

# Three calls for Central and Eastern Europe

Central banks in the CEE region should continue the cutting cycle, but each in its own way. Inflation is back to single digits, but a return to the central banks' target will be complicated and in most cases, will not happen in the next year. In addition, persistent core inflation will be a major problem supported by an increasingly tight labour market



The extremely tight labour market remains a regional feature on which little will change in the coming year

## 1 Central banks set to cut rates but each in its own way

The National Bank of Poland stopped the cutting cycle in November and switched to a wait-and-see mode after the general election. The next steps will depend on the new government and fiscal policy, which may affect the inflation profile. So the question is whether the next cut will come next year or will we have to wait a bit longer; we prefer the second option. The National Bank of Hungary continues to cut at a rapid pace of 75bp, which we believe will stay with us at least until February next year. The cutting cycle is expected to continue, but perhaps at a slower pace later. On the other hand, the Czech National Bank prefers to stay on the safe side and the start of the cutting cycle has been delayed until the first quarter of 2024. However, given the best inflation profile in the region, we can expect some acceleration in the pace of cuts later. The National Bank of Romania should be the last to join the rate-cutting club in second quarter of 2024 given the weak will to consolidate fiscal policy and persistent inflation.

## 2 Inflation is heading to target but the last mile will be the hardest

This year was marked by a significant disinflationary trend, with the entire region going from levels of around 20% to single digits by the end of the year. However, as it is popular to say today "the last mile is the hardest". With the exception of the Czech Republic, we do not expect a sustained achievement of the inflation target this year in the CEE region. Moreover, the focus will shift to core inflation, which will be more persistent. Across the region, we expect a return to real wage growth supported by minimum wage increases and loose fiscal policy. The extremely tight labour market remains a regional feature on which little will change in the coming year, supporting a structural inflationary environment. Overall, this should warn central banks against cutting interest rates too quickly and push them to the hawkish side later next year.

## 3 Optimism about next year, but we expect the recovery to be fragile

The entire CEE region has seen essentially flat growth on average this year. The Czech Republic and Hungary are likely to show modest negative growth for this year, while Poland and Romania should show modest growth. Overall, however, this is a big downward slide for the region after a strong previous year. For next year, we expect a strong economic recovery across the region, in line with the consensus. However, downside risks remain due to developments abroad and external demand. And we can see that the market consensus for GDP growth in the region for next year has been gradually shifting lower of late. In any case, we expect the recovery will be fragile and may thwart initial optimism about the positive outlook for next year.

### Author

#### Frantisek Taborsky

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

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