

CEE: Delayed recovery but no fundamental change to the outlook

The recovery is delayed, but not derailed. Although coming later than expected, we still look for a meaningful rebound from the second quarter. Our outlook for central banks and asset markets is unchanged. The Czech central bank should hike twice this year, while Poland and Hungary should stick to QE. CZK remains our top pick while HUF is the least preferred



Long queue of border commuters at Czech-Germany border-crossing in Folmava, Czech Republic - 25 Jan 2021

Source: Shutterstock

Covid-related restrictions delay the recovery...

As is the case in the eurozone, Covid restrictions will stay in place in the Central and Eastern European region for longer than initially expected. The pace of vaccination is similarly rather slow and as such, the expected rebound will come later than expected. But while the recovery has been delayed, the latest Covid restrictions will not derail the regional growth story and the outlook for local central banks and asset markets remains largely unchanged.

The Czech Republic provides a case in point. Although the country has suffered from one of the worst daily death rates in the world, this has not led to stricter lockdown measures in comparison

to its European peers, thus not translating into a more pronounced fall in economic activity and in turn not warranting a material revision to the growth outlook relative to others.

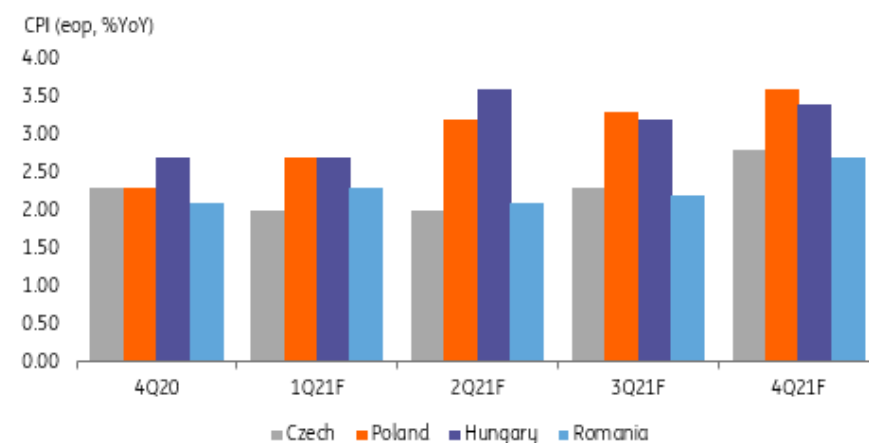
The expected rebound in CEE economies from the second quarter onwards, as restrictions ease in the spring, should be driven by a mix of factors such as consumption, exports, and public investment (with the strength of each varying among CEE countries).

... but this should have a limited impact on the stance of local central banks

On the inflation front, we will see some divergence in coming months (see the chart below). While in the Czech Republic, inflation will move temporarily lower, in Hungary and Poland, CPI should move above target, with Hungarian CPI likely to reach 4% in May (albeit temporarily and due to base effects). But the National Bank of Poland and Hungary are unlikely to react and should keep policy accommodative (both central banks should continue with QE and rule out rate hikes). The Czech National Bank should be a first mover in the region and Europe as whole, commencing a tightening cycle in the second half of the year as CPI picks up again.

Hence, and despite the delayed post-Covid recovery, the outlook for the region remains unchanged, with the CNB regaining its position as the hawkish outlier in Europe, while the NBP and the NBH leave their respective policies accommodative. In Romania, the central bank delivered a surprise 25bp rate cut in early January. Albeit a close call, we don't expect further rate cuts from here.

Diverging trends in CEE CPIs during the first half of the year



CZK still the top pick, HUF the least preferred

With the prolonged Covid restrictions having a largely non-differentiating impact on CEE economies and the outlook for local central banks remaining unchanged, our CEE FX view for 2021 has not changed either. We have a strong preference for the Czech koruna, a neutral view on Poland's zloty and the Romanian leu, and see Hungary's forint as the least attractive currency in the region.

CZK should benefit from the most hawkish central bank in Europe. The 50bp tightening we forecast

for this year should help EUR/CZK to move to 25.50, with a strong downside risk to 25.00. While the NBP continues to threaten FX intervention, this will be hard to justify from mid-year onwards once the economic recovery gains traction. Add to this the highest current account surplus in the region and EUR/PLN should dip below 4.40 in the second half of the year. In contrast, Hungary's non-tightening policy stance, less sound current account position (vs Poland) and preference for gradual currency weakness all suggest that the forint should lag the koruna and zloty, with EUR/HUF likely moving higher in the second quarter as inflation starts to rise (albeit temporarily) towards 4%.