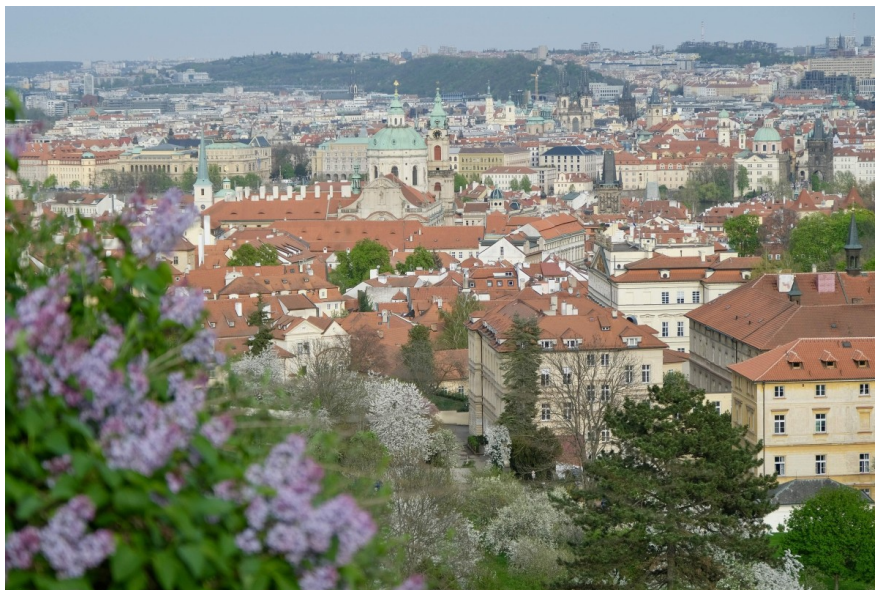


More divergence to come for the CEE region

The story in the CEE region is entering another phase of divergence, both in the economy and inflation profile as well as in monetary and fiscal policy. Signs of economic recovery are a mixed bag for now, but the region is moving in the right direction. On the other hand, inflation will bounce up in some cases – and this will be a problem for monetary policy



Prague, Czech Republic

Poland: Gradual GDP recovery as central banks grow more hawkish

Monthly data and short-term forecasts show that the consumption revival is finally underway, with rapid disinflation and double-digit growth in nominal wages buoying real household income. We are of the view that the scale of improvement in the real disposable incomes of households gives room for both higher savings and spending. Polish – and global – manufacturing is gradually recovering. We have confidence in our forecast of 2024 GDP growth of 3% on the back of domestic demand, with some upside risk.

CPI fell to 1.9% year-on-year in February. Two-thirds of the decline from the February 2023 peak is

due to the unwinding of supply shocks. Headline inflation temporarily fell below the National Bank of Poland's target, but is expected to bounce back in the coming months as the long-awaited economic rebound gains steam on the back of a consumption-led recovery, supported by a robust expansion of real disposable income. We don't think the NBP has room for complacency as the inflation target was not reached in a sustainable manner. Headline inflation is set to start mounting in the coming months amid a return of VAT on food, the upcoming expiration of the energy shield and some pickup in core inflation along with consumption growth acceleration in upward pressure on services prices from high wages growth.

The NBP remains cautious, stressing upside risks to inflation prospects and even showing rising concerns about elevated wage growth. The MPC saw a change in tone and became even more dovish in April. NBP Governor Adam Glapiński stated that rate cuts are not debated within MPC. We are of the view that policy rates will be kept on by the end of 2024. We see 75-100bp of cuts in 2025.

Czech Republic: Signs of recovery with inflation heading below target

Recent weeks have seen the first signals of a recovery in the Czech economy, especially in leading indicators such as PMI and consumer confidence. But we've also seen some positive signs in retail sales and a strong auto sector within industrial production. It's still a long way from turning us positive, but at least expectations have touched bottom and the trend of negative surprises may be over. Moreover, the latest GDP data delivered a significant fourth quarter improvement in 2023 over flash expectations, which even the pessimistic Czech National Bank did not ignore in its comments. Nevertheless, the Czech economy's flagship within the CEE region remains its inflation profile, which we estimate is heading below 2% since the central bank's target has been reached. Core inflation should also approach the target as service inflation pressures ease. The labour market also saw some signs of easing that haven't occurred in the Czech Republic for several years, while 2023's final quarter national accounts suggest that wage growth is slowing further but turning into positive territory in real terms.

Overall, the central bank may be quite happy about the current developments – but given the weaker CZK, it seems to continue to prefer a more cautious approach, i.e., cutting rates at the current pace of 50bp per meeting. An analysis of the new neutral rate estimate should be presented at the May meeting, which could move above the current 3.00%. However, for now we leave our forecast unchanged, implying 3.50% for the CNB rate at the end of this year mainly due to the undershooting of the inflation target in the coming months.

Hungary: Waiting for more clarity

Another month has passed in 2024, and yet the general economic outlook in Hungary is hardly any clearer. The incoming data was rather mixed. On the activity side, the sectoral divergence continued – but this time, industrial production surprised on the upside while retail sales were something of a cold shower. Despite strong real wage growth, households remain cautious. We may be in the first phase of recovery from the extreme inflation shock. Consumers may be upscaling as their financial situation slowly improves, but this only helps in terms of sales value and not volume. Labour market statistics are also deteriorating, while the savings rate remains near historic highs. A more optimistic explanation could be that demand for services is rising, but to be sure, we need to wait for the detailed first-quarter GDP data. However, if we add to the mix

the exceptionally strong performance of the construction sector in February, we may be in for an upside surprise in terms of overall economic activity in the first quarter. On the other hand, inventory levels in Hungary – and virtually across all of Europe – are still near record highs, while industrial order books are deeply negative (-17% year-on-year), suggesting that a booming recovery is still a long way off.

With inflation less of a hot topic, investors are focusing more on monetary and fiscal policy. The main news is the spectacular (almost theatrical) improvement between policymakers in Hungary. With the hatchet at least seemingly buried, the country-specific risk premium on the forint has started to evaporate. On the other hand, the central bank's hawkish communication has been well received. Perhaps too well, as the market is pricing in a really significant downscaling of rate cuts in the second quarter, which we tend to disagree with, especially if market stability remains high. As a result, with yet another supportive inflation print in March, the market may start to price in a stronger rate cut (current pricing is 50bp versus our call of 75bp), pushing EUR/HUF higher again. And with the delivery of 75bp of easing, rate cut expectations for May-June could also be raised. If we continue to get strong US data and/or some global risk-off (e.g., escalation in the Middle East), we could easily end up at around 400 in EUR/HUF in the second quarter.

Romania: Accelerating growth and a cautious easing cycle ahead

The Romanian economy lost speed in 2023, growing only 2.1% (compared to 4.7% in 2022). The breakdown for the fourth quarter of last year released on 8 March confirmed both persistently strong investment activity and strengthening momentum in private consumption, on the back of continued EU funds inflows and sharp real wage gains respectively. This year, we expect the stronger momentum in private consumption to continue and re-emerge as a key growth pillar, along with still-strong fixed investments. Overall, we expect growth to accelerate to 2.8%.

On the monetary policy front, we think that the National Bank of Romania is preparing the ground for a cautious easing cycle ahead. We continue to expect the first 25bp rate cut at the next meeting in May, as well as a total of 100bp rate cuts by year-end. There are mild upside risks to our year-end key rate forecast, driven by the fiscal slippage, high wage growth and a stronger-than-expected private consumption early in the year.

On the fiscal front, the budget deficit slipped visibly to 1.7% of GDP by February and it reportedly reached 2.5% in March (2024 official target: 5.0% of GDP). We keep our 5.5% forecast at this stage. The government could still cut some investments, should the European Commission (EC) want immediate progress. Moreover, the reorganisation of the tax collection authority and a potential increase in SMEs taxation are key factors to watch. Lastly, a new EC leadership team from summer onwards brings another layer of uncertainty. Getting to -3.0% of GDP looks out of sight until 2027-2028 at the earliest. We expect the EC to remain tolerant towards delays in the deficit reduction as long as public investments stay strong.

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