

Disinflation continues across CEE at varying speeds

Disinflation continues across Central and Eastern Europe, opening up the possibility of central bank rate cuts. However, lower inflation does not necessarily mean faster rate cuts. The local story will increasingly create divergence across the region



National Bank of Hungary, the National Bank of Poland and the Czech National Bank

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Poland: Central bank easing around the corner

Second-quarter growth in Poland most likely underperformed (with flat or negative year-on-year growth), given poor retail sales, industrial output and a 45.1 point manufacturing PMI reading in June. Consumer sentiment is improving but from a very low level. Moreover, real wages will just start to grow in the third quarter, after around a year of declines. Plus, the government's cheap mortgage scheme has only recently started, arriving too late to give a boost to housing construction this year. Net exports are to be a key GDP driver this year.

We expect no policy changes from the National Bank of Poland in July. However, we estimate that the chances of a rate cut after the August Monetary Policy Council break have increased to 65-70%. This is following the guidance provided by some MPC members, including President Adam Glapinski, and the lower-than-expected June CPI print. We see more than one interest rate cut in 2023 as possible. Our short-term inflation forecast is optimistic, with CPI falling to single digits in August. Our long-term CPI forecasts are substantially far less favourable, however. Core inflation may stabilise around 5% year-on-year in 2024-25 given the tight labour market, the large rise in

the minimum wage and the valorisation of 500+ child benefits.

The zloty continues to benefit from a mix of the current account surplus, more FX sales on the market by the Ministry of Finance, inflows from foreign direct investment, and portfolio capital. Some investors seem to expect a more market-friendly political environment after the parliamentary elections. We expect all those factors to persist at least until the elections. We expect EUR/PLN to gradually sink to, or slightly below, 4.40 in the coming weeks.

Despite higher overall 2023 borrowing needs after the state budget amendment, the government aims to finance them via the reduction of the sizeable cash buffer (PLN117bn as of the end of May) and FX funding, hence limiting Polish government bond (POLGBs) issuance compared to the initial budget bill. In tandem with the expectations for monetary policy easing, this suggests a further drop in yields across the curve and some tightening in asset swaps.

Czech Republic: Inflation below 10% is not enough for the Czech National Bank

The economy has confirmed weak activity in recent months, but the numbers are more in line with expectations. At the same time, inflation is surprising to the downside and the overall labour market picture is more anti-inflationary than expected. Looking ahead, the inflation profile looks comfortable – probably the best in the region. We expect June inflation to fall below the 10% YoY threshold and the disinflationary momentum to continue through the summer months. However, disinflation will slow in the autumn and winter, making it challenging for the CNB to cut rates. We expect the first rate cut in November when the central bank will have a new forecast in hand, but we see a risk of delaying a rate cut until the first quarter of next year. This again makes the CNB the most hawkish central bank in the CEE region.

On the fiscal side, we also see a big story. The government recently approved a state budget for next year of CZK235bn targeting 1.8% of GDP, by far the lowest figure in the region. We expect a successful legislative process during the summer months, which implies a reduction of next year's borrowing needs to 60% of this year's level. In addition, June's state budget result showed an improvement for the first time this year.

We thus remain positive on Czech assets. Czech government bonds (CZGBs) should maintain strong demand and we expect the market to shift its focus to supply dynamics soon. The Czech koruna has traded at weaker levels than we expected in recent weeks. However, the koruna should benefit most from the EUR/USD recovery and we see room for a reassessment of market expectations for a CNB rate cut.

Hungary: Technical recession set to end soon

Economic activity has slowed significantly in all sectors except for one. Base effects and favourable weather conditions have boosted the positive contribution from agriculture which could lift Hungary out of technical recession in the second quarter of 2023. In the meantime, we still won't have too much to cheer about. A lack of domestic demand is weighing on retail sales, construction and industrial output, with the latter currently being supported mainly by export sales. We see GDP growth of just 0.2% in 2023.

The only silver lining coming from the weak economy is that the pricing power of companies is rapidly diminishing, thus the disinflationary process has shifted into a higher gear. We see single-

digit inflation in November 2023 with the full-year average being around 18%. Disinflation with preserved market stability helps the central bank's agenda: the ongoing normalisation of monetary policy. We see 100bp of further cuts to the effective rate before it reaches the base rate at the September meeting. After that, we see the National Bank of Hungary remaining cautious.

Weakening economic activity is hitting import demand which, combined with lower energy prices, is helping the country's external balances improve. We expect the current account deficit to narrow to around -2.2% of GDP this year with positive risks. However, the marked drop in consumption is putting significant pressure on the budget's VAT revenue stream, and key challenges loom. With structural improvements in all other aspects though, we do not expect any sovereign credit rating changes from rating agencies in the near future.

We expect EUR/HUF to oscillate in the current range of 368–378, depending on the National Bank of Hungary's communication regarding the rate-cutting cycle and on progress with the EU. Regarding the latter, our base case remains an agreement and partial access to the Cohesion Fund before the year ends. Hungarian Government Bonds can benefit the most from monetary policy normalisation, further supported by government measures and debt agency funding control (for more details, check out our [Monitoring Hungary](#)).

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