

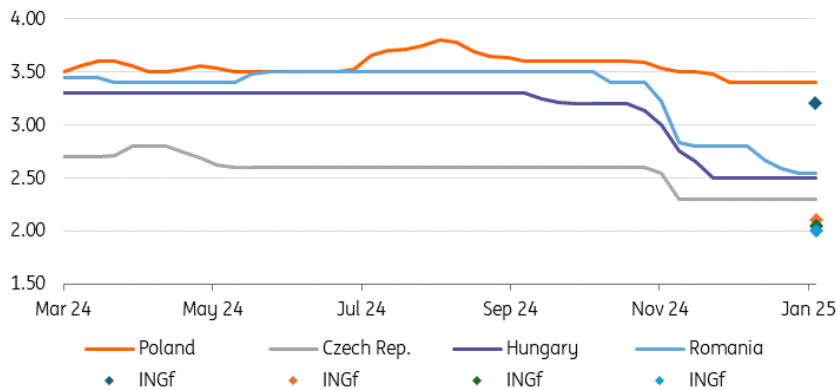
CEE: Awaiting a full economic recovery

Economic growth last year was disappointing across much of the CEE region, and we expect a similar story this year. Its recovery should continue, but we think it'll be weaker than market consensus assumes. Risks point clearly to the downside from this point, and further disinflation is complicated. Central banks in CEE no longer have much room for rate cuts



Poland was the only CEE country whose economic performance didn't disappoint against initial expectations for 2024 growth prospects

Consensus forecasts for 2025 GDP growth (%)



Source: Macrobond, ING estimates

Poland: Economic growth outshines CEE peers

December's monthly data and the preliminary estimate for 2024 GDP suggest that the Polish economy resumed its recovery in the fourth quarter of last year after a weaker third quarter. Retail sales also resumed growth after a soft third quarter. We see some improvement in the infrastructure part of the construction sector as the new cycle of public investment unfolds, driven by the EU's Recovery and Resilience Facility (RFF) and Cohesion funds. The manufacturing sector, however, is stagnating on a year-on-year basis. Some export sectors continue to grow, while others have stalled. We also see mixed signals from industries that could benefit from a recovery in public investment.

We estimate that GDP grew by around 3.5% YoY in the final quarter of 2024, compared to 2.7% YoY in the third quarter. As the main driver of GDP, consumption grew by a strong 3.5% YoY – but spending was less dynamic than in the first half of 2024. Investment activity remained muted (around 0.0% YoY), especially in the private sector, and continued to decline. The negative contribution of net exports reached 1.1 percentage points, reflecting stagnation in both Germany and the euro area.

Economic growth last year was close to 3%, broadly in line with forecasts made a year earlier. Poland was the only CEE country whose economic performance did not disappoint against initial expectations for 2024 growth prospects. Elsewhere in the region, growth was a third (Czech Republic) or even two-thirds (Hungary, Romania) slower than expected (against consensus a year ago). The overall economic picture – together with a hawkish policy stance from the National Bank of Poland (NBP) – should allow the Polish zloty to remain strong, or even to strengthen further than we had expected. The outlook for the PLN also depends on developments regarding the war in Ukraine and the actions of the new US presidential administration in this regard. There are early signs that President Donald Trump is now inclined to take a more positive approach to the region than statements made during his presidential campaign had suggested.

The NBP is expected to keep interest rates on hold at 5.75% in February. Since the January meeting, we've seen solid economic growth data and no news on inflation. We expect that, when asked what a firmer PLN means for the outlook, NBP Governor Adam Glapiński will emphasise Poland's floating exchange rate. The NBP only intervenes when currency moves are deemed excessive. Recent comments from the Monetary Policy Council's Ludwik Kotecki suggest that rate cuts will be delayed until the July meeting at the earliest, when the new projections will be published. We see room for 50-100bp of easing, although a stronger currency and the improved inflation outlook would call for a 100bp scenario, especially if the European Central Bank (ECB) continues to ease.

Czech Republic: Underperforming industry a threat as final rates get closer

The Czech economic rebound is on track, and we think it's set to gain traction this year. The continued real wage growth will provide enough support to household budgets to carry on with solid spending. In contrast, industry remains under pressure due to havoc in European automotive sector, with its main trading partners (such as Germany) seemingly unable to reach the bottom.

The manufacturing base faces rising costs – be it wage bills or materials – which act as a drag on profit margins. Such a situation poses a risk to the willingness and ability of firms to maintain

robust wage increases. The protracted underperformance in manufacturing has implied continuous layoffs over the past quarters, only partially offset by a rebound in construction. The mounting uncertainty and gradually deteriorating labour market conditions have been recognised by households, which could curtail consumption for precautionary reasons in the second quarter.

Inflation is set to slow down in January, but both the headline and core rate are expected to remain above the inflation target throughout this year. Moreover, some inflationary risks have emerged that will feed through to consumer prices, such as accelerating prices of agricultural products and recovering prices in the residential market. So, food prices and imputed rents represent an upward risk to inflation.

We still see some space for further monetary easing – but it is limited, with real interest rates likely to drift below 1% by mid-year. We don't see the Czech National Bank (CNB) willing to get close to the zero-bound in terms of real rates. We therefore see 3.25% as the final destination for the base rate, which would be reached in a cautious cut-pause-cut fine-tuning approach in the summer. The more potent interest rate differential toward the European Central Bank (ECB) and better economic performance across the eurozone will support the domestic currency over the coming quarters.

Hungary: Moving in the wrong direction

The market consensus on the GDP outlook for 2025 is slowly but surely moving lower, especially after the weak GDP growth seen in the fourth quarter of 2024. With only 0.5% quarter-on-quarter growth, the carry-over effect will be virtually zero. This makes the government's target of 3.4% growth this year much harder to achieve. Hungary would need four quarters of strong growth (at least an average of 1.325% QoQ) to achieve this. With all the local and global headwinds, we still see 2% GDP growth as the base case. And there are plenty of headwinds. Consumer and business confidence are both moving in the wrong direction, reducing the potential for a quick and strong turnaround in the economy. Trump's tariffs will be the icing on the cake for a country that is deeply integrated into global value chains. We haven't seen any confirmation of tariffs on the EU as of yet and so hope remains that those will be delayed.

Speaking of indicators moving in the wrong direction, we can also point to inflation. Underlying inflation indicators, like core inflation and sticky price inflation, both ticked up in December. Price expectations for retail sales and services also jumped higher, as did perceived inflation and household inflation expectations. We therefore revise our average inflation forecast for 2025 up to 4.5%. And while the unemployment rate surprised with a decline at the end of the year, this is more due to the combination of shrinking labour supply and a lack of demand for labour. In such an environment, the risk of a negative feedback loop for further weakness in consumer and business confidence increases.

Global uncertainty and FX and interest rate volatility are additional factors – alongside inflation developments – that justify the National Bank of Hungary's caution. While we stick to our latest base case of a total of 75bp of back-loaded easing in 2025, we admit that the probability of this happening decreases sharply as the likelihood of a flat policy rate of 6.50% increases. In this environment, we see little point in chasing a rally for the forint here as EUR/USD is likely to continue its slide, which in turn should put some pressure back on EM currencies in general. We see EUR/HUF peaking at around 420 this year.

Romania: A challenging fiscal and external picture fuels the upside risks for rates

We expect domestic demand to have remained firm over the last quarter of 2024. That said, the structural need for imports should have continued to weigh on growth. For 2024, we expect GDP growth at 0.7%. For 2025, we have recently adjusted our full-year GDP growth forecast from 2.1% to 1.6% due to little prospect of structural improvements in the trade deficit, the potential need for an even higher tax burden down the line, and the upside pressures on interest rates stemming from global trade unrest. On the other hand, consumer demand should remain robust, and productivity improvements from the Schengen ascension and new infrastructure developments should provide some tailwinds ahead

On the monetary policy front, the National Bank of Romania (NBR) left rates on hold at its January meeting. We think that the current external environment will convince policymakers to hold fire until the July meeting at the earliest, given the rising premiums necessary to compensate Romania's macro imbalances at the current juncture in global trade and financial markets. For 2025, we foresee a total of 50bp of rate cuts, taking the key rate to 6.00%, with risks mildly to the upside.

On the fiscal front, the 2024 budget deficit stood at 8.6% of GDP. At this stage, we continue to expect a correction to 7.0% in 2025, with risks tilted to the upside again. The government coalition elaborated an investment-driven budget for 2025, which counts on solid EU funds absorption. So far, some early signs and measures point to the fact that fixing fiscal issues through more moderate spending and better tax collection is indeed a priority for officials. Risks to the outlook stem from scenarios of weaker-than-expected consumption and tougher financing conditions.

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