

CEE central banks are looking for a peak in the hiking cycle

In Central and Eastern Europe, the hiking cycle is coming to an end. In the Czech Republic, we're not expecting any further rate rises. Poland should deliver some fine-tuning, and expect the rate of interest rate hikes to slow in Romania and Hungary. That said, peak inflation is yet to come so risks abound



The rate hike cycle in Central and Eastern Europe is coming to an end despite inflationary pressures

Poland: NBP turning dovish, but the peak in inflation is yet to come

Poland's GDP growth in the second quarter surprised to the downside, reaching 5.5% YoY vs 8.5% YoY in the first three months. The sequential slowdown of 2.1% Quarter-on-Quarter (seasonally adjusted) was the second worst in the last few decades, only coming in deeper during the pandemic in early 2020. We think the data exaggerates the magnitude of the economic slowdown in the last quarter and the sharp sequential slide was also caused by statistical revisions. Still, the numbers mark a turning point in activity and the possible beginning of a technical recession in 2022.

July activity figures present a similar picture, with industrial and construction, production, and

retail sales surprising on the downside; the backdrop of this data shows the economy is losing momentum. The previous growth engines in manufacturing slowed, and seasonally adjusted retail sales indicate that the consumption boom is fading. Now we see indicators such as the PMI index fall well below 50 and consumer sentiment is worse than during the pandemic. The influx of some 2 million Ukrainian refugees supports the sale of necessities, but growth in durable goods is weakening.

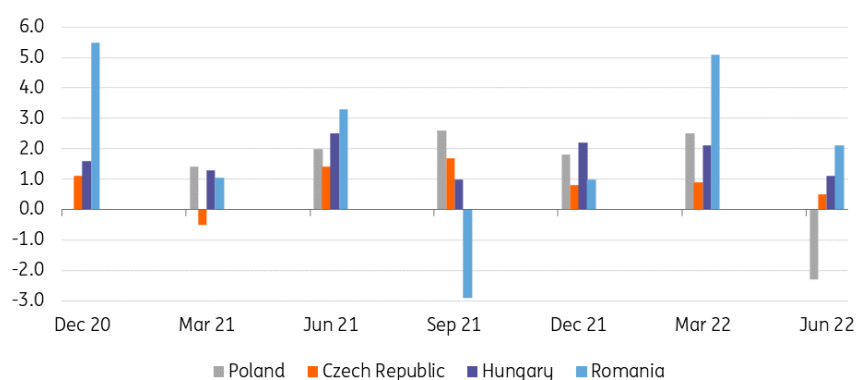
After stabilising during the summer, August CPI figures show inflation pressures are resuming in all categories. Most worrisome is the sequential growth of core inflation, which spiked again after the June-July slowdown. This matches our non-consensus view that CPI should reach its new peak later this year and into next, reaching just below 20% YoY. The energy price shock is largely to blame and the government is preparing offsetting measures but sustaining those is perhaps prohibitively expensive.

The 2023 budget draft presents a sector deficit of 4.4% of GDP almost in line with our forecast and about 4.5% in 2022. We see revenue estimates as reasonable, but worry spending may be higher given the energy crisis. Also, locally funded investment projects may replace the EU Recovery Plan, so raising borrowing needs or the deficit.

Overall, the fiscal stimulus in 2023 should be comparable to over 3% of GDP we estimate for 2022, thus we see an upside risk for the 2023 deficit and higher borrowing needs than planned. Still, Poland seems to be somewhere between Hungary (where pre-election fiscal expansion was very high) and the Czech Republic, which delivered orthodox monetary and fiscal consolidation in 2022.

Poland's Monetary Policy Committee switched to a dovish tone, but the governor withdrew from his opinion of 'one 25bp hike and done'. We downgraded our terminal rate forecast from 8.5 to 7.5%, which is a bit higher than consensus but matches market pricing. We still think that the risk of persistent inflation is high, but the government should mask inflation with additional extraordinary measures and fiscal stimulus would still be directed to households. The economic slowdown would make the MPC less prone to hike, but still recent CPI data from Poland and elsewhere support our view that the energy shock has to pass through to prices and the CPI peak is still ahead of us.

GDP growth in the CEE region (%QoQ)



Source: Macrobond, ING

Czech Republic: CNB is comfortable with the end of the hiking cycle

Second-quarter Czech GDP had shown a slight increase instead of the expected economic contraction; the second estimate brought another upward revision. The main reason for the positive surprise is the rise in inventories, while consumption fell slightly. So, the outlook for the second half of the year has not changed significantly and the slowing economy is confirmed by both leading indicators and monthly data. Inflation surprised to the downside in July for the first time since last May, mainly due to energy prices and the unclear fix/float mix of household contracts. This may imply a slower pass-through of energy prices into CPI, but we still expect inflation to peak around 20% in the coming months.

On the fiscal side, upward pressure on wages and household energy cost subsidies remain, but the government's actions to date do not pose a material risk to our forecast of a government deficit of 4.1% of GDP. Moody's, unsurprisingly, downgraded the Czech Republic's rating outlook from stable to negative in early August following Fitch's earlier decision. We do not expect a downgrade in ratings unless there is a complete cut-off of gas supplies from Russia.

On the monetary policy side, the CNB remains in 'wait-and-see' mode. Our forecast remains unchanged, i.e. no interest rate hike. Although the economic picture is slightly better, surprisingly low inflation has created a solid buffer for the new board to remain dovish in the months ahead. Moreover, the depreciation pressure on the koruna has eased, so we do not see unsustainable intervention costs as a risk for the coming months either. The koruna should hold at current levels near the intervention band of 24.60-24.70 EUR/CZK.

Hungary: The first signs of the winds of change

In general, economic activity in Hungary is doing OK despite the plethora of challenges, which is represented well by the 6.5% year-on-year GDP growth in the second quarter. However, the first red flags have already popped up. The volume of retail sales has been on a downward trajectory for three months, a phenomenon which was last seen during 2008-2009 and in 2012. Hungary fell into recession in both periods. Real wage growth is still holding up (+3.3% YoY in June), but it is slowing quickly. The continued acceleration in inflation (13.7% in July) and the expected peak at 22% means a meaningful deterioration in real disposable incomes in the coming months. Finally, the unemployment rate increased for the first time in six months in June, though the labour market has remained extremely tight.

Against this backdrop, we expect a technical recession in Hungary during the second half of the year. Its impact will mostly be felt in the 2023 average GDP growth (1.0-1.5%), as the strong first half in 2022 will keep this year's economic performance elevated. However, any economic wobble shouldn't frighten the National Bank of Hungary and we see the central bank continuing its fight against inflation with interest rate hikes and more. A 14% terminal rate might prove to be enough in our view if the upcoming rate hikes are accompanied by measures which actively tighten excess liquidity in the financial system. This combination could give a temporary boost to the still vulnerable local currency, but the real story of the forint can be found elsewhere, i.e. the gas and EU story. A satisfying conclusion in both (or at least in the Rule-of-Law debate) could free up the forint's hidden potential.

Romania: Hiking cycle nears peak

Despite high-frequency indicators pointing to a small quarterly growth for second quarter GDP, the flash data again surprised strongly to the upside. Second quarter GDP expanded by 2.1% versus the previous quarter, dashing speculation about an ongoing recession. Corroborating this with the even stronger 5.1% quarterly growth from the first quarter and assuming no significant data revisions going forward, we can safely say that even a stagnant economy in the second half of 2022 would still take real GDP growth to 7.0% in 2022.

On the inflation front, starting in the fourth quarter of this year the inflation profile will start descending gradually and the central bank estimates it will enter the target band (1.5%-4.5%) by the end of its two-year forecast horizon. This is in line with our forecast, though the recent spike in energy prices might complicate things again. We see the year-end inflation rate at 13.6% in 2022 and 7.0% in 2023.

The relative stabilisation of the inflation trend will most likely incentivise the National Bank of Romania to reduce its hiking pace further. With two more policy meetings this year, the pace of tightening is likely to soften to 50 basis points in October and 25 basis points in November, taking the key rate to 6.25% by year-end. However, the broad monetary conditions might not fully reflect the remaining tightening steps. As we move ahead into the second half of 2022 the liquidity picture could improve a bit as the government should speed up its spending if it were to stick to its 5.8% of GDP budget deficit target. As of the end of July, the budget deficit stood below 2.0% of GDP, hence there's almost 4.0% of GDP to spend (approximately RON55bn) in the remaining five months of 2022.

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