Executive summary

Economic recovery in most of the countries of Central, East and Southeast Europe (CESEE) gathered momentum in Q1 2024, with annual growth ranging from 5.7% in Turkey to -2.4% in Estonia. However, the recovery continued to be lopsided: private consumption and services picked up, whereas industry and exports still struggled, due to industrial weakness in Germany – the main trading partner of most CESEE countries. By contrast, countries outside the German-led manufacturing cluster, such as the states of the CIS and Turkey, have shown much better industrial performance.

The main drivers behind the recovery in household consumption have been the growth in real wages on the back of recent disinflation and a sharp rise in nominal wages. For the first time in the past three years, real wage growth in Q1 turned positive everywhere in the region. However, only part of the extra money from rising wages is being spent; the rest is being used to replenish the savings that were dipped into to smooth consumption over the previous two years. Besides, the recent slowdown in inflation – to 2-3% in many countries – is likely to be nearing its end, as consumer demand strengthens further and production costs rise on the back of the major growth in wages – which is in part a consequence of resurgent labour shortages. In Russia and Belarus – to say nothing of Turkey – inflationary pressures remain high, arguably reflecting conditions of economic overheating.

Despite some monetary easing in many CESEE countries recently, financial conditions remain generally tight, with real policy interest rates hovering in positive territory nearly everywhere. **At the same time, economic recovery is being supported by lax fiscal policy.** Budget deficits are generally on the rise, in part due to the elections in many countries this year, as well as high levels of military spending. Although deficits can be comfortably financed in most cases, the forthcoming (re)launch of the EU Excessive Deficit Procedure (EDP) against Poland, Hungary, Slovakia and Romania – all of which will run public deficits in excess of 5% of GDP this year – may exert some consolidation pressure.

Compared with our Spring 2024 Forecast, the growth prospects in CESEE for this year have generally improved. The economy of the region as a whole is projected to grow by 3.1% – roughly the same pace as in 2023, with the acceleration in EU-CEE (and, to a lesser extent, Western Balkans) being offset by the slowdown in Turkey, CIS3 and particularly Ukraine, where the large-scale destruction of power generation capacity will weigh heavily on the economic performance. In 2025-2026, economic expansion in CESEE is projected to pick up pace only marginally, and the risks are mainly on the downside. The most important risk is related to the possible victory of Donald Trump in the US presidential elections in November: that could lead to another round in the trade war with China and to a weakening of the US security commitment to the CESEE region.