

Central and eastern Europe: Riding the second wave

The CEE region is feeling the heat of the second Covid wave. But with less severe restriction, the economic hit should be less painful too. We also think there will be less pronounced fiscal and monetary support, as deflation seems unlikely. CEE FX remains a global beta, rather than a local alpha story



A protester against new lockdown measures in Prague

Hit by Covid, but the negative impact should be more muted vs spring

Central and Eastern European countries have been hit by the second wave of the pandemic and subsequent lockdowns. While Covid cases are substantially larger than during the first wave, we expect the negative impact on the economy to be less pronounced because (a) new measures are less restrictive (b) temporary shutdowns of large factories - such as automakers seems unlikely at this point and (c) compared to the first wave, the pandemic has had a more diverse impact on global regions.

In particular, Asia's resilience may provide some breathing room to the export-oriented CEE countries, either directly or indirectly via German and eurozone exports

Less pronounced fiscal and monetary support

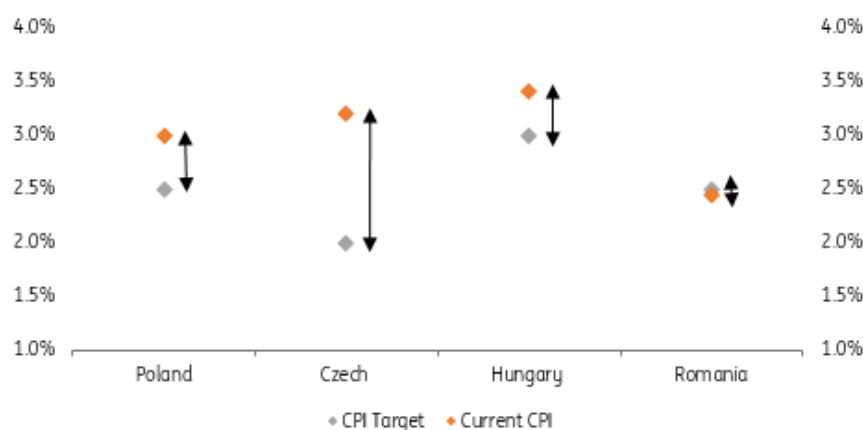
Compared to the first wave, CEE fiscal and monetary support is likely to be less pronounced.

On the fiscal side, this is due to various factors (differing from country to country) such as a move from broad-based to more targeted support measures, less negatively impacted industrial sectors (vs the first wave) and a lower willingness to increase the deficit.

On the monetary side, no urgent easing is expected either. The second wave poses a lower degree of downside risk to the domestic growth outlook and importantly, the ordinary monetary channels have now been more or less exhausted, thus raising the bar for further easing.

In Poland and the Czech Republic, interest rates are close to zero, while in Hungary the interest rate channel continues to be perceived as an FX stabilising tool (hence, limited room to cut rates). Equally, the situation isn't so urgent for local central banks to consider new unorthodox measures - with the exception of Poland's central bank, which we expect to extend its quantitative easing programme into 2021.

Deflation risks nowhere to be found



Source: ING

Deflation risk is not an issue

Vastly different CEE inflation dynamics are one reason why the European Central Bank is bracing itself for another large monetary stimulus (to come in December), while CEE central banks are not - at least at this point.

In sharp contrast to the eurozone, the risk of deflation is not an issue in central and eastern Europe

In sharp contrast to the eurozone, the risk of deflation is not an issue in central and eastern Europe (see chart above) as all countries have had some cushion of high and above-target CPI going into the crisis. In the coming months, we should continue to see more normalisation from the previous high levels towards the inflation target, with limited risk of an undershoot.

Purely from a price stability point of view, the case for more monetary stimulus just isn't there.

CEE FX is a global beta play

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The deterioration in the domestic and eurozone growth outlook in October led to a meaningful underperformance of local currencies, but with a lot of bad news priced in. With the US election outcome not being a negative for emerging market FX (in fact, the prospects of an end to unpredictable trade wars, a modest US fiscal stimulus and a limited scope for a sell-off in global bond markets should benefit emerging market FX next year) this should provide some breathing room to battered CEE FX too.

We continue to prefer the Czech koruna and Hungarian forint to the Polish zloty, given the larger NBP bias towards easing and higher tolerance towards currency weakness.