2 |
| REER (Index, 2010=100) | 110.9 | 113.4 | 101.5 | 76.6 | 91.2 | 101.6 | 127.2 | 108.0 | - | 47.3 | 103.7 | 87.3 | 62.7 | 82.2 | 107.9 | 93.6 | 109.4 | 126.1 | - |
| **Domestic Finances** | | | | | | | | | | | | | | | | | | | |
| Corporate debt (% of GDP) | 44.4 | 50.3 | 61.9 | 58.2 | 43.9 | 39.3 | 46.2 | 53.1 | 54.8 | 71.5 | 36.3 | 24.8 | 54.4 | 103.0 | 44.2 | 35.2 | 54.7 | 152.8 | 18.0 |
| Household Debt (% of GDP) | 24.1 | 34.3 | 36.3 | 23.8 | 35.0 | 20.7 | 20.5 | 20.4 | 45.4 | 13.6 | 4.5 | 16.3 | 33.8 | 38.6 | 30.3 | 16.3 | 37.1 | 61.6 | 4.5 |
| Nonresident holdings of LC gov.debt (% total) | 0.4 | 26.7 | - | 25.2 | 25.9 | 15.8 | 0.0 | 39.4 | 43.9 | 1.2 | - | 17.2 | 7.2 | - | 28.6 | 22.8 | - | 11.1 | - |
| **Banking System** | | | | | | | | | | | | | | | | | | | |
| Credit Impulse (% of GDP) | 3.1 | 2.1 | -1.1 | 0.2 | 2.4 | 2.3 | 0.4 | - | 2.3 | -8.1 | -1.2 | 3.3 | 2.9 | 6.8 | 4.7 | 2.7 | -0.9 | 0.8 | 1.6 |
| Loans/deposit ratio (%) | 68.5 | 62.8 | 76.2 | 61.1 | 84.8 | 72.2 | 88.4 | 91.1 | 105.0 | 92.1 | 134.4 | 88.7 | 113.0 | 113.4 | 97.7 | 83.9 | 107.3 | 78.7 | 132.3 |
| NPL (% of total loans) | 6.1 | 2.2 | 6.1 | 2.9 | 2.9 | 3.3 | 3.3 | 7.0 | 2.1 | 2.8 | 28.5 | 2.4 | 2.4 | 1.2 | 4.4 | 3.0 | 6.5 | 1.7 | 3.6 |
| Domestic Banks CAR (%) | 21.9 | 21.3 | 25.6 | 20.1 | 18.5 | 23.1 | 20.0 | 12.4 | 19.8 | 20.4 | 18.0 | 18.4 | 16.8 | 14.9 | 17.7 | 25.7 | 14.8 | 15.1 | 27.0 |
| Domestic Banks RoE (%) | 15.6 | 12.7 | 9.6 | 8.2 | 4.3 | 13.6 | 9.7 | 24.6 | 7.6 | 22.3 | -0.3 | 16.1 | 15.6 | 16.6 | 13.7 | 11.1 | 9.9 | 9.6 | - |

BG = Bulgaria, BR = Brazil, CL = Chile, CN = China, HR = Croatia, CZ = Czech Republic, HU = Hungary, IN = India, ID = Indonesia, MX = Mexico, PL = Poland, RO = Romania, RU = Russia, RS = Serbia, SK =Slovakia, SA = South Africa, TR = Turkey, UA = Ukraine. *External debt incl ICL for CZ, RS, TR, MX, CL and SA

*External debt incl. ICL for CZ, RS, TR, MX, CL and SA

Source: Haver, Bloomberg, National Statistics Offices, Central Banks, IMF, UniCredit Research

| Legend |
|---|
| Low vulnerability |
| Moderate vulnerability |
| Significant vulnerability |
| High vulnerability |

### EM VULNERABILITY HEATMAP (CONTINUED)

| | BG | CZ | HR | HU | PL | RO | RS | RU | SK | TR | UA | MX | BR | CL | SA | ID | IN | CN | AG |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Policy** | | | | | | | | | | | | | | | | | | | |
| Policy Rate, nominal (%) | - | 7.00 | - | 7.75 | 6.00 | 3.75 | 2.50 | 9.50 | 0.00 | 14.00 | 25.00 | 7.00 | 12.75 | 8.25 | 4.75 | 3.50 | 4.40 | 4.35 | 49.00 |
| Real policy rate (%) | - | -9.0 | - | -2.6 | -6.9 | -10.8 | -7.2 | -6.5 | - | -34.3 | 5.9 | -0.6 | 0.9 | -3.0 | -1.7 | -0.1 | -2.4 | -2.0 | -7.3 |
| Real Money market rate (%) | - | -8.8 | -0.3 | -2.6 | -6.2 | -8.3 | -7.3 | -6.4 | - | -33.1 | 4.2 | -0.6 | -1.0 | -3.5 | -1.9 | 0.2 | -2.1 | 1.0 | -16.8 |
| Headline inflation (% yoy) | 15.6 | 16.0 | 10.8 | 10.7 | 13.9 | 14.5 | 10.4 | 17.1 | 12.6 | 73.5 | 18.0 | 7.7 | 11.7 | 11.5 | 6.6 | 3.6 | 7.0 | 2.0 | 60.7 |
| Core Inflation (% yoy) | 9.2 | 13.9 | 9.8 | 12.2 | 8.5 | 9.1 | 6.3 | 19.9 | 12.1 | 56.0 | 7.9 | 7.3 | 10.4 | 9.0 | 4.1 | 2.8 | 5.8 | 0.6 | 63.2 |
| GG Fiscal balance (% of GDP) | -2.5 | -5.9 | -2.9 | -11.4 | -1.9 | -6.6 | -4.9 | 1.0 | -6.2 | -2.3 | -3.4 | -2.7 | -3.2 | -6.3 | -5.0 | -4.5 | -6.7 | -3.8 | -3.2 |
| GG Primary balance (% of GDP) | -2.0 | -5.2 | -3.3 | -9.1 | -0.9 | -5.2 | -3.2 | 1.8 | -5.0 | 0.3 | -0.6 | -0.1 | 1.4 | -5.4 | -0.8 | -2.7 | -3.3 | - | - |
| Government Debt (% of GDP) | 22.7 | 41.9 | 79.6 | 77.1 | 54.2 | 48.8 | 56.5 | 15.5 | 63.1 | 42.0 | 45.4 | 43.6 | 70.3 | 57.2 | 67.4 | 60.7 | 56.3 | 70.1 | 74.8 |
| **Markets** | | | | | | | | | | | | | | | | | | | |
| External Debt Spread (10Y, bp)** | 211.2 | - | 196.0 | 247.4 | 143.1 | 450.2 | 489.4 | 3452.8 | 74.4 | 719.0 | 3006.4 | 154.3 | 271.2 | 132.9 | 357.9 | 165.4 | 132.4 | 17.9 | - |
| Local Currency Curve (5Y, %)*** | 1.2 | 5.6 | 0.5 | 8.5 | 7.5 | 8.8 | 6.5 | 15.2 | 1.9 | 19.6 | 45.0 | 9.2 | 13.1 | 5.6 | 8.8 | 6.3 | 7.3 | 2.7 | 60.5 |
| Local currency bond spread (2s10s)**** | 174.1 | -130.0 | 200.6 | -28.2 | -83.2 | 18.7 | 238.9 | 33.0 | 127.0 | -504.0 | -5671.1 | -28.0 | 250.0 | 108.0 | 283.0 | -513.2 | 91.4 | 55.5 | -781.5 |
| CDS (10Y, bp) | 126 | 53 | 140 | 185 | 135 | 294 | 342 | 6780 | 64 | 706 | 7217 | 247 | 380 | 173 | 366 | 201 | 182 | 82 | 28844 |
| FX 3m implied volatility (%) | - | 6.6 | 4.0 | 12.1 | 9.2 | 2.4 | - | 46.5 | - | 31.3 | - | 12.0 | 19.5 | 18.5 | 16.5 | 7.7 | 5.7 | 5.3 | 15.1 |
| **Structural***** | | | | | | | | | | | | | | | | | | | |
| WEF Competitiveness Ranking | 61 | 41 | 51 | 52 | 40 | 52 | 44 | 28 | 45 | 33 | 64 | 60 | 124 | 59 | 84 | 73 | 63 | 31 | 126 |
| Unemployment (%) | 53 | 32 | 63 | 47 | 37 | 51 | 72 | 43 | 42 | 61 | 85 | 48 | 71 | 33 | 60 | 50 | 68 | 28 | 83 |

** Spread between 10Y EUR government bond yields and the corresponding German government bond yields for BG, HR, HU, PL, RO. For CZ, the spread refers to the 5Y yield. For the other countries, the spread is computed with respect to US government bond yields; *** Data for UA refer to the generic USD bond. Data for HR refer to the 4Y bond; **** Data for UA refer to the generic USD bond. Data for CL refer SA to the spread between 8Y and 2Y bond and 9Y and 2Y bond respectively. Data for HU refer to spread between 10Y and 3Y bond; ***** WEF indicators for 2019

Source: Haver, Bloomberg, National Statistics Offices, Central Banks, IMF, UniCredit Research

| Legend |
|---|
| Low vulnerability |
| Moderate vulnerability |
| Significant vulnerability |
| High vulnerability |

# CEE Strategy: Inflation and growth risks collide

**Elia Lattuga**,
Cross Asset Strategist
Deputy Head of Strategy Research
(UniCredit Bank, Milan)
+39 02 886200851
elia.lattuga@unicredit.eu

- EM assets have posted very negative performance YTD and investors have shed positions significantly. The short-term picture remains challenging, with core rates exposed to inflation risk and hawkish central bank remarks.
- However, before year-end, disinflation and rising recession risk might push the Fed/ECB to strike a less-aggressive tone. Falling Bund and UST yields and a weaker USD would favor a return of confidence across EM. Dropping core rates would add to carry and contribute to positive returns across hard-currency exposure, while spreads would remain wide.
- Stabilization in inflation and the prospect of positive real yields would boost demand for CEE bonds at a time when investors are looking for an entry point. This could favor Czechia and Romania already in 3Q22, while interest on Hungary and Poland might only pick-up towards year-end. Given the synchronized moves of the past few months, dropping EGB yields would add tailwind to CEE bond demand.

**Poor performance so far this year**

The second quarter of the year failed to bring the recovery EM bond investors were expecting. EM bond benchmarks added to 1Q losses, to deliver, in most cases, double-digit losses close to the 15-20% area. Upward pressure on risk-free yields added to spread widening, while long duration created additional drag. YTD, longer-dated USD-denominated EM bonds have lost nearly twice as much as bonds in the one- to three-year area. Across regions, the second quarter levelled returns, with local bonds in Asia and LatAm failing to avoid the sharp pressure placed on EMEA bonds like in 1Q. YTD performance remains sharply negative in EMEA, where losses are larger than 20%. Asian bonds are approaching -10% in total return, while LatAm bonds have offset all of their positive 1Q performance. In relative terms, hard-currency EM bonds' performance has been a tad more negative than US or European high yield, albeit a bit better than that of global equities. Local bonds outperformed, and their YTD losses are lower than those of long-dated USTs, but their performance has been deteriorating over the past few months, also in relative terms.

**CHART 1: A DIFFICULT START OF THE YEAR FOR EM BONDS**

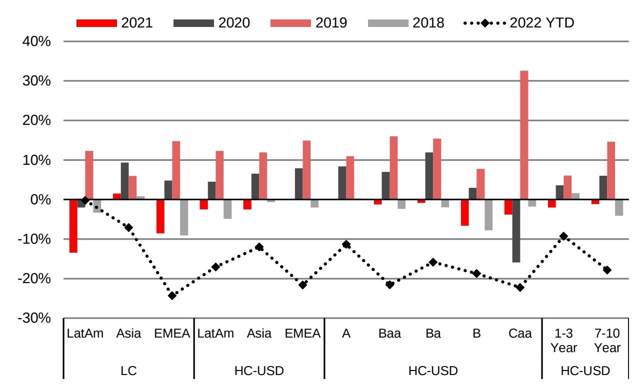
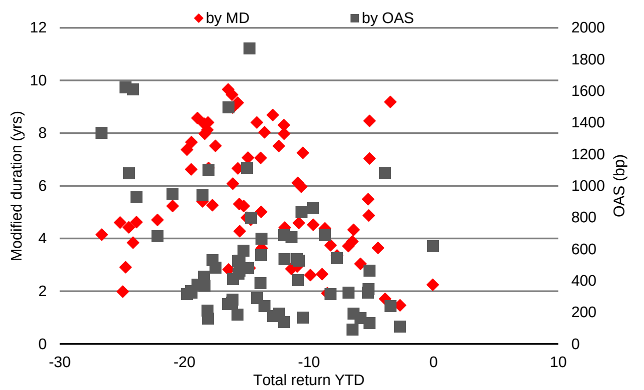



**CHART 2: CREDIT AND INTEREST RATE RISK**




Source: Bloomberg, UniCredit Research

**Correlated markets**

At a time of negative performance among DM equities and bonds, EM bonds have not offered many diversification benefits. Correlation to UST returns increased sharply over the last few months of 2021, deviating from long-term near-zero levels for both hard- and local-currency indices. With commodity prices being a key driver of rising inflation across DM, the performance of commodity exporters (with Russia as a notable exception) managed to deviate from a generally negative trend, but not for long. Correlations to UST performance were only temporarily negative at the beginning of 2Q. Meanwhile, performance correlation with US HY and global equity markets have remained at or slightly above average. As the Fed started to tighten monetary policy, flagging the end of ultra-expansionary measures, volatility across the rates and equity world started to rise, the USD strengthened and confidence in EM performance took a hit.

**Increasingly light positioning**

Alongside such increasingly negative performance, portfolio outflows have also increased. Redemptions were particularly intense in mid-March and mid-May. Ongoing repositioning in EM bond portfolios appears comparable to that which occurred in early 2020, when there was a sharp acceleration in outflows from both bond and equity portfolios. In cumulative terms, positioning on EM bonds never really managed to recover from 2020 outflows, and recent redemptions have gone beyond positioning levels following the 2020 sell-off. Equity flows had recovered all of their 2020 outflows, but YTD outflows have erased all such gains. At the moment, positioning, particularly in EM bonds, looks very light.

**CHART 3: PORTFOLIO FLOWS INTO EM**

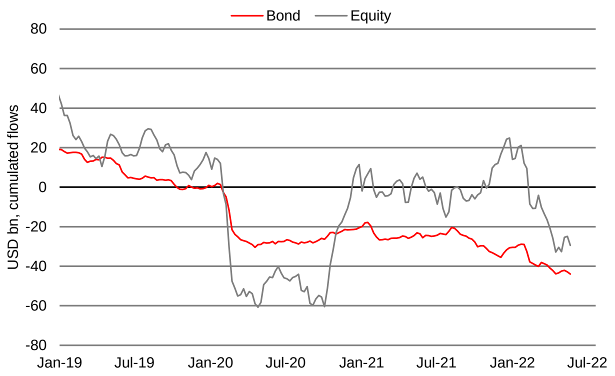
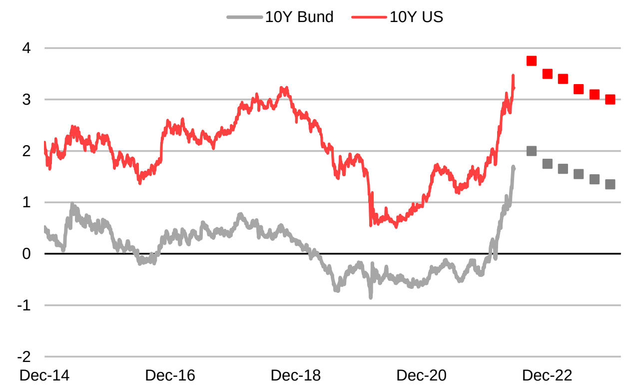



**CHART 4: OUR 10Y BUND AND UST YIELD FORECAST**




Source: Haver, Bloomberg, UniCredit Research

**UST and Bund yields: more upward pressure before yields ease**

In the current environment, which is characterized by still-high inflationary risk across Europe and the US, with the Fed and the ECB focused on reining in price pressure and willing to look through deteriorating growth indicators, volatility in both rates and equity markets is likely to persist, and credit spreads might remain between a rock and a hard place. Indeed, while inflation might be close to peak in both the eurozone and US, it will likely remain elevated for most of 2022, and central banks are likely to continue to convey hawkish messaging. Hence, for the coming months, we do not expect to see much of a repricing happening with regard to rate-hike expectations, and Bund and UST yields might face some renewed upward pressure. More signs of disinflation and a softening growth outlook as we approach year-end, might allow central banks to strike less-aggressive tones. This, in turn, would push Bund and UST yields lower. We expect to see 10Y Bunds reaching 1.75% by end-2022 and falling further to 1.35% at end-2023. For 10Y UST yields, we forecast 3.5% and 3.0% for end-2022 and end-2023, respectively. A less hawkish Fed and ECB, declining UST and Bund yields and a somewhat weaker USD at that point would support a return of confidence in EM assets.

**Growth concerns**

However, growth concerns will likely remain and possibly intensify given the delayed impact of the ongoing tightening in financial conditions. A virtually flat UST yield curve points to the significant chance of recession in the next eight quarters. Indeed, the shape of the US curve has changed significantly over the past few months. Since the Fed started hiking rates, several segments of the curve have moved close to inverted levels. Over the past sixty years, every US recession has been preceded by an inversion of the yield curve. Moreover, after each inversion, the US economy has slowed and gone into recession in all but one instance. Current US yield-curve levels suggest there is about a one-in-four chance of recession over the coming four quarters and a one-in-two chance over the next eight quarters. In such environment, EM credit spreads might remain elevated, with the rate component (along with carry) contributing to positive returns.

**China might be the wildcard for EM**

It should be noted however that the growth outlook across EM has been significantly weaker than that for DM in recent months, with a large number of countries displaying PMIs in contraction territory. CEE has been an outlier due to the strong start of the year, with consumers and companies frontloading spending and borrowing. Over the coming months, a lot of attention will be on China. Lockdowns and restrictions have taken their toll on economic activity, and caution has prevailed on the consumer side, possibly leading to a stagnation in economic activity in 2Q22. While the course of the virus will be a key determinant of the growth outlook for the coming quarters, fiscal and monetary authorities are stepping up their support. Tax cuts and rebates along with infrastructure spending are being put in place, while the PBoC is acting on several fronts (rates, liquidity and SME lending) to shore up growth. Given negative sentiment, a pickup in China might contribute to a return of flows into battered EM bonds and equities.

**CHART 5: BETA MOVES**

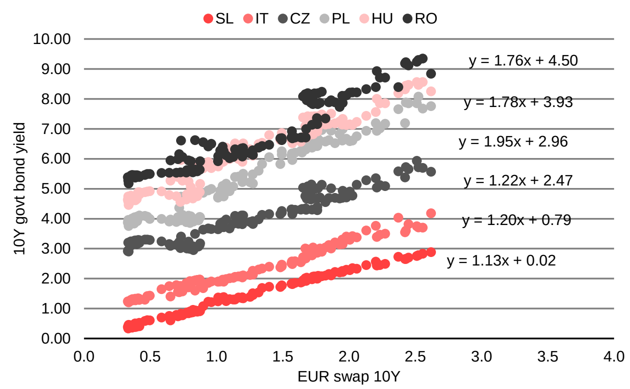
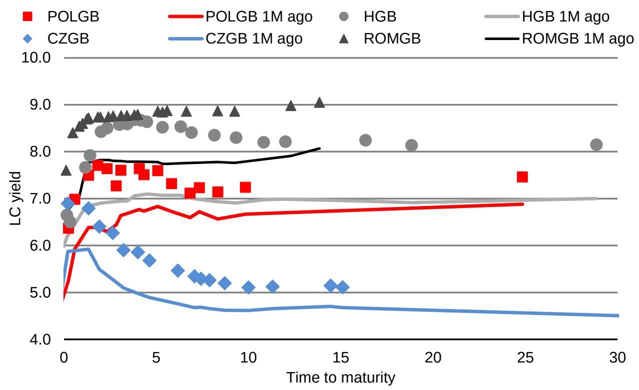



**CHART 6: LOCAL YIELD CURVES**




Source: Bloomberg, UniCredit Research

**Our view on CEE bonds**

CEE local bond yields have been driven by high inflation and hawkish central bank moves, but their behavior, at least at the long end, has been very much in line with the generalized repricing in global yield curves. Chart 5 shows a scatter plot of the EUR swap 10Y level against a number of 10Y government bond yields, including Italian BTPs and CEE bonds. While yields started from different levels, the trend has been very much aligned. Moreover, there has been a tight relationship between yield levels and the beta of adjustment compared to the EUR swap market. From the chart, idiosyncratic moves appear more common on the 10Y ROMGB and HGB, but overall, beta prevails. We see chances of higher EUR rates in the next few months, but eurozone inflation is close to peaking in our view and, as we approach year-end, Bunds and EUR swap rates will likely move lower (and even more so in 2023). A key risk would disappear, and beta-guided moves would then drive positive momentum at the long end of CEE curves.

Central banks in the region are eying a slower pace of rate hikes and the peak in the current cycle. We see the NBH and NBP taking official rates to 9 and 7%, respectively, with rate cuts to 6.5% and 6% expected in 2023. In Czechia we see rates on hold until 2H23 at 7%, followed by cuts to 5% before the end of 2023, while in Romania, we see the NBR taking the policy rate to 6% and keeping it stable in 2023.

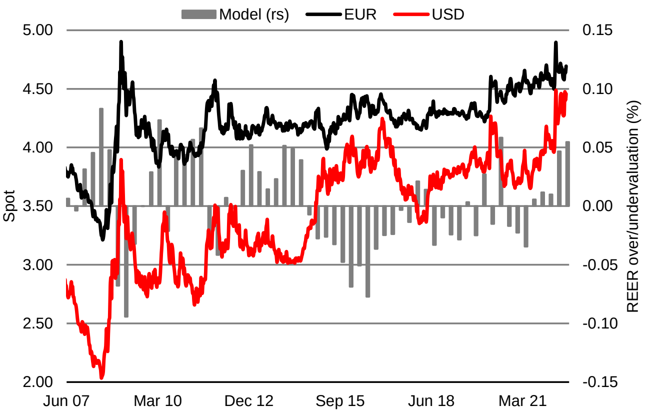
Markets project a continuation of the tightening cycle for the next 6-9 months before expected yields gradually move lower. The risk for central banks appears one of too timid tightening over the coming months. This would increase currency depreciation pressure and volatility along local yield curves. Adding to such risks, curves might have to face either deteriorating fiscal balances or rising CPI if/when price caps on energy and food prices are removed. Political uncertainty would come on top. We think this scenario deserves monitoring in Romania, where official rates might not be hiked enough to calm pressure on the short end of the curve and on the RON, and the NBR might have to allow the EUR-RON to move up to 5.00-5.10 in 1Q23. CZGBs remain exposed to a dovish turn by the new MPC majority, which we expect to maintain a cautious approach. HGBs and POLGBs might also see more curve inversion over the coming months before inflation fears subside.

Despite all these risks, investors are looking for an entry point into regional bonds, betting on inflation expectations remaining anchored and core inflation starting to fall in 2023. Demand for bonds could increase once inflation stabilizes and real yields computed with expected inflation 1Y forward turn positive. This could happen in 3Q22 for Czechia and Romania but might not happen before the end of the year in Hungary and Poland. Signs of a peak in inflation and the prospect of Bunds yields also falling, possibly into year-end, would accelerate dovish repricing on local curves.

# REER model updates

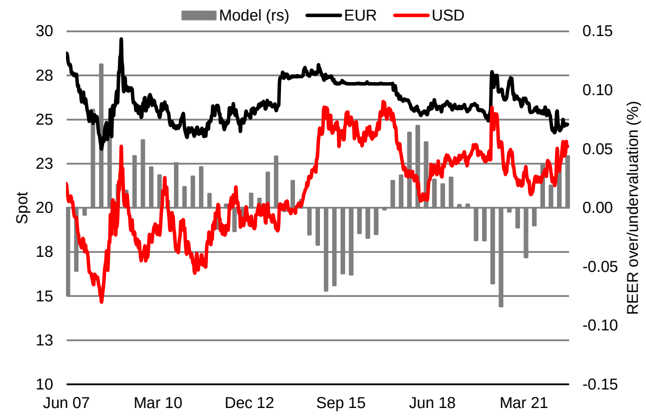
### PLN

- After retracing May's rise, the PLN REER is roughly unchanged over the quarter. EUR-PLN has mostly traded between 4.60 and 4.70 in 2Q.
- In REER terms, the zloty remains somewhat overvalued compared to our model's fair value, but we do not expect this to be a driven. Trade data relative to regional peers, as well as real effective exchange rates computed using CPI, PPI and unit labor costs suggest the PLN is undervalued compared to the HUF, the CZK and especially the RON.
- We see EUR-PLN trading between 4.65 and 4.75 in 2H22 and at 4.80 by YE23. Representatives of the NBP and the Polish government have said that the PLN is heavily undervalued above EUR-PLN 4.80. Excursions above this level would likely trigger FX intervention.



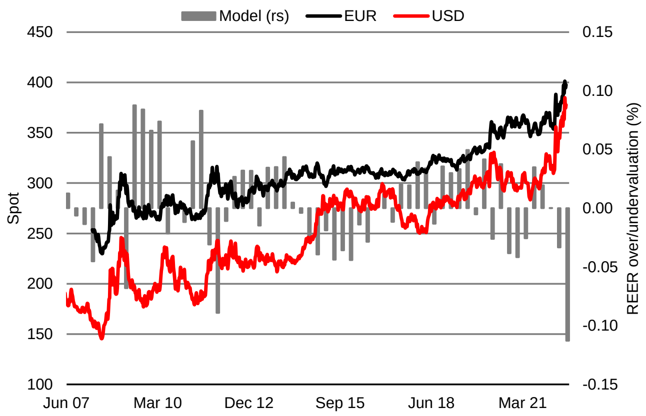

### CZK

- EUR-CZK spikes have proved short-lived, even though the pair has inched somewhat higher in 2Q and is now in the 24.50-25.00 range. Despite recent volatility, the CZK REER has remained on its appreciation trend, returning to the highs marked in February. In our model, it remains moderately overvalued. The extent of overvaluation has been roughly unchanged over the past four quarters.
- We do not expect a dovish shift from the CNB, and, in our view, rates will be kept on hold until 2H23. We see EUR-CZK remaining close to 25 throughout the forecast horizon. However, volatility could increase in the short term while investors gauge the policy direction of the new MPC majority.




### HUF

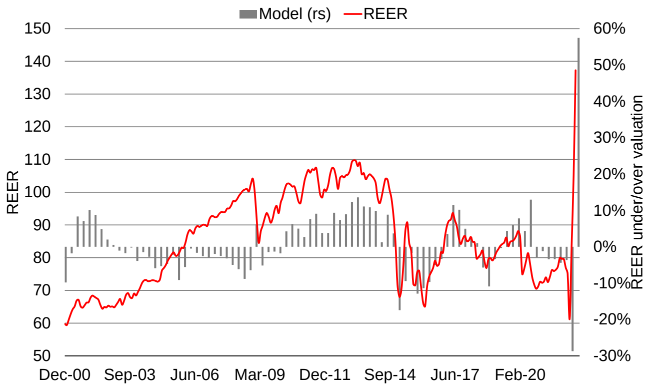
- HUF underperformance in CEE3 has accelerated in recent months. In REER terms, the HUF is trading at its lowest level in over 20 years, while against the EUR, it is down over 7% YTD. Our REER model for the HUF sees the currency as undervalued and this undervaluation has increased over the past quarter.
- The NBH has hinted that EUR-HUF should not be above 390, although recently the pair crossed 400. We forecast EUR-HUF at 395 at YE22 and then expect it to move broadly sideways between 393 and 400 in 2023.
- If the NBH hikes rates above peers, as we expect, the carry could become a deterrent for some of the short HUF positions. In our view, though, stable capital flows could remain negative for the HUF in 2H22 and 2023.



Source: Haver, Bloomberg, UniCredit Research

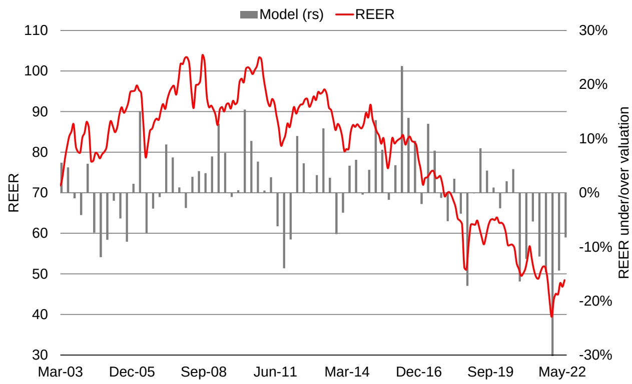
**RUB**

- The positive momentum for RUB continued into 2Q, with USD-RUB falling towards 50, over 60% lower than March peaks but also nearly 30% lower YTD.
- As such, the RUB has recovered all of its undervaluation in REER terms and more. Our model suggests that the RUB is over 50% overvalued in REER terms.
- With the CBR gradually unfreezing the FX market, the RUB will start depreciating. Gradual easing of the CBR's capital controls, rate cuts, lower exports and higher imports going forward might allow the RUB to depreciate towards year-end, remaining overvalued this year when accounting for the productivity shock. We see USD-RUB at 80 by YE22 and at 100 by YE23.




**TRY**

- USD-TRY has inched lower recently, falling back towards 16.50-17.00. YTD, the exchange rate is still sharply higher.
- In REER terms, the TRY remains undervalued, but the magnitude of undervaluation has been gradually declining over the past few quarters.
- We expect the CBRT to keep rates on hold until after next year's elections, with more quasi-capital controls introduced to slow TRY depreciation. We see USD-TRY at 22 by YE22 and a recovery towards 18.5 by YE23 if a new government majority allows the CBRT to hike rates sharply in order to stabilize inflation.




Source: Haver, Bloomberg, UniCredit Research

# Countries

# Bulgaria

## Baa1 stable/BBB stable/BBB positive*

### Outlook

The outlook for the economy continues to be dominated by the Russia-Ukraine conflict and its impact on inflation and the stability of energy supplies. We are raising our GDP growth forecast for this year to fully capture the strength of the economy in 1Q22. However, we are lowering our growth projection for next year, as we now see a less favorable external environment, with higher interest rates expected in the euro area on top of weaker growth for some of Bulgaria's key trading partners. The recent rise in political uncertainty is not likely to translate into any major change in economic policy. We continue to see euro adoption in 2024 as more likely than not, but we are worried that the transition to a new government could slow decision making in administration, which will negatively affect public capex supporting infrastructure, the green transition and digitalization.

### Strategy

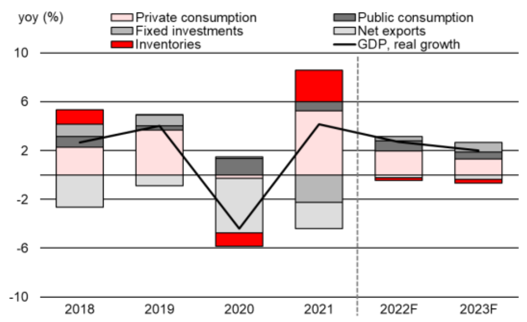
The government looks set to meeting its budget deficit target for this year. If so, we expect an additional BGN 1.0bn of bonds issued on the domestic market and EUR 3.0bn of bonds issued externally by the end of the current year.

**Author**: **Kristofor Pavlov,** Chief Economist (UniCredit Bulbank)

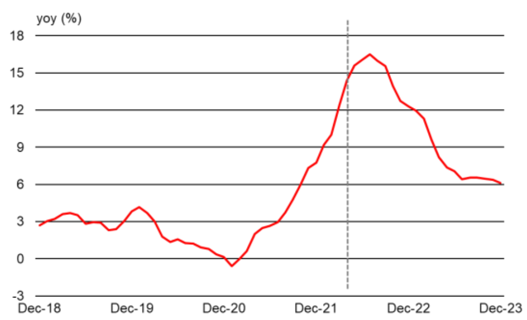
#### KEY DATES/EVENTS

- 15 Jul, 16 Aug, 14 Sep: CPI
- 17 Aug, 7 Sep: 2Q22 GDP (flash, structure)
- 23 Sep: HPI 2Q22
- 30 Sep: sovereign rating review by Moody's

#### GDP GROWTH FORECAST




#### INFLATION FORECAST




Source: National Statistical Institute, UniCredit Research

#### MACROECONOMIC DATA AND FORECASTS

| | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 61.6 | 61.3 | 67.9 | 80.0 | 88.9 |
| Population (mn) | 7.0 | 6.9 | 6.8 | 6.8 | 6.7 |
| GDP per capita (EUR) | 8 855 | 8 867 | 9 924 | 11 811 | 13 269 |
| **Real economy, change (%)** | | | | | |
| GDP | 4.0 | -4.4 | 4.2 | 2.7 | 2.0 |
| Private consumption | 6.0 | -0.4 | 8.0 | 2.9 | 1.9 |
| Fixed investment | 4.5 | 0.6 | -11.0 | 2.0 | 4.4 |
| Public consumption | 2.0 | 8.3 | 4.0 | 4.4 | 3.1 |
| Exports | 4.0 | -12.1 | 9.9 | 3.5 | 3.3 |
| Imports | 5.2 | -5.4 | 12.2 | 3.4 | 3.5 |
| Monthly wage, nominal (EUR) | 648 | 709 | 793 | 878 | 968 |
| Real wage, change (%) | 7.5 | 7.7 | 8.5 | -3.0 | 2.4 |
| Unemployment rate (%) | 4.2 | 5.1 | 5.3 | 5.1 | 5.5 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | 2.1 | -4.0 | -4.1 | -5.3 | -3.5 |
| Primary balance | 2.7 | -3.5 | -3.6 | -4.8 | -3.0 |
| Public debt | 19.6 | 24.1 | 24.5 | 24.6 | 25.3 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | 1.1 | 0.0 | -0.3 | -2.3 | -1.9 |
| Current account balance/GDP (%) | 1.9 | -0.1 | -0.4 | -2.9 | -2.1 |
| Extended basic balance/GDP (%) | 5.0 | 5.8 | 2.4 | -0.4 | 0.7 |
| Net FDI (% of GDP) | 2.0 | 4.5 | 1.7 | 1.3 | 1.3 |
| Gross foreign debt (% of GDP) | 61.3 | 64.9 | 61.8 | 53.8 | 49.4 |
| FX reserves (EUR bn) | 24.8 | 30.8 | 34.6 | 32.0 | 31.5 |
| Months of imports, goods & services | 7.4 | 10.4 | 9.3 | 6.4 | 5.5 |
| **Inflation/monetary/FX** | | | | | |
| CPI (pavg) | 3.1 | 1.7 | 3.3 | 13.7 | 7.8 |
| CPI (eop) | 3.8 | 0.1 | 7.8 | 12.3 | 6.1 |
| LEONIA (eop) | -0.61 | -0.70 | -0.53 | n.a. | n.a. |
| USD/BGN (eop) | 1.74 | 1.60 | 1.73 | 1.81 | 1.73 |
| EUR/BGN (eop) | 1.96 | 1.96 | 1.96 | 1.96 | 1.96 |
| USD/BGN (pavg) | 1.75 | 1.71 | 1.66 | 1.83 | 1.76 |
| EUR/BGN (pavg) | 1.96 | 1.96 | 1.96 | 1.96 | 1.96 |

Source: Bulgarian National Bank, Eurostat, National Statistical Institute, UniCredit Research

*long-term foreign-currency credit ratings by Moody's, S&P and Fitch, respectively

## Higher-for-longer inflation to keep GDP growth subdued

**Another coalition government supported by the same four parties is likely**

The Bulgarian political scene was thrust into uncertainty after the government of Prime Minister Kiril Petkov was forced to resign. We see two equally likely scenarios from here. In the first one, we think the odds are good that the four parties in the outgoing government will form a new coalition government, perhaps one with a limited mandate for reforms, which will implement most of the budget amendments that have already been agreed in order to mitigate the negative impact of surging inflation. In this scenario, there is a probability that Kiril Petkov, founder and co-leader of the largest party in parliament, would not be the next prime minister, and that some of the other leaders of WCC partly would replace him. In the second scenario, the parliament would be dissolved and new general election would be held in the autumn.

**Snap election cannot be ruled out later this year**

**No major changes in economic policy likely**

**Risks to rise in case of new election**

Either way, we do not expect any major changes in economic policy. This is because we think that Bulgaria's position on North Macedonia's EU accession talks was the key reason for the collapse of Mr. Petkov's government, not its economic policy. We continue to see euro adoption in 2024 as more likely than not, since the parties with a pro-Western geopolitical orientation combined can count on the support of around three-fifths of the electorate. In the event of new elections, the transition to a new government is likely to slow decision making in the administration. This is bad news for public capex and the country's chances of speeding up the green transition and digitalization. It may also threaten country's euro entry in 2024, especially if another round of election lead to an increase of the support for populist parties

**We have raised our 2022 GDP growth forecast**

The outlook for the economy continues to be dominated by the Russia-Ukraine conflict and the impact it is having on commodity prices, and by supply-chain disruptions, leading to higher inflation. However, a host of indicators have revealed that growth momentum had reached a very strong level before the Russian invasion of Ukraine at the end of February. The strength of the recovery in 1Q22 is perhaps best illustrated by the industrial production index, which posted its strongest year-on-year reading in more than two decades (see chart). Consequently, we have raised our 2022 GDP growth forecast to 2.7%, from 1.4% we forecast in April.

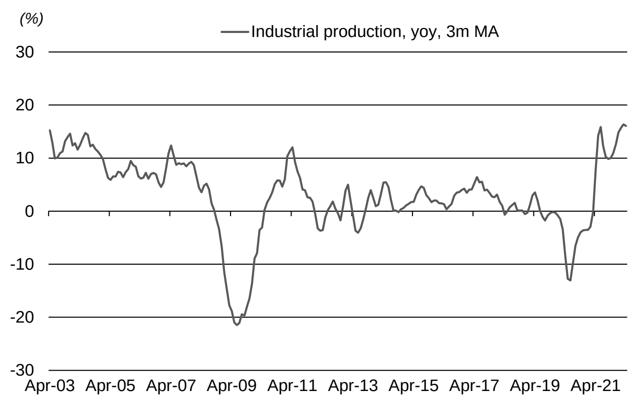
**Mild contraction is likely in 2Q22**

We expect a mild contraction in 2Q22, as industrial production and consumer confidence face serious headwinds from supply disruptions and surging prices resulting from continued lockdowns in parts of China, as well as the Russia-Ukraine conflict. However, we expect a slight pickup in quarterly growth in 3Q22 as fiscal support measures are activated, wages rise in the context of the tight labor market, and some of the headwinds to industrial activity fade.

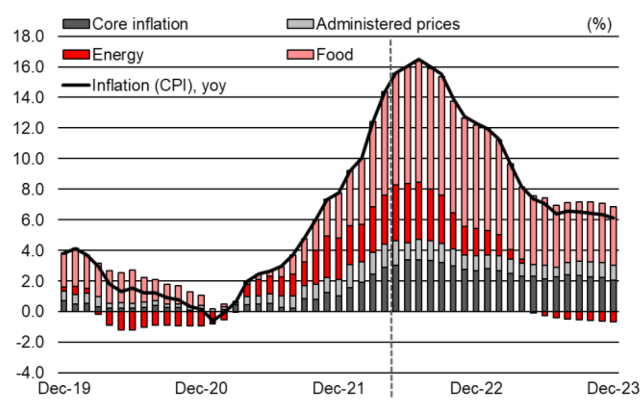
**We have lowered our growth outlook for 2023**

We have downwardly revised our GDP growth outlook for next year to 2.0% yoy, from 3.5% in April. This mostly reflects higher oil and gas prices in our global scenario, which implies higher-for-longer inflation (see chart), which will act as a larger drag on real incomes. Moreover, our global scenario envisages higher interest rates in the euro area on top of somewhat weaker growth for some of Bulgaria's key trading partners, which will weigh on export volumes.

**STRENGTH OF ECONOMIC RECOVERY SURPRISED IN 1Q22**




**BUT HIGHER-FOR-LONGER INFLATION LIES AHEAD**




Source: National Statistical Institute, UniCredit Research

**Inflation to remain elevated this year**

Consumer price inflation is set to remain high throughout this year. The Russia-Ukraine conflict has already pushed Bulgaria's energy and food prices to levels not seen since the late stages of the real estate bubble period preceding the global financial crisis in 2008-9. Russia's decision to suspend gas supplies to Bulgaria, for its refusal to start paying in rubles, has pushed prices even higher, although these increases were contained for the time being, as consumption of gas went down significantly after the end of the heating season.

**We see higher-for-longer inflation**

We expect inflation to peak in 3Q22 and to remain elevated in 4Q22 and 1H23. In Ukraine, the fighting has forced farmers to leave large areas of arable land unplanted and pushed fertilizer prices markedly higher, leading to a reduced harvest volumes and increased pressure on food commodity prices in response. To make things worse, Russia has blocked Ukrainian grain exports via the Black Sea, which threatens to cause food shortages in some of the poorest countries in the world while pushing food commodity prices higher for longer.

To capture all of these developments we have upwardly revised our 2023 average inflation forecast to 7.8%, from 4.5% in April. We still think that the shock to real incomes will ultimately significantly dampen aggregate demand and price pressure. This will need more time to materialize however and we now expect 6.1% inflation at the end of 2023, from 3.4% in April.

**Consumers to reshuffle their spending priorities**

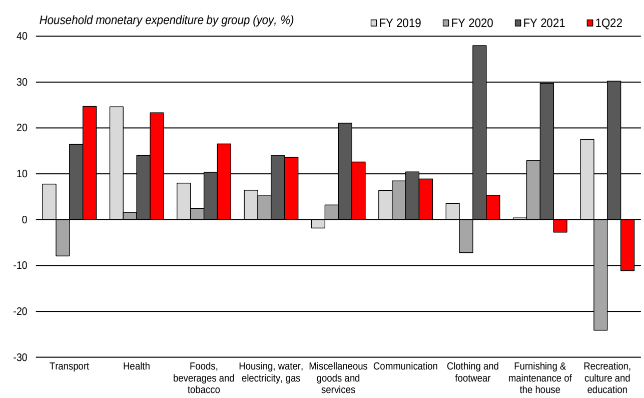
Consumers are set to become gloomier, but this does not mean they will stop spending. As the summer holiday season approaches, consumers will prepare for more services spending and particularly for more vacation-related spending, such as spending on restaurants and hotels. To do so they will have to reshuffle their spending priorities, as inflation is set to reach new heights in the summer. We expect consumers to cut back on discretionary purchases of cars, furniture, electronics and online shopping to keep little changed the portion of their budget allocated on necessities such as food, gasoline and shelter, which are now pricier (see chart).

**Fiscal support of 1.4% of GDP proposed to contain high inflation impact on incomes**

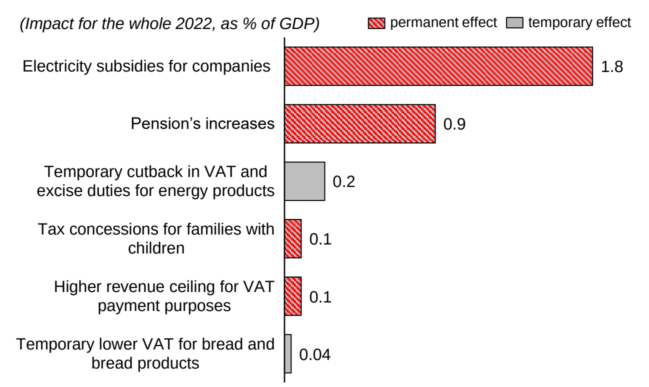
**The budget revision would not trigger large deficit widening**

To mitigate the impact of high inflation, fiscal measures amounting to BGN 2.1bn or 1.4% of GDP were proposed as part of the government's plan to revise the budget (see chart). This comes on top of electricity subsidies for companies, which would cost another 1.8% of GDP in 2022. Almost two-thirds of support would go to increasing pensions, which is positive, as high inflation hits pensioners harder than any other group in society. However, there were some controversial proposals, such as the temporary reduction of VAT on bread, which gained government backing despite being heavily criticized as untargeted and regressive. We think that most measures are justified and properly targeted. The size of the measures have been calibrated such so as not to lead to exceeding the budget deficit target this year. Essentially, the measures will return to the households and companies the revenue windfall triggered by inflation, which is set to exceed significantly the level in the initial budget forecast. At the same time, public capex remains forecast at a very ambitious 5.3% of GDP, which leaves room for adjustment in the rest of the year, in case other needs emerge or some risks materialize.

**RESHUFFLING OF SPENDING PRIORITIES TO CONTINUE**




**FISCAL SUPPORT MEASURES TO REACH 3.2% OF GDP IN 2022**




Source: Eurostat, National Statistical Institute, MoF, UniCredit Research

## The government looks set to meet its deficit target in 2022

**Government likely to meet its deficit target**

Our forecast from April that the Russia-Ukraine conflict would push sovereign funding needs higher and the budget deficit wider has failed to materialize for the time being.

**Better-than-expected budget position so far this year**

Instead, a small budget surplus equivalent to 0.4% of GDP was posted in May, compared to a deficit of 0.1% one year before. This reflects a number of developments, with the most important being higher-than-expected inflation pushing VAT and excise rate-related fiscal revenue higher. Limited public sector wage increases so far this year and the budget-neutral design of the electricity subsidies for firms further contributed to this favorable budget balance outcome.

**But spending is set to increase in 2H22**

However, fiscal measures to contain the negative impact of high inflation and some selective increases in public-sector wages are likely to push expenditure higher in 2H22 by an amount equivalent to slightly more than 2% of GDP. Nevertheless, we think that the budget deficit this year will be only a notch higher than the targeted 4.1% of GDP on a cash basis. This is because elevated inflation will continue to push VAT and excise duty-related revenues higher, while, at the same time, public capex is likely to fall short of the 5.3% of GDP target set in the budget.

**Public capex to act as a buffer to contain deficit widening**

**Providing fiscal support without adding to inflationary pressure**

Lower-than-targeted public capex are likely to reflect a combination of two main factors. First, capex is lagging the plan, as suggested by the 20% yoy drop in public capex so far this year, which comes against the backdrop of weak performance in the prior year. This fuels concerns that the massive increase in planned public capex in 2022 is not in line with the absorption capacity of public sector institutions responsible for the projects' implementation. Second, policymakers will need to strike a reasonable balance between supporting low-income households in the context of war-induced inflation, while, at the same time, not fueling inflationary pressure too much further to avoid putting euro adoption at risk. This may warrant some cutback in public capex, in our view, to keep the budget deficit close to the target.

**New debt issuance likely to total BGN 8.7bn this year**

To meet funding needs, we expect BGN 1.0bn of bonds to be issued on the domestic market, on top of BGN 1.8bn already issued so far this year. In addition, we expect EUR 3.0bn to be issued externally, bringing total debt issuance to BGN 8.7bn this year.

**GOVERNMENTAL GROSS FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **2.6** | **5.0** | **4.9** |
| Budget deficit | 2.0 | 3.4 | 3.2 |
| Amortization of public debt | 0.6 | 1.6 | 1.7 |
| Domestic | 0.4 | 0.2 | 0.3 |
| Bonds | 0.4 | 0.2 | 0.3 |
| Bills | 0.0 | 0.0 | 0.0 |
| Loans/other | 0.0 | 0.0 | 0.0 |
| External | 0.2 | 1.4 | 1.4 |
| Bonds and loans | 0.0 | 1.3 | 1.2 |
| IMF/EU/other IFIs | 0.2 | 0.2 | 0.2 |
| **Financing** | **2.6** | **5.0** | **4.9** |
| Domestic borrowing | 1.9 | 1.4 | 1.4 |
| Bonds | 1.9 | 1.4 | 1.4 |
| Bills | 0.0 | 0.0 | 0.0 |
| Loans/other | 0.0 | 0.0 | 0.0 |
| External borrowing | 1.7 | 3.1 | 3.1 |
| Bonds and loans | 0.5 | 3.0 | 3.0 |
| IMF/EU/other IFIs | 1.2 | 0.1 | 0.1 |
| Privatization/other | 0.0 | 0.0 | 0.0 |
| Fiscal reserves change (- =increase) | -1.1 | 0.4 | 0.5 |

**GROSS EXTERNAL FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **20.7** | **23.5** | **23.3** |
| C/A deficit | 0.3 | 2.3 | 1.9 |
| Amortization of medium- and long-term debt | 4.7 | 5.3 | 5.2 |
| Government/central bank | 0.2 | 1.4 | 1.4 |
| Banks | 0.8 | 0.8 | 0.9 |
| Corporates/other | 3.8 | 3.0 | 2.8 |
| Amortization of short-term debt | 15.7 | 15.9 | 16.3 |
| **Financing** | **20.7** | **23.5** | **23.3** |
| FDI (net) | 1.1 | 1.0 | 1.2 |
| Portfolio equity, net | -2.3 | 0.4 | -0.2 |
| Medium- and long-term borrowing | 6.2 | 5.5 | 5.3 |
| Government/central bank | 1.7 | 3.1 | 3.1 |
| Banks | 0.9 | 1.0 | 1.1 |
| Corporates/other | 3.7 | 1.4 | 1.2 |
| Short-term borrowing | 15.9 | 16.3 | 16.7 |
| EU structural and cohesion funds | 0.8 | 0.9 | 1.4 |
| Other | 2.6 | -3.1 | -1.6 |
| Change in FX reserves (- = increase) | -3.7 | 2.6 | 0.5 |
| Memoranda: | | | |
| Nonresident purchases of LC gov't bonds | 0.0 | 0.0 | 0.0 |
| International bond issuance, net | 0.5 | 1.8 | 1.8 |

Source: Bulgarian National Bank, Ministry of Finance, UniCredit Research

# Croatia

## Ba1 stable/BBB- stable/BBB positive*

### Outlook

The main event for Croatia in 2022 is the formal decision on eurozone accession, which is expected in July (11-12). This will be followed by intensified measures to implement conversion – technically and operationally. Stronger-than-expected growth so far this year, with signs of a solid outlook for tourism, has prompted us to increase our projection for 2022, to 4.1% (from 2.9%), while we cut our forecast for 2023 to 3.3% (from 4.5%). The latter is faced with higher uncertainties and risks as we revise our inflation outlook (up), private consumption (down), the external demand outlook (down) and the interest rate outlook (up in the eurozone). The driving factor for growth in 2023 should be investment funded by EU funds (final year to spend the remaining allocation from 2014-2020 budget) if spending follows the amount of projects contracted.

### Strategy

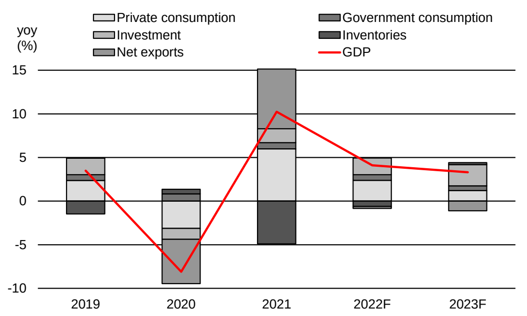
CROATI-Bund spreads could tighten again if the ECB manages to prevent fragmentation in eurozone bond markets.

**Author: Hrvoje Dolenec,** Chief Economist (Zagrebačka banka)

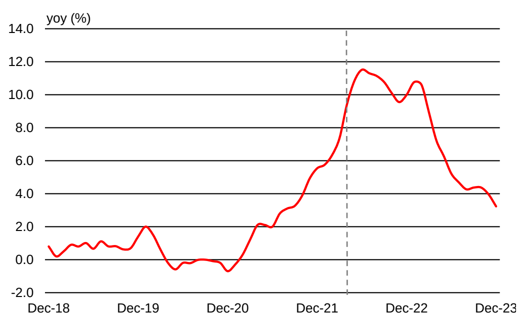
**KEY DATES/EVENTS**

- 11 July: Eurogroup meeting
- 12 July: Economic and Financial Affairs Council meeting
- 26 August: 2Q22 GDP
- 5 September: start of mandatory dual price presentation period (until the end of 2023)

**GDP GROWTH FORECAST**




**INFLATION FORECAST**




Source: Eurostat, CNB, Crostat, UniCredit Research

**MACROECONOMIC DATA AND FORECASTS**

| EUR bn | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 55.6 | 50.2 | 57.2 | 63.2 | 67.9 |
| Population (mn) | 4.1 | 4.0 | 3.9 | 3.9 | 3.8 |
| GDP per capita (EUR) | 13,677 | 12,410 | 14,718 | 16,332 | 17,643 |
| **Real economy, change (%)** | | | | | |
| GDP | 3.5 | -8.1 | 10.2 | 4.1 | 3.3 |
| Private consumption | 4.0 | -5.3 | 10.1 | 4.0 | 2.0 |
| Fixed investment | 9.8 | -6.1 | 7.6 | 9.3 | 11.3 |
| Public consumption | 3.3 | 4.1 | 3.1 | 3.0 | 2.5 |
| Exports | 6.8 | -22.7 | 33.3 | 9.9 | 7.7 |
| Imports | 6.5 | -12.3 | 14.7 | 10.2 | 9.6 |
| Monthly gross wage, nominal (EUR) | 1182 | 1224 | 1276 | 1362 | 1461 |
| Real wage, change (%) | 3.0 | 2.4 | 1.5 | -2.5 | 1.2 |
| Unemployment rate (%) | 6.6 | 7.5 | 7.6 | 6.9 | 6.1 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | 0.2 | -7.3 | -2.9 | -3.3 | -2.6 |
| Primary balance | 2.4 | -5.3 | -1.3 | -1.9 | -1.1 |
| Public debt | 71.1 | 87.3 | 79.8 | 75.4 | 72.8 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | 1.7 | -0.1 | 1.9 | 0.7 | -0.7 |
| Current account balance/GDP (%) | 3.0 | -0.1 | 3.4 | 1.1 | -1.0 |
| Extended basic balance/GDP (%) | 10.7 | 3.4 | 10.8 | 6.0 | 4.2 |
| Net FDI (% of GDP) | 6.1 | 1.3 | 5.0 | 1.7 | 1.7 |
| Gross foreign debt (% of GDP) | 72.4 | 79.8 | 77.9 | 71.9 | 69.1 |
| FX reserves (EUR bn) | 18.6 | 18.9 | 25.0 | 29.2 | 32.0 |
| Months of imports, goods & services | 7.8 | 9.3 | 9.8 | 9.6 | 9.1 |
| **Inflation/monetary/FX** | | | | | |
| CPI (pavg) | 0.8 | 0.1 | 2.6 | 9.5 | 6.0 |
| CPI (eop) | 1.4 | -0.7 | 5.5 | 10.1 | 3.2 |
| 3M money market rate (Dec avg.) | | | | | |
| USD/FX (eop) | 6.65 | 6.14 | 6.64 | 6.98 | EUR |
| EUR/FX (eop) | 7.44 | 7.54 | 7.52 | 7.53 | EUR |
| USD/FX (pavg) | 6.62 | 6.61 | 6.36 | 7.05 | EUR |
| EUR/FX (pavg) | 7.41 | 7.53 | 7.52 | 7.54 | EUR |

Source: Eurostat, CNB, UniCredit Research

*long-term foreign currency credit rating provided by Moody's, S&P and Fitch, respectively

## Euro adoption to shield against rising risks

**Croatia is awaiting formal decision to adopt the euro…**

**…after both the ECB and the EC gave the green light**

In a very uncertain environment, Croatia is awaiting the formal decision by the Eurogroup/Economic and Financial Affairs Council to adopt the euro on 1 January 2023. Both the European Central Bank's (ECB) and European Commission's (EC) convergence reports released at the beginning of June paved the way for the final decision. The ECB's assessment concluded that Croatia is within the reference values of the convergence criteria. The EC concluded that Croatia is ready to adopt the euro on 1 January 2023, bringing the number of euro area member states to twenty.

**The decision will be made on 11 and 12 July by the Eurogroup and Economic and Financial Affairs Council, followed by the ECB's decision on the conversion rate**

The meetings of the Eurogroup and Economic and Financial Affairs Council are scheduled for 11-12 July, just after the two-year period of ERM II participation expires. This should be followed by the ECB's decision on the conversion rate (to be used on 1 January 2023), which should be the one defined for parity rate in ERM II - 7.5345 HRK for 1 EUR. After the decision, Croatia will enter a period during which it will have to implement measures to allow for technical and operational conversion. As of 5 September, prices will have to be displayed both in kuna and in euro to allow consumers to compare prices and prevent goods & services providers from introducing inappropriate and unfair changes in prices – one of the instruments to be used to prevent unjustified price hikes, however this will be challenging in an environment of rising consumer prices.

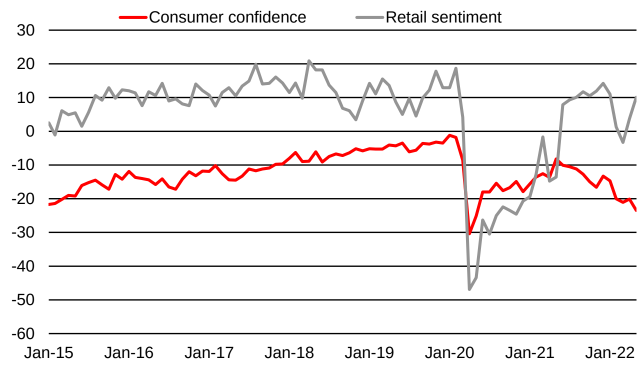
**A strong start to the year prompted us to increase our forecasts for 2022 to 4.1% and to cut the estimate for 2023 to 3.3%**

The Croatian economy had a strong start to 2022, with significant carryover from 2021 (1.8pp) and growth (7% yoy) in 1Q22 driven by personal consumption, investment and exports. We have therefore increased our growth expectations for 2022 to 4.1% from 2.9%. In 2022, we still expect strong demand in tourism. The year-to-date performance combined with bookings for the main season still point to a strong tourism contribution this year, as the impact of quickly rising inflation on real income and confidence has not yet affected tourism arrivals. Tourism contributes around 15-17% of GDP, thus every 10% increase in tourism real growth results in around 1.5pp of GDP growth. So far, our growth projection for 2022 is faced with upside risk if the season performs above our baseline expectations (a repeat of 2021 results). However, there is the risk of a move in the opposite direction after the tourist season ends (in 4Q22) when real incomes drop (the effect of inflation) and external demand deceleration will have a bigger impact on economic activity.

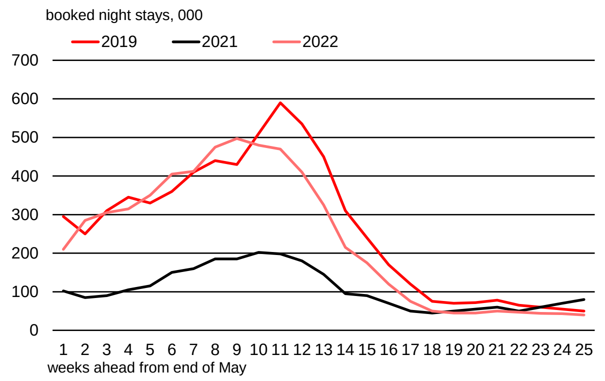
**The outlook for end of 2022 and whole 2023 faces many challenges due to the worsening environment, with the effective and efficient absorption of EU funds becoming crucial for growth performance in 2023**

Short-term prospects for growth significantly deteriorated for next year when investment performance becomes the main growth factor, especially with accelerated spending of EU funds in 2023. Most of this investment should be funded by unspent allocations from the 2014-20 budget, which is eligible for spending until the end of 2023. This may keep the growth above 3% yoy in 2023 despite declining domestic private demand and likely weaker external demand (mainly on the goods side as tourism may still find some support when Croatia joins the eurozone and the Schengen area in 2023, with the latter, however, still not confirmed).

**WHILE CONSUMER SENTIMENT IS WEAKENING…**




**…RETAIL AND TOURISM IS STILL POSITIVE**




Source: EC, HNB, AirDNA, UniCredit Research

**The inflation outlook is deteriorating, with increased pressure on food & energy prices on the global market, while Croatia is adopting the euro in such an environment…**

The deteriorated growth outlook, with food & energy prices rising, inflation remaining at elevated levels in 2023, while interest rates rise and financial conditions worsen, will weigh heavily on the Croatian economy. The inflation outlook has worsened with inflation entering the double-digit area; it is not expected to start declining until 2023 when food and energy prices are estimated to start to ease. The euro conversion process will not be a supporting factor as it also, albeit modestly, tends to increase some parts of the consumer basket, likely prices for services, thus further impacting the perception of inflation.

**The government introduced a significant package to mitigate the impact of inflation…**

Inflation is tackled by the government package introduced in April, estimated at 1% of GDP, while the government is also trying to lower the impact of rising oil prices on automotive fuel. As part of the package, the government introduced measures to counter the increase in electricity prices (fees for electric energy limited), gas prices (cut in VAT + subsidies per consumption), some solid fuels (VAT cut) and food products (VAT cut). With respect to automotive fuels, the government cut excise taxes and limited dealer margins to contain price increases.

**…but also to support small businesses and farmers**

The overall package to address rising prices also includes subsidies to companies (with energy consumption below a defined limit), the agricultural and fishing sector (due to the rising cost of energy) and socially vulnerable groups (low-income households and pensioners). Moreover, the government decided to raise wages in the public sector (4% since May) and increase pensions (in 2022 in two cycles, so far 2.2% in 1H, another 5-6% in 2H).

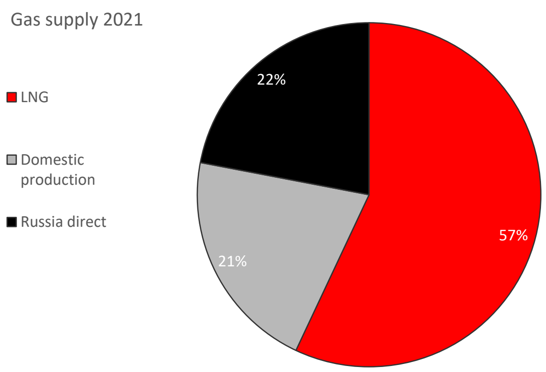
**Afterwards, the government introduced budget amendments to address both rising revenues and spending but keeping the deficit in line with the 3% mark**

Enjoying the increase in revenue due to the inflation effect, the government made budget amendments in May, adjusting not only revenues (up 4% on inflation effects and new tourism projections), but also expenditures (by 6.3%) to address the gap in the health sector, the package of subsidies and the adjustments in wages and pensions for 2022. Although the target for the government deficit remains just below 3% of GDP, due to the series of new decisions on expenditures and support announced for its citizens after the budget amendments were approved, and despite a solid tourism season effect on revenues, we project it to be moderately above 3%.

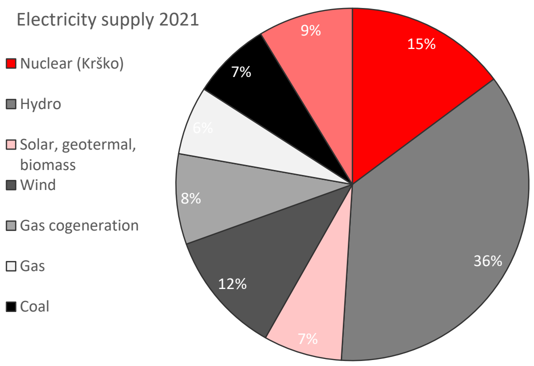
**As a result of energy price increases, energy sector investments became an interesting topic for the government**

The energy price increase raised another important topic – energy sector investments in Croatia. Although most of the attention is focused on renewable energy (solar, wind, hydro energy), where a number of projects are in pipeline – a few other projects are moving into focus in the current environment. Croatia activated an LNG terminal in 2021. This may lower (if used for domestic purposes only) its dependency on gas imports from Russia (but not completely as long as storage capacities are not increased to meet peak consumption in the winter). Furthermore, there are discussions about increasing its capacity for storage and transshipment, due to increased demand from neighboring countries. The second big project, still in negotiation, is the construction of a second bloc at the nuclear power plant Krško in Slovenia (close to HR-SI border), which is a joint venture between the Croatian and Slovenian national electricity companies. While this is a long-term project, it may contribute to covering the demand for energy and to moving away from fossil fuel-based power plants in the future.

**CROATIA AIMS TO DIVERSIFY ITS SOURCES OF GAS…**




**…AND INCREASE ITS PRODUCTION OF ELECTRICITY**




Source: Eurostat, Crostat, Ministry of Economy and Sustainable Development

# CROATI suffering from spillovers from the eurozone periphery

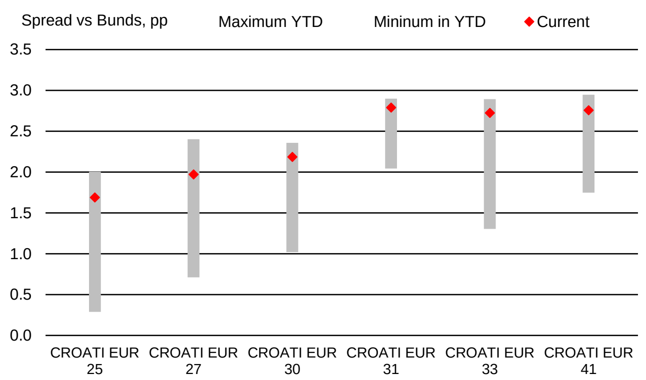
**Croatian bonds affected by contagion from eurozone periphery in 2Q22…**

CROATI spreads to Bunds widened in 2Q22 amid a general loss in risk appetite for European bonds. CROATI-Bund spreads are currently close to all time-highs, continuing not to price the approaching euro adoption. There has been some contagion from the eurozone periphery, with correlation to BTPs increasing recently. However, this correlation appears too high after the ECB vowed to prevent fragmentation in eurozone bond markets.

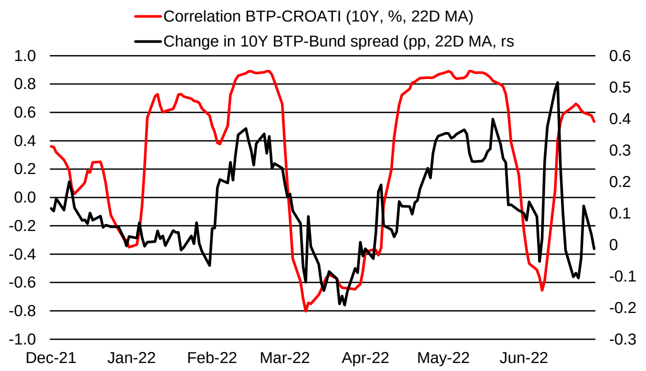
**…could benefit if the ECB prevents fragmentation in eurozone bond markets**

If the ECB manages to stabilize yields in the eurozone by preventing fragmentation in bond markets, CROATI should start reversing some of the recent spread widening.

**SPREADS TO BUNDS CLOSE TO ALL-TIME HIGHS**




**HIGHER CORRELATION TO EUROZONE PERIPHERY**




Source: Croatian ministry of finance, Bloomberg, UniCredit Research

**GOVERNMENT GROSS FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **9.0** | **10.6** | **9.5** |
| Budget deficit | 1.6 | 2.1 | 1.8 |
| Amortization of public debt | 7.3 | 8.5 | 7.8 |
| Domestic | 5.5 | 6.6 | 6.0 |
| Bonds | 0.8 | 2.0 | 1.5 |
| Bills | 3.1 | 3.2 | 3.2 |
| Loans | 1.6 | 1.4 | 1.3 |
| External | 1.9 | 1.9 | 1.8 |
| Bonds and loans | 1.8 | 1.8 | 1.7 |
| IMF/EU/other international financial institutions | 0.1 | 0.1 | 0.1 |
| **Financing** | **9.0** | **10.6** | **9.5** |
| Domestic borrowing | 5.4 | 7.2 | 6.5 |
| Bonds | 1.2 | 2.7 | 1.8 |
| Bills | 3.2 | 3.2 | 3.2 |
| Loans | 1.0 | 1.4 | 1.5 |
| External borrowing | 3.5 | 3.3 | 3.0 |
| Bonds | 2.0 | 1.2 | 1.5 |
| IMF/EU/other international financial institutions | 1.5 | 2.1 | 1.5 |
| Privatization/other | 0.0 | 0.0 | 0.0 |

**GROSS EXTERNAL FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **11.0** | **11.8** | **10.0** |
| C/A deficit | -0.9 | 0.5 | 1.0 |
| Amortization of medium- and long-term debt | 4.9 | 4.3 | 4.1 |
| Government/central bank | 2.0 | 1.9 | 1.8 |
| Banks | 0.6 | 0.4 | 0.3 |
| Corporates/other | 2.3 | 2.0 | 2.0 |
| Amortization of short-term debt | 7.0 | 7.0 | 4.9 |
| Government/central bank | 0.6 | 2.0 | 0.9 |
| Banks | 2.4 | 2.4 | 2.0 |
| Corporates/other | 4.0 | 2.5 | 2.0 |
| **Financing** | **11.0** | **11.8** | **10.0** |
| FDI (net) | 1.5 | 1.1 | 1.0 |
| Portfolio equity, net | 0.4 | -0.3 | -1.0 |
| Medium and long-term borrowing | 5.4 | 5.3 | 4.9 |
| Government/central bank | 4.0 | 3.8 | 3.5 |
| Banks | 0.5 | 0.5 | 0.4 |
| Corporates/other | 0.9 | 1.0 | 1.0 |
| Short-term borrowing | 7.0 | 4.9 | 4.0 |
| EU structural and cohesion funds | 2.1 | 2.9 | 3.3 |
| Other | 0.2 | 0.4 | 0.0 |
| Change in FX reserves (= increase) | -5.6 | -2.5 | -2.2 |
| Memoranda: | | | |
| Nonresident purchases of LC gov't bonds | n.a. | n.a. | n.a. |
| International bond issuance, net | 0.9 | 0.7 | 0.8 |

Source: CNB, Croatian ministry of finance, UniCredit Research

# Czechia

**Aa3 stable/AA- stable/AA- negative***

## Outlook

Inflation could be the most important drag on economic growth in Czechia, which we see slowing to 1.5% in 2022 and 0.9% in 2023. We expect inflation to peak at between 16% and 17% yoy in 2H22 and to remain above target in 2023. Due to high inflation, the CNB may not start cutting rates until 3Q23. We expect FX interventions to be used only in times of market stress. Wage growth will react to high inflation with a considerable delay. As a result, private consumption is facing a sharp loss of momentum, a downtrend that might have started in 2Q22. Business investment is set to slow, and exports will be impeded from both the supply and the demand side.

## Strategy

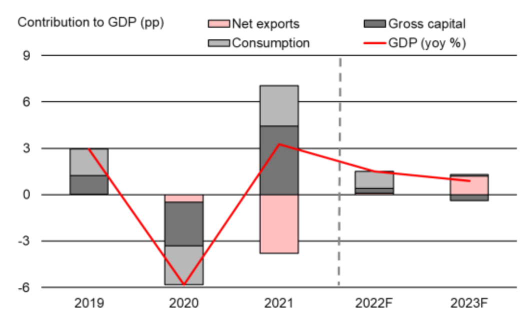
CZGBs could remain the best-performing local-currency bonds in CEE if monetary policy remains cautious.

**Author: Pavel Sobíšek,** Chief Economist (UniCredit Bank Czech Republic and Slovakia)

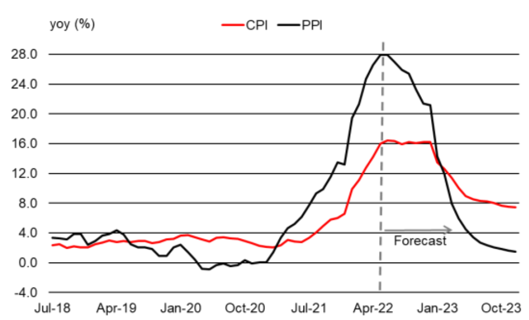
### KEY DATES/EVENTS

- 22 June, 4 August, 29 September: ČNB policy meetings
- 29 July, 30 August: 2Q22 GDP (flash, structure)
- 13 July, 10 August, 12 September: CPI
- 5 August: rating update from Moody's

### GDP GROWTH FORECAST




### INFLATION FORECAST




Source: CZSO, UniCredit Research

### MACROECONOMIC DATA AND FORECASTS

| EUR bn | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 225.7 | 215.4 | 238.6 | 271.5 | 287.3 |
| Population (mn) | 10.7 | 10.7 | 10.7 | 10.7 | 10.7 |
| GDP per capita (EUR) | 21,151 | 20,133 | 22,291 | 25,365 | 26,817 |
| **Real economy, change (%)** | | | | | |
| GDP | 3.0 | -5.8 | 3.3 | 1.5 | 0.9 |
| Private consumption | 2.6 | -6.8 | 4.3 | 1.8 | -0.5 |
| Fixed investment | 5.9 | -7.5 | 0.6 | 3.6 | 2.5 |
| Public consumption | 2.5 | 3.4 | 3.0 | 2.6 | 1.0 |
| Exports | 1.4 | -7.0 | 5.0 | -0.9 | 4.7 |
| Imports | 1.5 | -6.9 | 11.4 | -1.3 | 3.2 |
| Monthly wage, nominal (EUR) | 1347 | 1368 | 1478 | 1644 | 1769 |
| Real wage, change (%) | 5.0 | 1.4 | 1.0 | -6.6 | 0.4 |
| Unemployment rate (%) | 2.8 | 3.6 | 3.8 | 3.3 | 3.5 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | 0.3 | -5.8 | -5.9 | -5.0 | -4.0 |
| Primary balance | 1.0 | -4.8 | -6.2 | -4.1 | -3.0 |
| Public debt | 30.1 | 37.7 | 41.9 | 43.3 | 44.1 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | 0.7 | 4.3 | -2.0 | -10.9 | -9.4 |
| Current account balance/GDP (%) | 0.3 | 2.0 | -0.8 | -4.0 | -3.3 |
| Extended basic balance/GDP (%) | 3.1 | 5.1 | -0.3 | -2.9 | -1.9 |
| Net FDI (% of GDP) | 2.4 | 2.6 | 0.1 | 0.6 | 0.8 |
| Gross foreign debt (% of GDP) | 75.7 | 75.9 | 73.1 | 67.1 | 67.7 |
| FX reserves (EUR bn) | 133.4 | 135.4 | 153.3 | 159.5 | 161.0 |
| Months of imports, goods & services | 10.5 | 11.9 | 11.1 | 9.6 | 9.4 |
| **Inflation/Monetary/FX** | | | | | |
| CPI (pavg) | 2.8 | 3.2 | 3.8 | 14.8 | 9.3 |
| CPI (eop) | 3.2 | 2.3 | 6.6 | 16.2 | 7.4 |
| Central bank target | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Central bank reference rate (eop) | 2.00 | 0.25 | 3.75 | 7.00 | 5.00 |
| 3M money market rate (Dec avg.) | 2.18 | 0.35 | 3.50 | 7.15 | 5.05 |
| USD/FX (eop) | 22.62 | 21.39 | 21.95 | 23.06 | 22.12 |
| EUR/FX (eop) | 25.41 | 26.25 | 24.86 | 24.90 | 25.00 |
| USD/FX (pavg) | 22.93 | 23.20 | 21.68 | 23.08 | 22.70 |
| EUR/FX (pavg) | 25.67 | 26.44 | 25.65 | 24.70 | 25.20 |

*long-term foreign-currency credit rating provided by Moody's, S&P and Fitch, respectively

## Crossing the pain threshold

**GDP growth could slow further in 2H22**

Signs are mounting that economic activity has been gradually weakening. In our view, GDP growth could weaken further in 2H22. Households are facing a considerable loss of real income, as inflation rises further and is likely to be stickier than previously hoped. Business investment is set to slow, as companies are hesitant to start new projects in an environment of weaker economic activity (except perhaps in residential building and energy saving). Exports will be impeded from the supply side by the ongoing value-chain disruption in the automotive industry and from the demand side by deteriorating business confidence in Europe. Czech exports to Russia declined by 78% yoy in CZK terms in March-April and we expect them to remain low. Furthermore, GDP will cease to receive support from inventory accumulation. A drawdown of inventories seems inevitable as borrowing costs rise, although its pace remains uncertain.

**Inflation is seen as the most important drag on economic growth…**

Inflation is viewed as by far the most important drag on economic growth. In the production sphere, price pressure is dominated by energy, but double-digit growth is being observed across the board. With prices of inputs at the start of the production chain rising sharply, the passthrough to more sophisticated products could be protracted. Meanwhile, a second wave of price increases seems to be being driven by crude oil. Also importantly, the prices of some agricultural commodities (such as grain and cooking oil) have climbed by more than 40% yoy, adding pressure from a section of PPI that has been more muted in the past. Companies have initially been successful in passing on higher costs to their customers without much delay. We expect the process to slow over time as end customers become more reluctant to accept price hikes.

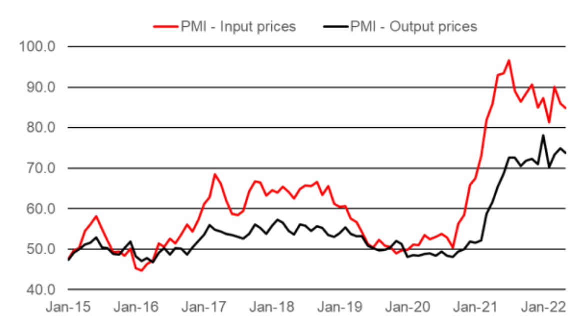
**…being driven by European-wide shocks and country-specific factors.**

There are country-specific factors contributing to inflation, besides price pressure seen across Europe. Above all, these include the price categories clothing and footwear, and restaurants and hotels, which rose in May by 20.8% and 22.2% yoy, respectively – faster than anywhere else in the EU. What is also adding to current headline inflation, which currently stands at 16% yoy, is a relatively muted government response compared to Czechia's peers. The single measure adopted to date, a moderate excise tax cut on motor fuel, could theoretically knock down inflation by no more than 0.15pp. The government is considering introducing a special "savings" tariff on electricity and gas for households from this autumn, which has the potential to become a more visible (and more costly) brake on inflation.

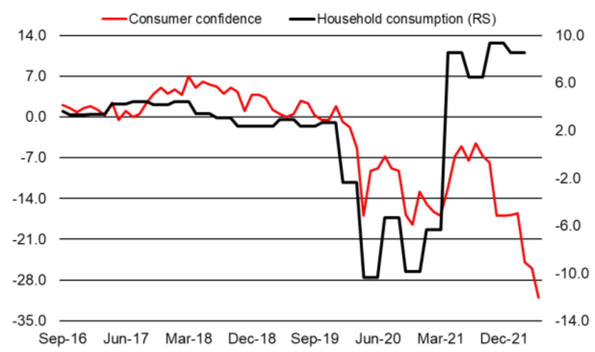
**Inflation will remain well above target in 2023**

Meanwhile, we expect CPI to tick up further in June, peaking at between 16% and 17% yoy. While in 2H22, the base effect will start working against a further rise, its power may just be sufficient to stabilize annual inflation, rather than bring it down. We now believe that inflation will remain well above target in 2023, as second-round effects of past price changes could combine with fresh shocks. However, as a substantial change, 2023 inflation will no longer be driven by demand, which will lead to it becoming more of a burden on GDP growth.

**A MAJORITY OF FIRMS ARE ABLE TO PASS ON HIGHER INPUT PRICES TO THEIR OUTPUT**




**CONSUMER CONFIDENCE IS LEADING HOUSEHOLD CONSUMPTION TO A SHARP ADJUSTMENT**




Source: CZSO, IHS Markit, UniCredit Research

**Wage growth will react to the inflation wave with a considerable delay**

Wage growth will react to higher inflation with a delay. First, a certain lag comes naturally from corporate policies. Second, the government seems to be actively slowing down wage bargaining in the public sector, pointing to the risk of a wage-inflation spiral. While the stance may come at a political cost, we think it will be effective in 2022, when we forecast real wages to fall by 6.6%. In 2023, real wage growth may turn marginally positive, as nominal wage growth is set to accelerate and inflation eases.

**Private consumption is facing a sharp loss of momentum**

As a result, private consumption is facing a sharp loss of momentum. Pent-up household demand could wane by the end of 3Q22, with growth in spending on holidays abroad being stronger than that for the purchase of goods. However, on a sequential basis, we count on a decline in consumption starting already in 2Q22. We expect the influx of Ukrainian refugees, accounting for roughly 2% of Czech population, to have a minor impact on spending (statistically reflected as exports of services) and employment. Most refugees who have found jobs are working part-time, bringing the number of job vacancies down without raising domestic unemployment. Finally, we need to stress that our GDP forecasts, at 1.5% for 2022 and 0.9% for 2023, assume that gas from Russia, albeit expensive, continues to flow in. Gas rationing, if implemented, could subtract several percentage points from economic growth in 2022-23, with Czechia being more dependent on gas consumption in the all-important heavy industry than its regional peers.

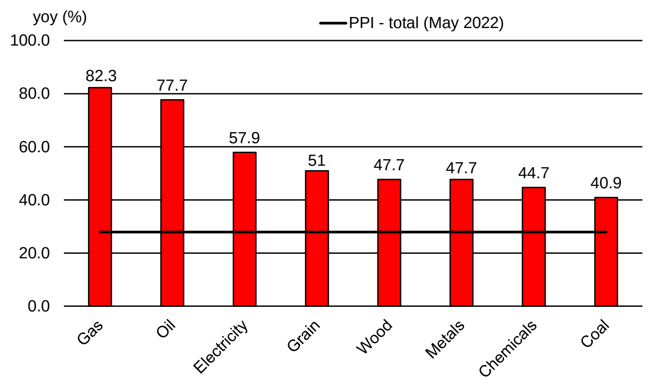
**CZK will be burdened by wider current account deficit and narrowing CZK-EUR interest rate spread**

A deterioration in 2023 GDP, even under our baseline scenario, would likely prevent the CZK from appreciating. In the same vein, the value of the koruna will have to factor in a wider C/A deficit and a narrowing CZK-EUR interest rate spread if the ECB starts tightening. Our revised view of CZK value is at odds with the ČNB's policy assumptions, questioning the timing of a reversal in monetary policy. Currently, we are calling for a first rate cut in 3Q23. It is also uncertain whether the June 2022 repo rate level, at 7%, represents the peak. The ČNB's forecast assumptions will likely need to be tweaked to stop indicating the need for more tightening. Finally, we expect the ČNB to employ FX interventions in times of market stress but not as a long-term tool to tame inflation.

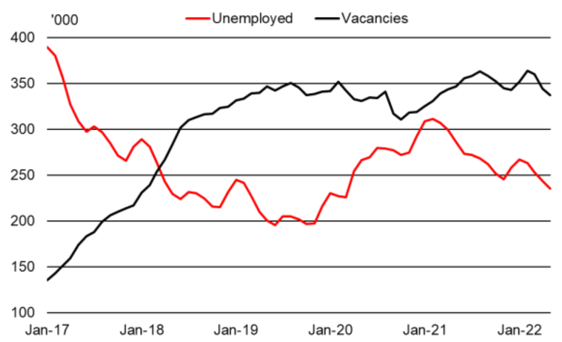
**Fiscal consolidation will slow, and long-term government reforms are unlikely**

Czechia will take over the presidency of the Council of the European Union in 2H22 and the government may have to focus less on domestic policy issues. However, our impression from 1H22 is that the executive might have been changing as little as possible from the current policy setting or interfering as little as possible with market forces. Whether this is going to be a winning strategy in the medium-term, remains to be seen. For the moment, our takeaway is twofold. First, fiscal consolidation will slow and may stop entirely in the second half of the election cycle (2023-24). Second, we are becoming more skeptical about the political focus and will to implement long-term government reforms, such as pension and health care financing.

**PRODUCER PRICES ARE PULLED UP MAINLY BY COMMODITY PRICES**




**LABOR MARKET REMAINS TIGHT, WITH WAR REFUGEES REDUCING JOB VACANCIES BY A SMALL PERCENTAGE**




Source: Czech Fiscal Council, CZSO, UniCredit Research

## Demand for CZGBs needs vigilant monetary policy

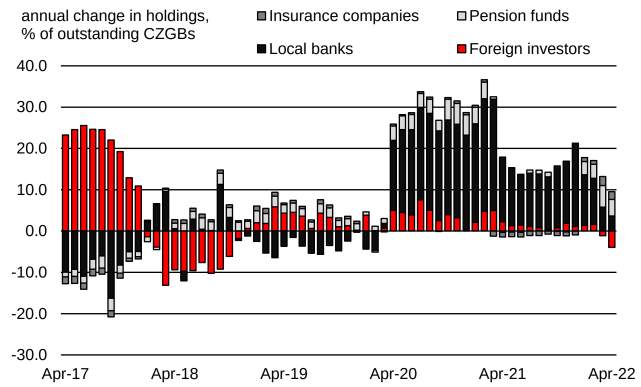
**Strong local support for CZGBs a reason for outperformance**

CZGBs outperformed other CEE bonds this year. Local support from both buy-side and sell-side investors easily covered a decline in foreign interest in 2Q22. Czech banks have around 10% of assets in CZGBs, a significantly lower proportion than in neighboring countries. Thus, the scope for additional bond purchases remains high, especially if inflation starts falling in 2H22.

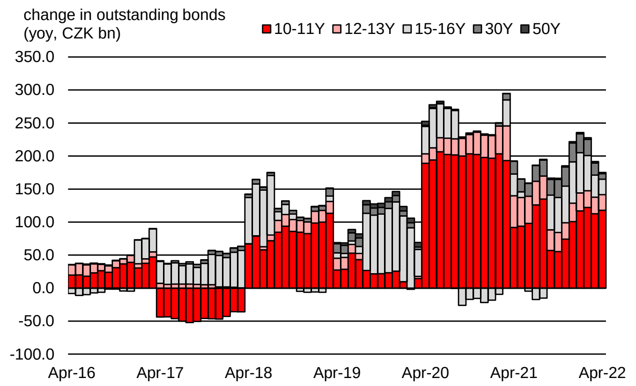
**CZGBs remain our top pick in Central Europe**

The main risk to GZGBs stems from a potential dovish shift in monetary policy. While we believe that such a shift would be contained by market reactions (CZK depreciation and rising yields), the uncertain stance of several new MPC members has led investors to become more cautious. We do not expect the CNB to cut rates into the ECB's and the Fed's rate hike cycle. The Czech MPC has a long tradition of observing staff projections and acting proactively to tame monetary and financial risks. Pending proof of similar behavior, we expect CZGBs to remain the best-performing local-currency bonds in CEE in 3Q22.

**DOMESTIC INVESTORS DRIVE DEMAND FOR CZGBS**




**THE LONGEST DURATION OF NEW ISSUANCE IN CEE**




Sources: ČNB, Bloomberg, UniCredit Research

**GOVERNMENT GROSS FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **22.2** | **23.7** | **20.8** |
| Budget deficit | 14.1 | 13.6 | 11.5 |
| Amortization of public debt | 8.1 | 10.1 | 9.3 |
| Domestic | 6.1 | 7.4 | 9.3 |
| Bonds | 5.0 | 5.9 | 8.3 |
| Bills | 1.0 | 1.4 | 1.0 |
| Loans | 0.1 | 0.1 | 0.1 |
| External | 2.0 | 2.7 | 0.0 |
| Bonds and loans | 2.0 | 2.7 | 0.0 |
| IMF/EU/Other IFIs | 0.0 | 0.0 | 0.0 |
| **Financing** | **22.2** | **23.7** | **20.8** |
| Domestic borrowing | 22.0 | 23.2 | 20.3 |
| Bonds | 20.5 | 22.1 | 19.7 |
| Bills | 1.3 | 1.0 | 0.5 |
| Loans | 0.1 | 0.1 | 0.1 |
| External borrowing | 0.2 | 0.5 | 0.5 |
| Bonds | 0.2 | 0.5 | 0.5 |
| IMF/EU/Other IFIs | 0.0 | 0.0 | 0.0 |
| Privatization/Other | 0.0 | 0.0 | 0.0 |

Source: ČNB, MoF, CZSO, UniCredit Research

**GROSS EXTERNAL FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **104.0** | **125.5** | **133.1** |
| C/A deficit | 2.0 | 10.9 | 9.4 |
| Amortization of medium and long term debt | 9.6 | 8.3 | 5.5 |
| Government/central bank | 4.7 | 4.3 | 3.3 |
| Banks | 2.4 | 1.8 | 0.9 |
| Corporates/other | 2.5 | 2.2 | 1.3 |
| Amortization of short-term debt | 92.4 | 106.3 | 118.2 |
| Government/central bank | 6.1 | 9.8 | 14.0 |
| Banks | 52.9 | 58.5 | 62.1 |
| Corporates/other | 33.4 | 38.1 | 42.1 |
| **Financing** | **104.0** | **125.5** | **133.1** |
| FDI (net) | 0.2 | 1.6 | 2.4 |
| Portfolio equity, net | -3.8 | -2.0 | -1.6 |
| Medium and long-term borrowing | 5.9 | 10.3 | 8.9 |
| Government/central bank | 1.0 | 6.3 | 6.7 |
| Banks | 2.4 | 1.8 | 0.9 |
| Corporates/other | 2.5 | 2.2 | 1.3 |
| Short-term borrowing | 116.3 | 118.2 | 120.3 |
| EU structural and cohesion funds | 3.3 | 3.6 | 3.6 |
| Other | 0.0 | 0.0 | 1.0 |
| Change in FX reserves (- = increase) | -17.9 | -6.2 | -1.5 |
| Memoranda: | | | |
| Nonresident purchases of LC govt bonds | 0.8 | 5.8 | 6.2 |
| International bond issuance, net | 0.2 | 0.5 | 0.5 |

# Hungary

## Baa2 stable/BBB stable/BBB stable*

### Outlook

We expect economic growth at around 4.6% in 2022, helped by very strong consumer demand. Price caps and tax cuts could keep inflation below 13% for most of 2022, but Hungary is at risk of a wage-inflation spiral. An ambitious program of spending cuts is unlikely to reach its goals, threatening fiscal targets. We expect rate hikes to 9.5% in 2022 and FX interventions to slow HUF depreciation. Later this year, Hungary could reach a deal with the European Commission to unfreeze NGEU funds. Tighter financial conditions, negative real wage growth and export caps could slow GDP growth to around 2.8% next year. In 2023, the government faces a tradeoff between above-10% inflation and a budget deficit of around 5% of GDP.

### Strategy

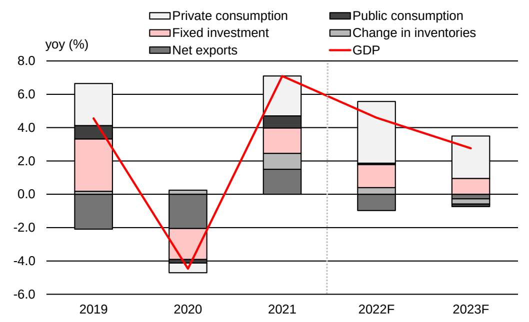
HGB yields could increase further in 2Q22 due to tighter monetary policy, FX volatility and large funding needs.

**Authors:**
**Dan Bucșa,** Chief CEE Economist (UniCredit Bank London)
**Ágnes Halász,** Head of Economics & Strategic Analysis (UniCredit Bank Hungary)

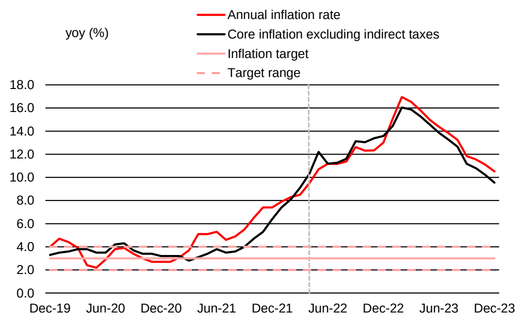
**KEY DATES/EVENTS**

- 8 July, 9 August, 8 September: CPI
- 26 July, 30 August, 27 September: monetary-policy decisions
- Every Thursday: 1W deposit rates
- 17 August, 1September: 2Q22 GDP (flash, structure)
- 22 Jul, 12 Aug, 23 Sep: rating updates from Fitch, S&P, Moody's

**GDP GROWTH FORECAST**




**INFLATION FORECAST**




Source: HCSO, UniCredit Research

**MACROECONOMIC DATA AND FORECASTS**

| EUR bn | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 146.1 | 137.5 | 154.1 | 172.5 | 187.0 |
| Population (mn) | 9.8 | 9.8 | 9.8 | 9.7 | 9.7 |
| GDP per capita (EUR) | 14,941 | 14,067 | 15,776 | 17,732 | 19,254 |
| **Real economy, change (%)** | | | | | |
| GDP | 4.6 | -4.5 | 7.1 | 4.6 | 2.8 |
| Private consumption | 5.0 | -1.2 | 4.6 | 7.2 | 4.8 |
| Fixed investment | 12.8 | -7.0 | 5.9 | 5.4 | 3.7 |
| Public consumption | 4.3 | -1.2 | 3.8 | 0.5 | -0.9 |
| Exports | 5.4 | -6.1 | 10.3 | 4.3 | 5.7 |
| Imports | 8.2 | -4.0 | 8.7 | 5.5 | 6.0 |
| Monthly wage, nominal (EUR) | 1131 | 1150 | 1224 | 1337 | 1460 |
| Real wage, change (%) | 7.6 | 6.2 | 3.4 | 4.7 | -0.5 |
| Unemployment rate (%) | 3.3 | 4.1 | 4.1 | 3.6 | 3.3 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | -2.1 | -7.8 | -6.8 | -5.2 | -4.1 |
| Primary balance | 0.1 | -5.5 | -4.4 | -2.6 | -1.4 |
| Public debt | 65.5 | 79.6 | 76.8 | 74.6 | 74.0 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | -1.0 | -1.4 | -4.5 | -10.2 | -9.4 |
| Current account balance/GDP (%) | -0.7 | -1.0 | -2.9 | -5.9 | -5.0 |
| Extended basic balance/GDP (%) | 1.4 | 2.9 | 1.3 | -1.9 | -1.1 |
| Net FDI (% of GDP) | 0.2 | 1.9 | 1.7 | 1.0 | 1.8 |
| Gross foreign debt (% of GDP) | 96.9 | 149.5 | 153.9 | 141.1 | 128.4 |
| FX reserves (EUR bn) | 26.5 | 31.8 | 30.8 | 32.7 | 31.6 |
| Months of imports, goods & services | 2.7 | 3.6 | 3.0 | 2.6 | 2.2 |
| **Inflation/Monetary/FX** | | | | | |
| CPI (pavg) | 3.6 | 3.3 | 5.1 | 11.1 | 14.2 |
| CPI (eop) | 4.0 | 2.7 | 7.4 | 13.2 | 10.8 |
| Central bank target | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Central bank reference rate (eop) | 0.90 | 0.60 | 2.40 | 9.50 | 6.50 |
| 3M money market rate (Dec avg) | 0.16 | 0.75 | 3.80 | 9.60 | 6.70 |
| USD/FX (eop) | 294.7 | 297.4 | 325.7 | 362 | 357 |
| EUR/FX (eop) | 330.5 | 365.1 | 369.0 | 395 | 400 |
| USD/FX (pavg) | 290.7 | 308.0 | 303.1 | 351 | 359 |
| EUR/FX (pavg) | 325.4 | 351.2 | 358.5 | 381 | 397 |

Source: Eurostat, HCSO, NBH, UniCredit Research

*long-term foreign currency credit rating provided by Moody's, S&P and Fitch, respectively

## The fiscal conundrum

**The Fidesz-KDNP election win came at the cost of a large budget deficit**

On 3 April, the ruling Fidesz-KDNP coalition won a fourth consecutive parliamentary election. While we had expected this outcome, the winning margin and the resulting constitutional majority were surprising. The same can be said of fiscal spending before the elections: the budget deficit rose to 4.2% of GDP in May, while the 12-month rolling budget deficit was 11.1% of GDP, just 0.4% of GDP off the pandemic high. From here on, the government needs to tighten public spending or face further inflationary and financial pressure. The signs are ominous: the HUF the worst total return among floating EM currencies this year.

**A fiscal consolidation package of 3% of GDP consists of sectoral taxes…**

The government announced a fiscal consolidation package of around 3% of GDP. 40% (HUF 815bn) will come from sectoral taxes, a proof that Hungary's low taxation is not sustainable in times of economic stress. Almost three quarters of sectoral taxes will be paid by banks and energy companies, as the government believes that the two sectors benefit from large profits from past central-bank lending schemes and the spread between Brent and Urals oil prices, respectively. The rest of the adjustment comes from lower government spending: 1% of GDP from line ministries and 0.5% of GDP from public investment.

**…and hard-to-achieve spending cuts**

Spending cuts might be difficult to achieve for at least two reasons. First, the government wants to continue subsidizing utility and energy prices for companies and households. Since the start of 2010, the gap between European gas prices (the Dutch TTF) expressed in HUF and domestic retail gas prices exceeds 400%. While Hungary benefits from advantageous prices for Russian gas, import tariffs are likely to rise. The government estimates that its subsidy for retail gas prices costs around 2% of GDP. If subsidies are maintained at current levels, Hungary's medium-term fiscal adjustment could be achieved only by crowding out other types of spending, especially investment. Second, the prime minister increased the number of ministries that can spend independently, hardly a sign of thrift. Thus, budget deficits could be larger than the government expects in both 2022 (5.2% of GDP vs. 4.9% of GDP) and 2023 (4.1% of GDP vs. 3.5% of GDP). We expect public debt to fall to 74% of GDP next year.

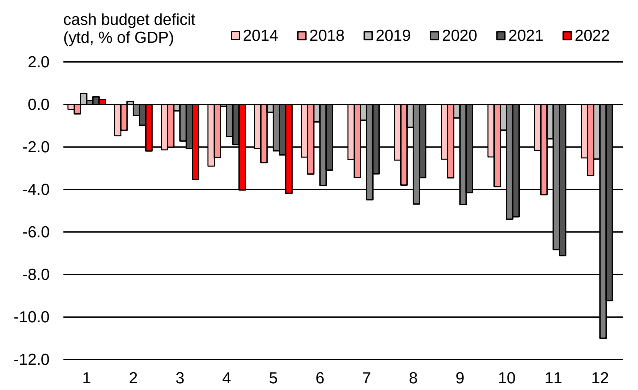
**Both public deficits and debt are likely to exceed plan**

**The economy could grow by around 4.6% in 2022 and less than 3% in 2023…**

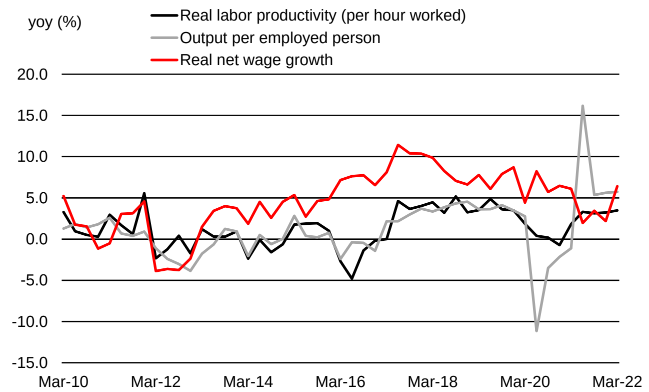
Even if fiscal spending adjusts from here on, economic growth is likely to be around 4.7% in 2022 due to the strong carryover from 2021 (4.4pp), frontloading in private consumption and strong building activity. Hungarian households still had around 4% of GDP in precautionary savings at the end of April, having spent just 0.6% of GDP from what they accumulated in 2020-21. This could prop the residential housing market, already the most overheated in CEE, and delay a potential spending slowdown brought about by higher inflation. In addition, real wage growth might remain positive this year due to tight labor-market conditions and government measures to cap inflation. Hungary is one of the few EU-CEE countries where labor shortages could cause a wage-inflation spiral. Thus, we expect the number of guest workers to shoot up.

**…spurred by strong consumer demand**

**2022: THE LOOSEST BUDGET EXECUTION IN THE FIDESZ ERA**




**REAL WAGE GROWTH ACCELERATED DESPITE INFLATION**




1Q22 real wage growth excludes the bonuses paid in February to public-sector workers.

Source: ministry of finance, HCSO, UniCredit Research

**Price caps lowered inflation by around 4.5pp**

Mindful of rising inflation expectations, the government imposed price caps on fuels and some. foodstuffs, temporarily cut some indirect taxes and did not raise regulated prices for energy and heating. As a result, authorities estimate that inflation is 4-5pp lower than in a free-price environment. In turn, these measures boosted demand and core inflation. The inflation outlook depends on whether the government will remove price caps and will raise gas and electricity prices next year. If both measures are implemented, inflation could end 2022 close to 13% and 2023 at around 10%, with core inflation at a similar level. If neither measure is implemented, inflation could end 2023 at around 7%, at the cost of a larger budget deficit of around 5% of GDP.

**2023: tradeoff between above-10% inflation and a larger budget deficit**

**The NBH could raise the key rate to around 8% by October**

The NBH is currently the most hawkish central bank in CEE, pledging to continue to raise rates in 2H22. We expect the policy rate to peak at around 9.5% in November. We expect more rate hikes and tighter financial conditions if the government fails to adjust the budget deficit in line with plans. If the NBH sees inflation returning close to target in 2024 amid negative fiscal impulses, it could cut the policy rate to around 6.5% in the second half of next year.

**Disinflation requires tighter fiscal policy**

Inflation will fall meaningfully only if fiscal policy tightens to slow the growth rate of real household income. However, this seems to run contrary to the government's priorities. Monetary policy has little leeway in curbing domestic demand because most mortgage and SME loans are paying fixed, subsidized interest rates. Tighter financial conditions could be more effective than rate hikes in curbing new lending. Household lending accelerated in spring, probably spurred by fixed-interest green mortgage loans.

**EUR-HUF could permanently climb above 400 in 2023, despite FX interventions**

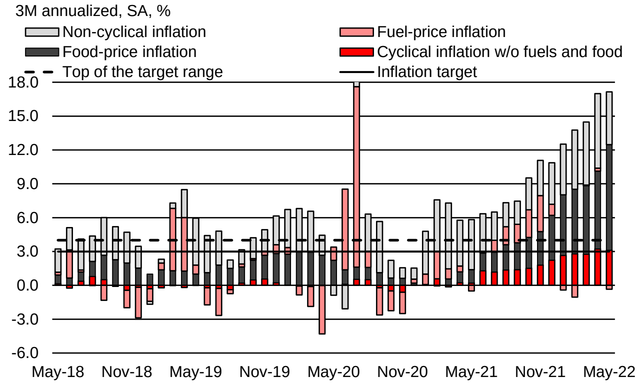
FX interventions are likely if EUR-HUF threatens to exceed 400 again. This could lead to more volatility in short-term rates. Next year, we expect EUR-HUF to move higher still, with a permanent breach of 400. The trade balance will continue to be affected by supply-chain bottlenecks, at least in 2022. If supply chains are restored to normal functioning, an inflow of foreign investment in automotive, electric batteries and durable goods could ensure that imports outpace exports even if commodity prices start to fall. Restrictions on exports of food, fertilizers and construction materials, as well as likely caps on fuel exports due to the competitive advantage from access to cheap Urals oil would further affect the trade balance. FDI and EU funds are not expected to cover the ensuing C/A deficit in 2022-23.

**Negative EBB in 2022-23**

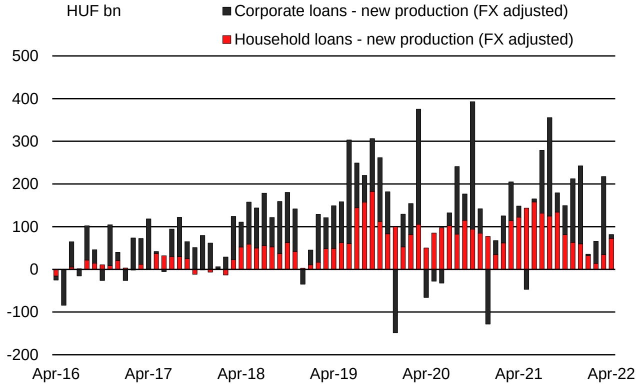
**Hungary and the EC could reach an agreement on NGEU funds before year-end**

Regular EU fund flows accelerated slightly in 2022 but could be stopped if the European Commission is unhappy with Hungary's progress in observing the rule of law, human rights, and more transparent and competitive tenders for EU-funded projects. Negotiations over RRF funding must be concluded this year for Hungary not to lose most NGEU funds. We expect a deal to be reached before year-end. The Hungarian government is likely to make concessions to unlock EUR 7.2bn in grants and EUR 9.7bn in loans, but disbursements could be interrupted if additional reforms are not implemented. We see EU funds contributing little to GDP growth.

**FOOD AND CORE PRICES DOMINATE INFLATION MOMENTUM**




**NEW HOUSEHOLD LENDING PICKED UP DESPITE RATE HIKES**




Source: HCSO, NBH, UniCredit Research

## HGB yields probably face another leg higher

**Demand for HGBs remains subdued…**

**…and more FX issuance is on the cards later this year**

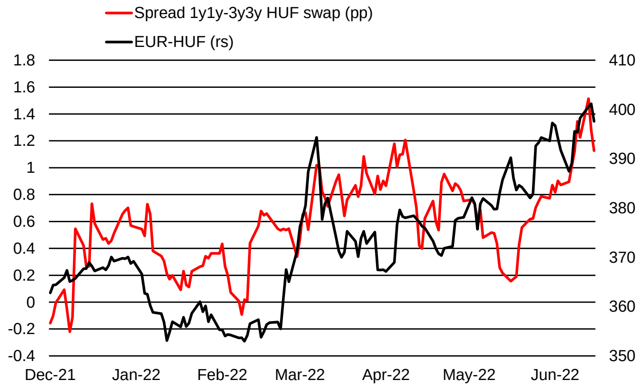
In 2Q22, the AKK continued to fall behind its issuance plan. Excluding bonds issued but not sold, HGB and HTB issuance reached around 40% of the official plan. Besides the delay in approving RRF disbursements to Hungary, we believe that limited appetite for HGBs was a strong reason for the NBH to issue three REPHUN bonds for the equivalent of EUR 3.5bn in June. We expect up to EUR 2bn in further external issuance before year-end.

**HGB yields are affected by pressure on the HUF and short-term rates…**

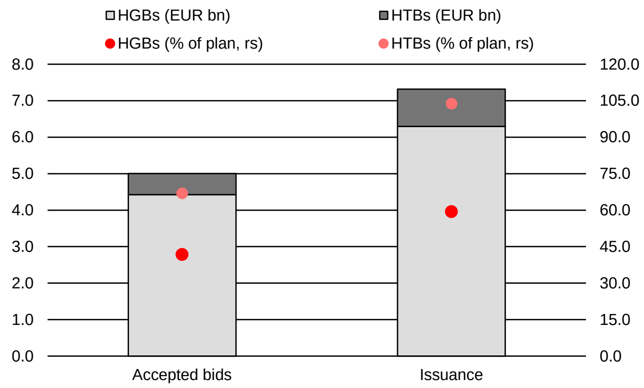
**…and by the cloudy inflation and fiscal outlook**

Additional NBH rate hikes and the need to sterilize liquidity to defend the HUF will probably lift HGB yields further. Local banks remain the largest buyer of bonds and they demand positive asset-swap spreads to increase their exposure (which returned to 15% of total assets in 2Q22). Pressure on the HUF could also lead to more volatility in short-term rates and reduce the appetite for HGBs for investors who prefer to hedge their currency exposure. It is difficult to argue for HGBs over REPHUNs given FX risks, unless the former sell off more or global risk appetite improves significantly. We think the latter is unlikely in 3Q22. If the government chooses to further cap inflation by keeping energy and gas prices unchanged, larger budget deficits could outweigh lower inflation in the investors' decision to avoid HGBs.

**HUF DEPRECIATION RAISES SHORT-TERM FUNDING COSTS**




**THE AKK SOLD 42% OF PLANNED HUF BONDS IN 1H22**




*only T-bills that mature in 2023

Source: Debt Management Agency, HCSO, UniCredit Research

**GOVERNMENT GROSS FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **33.9** | **30.5** | **27.4** |
| Budget deficit | 14.2 | 13.0 | 10.8 |
| Amortization of public debt | 19.7 | 17.5 | 16.6 |
| Domestic | 17.1 | 15.3 | 11.5 |
| Bonds | 8.7 | 6.8 | 5.2 |
| Bills | 1.8 | 1.5 | 2.3 |
| Loans & retail securities | 6.6 | 7.0 | 4.0 |
| External | 2.6 | 2.2 | 5.1 |
| Bonds | 1.7 | 1.6 | 2.9 |
| IMF/EU/Other IFIs | 0.9 | 0.6 | 2.2 |
| **Financing** | **33.9** | **30.5** | **27.4** |
| Domestic borrowing | 26.6 | 22.2 | 21.9 |
| Bonds | 13.7 | 10.6 | 11.0 |
| Bills | 1.8 | 2.3 | 1.9 |
| Loans & retail securities | 11.1 | 9.3 | 9.0 |
| External borrowing | 7.3 | 7.5 | 5.5 |
| Bonds | 6.3 | 6.0 | 3.0 |
| IMF/EU/Other IFIs | 1.0 | 1.5 | 2.5 |
| Change in fiscal reserves (- = increase) | 0.0 | 0.8 | 0.0 |

**GROSS EXTERNAL FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **25.4** | **25.6** | **32.0** |
| C/A deficit | 4.5 | 10.2 | 9.4 |
| Amortization of medium and long-term debt | 8.7 | 6.1 | 13.1 |
| Government/central bank | 3.5 | 1.7 | 6.9 |
| Banks | 3.7 | 2.9 | 3.7 |
| Corporates/other | 1.5 | 1.5 | 2.4 |
| Amortization of short-term debt | 12.3 | 9.4 | 9.6 |
| **Financing** | **25.4** | **25.6** | **32.0** |
| FDI (net) | 2.7 | 1.7 | 3.3 |
| Portfolio equity, net | -1.5 | -0.5 | 0.0 |
| Medium and long-term borrowing | 10.6 | 11.6 | 13.1 |
| Government/central bank | 6.4 | 7.3 | 6.9 |
| Banks | 2.8 | 2.6 | 3.4 |
| Corporates/other | 1.4 | 1.7 | 2.9 |
| Short-term borrowing | 9.4 | 9.6 | 10.6 |
| EU structural and investment funds | 3.9 | 5.1 | 4.0 |
| Change in FX reserves (- = increase) | 0.4 | -1.9 | 1.1 |
| Memoranda: | | | |
| Non-resident purchases of LC govt bonds | -0.9 | -0.2 | 1.4 |
| International bond issuance, net | 4.6 | 4.4 | 0.1 |

Source: NBH, Hungarian Ministry of Finance, UniCredit Research

# Poland

**A2 stable/A- stable/A- stable***

**Outlook:** We expect economic growth at 4.2% in 2022 and 2.8% in 2023, helped by consumption and investment. The government is expected to increase fiscal support ahead of parliamentary elections, which will be held in 4Q23. Government outlays, supply shocks and strong domestic demand could keep inflation in double digits for most of 2022-23. The NBP could try to stop hiking at 7% in October, but further tightening is needed if fiscal policy does not adjust. We expect the C/A deficit to widen to more than 2% of GDP in 2022-23, being fully covered by FDI and EU transfers. Poland could receive this year more than EUR 3bn in support for refugees and up to EUR 4.5bn in pre-funding from the RRF in late 2022 or early 2023.

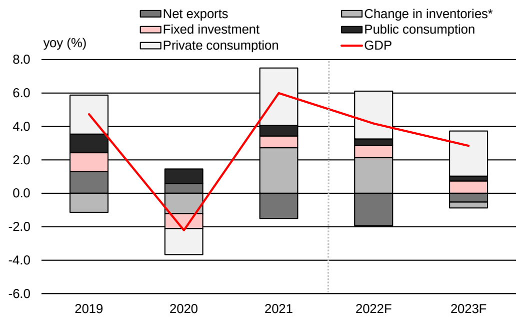
**Strategy:** Foreign demand for POLGBs could increase if inflation peaks in July, as we expect. The POLGB curve could invert further. The NBP has the firepower to keep EUR-PLN below 4.80 for most of 2022-23.

**Author: Dan Bucşa,** Chief CEE Economist (UniCredit Bank AG, London)

### KEY DATES/EVENTS

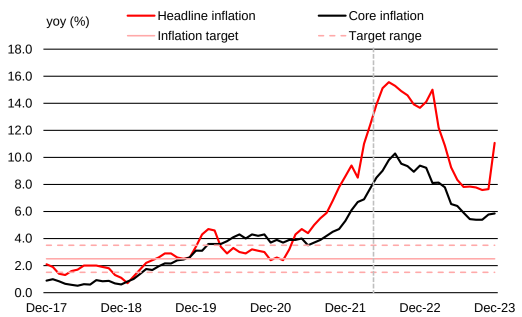
- 7 July, 7 September: monetary-policy decisions
- 1/15 Jul, 29 Jul/12 Aug, 31 Aug/16 Sep: CPI
- 22 July, 30 September: rating updates from Fitch and S&P
- 17/31 August: 2Q22 GDP (flash, structure)

### GDP GROWTH FORECAST




*adjusted to take into account statistical errors

### INFLATION FORECAST




Source: Statistics Poland, NBP, UniCredit Research

### MACROECONOMIC DATA AND FORECASTS

| EUR bn | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 533.7 | 526.4 | 574.1 | 656.3 | 736.9 |
| Population (mn) | 38.4 | 38.3 | 38.1 | 38.0 | 37.9 |
| GDP per capita (EUR) | 13904 | 13755 | 15077 | 17283 | 19460 |
| **Real economy, change (%)** | | | | | |
| GDP | 4.7 | -2.2 | 6.0 | 4.2 | 2.8 |
| Private consumption | 4.0 | -2.7 | 5.9 | 4.9 | 4.6 |
| Fixed investment | 6.1 | -4.8 | 3.9 | 4.1 | 4.2 |
| Public consumption | 6.5 | 5.0 | 3.4 | 2.2 | 1.6 |
| Exports | 5.2 | 0.0 | 11.8 | 3.4 | 5.5 |
| Imports | 3.0 | -1.2 | 15.8 | 7.0 | 6.5 |
| Monthly wage, nominal (EUR) | 1199 | 1215 | 1285 | 1427 | 1556 |
| Real wage, change (%) | 4.2 | 1.3 | 3.3 | 0.4 | 1.0 |
| Unemployment rate (%) | 5.4 | 5.9 | 6.0 | 5.1 | 4.7 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance (w/ PFR) | -0.7 | -6.9 | -1.9 | -4.0 | -4.0 |
| Primary balance (w/ PFR) | 0.5 | -5.7 | -0.9 | -2.9 | -2.8 |
| Public debt (w/ BGK and PFR) | 45.6 | 57.1 | 53.8 | 50.3 | 49.1 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | 2.5 | 15.3 | -3.5 | -13.7 | -18.2 |
| Current account balance/GDP (%) | 0.5 | 2.9 | -0.6 | -2.1 | -2.5 |
| Extended basic balance/GDP (%) | 4.4 | 7.3 | 4.6 | 2.3 | 1.6 |
| Net FDI (% of GDP) | 1.9 | 2.1 | 3.6 | 2.9 | 2.7 |
| Gross foreign debt (% of GDP) | 59.5 | 62.4 | 53.9 | 48.9 | 44.3 |
| FX reserves (EUR bn) | 103.3 | 112.8 | 128.1 | 130.5 | 137.8 |
| Months of imports, goods & services | 4.6 | 5.2 | 4.8 | 4.0 | 3.8 |
| **Inflation/monetary/FX** | | | | | |
| CPI (pavg) | 2.3 | 3.4 | 5.1 | 13.8 | 10.8 |
| CPI (eop) | 3.4 | 2.4 | 8.6 | 15.1 | 11.1 |
| Central-bank target | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 |
| Central-bank reference rate (eop) | 1.50 | 0.10 | 1.75 | 7.00 | 6.00 |
| 3M money-market rate (Dec. avg.) | 1.70 | 0.21 | 2.35 | 7.50 | 6.20 |
| USD/FX (eop) | 3.80 | 3.76 | 4.06 | 4.36 | 4.29 |
| EUR/FX (eop) | 4.26 | 4.61 | 4.60 | 4.75 | 4.80 |
| USD/FX (pavg) | 3.84 | 3.90 | 3.86 | 4.28 | 4.28 |
| EUR/FX (pavg) | 4.30 | 4.44 | 4.57 | 4.66 | 4.74 |

Source: Statistics Poland, NBP, UniCredit Research

*long-term foreign currency credit rating provided by Moody's, S&P and Fitch, respectively

## Pre-election largesse to hamper disinflation

**The pre-election answer to high inflation is more spending**

Parliamentary elections are more than a year away, but they loom large over politics and policies in Poland. The ruling United Right is still leading in opinion polls with around 35% of voting intentions but is down from the pre-pandemic highs of over 40%, which would help it to another parliamentary majority. The United Right's solid economic record, with GDP and household income growth, best tax collection in EU-CEE and promises of lower taxes on the worse-off should help it remain in power. However, high inflation threatens the government's popularity. The answer to this risk seems to be more spending and more inflation.

**The Anti-Inflation Shield could be maintained until after the elections**

In January, the government announced the Anti-Inflation Shield (AIS), a program including tax cuts on fast-rising prices, such as those for food, electricity, natural gas and fuels, but also subsidies. The program was supposed to run until the end of July but has been steadily beefed up and extended until the end of October. The government estimates that the AIS has lowered inflation by 1.5-2pp. We believe that its tax-cut component has a bigger disinflationary impact, which is partly offset by its inflationary transfer component. With inflation momentum being the highest in Central Europe, especially in the cyclical component of core inflation, we expect the AIS to be kept in place until after parliamentary elections, which are expected on or before 17 November 2023. This may not prevent inflation from rising further.

**We expect inflation to end 2022 at around 13% and 2023 at 11%**

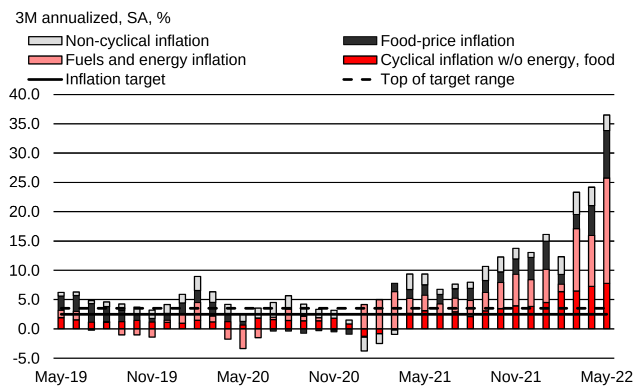
We expect headline inflation to peak above 15% in July and to decline to around 13% by the end of the year. Assuming that gas prices have increased by around 20% next year, inflation could fall into single digits between May and November, only to return above 11% (the highest in EU-CEE) if the AIS tax cuts are removed in December 2023.

**Fiscal handouts could multiply if inflation remains high…**

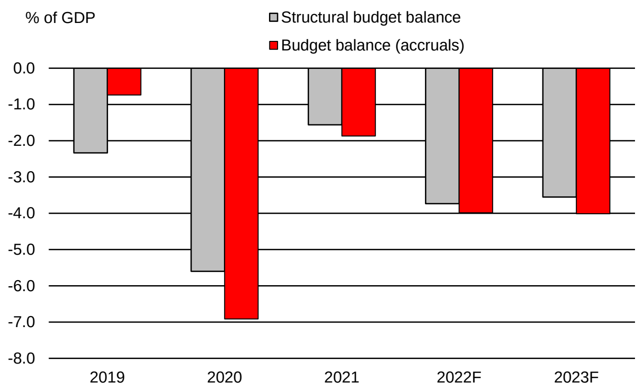
Inflation strength is a product of supply shocks, but also of strong demand underpinned by fiscal policy. In July, the government will cut the personal income tax from 17% to 12% for those earning at most PLN 30,000 a year, while increasing it to 32% for those earning more than PLN 120,000. Other tax deductions will target unmarried parents, children and SMEs, but a planned tax reduction for the middle class has been abandoned. Instead, the government will introduce more subsidies (the latest one to be announced, for coal, will cost around PLN 3bn in 2023). A fourteenth pension paid in November 2021 will be repeated in 2022 and probably also in 2023. If inflation fails to decline sharply next year, we expect cash handouts to multiply ahead of the elections. Thus, Poland's fiscal adjustment from 2021, when the budget deficit fell to 1.9% of GDP, is likely to be reversed this year, when we expect the budget deficit at around 4% of GDP. Some of the one-off spending items are becoming recurring and, as a result, we expect the budget deficit at around 4% of GDP also in 2023. High nominal GDP growth might push public debt below 50% of GDP by next year, preventing rating and outlook downgrades.

**…widening the budget deficit to around 4% of GDP in 2022-23**

**INFLATION MOMENTUM SPIKED AFTER UKRAINE WAS INVADED**




**FISCAL EASING AHEAD OF ELECTIONS**




Source: Statistics Poland, Ministry of Finance, NBP, Eurostat, UniCredit Research

**Poland will receive EUR 4.5bn in prefunding from the RRF in late 2022 or early 2023**

Higher spending will receive a boost from more transfers and loans from the EU and from IFIs. On 1 June, the European Commission finally endorsed Poland's application to receive RRF funding. The country applied for all available grants (EUR 23.9bn), but only for a third of available loans (EUR 11.5bn) under the RRF, despite loans having a smaller cost and a longer maturity than sovereign bonds. Prepayments of up to EUR 4.5bn (of which EUR 3.1bn in grants) could arrive later this year or in early 2023. The government expects more than EUR 6bn next year, but it may struggle to achieve all needed reforms to unlock the funds in an election year.

**At least EUR 3bn in funds to support Ukrainian refugees**

Poland can access the lion's share of the EUR 3.5bn the EU made available to support Ukrainian refugees and stands to receive EUR 2bn in loans from the EIB for the same reason. While the government estimates the costs for 2mn refugees at EUR 11bn, most of the expenses are borne by the private sector. Of the approximately 4.2mn Ukrainian refugees arriving in Poland, 1.2-1.5mn remain in the country. Of the 1.1mn eligible to work, around 240,000 found jobs, mostly part time. At the time of writing, there were more Ukrainians returning home than arriving in Poland, as the conflict became more localized.

**The NBP might try to end rate hikes in October, at 7%**

With fiscal policy continuing to fuel inflation, the NBP will have to continue hiking interest rates. However, the pace of rate hikes could fall as economic growth slows. We expect the policy rate to be taken to 7% by October, following signals from NBP President Adam Glapinski that the hiking cycle is nearing an end. This might not be enough to curb lending, with corporate loans continuing to accelerate. We believe that rate hikes remain a function of fiscal policy. If fiscal policy continues to boost domestic demand, the NBP's key rate should be in double digits. This is unlikely due to lower GDP growth ahead, but so are rate cuts in 2023 if inflation is high.

**We expect GDP growth at 4.1% in 2022 and 2.8% in 2023…**

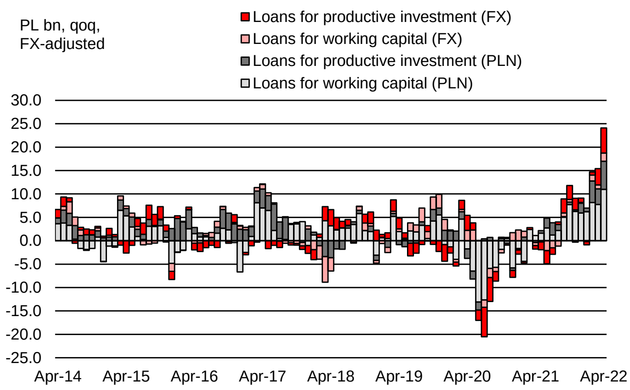
**…helped by consumption and investment**

Economic growth could decline gradually to 4.1% this year and to 2.8% in 2023. Consumption is likely to remain the biggest driver of growth, despite consumer pessimism. Real wage growth might dip below inflation this year, but tax cuts and handouts will supplement household income and keep core inflation at one of the highest levels in CEE. Construction will benefit from larger public investment, with the Sovereign Investment Fund prefunding projects that will eventually be covered from the RRF. Housing starts are slowing, but the real estate market could remain strong as investment alternatives in financial markets suffer from the global selloff. Lingering labor shortages raise the risk of a wage-inflation spiral.

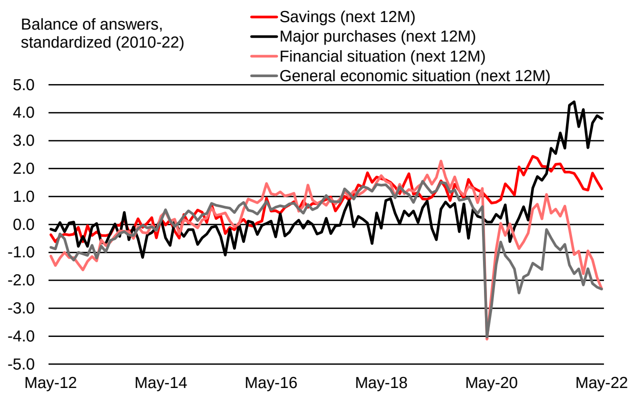
**Wider C/A deficit could be fully covered by FDI and EU transfers**

We expect the C/A deficit to widen further to 2.1% of GDP this year and 2.5% of GDP in 2023, despite the undervalued PLN, which supports exports. Persisting supply-chain bottlenecks might hamper exports this year and next, while imports will continue to grow at a fast pace as Poland has to replace Russian oil and gas from other (probably more expensive) sources.

**CORPORATE LOANS ARE ACCELERATING DESPITE HIKES**




**PESSIMISTIC CONSUMERS STILL INTEND TO SPEND A LOT**




Source: Statistics Poland, NBP, UniCredit Research

## End of rapid inflation rise could support POLGBs

**Demand for POLGBs could rise once inflation peaks in July**

As inflation approaches its peak, foreign investors are looking for an opportunity to buy more POLGBs. This could happen once inflation reaches its 2022 peak in July (with a potential short-term selloff after June inflation numbers). We see little pressure from the primary market, with Poland having completed more than three quarters of this year's issuance. The government has the equivalent of 3.7% of GDP in fiscal reserves. The NBP is unlikely to manage liquidity very tightly, even if it continues to hike. As a result, the swap curve and the bond yield curve could invert further.

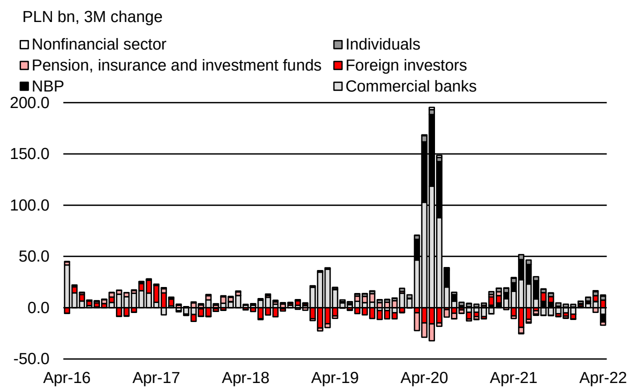
**EUR-PLN likely to mostly trade below 4.80 in the medium term**

We do not see major risks affecting the PLN, which remains undervalued. We expect FDI and EU transfers to fully cover the C/A deficit in 2022-23, thus providing a medium-term cap to EUR-PLN at around 4.80. The central bank also believes that the PLN is undervalued and has the firepower to intervene in FX markets if it needs to support the currency.

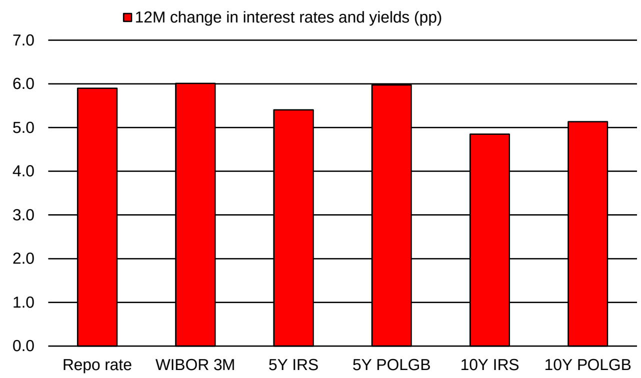
**At least EUR 1bn in additional FX bond issuance**

We expect the MinFin to issue at least EUR 1bn more on external markets, on top of the EUR 2bn issued in May.

**FOREIGN AND RETAIL INVESTORS ARE THE LARGEST BUYERS OF POLISH BONDS**




**CURVES LIKELY TO INVERT FURTHER IF THE NBP CONTINUES TO HIKE**




Source: Bloomberg, Ministry of Finance, UniCredit Research

**GOVERNMENT GROSS FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **34.9** | **45.3** | **53.9** |
| Budget deficit | 5.8 | 13.3 | 26.6 |
| Amortization of public debt | 29.1 | 32.0 | 27.3 |
| Domestic | 21.7 | 26.6 | 23.1 |
| Bonds | 17.0 | 23.5 | 20.1 |
| Bills | 2.4 | 0.0 | 0.0 |
| Loans/other | 2.4 | 3.1 | 3.0 |
| External | 7.4 | 5.4 | 4.2 |
| Bonds | 6.9 | 4.4 | 3.7 |
| Loans, IFIs, other | 0.5 | 1.0 | 0.5 |
| **Financing** | **34.9** | **45.3** | **53.9** |
| Domestic borrowing | 44.5 | 36.4 | 40.0 |
| Bonds | 38.4 | 30.7 | 35.0 |
| Bills | 0.0 | 0.0 | 0.0 |
| Loans/PFR/other | 6.1 | 5.8 | 5.0 |
| External borrowing | 2.5 | 7.0 | 11.5 |
| Bonds | 0.0 | 3.0 | 6.0 |
| Loans, IFIs, other | 2.5 | 4.0 | 5.5 |
| Change in fiscal reserves/other (-=increase) | -12.1 | 1.9 | 2.4 |

**GROSS EXTERNAL FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **104.5** | **119.3** | **124.8** |
| C/A deficit | 3.5 | 13.7 | 18.2 |
| Amortization of medium and long-term debt | 51.6 | 51.6 | 52.1 |
| Government/central bank | 9.1 | 7.8 | 6.2 |
| Banks | 16.1 | 15.4 | 14.6 |
| Corporates/other | 26.4 | 28.5 | 31.3 |
| Amortization of short-term debt | 49.4 | 54.0 | 54.5 |
| Financing | **104.5** | **119.3** | **124.8** |
| FDI (net) | 20.9 | 19.1 | 20.0 |
| Portfolio equity, net | -3.4 | -1.0 | 0 |
| Medium and long-term borrowing | 32.1 | 43.7 | 52.7 |
| Government/central bank | 3.0 | 13.2 | 20.3 |
| Banks | 8.1 | 7.7 | 7.3 |
| Corporates/other | 21.1 | 22.8 | 25.1 |
| Short-term borrowing | 50.5 | 55.3 | 54.2 |
| EU structural and cohesion funds | 9.3 | 9.5 | 9.8 |
| Other | 7.9 | -5.0 | -4.5 |
| Change in FX reserves (- = increase) | -12.8 | -2.4 | -7.3 |
| Memoranda: | | | |
| Nonresident purchases of LC gov't bonds | -1.2 | 4.2 | 7.4 |
| International bond issuance, net | -6.9 | -1.5 | 2.3 |

Source: Statistics Poland, NBP, UniCredit Research

# Romania

## Baa3 stable/BBB- stable/BBB- negative*

### Outlook

Large statistical revisions have forced us to raise our GDP growth forecast for 2022 to 4.3%, while leaving our nominal GDP forecast largely unchanged. After frontloading consumption in 1H22, consumers are expected to reduce spending and borrowing, while private investment could be limited to real estate and reinvested profits. The budget deficit might exceed 7% of GDP in 2022 and 5% in 2023, when GDP growth could slow to 2.8%. We expect inflation to peak above 15% in September, falling to around 14% by year-end and 9% in 2023, with core inflation 4pp lower. The NBR might hike to 6% and cap EUR-RON at 5.00 in 2022.

### Strategy

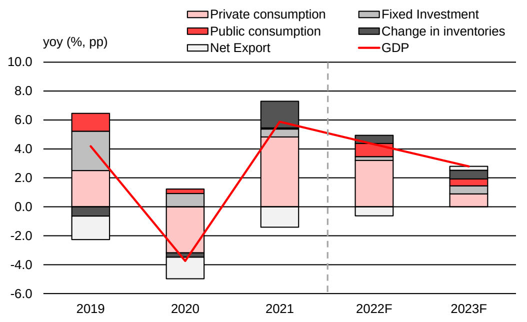
ROMGBs and ROMANIs can rally further if inflation peaks and issuance is more flexible.

**Authors:**
**Dan Bucșa**, Chief CEE Economist (UniCredit Bank London)
**Mihai Jugravu**, Economist (UniCredit Bank Romania)

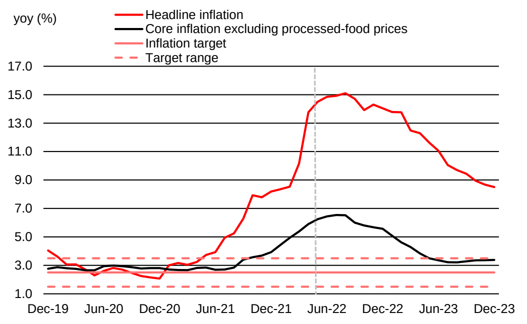
### KEY DATES/EVENTS

- 6 July, 5 August: monetary policy decisions
- 12 July, 11 August, 12 September: CPI
- No rating updates in 3Q22.
- 17 August, 7 September: 2Q22 GDP (flash, structure)
- August: potential budget revision

### GDP GROWTH FORECAST




### INFLATION FORECAST




Source: NIS, NBR, UniCredit Research

### MACROECONOMIC DATA AND FORECASTS

| EUR bn | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 223.2 | 218.9 | 240.2 | 275.3 | 301.5 |
| Population (mn) | 19.4 | 19.3 | 19.2 | 19.1 | 19.1 |
| GDP per capita (EUR) | 11,488 | 11,326 | 12,520 | 14,388 | 15,778 |
| **Real economy, change (%)** | | | | | |
| GDP | 4.2 | -3.7 | 5.9 | 4.3 | 2.8 |
| Private Consumption | 3.9 | -5.1 | 7.9 | 5.1 | 1.5 |
| Fixed Investment | 12.9 | 4.1 | 2.3 | 1.1 | 2.4 |
| Public Consumption | 7.3 | 1.8 | 0.4 | 5.2 | 2.9 |
| Exports | 5.4 | -9.4 | 12.5 | 7.4 | 4.8 |
| Imports | 8.6 | -5.2 | 14.6 | 7.8 | 3.8 |
| Monthly wage, nominal (EUR) | 1069 | 1116 | 1175 | 1310 | 1437 |
| Real wage, change (%) | 8.9 | 3.6 | 2.0 | -0.8 | 0.1 |
| Unemployment rate (%) | 4.9 | 6.0 | 5.6 | 5.5 | 5.4 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | -4.4 | -9.4 | -7.7 | -7.1 | -5.3 |
| Primary balance | -3.3 | -8.0 | -6.2 | -5.6 | -3.7 |
| Public debt | 35.3 | 47.2 | 48.8 | 49.6 | 50.4 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | -10.9 | -11.0 | -17.0 | -24.0 | -24.1 |
| Current account balance/GDP (%) | -4.9 | -5.0 | -7.1 | -8.7 | -8.0 |
| Extended basic balance/GDP (%) | -1.7 | -2.2 | -1.8 | -3.3 | -2.8 |
| Net FDI (% of GDP) | 2.2 | 1.4 | 3.0 | 3.2 | 3.0 |
| Gross foreign debt (% of GDP) | 33.3 | 42.7 | 44.9 | 43.9 | 44.5 |
| FX reserves (EUR bn) | 32.9 | 37.4 | 40.5 | 40.2 | 39.7 |
| Months of imports, goods & services | 4.0 | 4.9 | 4.4 | 3.4 | 3.0 |
| **Inflation/Monetary/FX** | | | | | |
| CPI (pavg) | 3.8 | 2.7 | 5.0 | 13.1 | 11.1 |
| CPI (eop) | 4.0 | 2.1 | 8.2 | 14.1 | 8.9 |
| Inflation target | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 |
| Central bank reference rate (eop) | 2.50 | 1.50 | 1.75 | 6.00 | 6.00 |
| 3M money market rate (Dec. avg.) | 3.12 | 2.04 | 2.83 | 7.02 | 6.50 |
| USD/FX (eop) | 4.26 | 3.97 | 4.37 | 4.61 | 4.48 |
| EUR/FX (eop) | 4.78 | 4.87 | 4.95 | 4.98 | 5.06 |
| USD/FX (pavg) | 4.24 | 4.24 | 4.16 | 4.61 | 4.52 |
| EUR/FX (pavg) | 4.75 | 4.84 | 4.92 | 4.95 | 5.02 |

Source: Eurostat, National Institute of Statistics (NIS), UniCredit Research

*long-term foreign currency credit rating provided by Moody's, S&P and Fitch, respectively

## A blurred outlook

**GDP forecast lifted to 4.2% for 2022 due to large statistical revisions**

Large statistical revisions to 2021 data turned Romania from a growth laggard into one of the EU's top performers and postponed the risk of a technical recession. The outstanding growth published for 1Q22 (5.2% qoq, 6.5% yoy) relied on four sectors, namely trade, IT, support services and real estate services. For the latter three, the NIS reported price declines compared to 1Q21, in sharp contrast to rising producer and consumer prices. Data revisions have forced us to lift our GDP growth expectations significantly to 4.2% in 2022 from 1.4% previously, with the carryover accounting for the whole increase. However, we leave our nominal GDP forecast almost unchanged, since our 1Q22 forecast was equal to the level published by the NIS.

**Consumption frontloading probably ended in 2Q22**

Leaving aside the puzzling data revisions, signals from the economy suggest that domestic demand is weakening after significant frontloading in the spring. Facing higher prices and interest rates, households increased purchases in 1H22 and spent most of the precautionary savings accumulated in 2020-21, while also borrowing more. However, inflation is likely to outpace wage growth from here on, with salaries rising faster in sectors in which they lagged in 2020-21 or where labor shortages are high (IT, retail, leisure services and construction). Negative real wage growth should slow growth in private consumption and lending.

**Investment relies on building and profits reinvested by multinationals**

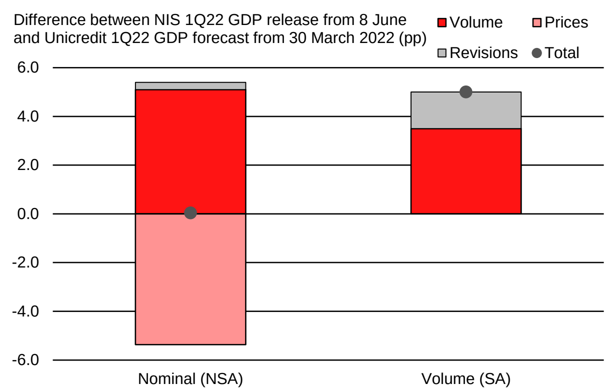
In 2021-22, investment has been driven by real estate projects, with non-residential overtaking housing recently. However, construction is one of the most leveraged sectors in Romania and higher borrowing costs could eventually weigh on new building starts. Public investment increased by 7% this year, helped by EUR 3.8bn in prefunding from the RRF, but it could slow if the government does not receive the first RRF tranche of almost EUR 3bn (1.1% of GDP) soon. Productive investment continues to rely heavily on reinvested profits, while the pipeline of new investment projects could again be affected by the uncertain tax outlook.

**Fiscal support package could reach 2% of GDP…**

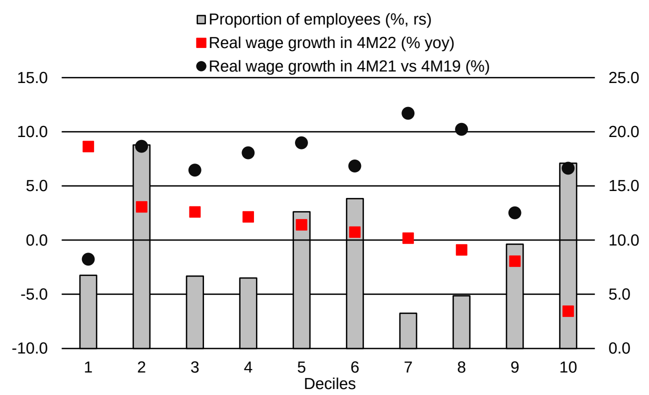
**…pushing the budget deficit to 7.1% of GDP in 2022 and 5.3% of GDP in 2023**

The government is expected to squeeze capital spending out of own resources as it tries to spend around 1.3% of GDP on the Support for Romania program that aims to help, among others, productive investment (0.4% of GDP) and farmers (0.2% of GDP), with the lion's share going households. This package is likely to be expanded and to exceed 2% of GDP by further increasing handouts to families and/or reducing their taxes. To offset additional spending, the government is considering a solidarity tax imposed on the largest companies (most of which are foreign owned) that could bring the equivalent of 0.3% of GDP in budget revenues. Higher property taxes, excise duties and other consumption levies. We do not expect the government to cover the entire cost of the program unless it also raises personal income taxes. We forecast the budget deficit to be 7.1% of GDP in 2022, 0.9% of GDP higher than the government's target, and 5.3% of GDP in 2023.

**DATA REVISIONS AND LOW DEFLATORS LIFTED REAL GDP GROWTH IN 1Q22**




**REAL WAGE GROWTH REALTED TO LABOR SHORTAGE AND INVERSELY CORRELATED TO CATCH UP IN 2020-21**




Source: NIS, UniCredit Research

**Inflation could end 2022 at 14% and 2023 at 9%**

Public debt could rise gradually to above 50% of GDP by 2023, despite high nominal GDP growth. The government's support measures for families could smooth the inevitable slowdown in household spending, although price subsidies for gas, fuels and energy are likely to fuel inflation. The main contributors to inflation remain food and energy prices, whose large weight in the CPI basket could push inflation above 15% in September 2022. In addition, retail markets for energy and gas were liberalized early last year, making price caps less effective. Contracts are still resetting from past fixed prices to current caps and have led to fivefold increases in extreme cases. Headline inflation could end this year at around 14%, with core inflation 4pp lower. Even if energy and gas price caps are removed next April, as currently foreseen, headline inflation could fall to around 9% at the end of 2023. By then, we expect higher energy, gas, utility and food prices to sap consumer spending and push core inflation down to 5%, while returning core excluding processed-food prices inside the target range.

**Core excluding food and energy inside the target range in 2H23**

**We expect rate hikes to 6% in 2022 and flat rates next year**

The NBR remains mindful of weak domestic demand and is likely to aim for fewer rate hikes than its regional peers. Thus, we expect the policy rate to be taken to 6% this year and kept flat in 2023. Tight liquidity management and FX interventions could push interbank interest rates to around 7% and therefore in line with Central European interbank interest rates.

**EUR-RON move to 5.00-5.10 range postponed to 2023**

In the first five months of the year, the NBR intervened to keep EUR-RON below 5.00. Interventions and external bond redemptions were fully covered by external issuance and EU transfers, leaving FX reserves flat compared to the end of 2021. While we expected the NBR to allow the RON to depreciate against the EUR this year to a 5.00-5.10 range, the Russia-Ukraine conflict and surging inflation probably postponed this depreciation step to next year.

**Industry hit by multiple supply shocks…**

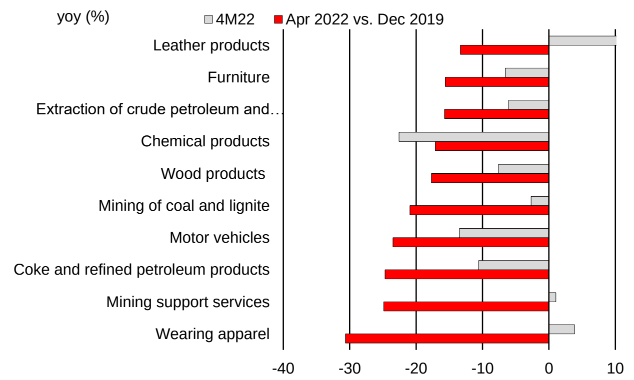
The stable currency may help shave 0.3-0.5pp from inflation, but it also leaves the RON heavily overvalued compared to its regional peers, whether adjusted for CPI, PPI or unit labor costs. A further loss of cost competitiveness hit production in low-value-added sectors, such as the manufacturing of textiles, leather, wood and furniture. This deterioration is accompanied by falling employment, especially in small, mono-industrial towns where many such companies have closed. Companies in energy-intensive sectors, such as the manufacturing of chemicals and metals, have had to reduce or shut down operations due to rising production costs. Very few such companies were hedged against rising commodity prices. All these negative trends are likely to continue, further widening the trade gap and probably pushing the C/A deficit above 8% of GDP in 2022-23. FDI and EU fund inflows could cover less than two thirds of the external shortfall. The implementation of NGEU-related reforms is lagging, but we expect at least one EUR 3bn disbursement of the two originally scheduled for this year.

**…could push the C/A deficit over 8% of GDP in 2022-23**

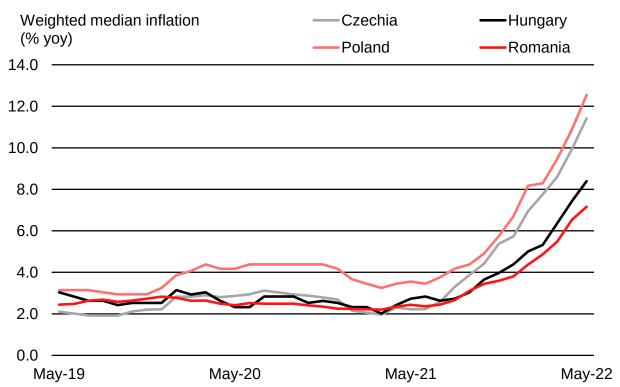
**GDP could grow by 2.8% in 2023**

If domestic demand and supply weaken before the end of 2022, the carryover into 2023 could be low. A subsequent rebound in 2H23 might help GDP growth to reach 2.8% next year.

**WEAK PRODUCTION IN LOW-VALUE-ADDED AND ENERGY-INTESIVE SECTORS**




**MEDIAN INFLATION IS LOWER THAN IN CENTRAL EUROPE**




Source: national statistical offices, central banks, UniCredit Research

## Cheap bonds waiting for a signal

**Fiscal buffer at more than 4% of GDP in mid-2022**

Whether the signal is to buy or to sell will depend a lot on the ministry of finance, which has created among investors the perception of funding shortages and inflexible issuance strategy. The situation is far from dramatic: the central government probably had more than 4% of GDP in fiscal reserves at the end of 1H22, including the ROMANI issued in June, but excluding the deposits of local administrations, social security accounts and the estimated average monthly balance of the treasury account. This is the highest buffer in Central Europe and could cover three quarters of the budget deficit expected to be incurred before the end of the year. Issuance has fallen behind schedule for ROMGBs (EUR 4.4bn equivalent or 40% of expected issuance in 2022) but is ahead of schedule for ROMANI (EUR 6.3bn equivalent or 63% of expected issuance). External issuance could exceed EUR 10bn if market conditions permit and none or only one of the two disbursements from the RRF arrives this year (up to EUR 3.0bn instead of EUR 6.2bn).

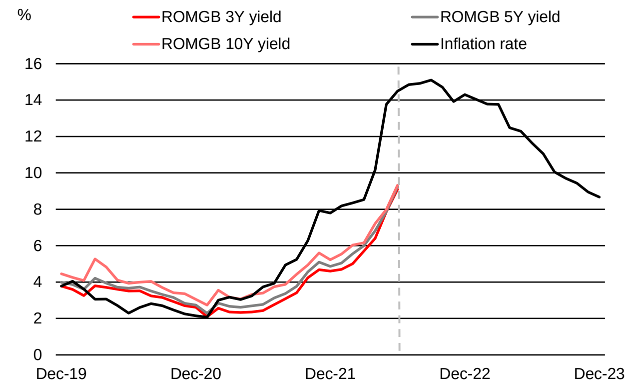
**ROMGB issuance behind schedule**

**ROMANI issuance will depend on RRF disbursements**

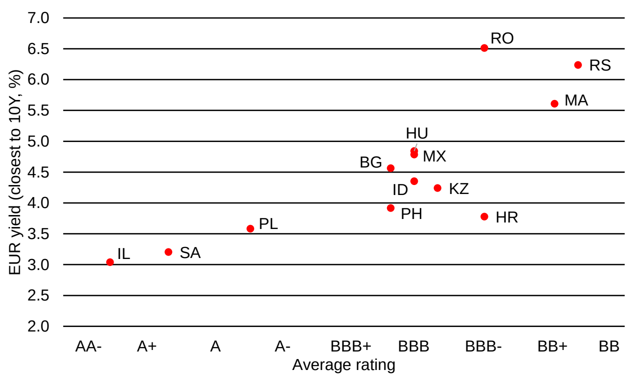
**ROMGBs and ROMANIs are cheap compared to EM peers**

Investors might increase ROMGB purchases ahead of a likely peak in headline inflation in September. ROMGBs have the highest yields in EM when adjusted for FX volatility. ROMANI EUR also look attractive, trading well outside their rating peers. However, the current spread between ROMGB and ROMANI covers potential RON depreciation of around 2% in 2023.

ROMGB YIELDS CLOSE TO INFLATION EXPECTED IN 2H23




ROMANI EUR TRADE WELL OUTSIDE RATING PEERS




Source: NSI, Bloomberg, UniCredit Research

**GOVERNMENT GROSS FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **26.4** | **31.1** | **29.3** |
| Budget deficit | 16.3 | 18.3 | 15.4 |
| Amortization of public debt | 10.2 | 12.9 | 13.9 |
| Domestic | 10.2 | 9.9 | 12.5 |
| Bonds | 7.9 | 8.3 | 10.4 |
| Bills | 1.0 | 1.3 | 1.8 |
| Loans | 1.3 | 0.3 | 0.3 |
| External | 0.0 | 3.0 | 1.3 |
| Bonds and loans | 0.0 | 3.0 | 1.3 |
| IMF/EU/Other IFIs | 0.0 | 0.0 | 0.0 |
| **Financing** | **26.4** | **31.1** | **29.3** |
| Domestic borrowing | 14.9 | 16.8 | 18.0 |
| Bonds | 10.6 | 11.0 | 12.0 |
| Bills | 1.3 | 1.8 | 2.0 |
| Loans and retail bonds | 3.0 | 4.0 | 4.0 |
| External borrowing | 10.6 | 13.0 | 11.0 |
| Bonds | 7.0 | 10.0 | 8.0 |
| IMF/EU/Other IFIs | 3.6 | 4.0 | 3.0 |
| Fiscal reserves change (- =increase) | 1.0 | 0.4 | 0.3 |

**GROSS EXTERNAL FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **41.6** | **52.3** | **50.5** |
| C/A deficit | 17.0 | 24.0 | 24.1 |
| Amortization of medium- and long-term debt | 9.7 | 12.5 | 11.0 |
| Government/central bank | 1.1 | 4.3 | 3.1 |
| Banks | 2.8 | 2.5 | 2.2 |
| Corporates/Other | 5.8 | 5.7 | 5.7 |
| Amortization of short-term debt | 14.9 | 15.8 | 15.4 |
| **Financing** | **41.6** | **52.3** | **50.5** |
| FDI (net) | 7.3 | 8.7 | 9.2 |
| Portfolio equity, net | -0.5 | -0.5 | 0.1 |
| Medium and long-term borrowing | 17.8 | 21.5 | 19.6 |
| Government/central bank | 11.8 | 12.9 | 11.3 |
| Banks | 1.9 | 2.2 | 2.0 |
| Corporates/Other | 4.1 | 6.3 | 6.2 |
| Short-term borrowing | 13.8 | 16.0 | 14.6 |
| EU structural and cohesion funds | 5.2 | 6.3 | 6.6 |
| Change in FX reserves (- = increase) | -2.1 | 0.3 | 0.4 |
| Memoranda: | | | |
| Net foreign purchases of LC govt bonds | -0.8 | -0.3 | 1.3 |
| International bond issuance, net | 7.0 | 7.0 | 6.7 |

Source: BNB, MoF, UniCredit Research

# Slovakia

**A2 stable/A+ negative/A stable***

## Outlook

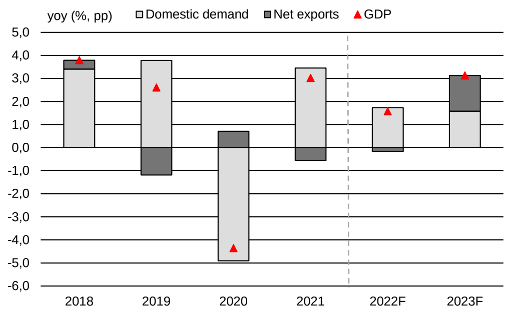
The Russia-Ukraine conflict, supply-chain bottlenecks and record-high inflation will slow economic growth in the coming quarters. We foresee GDP contracting in 2Q22, mainly due to supply-chain bottlenecks in the car sector, with a slow recovery from 2H22 onwards backed by public investment financed through EU funds. Inflation is expected to peak in 2022 but will remain close to 10% in 2023. Gas prices could add 4pp to 2023 inflation if the government decides to raise regulated gas prices for households. Real wages are likely to decline for the first time since 2012, resuming growth in 2H23 at the earliest and dragging on further increases in household consumption. Inflation and slower economic growth are putting pressure on the budget deficit, which could remain above 3% of GDP until 2025. Tensions are continuing to grow in the governing coalition, increasing the likelihood of a government reshuffle or early elections and slowing the progress of reforms.

**Author: Ľubomír Koršňák,** Analyst (UniCredit Bank Czech Republic and Slovakia)

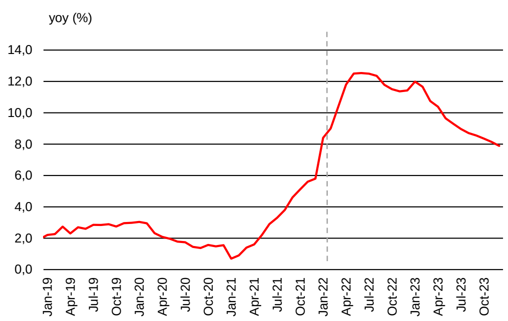
### KEY DATES/EVENTS

- 11 Jul, 10 Aug, 9 Sep: industrial production
- 14 Jul, 15 Aug, 14 Sep: CPI
- 16 Aug: flash 2Q22 GDP
- 19 Aug: rating update from Fitch
- 6 Sep: 2Q22 GDP structure

### BOTTLNECKS, INFLATION AND SANCTIONS WILL DRAG ON GDP GROWTH




### INFLATION TO PEAK IN 2022 BUT WILL LAST IN 2023




Source: NSI, UniCredit Research

### MACROECONOMIC DATA AND FORECASTS

| EUR bn | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 94.0 | 92.1 | 97.1 | 107.2 | 118.7 |
| Population (mn) | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| GDP per capita (EUR) | 17 243 | 16 868 | 17 790 | 19 640 | 21 752 |
| **Real economy, change (%)** | | | | | |
| GDP | 2.6 | -4.4 | 3.0 | 1.6 | 3.1 |
| Private consumption | 2.6 | -1.3 | 1.1 | 0.9 | -0.4 |
| Fixed investment | 6.7 | -11.6 | 0.6 | 5.8 | 6.3 |
| Public consumption | 4.6 | 0.9 | 1.9 | 2.5 | 2.5 |
| Exports | 0.8 | -7.3 | 10.2 | 2.7 | 5.6 |
| Imports | 2.1 | -8.2 | 11.2 | 2.9 | 4.1 |
| Monthly wage, nominal (EUR) | 1 092 | 1 133 | 1 211 | 1 308 | 1 423 |
| Real wage, change (%) | 5.0 | 1.8 | 3.6 | -2.9 | -0.7 |
| Unemployment rate (%) | 5.8 | 6.7 | 6.8 | 6.4 | 5.9 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | -1.3 | -5.5 | -6.2 | -4.7 | -4.3 |
| Primary balance | -0.1 | -4.9 | -4.8 | -3.2 | -2.9 |
| Public debt | 48.1 | 59.7 | 63.1 | 59.9 | 58.3 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | -3.2 | 0.3 | -1.9 | -6.8 | -5.7 |
| Current account balance/GDP (%) | -3.4 | 0.4 | -2.0 | -6.4 | -4.8 |
| Extended basic balance/GDP (%) | -0.3 | -0.9 | -0.9 | -3.3 | -2.6 |
| Net FDI (% of GDP) | 2.3 | -2.1 | -0.3 | 1.3 | 0.5 |
| Gross foreign debt (% of GDP) | 112.7 | 120.5 | 137.0 | 132.7 | 129.1 |
| FX reserves (EUR bn) | EUR | EUR | EUR | EUR | EUR |
| Months of imports, goods & services | - | - | - | - | - |
| **Inflation/monetary/FX** | | | | | |
| CPI (pavg) | 2.7 | 2.0 | 3.2 | 11.3 | 9.5 |
| CPI (eop) | 3.0 | 1.6 | 5.8 | 11.4 | 7.9 |

Source: Eurostat, SOSR, UniCredit Research

*long-term foreign currency credit rating provided by Moody's, S&P and Fitch, respectively.

## Shocks all around

**Economic growth likely to slow due to bottlenecks, high prices and war in Ukraine**

The Russia-Ukraine conflict, supply-chain bottlenecks and record-high inflation will drag on economic growth in the coming quarters. GDP is likely to fall in 2Q22, followed by a slow, mostly technical rebound in following quarters. We forecast GDP growth to moderate to 1.6% this year, with a rebound to 3.1% next year backed by EU-funded public investment and new production capacity in the car sector. At the same time, the promising rebound in household spending seen in recent quarters and private investment are likely to be hampered by rising prices.

**Russian oil embargo not applied to Slovakia…**

**…but ban on export of fuels made from Russian oil will lower its local production.**

The embargo on Russian oil will affect the Slovak economy despite it not applying to deliveries through the Southern Druzhba pipeline. The exemption will ensure self-sufficiency in fuel production but will limit local production due to the ban on the export of petroleum products derived from Russian oil – 20-30% of Russian oil imports to Slovakia are subsequently exported as petroleum products to neighboring countries. The longest exception, lasting until the end of 2023, will be applied to exports to Czechia, which account for almost 40% of Slovak fuel exports. The government plans a special tax on the additional revenue from discounted Urals prices.

**A stop in gas deliveries would lead to recession…**

**…but gas dependency on Russia could decline**

Extending sanctions to Russian gas would plunge the Slovak economy into recession. In our baseline, we expect a 60% reduction in Russian gas dependency as the dominant state-owned gas company aims to import more Norwegian gas and regasified LNG from Croatia and Poland. The filling of local gas storage, which may cover up to 60% of annual domestic consumption, has accelerated in recent weeks, but still lags behind the average of previous years.

**Labor market remains tight...**

**...but real wages still likely to decline,**

**…affecting household spending at the turn of the year.**

The labor market remains tight. Labor shortages will support the transmission of record-high inflation to wages. Nevertheless, real wages will fall this year for the first time since 2012, due to backward-looking indexation and subdued wage growth in the public sector. Real wage growth is expected to resume in 2H23, as inflation partially eases and the approaching general elections (February 2024) support wages in public sector. The decline in real income will disrupt the recovery in household spending from 2H22 onwards. In recent quarters, households financed consumption at the expense of savings, although precautionary savings were lower than in other countries in the region. We assume that consumption growth will slow once low and middle-income households exhaust their financial cushions.

**Inflation to remain high, but peaking in the summer**

Inflation is likely to peak this summer. Disinflation will probably be slow, with the headline figure remaining above 10% until 2H23, despite the government likely reducing the regulated-gas-price hike planned for 2023. If the government does not mitigate the rise in gas prices or opts for direct transfers to households, inflation would likely be 4pp higher next year.

**Bottlenecks continue to plague the car sector...**

**…mitigating the effect of new local capacity.**

The key automotive industry is slowing down the economic recovery due to persistent bottlenecks. New bottlenecks related to the war in Ukraine (wire harnesses) should be short-lived due to their low technological complexity and the existence of alternative production capacity. However, the semiconductor shortage will continue in 2023 and will dampen the positive impact of new production capacity in the car sector that is set to open in 2023.

**Economic growth boosted by EU-funded public investment…**

**…but record-high inflation could reduce the positive effects on the real economy.**

Public investment financed through EU funds from the previous 2014-20 budget period and the first NGEU transfers will support economic growth in 2H22 and 2023. Slovakia still has 40% of its allotment from the 2014-20 EU budget left. However, the impact on the real economy will be dampened by high prices, which also increases the likelihood of underspending. Slower economic growth and a weaker residential real estate market will slow private investment.

**Budget consolidation to slow as political risks rise**

Inflation and weaker economic growth could slow budget consolidation more than we previously expected. The general government deficit might not fall below 3% of GDP before 2025 and public debt will remain anchored close to 60% of GDP. The risks to the public budget are increased by the approaching elections in 1H24 (general, presidential and EU elections). Tensions in the governing coalition are continuing to grow. The likelihood of early elections or a minority government is increasing. The coalition government is currently primarily relying on ad-hoc agreements, which further complicates reforms and the approval of new measures.

# Slovenia

## A3 stable/AA- stable/A stable*

### Outlook

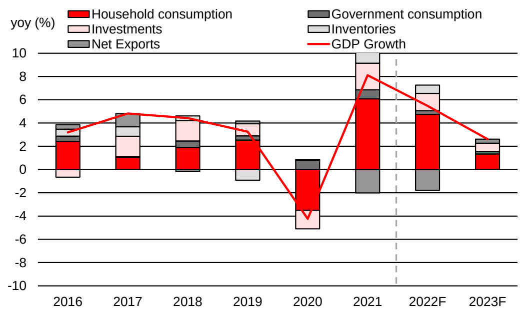
Strong carryover will mask a likely deterioration in growth due to the impact of high inflation, lower growth of main trading partners, supply-chain disruptions and deterioration in confidence due to the Russia-Ukraine conflict. We expect GDP growth at 5.5% in 2022 and 2.6% in 2023. The main risk is disruption of the flow of gas and oil from Russia. Inflation will likely remain high in the remainder of 2022 and first half of 2023, before starting to gradually decline. The fiscal challenge will be to balance the need for some gradual consolidation with continued support for the economy. The new government coalition could be more stable than previous governments and have a more pro-EU stance.

**Author: Mauro Giorgio Marrano,** Senior CEE Economist (UniCredit Bank, Vienna)

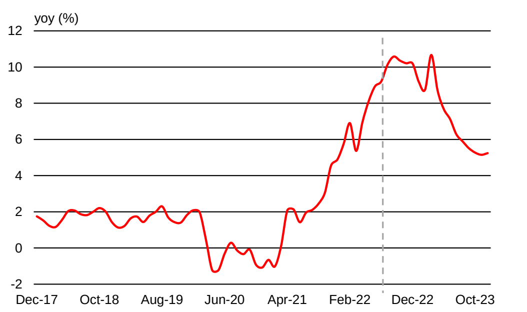
**KEY DATES/EVENTS**

- 16 Aug: 2Q22 GDP
- 29 Jul, 31 Aug, 30 Sep: CPI inflation

**GDP GROWTH FORECAST**




**INFLATION FORECAST**




Source: SURS, UniCredit Research

**MACROECONOMIC DATA AND FORECASTS**

| | 2019 | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 48.4 | 46.9 | 52.0 | 59.3 | 65.1 |
| Population (mn) | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| GDP per capita (EUR) | 23,167 | 22,312 | 24,678 | 28,147 | 30,871 |
| **Real economy, change (%)** | | | | | |
| GDP | 3.3 | -4.2 | 8.1 | 5.5 | 2.6 |
| Private Consumption | 4.8 | -6.6 | 11.6 | 8.8 | 2.4 |
| Fixed Investment | 5.5 | -8.2 | 12.3 | 7.7 | 3.7 |
| Public Consumption | 2.0 | 4.2 | 3.9 | 1.7 | 1.1 |
| Exports | 4.5 | -8.7 | 13.2 | 4.0 | 5.5 |
| Imports | 4.7 | -9.6 | 17.4 | 6.5 | 5.3 |
| Monthly wage, nominal (EUR) | 1,754 | 1,858 | 1,970 | 2,068 | 2,254 |
| Real wage, change (%) | 2.6 | 6.2 | 4.1 | -3.6 | 1.9 |
| Unemployment rate (%) | 4.4 | 5.0 | 4.5 | 4.4 | 4.2 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | 0.4 | -7.8 | -5.2 | -4.9 | -3.8 |
| Primary balance | 2.1 | -6.2 | -3.5 | -3.3 | -1.2 |
| Public debt | 65.6 | 79.8 | 74.7 | 72.0 | 70.0 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | 2.9 | 3.5 | 1.7 | 0.4 | 0.6 |
| Current account balance/GDP (%) | 6.0 | 7.4 | 3.3 | 0.7 | 1.0 |
| Extended basic balance/GDP (%) | 8.6 | 8.5 | 7.2 | 6.1 | 6.1 |
| Net FDI (% of GDP) | 1.6 | -0.6 | 1.0 | 1.2 | 1.2 |
| Gross foreign debt (% of GDP) | 91.5 | 101.9 | 97.0 | 90.1 | 85.6 |
| FX reserves (EUR bn) | | | | | |
| Months of imports, goods & services | | | | | |
| **Inflation/Monetary/FX** | | | | | |
| CPI (pavg) | 1.7 | -0.3 | 1.9 | 8.6 | 7.1 |
| CPI (eop) | 2.0 | -1.2 | 4.9 | 10.2 | 5.2 |

Source: SURS, Eurostat, UniCredit Research

*long-term foreign-currency credit rating at Moody's, S&P and Fitch, respectively

## Headwinds to growth

**Strong carryover to mask deterioration in the growth path**

Strong carryover will mask likely deterioration in growth due to the impact of high inflation, lower growth of main trading partners, supply-chain disruptions and deterioration in confidence due to the Russia-Ukraine conflict. The carryover from 2021 and 1Q22 is 5.9pp. Assuming moderate contraction of GDP in 2Q22 and 3Q22 and a modest rebound in 4Q22, we expect growth at 5.5% in 2022. Uncertainty about the growth path is very high.

**Effect on consumption limited by precautionary savings and wage growth**

The impact of these factors on consumption will probably be mitigated by still high precautionary savings and wage growth. We estimate precautionary savings at 2% of GDP at the end of April. Wage growth will limit the squeeze on real incomes to some extent, thanks to a 4.9% increase in the minimum wage and continued wage growth in the private sector due to an increasing shortage of workers. While we expect some deterioration in qoq consumption growth in the remainder of the year, annual growth could 9% due to strong carryover.

**Public investment to support growth**

Public investment could be an important driver of growth, based on the government's plan to increase it by 40% to almost EUR 3.6bn (6.1% of GDP). Implementation remains a risk, as last year demonstrated, and we see a smaller increase of 20% as more likely. Public investment will be partly funded by the EU's RRF (planned at EUR 285mn) and funding from the EU budget from the previous 2014-20 program and the new 2021-27 program (EUR 600mn in 2022). Private investment will probably moderate in the reminder of the year due to uncertainty, supply-chain disruptions, high production costs, and worker shortages.

**Net exports a large drag**

We expect net exports to subtract significantly from growth, 1.8pp, which will result in a very material narrowing of the current account surplus.

**In 2023 growth at 2.6%**

In 2023, we see growth at 2.6% with lower growth in consumption and investment but less drag from net exports.

**Disruption to gas and oil flows the main risk**

As is the case for other countries, a material risk is the disruption of gas and oil flows from Russia. According to 2019 data, Slovenia imported 15% of its oil and petroleum products, mainly diesel products, from Russia. It imports most of the rest from EU countries, but this could in part be made up of oil products produced using Russian crude oil. Thus, total exposure to Russian oil could be greater. We estimate that Slovenia imports most of its gas from Russia, which is mainly used by industry. In most sectors, gas has a share of over 30% of total energy used and thus an interruption of flows could cause significant disruption to production. In addition, Slovenia has no gas storage and there is vulnerable to halt in flows.

**Inflation to remain high**

Inflation is likely to continue to squeeze incomes. We expect it to increase further, driven by energy, food and core inflation, and it could reach 10% yoy this year from 8.1% in May, unless some of the measures to mitigate the impact of energy prices and other prices are extended. Core inflation will likely increase further, driven by the pass-through of higher producer prices and also the effect of continued wage growth. In 2023, inflation will likely remain high in the first half of the year before declining gradually in the second half, driven by base effects in energy and food as well as some deceleration in core inflation.

**Public finances: balancing the need for consolidation with support for the economy**

The need for gradual fiscal consolidation will have to be balanced with the need to mitigate the impact of high commodity and food prices on the economy. The fiscal deficit is likely to remain high in 2022 and 2023, at 5% and 4% of GDP, respectively, after 5.2% in 2021. Some of the measures adopted during the pandemic – mainly in the areas of pensions, labor costs, and health care – will have a permanent effect, which the Fiscal Council estimates at 2.2% of GDP in 2022. In addition, pension and health-care reform remain crucial areas for long-term fiscal sustainability. At the same time, high food and commodity prices might require further government support for the economy on top of that already provided, estimated at EUR 600mn (1% of GDP) in 2022. A budget revision is likely in coming months. Government debt will likely ease from 74.7% of GDP to 72.0%, mainly due to the impact of inflation, and to 70% in 2023.

**A more stable government coalition**

The new coalition government that was formed following the elections in April is made up of three parties, Robert Golob's Freedom Movement, the Social Democrats, and Levica, and has a majority of 53 of 90 seats in the National Assembly. This coalition could be more stable than previous governments, which were comprised of a larger number of parties.

# Bosnia and Herzegovina

**B3 stable/B stable/not rated***

## Outlook

Growth in 2022 has been more resilient than expected. For this reason we are raising our 2022 GDP growth forecast to 3.2% (from our previous forecast of 2.7%) while cutting our growth projection for 2023 to 2.4% (from 2.9%), with deceleration likely noticeable in late 2022 already. The inflation outlook has worsened with projected food and energy price growth. We forecast average inflation surpassing 12% in 2022 before settling down in 2023, when we see average inflation just below 7%. The fiscal position of the country will likely deteriorate in 2022 due to spending triggered by demand to mitigate inflation pressures, which is hard to resist before the elections set for October. Fiscal consolidation should continue after the elections. The political environment may again heat up occasionally during the summer and early autumn in the run-up to the elections, but the international community is likely to become more involved in resolving existing disputes among the three national communities on election regulations and common policy for the country.

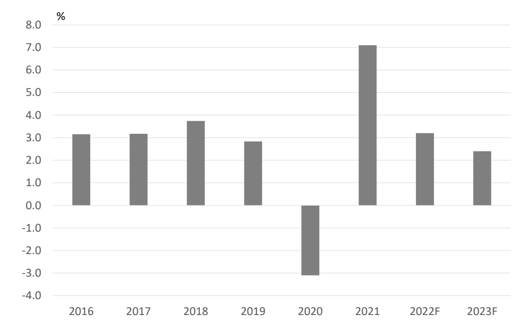
**Author:**
Hrvoje Dolenec, Chief Economist Croatia (Zagrebacka banka)

.

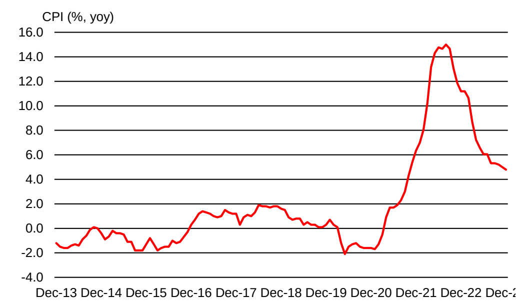
**KEY DATES/EVENTS**

- 30 June: GDP 1Q22
- 20 July: CPI June 2022
- 30 September: Balance of payments 2Q22
- 2 Oct: General elections

**GDP GROWTH FORECAST**




**INFLATION FORECAST**




**MACROECONOMIC DATA AND FORECASTS**

| EUR bn | 2019 | 2020 | 2021F | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 18.05 | 17.51 | 19.08 | 21.29 | 22.78 |
| Population (mn) | 3.46 | 3.45 | 3.42 | 3.40 | 3.37 |
| GDP per capita (EUR) | 5169 | 5040 | 5523 | 6199 | 6671 |
| **Real economy, change (%)** | | | | | |
| GDP | 2.8 | -3.1 | 7.1 | 3.2 | 2.4 |
| Monthly wage, nominal (EUR) | 727 | 741 | 789 | 854 | 901 |
| Real wage, change (%) | 3.7 | 2.9 | 4.4 | -3.5 | -1.2 |
| Unemployment rate (%) | 33.3 | 33.8 | 32.5 | 30.5 | 29.5 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | 1.4 | -4.7 | 0.8 | -1.2 | -0.4 |
| Primary balance | 2.1 | -3.9 | 1.5 | -0.5 | 0.4 |
| Public debt | 32.5 | 36.5 | 36.7 | 34.1 | 32.3 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | -0.5 | -0.7 | -0.4 | -0.8 | -0.9 |
| Current account balance/GDP (%) | -2.8 | -3.8 | -2.1 | -3.6 | -3.9 |
| Extended basic balance/GDP (%) | -0.2 | -1.1 | 0.7 | -0.5 | -0.9 |
| Net FDI (% of GDP) | 1.5 | 1.7 | 2.1 | 2.4 | 2.2 |
| Gross foreign debt (% of GDP) | 23.1 | 25.5 | 25.0 | 24.7 | 25.1 |
| FX reserves (EUR bn) | 6.4 | 7.1 | 8.4 | 8.4 | 8.6 |
| Months of imports, goods & services | 7.8 | 10.0 | 9.3 | 8.4 | 7.9 |
| **Inflation/monetary/FX** | | | | | |
| CPI (pavg.) | 0.6 | -1.0 | 2.0 | 12.3 | 6.8 |
| CPI (eop) | 0.3 | -1.6 | 6.4 | 11.2 | 4.8 |
| 1M money-market rate (Dec. avg.) | -0.44 | -0.55 | -0.58 | 0.80 | 1.25 |
| USD/FX (eop) | 1.75 | 1.59 | 1.73 | 1.81 | 1.73 |
| EUR/FX (eop) | 1.96 | 1.96 | 1.96 | 1.96 | 1.96 |
| USD/FX (pavg.) | 1.73 | 1.70 | 1.66 | 1.83 | 1.76 |
| EUR/FX (pavg.) | 1.96 | 1.96 | 1.96 | 1.96 | 1.96 |

Sources: Central Bank of Bosnia and Herzegovina, Agency for Statistics of Bosnia and Herzegovina, UniCredit Research

*long-term foreign-currency credit ratings are provided by Moody's, S&P and Fitch, respectively.

## Economic challenges likely to be pushed aside by upcoming elections

**We are revising our GDP growth projection to 3.2% in 2022 and 2.4% in 2023 based on the greater resilience of the economy in 2022 and the deteriorating global outlook in 2023**

Bosnia and Herzegovina's economic performance in 2022 has been more resilient than expected. This is demonstrated by solid industrial production performance, albeit slowing, and retails sales, which point to resilience in personal consumption. Finally, though warned by international financial institutions, public spending might rise as the authorities may find it difficult to resist demands for non-targeted election-related spending and to contain the relatively large public-sector wage bill. We therefore raise our GDP growth projection to 3.2% (from our previous forecast of 2.7%) for this year, despite potential deceleration in activity later in the year. However, the general environment tends to be much bleaker for 2023, when we expect deceleration in both domestic and external demand. Domestic demand may be impacted by declining real income and limited public spending, especially on investment, if the time it takes to form a government, both on state and entity level, is drawn out. For instance, FBiH (Federation of Bosnia and Herzegovina) has had a technical government for the entire current legislative period. External demand is a function of the performance of neighboring countries and the European Union, the main trading partners of BiH; in the EU and in neighboring countries economic performance is trending lower. As a result, we lower our GDP projection for 2023 to 2.4% (from 2.9%). BiH remains very much exposed to higher commodity prices, slower economic growth in Europe, and tighter financial conditions, all of which will remain risks for growth in late 2022 and in 2023, and likely beyond 2023.

**The inflation outlook is deteriorating with increases in food and energy prices, which have pushed inflation far above that in the eurozone, decoupling it from the previous trend**

The inflation outlook has worsened significantly on increasing food and energy prices. The government in FBiH has capped energy price increases for corporates at 20% and has not allowed price increases for individuals, while in RS (Republika Srpska) energy prices have increased by about 40% for corporates thus far in 2022. Inflation has risen by a double-digit percentage and we expect it to remain at an elevated level for most of 2022 before starting to decline. Average inflation should be above 12% in 2022 and moderate gradually in 2023, following the trend in the eurozone, yet at a much higher level in BiH. One of the ideas to contain inflation was to suspend excise duties on oil and oil derivatives on a temporary basis. At the same time there was a proposal to lower VAT on essential goods. However, for the time being both ideas have been put on hold as they must be approved by parliament and it seems implementation is complex and would mean significant costs for the Indirect Taxation Authority and it would require a special funding decision to implement the necessary adjustments – another example of the complexity of the governing structure in BiH. For a long time, inflation in BiH was below that of the eurozone but it has now decoupled due to the strong impact of a higher share of food and energy prices in the consumer basket. However, inflation should decline to the 3% level by the end of 2023, lowering the annual average to just below 7% in 2023.

**Due to the complex structure of political decision making in BiH, initial ideas to mitigate inflation pressures have been put on hold**

**The fiscal outlook is also worsening in 2022 with spending partially driven by demands for alleviation of the negative impact of inflation on real income and ahead of the general elections**

The fiscal outlook in 2022 has worsened as fiscal policy is largely swayed by rising social demands in response to rising inflation. However, the fiscal deficit should remain moderate at 1.2% of GDP in 2022 as expenditure (10.3% yoy) is rising faster than revenue (6.9% yoy). Higher expenditure is driven by a rise in the public wage bill (11.7% yoy) and spending on goods, services and social benefits (pensions), measures to mitigate the impact of higher inflation. On the other hand, capital spending is increasing only moderately in 2022. A return to a period of lower spending is likely after the elections and fiscal consolidation likely in 2023.

**General elections are set for October this year, with a heated summer ahead as disputes continue among the largest political actors**

The summer ahead will likely be colored by political disputes in the run-up to the general elections set for October. While there is less tension now from the Serbian side, there are general uncertainties remaining due to negotiations between Croatians and Bosniaks on admendments to the election law. The Croatian side is continuing to insist on changes that would allow more autonomy in electing Croatian representatives to the presidency, state government and the government of the FBiH. The EU has made efforts recently to steer discussion and negotiations among the political leaders in BiH. The general elections were at risk from the lack of a decision on funding until the Office of the High Representative intervened and ensured funding and election implementation.

# North Macedonia

## Not rated/BB- stable/BB+ Neg*

### Outlook

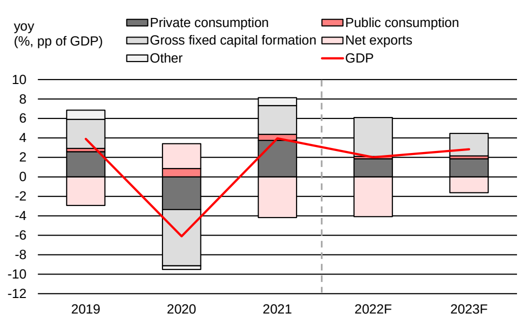
We have lowered our GPD growth forecasts to 2.5% for 2022 and 2.8% for 2023. Risks are skewed to the downside. Consumption and investment will likely be the main drivers of growth in 2022, thanks to significant wage growth, government support and public investment. We expect IMF funding to cover a significant proportion of North Macedonia's financing needs. We continue to expect the opening of formal EU-accession negotiations before the end of the summer.

**Author: Mauro Giorgio Marrano,** Senior CEE Economist (UniCredit Bank, Vienna)

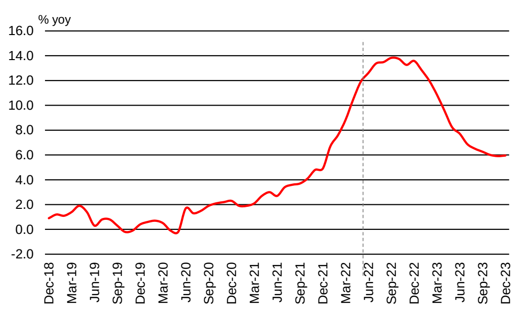
### KEY DATES/EVENTS

- 2 Sep: 1Q22 GDP
- 29 Jul, 31 Aug, 30 Sep: industrial production
- 19 Aug: rating update by S&P

### GDP GROWTH FORECAST




### INFLATION FORECAST




Source: state statistics office, UniCredit Research

### MACROECONOMIC DATA AND FORECASTS

| EUR bn | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 11.2 | 10.7 | 11.4 | 13.0 | 14.5 |
| Population (mn) | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| GDP per capita (EUR) | 5,355 | 5,078 | 5,449 | 6,214 | 6,898 |
| **Real economy, change (%)** | | | | | |
| GDP | 3.9 | -6.1 | 4.0 | 2.5 | 2.8 |
| Private consumption | 3.5 | -4.6 | 5.0 | 2.5 | 2.5 |
| Gross capital formation** | 8.7 | -16.1 | 9.2 | 11.8 | 6.3 |
| Public consumption | 2.5 | 6.4 | 4.1 | 1.7 | 2.0 |
| Exports | 8.9 | -10.9 | 12.3 | 5.9 | 6.8 |
| Imports | 10.1 | -10.9 | 13.9 | 8.6 | 6.5 |
| Monthly wage, nominal (EUR) | 609 | 660 | 697 | 753 | 798 |
| Real wage, change (%) | 4.3 | 7.0 | 2.4 | -3.2 | -2.1 |
| Unemployment rate (%) | 17.3 | 16.4 | 15.7 | 15.2 | 14.6 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance (central government) | -2.0 | -8.2 | -5.4 | -5.4 | -4.0 |
| Primary balance (central government) | -0.8 | -7.0 | -4.1 | -4.3 | -3.0 |
| Government debt (general government) | 40.2 | 51.9 | 51.8 | 50.5 | 49.5 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | -0.4 | -0.4 | -0.4 | -0.9 | -0.6 |
| Current account balance/GDP (%) | -3.3 | -3.4 | -3.6 | -7.1 | -4.0 |
| Extended basic balance/GDP (%) | 0.0 | -1.9 | 0.2 | -3.9 | -1.1 |
| Net FDI (% of GDP) | 3.2 | 1.5 | 3.8 | 3.1 | 2.9 |
| Gross foreign debt (% of GDP) | 72.4 | 80.3 | 81.4 | 78.0 | 76.0 |
| FX reserves (EUR bn) | 3.3 | 3.4 | 3.6 | 3.5 | 3.5 |
| Months of imports, goods & services | 4.6 | 5.3 | 4.5 | 3.6 | 3.2 |
| **Inflation/monetary/FX** | | | | | |
| CPI (pavg) | 0.8 | 1.2 | 3.2 | 11.6 | 8.2 |
| CPI (eop) | 0.4 | 2.3 | 4.9 | 13.6 | 6.0 |
| Central bank target | - | - | - | - | |
| Central bank reference rate (eop) | 2.25 | 1.50 | 1.25 | 2.50 | 2.50 |
| USD-MKD (eop) | 55.0 | 50.2 | 54.5 | 58.2 | 55.1 |
| EUR-MKD (eop) | 61.5 | 61.7 | 61.6 | 61.7 | 61.7 |
| USD-MKD (pavg) | 55.0 | 54.0 | 52.2 | 56.4 | 56.6 |
| EUR-MKD (pavg) | 61.5 | 61.7 | 61.6 | 61.7 | 61.7 |

**Gross capital formation also includes inventories. The national statistics office does not publish a separate quarterly series for gross fixed-capital formation.

Source: state statistics office, Ministry of Finance, National Bank of the Republic of North Macedonia, Bloomberg, UniCredit Research

*long-term foreign currency credit rating as provided by Moody's, S&P and Fitch, respectively

# North Macedonia gets closer to starting the EU accession process

**We have lowered our GDP growth forecast**

We have lowered our GPD growth forecasts to 2.5% for 2022 and 2.8% for 2023, reflecting slower growth among North Macedonia's main trading partners, higher inflation, continued supply-chain disruptions and increased uncertainty due to the Ukraine-Russia conflict.

**Consumption and investment will likely be the main drivers of growth**

Consumption will probably be the main driver of growth, as the impact of the squeeze in real income will be mitigated by wage growth, including an increase in the public-sector wage bill of around 5.4% yoy, a 18.5% increase in the minimum wage, pent-up demand and remittances. A support package announced by the government will also support disposable income. Investment should be boosted by a significant increase in government spending, which should increase by 40%, according to North Macedonia's 2022 budget, but we think the increase could be lower in order to contain the widening of the budget deficit, as explained further below. We expect net exports to drag on growth.

**Risks are skewed to the downside**

Risks are skewed to the downside, in particular in relation to the potential repercussions of the Ukraine-Russia conflict. North Macedonia is entirely dependent on Russian gas, and its industries are less exposed to gas than those elsewhere in EU-CEE. Oil is more important for North Macedonia, which receives most of its oil products from the EU, although this is likely to be impacted indirectly by bans on Russian imports.

**Inflation is likely to remain high in 2022**

We have raised our inflation forecasts, reflecting higher energy prices, food inflation and core inflation. We now expect inflation to remain around 10% for most of the year before declining gradually in 2023. Energy and food prices and protracted supply-chain bottlenecks represent the main upside risk.

**A larger deficit to mitigate the impact of the conflict in Ukraine**

The government's fiscal target for 2022 was increased from 4.3% of 5.3% to account for the announced support measures to mitigate the impact of the Russia-Ukraine conflict, including subsidies and tax reductions, estimated to amount to 3% of GDP. In terms of fiscal repercussions, the effect of these measures was partly offset by higher planned revenues for 2022 and a reduction of other expenditures. Lower-than-planned capital expenditure, which has been a recurrent feature in recent years, could help mitigate the risk of a further widening of the deficit. The supplementary budget still envisages an ambitious increase in capital expenditure of 40%, to EUR 530mn, or 4% of GDP. In 2023, the deficit could fall to 4.0% of GDP as the effect of support measures is phased out and revenues recover. The general government debt could decline somewhat in 2022 and edge down further in 2023 due to the effect of inflation.

**IMF funding will help cover financing needs**

In terms of financing, given deteriorating global market conditions, it is likely that the government will rely more on international financial institutions for funding, although the issuance of a Eurobond has still not been ruled out. We estimate that its remaining funding needs amount to EUR 700mn, including EUR 140mn in debt repayment and EUR 560mn of deficits to be realized. North Macedonia has requested from the IMF a two-year precautionary and liquidity line, which could provide EUR 450mn for the first year and EUR 890mn in total. Thus, this could cover a big part of the country's financing needs. The rest will likely be covered by domestic issuance, planned at EUR 400mn, but it could be lower. Government deposits at the central bank, which stood at EUR 570mn in May, provide a buffer, although the government said it wants to keep funds to pre-finance next year's repayments. In 2023, repayments will be significantly higher (EUR 1bn).

**The current-account deficit will likely widen**

High energy prices and higher growth of imports compared to exports means that the current-account deficit could widen to 7% of GDP in 2022. We expect FDI to amount to 3% of GDP and assume that the rest of the current-account deficit will be covered mainly by financing from international financial institutions. FX reserves declined by around EUR 450mn to EUR 3.1bn between the end of 2021 and end of May mainly due to companies' energy payments and in part due to household demand for FX, although the central bank reported that pressure on the currency from these factors had diminished.

**We expect the formal start of EU accession negotiations to occur before the end of the summer**

North Macedonia is getting closer to formally starting EU accession negotiations. The Bulgarian parliament voted in favor of lifting a veto. Bulgaria, however, has posed some conditions that might be fully accepted by North Macedonia. We continue to think that the formal opening of EU accession negotiations will probably take place before the end of the summer. Geopolitical tension since the beginning of the Russia-Ukraine conflict might have added urgency to solving the dispute and more generally to strengthening the EU's commitment to the Western Balkans.

# Russia

## Rating withdrawn / not rated / withdrawn*

### Outlook

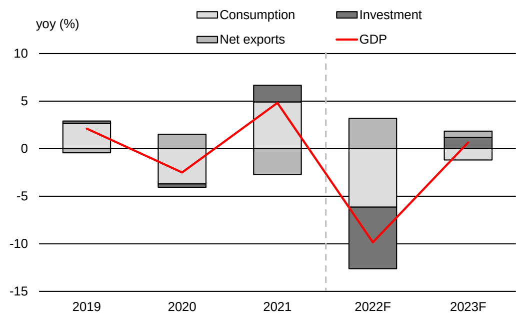
Western sanctions and the fallout from military operations have dealt a large and lasting blow to the Russian economy and financial system. So far both seem to be coping better than expected, but another shock looms later this year as incomplete import substitutions and sanctions could weigh on supply. We expect the CBR to cut the policy rate to 8% in 2022 and 7% in 2023, despite inflation deviating from target in 2022-23. Fiscal policy could undergo significant changes, with an announcement pending in July. We expect the RUB to depreciate gradually, reflecting lower energy exports, gradually rising imports and looser capital controls. Russia's GDP might contract by around 10% this year, although a lot is likely to depend on sales of oil and gas. In 2023, GDP could stagnate if supply bottlenecks offset a rebound in domestic demand driven by looser financial conditions and a return to real wage growth.

**Authors:**
**Artem V. Arkhipov**, Head of Macroeconomic and Strategic Research (UniCredit Russia)
**Ariel Chernyy**, Economist (UniCredit Russia)

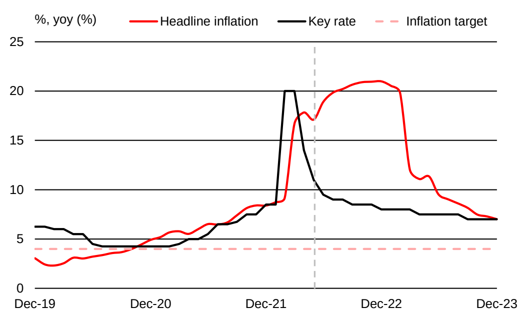
### KEY DATES/EVENTS

- 5-9 of each month: monthly CPI
- 22 July, 16 September: monetary policy meetings
- 18-22 of each month: monthly economic data
- July: budget, revision to budget rule

### GDP GROWTH FORECAST




### INFLATION FORECAST




Source: CBR, Rosstat, UniCredit Research

### MACROECONOMIC DATA AND FORECASTS

| EUR bn | 2019 | 2020 | 2021 | 2021F | 2022F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 1512.1 | 1301.3 | 1500.2 | 1813.0 | 1554.8 |
| Population (mn) | 147.0 | 147.0 | 146.9 | 146.9 | 146.8 |
| GDP per capita (EUR) | 10286.4 | 8853.6 | 10209.7 | 12344.7 | 10593.6 |
| **Real economy, change (%)** | | | | | |
| GDP | 2.2 | -2.7 | 4.7 | -9.9 | 0.7 |
| Private consumption | 3.8 | -7.3 | 9.4 | -11.3 | 0.7 |
| Fixed investment | 1.0 | -4.4 | 6.8 | -27.4 | 6.3 |
| Public consumption | 2.4 | 1.9 | 0.2 | 0.5 | -7.5 |
| Exports | 0.7 | -4.1 | 1.6 | -19.2 | 2.6 |
| Imports | 3.1 | -12.1 | 14.7 | -33.9 | -0.3 |
| Monthly wage, nominal (EUR) | 660.3 | 622.6 | 647.1 | 801.4 | 708.2 |
| Real wage, change (%) | 4.8 | 3.8 | 3.0 | -5.0 | 0.0 |
| Unemployment rate (%) | 4.6 | 5.8 | 4.8 | 5.2 | 5.5 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | 1.8 | -3.8 | 0.4 | -2.0 | -2.1 |
| Primary balance | 2.5 | -3.1 | 1.2 | -1.0 | -1.1 |
| Public debt | 13.1 | 18.3 | 16.6 | 14.8 | 17.1 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | 58.4 | 31.6 | 103.2 | 129.4 | 115.4 |
| Current account balance/GDP (%) | 3.9 | 2.4 | 6.9 | 7.1 | 7.4 |
| Extended basic balance/GDP (%) | 4.5 | 2.7 | 5.5 | 4.5 | 4.9 |
| Net FDI (% of GDP) | 0.6 | 0.2 | -1.4 | -2.7 | -2.5 |
| Gross foreign debt (% of GDP) | 29.0 | 29.4 | 28.1 | 20.2 | 19.6 |
| FX reserves (EUR bn) | 386.4 | 363.9 | 411.7 | 380.1 | 369.9 |
| Months of imports, goods & services | 13.1 | 14.4 | 13.0 | 19.3 | 19.8 |
| **Inflation/monetary/FX** | | | | | |
| CPI (pavg.) | 4.5 | 3.4 | 6.7 | 17.7 | 11.0 |
| CPI (eop) | 3.0 | 4.9 | 8.4 | 21.0 | 7.0 |
| Central bank target | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| Central bank reference rate (eop) | 6.3 | 4.3 | 8.5 | 8.0 | 7.0 |
| 3M money market rate (Dec avg.) | 6.6 | 4.9 | 9.3 | 8.3 | 7.3 |
| 3M money market rate (year avg.) | 7.8 | 5.4 | 6.6 | 13.1 | 7.8 |
| USD-RUB (eop) | 61.9 | 73.9 | 74.3 | 80.0 | 100.0 |
| EUR-RUB (eop) | 69.3 | 90.7 | 84.1 | 87.2 | 112.0 |
| USD-RUB (pavg.) | 64.7 | 72.2 | 73.6 | 72.5 | 89.2 |
| EUR-RUB (pavg.) | 72.5 | 82.5 | 87.2 | 78.7 | 98.8 |

*long-term foreign-currency credit rating provided by Moody's, S&P and Fitch, respectively

## First shock weathered, next one in sight

**So far, the Russian economy coped with sanctions better than expected**

Western sanctions and the fallout from military operations in Ukraine dealt an expectedly large and lasting blow to the Russian economy and financial system. However, so far both seem to have coped better than we had expected. Economic activity is stabilizing (albeit at a subdued level) after a sharp initial downturn, financial markets have calmed down and the RUB has appreciated to its strongest level since 2017, thanks mainly to efficient capital controls implemented by the Bank of Russia and to the widening trade surplus. That said, one should expect long-term sanctions to further sever existing supply chains, forcing the Russian economy to substitute imports from NATO countries with local production or other imports. The current RUB strength looks unsustainable, and the longer-term implications of a sharp turn in relations with the West are only just starting to kick in and are not likely to be fully felt until next year and beyond.

**Demand contraction stabilized at about 10% yoy**

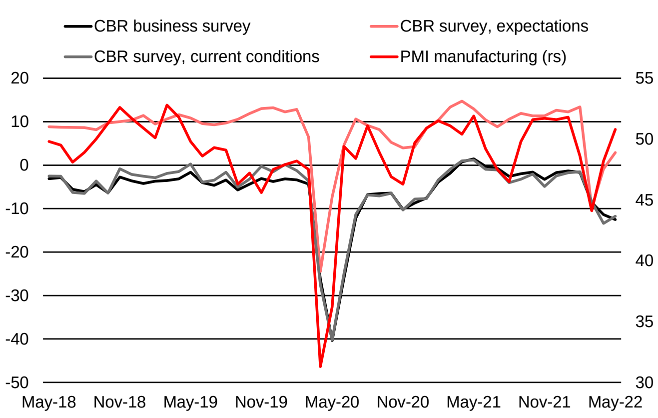
Recent data on consumer activity[35] show that household demand collapsed in April, but the pace of contraction immediately stabilized at about -10% yoy. After a panic-induced surge in demand in March, the household savings rate likely climbed in 2Q22, triggering a fall in consumer spending, especially on durables. In previous crises, the savings rate increased for up to three quarters after the initial shock before gradually returning to trend. This time, there might be a shorter period of abnormally high savings rates, as interest rates are rapidly declining and households are running out of stocks they built up in March-April.

**Limited supply decline could accelerate in domestic-oriented sectors once inventories are depleted, as imports continue to shrink**

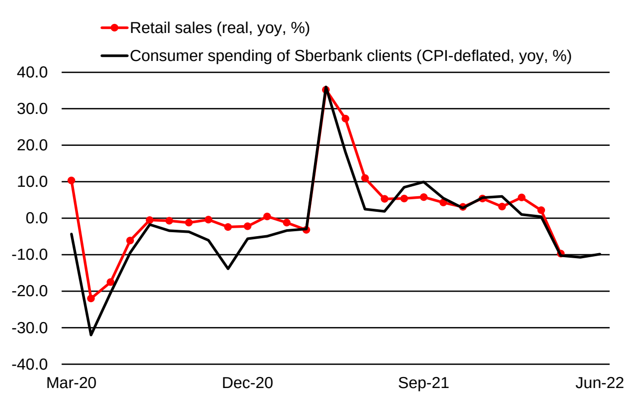
**Exporting companies in oil, gas and coal are likely to be affected by the EU's decision to cap or end imports from Russia**

On the production side, the decline is unfolding more slowly. In April, industrial production was down by only 1.6% yoy. Moreover, many business-sector activity indicators seem to have bottomed out in March, at least their expectations components. Imports are in freefall, their contraction being driven by logistical bottlenecks and payment difficulties related to sanctions. Import dependence is lower in agriculture, chemicals and pharma, mechanical engineering, and metal working. However, industrial production is likely to slow down further as inventories will soon be depleted in sectors where import substitution is incomplete at best, such as automotive and aviation, or where assembling and maintenance are outsourced to foreign companies. Oil, gas and coal exporting companies might be affected by the EU's decision to cap or end imports from Russia. Regionally, exporters in richer Western Russia will be more affected, as they were catering mostly to European customers. Some formerly foreign-owned companies are likely to re-open, especially in services such as restaurants and catering that do not require significant foreign inputs. Local regulation does not allow activity to stop without meaningful economic reasons (as it would hurt local employees). Some companies could be sold to investors based in Asia, but investors subject to capital controls and willing to sell businesses are unable to repatriate the proceeds.

**BUSINESS EXPECTATIONS ARE SURPRISINGLY RESILIENT**




**RETAIL DECLINE IS STALLING**




Source: IHS Markit, Rosstat, Sberbank, UniCredit Research

[35] up to April as for official Rosstat retail sales data, up to mid-June for polls and estimates of the largest banks and retailers

**Labor-market adjustment not leading to higher unemployment rate**

The labor market has adjusted little so far. The unemployment rate fell to an all-time low of 4.0% in April, as companies adjusted by cutting pay (especially bonuses) and by increasing the number of part-time workers, rather than by laying off employees. The labor force recovered to its January level after the exodus of highly skilled workers in the first months of the crisis. This suggests that the available labor supply will be less productive, which is likely to have an impact on economic efficiency.

**We expect rate cuts to 8% in 2022 and 7% in 2023**

The monetary authorities have been highly active since March. As inflation moderated, the CBR cut its policy rate by 10.5pp to the pre-crisis level of 9.5% (see EEMEA Macro Flash – Central Bank of Russia: focus shifts to managing downturn, 10 June). We expect another 150bp in cuts before the end of the year. The CBR seems to have a strong mandate to bring inflation to 4% in 2024, implying a more prudent approach from here on. Financial conditions remain tight, as banks impose additional requirements on potential borrowers. According to the CBR, this will be considered when deciding on the level of interest rates, with the key rate likely to be cut to 7% in 2023. Other measures to loosen financial conditions and restart lending are the dissolution of RUB 900bn in macroprudential buffers, more flexible limits for single-name exposure and FX positions, and wider eligibility of items to be included in capital. Fiscal policy is a large source of uncertainty for the inflation outlook, as the CBR remains mindful of demand outpacing supply and potentially pushing inflation higher during the adjustment.

**The budget rule could be revised in July**

The new budget model, possibly effective after 2025, will be presented in July, but some aspects of it have already been disclosed, e.g. excess income could be determined from oil extraction and export volumes (instead of benchmark oil prices), the National Wealth Fund may be mostly accumulated in RUB (instead of hard currency) and the "excess" of the NWF might be spent in the country (like in the old budget rule).

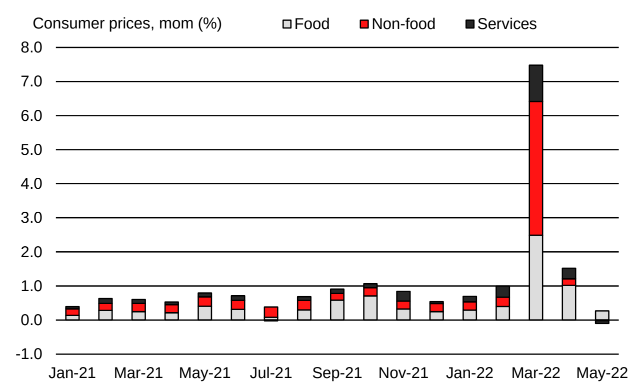
**No widening in the budget deficit**

Starting from May, the ministry of finance stopped publishing a detailed breakdown of expenses. Compared to January, planned spending for this year increased in April (latest available data) by less than RUB 700bn or 3% of the initial spending plan. The annual growth rate of public spending in Jan-May only marginally exceeded the inflation rate. As for the income side, so far oil revenues are more than compensating for the decline in non-oil taxes.

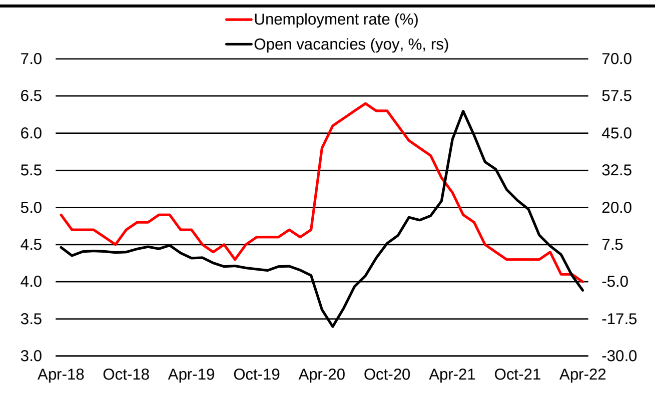
**USD-RUB could climb to around 80 by year-end as exports decline, imports recover and capital controls are loosened**

Russia's oil and fuel output decline could accelerate from 1 mb/d in 2Q22 to 3mb/d by the end of the year if the EU implements the partial embargo on Russian crude oil and petroleum products, on top of a ban on shipping insurance for oil exports from Russia. Until then, exports are likely to remain high, contributing to RUB strength. While Russia can reroute some of its oil exports from Europe to Asia, principally India and China, the same is not true for gas due to a lack of infrastructure. USD-RUB could climb to around 80 by year-end as imports recover, capital controls are loosened and the productivity shock affects relative prices.

**NON-FOODS CONTRIBUTED TO DISINFLATION**




**LABOR DEMAND FELL WITHOUT AFFECTING UNEMPLOYMENT**




Source: CBR, Rosstat, UniCredit Research

**Economic growth will depend on the success of substituting imports from the West.**

**GDP could fall by about 10% in 2022 and stagnate in 2023**

With energy exports likely to slow in 2H22 and 2023, economic growth will depend on the success of substituting imports from the West. Some supply chains might be rebuilt at the cost of lower productivity and smaller capital inflows, both resulting in lower potential growth. Failure to fully replace technology imports could threaten activity in sectors with higher added value. GDP will probably decline by about 10% in 2022, with domestic demand expected to fall by 13%. In 2023, GDP could stagnate if supply bottlenecks offset a rebound in domestic demand driven by looser financial conditions and a return to real wage growth.

### GOVERNMENT GROSS FINANCING REQUIREMENTS

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | 6.0 | 51.2 | 43.6 |
| Budget deficit | -5.9 | 35.3 | 33.2 |
| Amortization of public debt | 11.9 | 15.9 | 10.4 |
| Domestic | 11.3 | 13.5 | 7.8 |
| Bonds | 11.3 | 13.5 | 7.8 |
| Bills | -- | -- | -- |
| Loans | 0.0 | 0.0 | 0.0 |
| External | 0.6 | 2.5 | 2.5 |
| Bonds | 0.0 | 0.0 | 0.0 |
| Loans | 0.0 | 0.0 | 0 |
| Other | 0.0 | 0.0 | 0 |
| **Financing** | 6.0 | 51.2 | 43.6 |
| Domestic borrowing | 42.7 | 2.4 | 32.1 |
| Bonds | 42.1 | 1.7 | 32.1 |
| Bills | -- | -- | -- |
| Loans | 0.6 | 0.7 | 0.0 |
| External borrowing | 3.5 | 0.0 | 0.0 |
| Bonds | 3.5 | 0.0 | 0.0 |
| Privatization | 0.0 | 0.0 | 0.0 |
| Revaluation | 0.0 | 0.0 | 0.0 |
| Change in budget accounts, "-": increase | -40.2 | 48.8 | 11.5 |

### GROSS EXTERNAL FINANCING REQUIREMENTS

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **-14.5** | **-109.7** | **-86.5** |
| C/A deficit | -102.9 | -174.7 | -153.5 |
| Amortization of medium and long term debt | 40.2 | 29.7 | 28.8 |
| Government/central bank | 3.6 | 0.8 | 0.5 |
| Banks | 6.2 | 3.2 | 5.9 |
| Corporates/Other | 30.4 | 25.7 | 22.3 |
| Amortization of short-term debt | 48.2 | 35.3 | 38.2 |
| **Financing** | **-14.5** | **-109.7** | **-86.5** |
| FDI (net) | -21.4 | -48.0 | -39.4 |
| Portfolio investments (net) | -19.9 | -22.7 | -16.2 |
| Medium and long-term borrowing | 15.7 | -43.9 | -25.7 |
| Government/central bank | 14.5 | -18.4 | -12.6 |
| Banks | -7.3 | -20.3 | -7.3 |
| Corporates/Other | 8.6 | -5.2 | -5.8 |
| Short-term borrowing | 64.8 | 9.7 | 14.8 |
| other investment (net) | 0.0 | -36.4 | -30.3 |
| Change in FX reserves (- = increase) | -53.7 | -31.6 | -10.2 |
| Memoranda: | | | |
| Nonresident purchases of LC gov't bonds | 17.9 | -18.4 | -12.6 |
| International bond issuance, net | 2.9 | -2.5 | -2.5 |

Source: CBR, Rosstat, Russian Ministry of Finance, UniCredit Research

# Serbia

**Ba2 stable/BB+ stable/BB+ stable***

### Outlook

External factors have further worsened the outlook for the Serbian economy. We have lowered our 2022 GDP growth forecast from 3.0% to 2.5%, assuming lower investment growth and a greater drag from net exports than previously expected. Consumption will likely remain resilient. In 2023, we expect growth at 3%. A sudden stop in deliveries of gas and oil from Russia is a material risk. The government's plan to narrow the fiscal deficit to 3% of GDP in 2022 implies limited fiscal space to support growth. The main fiscal risk stems from state-owned gas and electricity utility companies Srbijagas and EPS. Inflation will likely rise further and decline only in 2023, albeit remaining above the target range. We expect monetary policy to be tightened further.

### Strategy

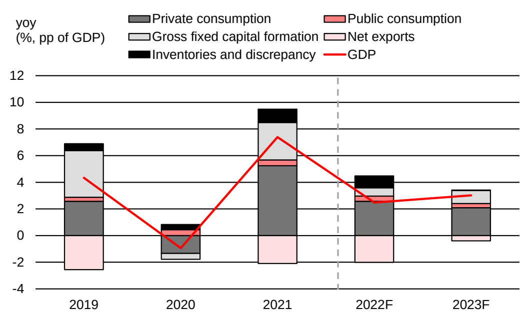
We expect less local currency issuance than originally planned in the remainder of the year, with the additional funding needs likely to be covered by external issuance.

**Author: Mauro Giorgio Marrano,** Senior CEE Economist (UniCredit Bank, Vienna)

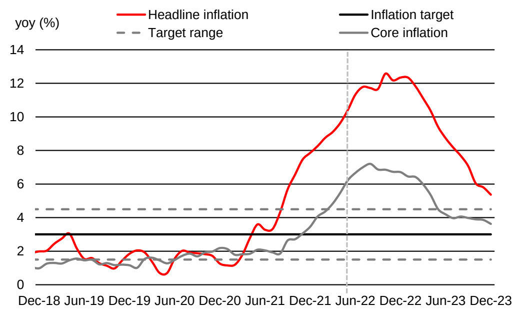
**KEY DATES/EVENTS**

- 7 Jul, 11 Aug, 9 Sep: central bank monetary policy decision
- 12 Jul, 12 Aug, 12 Sep: CPI inflation
- 1 Aug, 31 Aug: 2Q22 GDP (flash, structure)
- 19 Aug: Fitch to update sovereign rating
- 2 Sep: Moody's to update sovereign rating

**GDP GROWTH FORECAST**




**INFLATION FORECAST**




Source: Statistical Office of the Republic of Serbia, UniCredit Research

**MACROECONOMIC DATA AND FORECASTS**

| | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 46.0 | 46.8 | 53.3 | 60.5 | 67.3 |
| Population (mn) | 6.9 | 6.9 | 6.9 | 6.8 | 6.8 |
| GDP per capita (EUR) | 6,623 | 6,783 | 7,760 | 8,856 | 9,906 |
| **Real economy, change (%)** | | | | | |
| GDP | 4.3 | -0.9 | 7.4 | 2.5 | 3.0 |
| Private consumption | 3.7 | -1.9 | 7.6 | 3.7 | 3.0 |
| Fixed investment | 17.2 | -1.9 | 12.5 | 2.6 | 4.2 |
| Public consumption | 1.9 | 2.8 | 2.7 | 2.5 | 2.0 |
| Exports | 7.7 | -4.2 | 19.4 | 7.1 | 8.0 |
| Imports | 10.7 | -3.6 | 19.3 | 8.7 | 7.0 |
| Monthly wages, nominal (EUR) | 643 | 706 | 772 | 861 | 918 |
| Real wages, change (%) | 8.5 | 7.8 | 5.1 | 0.6 | -1.5 |
| Unemployment rate (%) | 11.6 | 10.1 | 11.4 | 10.0 | 9.0 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | -0.2 | -8.0 | -4.1 | -3.0 | -1.5 |
| Primary balance | 1.8 | -6.0 | -2.4 | -1.4 | 0.1 |
| Public debt | 53.2 | 57.8 | 57.1 | 54.4 | 52.1 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | -3.2 | -1.9 | -2.3 | -4.2 | -4.4 |
| Current account balance (% of GDP) | -6.9 | -4.1 | -4.4 | -7.0 | -6.5 |
| Extended basic balance/GDP (%) | 0.8 | 2.2 | 2.4 | -2.0 | -1.6 |
| Net FDI (% of GDP) | 7.7 | 6.3 | 6.8 | 5.0 | 4.9 |
| Gross foreign debt (% of GDP) | 61.4 | 65.8 | 63.0 | 61.8 | 58.5 |
| FX reserves (EUR bn) | 13.5 | 13.8 | 16.6 | 17.2 | 17.8 |
| Months of imports, goods & services | 5.8 | 6.3 | 6.0 | 5.1 | 4.5 |
| **Inflation/Monetary/FX** | | | | | |
| CPI (pavg) | 1.8 | 1.6 | 4.1 | 10.8 | 8.6 |
| CPI (eop) | 1.8 | 1.3 | 7.9 | 12.3 | 5.4 |
| Central bank target | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Central bank reference rate (eop) | 2.25 | 1.00 | 1.00 | 4.00 | 4.00 |
| 3M money market rate (Dec avg) | 1.67 | 0.94 | 0.93 | 4.00 | 4.00 |
| USD/FX (eop) | 104.9 | 95.7 | 103.9 | 107.9 | 105.6 |
| EUR/FX (eop) | 117.6 | 117.6 | 117.6 | 117.6 | 118.2 |
| USD/FX (pavg) | 105.2 | 103.2 | 99.4 | 108.1 | 106.5 |
| EUR/FX (pavg) | 117.9 | 117.6 | 117.6 | 117.6 | 117.9 |

Source: Bloomberg, Eurostat, SORS, NBS, Public Debt Agency, UniCredit Research

*long-term foreign-currency credit rating is provided by Moody's, S&P and Fitch, respectively.

## Rising downside risks

**A further deterioration of the growth outlook**

External factors have further worsened the outlook for the Serbian economy and increased downside risks. High energy, food, and other commodities prices, a tightening in global financial conditions, slower growth in trading partners and a deterioration in confidence due to the Russia-Ukraine conflict will likely weigh on the economy in 2H22 and part of 2023.

**We revised our 2022 growth forecast from 3.0% to 2.5%**

While there is significant uncertainty about how these factors will play out, we have lowered our 2022 GDP growth forecast further from 3.0% to 2.5%, assuming lower investment growth and a greater drag from net exports than previously expected. This assumes modest growth in 2Q22 and 3Q22 of 0.3% qoq, and an improvement in 4Q22, following the 0.5% contraction in 1Q22. We estimate the carryover from 2021 and 1Q22 to be 1.8pp.

**Consumption expected to be the main driver of growth**

Consumption will probably remain resilient and be the main driver of growth in 2022. Precautionary household saving, estimated to be 2% of GDP at the end of April, could help delay the effect of the squeeze in real income on consumption. In addition, the squeeze in income will be limited by increases in public-sector wages and pensions (of 7.0% and 5.0%, respectively), the hike in the minimum wage (9.2%), some one-off transfers, and solid wage growth in the private sector (left chart). Caps on food prices, reduction of excise duty on petroleum products and frozen utility prices will provide largely temporary support, with the effect likely concentrated in 2Q22 and 3Q22 if the measures are extended beyond 30 June.

**Weak private and public investment in 2022**

Investment is likely to be weaker than previously envisaged. Private investment could return to modest growth after two years of contraction. However, a deterioration in sentiment, supply-chain disruptions and higher production costs will weigh on corporate spending. Support from public investment will be limited as it is planned to grow by only 6.5% in nominal terms, although remaining high as a percentage of GDP, at 7%.

**Net exports a drag on growth**

Slower growth among Serbia's main trading partners and solid consumption growth imply that net exports will likely provide a greater drag on growth than previously envisaged.

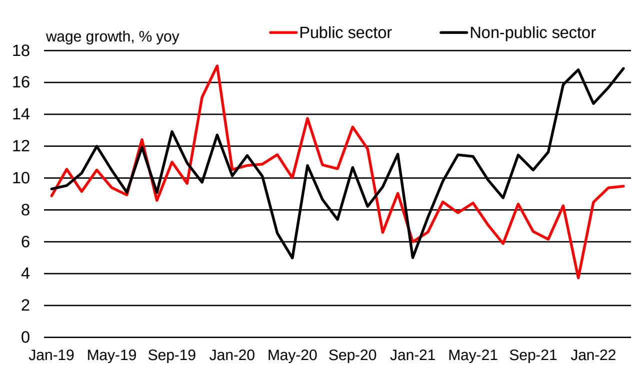
**Growth at 3% in 2023**

In 2023, we expect growth to be 3.0%, with the acceleration driven by a smaller drag from net exports as they benefit from an expected recovery in the country's main trading partners, as well as a pick un in investment, as we assume global uncertainty will decline.

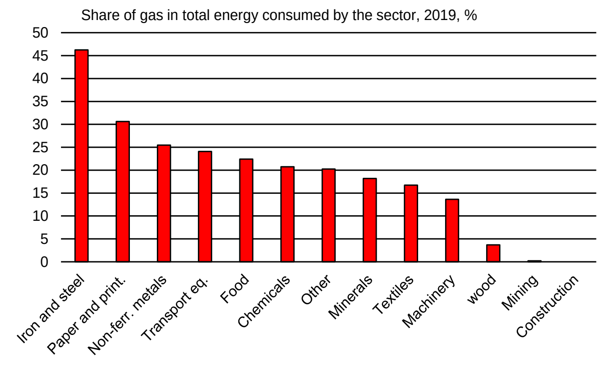
**A sudden stop of deliveries of gas and oil is a material risk, especially for gas**

A sudden stop in deliveries of gas and oil from Russia is a material risk, particularly for gas. First, the share of oil and petroleum products from Russia has already declined from 40% before the pandemic to 15% in 2021, with a similar share in 1Q22.  Second, Serbia already plans to replace Russian oil with imports from Iraq, given that it will not be able to import Russian oil (which it receives from Croatia) from November due to EU sanctions.  For gas, the risk is larger as Serbia imports all its gas from Russia, which is delivered through Bulgaria and Hungary, therefore it is at risk of disruption if the flow of gas to these two countries is reduced. Serbia is participating in the construction of a gas pipeline from Azerbaijan, however, it will probably take two years to be operational. An interruption of gas flows would create significant disruption as Serbian industry is significantly reliant on gas (right chart). To reduce the risk, Serbia is increasing its storage capacity.

**SOLID WAGE GROWTH TO LIMIT THE SQUEEZE ON INCOME**




**INDUSTRY IS DEPENDENT ON GAS**




Source: Statistical Office of the Republic of Serbia, Eurostat, UniCredit Research

**Limited fiscal space and important fiscal risks**

The government's plan to narrow the fiscal deficit to 3% of GDP in 2022 implies limited fiscal space to support growth. The main fiscal risk stems from state-owned gas and electricity utility companies Srbijagas and EPS, as the government might of have to step in to cover their losses. Srbijagas has already received EUR 500mn in loans from December 2021 to cover additional imports and losses due to gas prices being frozen for households. EPS has covered EUR 400mn of losses due to structural problems in 4Q21 and frozen electricity prices, mainly by borrowing from commercial banks so far. The expected increases in gas and electricity prices in 2H22 could provide some relief to the companies' finances. Another fiscal risk is lower revenue if growth weakens more than expected. We see government debt falling from 57.1% of GDP in 2021 to 54.4% of GDP in 2022, mostly due to the impact of inflation, and to 52.1% of GDP in 2023.

**High inflation in 2022 and most of 2023**

Shocks to food and energy prices and the pass-through from high producer prices will continue to push up inflation in 2022. After reaching 10.4% in May, inflation could climb further to above 12% yoy in the autumn, with the increase smoothed by the cap in some food prices and the measure to limit the impact of high energy prices, if they are extended. Increases in utility prices now look inevitable. The new gas deal with Gazprom envisages a price ranging from USD 310 to USD 408 per 1,000 cubic meters, up from USD 270, which covers 73% of Serbia's needs, with the rest having to be imported at market prices. We assume a 20% hike in both gas and electricity prices in the autumn. Inflation might start to gradually slow in 2023, although it will likely remain above the upper bound of the central bank target range (4.5%).

**Monetary policy will likely be tightened further, although less than in Central Europe**

Against this inflation outlook, monetary policy will likely be tightened further. Two factors justify further tightening, namely **1.** high inflation, with the related risk of second round effects; and **2.** monetary policy tightening by ECB and Fed, which could weaken capital flows to emerging markets and put pressure on the currency. However, given that domestic price pressure appears lower than it is in Central European countries and in light of the central bank's concerns about growth, the NBS could limit its hikes to 4%, likely delivered by the end of the summer. In addition, we expect the central bank to continue tighten liquidity.

**Wider current account deficit**

Serbia's current-account deficit could widen to 7.0% of GDP in 2022, from 4.3% of GDP in 2021, mainly due to the impact of higher commodity prices and solid consumption growth. If FDI amounts to EUR 3bn, or 5% of GDP, this would not fully cover the deficit. We believe that international bond issuance and other inflows will compensate for this. The NBS will continue to intervene to keep the RSD stable in the event that pressure builds on the currency. In the past two months the currency has mainly experienced appreciation pressure.

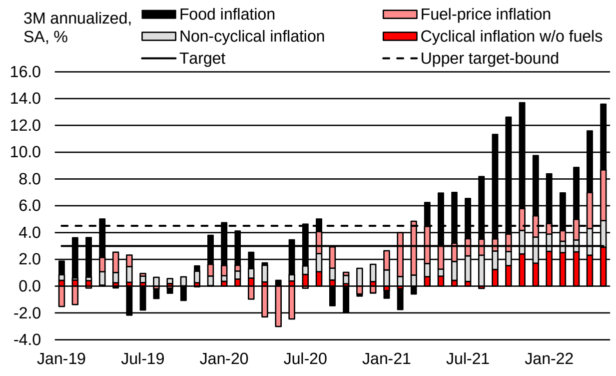
**Difficult choices**

Regarding the, geopolitical situation, Serbia is continuing a balancing act. Serbia's president Aleksandar Vučić reaffirmed that the future of Serbia is in the EU and condemned the encroachment on the territorial integrity of Ukraine. However, the country continues to refuse to join in Western sanctions, despite some EU countries stepping up pressure. This balancing act is unlikely to be sustainable if pressure from the EU increases further.

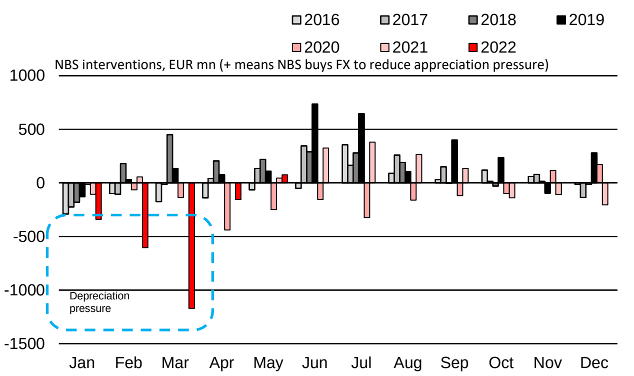
**A new government over the summer should not lead to policy changes**

A new government will likely be formed during the summer following the elections in April and should not lead to significant policy changes. The priorities remain dealing with the impact of high energy and commodity prices, along with the repercussions of the Ukraine-Russia conflict, including the risk of disruptions to energy flows, re-starting the dialogue with Kosovo, and progress on the EU accession process.

**CYCLICAL INFLATION STILL BELOW THAT IN CENTRAL EUROPE**




**DEPRECIATION PRESSURES EASED**

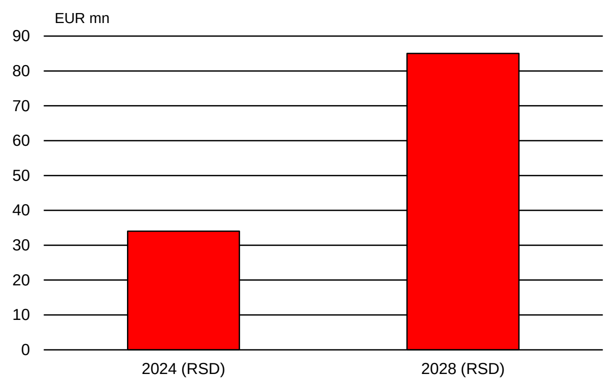



Source: NBS, SORS, UniCredit Research

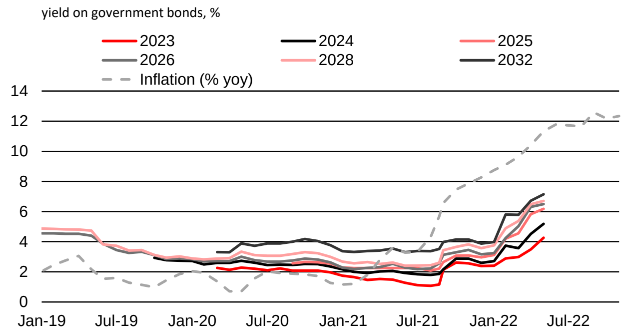
## We expect local-currency issuance to be lower and that Serbia may issue a Eurobond

Serbia's high funding needs and the low appetite for local-currency bonds among foreign investors mean that Serbia's funding plan might have to be changed. We expect Serbia to issue less in local currency compared to the EUR 2.0bn initially planned. Of this, the equivalent of EUR 800mn have already been issued. Serbia's other funding needs could be covered by the issuance of a Eurobond, which was not envisaged in the original issuance planning. We think its size could be EUR 1.5-2.0bn.

**SMALL SERBGB ISSUANCE IN 3Q22**




**NEGATIVE REAL YIELDS**




Source: NBS, Serbian Ministry of Finance, Public Debt Agency, SORS, UniCredit Research

**GOVERNMENT GROSS FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **5.0** | **5.4** | **4.8** |
| Budget deficit | 2.2 | 1.8 | 1.0 |
| Amortization of public debt | 2.8 | 3.6 | 3.8 |
| Domestic | 1.4 | 2.4 | 2.8 |
| Bonds | 1.3 | 2.1 | 2.6 |
| Bills | 0.0 | 0.0 | 0.0 |
| IFIs/others | 0.1 | 0.3 | 0.2 |
| External | 1.4 | 1.2 | 1.0 |
| Bonds | 0.6 | 0.0 | 0.0 |
| IFIs/others | 0.8 | 1.2 | 1.0 |
| **Financing** | **5.0** | **5.4** | **4.8** |
| Domestic borrowing | 1.5 | 1.2 | 2.0 |
| Bonds | 1.5 | 1.2 | 2.0 |
| Bills | 0.0 | 0.0 | 0.0 |
| Others | 0.0 | 0.0 | 0.0 |
| External borrowing | 3.8 | 3.6 | 2.5 |
| Bonds | 2.8 | 1.0 | 1.0 |
| IFIs/others | 1.0 | 2.6 | 1.5 |
| Fiscal reserves change (- =increase) | -0.2 | 0.6 | 0.3 |

**GROSS EXTERNAL FINANCING REQUIREMENTS**

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **6.1** | **7.8** | **7.8** |
| C/A deficit | 2.3 | 4.2 | 4.4 |
| Amortization of medium- and long-term debt | 3.0 | 2.7 | 2.6 |
| Government/central bank | 1.9 | 1.6 | 1.5 |
| Banks | 0.5 | 0.5 | 0.4 |
| Corporates | 0.6 | 0.7 | 0.7 |
| Amortization of short-term debt | 0.7 | 0.9 | 0.8 |
| Government/central bank | 0.0 | 0.0 | 0.0 |
| Banks | 0.7 | 0.8 | 0.8 |
| Corporates | 0.1 | 0.1 | 0.0 |
| **Financing** | **6.1** | **7.8** | **7.8** |
| FDI (net) | 3.6 | 3.0 | 3.3 |
| Medium and long-term borrowing | 5.1 | 4.0 | 3.7 |
| Government/central bank | 4.2 | 3.1 | 2.7 |
| IFIs/others | 1.0 | 2.6 | 1.5 |
| Banks | 0.3 | 0.4 | 0.4 |
| Corporates | 0.6 | 0.6 | 0.6 |
| Short-term borrowing | 0.5 | 0.5 | 0.5 |
| Other | -0.3 | -0.5 | 0.0 |
| Change in FX reserves (- = increase) | -2.9 | 0.7 | -0.7 |
| Memoranda: | | | |
| Non-resident purchases of LC gov't bonds | -0.1 | -0.1 | -0.2 |
| International bond issuance, net | 2.2 | 1.5 | 1.0 |

Source: Bloomberg, NBS, Serbian Ministry of Finance, Public Debt Agency, SORS, UniCredit Research

# Turkey

## B2 negative/B+ negative/B+ negative*

### Outlook

The Turkish economy could grow by 4.4% this year and by 3.3% in 2023. Inflation will likely end this year at 84% and ease to 43% at the end of next year. Policymakers have opted for macroprudential policies to curb loan growth and increase FX conversion by exporters to support the CBRT's reserves, but these policies are not a substitute for interest rate hikes to address inflation or TRY depreciation pressure. Orthodox monetary policy will likely resume if the opposition wins the election, which we expect to be held in June 2023.

### Strategy

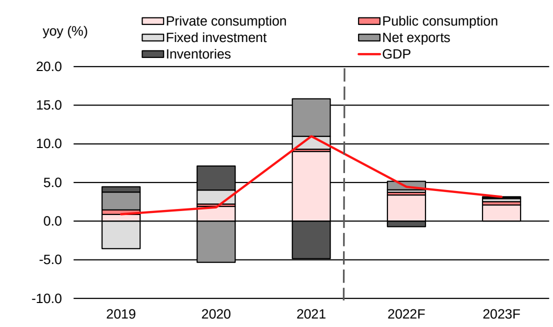
Further TRY weakness is likely due to a widening current account deficit, although tourism revenue could help slow the pace of depreciation over the summer.

**Author:**
Gokce Celik, Senior CEE Economist (UniCredit Bank, London)

### KEY DATES/EVENTS

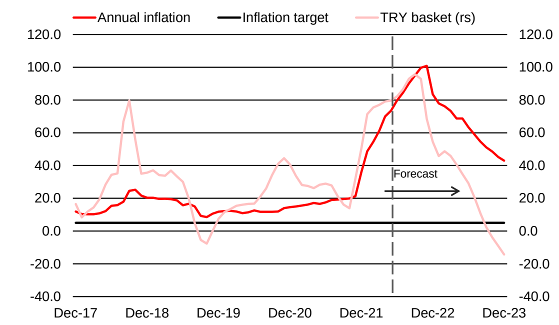
- 4 Jul, 3 Aug, 5 Sep: inflation data
- 21Jul, 18 Aug, 22 Sep: monetary-policy decisions
- 31 Aug: 2Q22 GDP
- 8 Jul, 30 Sep: Fitch and S&P rating reviews

### GDP GROWTH FORECAST




Source: Turkstat, UniCredit Research

### INFLATION FORECAST




Source: Turkstat, CBRT, Bloomberg, UniCredit Research

### MACROECONOMIC DATA AND FORECASTS

| EUR bn | 2019 | 2020 | 2021 | 2022F | 2023F |
|---|---|---|---|---|---|
| GDP (EUR bn) | 680.2 | 626.9 | 687.6 | 725.5 | 946.7 |
| Population (mn) | 82.6 | 83.6 | 84.6 | 85.6 | 86.6 |
| GDP per capita (EUR) | 8237 | 7498 | 8126 | 8474 | 10931 |
| **Real economy, change (%)** | | | | | |
| GDP | 0.9 | 1.8 | 11.0 | 4.4 | 3.3 |
| Private consumption | 1.5 | 3.2 | 15.1 | 5.5 | 3.3 |
| Fixed investment | -12.4 | 7.2 | 6.4 | 1.3 | 1.7 |
| Public consumption | 4.1 | 2.2 | 2.1 | 2.6 | 3.3 |
| Exports | 4.6 | -14.8 | 24.9 | 7.0 | 4.6 |
| Imports | -5.4 | 7.6 | 2.0 | 2.8 | 3.9 |
| Monthly wage, nominal (EUR) | 753 | 634 | 598 | 574 | 739 |
| Real wage, change (%) | 2.7 | -4.9 | 2.6 | -5.0 | 2.0 |
| Unemployment rate (%) | 13.7 | 13.1 | 12.0 | 11.7 | 12.5 |
| **Fiscal accounts (% of GDP)** | | | | | |
| Budget balance | -5.3 | -5.2 | -3.9 | -5.2 | -4.2 |
| Primary balance | -3.0 | -2.5 | -1.4 | -2.6 | -2.2 |
| Public debt | 32.6 | 39.7 | 42.0 | 41.7 | 36.9 |
| **External accounts** | | | | | |
| Current account balance (EUR bn) | 4.7 | -31.0 | -11.6 | -40.3 | -32.8 |
| Current account balance/GDP (%) | 0.7 | -5.0 | -1.7 | -5.6 | -3.5 |
| Extended basic balance/GDP (%) | 1.5 | -4.4 | -0.8 | -4.7 | -2.8 |
| Net FDI (% of GDP) | 0.8 | 0.6 | 0.9 | 0.9 | 0.7 |
| Gross foreign debt (% of GDP) | 54.7 | 60.4 | 54.9 | 58.8 | 47.6 |
| FX reserves (EUR bn) | 71.7 | 41.0 | 63.9 | 53.7 | 47.1 |
| Months of imports, goods & services | 4.3 | 2.6 | 3.0 | 1.9 | 1.7 |
| **Inflation/monetary/FX** | | | | | |
| CPI (pavg) | 15.7 | 12.3 | 19.6 | 79.6 | 59.2 |
| CPI (eop) | 11.8 | 14.6 | 36.0 | 84.0 | 43.0 |
| Central bank target | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| Central bank reference rate (eop) | 12.00 | 17.00 | 14.00 | 14.00 | 45.0 |
| 3M money market rate (Dec avg.) | 11.80 | 16.60 | 15.79 | 16.00 | 45.00 |
| USD/TRY (eop) | 5.95 | 7.44 | 13.30 | 22.00 | 18.50 |
| EUR/TRY (eop) | 6.67 | 9.08 | 15.08 | 23.32 | 20.72 |
| USD/TRY (pavg) | 5.68 | 7.03 | 8.90 | 17.54 | 21.48 |
| EUR/TRY (pavg) | 6.35 | 8.05 | 10.49 | 18.63 | 23.50 |

Source: Turkstat, CBRT, Turkey's ministry of finance, Bloomberg, UniCredit Research

*long-term foreign-currency credit ratings are provided by Moody's, S&P and Fitch, respectively.

## Policy inertia leads to larger imbalances

**We forecast the GDP to grow by 4.4% this year**

We are revising our growth forecast for this year from 4% to 4.4%, mainly due to the large carry-over implied by 1Q22 GDP for the rest of the year (4.1pp).

**Domestic demand could remain supported by loan growth and wage hikes in the short term**

The sharp acceleration in consumer lending in 2Q22 might have triggered another round of frontloaded consumption, after it stalled in 1Q22. The government could hike the minimum wage again in July as the 50.4% rise announced in December was wiped out by inflation over the past six months (54%). However, a further rise in inflation might keep real wage growth negative in 2022. Moreover, policymakers have tightened lending conditions for consumer loans and some corporate loans (excluding SME, agricultural and export loans, as well as loans for investment purposes).

**Higher input prices and supply disruptions could limit production in the manufacturing sector**

**Growth might stall in the final quarter of 2022, implying limited carryover into 2023**

Appetite for corporate investment might slow due to moderating demand and higher input costs. In addition to rising costs, supply bottlenecks continue to pose a risk for the manufacturing sector. Two major car makers (Toyota and Oyak Renault) will suspend their production for 2-3 weeks due to a shortage of semi-conductors. The strong rebound in tourism could support services and retail activity over the summer. However, a limited GDP contraction is on the cards in 4Q22 (curbing the carryover into 2023), due to slower global growth and energy costs weighing more on household disposable income in the winter.

**Budget targets have been revised due to high inflation**

On 20 June, President Recep Tayyip Erdogan submitted a supplementary budget proposal to increase expenditure by 62% and revenue by 73% above the initial plan while keeping the targeted deficit (TRY 278bn) unchanged. This change is mostly due to inflation being much higher than initially anticipated (9.8% for 2022). Revenue in the first five months of 2022 reached 42% of the new target as corporate tax revenue surged due to banks and companies recording strong profits, while import tax revenues were supported by TRY weakness.

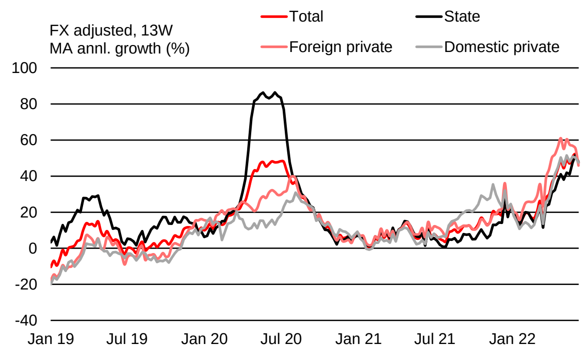
**Budget deficit is set to widen as subsidies on retail energy prices and contingent liabilities from FX-protected deposits grow**

We expect the budget deficit to widen from 2.7% of GDP in 2021 to 4.2% (IMF defined: 5.2%) in 2022 as expenditure will likely accelerate. The subsidies on natural gas and electricity prices (amounting to 0.5% of GDP in the first five months) might exceed 2% of GDP by the end of 2022, despite the retail prices of these items having increased by 66% and 46%, respectively over the first five months of this year. Moreover, around 1.4% of GDP could materialize from the Treasury's contingent liability from FX-denominated deposits (based on our end-2022 USD-TRY forecast of 22). This is much higher than the government forecast in its revised budget (0.3%). The budget deficit might widen further in 1H23, due to pre-election spending by the government.

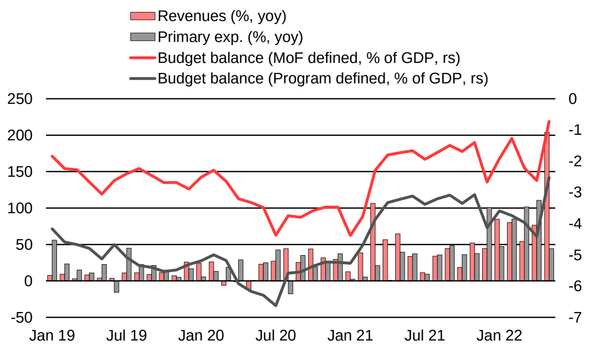
**We expect growth to slow to 3.3% next year**

Despite the support from fiscal policies and potentially another sizable minimum wage hike, we expect GDP growth to ease to 3.3% next year, reflecting slower growth in external demand. Domestic lending conditions will likely tighten in 2H23, if orthodox policies resume to fight inflation and curb macroeconomic imbalances. If Russia completely halts its energy exports to the EU, Turkey could undergo a recession in 2023, due to potential price shocks and hit to its export partners (even assuming Turkey's energy imports from Russia remain unchanged).

**Another surge in loan growth in 2Q22**




**Budget revenue supported by high profits and the weak TRY**




Source: BRSA, Turkey's ministry of finance, UniCredit Research

**We expect current account deficit to reach 5.6% of GDP at the end of 2022…**

**…before easing to 3.5% next year**

The 12M rolling current account deficit almost doubled between the end of 2021 and April to 3.2% of GDP, due to a higher energy import bill. We expect this trend to continue as energy imports (USD 39.7bn in January-May) will likely exceed USD 90bn this year. However, the pace could slow over the summer with the recovery in tourism revenue, which we now expect to exceed its 2019 level. The 11.3mn tourists recorded in January-May corresponds to 89% of the figure recorded in the same period of 2019. A gradual easing in energy prices will help lower the current account deficit next year, while slower growth in Europe could limit the improvement through higher export growth.

**Inflation is set to reach triple digits in 4Q22**

Inflation is heading to triple digits in 4Q22, with energy and food prices continuing to drive the rise. The latter is unlikely to display the usual seasonality over the summer due to high demand from the recovery in tourism and pass-through from global food prices. Core inflation might increase further as well. The government introduced rent controls from mid-June, limiting the annual rise to 25% instead of 12-month average CPI inflation. This could help slow inflation, given the significant weight rent has in the consumption basket (4.43%) and CPI-C (7.8%). Another sizable minimum wage hike at the beginning of 2023, along with other populist policies ahead of the elections will likely limit what would otherwise be a significant disinflationary base effect from December onward. We expect inflation to ease from 84% at the end of this year to 43% at the end of 2023.

**Recent measures aimed at limiting loan growth, are helping government borrowing costs…**

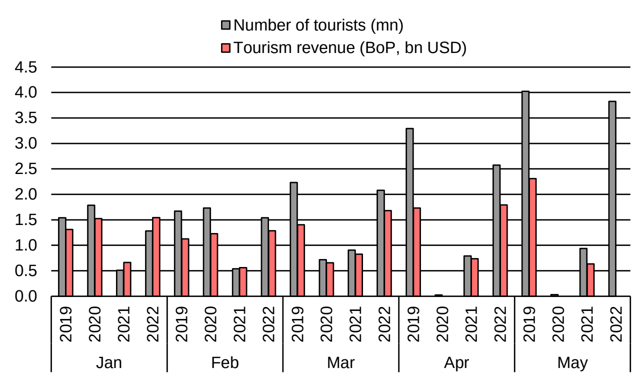
**…but are unlikely to substitute for proper monetary policy to curb inflation or pressure on the TRY.**

Rate hikes continue to remain off the table. Recently, the authorities have opted for a selective tightening of lending via macroprudential measures, increasing the TRY-denominated fixed-rate bond requirement as collateral for banks to help mitigate the Treasury's borrowing costs. The Treasury also issued a new retail bond, indexed to the revenues of two state-owned enterprises (the airports authority DHMI and the coastal safety directorate KEGM), to lure retail investors to TRY denominated assets. Moreover, the authorities signaled a relaxation of swap restrictions with non-residents, possibly conditional on their commitment to invest in local bonds or equities, although they tightened the restrictions on corporate offshore swaps (through banks, by increasing the risk weights on their loans). However, these measures do not address runaway inflation or further currency weakness amid the widening current account deficit and tightening global financial conditions.

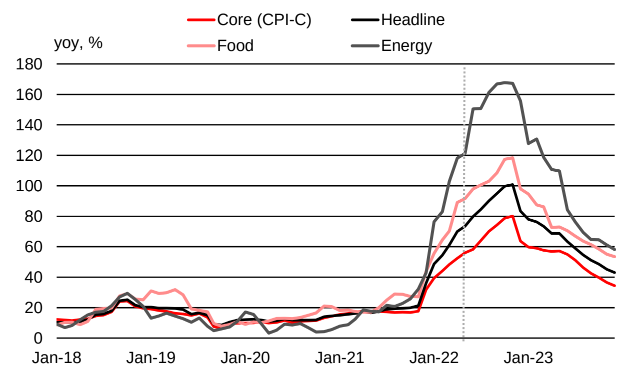
**Support for President Erdogan and his party is fading due to worsening economic conditions**

The deteriorating economic prospects continue to weigh on the electoral support for President Recep Tayyip Erdogan and the ruling AKP-MHP alliance. Despite demands from the opposition, Mr. Erdogan is unlikely to call early elections unless he sees polls improve for himself and his party. His recent remarks that inflation will ease from early 2023 onward hint that he hopes to turn things around in the meantime. In our view, significant improvement is unlikely in the absence of a major change in economic policy. As a result, we maintain our view that presidential and parliamentary elections will be held next year (18 June 2023). That said, we cannot rule out a recent claim by commentators close to the government that elections could be held a month earlier than to avoid clashing with national university entry exams.

**Tourism revenues have exceeded 2019 levels in January-April**




**Inflation heading to triple-digit in 4Q22**




Source: Turkstat, CBRT, UniCredit Research

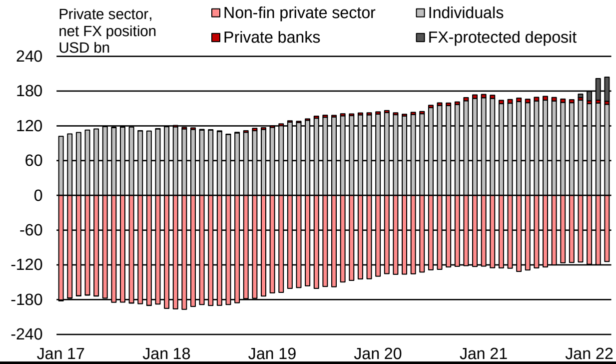
## FX risk continues to shift from private to public sector

**The CBRT increases the FX conversion requirement for exporters in exchange for cheaper lending**

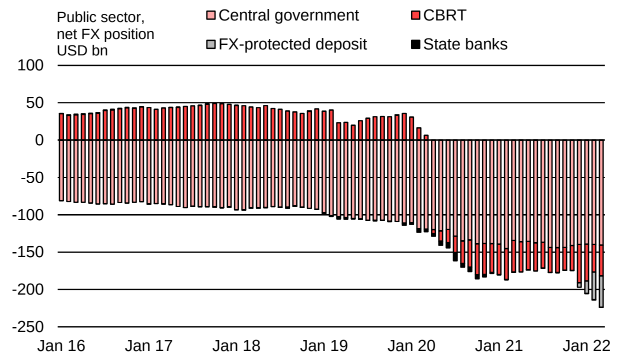
The CBRT continued to intervene in 2Q22, although TRY depreciation shows the limits of this practice when FX reserves are insufficient. We estimate the intervention might have amounted to USD 43bn in the first five months of 2022[36]. The CBRT is continuing to pursue measures aimed at replenishing its reserves. On 10 June, the CBRT changed the utilization conditions for export rediscount loans. The maturity of these loans has been increased, but exporters taking out these loans are required to sell 30% of their FX-denominated export receipts to a commercial bank on top of the 40% they are obliged to sell to the CBRT.

Although export rediscount loans are extended at rates below the policy rate, the additional FX conversion requirement could reduce demand from firms whose products have a higher import component (basic metals, electronics and motor vehicles). Otherwise, the improvement in companies' net FX positions might stall. The FX risk of the private sector has been shifting to the public sector since 2018. The deterioration in the public sector's net FX position since 2019 has been driven by the Treasury's FX-denominated debt issuance for local investors, CBRT's intervention in the FX market and, more recently, the FX-protected deposit scheme.

**FX risk shifting from private sector…**




**…to public sector**




Source: BRSA, CBRT, Turkey's ministry of finance, Haver, UniCredit Research

### GOVERNMENT'S GROSS FINANCING REQUIREMENTS

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **64.1** | **58.9** | **60.9** |
| Budget deficit | 27.1 | 37.4 | 39.6 |
| Amortization of public debt | 37.0 | 21.5 | 21.3 |
| Domestic | 30.1 | 13.9 | 14.3 |
| Bonds | 30.1 | 13.5 | 14.3 |
| Bills | 0.0 | 0.3 | 0.0 |
| Loans | 0.0 | 0.0 | 0.0 |
| External | 6.9 | 7.6 | 7.0 |
| Bonds | 5.3 | 6.2 | 5.6 |
| Loans | 1.5 | 1.4 | 1.5 |
| **Financing** | **64.1** | **58.9** | **60.9** |
| Domestic borrowing | 38.3 | 42.1 | 44.7 |
| Bonds | 37.7 | 42.1 | 44.7 |
| Bills | 0.7 | 0.0 | 0.0 |
| Loans | 0.0 | 0.0 | 0.0 |
| External borrowing | 9.7 | 8.3 | 8.6 |
| Bonds | 8.4 | 7.1 | 7.3 |
| Loans | 1.2 | 1.2 | 1.3 |
| Privatization/other | 13.9 | 6.9 | 6.2 |
| Fiscal reserves change (- =increase) | 2.2 | 1.6 | 1.4 |

### GROSS EXTERNAL FINANCING REQUIREMENTS

| EUR bn | 2021 | 2022F | 2023F |
|---|---|---|---|
| **Gross financing requirement** | **158.9** | **201.2** | **192.1** |
| C/A deficit | 11.6 | 40.3 | 32.8 |
| Amortization of medium and long-term debt | 50.5 | 47.1 | 33.8 |
| Government/central bank | 6.9 | 7.6 | 7.0 |
| Banks | 27.2 | 28.1 | 15.3 |
| Corporates/other | 16.5 | 11.3 | 11.5 |
| Amortization of short-term debt | 96.8 | 113.9 | 125.4 |
| **Financing** | **158.9** | **201.2** | **192.1** |
| FDI (net) | 6.1 | 6.4 | 6.6 |
| Portfolio equity, net | -1.2 | -3.3 | 2.3 |
| Medium and long-term borrowing | 57.8 | 40.3 | 37.0 |
| Government/central bank | 10.6 | 6.4 | 10.9 |
| Banks | 23.9 | 22.8 | 14.4 |
| Corporates/other | 23.3 | 11.1 | 11.8 |
| Short-term borrowing | 108.1 | 129.1 | 137.8 |
| Other | 7.9 | 0.0 | 0.0 |
| Change in FX reserves (- = increase) | -19.8 | 28.7 | 8.4 |
| Memoranda: | | | |
| Nonresident purchases of LC gov't bonds | 0.9 | -1.9 | 2.3 |
| International bond issuance, net | 3.1 | 0.8 | 1.7 |

Source: CBRT, Turkey's ministry of finance, UniCredit Research

[36] For details of our calculation, please see *CEE - Data Watch* published on 17 June 2022.

# Acronyms and abbreviations used in the CEE Quarterly

- BNB – Bulgarian National Bank
- C/A – current account
- CBR – Central Bank of Russia
- CBRT –Central Bank of the Republic of Turkey
- CE – Central Europe
- CEE – Central and Eastern Europe
- CNB – Czech National Bank
- DM – developed markets
- EA – euro area
- EC – European Commission
- ECB – European Central Bank
- EDP – Excessive Deficit Procedure of the European Commission
- EM – emerging markets
- EMU – European Monetary Union
- EU – European Union
- FCL – Flexible Credit Line (from the IMF)
- FDI – foreign direct investment
- IFI – international financial institutions
- IMF – International Monetary Fund
- MoF – Ministry of finance
- NBH – National Bank of Hungary
- NBP – National Bank of Poland
- NBR – National Bank of Romania
- NBS – National Bank of Serbia
- NBU – National Bank of Ukraine
- PLL – Precautionary and Liquidity Line (from the IMF)
- PM – prime minister
- PPP – public – private partnership
- qoq – quarter on quarter
- sa – seasonally adjusted
- SBA – Stand-by Arrangement (with the IMF)
- SOE – state-owned enterprise
- WB – World Bank
- yoy – year on year
- ytd – year to date

## Notes

# Legal Notices

## Glossary

A comprehensive glossary for many of the terms used in the report is available on our website: https://www.unicreditresearch.eu/index.php?id=glossary

## Disclaimer

Our recommendations are based on information obtained from or are based upon public information sources that we consider to be reliable, but for the completeness and accuracy of which we assume no liability. All information, estimates, opinions, projections and forecasts included in this report represent the independent judgment of the analysts as of the date of the issue unless stated otherwise. We reserve the right to modify the views expressed herein at any time without notice. Moreover, we reserve the right not to update this information or to discontinue it altogether without notice. This report may contain links to websites of third parties, the content of which is not controlled by UniCredit Bank. No liability is assumed for the content of these third-party websites.

This report is for information purposes only and (i) does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for any financial, money market or investment instrument or any security, (ii) is neither intended as such an offer for sale or subscription of or solicitation of an offer to buy or subscribe for any financial, money market or investment instrument or any security nor (iii) as marketing material within the meaning of applicable prospectus law . The investment possibilities discussed in this report may not be suitable for certain investors depending on their specific investment objectives and time horizon or in the context of their overall financial situation. The investments discussed may fluctuate in price or value. Investors may get back less than they invested. Fluctuations in exchange rates may have an adverse effect on the value of investments. Furthermore, past performance is not necessarily indicative of future results. In particular, the risks associated with an investment in the financial, money market or investment instrument or security under discussion are not explained in their entirety.

This information is given without any warranty on an "as is" basis and should not be regarded as a substitute for obtaining individual advice. Investors must make their own determination of the appropriateness of an investment in any instruments referred to herein based on the merits and risks involved, their own investment strategy and their legal, fiscal and financial position. As this document does not qualify as an investment recommendation or as a direct investment recommendation, neither this document nor any part of it shall form the basis of, or be relied on in connection with or act as an inducement to enter into, any contract or commitment whatsoever. Investors are urged to contact their bank's investment advisor for individual explanations and advice.

Neither UniCredit Bank AG, UniCredit Bank AG London Branch, UniCredit Bank AG Milan Branch, UniCredit Bank AG Vienna Branch, UniCredit Bank Austria AG, UniCredit Bulbank, Zagrebačka banka d.d., UniCredit Bank Czech Republic and Slovakia, ZAO UniCredit Bank Russia, UniCredit Bank Czech Republic and Slovakia Slovakia Branch, UniCredit Bank Romania, UniCredit Bank AG New York Branch nor any of their respective directors, officers or employees nor any other person accepts any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith.

This report is being distributed by electronic and ordinary mail to professional investors, who are expected to make their own investment decisions without undue reliance on this publication, and may not be redistributed, reproduced or published in whole or in part for any purpose.

This report was completed and first published on 30 June 2022 at 07:41.

**Responsibility for the content of this publication lies with:**

**UniCredit Group and its subsidiaries are subject to regulation by the European Central Bank**

a) UniCredit Bank AG (UniCredit Bank, Munich or Frankfurt), Arabellastraße 12, 81925 Munich, Germany, (also responsible for the distribution pursuant to §85 WpHG). Regulatory authority: "BaFin" – Bundesanstalt für Finanzdienstleistungsaufsicht, Marie-Curie-Str. 24-28, 60439 Frankfurt, Germany.

b) UniCredit Bank AG London Branch (UniCredit Bank, London), Moor House, 120 London Wall, London EC2Y 5ET, United Kingdom. Regulatory authority: "BaFin" – Bundesanstalt für Finanzdienstleistungsaufsicht, Marie-Curie-Str. 24-28, 60439 Frankfurt, Germany and subject to limited regulation by the Financial Conduct Authority, 12 Endeavour Square, London E20 1JN, United Kingdom and Prudential Regulation Authority 20 Moorgate, London, EC2R 6DA, United Kingdom. Further details regarding our regulatory status are available on request.

c) UniCredit Bank AG Milan Branch (UniCredit Bank, Milan), Piazza Gae Aulenti, 4 - Torre C, 20154 Milan, Italy, duly authorized by the Bank of Italy to provide investment services.

Regulatory authority: "Bank of Italy", Via Nazionale 91, 00184 Roma, Italy and Bundesanstalt für Finanzdienstleistungsaufsicht, Marie-Curie-Str. 24-28, 60439 Frankfurt, Germany.

d) UniCredit Bank AG Vienna Branch (UniCredit Bank, Vienna), Rothschildplatz 1, 1020 Vienna, Austria. Regulatory authority: Finanzmarktaufsichtsbehörde (FMA), Otto-Wagner-Platz 5, 1090 Vienna, Austria and subject to limited regulation by the "BaFin" – Bundesanstalt für Finanzdienstleistungsaufsicht, Marie-Curie-Str. 24-28, 60439 Frankfurt, Germany. Details about the extent of our regulation by the Bundesanstalt für Finanzdienstleistungsaufsicht are available from us on request.

e) UniCredit Bank Austria AG (Bank Austria), Rothschildplatz 1, 1020 Vienna, Austria. Regulatory authority: Finanzmarktaufsichtsbehörde (FMA), Otto-Wagner-Platz 5, 1090 Vienna, Austria

f) UniCredit Bulbank, Sveta Nedelya Sq. 7, BG-1000 Sofia, Bulgaria. Regulatory authority: Financial Supervision Commission (FSC), 16 Budapeshta str., 1000 Sofia, Bulgaria

g) Zagrebačka banka d.d., Trg bana Josipa Jelačića 10, HR-10000 Zagreb, Croatia. Regulatory authority: Croatian Agency for Supervision of Financial Services, Franje Račkoga 6, 10000 Zagreb, Croatia

h) UniCredit Bank Czech Republic and Slovakia, Želetavská 1525/1, 140 92 Praga 4, Czech Republic. Regulatory authority: CNB Czech National Bank, Na Příkopě 28, 115 03 Praga 1, Czech Republic

i) ZAO UniCredit Bank Russia (UniCredit Russia), Prechistenskaya nab. 9, RF-119034 Moscow, Russia. Regulatory authority: Federal Service on Financial Markets, 9 Leninsky prospekt, Moscow 119991, Russia

j) UniCredit Bank Czech Republic and Slovakia, Slovakia Branch, Šancova 1/A, SK-813 33 Bratislava, Slovakia. Regulatory authority: CNB Czech National Bank, Na Příkopě 28, 115 03 Praha 1, Czech Republic and subject to limited regulation by the National Bank of Slovakia, Imricha Karvaša 1, 813 25 Bratislava, Slovakia. Regulatory authority: National Bank of Slovakia, Imricha Karvaša 1, 813 25 Bratislava, Slovakia

k) UniCredit Bank Romania, Bucharest 1F Expozitiei Boulevard, 012101 Bucharest 1, Romania. Regulatory authority: National Bank of Romania, 25 Lipscani Street, 030031, 3rd District, Bucharest, Romania

l) UniCredit Bank AG New York Branch (UniCredit Bank, New York), 150 East 42nd Street, New York, NY 10017. Regulatory authority: "BaFin" – Bundesanstalt für Finanzdienstleistungsaufsicht, Marie-Curie-Str. 24-28, 60439 Frankfurt, Germany and New York State Department of Financial Services, One State Street, New York, NY 10004-1511

Further details regarding our regulatory status are available on request.

**ANALYST DECLARATION**

The analyst's remuneration has not been, and will not be, geared to the recommendations or views expressed in this report, neither directly nor indirectly.

All of the views expressed accurately reflect the analyst's views, which have not been influenced by considerations of UniCredit Bank's business or client relationships.

**POTENTIAL CONFLICTS OF INTERESTS**

You will find a list of keys for company specific regulatory disclosures on our website https://www.unicreditresearch.eu/index.php?id=disclaimer.

**RECOMMENDATIONS, RATINGS AND EVALUATION METHODOLOGY**

You will find the history of rating regarding recommendation changes as well as an overview of the breakdown in absolute and relative terms of our investment ratings, and a note on the evaluation basis for interest-bearing securities on our website https://www.unicreditresearch.eu/index.php?id=disclaimer and https://www.unicreditresearch.eu/index.php?id=legalnotices.

**ADDITIONAL REQUIRED DISCLOSURES UNDER THE LAWS AND REGULATIONS OF JURISDICTIONS INDICATED**

You will find a list of further additional required disclosures under the laws and regulations of the jurisdictions indicated on our website https://www.unicreditresearch.eu/index.php?id=disclaimer.

E 20/1

# Banking network

## UniCredit Group CE & EE banking network – Headquarters

### Bosnia and Herzegovina

**UniCredit Bank d.d.**
Kardinala Stepinca - bb,
BH-88000 Mostar
Phone: +387 33 222 999
Email: info@unicreditgroup.ba
www.unicreditbank.ba

**UniCredit Bank Banja Luka**
Marije Bursac 7
BA-78000 Banja Luka
Phone: +387 80 051 051
Email: info-bl@unicreditgroup.ba
www.unicreditbank-bl.ba

### Bulgaria

**UniCredit Bulbank**
Sveta Nedelya Sq. 7
BG-1000 Sofia
Phone: +359 70 01 84 84
www.unicreditbulbank.bg

### Croatia

**Zagrebačka banka d.d.**
Trg bana Josipa Jelačića 10
HR-10000 Zagreb
Phone: +385 1 6104 169
Email: zaba@unicreditgroup.zaba.hr
www.zaba.hr

### Czech Republic

**UniCredit Bank**
Želetavská 1525/1
CZ-140 92 - Prague 4
Phone: +420 955 911 111
Email: info@unicreditgroup.cz
www.unicreditbank.cz

### Hungary

**UniCredit Bank**
Szabadság tér 5-6
H-1054 Budapest
Phone: +36 1 301 12 71
Email: info@unicreditgroup.hu
www.unicreditbank.hu

### Romania

**UniCredit Bank**
1F, Blvd. Expozitiei
RO-012101 Bucharest 1
Phone: +40 21 200 2000
Email: office@unicredit.ro
www.unicredit.ro

### Russia

**UniCredit Bank**
Prechistenskaya nab. 9
RF-119034 Moscow
Phone: +7 495 258 7258
Email: unicredit@unicreditgroup.ru
www.unicreditbank.ru

### Serbia

**UniCredit Bank**
Rajiceva 27-29
RS-11000 Belgrade
Phone: +381 11 3204 500
Email: office@unicreditbank.rs
www.unicreditbank.rs

### Slovakia

**UniCredit Bank**
Săncova 1/A
SK-813 33 Bratislava
Phone: +421 2 4950 1111
www.unicreditbank.sk

### Slovenia

**UniCredit Bank**
Šmartinska Cesta 140
SI-1000 Ljubljana
Phone: +386 1 5876 600
Email: info@unicreditgroup.si
www.unicreditbank.si

# Contacts for entering into a business relationship with UniCredit's corporate banking network (UniCredit International Centers)

## UniCredit International Center CE & EE

**Roberto Poliak**
Mobile: +39 334 6824779
Email: roberto.poliak@unicredit.eu
Email: UIC_CEE@unicredit.eu

## UniCredit International Center Germany

**Holger Frank**
Phone: +49 89 378 20141
Email: holger.frank@unicredit.de
Email: UIC-Germany@unicredit.de

## UniCredit International Center Italy

**Alessandro Paoli**
Phone: +39 366 5265414
Email: alessandro.paoli@unicredit.eu
Email : UIC-Italia@unicredit.eu

## Austria

**Greta Qello**
Phone: +43 50505 52304
Email: greta.qello@unicreditgroup.at
Email: UIC-Austria@unicreditgroup.at

## Bosnia and Herzegovina

**UniCredit Bank d.d.**
**Lejla Sabljica**
Tel +387 33 491 777
lejla.sabljica@unicreditgroup.ba
international.desk@unicreditgroup.ba

**U UniCredit Bank a.d. Banja Luka**
**Mladen Radović**
Tel +387 51 243-423
Fax +387 51 212-060
mladen.radovic@unicreditgroup.ba
international.centerUBB@unicreditgroup.ba

## Bulgaria

**Mihael Novotny**
Phone: +359 882 374 323
Email: mihael.novotny@unicreditgroup.bg
Email: UIC-Bulgaria@unicreditgroup.bg

## Croatia

**Albert Hulshof**
Phone: +385 1 6305 480
Email: Albert.Hulshof@unicreditgroup.zaba.hr
Email: UIC-Croatia@unicreditgroup.zaba.hr

## Czech Republic

**Jan Świerczyna**
Phone: +420 602820212
Email: jan.swierczyna@unicreditgroup.cz
Email: UIC-CZ@unicreditgroup.cz

## Hungary

**Andrea D'Alessandro**
Phone: +36 1301 1207
Email: andrea.dalessandro@unicreditgroup.hu
Email: UIC-Hungary@unicreditgroup.hu

## Romania

**Alessandro Masotti**
Phone: +4 021 200 1616
Email: alessandro.masotti@unicredit.ro
Email:International-CBBM@unicredit.ro

## Russia

**Martin Madjarov**
Phone: +7 495 2587258 ext. 3317
Email: martin.madjarov@unicredit.ru
Email: UIC-Russia@unicredit.ru

## Serbia

**Dragos Bostan**
Phone: +381 66 805 76 54
Email: dragosiulian.bostan@unicreditgroup.rs
Email: International.Desk@unicreditgroup.rs

## Slovakia

Jan Świerczyna
Phone: +420 602820212
Email:jan.swierczyna@unicreditgroup.cz
Email: UIC-SK@unicreditgroup.sk

## Slovenia

**Alenka Kreuzer**
Phone: +386 1 5876 938
Email: alenka.kreuzer@unicreditgroup.si
Email: UIC-SLO@unicreditgroup.si

## UniCredit Research* CEE Macro & Strategy Research


**Marco Valli**
Global Head of Research,
Chief European Economist
+39 02 8862-0537
marco.valli@unicredit.eu

**Dr. Ingo Heimig**
Head of Research Operations
& Regulatory Controls
+49 89 378-13952
ingo.heimig@unicredit.de


### Head of Macro Research


**Marco Valli**
Global Head of Research,
Chief European Economist
+39 02 8862-0537
marco.valli@unicredit.eu


### Heads of Strategy Research


**Dr. Luca Cazzulani**
Head of Strategy Research
FI Strategist
+39 02 8862-0640
luca.cazzulani@unicredit.eu

**Elia Lattuga**
Cross Asset Strategist
Deputy Head of Strategy Research
+39 02 8862-0851
elia.lattuga@unicredit.eu


### EEMEA Economics Research


**Dan Bucşa**
Chief CEE Economist
+44 207 826-7954
dan.bucsa@unicredit.eu

**Gökçe Çelik**
Senior CEE Economist
+44 207 826-6077
gokce.celik@unicredit.eu

**Mauro Giorgio Marrano**
Senior CEE Economist
+43 50505-82712
mauro.giorgiomarrano@unicredit.de

**Artem Arkhipov**
Head, Macroeconomic Analysis
and Research, Russia
+7 495 258-7258
artem.arkhipov@unicredit.ru

**Hrvoje Dolenec**
Chief Economist, Croatia
+385 1 6006-678
hrvoje.dolenec@unicreditgroup.zaba.hr

**Dr. Ágnes Halász**
Chief Economist, Head, Economics and
Strategic Analysis, Hungary
+36 1 301-1907
agnes.halasz@unicreditgroup.hu

**Ľubomír Koršňák**
Chief Economist, Slovakia
+421 2 4950 2427
lubomir.korsnak@unicreditgroup.sk

**Anca Maria Negrescu**
Senior Economist, Romania
+40 21 200-1377
anca.negrescu@unicredit.ro

**Kristofor Pavlov**
Chief Economist, Bulgaria
+359 2 923-2192
kristofor.pavlov@unicreditgroup.bg

**Pavel Sobíšek**
Chief Economist, Czech Republic
+420 955 960-716
pavel.sobisek@unicreditgroup.cz


### Cross Asset Strategy Research


**Elia Lattuga**
Cross Asset Strategist
Deputy Head of Strategy Research
+39 02 8862-0851
elia.lattuga@unicredit.eu


**UniCredit Research, Corporate & Investment Banking, UniCredit Bank AG, Am Eisbach 4, D-80538 Munich, globalresearch@unicredit.de**
**Bloomberg: UCCR, Internet: www.unicreditresearch.eu**

CEE 22/4

*UniCredit Research is the joint research department of UniCredit Bank AG (UniCredit Bank, Munich or Frankfurt), UniCredit Bank AG London Branch (UniCredit Bank, London), UniCredit Bank AG Milan Branch (UniCredit Bank, Milan), UniCredit Bank AG Vienna Branch (UniCredit Bank, Vienna), UniCredit Bank Austria AG (Bank Austria), UniCredit Bulbank, Zagrebačka banka d.d., UniCredit Bank Czech Republic and Slovakia, ZAO UniCredit Bank Russia (UniCredit Russia), UniCredit Bank Romania.