Three calls for the CEE: The recovery is facing fresh risks

The global rate-cutting cycle might still be in its early stages, but progress in Central and Eastern Europe has moved much further along. The next step for most central banks will simply be fine-tuning. Meanwhile, the region's economic recovery is moving more slowly than expected as disinflation stalls; we're seeing new risks emerge

Poland's Prime Minister, Donald Tusk, with the German Chancellor, Olaf Scholz in the summer

1 Call 1: Economic recovery and a return of inflation to the target

We expect an economic recovery across the region next year, ranging from 2.0% in the Czech Republic to 3.5% in Poland. This year's GDP growth was a visible disappointment, but local fundamentals support some acceleration next year. Real wages have been growing at a strong positive pace since the start of the year, while the recovery in household consumption has been one of the main reasons for surprisingly slow growth in most places.

The high level of savings rates suggests a recovery here, while negative consumer confidence has raised concerns about the future. A second year of economic recovery and inflation returning to target should be cause for optimism. Moreover, fiscal policy remains loose, and the political cycle is hindering consolidation. We, therefore, believe that the CEE region should outperform the euro area, and central banks should get confirmation that the battle against inflation has been won.

2 Call 2: Weaker growth in the eurozone will hamper the CEE region's take-off

The eurozone and Germany could see another weak year, resulting in a downside risk to our forecast for the CEE economy. Don't forget that Germany is their main trading partner, and its structural issues are showing. Well-known geopolitical developments are just adding further downside risk for the region. Our baseline for the GDP growth of CEE countries is already below market consensus, and, similar to this year, we expect downward surprises and revisions in market views.

The outcome of the US election brings additional downside risk, which may lead to a stumble in the region's recovery next year. At the same time, fiscal policy in most places has little room to deliver additional stimulus to the economy. From GDP growth levels of between 2.0-3.5%, we could easily fall into the 1.5-2.8% range, similar to this year. At the same time, inflation could remain elevated in this scenario, reducing more significant rate cuts from central banks.

3 Our bold call: Central banks cut rates below neutral as the European economy collapses

Looking beyond the horizon of current downside risks, a collapse of the European economy under the weight of structural changes, higher energy prices and geopolitical events cannot be ruled out. In such a scenario, the CEE region would be hit hard given its significant links to the European economy and global supply chains. The benchmark could be this year's weaker growth or last year's GDP stagnation across the board. The European Central Bank cutting well below the neutral rate and a collapse in demand pressures on inflation would, in turn, allow central banks to be more aggressive in their respective cutting cycles while keeping interest rate differentials and FX roughly stable.

The Czech Republic and Hungary are the most exposed in this scenario due to the current weakness and concentration of the automotive sector. Central banks here could quickly follow suit, with the Czech National Bank being the first to go below the neutral rate. We think the National Bank of Romania would be the last willing to go drastically lower with the rate.

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