

## One region but very different stories for CEE countries

The story in the CEE region is becoming increasingly diversified due to varying economic outlooks, inflation profiles and reaction functions of central banks. We see more divergence looking forward than convergence, but some common themes remain that will temper the region's outlook in the year ahead



A man at a recent election rally in Poland

### Poland: Shift in power should unlock Poland's investment potential

In Poland, the opposition has now secured a majority in the recent general elections. A new government should be formed this year, committed to restoring the rule of law and unlocking the Recovery and Resilience Facility (RRF) payments. In 2024, Poland could receive €8 billion in grants. A shift in priorities could raise growth potential and also help with funding high borrowing needs and pre-election pledges. Gradually, this should unlock Poland's investment potential. After lagging behind its CEE peers, EU funding and increased FDI confidence should enable the country to begin catching up.

The new coalition aims to deliver its fiscal pledges, potentially adding PLN 30-35 billion to the 2024

budget, and we expect to see expansionary fiscal policy over the coming years. In our view, extra borrowing needs may not increase POLGB yields with foreign investors returning (foreign holding of 15% versus 25-30% in the rest of the region) and advances/loans from the RRF.

The third quarter of 2023 proved a turning point in the Polish economy. We estimate that GDP growth last quarter reached 0.5-0.7% year-on-year. Given a weak first half of the year, we expect full-year growth to come in at 0.4% YoY. Consumer spending should recover while EU-backed projects revive construction – both of which are likely to continue next year.

We forecast 2024 growth at 2.5% with risks to the upside, given improved investment prospects. Headline CPI moderated again in October, likely allowing for another 25bp rate cut from the National Bank of Poland (NBP) next month. However, the MPC may be less eager to ease in 2024. Extra fiscal risks still remain, and PLN gains may not last. NBP President Adam Glapiński's comments following the November meeting could also provide key insights.

The zloty rallied after the elections, and the rate has now stabilised around 4.46 as investors await the formation of the new government. In the short run, the MPC's stance should prove key as investors need clarity on NBP policy in the new political environment. The long end failed to rally alongside PLN as the fear of higher borrowing needs emerged. We expect some foreign inflows at the long end, allowing for tighter spreads against the German curve in the short run. Longer-term prospects are mixed at best, as extra fiscal stimulus looms for next year.

## Czech Republic: Central bank within reach of inflation target

The Czech economy disappointed again in the third quarter, and it's now confirmed that we will have to wait a little longer for a recovery. While we do not know the details, the monthly data suggests that the weakness in the economy is widespread. The only driver of the economy is essentially the auto sector, which is still benefiting from the recovery that followed the Covid-19 pandemic and problems with supply chains in the past.

Once again, it seems that the lowest unemployment level in the EU is a problem for the economy. On the other hand, however, we see great progress in the decline in inflation, which fell to 6.9% YoY in September. We believe this will be the lowest level this year. However, the main story here is that household energy prices are falling faster and earlier than expected. This should moderate the increase in the year-on-year rate over the coming months due to base effects from the previous year. We therefore expect growth to take us only slightly above 8% and fall back below that level by the end of the year. It should reach close to the central bank's 2% target in January.

The Czech National Bank (CNB) confirmed its readiness to discuss rate cuts in September, and we expect the cutting cycle to start by the end of this year. However, as a result of a fairly certain drop in inflation early next year, there is a possibility that the CNB could begin accelerating the pace soon. This leads us to the question of where the terminal rate is. We think it is 3% in the Czech Republic, as indicated by the central bank, which will be the target for the current board. In our forecast, we expect the rate to end at 4% next year – but it is clear that the main issue for the CNB will be maintaining the stability of inflation near the target, which will drive the cutting pace next year.

## Hungary: The moment of truth approaches

We are now at a critical juncture in Hungary. Firstly, there's an ongoing debate regarding EU funds.

The Hungarian government has responded to the nine questions posed by the European Commission and the net 90-day review period is quickly nearing its end with less than 10 days to spare. A big part of the Cohesion Fund (EUR 13 billion) is at stake, and we anticipate a resolution soon. Another defining moment in the upcoming weeks will be the release of the third-quarter GDP figures. Our forecast indicates the end of the technical recession, due largely to both agriculture and industry. Despite this, we continue to maintain our full-year call, estimating a 0.5% reduction in this year's real GDP as compared to 2022.

The most significant problem in the economy (and for the budget) continues to be consumption. Even though real wage growth is expected to turn positive by September, we doubt that it will have a significant impact on consumption. Household purchasing power has plummeted to 2021 levels as a result of rampant inflation in the last two years, with consumer confidence hovering at a 10-year low in parallel.

However, this strain will ease in 2024 as disinflation and positive real wage growth come together. The September inflation reading was better than expected, leading us to lower our short-term inflation estimates. We expect the average annual figure to be at 17.8%, with a year-end reading of 7% year-on-year. Nonetheless, our 2024 prospects remain stable at 5.1% due to an increase in both global and domestic inflationary risks. Improved inflation dynamics and the HUF's surprising resilience provided the National Bank of Hungary (NBH) with the ammunition to execute a 75bp rate cut in September. Consequently, we expect the central bank to maintain this momentum and cut rates further in the coming months, with the year-end base rate at 10.75%.

Nevertheless, the pace of cuts will decelerate in the first quarter as disinflation slows, and from there the anchor could be the ex-post real interest rate (around 200-300bp) in our view. As a result, we expect the forint to gain strength, subject to the situation regarding the EU deal. Our projection is for 375 EUR/HUF by year-end and 365 EUR/HUF in the middle of next year, bolstered by the region's most favourable positive real rate and carry.

## Romania: Signs of bottoming in the economy

The latest hard frequency data continues to point to a mixed sectorial picture in Romania, although overall, we see signs of a bottoming of the economy. Essentially, growth is dependent on one engine these days – the public infrastructure investments. This translates into a booming construction sector with civil engineering projects. Some help with GDP growth is likely to come from net exports as well and – while this is usually a large unknown – the agriculture sector. All of these factors are likely to keep the economy green in the third quarter of this year, offsetting the less overwhelming developments in industry and services. Our 1.5% GDP growth estimate for 2023 is looking rather conservative as it requires rather meagre 0.1-0.2% quarterly advances of the economy, which look reasonably within reach.

We continue to expect 150bp of rate cuts from the National Bank of Romania (NBR) in 2024, although we have shifted the starting point from the first to the second quarter – most likely at the April 2024 meeting. On-hold for longer seems to be considered by the NBR a safer choice than starting to ease as we're now seeing in Poland, Hungary and most likely the Czech Republic. Meanwhile, it remains likely that any upward pressure on the EUR/RON will be used as an opportunity to mop up some of the excess liquidity from the local market, leading to a stable FX rate. As for the outlook on the liquidity itself, as uncomfortable as the central bank might be with the situation, the latest numbers (+29bn RON in September) together with the higher budget

deficit target announced by the Ministry of Finance make a return of liquidity levels to anywhere near the historical average quite unlikely for the foreseeable future. The liquidity surplus has most likely become a structural feature of the local banking system.

Relevant risks stem from the fiscal package recently adopted, which might be consistent with a higher for longer local rate environment, and possibly lower growth in the private sector. The upside of this is likely the fact the European Commission will allow for a deviation from the planned budget deficit reduction, with this year's target probably somewhere in the 5.5-5.7% of GDP range and next year in the 4.5-5.0% of GDP. While accumulating delays, the absorption of EU funds via the National Recovery and Resilience Plan (NRRP) and the multiannual financial frameworks (MFF) is likely to continue without any major hiccups.

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