

CEE: The big inflation build-up

Spiking inflation in Central and Eastern Europe brought responses from central banks and a shift in bias will soon be followed by rate hikes. But price pressures are set to remain in place for the rest of the year as reopening economies boost demand. In FX, we tactically favour Hungary's forint and Poland's zloty to the Czech koruna mostly due to positioning



Prices are rising in many parts of central and eastern Europe, not least for these shoppers in Poland

Cost-driven price pressures to be joined by the demand side

Inflation pressures in the CEE region are clear and material.

Headline inflation is above target across the entire region, with the overshoots being particularly pronounced in Poland and Hungary. The region shares the same trend. While the worst in terms of core prices should be behind us and core CPIs should continue grinding lower from their peaks, the risks to headline inflation remain on the upside.

Generally, headline CPI pressures have so far been cost-driven; a mix of higher commodity, food and regulated prices. While these are largely due to base effects, the demand side of CEE economies should start to contribute from the summer onwards as the economic reopening unleashes pent-up demand.

Trend wise, the Czech, Hungarian and Polish CPIs should all see a double top this year, with the high price pressures observed this quarter normalising somewhat in the third quarter before rising again towards the end of the year. By contrast, Romania CPI should linearly increase into the year-end, reaching 4.3%, due to the hikes in gas and electricity prices starting on 1 July 2021.

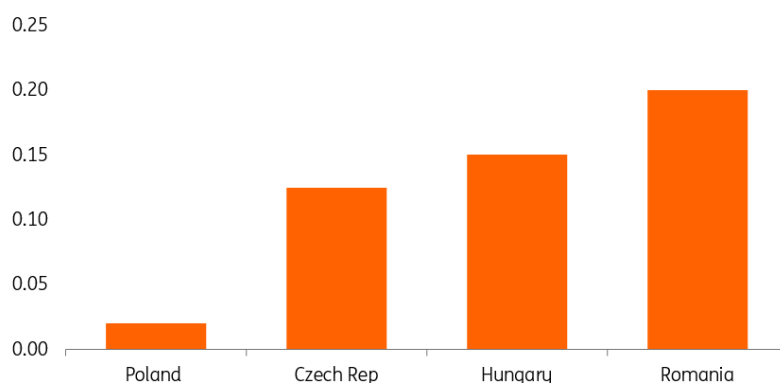
In 2022, these price pressures should ease as some of the base effects wear off. Yet, the rest of this year should be characterised by the upside risks to CPI, largely stemming from the reopening of local economies.

Rate hikes ahead

In terms of the risk of de-anchoring inflation expectations, the recent shift in Poland and Hungary's central banks away from an ultra-dovish stance, where both the National Bank of Poland and the National Bank of Hungary hinted at policy normalisation, should help to tame such concerns. We expect the NBH to deliver the first hike in June and the Czech National Bank to raise the base rate by 25bp either at the June or August meeting; there's a 50:50 probability in our view. The NBP is likely to deliver a mix of QE tapering and modest hikes in the second half of the year.

Romania has the highest FX pass-through

Passthrough from the exchange rate into inflation. The effect of 1% move in the FX on the CPI inflation



Source: ING

CEE FX: A lot of positives

As for FX, the wider European and CEE economic recovery coupled with a shift in the CEE central bank biases are positive for local currencies. Tactically, we favour HUF and PLN to CZK, largely due to the positioning. We judge the CZK's positioning to be one way (long). However, HUF gains should not last long and we expect EUR/HUF to end the year around/above 355 as a lot is already priced in and, unlike CZK or PLN, the forint should not have a tailwind of the current account surplus this year. We like short EUR/RON positions as high CPI and high FX pass-through should keep the NBR tolerance for further RON weakness rather low.