Executive summary

Subdued growth in Western Europe continues to act as a drag on output in Central, East and Southeast Europe (CESEE), but there are tentative signs of improvement. In the euro area, fiscal expansion for defence and infrastructure is providing modest support, while disinflation is helping to restore purchasing power. The protectionist trade policy of the US has introduced new frictions and uncertainty, yet the euro area remains resilient, aided by strong labour markets and a gradual easing of monetary conditions. Inflation is projected to stabilise at just below 2% and the European Central Bank is expected to maintain an accommodative stance. For the economies of CESEE, these assumptions imply a relatively favourable external environment, even if global trade and investment remain constrained by geopolitical fragmentation.

Politically, the war in Ukraine is continuing without any credible prospect of settlement. The Trump administration has shifted the financial and logistical burden of supporting Kyiv toward Europe, while the EU is seeking to preserve unity through a mixture of fiscal solidarity and pragmatic dependence on US defence supplies. Despite periodic tensions within the bloc – especially with Hungary, Slovakia and now Czechia – EU cohesion has so far held. In Poland and Romania, domestic political deadlock complicates policy, but does not alter the overall pro-European orientation. Across the region, illiberal forces remain influential, but constrained by institutions, coalitions and EU conditionality. While political volatility is likely to persist, there is no clear drift away from European integration. The dominant feature of the outlook is the normalisation of conflict – an environment of chronic insecurity that compels higher defence spending and a structural reordering of the region's economies.

Against this backdrop, the CESEE region continues to grow faster than Western Europe, though at a slower and more uneven pace than before the pandemic. Regional GDP is expected to expand by about 2.2% in 2025 and 2.7% by 2027. The slowdown largely reflects Russia's weaker performance and tighter fiscal policies elsewhere, but most economies are continuing to converge gradually with the EU average. Poland and Kazakhstan are among the leaders in the region, the former buoyed by strong consumption, EU recovery funds and defence-sector expansion; the latter by energy exports and infrastructure investment. Southeast Europe remains a bright spot, thanks to tourism, services exports and large-scale public investment. By contrast, growth in Hungary, Romania and Slovakia is restrained by fiscal consolidation, capacity limits and subdued German demand. Ukraine and Moldova are recovering gradually, though they are dependent on foreign aid and reconstruction funds.

Defence spending is becoming a central macroeconomic driver. Most NATO members in the region are now spending at least 2% of GDP on defence – and in some cases the figure is far higher. Modelling suggests that these increases could add 0.2-0.3 percentage points to annual growth in the coming years – and even more in the Baltics and Poland. Beyond the short-term stimulus, defence investment is speeding up industrial upgrading. Poland, Czechia and Slovakia are expanding dual-use production and modernising supply chains, while defence procurement is stimulating the metal, electronics and IT industries. This is gradually transforming CESEE's industrial structure, creating spill-overs that extend beyond security-related sectors.

Inflation across the region is continuing to moderate, following the shocks of 2022-2023, though in some countries it remains well above target. Monetary policy has shifted decisively from tightening to gradual easing, helping to revive private credit and investment. Fiscal policy, however, is diverging. Romania faces the most abrupt consolidation, but other countries are following more gradually. Large deficits in Hungary, Poland and Turkey remain a vulnerability, particularly if investor sentiment turns. Fiscal policy will be much less supportive of growth during the forecast period in parts of CESEE, especially EU-CEE.

A major structural change under way is the erosion of cost competitiveness. Since 2020, real effective exchange rates have appreciated by 10-30%, and nominal unit labour costs have risen far faster than productivity. This reflects tight labour markets, demographic decline and a necessary correction after decades of low pay relative to output. The region's long-standing model of low-wage, export-led growth is therefore reaching its limits. Yet this is not only a constraint: it is also a rebalancing. Rising wages are fostering domestic demand and pushing firms to automate, innovate and climb the value chain. In this sense, the apparent loss of competitiveness may prove to be the catalyst for a more mature, productivity-based growth model.

Investment will be the key driver of this transformation. EU funds, lower interest rates and revived business confidence are supporting a recovery in capital formation. Firms across CESEE report stronger sales projections and higher planned investments. Public investment remains substantial, anchored by EU Recovery and Resilience Facility inflows and pre-accession financing for the Western Balkans. These programmes not only sustain short-term growth, but also enhance long-term capacity through the modernisation of transport, energy and digital networks. Defence, the green transition and near-shoring further reinforce the investment cycle, offering new sources of resilience.

The regional risk landscape remains complex. Structural labour shortages are prevalent in almost all economies, fiscal credibility is under scrutiny in several, and political uncertainty clouds investor confidence. The proximity of conflict and persistent Russian hybrid threats continue to generate security costs. Yet these risks coexist with historic opportunities. Near-shoring and European reindustrialisation are drawing high-value investment into CESEE; energy diversification and the expansion of renewables are strengthening resilience; digitalisation and IT services are creating new competitive advantages; and eventually, the reconstruction of Ukraine will generate a powerful regional growth impulse.

In sum, the countries of CESEE are entering a new phase of economic development, shaped by higher defence outlays, deeper EU integration and a gradual shift away from the low-cost growth paradigm. The coming years will bring slower but more sustainable convergence with Western Europe. Productivity-enhancing investment and security-related spending will underpin growth; but there is no room for complacency over the cost of adjustment, which includes fiscal strain, labour shortages and political volatility. The region's challenge is to turn these pressures into drivers of transformation, ensuring that resilience, innovation and integration replace cheap labour as the basis of prosperity.

COUNTRY SUMMARIES

ALBANIA

Economic activity in the first half of 2025 expanded by 3.6% – a similar pace as in 2024. Inflationary pressures continued to be moderate and below the target level of the central bank as core inflation remains relatively low. Monetary policy is still supportive of the economy, while the SEPA system, in operation since October 2025, will further strengthen financial integration with the EU, and will intensify and formalise cross-border transactions. The current account balance is benefiting from growing tourism and remittances. The interest of foreign direct investors in Albania is still strong, despite the global headwinds. There has been a further appreciation of the domestic currency, which is presenting a challenge to export-oriented companies.

BELARUS

In H1 2025, GDP grew by 2.1% year on year, broadly in line with earlier expectations of a slowdown, despite government efforts to stimulate domestic demand. Initially, political considerations impelled the authorities to aim for higher growth in 2025 than would have been natural, given the poor foreign demand and the accumulated macroeconomic imbalances. However, they now seem more accepting of a slow-growth environment and are placing more emphasis on taming inflation. This approach will likely result in GDP growth falling below 2% in 2026-2027, with somewhat heightened inflation in the 6-7% range.

BOSNIA AND HERZEGOVINA

The first half of 2025 was marked by slower economic growth, rising inflation and heightened political tension. Growth eased as the construction and energy sectors contracted amid weaker FDI inflows, while political uncertainty in Republika Srpska further weighed on investor sentiment. Inflation picked up, driven by higher food and energy prices and sharp hikes in the minimum wage, but real wages continued to rise, improving purchasing power. With these mixed signals and ongoing political instability, we have revised our growth forecast slightly downward and have raised the outlook for inflation.

BULGARIA

Bulgaria is set to adopt the euro on 1 January 2026 – something that is expected to benefit the country significantly in the long term. The government anticipates a disbursement of EUR 440m under Bulgaria's Recovery and Resilience Plan. In addition, the economy is projected to grow by 2.9%, driven by strong domestic demand, with further acceleration anticipated in the following two years. The nation's sovereign credit rating has been upgraded, reflecting the positive economic outlook.

CROATIA

Croatia's GDP growth reached 3.9% in 2024, helped along by the inflow of EU funds, its 2023 accession to the euro area and its membership of the EU's border-free Schengen zone. Although growth is expected to slow to 3% in 2025 and 2.8% in 2026, owing to moderating domestic demand, it will still surpass that in the euro area. Tourism remains the main driver of growth, while the lack of skilled workers continues to pose an obstacle to higher growth. Inflation reached 4% in 2024 and will likely decline to 3.7% this year, remaining above the European Central Bank target over the forecast horizon.

CZECHIA

The Czech economy showed notable resilience in the first half of 2025, driven by strong household consumption, as wages rose and inflation eased. Investment and trade remained weak, but most sectors contributed positively to growth. Having just won the election, ANO, led by former Prime Minister Andrej Babiš, has promised increases in welfare spending and tax cuts, and has voiced its opposition to further green measures. This – together with higher defence spending – will likely constrain fiscal policy. Growth is forecast to be 2.2% this year, followed by an acceleration to 2.4% and 2.7% in 2026 and 2027, respectively.

ESTONIA

After two years of recession and stagnation, Estonia's economy is set to return to growth over the forecast horizon. The recovery will be supported by improving external demand, gradually strengthening household consumption, and the resilience of services and ICT. However, the pace is expected to remain modest, as weak confidence, high defence spending and persistent competitiveness challenges limit the outlook.

HUNGARY

The economic stagnation is expected to persist this year. The only vigorous expansion recorded has been in household and government consumption; meanwhile, on the output side, services have shown modest growth – but only sufficient to secure an increase in GDP of around 0.5%. The spending spree ahead of the April 2026 elections will temporarily boost growth, but the large fiscal deficit will necessitate restrictive measures as early as the second half of next year.

KAZAKHSTAN

Kazakhstan's real GDP is expected to grow by 6% in 2025, marking the strongest expansion in over a decade. This robust economic performance is driven by credit-led private consumption, alongside infrastructure and manufacturing investment. However, growth is projected to slow slightly in the coming years, due to the expected cooling of consumer demand amid stubborn inflation, tight monetary policy and fiscal consolidation measures. A fall in global oil prices and completion of the Tengiz oil field expansion will likely drag down oil-sector investment. Major risks to the forecast stem from potential disruptions to oil transportation, a deeper plunge in global oil prices, or weakening demand from the country's main trading partners.

KOSOVO

The economy is expected to grow by 3.9% in 2025 – a moderate deceleration from the 4.5% expansion of 2024. Inflation picked up during Q2 and Q3 2025, and exposure to import price shocks remains high, given the country's heavy dependence on imports. The trade imbalance will lead to a persistent current account deficit. Domestic demand, public investment and services exports remain the primary growth engines, but downside risks from the political deadlock, inflationary risks and trade headwinds remain elevated.

LATVIA

A rebound in investment and exports has brought GDP growth into positive territory, following last year's recession. However, we expect only a modest upswing of 1.0% this year. External demand is recovering only slowly, while increasing inflation is damping down wage growth; however, at about 6% in annual net terms, it still supports the growth in household consumption. The government has sharply increased public investment, while private investment remains subdued. Owing to the relatively tight labour market, the unemployment rate is set to remain stagnant in 2025 and then to decline slightly over the next two years. Assuming that economic activity among the country's main trading partners rebounds faster in the coming years, Latvia's own economy should also pick up, by a projected 2.4% in 2026 and 2.3% in 2027.

LITHUANIA

The economy performed decently in Q2 2025, but less well than expected, with real GDP increasing by 3.1% year on year. This year's higher inflation has meant that the growth in real incomes has lost steam – a trend that will largely continue over the next two years. Still, growth in household consumption remains stable. Employment is expanding steadily, and unemployment has remained almost unchanged. Alongside public investment, private investment is on the rise, as external demand emerges from the doldrums. Meanwhile, the government has further plans to raise investment in both infrastructure and, particularly, defence. We expect real GDP to grow by 2.6% in 2025, followed by 3.2% in 2026 and 2.4% in 2027.

MOLDOVA

Moldova is recovering from January's energy crisis and may achieve economic growth of 0.8% in 2025. Favourable weather, strong investment activity and pre-election stimuli have supported growth. The outlook is brighter still, with 2.5% growth expected in 2026. The country no longer depends on Russian energy, and the pro-EU Party of Action and Solidarity (PAS) secured victory in the 28 September elections. Reforms are set to accelerate; thus, Moldova can benefit from more European funds. Yet weak competitiveness, agriculture's dependence on the weather and Russian destabilisation remain key risks.

MONTENEGRO

In autumn 2025, Montenegro is faced with a dichotomy: on the one hand, economic growth is broadly in line with expectations, unemployment has reached an all-time low, and households are benefiting from a strong increase in real wages. On the other hand, the economy's vulnerabilities are becoming more sharply defined, with inflation again picking up, the trade deficit widening and the Pension Fund sinking deeper into deficit. EU accession is advancing more slowly than expected: Chapter 5 on public procurement was provisionally closed in June, but much of the negotiation agenda is still stalled.

NORTH MACEDONIA

Growth has exceeded expectations, driven by residential construction and strong exports, partly boosted by front-loading ahead of the US tariffs. Meanwhile, there has been a resurgence of inflation, which is eroding real wages. Fiscal policy has remained loose, breaking fiscal rules, with populist spending on pensions instead of on capital projects. The upcoming local elections will be the first major test of the new government's popularity, and could determine whether it maintains its course or adjusts its policies.

POLAND

Poland's economy has been growing steadily in 2025, with GDP expected to rise by 3.5%, driven by household and government spending, as well as by firms replenishing their inventories. However, private investment and exports remain weak, and unemployment is slowly rising, especially in export-oriented sectors. Inflation has eased, but real wage growth is slowing as well, which may reduce consumer demand in the coming years. In the context of a high policy rate and growing private savings, fiscal policy remains expansionary, pushing public debt higher. Despite current stability, structural change in international competitiveness and political tension between the government and the president pose risks to future growth.

ROMANIA

Economic growth will reach 0.8% at best in 2025. After some growth in H1, GDP will more or less stagnate in H2 2025 and H1 2026. An improving external balance and better agricultural output may help, but fiscal austerity will suppress growth. The EU has agreed to a new fiscal consolidation path, which will allow for the release of EU funds, so that investment is set to rise. Inflation has accelerated due to tax hikes, while real wages are stagnating. Monetary policy is under pressure, as the currency remains overvalued despite recent depreciations, and a policy rate hike cannot be ruled out.

RUSSIA

Thanks to extremely tight monetary policy, inflation has largely been brought under control. However, this success has come at the cost of weakening domestic demand and stalling GDP growth. Stagnation, moderate oil prices and a strong rouble have all put government revenue under pressure, which has prompted further tax hikes, including in the VAT rate. After a disappointing 1.2% this year, growth is expected to accelerate slightly, to 1.4% and 1.5% in 2026 and 2027, respectively, with a further easing of monetary policy providing modest support to consumption.

SERBIA

Economic activity has slowed visibly, driven by a halving of FDI inflows amid the global political uncertainty. The labour market is showing early signs of losing steam, with unemployment edging up a bit. Inflation has flared up again, to run at close to 5%. The domestic political crisis is continuing: while the president has so far managed to buy time and avoid calling a snap election, it is clearer than ever that his time is up. All in all, Serbia seems to be in waiting mode – and, as the saying goes, good things come to those who wait.

SLOVAKIA

The wiiw growth forecasts for this year and next have been revised sharply downwards, to 0.7% and 1.1%, respectively. Growing imports in the first half of 2025 had an adverse effect on growth. In addition, fiscal consolidation is weighing on household consumption, while external uncertainties are affecting trade. However, the important automotive sector has so far proved resilient, and planned new capacities will boost exports and improve the outlook for 2027.

SLOVENIA

Slovenia's economy remains under pressure from subdued export growth and weak sentiment among households and businesses. We forecast GDP growth of 0.5% in 2025; this will pick up to 1.8% in 2026, as external demand gradually improves and government expenditure strengthens. Inflation in 2025 will remain elevated at 2.8%, driven primarily by rising food prices. Energy-intensive industries are continuing to contract, weighing on employment despite the structural labour shortages. The political scene is hotting up ahead of the 2026 parliamentary elections, when a shift to the right appears increasingly likely.

TURKEY

Turkey's economy demonstrated resilience in Q2 2025, with GDP growing by 4.8% year on year, driven by strong household consumption and investment, despite tighter monetary policy. The economic impact of the domestic political turmoil following Istanbul Mayor Ekrem İmamoğlu's arrest appears to have been largely absorbed; thus we have maintained our 2025 growth forecast at 3.4%. However, risks remain, as upcoming court cases against the main opposition party could weaken the lira and push up inflation. Fiscal consolidation is continuing, though the budget deficit remains elevated. US-Turkey ties appear stronger in President Trump's second term than they were in his first, while domestic political tension remains the main risk to the economic outlook.

UKRAINE

It is estimated that Ukraine's economy will grow by only 2% this year, primarily because of its poor export performance following last year's bad harvest. Inflation is declining, thanks to a tight monetary policy and a stable exchange rate. As the war is now expected to last longer than was previously thought, we have downgraded our GDP forecast for the next two years. Needless to say, the forecast is subject to very high levels of uncertainty, due to unpredictability in how the war develops and in the availability of external aid.

Keywords: CESEE Central and Eastern Europe, economic forecast, Western Balkans, CIS, Ukraine, Russia, Turkey, EU, business cycle, economic sentiment, euro area, convergence, labour markets, unemployment, Russia-Ukraine war, commodity prices, inflation, price controls, trade disruptions, renewable energy, gas, electricity, monetary policy, fiscal policy

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