Recovery in peril for the CEE region

Economic recovery in the CEE region is below expectations but the disinflationary process has come to an end and inflation is higher in some places. The central banks' cutting cycle is thus entering a fine-tuning phase

Poland's second-quarter GDP reading came in higher than expected

Poland: Governor pivots towards easing but reasons to be cautious

Economic recovery is continuing in Poland thanks to robust private and public consumption. The second-quarter GDP reading came in higher than expected and seasonally adjusted data suggests that the recovery is gaining momentum, despite economic stagnation in its main trading partner Germany.

At the same time, the headline reading reached a bottom in March and will near 4.7% year-on-year at the end of 2024, while core inflation remains elevated. The National Bank of Poland (NBP) President Adam Glapiński stated in July that rates could remain unchanged until 2026, but other MPC members are less hawkish and are leaning towards monetary easing in 2025. In August, Glapiński pivoted by saying that rate cuts could indeed start next year.

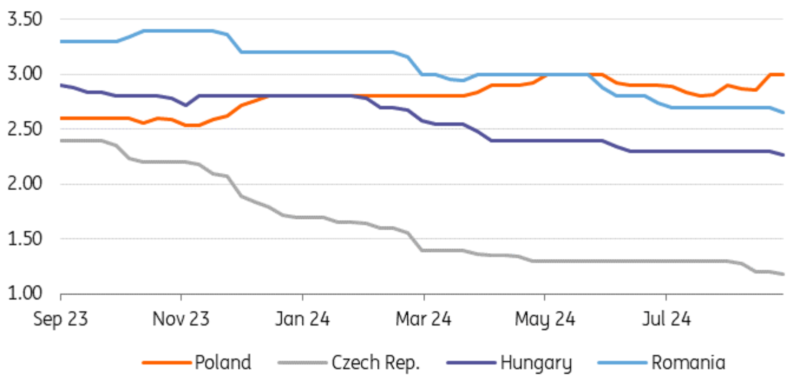
Government officials said they would continue to protect households from high electricity prices in 2025 as well, so the inflation path is unlikely to be as high as in the July NBP projection. That, along with the prevailing majority within the Council for policy easing in 2025, probably led to an amendment of the NBP governor policy bias. Still, there are arguments for remaining cautious in any imminent decision to cut rates, including economic recovery, elevated inflation and loose fiscal policy.

The 2025 draft budget bill envisages a record-high cash basis state budget deficit and borrowing needs, but it's important to note that spending includes financial support for the Polish Development Fund (PFR) and state-owned BGK bank to allow them to redeem state-guaranteed bonds issued during the pandemic. This transaction is neutral for the general government deficit and debt and should be deducted from 2025 net borrowing needs.

Expenditures by PFR and BGK were reported in the previous year and the state-guaranteed debt was replaced by state treasury debt. The MinFin funding plan assumes record-high borrowing needs but bond supply is split among different instruments, EU funding and has an elevated cash buffer. So funding needs in 2025 are manageable but the economy needs credible fiscal adjustments in the coming years.

The government has revised the 2024 general government deficit to 5.7% of GDP, up from the previous estimate of 5.1%, which effectively presents a higher fiscal expansion than expected for 2024. For 2025, the headline deficit is also higher than planned a few months ago, but in terms of the structural deficit corrected for (imported) defence spending, 2025 presents a kind of fiscal tightening versus an expansionary 2024. Glapinski should therefore not use fiscal expansion as an argument against easing. We expect NBP rates to remain unchanged in 2024 and the first cut to be delivered in the second quarter of next year. In 2025, we foresee a policy easing of 100bp.

Consensus forecasts for 2024 GDP growth (%)



Source: Reuters, ING

Czech Republic: Inflation to stay close to target amid lukewarm recovery

Given the continued weakness in industry, nominal wage growth is expected to soften in the second half of the year, and so are real wages, with inflation remaining close to target. Manufacturers face tepid demand from abroad which is set to erode their willingness to support further lofty wage increases. The confidence of Czech consumers is set to drop, while household consumption expenditure decelerated noticeably in the second quarter. We expect the elevated uncertainty and less buoyant wage increases to restrain consumer spending in the months ahead.

That said, the annual real GDP growth is set to quicken in the two following quarters due to the low comparison base of the previous year.

Pricing in industry is about to remain on the soft side as anaemic demand exerts pressure on boosting cost competitiveness, representing a risk to future employment gains. That said, the labour market remains tight, with firms seeing incentives to keep or hire skilled employees in case Europe's economic performance picks up. The deteriorating mood in the service sector is worrisome, as this was the segment where the economy performed well until now. Overall, we expect the economy to expand by 1% this year, which is well below its potential.

Such a gradual rebound will keep headline inflation close to the Czech National Bank target, or even below, in the coming months. A gradually strengthening koruna fosters this expectation via subdued import prices. All this implies a restrictive monetary policy stance, with real interest rates exceeding 2% over the coming months. We foresee the Bank Board going ahead with two more soft rate cuts during the two consecutive meetings this year, followed by a break at 4% toward the year-end. One should bear in mind that policymakers have not appeared concerned about sub-target inflation for some time.

Hungary: Improved growth is contingent on confidence

There was some fragile optimism on our part at the beginning of this summer, but it has since faded. Or at least it has become highly dependent on an improvement in business and consumer confidence, which is still weak. With the latest incoming data painting a rather cloudy picture in the short term, we maintain our pessimistic growth outlook for 2024. We see only 1.5% GDP growth this year, as both consumption and investment have failed to provide the expected boost to economic activity. However, some more positive underlying factors balance the overall long-term picture and lead us to believe that 2024 will be a slow healing process, while 2025 will be a year of healthy and solid GDP growth (averaging 3.6%).

The resilience of the labour market is remarkable and, while the jury is still out, if the global inventory cycle does indeed turn soon and consumers and businesses feel confident enough to start spending again, labour hoarding will provide a stable springboard to quickly meet the needs of rising external and domestic demand. The only caveat could be the renewed pricing power of companies as demand picks up. This, together with rising labour costs due to labour shortages and the rising or non-easing tax burden resulting from the government's recent fiscal measures, could pose a pro-inflationary risk.

However, even if we do not expect a significant demand-driven price shock, we expect above-average repricing and base effects to lead to an average inflation rate of 4.5% in 2025, compared with 4.0% in 2024. Against this backdrop, the National Bank of Hungary could remain careful, patient and stability-oriented in the short term, and we see only two more 25bp rate cuts to 6.25% over the rest of the year. This approach could keep EUR/HUF in a narrow range of 390-400 in 2024. The political cycle and uncertainties stemming from a new central bank governor and a changing Monetary Council could trigger a level shift in the currency pair with a new range of 400-410 in 2025.

Romania: Weaker-than-expected growth clouds the robust internal demand picture

Private consumption is set to re-emerge as the key growth driver this year. Over the first half of the year, retail sales grew by a solid 7.0% in annual terms. With public wages and pensions on the rise this year, momentum should remain strong. That said, growth over the second quarter surprised negatively, coming in at 0.8% year-on-year following a downwardly revised first quarter. Data on 6 September should bring more clarity and we expect to learn that net exports were the main culprit. Our forecast is under review until then and, in the meantime, we have revised our 2024 GDP growth projection from 2.8% to 2.0%.

On the monetary policy front, at this stage, we hold on to our call of no further rate cuts this year, although we acknowledge that risks have increased due to the recently released weak GDP growth numbers. On another note, it's worth mentioning that the political arena is set to decide this month on the composition of the new National Bank of Romania board. All in all, we expect a cautious and gradual easing cycle ahead, with the key rate at 6.50% by year-end and 5.75% by the end of 2025.

On the fiscal front, the budget deficit slipped visibly to 4.06% of GDP between January and July. At this stage, we expect the deficit to end the year at 7.0% of GDP, with balanced risks. The key factor to watch ahead is the outcome of the negotiations with the European Commission (EC) this autumn. A seven-year deficit adjustment plan is the most likely to be agreed with the EC, with lower corrections until 2027 in order to sustain the investment momentum.

Author

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Disclaimer