

## CEE: No hiding from the slower growth pace

Restrictions are back as Covid cases rise. But as measures will be less draconian than in 1H20, we look for a slower pace of recovery in the fourth-quarter without dipping back into recession. We think Polish authorities will be least concerned about FX weakness while CEE asset prices are primarily driven by shifting perceptions on global growth



Source: Shutterstock

### Slower pace of recovery but no recession

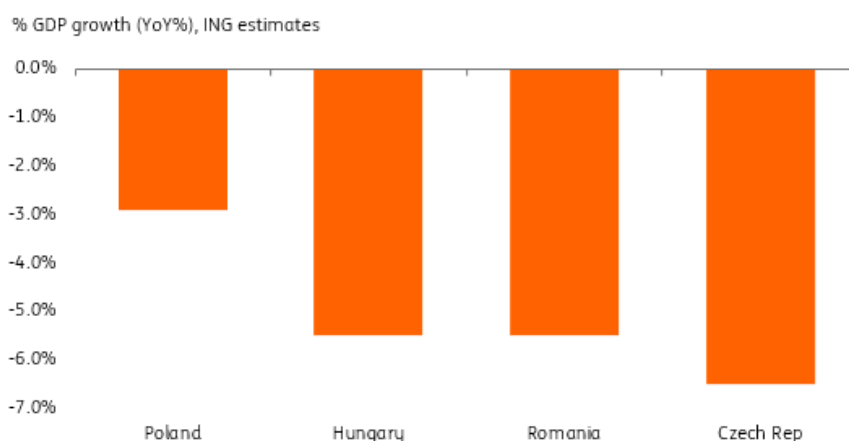
Growth dynamics in Central and Eastern Europe are not dissimilar to those seen in developed markets in Europe. After the poor first and second quarters, we have seen a meaningful rebound in the third quarter. Within the region, Poland stands out, as a strong fiscal and monetary response helped to soften the blow, allowing the country to contract 'by 'only' 3% this year. This contrasts to around a 6% decline for the other CEE countries (Fig 1).

As is the case in the EU, after the calm summer, the rise in Covid-19 cases is now taking centre stage and CEE governments have re-introduced restrictive measures. Compared to the first half of the year, we see a differentiation in the Covid dynamics in relative terms, with the Czech

Republic being hit particularly hard (the worst country in the EU, in terms of new cases per 100,000 people) largely because of the full easing of restrictions in summer and the failure to pre-emptively respond.

While restrictive measures are on the rise in the CEE (Hungary closed its borders except to V4 countries), these are not and should not be as draconian as during the first lockdown, which should soften the blow. But nonetheless, we expect a slowdown in the pace of the recovery in 4Q as restrictions dampen confidence and consumer spending. However, the slowdown should not equate to a recession.

### Figure 1: Poland weathered the Covid crisis better



Source: ING

### The two inflation laggards – the Czech Republic and Hungary

Within the CEE region and Europe, both the Czech Republic and Hungary have both been outliers in terms of inflation, generally with price pressures just peaking / about to peak.

The former has been the case in Hungary, but the latest correction in price pressures lower (September CPI surprised meaningfully on the downside) came one month too late, with the National Bank of Hungary being forced, in the meantime, to deliver a 15 basis point hike in the 1-week deposit rate late last month to end the forint's underperformance (which threatened the inflation outlook).

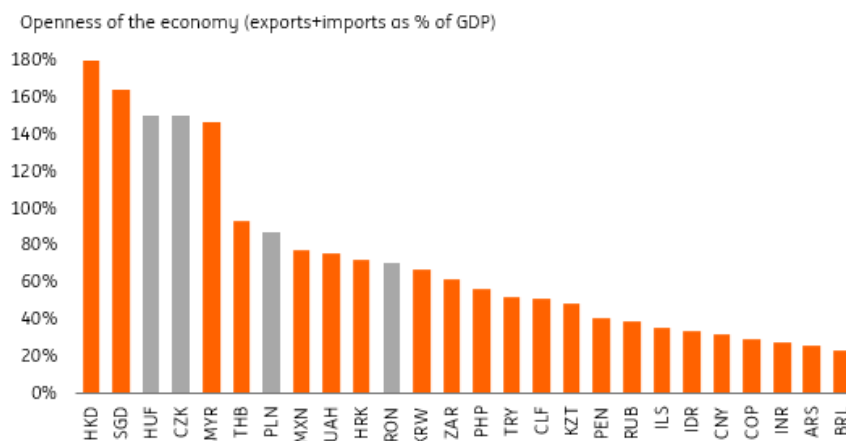
As the worst is behind us, the Hungarian central bank should now stay cautiously on hold. As for the Czech Republic, the peak should be the September CPI reading due on Monday, but with koruna weakness seen by the Czech National Bank more as an automatic stabiliser for monetary conditions rather than a threat to the CPI outlook, the CNB should remain firmly on hold.

### Varying tolerance levels for currency weakness

The extent to which local authorities are willing to tolerate further currency weakness is one of the regional themes emerging for the coming months. In Hungary, the NBH is now clearly leaning against the wind, in Romania, FX intervention is the daily bread and butter and in the Czech Republic, the CNB's Governor has been clear that the central bank is not willing to tolerate meaningful koruna weakness. In contrast, the Polish authorities appear the least concerned about currency weakness at this point.

In its last statement, the National Bank of Poland mentioned that the pace of economic recovery could be limited by the lack of a marked adjustment in the PLN exchange rate despite the global shock caused by the pandemic and a loosening of NBP monetary policy. This underlines our view that the zloty currently looks like the least attractive currency in the region (particularly since the NBH has stabilised the forint and more quantitative easing from the National Bank of Poland is on cards for 2021).

## Figure 2: CEE defined by small open economies



Source: IMF

## CEE asset prices primarily driven by global factors

In general, as the CEE region is defined by small open economies levered to global (Fig 2) and European growth, and this is the way many investors form their expectations, external factors have clearly been spilling over into local asset markets. The rise in FX volatility among local currencies since the re-rating of the global growth outlook last month and the evident underperformance of local currencies provides a case in point, as well as the flattening of local curves.

Global factors are heavily determining local markets at this point with only limited domestic idiosyncratic drivers. We thus prefer relative value positions rather than outright bets.