Geopolitics and inflation hinder prospects of further rate cuts in the CEE

The increase in geopolitical risk is bringing unusual FX weakness to the CEE region, while the potential for higher oil prices is reintroducing inflation concerns. At the same time, the fiscal picture is raising eyebrows in some countries in the region, and any further central bank rate cuts remain conditional

A partially empty terrace restaurant at Krakow Market Square, 2024: Core CPI is stickier in Poland compared to its CEE peers

Poland: Outperformance despite eurozone stagnation

Economic recovery in Poland remains uneven. Data on first-quarter GDP disappointed, but second-quarter performance was stronger than expected. The external environment deteriorated between July and September. High-frequency data suggests that GDP growth in the third quarter probably slid back below 3% year-on-year again.

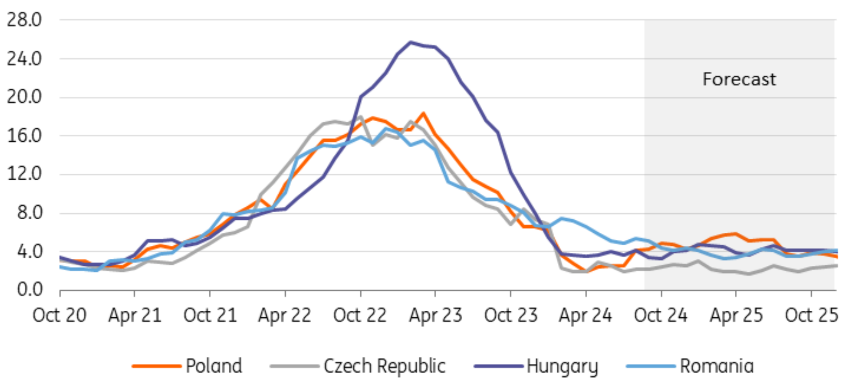
Economic growth continues to be primarily driven by consumption, thanks to improvements in real disposable income. However, manufacturing performance remains weak, and construction activity is sluggish. Fixed investment rebounded in the second quarter of 2024, growing by 2.7% YoY after a 1.8% decline in the first quarter. This strong performance is largely attributed to public defence spending, as investment in mid-size and large enterprises continued to decline. We stick to our forecast of 3% economic growth for 2024 and expect it to accelerate to 3.5% in 2025, driven by a rebound in fixed investment supported by EU funds.

After hitting a local low of 2.0% YoY in March, headline inflation rebounded and is now nearly double the National Bank of Poland's (NBP) target of 2.5%, reaching 4.9% year-on-year in September. This increase was driven by the partial removal of measures that previously shielded households from high energy prices. Therefore, we are now seeing past inflation being reflected in the headline figures. With some protective measures still in place for the second half of 2024 (such as the electricity price cap and exemption from the capacity fee), we anticipate the CPI to peak around 6% year-on-year in March 2025.

Core CPI is stickier in Poland compared to its CEE peers, and the NBP is not following the global trend of monetary easing. Unless an increase in relative restrictiveness of monetary policy and actual widening of interest rate disparity leads to excessive firming of the zloty, the Polish MPC is likely to postpone rate cuts until spring 2025. We expect the first 25bp rate cut in the second quarter of next year and believe rates may go down by 100bp next year.

Despite the excessive deficit procedure imposed on Poland, the 2025 draft budget remains expansionary. Authorities now expect the fiscal imbalance in 2024 to be wider than previously projected, increasing from 5.1% to 5.7% of GDP. The planned structural adjustment is minimal, around 0.2% of GDP. The government appears to be delaying significant adjustments and avoiding austerity measures in 2025, likely due to the upcoming presidential elections. The pursuit of multiple fiscal goals, such as increased spending on the military, may prove unsustainable and require future re-evaluation. We see an adjustment in 2026, mainly based on the cyclical improvement of revenues.

Headline inflation forecast (%YoY)



Czech Republic: Mounting challenges to global growth represent a risk

Economic recovery has gained attention now that inflation is largely under control. We anticipate continued expansion in the second half of the year, resulting in overall economic growth of 1.1% for the year. Both household and government consumption are expected to significantly contribute to this rebound. Meanwhile, fixed investment should be a laggard due to the weak start to the year affected by the onset of the new EU funding period.

Net exports are about to boost overall performance, mainly on account of declining imports. Exports will grow only moderately this year as the leading European trading partners face challenges while tepid foreign demand is giving the Czech export engine a hard time. Industrial production has remained roughly flat since 2018, with the PMI survey pointing to lukewarm foreign demand as the main source of the trouble. Indeed, German manufacturing output has been trending down for more than six consecutive years, with the recent news not indicating a turnaround any time soon.

Headline inflation is expected to increase to 3% in December, partially due to a low comparison base. A major electricity and natural gas distributor announced a reduction in end prices, which is expected to lower headline inflation by 0.2 percentage points early next year, helping it return to target. However, core inflation will likely remain elevated, driven by the stubborn price dynamic in the service sector and solid household spending. There is also a risk that the market and imputed rents will follow the renewed growth in property prices, potentially leading to upward repricing in January. Overall, we see a twofold situation in consumer prices, with headline inflation close to the target over the next year, while core inflation is a drag to real income growth.

We expect the Czech National Bank to carry on with another soft cut in November to bring the policy rate to 4%. As for December, we see a pause as the most likely outcome, with the bank board waiting to see January's inflation data, which is prone to more pronounced moves than in other months. Whether to cut or not to cut at year's end will be a close call, as not much forward guidance was provided, except that the easing could be terminated at any time. The question is whether real interest rates below 1.5%, as measured by core inflation, are stringent enough to hold core inflation on a short leash, break the stubborn price growth in the service segment, and temper the accelerating credit growth.

Hungary: Looking for bright spots

We stand by our previous statement that the development of business and consumer confidence will influence economic activity going forward. However, we haven't seen any extreme changes and the incoming data and information tend to point to some downside risks for Hungary's economic performance.

The details of the disappointing second quarter GDP data highlighted some structural problems as well as some green shoots. Consumption is trending up, but investment activity (or rather the lack of it) is worrying. In general, we see GDP growth at 1.5% and 3.6% in 2024 and 2025 respectively. Focusing on the positives, the labour market has been the bright spot of the Hungarian economy, although labour hoarding and high wage growth pose both recessionary and inflationary risks. The coming quarters will decide which way we go, although the inflation outlook has improved significantly so far. We see inflation averaging 3.8% this year, with a slight acceleration to 4.0% in 2025. With this inflation, real wage growth continues to support the underlying growth outlook and provides the potential for a pick-up in domestic demand next year.

The country's external balances remain supportive of both real growth and financial market sentiment. Without such a positive base, the volatility of the forint would have been even more pronounced during the recent geopolitically-driven FX market shock. Like its CEE peers, HUF has come under pressure in recent weeks amid the global news. However, a weaker forint also means a more hawkish National Bank of Hungary (NBH), which should be a backstop for further weakness and an opportunity for a EUR/HUF fade. Our year-end forecast of 395 remains realistic. The significant reassessment of the key central bank's rate path also affects the NBH's room for manoeuvre, which is why we see only a 25bp rate cut, possibly in December. The political cycle and uncertainties related to a new central bank governor and a changing Monetary Council (the market is thinking of a dovish shift) could trigger a level shift in the currency pair with a new permanent range of 400-410 in 2025.

Romania: Fiscal splurge in full swing

Internal demand looks set to remain at healthy levels in the third and fourth quarters. Retail sales continued to grow strongly in August and, from September onwards, higher pensions will have boosted disposable income. Investments have also likely remained robust, driven by the ongoing large-scale infrastructure projects. That said, we expect net exports to continue to contribute negatively since the economy struggles to prevent the benefits of strong activity from dissipating externally through imports. Our forecast for 2024 GDP growth stands at 1.3%. One major risk ahead is the upcoming Eurostat-guided five-year revision of GDP due on 10 October, which can induce large base effects.

On the monetary policy front, the National Bank of Romania (NBR) left rates on hold at its October meeting, in line with our expectations. Policymakers highlighted the need for caution due to both internal and external risks. We don't exclude a 25bp rate cut in November – but in the absence of a higher-than-expected decline in September's inflation and a cooling of the upside risks stemming from the Middle East conflict in the meantime – no further cuts this year is our base case. For 2025, we foresee a total of 100bp of rate cuts, taking the key rate to 5.50%.

On the fiscal front, the budget deficit slipped visibly to 5.5% of GDP between January and September. At this stage, we expect the deficit to end 2024 at 8.0% and 2025 at 7.0%. The key factor to watch remains the outcome of the negotiations with the European Commission this autumn. A seven-year deficit adjustment plan is the most likely path. The only good news here is that the investment cycle looks set to continue.

Authors

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

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com