

CEE: Mounting pressure complicates the road to rate cuts

Central and Eastern European growth is being driven by consumption, but diverging inflation paths are set to shape monetary policy. Poland has resumed cuts amid low inflation, while the Czech Republic has paused easing as prices rise. Meanwhile, Hungary is keeping rates high amid sticky inflation, and Romania has tightened fiscally, risking recession



CEE growth is being driven by consumption, but diverging inflation paths are what's shaping monetary policy for the time being

Poland: Growth despite manufacturing stagnation, monetary easing to be frontloaded

Poland's interest rate cuts are set to be frontloaded with a target rate of 3.5% to be reached in early spring 2026. At the July meeting, the Monetary Policy Council unexpectedly cut interest rates by 25bp, bringing the main rate to 5.0%. This follows a 50bp cut in May and a pause in June. While the cut was justified by a radically improved inflation outlook and stagnation in manufacturing, it wasn't signalled ahead of the meeting by either NBP Governor Adam Glapiński or other MPC members.

Headline CPI is expected to fall to close to the 2.5% target in July, down from 4.1% year-on-year in June. This decline should be driven by statistical base effects in regulated prices, a strong zloty, and external 'lowflation', which are helping to contain past inflation impulses. Also, with GDP

growth just above 3% year-on-year in the second quarter of 2025, the output gap remains slightly negative.

GDP growth is being driven mainly by services, while manufacturing remains sluggish, as indicated by weak high-frequency data on industrial production and a collapse in the manufacturing PMI as the Trump front-loading effect faded away. Production in the construction sector is contracting too, due to the slow start of public investment and a shift in the EU funds' main projects for 2026. With resilient retail sales, Poland's growth is currently driven mainly by the consumption engine.

The National Bank of Poland's communication hasn't been very transparent as of late; Glapiński started the presser with a hawkish introduction, but surprised with more dovish rhetoric. He suggested the continuation of rate cuts and a target rate in the range of 3.0%-3.5%, but other MPC members appear to have taken this with a pinch of salt.

Nevertheless, we've adjusted our rate projection downwards and assume a 75bp cut in the second half of this year, and three additional cuts in the first half of 2026. We expect the NBP target rate of 3.5% to be reached in early spring 2026, broadly in line with market valuations. The ex-ante real rate at 1% is still higher than average under Glapiński's presidency and is above the pre-pandemic level.

Czech Republic: Mounting inflationary pressures end the cutting cycle

The Czech economy's expansion is gaining pace. Households are set to remain the dominant growth driver, now complemented by the booming construction sector. After quite some time, Czech industry appears to have bottomed out, with the PMI moving into the expansion zone in June for the first time in three years. That said, May's annual growth in industrial production gained momentum for a third month in a row after mostly hovering in negative territory for more than 20 months.

Should the rebound in manufacturing prove not to be another false dawn and remain resilient, it'd be full speed ahead for the Czech economy, with a tight labour market and further room for solid wage increases. The household spending appetite is reflected in buoyant real retail sales dynamics, which in turn provide solid ground for further increases in consumer prices.

Indeed, consumer inflation picked up in June, with the disinflationary process in the service sector coming to a halt and prompting unease among rate-setters. Moreover, the overheating housing market implies double-digit annual increases in residential prices, creating upward pressure on imputed rents and core inflation in the future. Add the accumulated cost pressures in agriculture, and it's easy to conclude that further rate reductions aren't on the menu for now.

And yes, Czech National Bank board members are well aware of the intensifying upward risks to inflation, as is clear in their rather hawkish commentary. We take rate stability for the rest of the year as our base case scenario, while still-positive real interest rates have only a moderately restrictive effect. The chapter of the Czech Republic's real economic growth outperforming the eurozone's is entering solid ground, and with Czech rates remaining stable, the koruna still has potential to strengthen gradually.

Hungary: Inflation sizzles while growth fizzles

The short-term outlook for Hungary remains subdued following a weaker-than-expected first quarter. We maintain our 2025 GDP growth forecast at just 1.0%, with downside risks persisting and a modest recovery of around 3% expected for 2026–2027. Household and business confidence remains low, further restraining consumption and investment. Nevertheless, consumption will remain the main driver of GDP, while investment activity is expected to continue to hinder growth for the third consecutive year.

The labour market, once resilient, has now clearly softened; participation and employment have slipped to their lowest levels in two years, and general wage growth continues to slow, although it remains high enough to create pipeline price pressure, especially in the services sector. Consequently, it is hardly surprising that price pressures in the Hungarian economy remain elevated.

Year-on-year inflation is still hot, sitting at 4.6% in June, and we project an average of 4.6% in 2025, before returning to close to 4% in 2026–2027. Despite limited demand-side pressure and various price shield measures (on food, household goods, pharmaceuticals, telecommunications and financial services), inflation expectations are proving sticky, which complicates the outlook for the economy as a whole.

In terms of monetary policy, the National Bank of Hungary kept the base rate at 6.50% for the ninth consecutive month in June amid ongoing inflationary pressures. According to the central bank's latest Inflation Report, the Monetary Council believes that inflation risks are tilted to the upside. Given this situation, we believe it is safest to assume that the policy rate will remain unchanged for the rest of the year.

Nevertheless, demand for Hungarian assets remains robust, supporting government financing even though the deficit target has officially been revised upwards to 4.1% of GDP in 2025. We also see a 0.5ppt slippage risk to that target, as well as a real possibility of another year with a rising debt-to-GDP ratio. Meanwhile, the forint has recently rallied, but mild depreciation is likely later in 2025, as a weaker economic outlook and budgetary and sovereign rating risks take centre stage. In this context, we expect the EUR/HUF exchange rate to crawl back to around 410 by the end of the year.

Romania: Fiscal reset begins

As widely anticipated, the Romanian government has rolled out a two-phase fiscal package aimed at addressing the widening budget deficit and reassuring markets, rating agencies, and the European Commission about the country's debt trajectory. The first wave of measures, set for early July, focuses on boosting revenues, primarily through tax hikes.

A second package, targeting spending cuts, is expected later in the month. In a move that surprised some observers, the government opted to raise both the reduced and standard VAT rates – likely the headline measure of the package. Other key changes include a 10% hike in excise duties, dividend tax increased from 10% to 16%, the bank tax doubled from 2% to 4%, broader application of social contributions, etc.

Despite these measures, we maintain our 2025 budget deficit forecast at 7.5%, though positive surprises are possible. The 2026 target of 6.4% of GDP also appears within reach. Markets have

responded positively to the size and timing of the package. However, the fiscal tightening coincides with a sharp increase in electricity prices scheduled for July, which is expected to push inflation higher. We now see year-end inflation at 7.5%, likely eliminating any room for monetary easing by the National Bank of Romania. The fiscal squeeze is also expected to weigh on growth. We have revised our 2025 GDP growth forecast down to 0.3% from 0.8%.

Bottom line: Romania is trading short-term growth for long-term fiscal credibility. But with inflation rising and growth slowing, the risk of a mild recession – or even a full-year contraction – can't be ruled out.

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