

## CEE: Inflation finally heading down but still sticky

Central and Eastern Europe is flirting with a technical recession. Inflation numbers are finally starting to head down but we are clearly in for a bumpy and sticky ride. So rate cuts will be later rather than sooner, though still on course for this year



Marton Kekesi of Hungary in action during the Men's Super-G race at the FIS Alpine Skiing World Championships in Courchevel, France, 09 February 2023

Source: Shutterstock

### Poland: Lower inflation but rate cut is not in sight

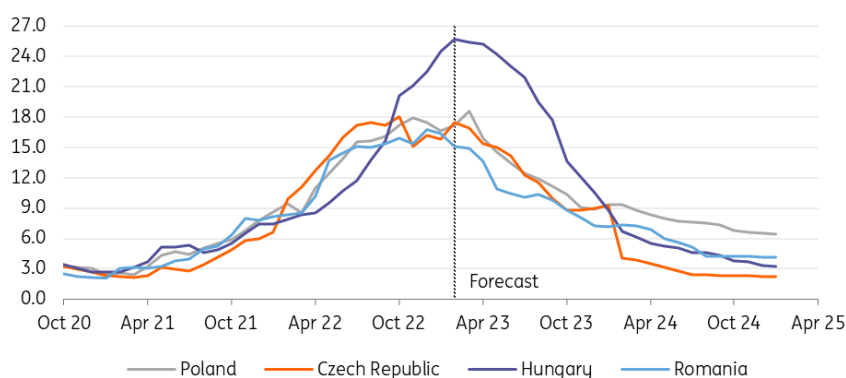
Poland's economy proved resilient in light of multiple shocks last year (war, high energy prices, sharp interest rate hikes), but the beginning of this year looks difficult. Activity data for January was worse than expected (industrial production, retail sales), growth in the first quarter will be negative in year-on-year terms, but still less so than expected a few months ago. Overall, we expect just 1% growth in 2023 compared to 4.9% in 2022. Our above-consensus view is supported by the better eurozone outlook. The primary reasons behind the GDP slowdown in 2023 are the high base effects from the post-Covid reopening, the disinvestments in inventories as well as the erosion of disposable incomes and private consumption due to the negative inflation surprise in 2022.

Although CPI inflation turned out lower than expected in January, it was still 17.2% year-on-

year with core inflation close to 12% YoY. This is far from an acceptable level. Base effects and global disinflationary forces should bring the headline inflation rate into single digits in December, but the core rate should stay persistently high. In our view, this will not justify interest rate cuts later in the year, but we cannot exclude such a signalling move by the Monetary Policy Council late this year.

In mid-February, local markets paid careful attention to a spokesman from the European Court of Justice who suggested that banks may not charge interest on CHF mortgages terminated by courts. If re-confirmed by the future ECJ verdict, this would be favourable to credit takers and affect banks' balance sheets. So far, the equity and bond market reaction has been rather muted because in the last few years, banks have already added high provisions and if they are given more time, they can absorb the shock. Still, this may impair credit creation and banks' willingness to buy domestic debt, to some extent. That is why the government is mulling a kind of legislative change to share the losses on CHF loans between banks and clients.

### CPI in CEE region (% YoY)



Source: Macrobond, ING

### Czech Republic: Record strong koruna

The Czech GDP report will likely confirm that the economy entered a recession in the second half of 2022. Business sentiment indicators suggest that even at the beginning of the first quarter this year, the economy has remained in negative territory. The recession has mainly been driven by the continuous strong decline in consumer spending as high energy prices weigh on household purchasing power. Still, the labour market has not seen a significant impact and the economy should return to soft growth in the second half of this year driven by the gradual improvement in external demand and investment. Inflation likely peaked in January and the February report will likely show a gradual moderation. Despite the expected softening in inflation, the central bank will likely maintain its prudent stance in terms of advocating for the current level of interest rates for a longer period. On the fiscal side, a discussion is opening up on the consolidation of the state budget deficit next year. The Ministry of Finance has signalled a CZK70bn reduction from the originally planned CZK295bn.

The Czech koruna has been breaking historically strong levels in recent weeks. Currently, the koruna is the strongest since July 2008. Domestic conditions, i.e. falling interest rate differentials and the current account deficit, do not support such levels. However, within the CEE region, the koruna seems to offer the best story. Although the Czech National Bank is not actively intervening,

it is still prepared to limit the upward movement. In addition, interest rates appear to be staying higher for longer. So together with a stable carry, this still seems to be the most popular currency in the region.

## **Hungary: Waiting for more evidence that better days are coming**

The Hungarian economy slumped into a technical recession during the second half of 2022. We are still waiting for hard evidence on whether the downturn continued in early 2023 or whether the economy has started to rebound. Our assumption, considering the very strong inflation data and its impact on purchasing power, is that Hungary is facing one more quarter of falling real GDP on a quarterly basis. However, as the labour market looks resilient enough and surveys suggest improvement in economic sentiment in 12 months, we foresee a rebound from the middle of this year. This will be fuelled by better export activity, with rising capacity and still-strong order levels in manufacturing early on. By the end of the year, the return of positive real wage growth might improve domestic demand as well. We see this translating into 0.7% GDP growth in 2023 as a whole with some upside risks, followed by a 3.6% full-year performance in 2024.

As good as this sounds, it comes with a significant caveat: this quick rebound might slow down or even keep inflation from descending further after reaching high single-digit territory (8-9% YoY) in the fourth quarter. In our view, the peak in headline inflation might be behind us with January's 25.7% year-on-year reading. Anecdotal evidence shows a pivot in food, fuel and energy prices, translating into easing price pressures from February. However, as wage growth will remain high and yet another round of energy price increases might come in the autumn, cost-side pressures and catch-up domestic demand might result in stronger repricing. We think that the road from the peak in inflation to single-digit territory might prove to be easier than getting prices down to the central bank's target range during 2024. That's why we think the pivot from the National Bank of Hungary will be gradual and slow, ensuring that the real interest rate environment remains positive during the easing cycle.

## **Romania: Rates to remain unchanged for rest of year**

The economy expanded in the fourth quarter of 2022 by 1.1% versus the previous quarter and by 4.6% when compared to the fourth quarter of 2021. This takes the full 2022 GDP growth to 4.8%, which is perhaps among the better figures that one could have hoped for. The available high-frequency data suggests that it's been a strong quarter for construction activity, which expanded by 7.4% versus the third quarter. Services for companies were also around 2.0% higher while retail sales rose by 0.8%. Industrial production lagged at -2.1%.

On the inflation front, we see the peak as behind us at 16.8% in November and we anticipate a gradual shift lower throughout 2023. We estimate year-end inflation at 7.4% with risks slightly to the downside. The main factors weighing on prices are base effects, energy price caps, and international energy and food prices stabilisation while upside forces include cost increases not yet fully passed-through, wage pressures and still negative real rates.

The National Bank of Romania is likely to maintain the current course of its monetary policy, meaning the key rate should remain unchanged at 7.00% for the rest of the year. Shorter-term market rates – which are more dependent on interbank liquidity situation – might have neared a

bottom, though that doesn't necessarily mean that an upward trajectory is to follow. In essence, we expect stability around current levels. The liquidity picture is more likely to remain accommodative, though the surplus could shrink to more manageable levels (say RON5bn-10bn). Should the inflation trajectory surprise (even mildly) to the downside, we wouldn't rule out a modest rate cut by the end of 2023.

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