

Central and Eastern Europe: Lifted by the kindness of strangers

As elsewhere in Europe, Putin's war in Ukraine will hit GDP across Central and Eastern European economies. Yet the unity showed by the region and the warm welcome offered to Ukrainian refugees could provide a short-term boost to consumption



Ukrainian refugees arriving at a station in Poland

Poland: Government support for refugees helps consumption

The war in Ukraine could lower Poland's GDP by 1.3ppt in 2022 (versus our prior baseline growth forecast of 4.5%). The impact is largely felt through the trade channel with Ukraine, Russia and Belarus, although lower confidence will affect the domestic investment environment. Yet the lower propensity to spend on durable goods from Polish households should be more than offset from government spending on welcoming refugees. As a result, overall consumption should be stronger.

The government should also extend its anti-inflation measures until the end of 2022, offsetting the spike in oil prices and another 30% hike in regulated gas prices in the fourth quarter of this year. The wild card is food prices. Corn and oilseed are less important for Poland, but the risk is of contagion to other soft commodities. Short-term weakness in the Polish zloty, labour shortages (some Ukrainian workers have left Poland to join the army) should also add to CPI upside risks. But

the government should provide a kind of inflation shield.

Given the slightly weaker GDP, but persistently high CPI, the upside risk to our rate forecast (at 4.5%) disappears and reaching the terminal rate may take longer. The National Bank of Poland (NBP) should use mildly hawkish language to support the FX intervention already taken.

The zloty will likely remain under pressure as the conflict continues. In our view, the risk is that this weakness becomes more persistent as the war drags on. A prolonged conflict increases the odds of harsher sanctions with a higher impact on commodities and on the CEE economies, including Poland. Should the fighting in Ukraine move to the west, close to the Polish border, this would clearly add to political/military risks. For the Polish central bank, the NBP, expect FX intervention to become more frequent, yet to remain focused on limiting volatility, rather than defending any particular EU/PLN levels.

As soon as market tensions fade, NBP tightening and resilient Polish GDP should contribute to a zloty recovery. Also, the current crisis makes a compromise on the EU's rule of law legal challenge and an unfreezing of EU Recovery funds for Poland more likely.

Hungary: Short term gains and continued NBH hawkishness

The impact on economic activity could be mildly positive in the very short term with Hungarian citizens and the government spending money to help refugees. The longer-term impact remains opaque, but further supply chain disruptions are posing downside risks. Thus we cut our previous 6.2% year-on-year GDP forecast to 5.2% in 2022. The escalation of supply-side and energy price shocks could possibly be limited by moderating GDP growth but in all, we move up our 6.9% headline inflation forecast to 7.4% in 2022, with upside risks.

Forint weakness is also adding to the inflation pressure, which is proving worrying for the monetary authority judging from recent verbal intervention from the National Bank of Hungary. In this regard, we see an elevated chance for weekly rate hikes in the one-week deposit rate again. Despite the rising rates complex, we still believe that the recent level of tensions is manageable from a debt financing and deficit target point of view. Politically, the recent situation is challenging both for Fidesz and the opposition with barely a month left until the election (3 April). However, our base case remains unchanged which sees the recent governing force winning by a simple majority.

Romania: Confidence and investment under pressure

For Romania, the impact of the conflict should be mainly through the confidence channel. Trade-wise, the links with both Russia and Ukraine are fairly limited, amounting to just over 3.0% of total trade volume. However, the uncertainty could put on hold some investment projects (private ones mainly) while consumers might turn more cautious. This will overlap an already weak economic context after the contraction from the previous quarter, hence the recession risk cannot be ignored. We are cutting our 2022 GDP forecast to 2.3% from 3.2%.

Otherwise, the National Bank seems very determined to maintain the EUR/RON rate close to 4.95. It will probably take some tectonic shift in the rest of CEE currencies (say EUR/PLN above 5.00 and EUR/HUF above 400) to see the leu lower. Providing a helping hand is the liquidity context which will likely turn into a shortage in March, if not February already. High carry will help maintain a more stable FX, hence we could see quite high short-term interest rates for a while.

In these circumstances, the key rate level itself will matter less, but we still expect hikes towards 4.00% this year. Inflationary pressures are now more balanced in our view given the prospects for the economy to slow beyond expectations.

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