

## CEE: central banks face tough policy decisions amid persistent inflation

The economies of Central and Eastern Europe are slowing, but the picture in most cases is not that bad. However, global conditions suggest it will be a hard winter. Central banks are trying to end the hiking cycle against market expectations, although the peak in inflation is not clear and fiscal policy has become more expansionary



Countries in Central and Eastern Europe continue to grapple with high inflation. Pictured: Brasov, Romania

### Poland: To end the hiking cycle or not?

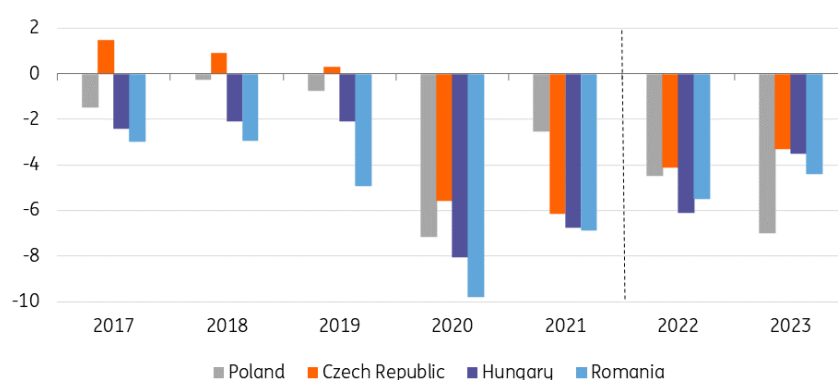
Poland faces persistently rising inflation and zloty (PLN) weakness. The National Bank of Poland's (NBP) forecast of CPI stabilising after the summer holidays has failed to materialise. In September, CPI rose to 17.2% year-on-year, a 25-year high. Upward pressure from energy prices is being accompanied by second-round effects. Core inflation continues to grow strongly. This throws Monetary Policy Council calls to end, or at least pause, hiking into question. We expect at least two 25bp rate hikes by the central bank in the fourth quarter of 2022. The rate hike cycle should conclude at 7.5%, or lower, in the first quarter of 2023. Proposed fiscal measures targeted at cushioning increases in electricity and gas prices for households should allow for a CPI slowdown and the NBP to ease in the second half of 2023. But the end of these measures could then cause CPI to rise above 10% year-on-year in 2024. For a more detailed outlook, check our latest

## Monitoring Poland.

The economy is on track to expand by 0.6% quarter-on-quarter, seasonally adjusted in the third quarter, after a decline of 2.1% QoQ, avoiding a technical recession in mid-2022. Annual growth may slightly exceed 3% in the third quarter, and 2022 full-year GDP should reach 4%, before slowing to 1.5% in 2023 amid the intensifying energy shock, deteriorating external conditions and elevated inflation. High inflation is projected to cool down consumer demand, while high interest rates hamper investment activity.

The zloty remains under pressure. Sentiment is unlikely to change given the unfavourable external environment (especially mounting tensions between Russia and the West) and the NBP signalling a prompt end to its tightening cycle. Still, positioning against PLN is already significant and should offer some scope for a recovery of the zloty if external factors improve. However, EUR/PLN is unlikely to move significantly below 4.8 in the fourth quarter regardless.

## General government balance (% of GDP)



Source: Macrobond, ING forecast

## Czech Republic: All work has been done

While leading indicators continue to disappoint - the PMI has fallen to its lowest level since 2020 and consumer confidence is at a record low due to rising inflation - the hard data has been more upbeat, with GDP surprising on the upside in the second quarter. Thus, the overall picture is better than expected but confirms a slowing economy. In terms of inflation, we have seen downside surprises in the last two months. However, this does not change the inflation trajectory, in our view. We expect a peak in the next few months, probably in the September number at 17.6% year-on-year.

Fiscal policy remains very unclear given the ongoing discussions at the government level on measures to counter energy prices. The government has approved an increase in the state budget deficit from CZK280bn to CZK330bn (4.9% of GDP), but MPs are proposing a further increase to CZK370bn (5.4% of GDP), which should be decided in the coming weeks. Monetary policy remains unchanged. The Czech National Bank [confirmed](#) the end of the hiking cycle at its last meeting in September and we don't see many triggers that would force the central bank to deliver an additional rate hike.

On the FX side, things are getting more interesting given the increase in the cost of central bank interventions during the September meeting, which puts the potential early exit of this

regime back on the table. In the baseline scenario, we expect the koruna to remain near intervention levels of 24.60-70 EUR/CZK until at least year-end, however, we see a higher risk that the Czech National Bank will be forced to make a change to the current regime sooner.

## Hungary: We see relief rallies despite gathering clouds

Anecdotal evidence and economic rationality suggest that the Hungarian economy is already navigating through recessionary territory. Households are facing higher energy bills after the change in the utility bill support scheme. Eurostat's harmonised index of consumer prices (HICP) is showing an 18.6% year-on-year inflation rate mainly driven by food and utility prices. These should affect consumption negatively. High interest rates and the cloudy outlook will take their toll on investment activity.

On the other hand, hard data regarding the third quarter has been limited. July readings haven't shown any major issues, so our gloomy view of the economy is based more on a hunch than real evidence. August data is coming soon and we will probably see the first set of hard data evidencing the downturn. We see a technical recession during the third and fourth quarters of 2022, providing a major headwind for 2023, where we see only 0.4% GDP growth alongside 15% average inflation. For a more detailed outlook, check our latest [Monitoring Hungary](#).

We see two key challenges ahead. First, the government needs to comply with the European Commission's recommendations to close the Rule-of-Law procedure for good as soon as possible. This could eliminate a big chunk of investor scepticism regarding the country's perceived, rather than real, fiscal and financing woes. We see the government and the debt management agency in control. New retail sales bonds are hot and in demand, providing a solid financing boost and giving relief to the Hungarian government bond markets. Though the forint has had some rough times lately, we still believe that the mid-November EU deal will free the HUF's potential alongside a marked drying-up of forint liquidity. The latter will be driven by the new set of National Bank of Hungary measures. And this is the second challenge. These measures are aimed at draining excess liquidity as monetary policy has moved into a new era, ending the rate hike cycle at 13% but continuing the tightening cycle with a focus on squeezing liquidity. We see these measures living up to expectations, though markets have remained sceptical so far. In our view, drying up around HUF4-5tr, or half of the excess liquidity in a short period of time could give enough support to the forint until the game changer EU deal is worked out and EUR/HUF might be back at 400 by the end of the year. Such a relief rally could come in the local bond markets as well on some of the expected positive headlines.

## Romania: The end of the hiking cycle is in sight

With the eurozone economy slowing down rapidly (likely already experiencing a recession) and most forecasts for 2023 already pointing to various degrees of GDP contraction (-0.8% is ING's house view), we believe that Romania's capacity to fend off the contractionary impact of these developments is limited. Therefore, our already below-market GDP estimate for 2023 of 3.0% is starting to look overly optimistic and we are revising it to 1.8%. At the same time, we marginally revise the GDP growth estimate in 2022 from 7.0% to 6.6% as a mild contraction in the third and fourth quarters cannot be excluded anymore. This all assumes that no significant statistical data revisions will occur which, given the abnormally high growth in the first half of 2022, is not such a light assumption to make.

On the inflation front, we maintain the view that we witnessed the peak in August at 15.3%,

although the September print will not be far from that (15.2% is our current estimate). Starting in October, stronger base effects will kick in and headline inflation should come in lower by at least 1ppt. However, our year-end forecast of 13.6% in 2022 is looking a bit optimistic given the persistently high energy prices, though we are not changing it at the moment. For end-2023, we maintain our 7.0% forecast, but the possibility of inflation hitting the National Bank of Romania's (NBR's) target band (1.5-3.5%) by the end of the two-year forecast horizon looks a touch more distant now.

With the above in mind, we reaffirm our view of a sequential approach by the NBR. This implies that the pace of policy tightening will slow down to 50bp in October and 25bp in November, taking the key rate to 6.25%. As usual, the level of the policy rate itself is not always the most relevant, as it corroborates with the strained liquidity conditions in the money market which will likely be maintained.

## Authors

### Rafal Benecki

Chief Economist, Poland

[rafal.benecki@ing.pl](mailto:rafal.benecki@ing.pl)

### Frantisek Taborsky

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

### Peter Virovacz

Senior Economist, Hungary

[peter.virovacz@ing.com](mailto:peter.virovacz@ing.com)

### Valentin Tataru

Chief Economist, Romania

[valentin.tataru@ing.com](mailto:valentin.tataru@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the

Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.