

Executive summary

The external environment for Central, East and Southeast Europe (CESEE) has deteriorated sharply since the previous forecast round. The war between the US/Israel and Iran, which began on 28 February 2026, is now the main new factor shaping the outlook. Its effects are being transmitted through higher energy prices, shipping disruptions and weaker confidence, with the biggest immediate risk to CESEE coming from renewed inflationary pressure.

This shock has interrupted a fragile euro-area recovery. Growth in late 2025 was being supported mainly by private consumption, though Germany remained weak. Since the outbreak of the Middle East conflict, business surveys have pointed to near-stagnation, while inflation, supply-chain stress and uncertainty have all risen again. This matters for CESEE, because many of the economies in the region remain closely tied to German industry and are heavily exposed to imported energy and inflation.

In our baseline scenario, the war is short-lived and the energy shock proves temporary, but the damage is still significant. Euro-area growth is revised down to 0.9% in 2026, inflation rises to 2.6%, and Brent oil is assumed to average USD 85 per barrel. In the pessimistic scenario, with a more protracted conflict, euro-area growth slows to 0.5%, inflation reaches 3.5% and oil averages USD 110 per barrel.

Despite this weaker external backdrop, CESEE is still expected to outperform Western Europe. In the baseline scenario, the CESEE region as a whole grows by 2.1% in 2026, compared with 0.9% in the euro area, before growth rises further in 2027 and 2028. However, this aggregate resilience masks increasingly wide divergence across the region. Southeast Europe, Kazakhstan and Poland are expected to remain among the stronger performers, while parts of EU-CEE, as well as Russia and Belarus, will lag behind. Romania and Slovakia stand out as particularly weak within EU-CEE, while Ukraine and Serbia are among the countries seeing the biggest forecast downgrades this year. In the pessimistic scenario, some countries would likely enter at least a technical recession.

Inflation is once again central to the outlook. The current shock is both more and less worrying than the 2022-2023 inflation crisis. It is less severe in one important sense: it is mainly an energy price shock, rather than a combined energy and broad supply shock, and gas prices remain far below the extremes of 2022. Europe is more diversified in terms of energy supply than it was then. But the shock is also potentially more persistent, because it is being driven by an unpredictable geopolitical conflict that could continue to keep the Strait of Hormuz effectively disrupted and global commodity prices elevated.

The regional pass-through from global prices to domestic inflation will not be uniform. Oil price rises feed quickly into domestic fuel prices. Food price effects tend to appear later, with a lag of roughly 6-12 months. Utilities prices vary most across countries because they depend heavily on national pricing systems, price controls and fiscal interventions. This means that even if global energy prices stabilise relatively soon, inflation across CESEE is still likely to rise further into late 2026, as delayed pass-through effects show up in food and household utility bills. In the baseline scenario, inflation forecasts

have therefore been revised upward across most of the region; in the pessimistic scenario, the increases are much larger, with particular vulnerability in Turkey, Belarus and parts of the Western Balkans.

Country exposure depends on a mix of structural and policy factors: energy import dependence, the weight of energy and food in consumer baskets, current inflation, exchange-rate stability and fiscal space. On this basis, Albania, Bulgaria, Czechia, Estonia and Slovenia look relatively well placed to withstand the shock. Romania appears to be the country worst positioned, because it enters this episode with already very high inflation and a weak fiscal position. Turkey and Ukraine stand out as special cases: Turkey because of its very high inflation and dependence on imported energy, and Ukraine because it is facing simultaneous pressure from fuel constraints, fertiliser prices and the ongoing war. Russia and Kazakhstan, by contrast, benefit from higher oil prices through stronger fiscal and external balances, even if sanctions, bottlenecks and domestic policy constraints limit the upside.

The war has also changed the monetary outlook across the region. Most central banks had been in a rate-cutting cycle. That process is now expected to slow, pause or partly reverse. Even where rates still fall, they are likely to remain higher than previously projected. This reflects both renewed inflationary pressure and concern about currency weakness. Countries such as Turkey, Romania, Ukraine, Kazakhstan and North Macedonia are now expected to maintain significantly tighter policy than was forecast in the winter. Exchange rates in the more vulnerable economies are also expected to come under greater pressure.

Beyond the short-term shock, the deeper message of this forecast round is structural: CESEE is moving from a convergence model based on cheap labour, strong FDI inflows, external openness, German industrial demand and generous EU funding toward a more complex and volatile model based on adaptation. Since 2020 the region has experienced a pronounced loss of cost competitiveness, driven by labour costs rising faster than productivity and by real exchange-rate appreciation. This is linked above all to demographic pressure and labour scarcity. Higher wages have supported consumption and living standards, but they have also weakened the low-cost export model that underpinned growth for decades. As a result, future growth will have to rely more on productivity-enhancing investment, automation, digitalisation and selective industrial upgrading.

Private consumption has been the main driver of growth in recent years, but that impulse is beginning to weaken, as real wage growth slows and inflation picks up again. Exports are unlikely to provide much support – not only because of weak external demand and higher energy costs, but also because Chinese competition in sectors such as electric vehicles, batteries, steel, chemicals and electronics is increasing rapidly. Investment is therefore becoming more important. But here, too, the picture is mixed. EU funds, defence procurement and reconstruction-related positioning for Ukraine are all supportive. But at the same time, the greater uncertainty, tighter financing conditions and governance weaknesses are holding back FDI and private capital expenditure in some countries.

Geopolitics is now part of the CESEE growth model. For the first time since the early 1990s, defence spending in EU-CEE is now higher as a share of GDP than FDI inflows. This signals a major shift away from a model centred purely on openness and convergence toward one shaped by security, resilience and state capacity. Defence spending is likely to remain structurally higher and could increasingly function as a form of industrial policy, supporting dual-use manufacturing, logistics, electronics and ICT. Poland and

Czechia are already showing early spillovers, while the Baltics are combining higher defence spending with EU funds. For businesses, this creates a more durable demand anchor than the traditional export cycle.

Institutional quality will increasingly determine which countries manage this transition successfully. Access to EU funds, credible defence procurement, legal predictability and the ability to direct resources toward productivity-enhancing investment, rather than political redistribution, are becoming central competitive advantages. Hungary illustrates the cost of getting this wrong: suspended EU funds, governance erosion and weak investor confidence have contributed to a prolonged investment slump and very weak growth. By contrast, countries that combine stronger governance with fiscal credibility, better fund absorption and an ability to scale automation stand a better chance of emerging as long-term winners.

The main conclusion is that CESEE remains resilient, but the era of simple convergence is over. The region is adapting faster than much of Western Europe to permanent shocks, but the path ahead will be more uneven and more selective. For firms, this means that country differentiation now matters much more for capital allocation, supply-chain design and investment timing. For policy makers, the priorities are clear: energy diversification, fiscal credibility, stronger institutions and policies that support productivity, automation and strategic investment. The countries that align these elements effectively will continue to converge; those that do not risk structural underperformance.

COUNTRY SUMMARIES

ALBANIA

GDP growth in 2026 is expected to slow slightly, to 3.6%, reflecting higher import costs and rising uncertainty. Domestic demand will remain the main engine of activity, supported by household and government spending, with tourism continuing to add momentum. External shocks pose a risk and may lift inflation through import prices. The rapid expansion of solar power will help reduce reliance on hydropower and soften the impact of global energy-price swings, offering partial protection against external volatility.

BELARUS

GDP growth slowed markedly in H2 2025 and even turned slightly negative in early 2026. This reflects a turbulent external environment, which has also affected domestic demand. Although the latter continued to provide support, its capacity to offset external shocks weakened. The authorities appear to be gradually accepting lower growth, while becoming more tolerant of elevated inflation. We expect growth to decelerate further in 2026 and to remain fragile in 2027-2028, with outlook increasingly dependent on uncertain export dynamics.

BOSNIA AND HERZEGOVINA

Following modest growth in 2025, further recovery is expected to be delayed due to the new war in the Middle East. Household consumption is still expected to grow, supported by rising wages, including a significant minimum wage increase in January. However, external imbalances are projected to persist, despite continued support from remittances and tourism. Inflation is expected to increase owing to energy price developments, which pose a major risk of an uptick in inflation. Overall, the outlook is constrained by weak external demand, structural rigidities and ongoing political uncertainty that continues to weigh on investment and reform momentum.

BULGARIA

Last year, economic growth reached 3.1%, supported by higher disposable income and increased household consumption, although manufacturing and exports posted declines. However, we expect economic growth to slow over the forecast period and inflation to remain elevated, owing to the current energy price shock. The country's transition to the euro has proceeded smoothly. Former president Rumen Radev emerged as the clear winner of the parliamentary election held on 19 April 2026.

CROATIA

Economic growth is expected to gradually moderate to below 3% over the forecast horizon, as the growth in private consumption weakens somewhat. Despite this, the country will likely remain one of the stronger performers within the euro area. Geopolitical factors, such as the conflict in the Middle East, will continue to be a key downside risk. The inflation forecast is now also subject to increased uncertainty because of the energy price shock, which could translate into second-round effects if the war in Iran drags on.

CZECHIA

The Czech economy grew solidly in 2025, supported by strong household consumption and a recovery in investment, while external demand also contributed positively. Industrial activity has continued to improve in early 2026, although the recovery remains uneven and is closely tied to developments in European manufacturing. Rising geopolitical tensions and energy price risks are raising the uncertainty, while monetary policy remains on hold and fiscal policy is turning more expansionary. Growth is projected to be 2.2% in 2026.

ESTONIA

After three years of recession and near-stagnation, the Estonian economy grew by 0.6% in 2025. Growth is projected to accelerate to 2.3% in 2026, supported by a strongly expansionary fiscal stance, improving external demand and a rebound in household spending; that will be followed by 2.8% in 2027 and 2.4% in 2028. Private consumption is set to become the main engine of growth, underpinned by the recently adopted income tax reform and lower inflation. However, an expanding fiscal deficit and persistent competitiveness challenges are clouding the medium-term outlook.

HUNGARY

Hungary's economy has remained largely stagnant since mid-2022. Factors such as an economic policy aligned with the election cycles, legal uncertainties, the excessive centralisation of decision making and an overall lack of transparency, plus corruption and strained relations with the EU have all weighed on investment and productivity. The Tisza party's landslide election victory opens up an ambitious and EU-oriented reform agenda; nevertheless, its implementation may encounter fiscal constraints.

KAZAKHSTAN

Economic growth peaked in 2025 and is expected to slow in 2026 amidst recent oil production disruptions and weaker growth of investment and private consumption. Nevertheless, high global oil prices will support budget revenues, strengthen the tenge and reduce the current account deficit. Double-digit inflation requires tight monetary policy and limits the scope for fiscal stimulus. Medium-term growth is likely to accelerate to 5% by 2028, but the outlook remains highly uncertain, given the geopolitical risks associated with oil prices and the transportation routes for oil exports.

KOSOVO

Economic growth in Kosovo remained solid in 2025, though structural vulnerabilities persist. The economy continues to be heavily dependent on imports and external financing, with gains in services exports, remittances, and FDI insufficient to offset the widening goods trade deficit. Growth is projected to be 3.4% in 2026 (slightly below earlier expectations), before rising to around 3.6% in 2027-2028, driven mainly by consumption and investment. The key challenges that remain are the deteriorating current account and the continued exposure to energy price volatility. The lifting of EU restrictive measures on Kosovo in January 2026 is a positive development, likely to support investment and confidence.

LATVIA

Latvia's economy is set to grow moderately in the coming years, supported primarily by strong public investment and improving domestic demand, though external conditions remain fragile. Inflation is expected to stay relatively elevated, driven by robust wage growth, and uncertainty remains high on account of the geopolitical tensions. While investment will continue to underpin growth, weak external demand and structural challenges in key sectors are likely to preclude more robust growth.

LITHUANIA

Lithuania's economy is continuing to expand at a healthy pace, supported primarily by domestic demand, though growth is becoming increasingly uneven. While investment and – to a lesser extent – consumption are sustaining economic activity, poorer external conditions and rising geopolitical uncertainty are having an impact on the outlook. As a result, the growth forecast for 2026 has been revised.

MOLDOVA

Growth is expected to remain moderate this year (1.7%), supported by donor-financed investment and EU-oriented reforms, but it is constrained by weak manufacturing performance and labour shortages. Inflation may rise again in H1 2026 due to higher energy prices, limiting monetary easing. Fiscal and external deficits will stay elevated but financed externally. Adverse risks stem from energy supply, weather and regional tensions, while stronger export capacity and energy independence are key to any medium-term improvement.

MONTENEGRO

Montenegro entered 2026 with inflation easing and growth set to remain a little above 3% over the medium term, but the overall picture is less reassuring than the headline numbers would suggest. The new Middle Eastern war and the oil-price shock it has triggered have significantly worsened the external environment. Exports remain weak, industrial output performed very poorly in 2025, and fiscal pressures are building ahead of large debt repayments. The continuation of the Bar–Bolja highway could support investment, but growing reliance on special intergovernmental arrangements for major projects adds a new layer of policy and governance risk.

NORTH MACEDONIA

Despite ending 2025 on a solid footing, the outlook at the start of 2026 has worsened substantially, with industrial production and exports falling deep into negative territory. The war in the Middle East will make things worse, fuelling inflation, eroding real incomes, slowing consumption and investment, and further weakening the already sharply reduced foreign direct investment. The only positive signal comes from revived domestic investment in infrastructure, but that is unlikely to prevent a slowdown in growth. We have therefore revised our GDP growth forecast for 2026 downward to 2.9% and have raised our inflation forecast to 5.0%, with the possibility of the outcomes being even worse.

POLAND

Poland's economy continues to grow solidly, supported by resilient domestic demand, lower interest rates and EU-funded investment. However, the latest escalation in the Middle East has sharply increased the risk of a new import cost shock through higher energy prices, although Poland enters this period with a relatively favourable external position. Fiscal policy is likely to remain expansionary, driven by high defence spending and measures to cushion the rising cost of living. GDP growth is still projected to be 3.6% in 2026, but the balance of risk has shifted towards somewhat lower growth and higher inflation.

ROMANIA

Romania's economy remained weak in 2025, with GDP growth of just 0.7%, as fiscal tightening and high inflation curbed consumption, leaving investment as the main driver. Conditions worsened in early 2026 amid falling industrial output, declining confidence and rising unemployment. Inflation remains elevated, despite stable exchange rates. Fiscal consolidation continues to weigh on demand, while external imbalances are slowly improving. A modest recovery is expected in late 2026, but risks from energy prices, weak competitiveness and political fragility persist.

RUSSIA

The windfall from high energy prices in the wake of the war in the Middle East has provided timely relief for the ailing government budget. It is also expected to have a moderately positive effect on economic growth, which turned negative at the beginning of 2026. In the baseline scenario, real GDP is forecast to grow by 0.9% this year, followed by an acceleration in 2027-2028 on the back of expected monetary policy easing. If global energy prices stay elevated for a long time or rise further, GDP growth will be higher, although inflation will speed up as well.

SERBIA

The positive signals seen at the start of 2026 are likely to be short-lived. The new war in the Middle East is set to have an impact on the economy through higher energy prices, rising costs for business and weaker foreign direct investment. Thanks to government intervention in domestic fuel prices, the inflationary effect may be less pronounced than in some neighbouring countries, but it will still be felt. We are therefore revising our GDP growth forecast for 2026 down to 2.0% and raising our inflation forecast to 4.5%, with the risk of far worse outcomes if the war in the Middle East drags on.

SLOVAKIA

After low growth in 2025, Slovak GDP will again increase only modestly this year. The wiiw forecast has been revised slightly downward and GDP is now expected to rise by just 0.5%, as ongoing fiscal consolidation continues to weigh on household consumption. In addition, external uncertainties threaten this modest expansion. The outlook is expected to improve in 2027, with a pause in fiscal tightening and the creation of export capacity at the new Volvo plant. However, consolidation could resume in 2028, leading to lower growth prospects once again.

SLOVENIA

Slovenia's economic outlook is marked by moderate but resilient growth (2% in 2026), supported primarily by domestic demand; meanwhile external headwinds and structural competitiveness challenges continue to weigh on the outlook. Inflationary pressures stemming from the Iran war, alongside expansionary fiscal policy and strong wage growth, will contribute to sustained inflationary pressures. The result of the parliamentary election held in March 2026 indicates a near-even split between left- and right-leaning blocs, pointing to a potentially protracted coalition-formation process.

TURKEY

Turkey's economy grew by 3.6% in 2025, driven by domestic demand, while net exports weighed on activity. As a net importer of energy, Turkey is highly exposed to the Middle Eastern conflict. In our baseline scenario – in which we assume that the conflict will end soon and that the energy price shock is only temporary – we forecast 3.7% GDP growth and 29% inflation in 2026. In the adverse scenario (in which the conflict persists and energy prices remain elevated for longer), the outlook would deteriorate

significantly. Monetary policy remains tight, while exchange-rate stability is supported by foreign-exchange interventions. The improved 2025 budget balance provides some scope to absorb the higher energy costs, though rising interest payments limit fiscal support.

UKRAINE

Massive missile attacks by Russia have significantly impacted Ukraine's economic activity, as the destruction of energy-sector infrastructure has led to electricity shortages and a record increase in energy imports. The war in Iran is also having an adverse impact on the country's economy, which is heavily reliant on imports of fuel and fertilisers. In light of these factors, we have downgraded our growth forecast for 2026-2027, and the downside external risks to the forecast have become larger.

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

JEL classification: E20, E21, E22, E24, E32, E5, E62, F21, F31, H60, I18, J20, J30, O47, O52, O57, P24, P27, P33, P52