

Report | 6 April 2021

FX BULGARIA CROATIA

# Directional Economics EMEA: Some like it hot

In this edition, we assess which policymakers will be more tolerant of inflation or, in other words, will be prepared to let their economies run hot. While many CEEMEA economies look set to witness above-target inflation this year, those most exposed to the CPI pass-through from currency weakness and higher oil prices are the likes of Hungary and Turkey



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## Executive summary

One of the hottest topics in financial markets right now is inflation. Certainly, there seem fewer concerns over growth trajectories even though the region is still struggling to gain control of the pandemic. Instead, the focus is on whether the exceptional stimulus delivered in 2020 by politicians and central bankers alike has laid the groundwork for a persistent rise in inflation.

Unlike Western counterparts, many economies in the CEEMEA space came into the Covid-19 crisis with relatively high levels of inflation – largely a legacy of tight labour markets. In theory, many central banks in the region (particularly CE4) should be questioning whether deeply negative real rate settings remain appropriate in 2021.

The focus of this edition of Directional Economics is to assess which policymakers will be more tolerant of inflation or, in other words, will be prepared to let their economies run hot. While many of the CEEMEA economies look set to witness above-target inflation this year, those most exposed to the CPI pass-through from currency weakness and higher oil prices are the likes of Hungary and Turkey.

The key difference between the two is the question of real interest rate settings. Those in Hungary look set to become even more negative through 2Q21, while in Turkey, the question is how long very positive real rates can be maintained.

Our call is that Hungary is forced to react with rate hikes in 2Q21 – largely in response to pressure on the forint – even though policymakers would prefer a very accommodative policy heading into elections in 2022. For Turkey, we are waiting to hear from the new CBT Governor. And in Poland, authorities are likely to look through the rise in inflation (peaking later in the year at 4%), helped by eventually a more stable currency.

Unlike central bankers in Hungary and Poland, those in the Czech Republic look set to embrace tighter monetary settings. We look for the first hike in 4Q21, followed by a further three in 2022.

Elsewhere in the region, Romania faces less pressure on the inflation front. Concerns do remain over Romania's twin deficits, however. Here the 5% of GDP current account deficit witnessed last year should be ringing alarm bells about structural imbalances. With the next elections not until 2024, fortunately, policy should have an opportunity to address these concerns with fiscal consolidation. 5%+ 2021 GDP growth should help.

Russia remains a growth laggard in the region, and we pencil in only 2.5% growth this year after a 3% contraction in 2020. Yet the Central Bank of Russia has already moved to tighten policy settings and looks set to deliver a further 75bp tightening of policy this year – stamping out the threat of inflation.

Contrasting tolerance levels to inflation will have an impact on financial markets in the region. Within FX, the Czech Koruna should remain the outperformer and the Hungarian Forint, the most fragile – until at least the NBH, responds with rate hikes. Pre-emptive tightening from the CBR should also provide the Rouble with some insulation from geopolitical challenges. Zloty performance should be somewhere mid-pack, and the NBP's reluctance to tightening should see further steepening of local yield curves.

As usual, our Directional Economics report showcases ING's unique geographical footprint in the CEEMEA region. We hope you enjoy it and actively encourage you to reach out to our local experts.

## **THINK economic and financial analysis**

**\*Please note that this is the non-investment research version of Directional Economics EMEA and does not include the investment strategies contained in the Global Markets Research version of this report.\*\***

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