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CE4 policy tools for the next downturn: Who’s got the firepower?

The early months of 2019 have seen the global economy struggling to shake off fears of a slowdown. A sharp downturn into 2020 isn t our baseline scenario, but which of the CE4 countries have the firepower to resist a downturn? We assess the scope to support their economies through fiscal and conventional and unconventional monetary policy

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Executive summary

Global trade is slowing and two of the main engines of world growth, China and Europe, are desperate to avoid stall-speed. A sharp downturn into 2020 isn't our baseline scenario, but in this edition of Directional Economics, our feature article analyses the stimulus tools available to CE4 authorities in the Czech Republic, Hungary, Poland and Romania, if a slowdown were to materialise.

In terms of conventional monetary policy, only Poland has real room for rate cuts – and just a 50 basis point easing cycle at that. Lower bound constraints and fears over a disorderly sell-off in local currencies limit the room for rate cuts elsewhere. On

unconventional policy, Hungarian central bankers look to have the most appetite and room to grow the balance sheet. The overly-liquid economies of Poland and Czech won't engage in quantitative easing.

When it comes to fiscal policy, the Czech Republic has the most room for stimulus, followed by Poland. However, the latter is already engaged in aggressive fiscal stimulus and could do more later this year. Looking across all available tools, Romania has the least room to support its economy, saddled by twin deficits and a very fragile currency.

Our second article looks at the travails of the German auto sector and its fallout across the EMEA region. Domestic and external factors hit this sector and the German economy hard in late 2018. Fresh US auto tariffs look the biggest threat to this industry over the next three to six months as President Trump mulls recommendations from his advisors.

A further slowdown in the German auto sector would have a disproportionate impact across the EMEA space. Poland looks best positioned to weather this headwind given its diversified export sector and the insulation provided by the recently announced and sizeable fiscal stimulus. The Czech Republic, Hungary and Romania are all very exposed to autos though, as above, of the three, Romania is the least able to offset it with a stimulus.

Returning to the baseline story, we see many EMEA economies coming off the boil from some very impressive growth figures in 2017-18. However, Poland should still be able to deliver 4% growth in 2019 supported by fiscal stimulus, and we see no need for the central bank of Poland to cut rates until late-2020. Re-balancing of the Czech economy in 2019 is probably welcome, but we're wary of crowded positioning long CZK becomes vulnerable once the Czech central bank tightening cycle concludes this year.

Assuming none of the external risks materialise, Hungary should also be able to post 4% growth. However, mixed messages from the Hungarian central bank on policy normalisation and some unconventional policy may create some near-term problems for the HUF.

We are more concerned by Romania, where slowing growth and four election rounds over the next couple of years create scope for policy errors.

Russia and Turkey face more local challenges in how to energise growth and manage the re-balancing of the economy, respectively. A benign external environment of low core rates should provide time for local authorities to make tough policy choices.

Please note this is the non-investment research version of Directional Economics EMEA and doesn't include the investment strategies contained in the Global Markets Research version of this report

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