

Central and Eastern Europe: Gradual recovery but no deflation

It seems that Central and Eastern European economies are through the worst and a gradual recovery lies ahead. Despite the sharp fall in growth, there aren't any deflationary pressures as these economies were running hot prior to the Covid-19 crisis. All this is likely to translate into limited monetary easing ahead, but Poland remains very dovish



Romanian seasonal workers wait for check-in at the Avram Iancu international airport, in central Romania.

Source: Shutterstock

Economic growth to gradually recover

Despite the high degree of uncertainty, the worst seems to be behind the CEE region. Significantly downward revisions to growth have been made vs pre-Covid-19 (Figure 1), but 2Q looks to be the bottom and the second half of the year should offer a gradual recovery. Still, local economies are unlikely to reach pre-Covid-19 levels until late 2021 or 2022.

2021 growth should range around 4% for the Czech Republic,

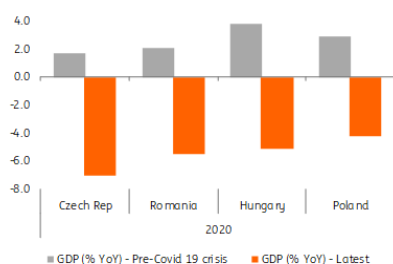
Poland and Hungary, while around 7% in Romania

The Czech economy is set to see the most negative growth in the region this year (-7.0%) though in terms of the scale of the outlook downgrades vs pre-Covid-19 situation, the almost 9% downward revision to Czech growth (+1.7% pre-crisis vs -7.0% now) is equal to the one in Hungary and larger than in Poland and Romania. This partly reflects the mix of the large openness of these two CEE economies (as very evident in Figure 3) as well as their exposure to the cyclical auto industry (particularly when compared to Poland).

The CEE growth recovery should stem from a mix of improving foreign demand and stabilising domestic demand, both underscored by the low base, generating solid YoY figures. The 2021 growth should range around 4% for the Czech Republic, Poland and Hungary, while around 7% in Romania.

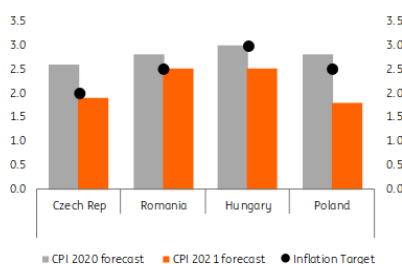
[See the full version of the CEE Economic Update for details and in-depth analysis of individual CEE country outlook](#)

Fig 1 Large drop in the GDP outlook due to Covid-19



Source: ING

Fig 2 No urgent CEE deflation risks on the horizon



Source: ING

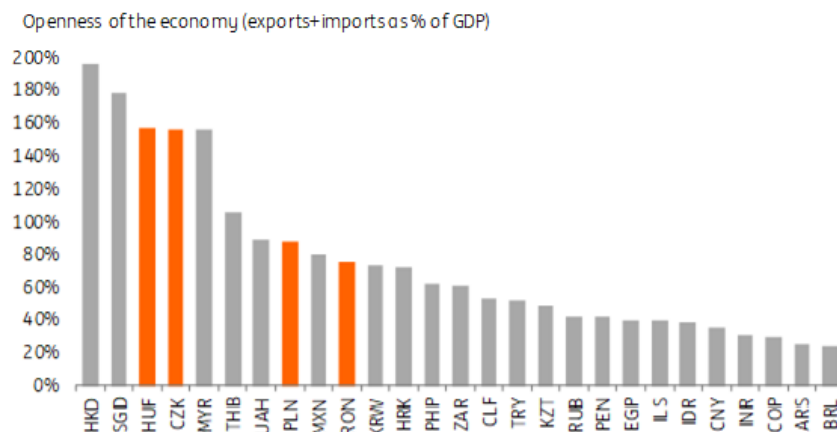
Declining CPI from above target levels means no deflation risks

As for the inflation outlook, the trend into the year-end is largely similar across the region. That is declining CPI (with the exception of stable inflation in Romania) from the rather high, well above the inflation target level starting points. The decline is to be mainly driven by lacklustre demand.

But any talk of deflation is premature and the regional inflation outlook for next year points to either at-target CPI (Czech and Romania) or modestly below the target CPI (Hungary and Poland) – Figure 2 .

As pre-Covid starting point for CEE inflation numbers was rather high vs the rest of Europe (due to most CEE economies running above their potential, solid labour market and high wage growth), the subsequent decline is not strong enough to cause deflation concerns.

Fig 3 Czech and Hungarian economies particularly opened



Source: OECD

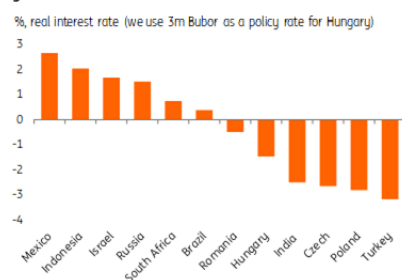
Limited easing ahead

As the worst seems to be over, there is a gradual recovery ahead and no imminent deflation pressures, this also means the bulk of the across-the-board aggressive monetary policy easing is behind us.

Note that Poland's central bank delivered one of the largest QE programmes globally while the cumulative 200bp worth of Czech national bank rate cuts was one of the largest conventional easings. We see both the CNB and the NBR as largely done.

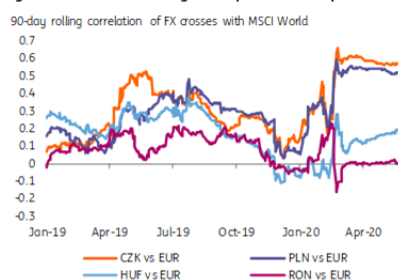
In Hungary, the central bank started the process of reversing the previous FX stabilising hikes, but additional easing should be only modest (one last 15bp cut and we don't see 3m Bubor below 0.60% this year) while the central bank has paused its QE programme. In this respect, the NBP should be the leader on the policy loosening front and we expect QE in Poland to be extended into 2021.

Fig 4 PLN suffers from one of the lowest real rates



Source: Bloomberg, ING

Fig 5 HUF risk sensitivity decoupled from its peers



Source: Bloomberg, ING

FX: CZK to outperform, PLN to underperform

In terms of allocation and preferences, we would argue that overweight CZK, neutral HUF and RON and underweight PLN makes sense.

CZK is our preferred CEE currency given limited scope for further Czech central bank easing, the solid fiscal position and the low odds of the central bank leaning against CZK strength (due to the low risk of deflation – vs the clear deflation risks in 2013 ahead of the start of FX interventions). We

see EUR/CZK at 26.00 by the year-end.

In contrast, the dovish bias of Poland's central bank should translate into the PLN underperformance as the NBP is likely to extend QE beyond this year. With inflation still high and rates at the zero lower bound, PLN currently suffers from one of the most negative real rates in the emerging market space (Figure 4).

While HUF weakened noticeably in recent days (following the surprising June National bank of Hungary cut), we don't see this as long-lasting. Not only was the 15bp cut modest, but the latest guidance suggests that only one additional 15bp cut will be delivered and the base rate is to stay at 0.60% - which is higher than in the Czech Republic and Poland.

We expect EUR/HUF to range trade around the 355 level in coming months

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