

## CEE: Some Like It Hot

Covid cases are rising, lockdowns are extended yet the growth outlook still points to a rebound from late in the second quarter and beyond. With CPI above target everywhere in the region, the reflation theme remains but the central banks' preferences vary. Some won't tighten (NBP), some will be forced to (NBH) and some will hike willingly (CNB)



Playing with fire:  
Inflation is above target  
in CEE countries

### Price pressure evident in the region

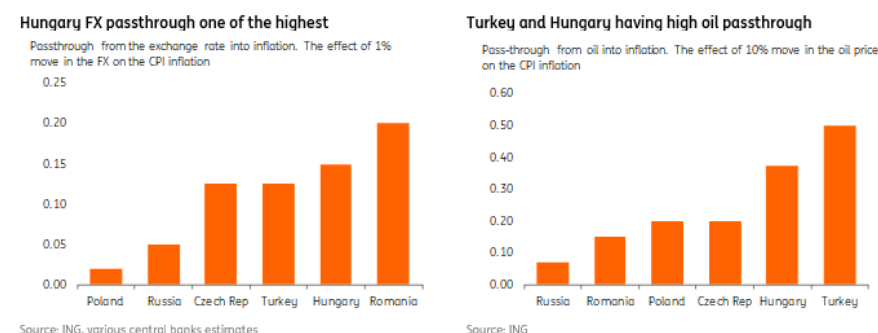
Despite the ongoing extensions of lockdowns across Europe, the CEE reflation theme remains intact. We expect politicians to have largely overcome vaccine challenges this summer and, as we're seeing in the Czech Republic, the stricter lockdowns now underway in most of the region will eventually lead to the decline in cases.

CPI everywhere in the region remains above the respective targets and headline numbers are set to, in most of the cases, rise further. The general drivers are similar; already high core prices, the expected 're-opening' inflation in the service sector and base effects coming from high oil prices.

However, the scale and persistency of those CPI overshoots, as well as CPI trends, will differ. And some countries will be more tolerant of higher inflation than others. Hungary will see the largest overshoot, with CPI likely hitting 5% in April or May. Poland will also see CPI above the upper tolerance band, but the peak will come much later. In contrast, Romanian and Czech CPIs will be

more well behaved, albeit still above target. In Russia, CPI has probably already reached its peak and should start gradually decelerating while the Turkish CPI outlook looks more challenging.

With price pressures building across the region, we look at two possible pro-inflationary risk factors to the already elevated CPI readings: currency depreciation and a higher oil price. Here, Hungary and Turkey stand out. Turkey suffers the highest oil passthrough in the region, while Hungary, among free-floating currency regimes, exhibits the highest FX passthrough as you can see in the two charts below.



## Central bank responses will vary

Despite high inflation, the central banks' preferences vary. In the low yielding CEE space, the two central banks with the most worrying inflation profiles, the NBP in Poland and the NBH in Hungary are, and will continue to be, heavily reluctant to tighten. While the NBP is likely to get away with loose monetary policy, we expect the NBH to be forced into hikes in the second quarter due to FX consideration.

We expect the Czech National Bank to raise rates later this year, despite less pressing price pressure compared to Poland and Hungary. Similar to the Central Bank of Russia (which has already started tightening), the CNB will hike due to its strong inflation targeting framework. But in contrast to frontloaded CBR tightening, we believe CNB hikes will be backloaded into late-2021.

Our call for CBT rate cuts in Turkey in the second half of the year remains unchanged, but the easing should come earlier and be more aggressive. As is likely going to be the case in Hungary in 2Q21, we do not rule out CBT tightening next quarter should the TRY need stabilising.

## CEE FX: Shifting risk factors

The risk factors for EMEA FX have moved away from global to regional specifics. The third wave of coronavirus across Europe is of concern for CEE FX while possible sanction risk and monetary policy are concerns for RUB in Russia and TRY in Turkey, respectively. A fair share of bad news seems already priced in, mainly for CZK in the Czech Republic and PLN in Poland. We like CZK the most and expect Hungary's HUF to come under pressure in the second quarter. Among high yielders, we favour the ruble over the Turkish lira due to CBR tightening and what we still see as a low probability of sectoral sanctions.

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