

## Inflation pressures continue to build in central and eastern Europe

Inflation pressure is building across central and eastern Europe, particularly in Poland and Hungary. Both central banks are reluctant to tighten; Poland should get away with it but Hungary may be forced to hike. The Czech central bank will likely raise rates in the fourth quarter and we expect CZK, our top pick, to strengthen and HUF to come under pressure



The Prime Ministers of Slovakia, Poland, Czech Republic and Hungary at a 'V-4' summit in Prague last year

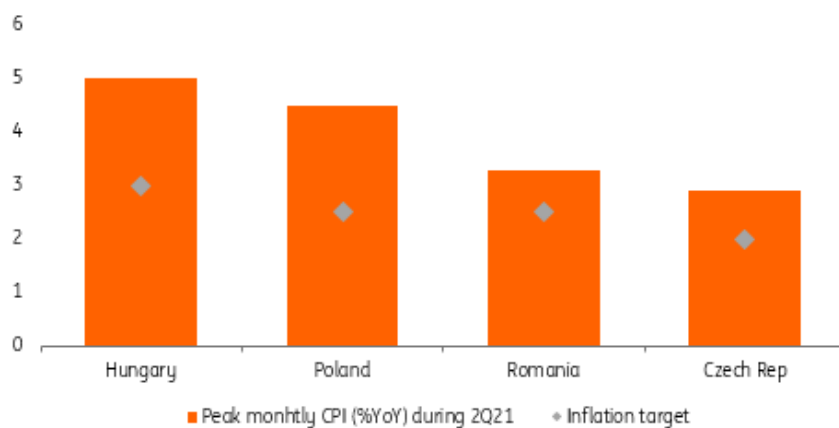
### Poland and Hungary leading the way

Inflationary pressures are building strongly in the CEE region. Poland and Hungary are both either experiencing or are about to experience a meaningful CPI overshoot versus the target. In Poland, April CPI breached the 4% level while in Hungary, April and May CPI readings should be particularly elevated, with the May CPI possibly breaching the 5% mark.

The price pressures are a function of both elevated core CPIs as well as one-off factors, such as the oil price. Neither of the central banks is overly keen to react as they clearly prefer the growth factor over inflation. While we expect the National Bank of Poland to get away with it and keep rates on hold (we only expect [the first rate hike in H2 2022](#)), we continue to look for the

emergency rate hikes from the National Bank of Hungary this quarter as high CPI will depress the Hungarian real rate. That will, in turn, weigh on HUF, the Hungarian forint, and force the national bank to react with FX stabilising hikes. Unlike the Polish zloty (PLN), the forint doesn't benefit from the tailwinds of the current account surplus and is, therefore, more vulnerable.

## CPI is above the target everywhere in the region



Source: ING

With the vaccination process gaining pace both in the CEE region and in the eurozone, its key trading partner, the economic data should see a meaningful improvement in the coming months. Local economies should rebound meaningfully in the third quarter as restrictions ease.

The worst being behind us and rising price pressures should eventually lead the Czech National Bank to hike rates, but the tightening should only come in the fourth quarter; a cautious CNB is likely to err on the side of caution and would want to see the recovery fully underway before tightening. The CNB monetary response should translate into the relative flattening of the CZK IRS curve vs the PLN curve as the CNB will be seen as pro-active rather than reactive, while the NBP in Poland will be considered as being behind the curve.

## We favour CZK; HUF not so much

In the CEE FX space, the Czech currency, CZK, remains our top pick to do well as the CNB is getting closer to the fundamentally justified rate hikes. Although this should be a story for the fourth quarter, the CNB should start considering the tightening more vocally in the autumn and this should, in turn, spill over into stronger CZK.

We see EUR/CZK at 25.50 in the second half of this year. Like PLN, the Czech koruna should also benefit from the current account surplus this year (around 2% of GDP), but the zloty is to lag behind due to the dovish central bank. In Poland, we expect the Swiss franc mortgage story to have a limited impact on PLN as the CHF/PLN conversion is likely to be done off-market via Poland's central bank, the NBP.

We continue to see HUF as the least attractive currency in the region and expect it to come under pressure (to EUR/HUF 370) this quarter as the real rate will fall. We like Romania's leu from a carry perspective (the highest carry in the region) and our view that the usual annual adjustment in EUR/RON higher is now behind us. We expect EUR/RON to stay within the 4.92-93 range in the

coming months.

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