CEE: Different inflation profile, different central bank approach

Inflation is diverging more and more within the region, calling for a different approach by central banks. In addition, growth prospects and fiscal policy look different, making a unified picture of the region even more complicated

Poland: Soft patch in early 2024, but outlook still solid

Poland's economy started this year on a weaker footing as January figures from industry and construction surprised to the downside. At the same time, retail sales continued to improve, albeit at a slow pace as consumers remained cautious and precautionary savings surged. The outlook for 2024 remains solid and we still see GDP growth of 3% on the back of household consumption. Against this background, the MPC policy bias has shifted even more into hawkish territory. Policymakers no longer seem to be paying attention to the risks to economic growth and are currently solely focused on the inflation target and mid-term inflation risks, stressing the threats from a tight labour market, robust wage growth and expansionary monetary policy. Our baseline scenario assumes that National Bank of Poland rates will remain unchanged by the end of 2024. However, some room for rate cuts may emerge in the final months of this year.

Czech Republic: Central bank on target, opening the door to further rate cuts

The economy is still rather disappointing, with neither the hard data for the fourth quarter nor the leading indicators for January suggesting much of a recovery. However, the Czech Republic is showing strength elsewhere. Inflation surprised to the downside in January, falling from 6.9% to 2.3% year-on-year. This means that the Czech National Bank is one of the few central banks globally to see inflation close to target. We believe the CNB has won from this perspective because, due to seasonality, most of the inflation takes place in January and the momentum in the rest of the year is only moderate. There is still a risk of a later new year repricing but we think it unlikely that inflation will move back above 3%. In fact, inflation could fall below the central bank's 2% target by mid-year. At the same time, core inflation has surprised to the downside and we expect it to fall further. Looking ahead, we thus expect the central bank to have a free hand to cut rates now, and March will see a further acceleration in the pace to 75bp. Given the surprise in inflation, we have also revised our rate path to 3.50% at the end of this year from 4.00% earlier. However, the main driver now seems to be FX, with EUR/CZK moving above the central bank's forecast after the last rate cut. The Czech Republic's other strength is fiscal policy, which has entered a consolidation process this year and we expect the deficit to fall to 2.5% of GDP, by far the lowest in the CEE region.

Hungary: Dancing on thin ice

Since our last monthly update, we've had some good, some bad, and some ugly news from a macroeconomic and market perspective. Let's start with the good news: disinflation continued in Hungary, as headline inflation fell into the National Bank of Hungary's tolerance band of 2-4% for the first time since March 2021. However, it would be very premature to declare victory, as the favourable base effects have essentially run their course. As a result, we expect inflation to stabilise (or ease slightly) in the coming months and to pick up again, especially in the second half of the year. By the end of 2024, we see inflation in the range of 5.5-6.0% year-on-year. The bad news is threefold: the economic recovery came to an abrupt halt in the fourth quarter of 2023, which doesn't bode well for the outlook for 2024 due to the much weaker-than-expected positive carry-over and the loss of positive momentum. As a result, we lower our GDP forecast for this year from 3.1% to 2.1%.

We also need to revise our outlook for the labour market, in particular, unemployment expectations. While the latest data on wage growth has been very strong, partly due to a one-off element, the unemployment rate has risen again, continuing its slow erosion. We expect this trend to continue in the coming months, reducing the wage bargaining power of the labour force as the rationalisation of labour demand continues. While this reduces the risk of reflation, it clearly limits hopes of any strong economic activity in the short term. Continuing with the bad news, details of January's fiscal performance showed that the inflow of EU funds boosted the monthly surplus, while underlying developments remain shaky, especially given the further contraction in the VAT line. The ugly news relates to market developments, as the forint has weakened by around 2% since the beginning of February, as the market is building rate cut expectations, which have been strengthened by the recent temporary acceleration of the easing cycle by the Hungarian central bank. However, we believe that these rate cut expectations are exaggerated and we call for a mid-cycle terminal rate of 6.5% in the summer, followed by a long pause.

Romania: Growth set to accelerate this year

While the economy lost speed in 2023, growing 2.0% overall, we think that data due on 8 March will show that private consumption has started to re-emerge as a key growth driver, on the back of last year's sharp real wage gains. We expect this trend to continue this year and, coupled with still-strong fixed investments, to lead to an acceleration of GDP growth to 2.8% in 2024. Growth should also find some support from lower interest rates from the National Bank of Romania but be weighed down by a rather lacklustre performance from European trading partners.

On the monetary policy front, while we continue to expect the first key rate cut in May, we have recently revised higher our year-end forecast, from 5.50% to 6.00%. The key reasons behind this are the recent upside surprise in inflation (due to broad-based price pressures) and the record-breaking liquidity in the interbank market (+60.7bn RON in January), which we expect to continue to diminish the need for rate cuts. What's more, higher-than-expected inflation means that EUR/RON is unlikely to meaningfully depart from current levels in the short term.

On the fiscal front, the recent decision to hold parliamentary elections in December complicates the possibility of a swift adoption of a fiscal package to offset the scheduled pension hikes (+22% starting September 2024). It could still be done very swiftly in January 2025 and applied starting February-March, but there is some time and revenue lost there. In 2024, we now expect a minimal deficit reduction from -5.7% to -5.5%, followed by another mild improvement to -5.0% in 2025. Getting to -3.0% of GDP looks out of sight now and given that around 12 countries will be under the excessive deficit procedure starting this year, we don't expect the European Commission to suddenly become very strict in its approach.

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