

Economic recovery gaining momentum in Central and Eastern Europe

Economic growth in the CEE region is picking up pace, but recent data shows some inflationary challenges. Additionally, geopolitical factors are once again impacting CEE countries, creating uncertainties that further complicate the continuation of central bank rate-cutting cycles



We project GDP growth of 3.2% in Poland in 2025. This time, domestic demand will be the primary driver

Poland: Back on recovery track with growth outlook above 3% in 2025

January's monthly data aligns with our baseline scenario for economic and price developments in 2025. Construction output has rebounded after 12 consecutive months of annual declines, indicating the anticipated resurgence of public investment has begun. We predict that Recovery and Resilience Fund projects, along with European Union Cohesion Funds, will drive a 9.5% increase in investments this year. We expect public investment to stimulate private spending through multiplier effects. Polish corporates are among the most deleveraged in the EU, so we see space for a private investment recovery possibly at the turn of 2025-26, subject to better business confidence and lower interest rates.

At the same time, industrial production indicates continued stagnation in domestic manufacturing, mirroring trends in Germany and the Czech Republic. With external demand

remaining weak due to Germany's prolonged recession, Poland's main trading partner, we anticipate further declines in net exports. Consequently, the current economic recovery will differ from previous cycles, where net exports positively contributed to the recovery. This time, domestic demand will be the primary driver. We project GDP growth of 3.2% in 2025.

CPI inflation rose more than anticipated in January, reaching 5.4% year-on-year from 4.7% in December, mirroring trends in other CEE countries. However, wage growth slowed to a single-digit rate at the turn of 2024 and 2025, which is expected to reduce cost pressures on businesses. Consequently, the outlook for service prices and core inflation is improving, potentially allowing the National Bank of Poland to implement rate cuts in the second half of 2025.

Zloty appreciation (EUR/PLN is at the lowest level in more than seven years) is also making the inflation outlook brighter. We expect CPI inflation to peak in March at around 6% YoY, ease slightly in the second quarter and head southwards in the second half of the year. Our baseline scenario assumes the NBP cuts rates by 50bp in September, followed by two more 25bp rate cuts in October and November, reducing the main policy rate to 4.75% at the end of this year.

Czech Republic: Expansion gains traction while the terminal rate approaches

The economic recovery is about to gain pace in the Czech Republic, further driven by solid real wage growth and consumption expenditure. That said, we see some risks to aggregate spending appetite should the situation in manufacturing remain bleak, as households could restrain expenses due to the economic and labour market situation looking less rosy ahead.

Still, the Czech economy is set to outperform the eurozone, as the real growth differential turned positive in the middle of last year after flying in the sub-zero range for three years. The convergence process for the Czech economy appears to be back on track, even in real terms. Although the economy is still growing below its potential, the output gap is expected to close by year-end, shifting the broader economic stance towards a more inflationary position than before.

We expect both headline and core inflation to remain above target, while the headline rate will be supported by increasing food prices and rents. Cost pressures have accumulated in the agricultural sector, and the property market is likely to heat up in the spring season. With the demand for residential properties hideously exceeding the supply side, the risks to core inflation are non-negligible. Steady price growth persistence of services may also contribute to elevated inflation, while the disinflation in the service sector is expected to continue gradually. However, this all comes down to whether the labour market tightness will recede somewhat to soften the buoyant wage growth. The construction sector lift-off will at least partially outweigh recent layoffs in manufacturing.

There is still room to further ease the monetary policy stance as the terminal rate approaches. We are likely to see a base rate reduction during meetings with a new Czech National Bank forecast, accompanied by hawkish commentary, bringing the nominal rate to 3.25% in August. However, if consumer price dynamics remain strong, the real interest rate could approach the zero bound. In such a scenario, we believe a 3.5% rate would also do the job.

Hungary: Waiting for clarity

The Hungarian Central Statistical Office will release the detailed GDP data for the fourth quarter of 2024 on 4 March, which will be a really important milestone. This will give us a better idea of whether there are signs of life in investment activity and whether the positive momentum in consumption has been maintained. If we see weak domestic demand, that could be another nail in the coffin of the government's plan for a flying start to 2025. We are now looking at 2% GDP growth in 2025, but with weak momentum at the end of last year, this forecast could be even lower.

Inflation could also be a party-killer here. After the January surprise, we've updated our average inflation forecast to 5.1%, subject to further upward revision if the February print shows that the jump in repricing at the beginning of the year was not just a one-off but rather the start of a trend. Rising inflation will translate into higher inflation expectations, weakening consumer confidence, the economic outlook and ultimately business confidence.

With labour hoarding, a further deterioration in projected economic performance could lead to layoffs, particularly in the manufacturing sector. Anecdotal evidence suggests that this has already begun. The next few months of labour market data will be crucial in measuring the expected damage and the possible impact on real wage growth as well. This kind of negative news about Hungary could raise market expectations that the government will feel some urgency and let go of this year's deficit target, reversing the recent positive market sentiment.

This sentiment has been driven more by hopes of a ceasefire and peace in Ukraine, though. With the second phase of Trump's tariffs on the horizon (from 12 March), this may also weigh on market sentiment. The bottom line is we expect uncertainty to increase in the coming months, leading to a weaker forint and possibly higher risk premiums on bond yields, and a hawkish repricing is also on the cards for the short end of the yield curve.

Romania: Fiscal and geopolitical risks continue to dominate the picture

After the fourth quarter preliminary release, Romania recorded a well-below-potential 0.9% GDP growth. The structural need for imports weighed on growth visibly last year and large improvements are rather unlikely in the short run. For 2025, we expect GDP growth to pick up towards 1.6%. Consumer demand should remain robust, and productivity improvements from the Schengen ascension and new infrastructure developments should provide some tailwinds ahead. Investments are also projected to strengthen. That said, risks are rather tilted to the downside, stemming from the potential need for an even higher tax burden down the line and the upside pressures on interest rates fuelled by geopolitical events. Lower wage growth should also prevent growth from accelerating too much.

On the monetary policy front, the National Bank of Romania left rates on hold at its February meeting. Policymakers hinted towards a cautious approach to monetary conditions until the fiscal outlook and its impact on inflation becomes clearer, and external risks moderate. For 2025, we foresee a total of 50bp of rate cuts left for the second half of this year, taking the key rate to 6.00%, with risks mildly to the upside.

Concerning the fiscal situation, we continue to expect a correction of the fiscal deficit to 7.0% in

2025, with risks tilted to the upside again, following the outsized 8.6% deficit in 2024. The government coalition elaborated an investment-driven budget for 2025, which counts on a solid EU-funds absorption. Based on the announced measures so far, achieving the desired target through increased spending efficiency and better tax collection looks like a priority for officials. Risks to the outlook stem from scenarios of weaker-than-expected consumption and more challenging financing conditions.

Author

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@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 www.ing.com.