

## Inflation is falling in the CEE region, but it's too early for monetary easing

The slowdown in inflation has begun across the region, while most countries in Central and Eastern Europe are already in a technical recession. However, the labour market remains strong and wage growth risks making inflation stickier for the rest of the year. Overall, we still see no room for monetary easing



Poland sees highest inflation in 26 years. March 2023, Warsaw, Poland

Source: Shutterstock

### Poland: Eyeing pace of disinflation

March brought about the beginning of the slide in CPI but the picture is rather like a half-full but half-empty story. On the one hand, headline inflation moderated from a 26-year peak at 18.4% year-on-year in February to 16.2% YoY in March, likely marking the beginning of a downward trend. On the other hand, momentum remained strong (1.1% month-on-month), food price growth remained robust (2.3% MoM) and the decline in annual inflation was mainly linked to a high reference base from energy prices. Most importantly, core inflation rose further to 12.3% YoY from 12.0% YoY in February. We think CPI should head towards single-digit levels in late 2023, but 'sticky' core inflation is unlikely to allow the Monetary Policy Council (MPC) to start cutting rates

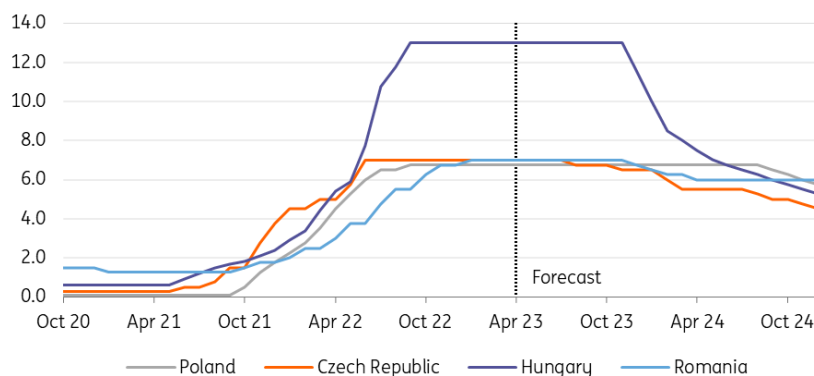
this year. Even MPC doves have recently gone against market expectations for cuts in 2023.

We downgrade our 2023 GDP growth forecast to 0.5% YoY from 1.0% YoY. Stubbornly high inflation has hit the real disposable income of households and dampened private consumption. Declining retail sales are accompanied by falling industrial output. The decline in annual GDP in the first quarter had been broadly expected for some time, but new downside risks to the global outlook (a possible US credit crunch) along with unfavourable trends in consumption have prompted us to revise our annual GDP forecast for 2023.

Economic policies are cautious. So far the government has offered no heavy pre-election promises, while the central bank hints at no prompt policy easing. We shall see if this holds in the months to come. In the pre-election period we have seen some competition for social grants, but so far have been rather limited in scale. The final proposals should be released in June-July, ie, ahead of the summer holidays and general elections in October.

Financial stability woes (especially in the US) are the elephant in the room for financial market developments now. With Europe arguably in a better position than the US due to more stringent regulations and financial oversight, European currencies (including CEE currencies) should benefit and a higher EUR/USD should support CEE FX. We see gains for the Czech koruna and Hungarian forint while Poland's zloty remains a laggard. EUR/PLN is expected to trade close to 4.76 in April. Curve steepening seems the most probable scenario for April. Rhetoric from the National Bank of Poland after the March decision may be not able to trim expectations for a prompt monetary easing, given poor domestic data in the first half of 2023.

## Key rate forecast in the CEE region



Source: Refinitiv, ING

## Czech Republic: Economy still in mild recession, central bank remains hawkish on inflation

Leading indicators support the view that the Czech economy remains in a mild recession but with slightly improving sentiment among entrepreneurs and stable sentiment among consumers. Households lost purchasing power – 1.2% quarter-on-quarter, 6.3% YoY in the fourth quarter of 2022. Hence the chance for a recovery of private consumption remains limited. This is in line with our expectation that private consumption will slow the economic recovery in the first quarter of 2023. At the same time, companies reported 46.9% profit growth, up 2.4% YoY. This suggests the inflationary environment is still quite strong. We expect inflation to moderate to 16.8% YoY in

March, thanks to the gentle decline in food and fuel prices, while core inflation moderated gently as well. Still, those are levels that are unlikely to push the Czech National Bank (CNB) to even think about rate cuts. We still expect the first debate about loosening monetary policy to be put on the table in August, but the first reduction of interest rates is more likely to materialise in the autumn.

The Czech koruna is strongly supported by the CNB's hawkish tone. Given that the CNB is unlikely to hike interest rates, FX remains its main weapon. The central bank has confirmed that it is ready to intervene if needed, but current levels are far from where the CNB was last active. The Czech koruna visibly welcomed the CNB's hawkish tone and moved below 23.60 EUR/CZK for the first time since the sell-off in global markets two weeks ago. On the other hand, the central bank's statement is clearly supportive of the koruna and implies that the currency is safe in the event of a global sell-off. Moreover, with the prospect of higher rates for a longer period of time, a solid FX carry is also certain. Overall, the koruna offers decent risk/reward and we expect it to strengthen further.

## Hungary: Peaks and troughs

The first quarter of 2023 was about peaks and troughs for the Hungarian economy. Although we do not have the full slate of hard data for proof, there is plenty of circumstantial evidence. We expect yet another drop in real GDP on a quarterly basis in the first quarter, the third decline in a row. The main reason behind this is purchasing power, which is plunging in response to sky-high inflation, causing the deepest real wage drop since the 2008-09 crisis. However, we believe that the technical recession will be cut short due to new export capacities helping growth from the second quarter. Then a more marked rebound comes on falling inflation, improving purchasing power and better investment activity on freed-up access to EU funds in the second half of 2023. Overall, we see GDP growth of 0.7% this year.

Touching upon inflation, the peak is behind us, and we see a gradual decline in the coming months, followed by speedy disinflation on energy, fuel and food base effects in the second half of the year. We forecast a single-digit inflation print in December with an 18.8% average price increase in 2023. In the meantime, the central bank is patiently waiting for a number of risks to alleviate. Thus, we believe that a dovish pivot can happen in June at the earliest with 50-100bp monthly step sizes and an 11.5% base rate by the year-end. The pivot will be helped by a stronger forint and structural improvements – lowering inflation, better growth prospects, the EU funds deal and a markedly narrowing current account deficit (from 8.1% to 4.5% of GDP). Along with the HUF, we also see strong potential for Hungarian government bonds helped by tighter fiscal policy complementing the other structural factors. For more details, check our latest [Monitoring Hungary](#).

## Romania: Disinflationary trend to become more pronounced

The economy advanced by a robust 4.8% in 2022, with a welcome rebalancing in growth drivers from consumption (still the main driver) towards investments. The availability of the high-frequency data for 2023 suggests that industrial production remains rather deep in negative territory, while retail sales and construction data have been much better. We maintain our 2.5% GDP growth estimate for 2023, with a small but positive quarterly growth of 0.2% in the first quarter.

On the inflation front, headline inflation for the first two months of 2023 may have printed a bit above expectations, but nevertheless, we believe that beginning with April inflation (currently forecast by us at around 11.5%), a clearer disinflationary trend will take shape. We've had a long-

standing 2023 year-end forecast of 7.4%, which we maintain. The recent spike in oil prices might change the story somewhat, but when looking at the bigger picture we believe that markets could still be surprised by lower inflation readings in April and even in August-September when the headline should finally dip into single-digits.

We believe the National Bank of Romania (NBR) will stay on course and keep the key rate unchanged at 7.00% for the rest of 2023. The liquidity surplus in the money market (which we estimate at around RON20bn for March) is likely an issue that the NBR will address either through permanent means (i.e. FX intervention) or if needed through open market operations (such as deposit auctions). Given the recent developments in the FX market, we believe that the preference is for the first option. This could lead to a mild reversal in the current downside trend in market rates and a repositioning of the curve up to one-year closer to the policy rate.

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