

## EUROPE: CEE PULSE

**Hungary** approaches crunch time to address the European Commission's (EC's) rule of law concerns, which could result in funding cuts. The leaders of **Serbia** and **Kosovo** are set to hold a series of meetings in Brussels in an attempt to de-escalate bilateral tensions. Following the meetings, **Serbia's** President Aleksandar Vucic is expected to propose a prime minister-designate to form the next government. Meanwhile, tensions over **Russia's** transit of goods via **Lithuania** to the Kaliningrad region might re-emerge soon. Finally, the war in **Ukraine** might escalate on 24 August – the country's Independence Day, which coincides with the six-month mark of Russia's invasion.

### Hungary

It is crunch time for Budapest, which has until the end of this week to address the EC's concerns over corruption and the rule of law under the bloc's [new conditionality mechanism](#) to protect the budget funds. However, the mechanism has never been applied before, and there might be some flexibility to continue the talks for longer. Failure to address these issues would put Hungary at risk of losing part of the funding from the bloc's 2021-2027 budget. In such a scenario, Brussels would also likely further delay the approval of Hungary's EUR 5.8bn post-pandemic recovery plan, even if the budget and post-pandemic recovery funds are formally unrelated.

Considering the tense fiscal situation at home and the billions of EU funds at stake, Budapest is showing flexibility and making efforts to address Brussels' concerns. However, it is unclear whether the EC considers Budapest's proposals sufficient to avoid financial sanctions. It is also noteworthy that the broader political backdrop for an agreement is unfavorable, given Prime Minister Viktor Orban's pro-Russian leanings, his controversial (anti-EU) rhetoric, and the little trust between the two sides.

### Russia/Ukraine

On 24 August, Ukraine will celebrate its Independence Day, marking the declaration of the country's departure from the Soviet Union in 1991. The date symbolically coincides with the six-month mark of Russia's invasion. Given the Kremlin's penchant for symbolism and attempts to undermine public morale in Ukraine, the risk of unusual escalation, acts of sabotage, and attacks on that day will be heightened. There are unconfirmed reports in Ukrainian media that Russian proxies plan to hold a show trial of Mariupol defenders on that day. At the same time, given its newfound capabilities of hitting targets well beyond the frontlines, Kyiv might also be planning some strikes in the Russian-controlled territories.

### Serbia/Kosovo

The President of Serbia Aleksandar Vucic and the Prime Minister of Kosovo Albin Kurti are scheduled to meet in Brussels on 17-18 August in an attempt to defuse bilateral tensions, which escalated after Pristina announced new requirements for car license plates and identification documents for Serbian citizens living in or traveling to Kosovo. The new requirements were initially set to come into force on 1 August, but under Western pressure, Pristina postponed their implementation by one month as groups of armed ethnic Serbs started blocking border crossings in protest. Border tensions have been accompanied by inflammatory rhetoric from both sides, raising concerns about the potential outbreak of another armed conflict in Europe. On 17 August, Vucic and Kurti will meet the leadership of NATO, which has around 4,000 peacekeepers in Kosovo. On 18 August, the two leaders will continue talks under the EU-mediated dialogue overseen by the EU foreign affairs head Josep Borrell.

If a compromise is not found and new requirements come into force as scheduled on 1 September, violent skirmishes between ethnic Serbs (supported by Belgrade) and Kosovo's special police forces could be expected to renew and even intensify. However, a broader war – involving the entry of Serb military forces into Kosovo – is less likely due to the presence of NATO peacekeepers. In any case, Moscow will likely seek to stoke tensions via disinformation activities.

## Serbia

Following the meetings in Brussels this week, President Vucic intends to propose a prime minister-designate to lead the formation of the new government. The president is reportedly choosing between incumbent Ana Brnabic, the mayor of Novi Sad Milos Vucevic, and a potential third candidate proposed by potential coalition partners. Some of the previously mentioned candidates, such as Finance Minister Sinisa Mali and Serbia's ambassador to the US, Marko Duric, cannot be completely ruled out either. Regarding coalition partners, the ruling Serbian Progressive Party (SNS) intends to continue cooperation with the Socialist Party of Serbia (SNS) and might add some small parties to the mix. The constitutional deadline for the formation of the new government is 2 November, but the pace of the government formation process will likely pick up after the official proposal of a prime minister. President Vucic expects to finalize the formation of the government by the end of August.

## Lithuania/Russia

Tensions over [Russia's transit of goods](#) via Lithuania to the Kaliningrad region might re-emerge after, on 15 August, a private bank in Lithuania stopped accepting ruble payments used to cover the transit costs. The bank is also planning to halt all transactions with Russia and Belarus on 1 September. While such payments are not subject to the EU sanctions, private banks operating in Lithuania are still reluctant to engage with these markets. Moscow has already submitted a diplomatic note of protest on the issue, but Vilnius claims it cannot force private banks to accept such payments. In recent weeks, the Kaliningrad regional government has also called on the EU to lift restrictions for the transit of goods as some of the EU quotas have already been reached.

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