

WHAT'S UP CEE?

Weaker economic recovery reduces inflationary pressure in region, allowing banks to continue with monetary easing. Election schedules postpone fiscal consolidation in numerous CEE countries.

Key changes in the CEE outlook

We revised the GDP growth forecast for 2024 down in the following countries, with the CEE8 average at 2.4% in 2024

- In Czechia, to 1.0%, from 1.7%; in Hungary, to 2%, from 3.2%; and in Romania, to 2.6%, from 3.3%

In Croatia, the growth forecast got bumped up to 3.1%, owing to a stronger carry-over effect and further improving private consumption outlook.

We revised the inflation forecast downward in all CEE countries.

- Average inflation in 2024, compared to the previous year, is expected to be lower in all CEE countries as demand-side pressure and supply-side factors favor downward trend.
- Meager economic recovery is supporting lower inflationary pressure in the region, on top of easing supply-side factors such as easing prices of food.
- Inflation to fall toward the central bank's target in 2024 in several CEE countries.

Key changes in the CEE outlook

Monetary easing in full swing in the region

- Czechia surprisingly accelerated monetary easing in February, but the recent weakening of Czech koruna may hold off bigger interest rate cuts. We keep seeing the key policy rate at 4.0% at the end of the year.
- Hungary lowered the policy rate to 9.0% at the last meeting and we expect it to fall to 6.5% by mid-2024 and remain unchanged afterwards.
- Serbia, on the other hand, is likely to delay the beginning of monetary easing until the major central banks make the move and cut interest rates.
- Romania should begin with monetary easing in the second quarter of 2024.
- Poland may keep the policy rate flat at 5.75% throughout 2024 after frontloading a 100 basis point cut in the second half of 2023.

Global trends affecting our forecasts

- The Eurozone has been stagnating, with Germany's economy having a particularly negative impact on growth in the winter half-year, due to its heavy reliance on industry and global inventory reduction.
- In Eurozone, we anticipate only a slight recovery in economic momentum from the first half of 2024. The possibility of slight interest rate cuts in the major currency areas is expected to provide some much-needed economic optimism, as the major central banks are projected to implement monetary easing in mid-2024.
- In general, underlying economic weakness is expected to maintain lower demand pressure and disinflationary trends in the region, with external factors such as food prices remaining disinflationary throughout the year.
- However, the impact of these external factors should begin to wane, while cost pressures may increase in the months to come as a result of the Red Sea conflict and associated attacks.

Country-specific developments

- Weaker economic growth results in lower demand and may lead to further downward revisions of inflation forecasts. This could prompt the Czech National Bank to implement more rate cuts, potentially going below 4% by the end of the year.
- In Croatia, the parliamentary election procedure has been put in motion, as PM Plenkovic announced the current parliament will be dissolved on March 14, paving the way for elections to be held sometime between mid-April and mid-May. Fiscal expansion is expected to support growth in 2024. Spread levels clearly suggest that the market has for some time been pricing in additional credit rating hikes.
- In Hungary, recent inflation figures, along with a weak state of the real economy and positive developments in Hungary's risk assessment, have temporarily accelerated the pace of rate cuts. However, we anticipate a slowdown in the monetary easing process. Increased political noise and ongoing tensions between the government and central bank regarding the desirable pace of monetary easing do not support the Hungarian forint.
- In Poland, if inflation increases in the second half of the year, the central bank may opt to keep interest rates unchanged. The development of inflation will heavily depend on the decision to prolong or remove anti-inflationary measures from 2022. Furthermore, Poland is benefiting from a change of government and the unlocking of EU funds, as evidenced by the EURPLN moving down.

Country-specific developments

- In Romania, fiscal risks have been increasing, with the YTD budget deficit reaching 1.67% of GDP at the end of February. This indicates that our forecast of a 2024 budget deficit at 5.7% may be optimistic, particularly when overlooking one-offs like military spending. Twin deficits continue to be a key concern for markets and the rating outlook. Local and European elections scheduled for June 9 are expected to cement the current grand coalition's continuity beyond 2024.
- Slovakia is set to hold its presidential elections in April, with two frontrunners: Pellegrini, supported by the ruling coalition, and Korcok, associated with the opposition. The return of Robert Fico and his populist government has delayed fiscal consolidation and led to protests in response to changes in the judicial system. A threat of having EU funds blocked looms if the Criminal Code amendment enters into force.
- In terms of Serbia's international image, it appears that both the US and EU administrations are losing patience with the constant emergence of spats between Serbia and Kosovo. Crucial negotiations regarding normalization have stalled, but this could be justified by the expected formation of a new Serbian government. Meanwhile, Serbia is under greater pressure as its relations with Russia remain unchanged.

Growth outlook

We revised the GDP growth forecast for 2024 down in the following countries:

Czechia to 1.0%, from 1.7%

Hungary to 2%, from 3.2%

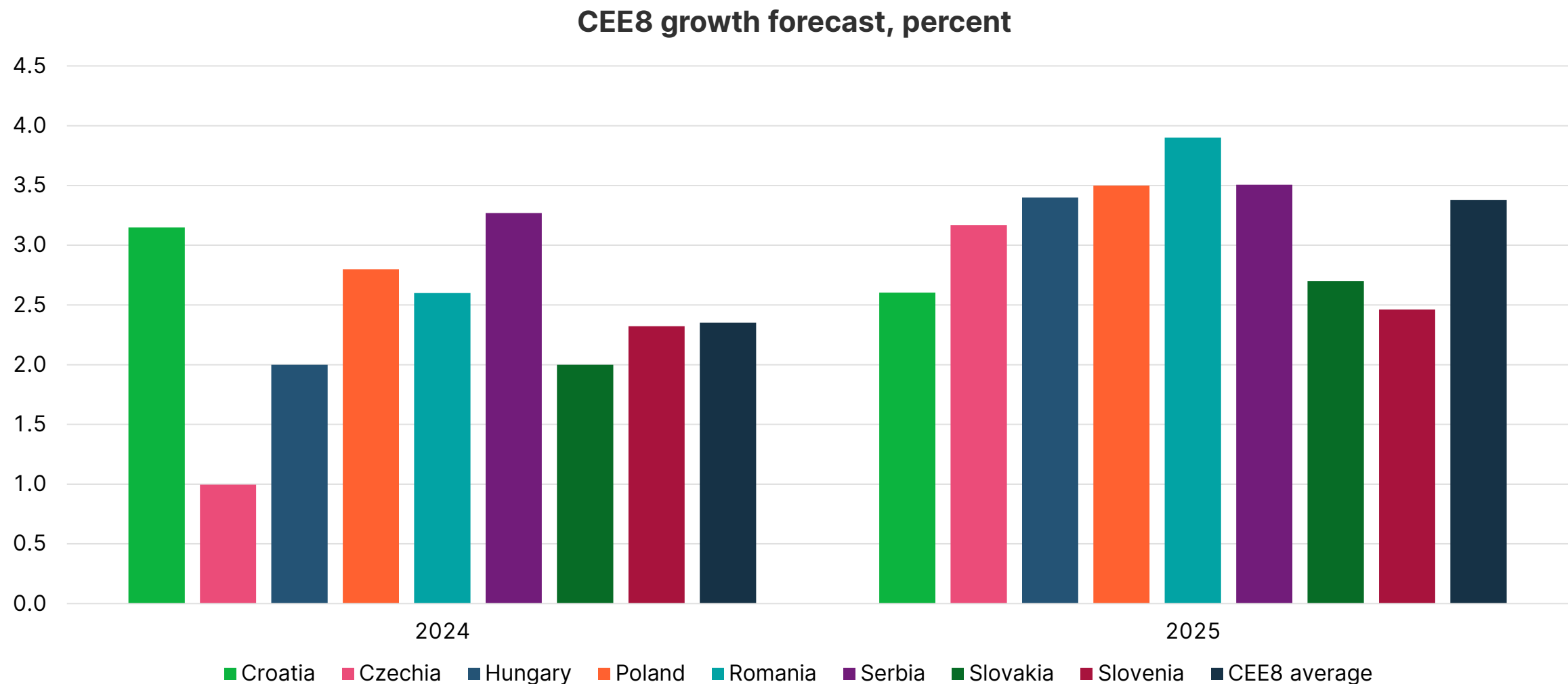
Romania to 2.6%, from 3.3%

In Croatia, the growth forecast got bumped up to 3.1%, owing to a stronger carry-over effect and further improving private consumption outlook.

The risks to the downside to our current CEE8 GDP forecast at 2.4% persist, as the German economy has been weak.



CEE growth should accelerate to 2.3% in 2024 (CEE8 average) from 0.6% in 2023



GDP structure in 2023 was mixed bag; both private consumption and investment declined only in Hungary

Private consumption was a drag in a number of countries

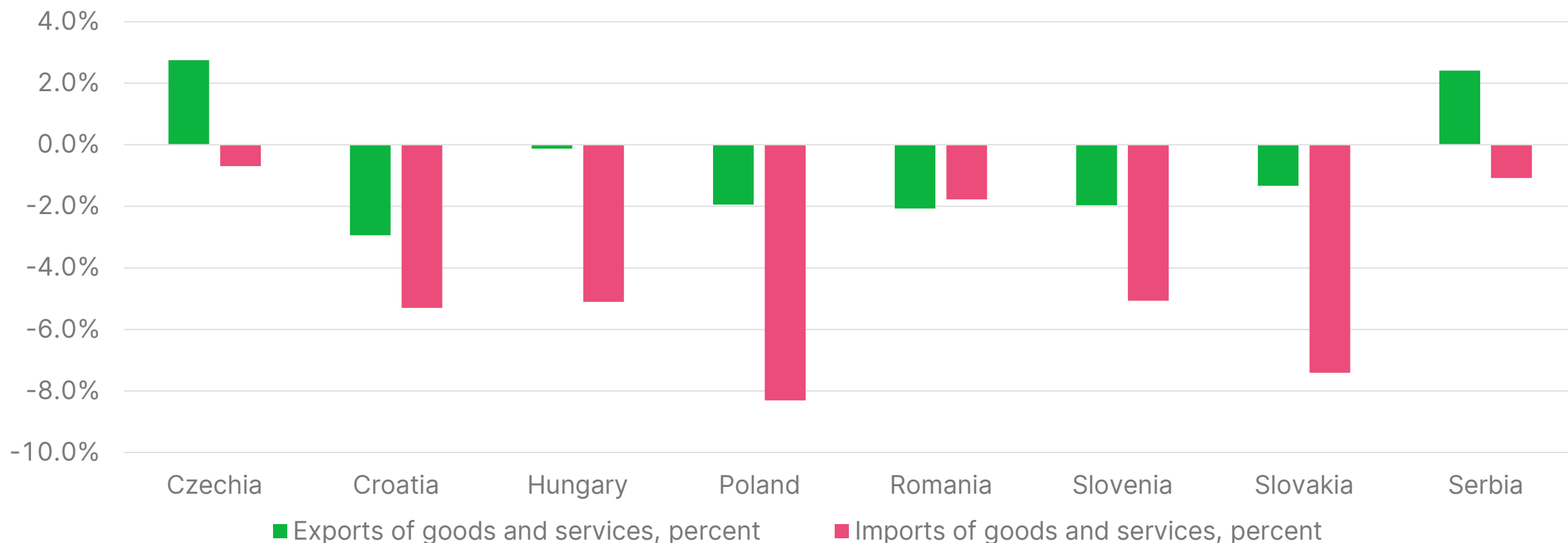


Investment grew everywhere but in Hungary

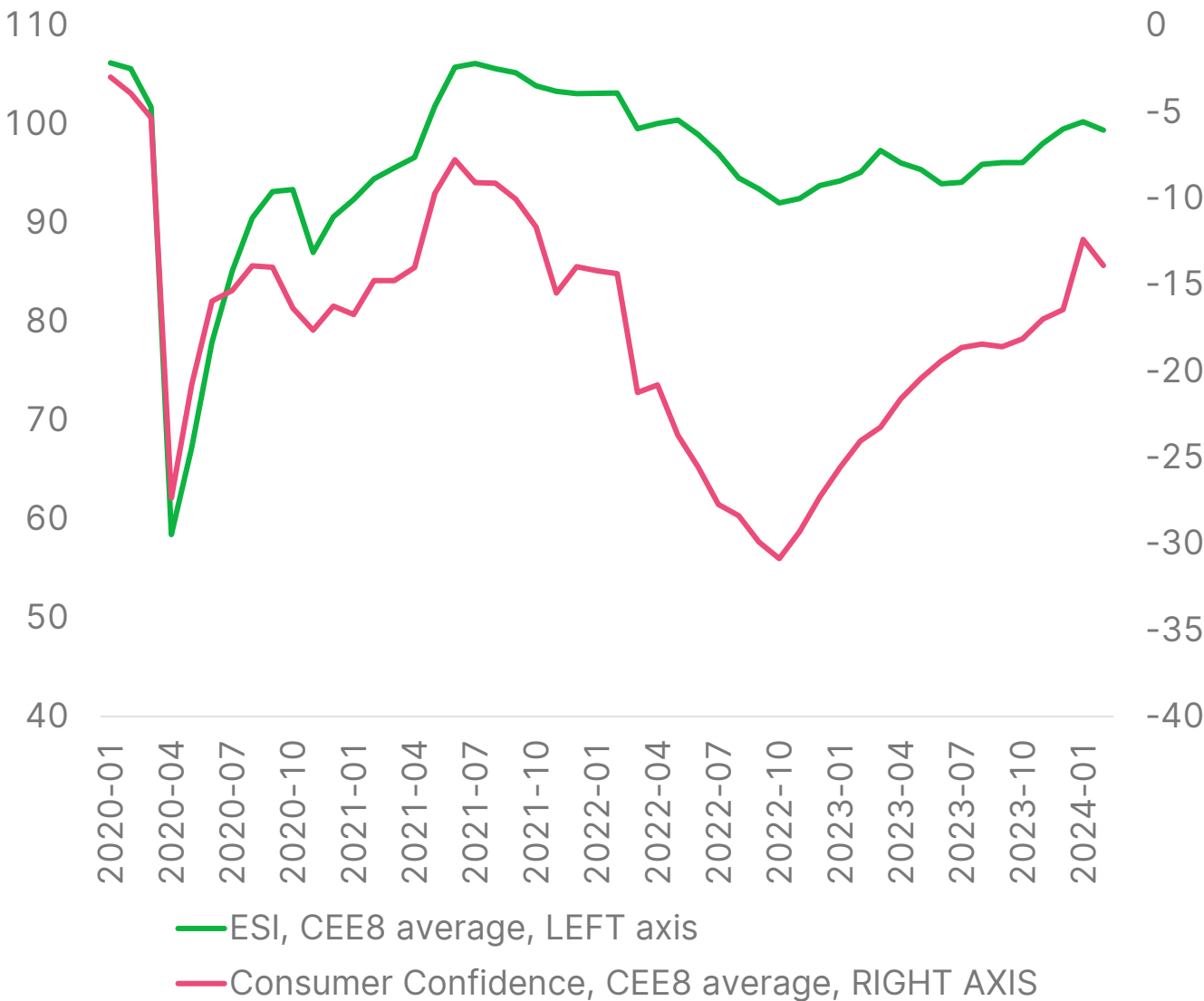


Net exports contributed positively to 2023 GDP growth. With revival of private consumption, imports should get impulse and reduce net export contribution in 2024

Growth of exports and imports of goods and services, percent



Economic Sentiment Indicator and Consumer Confidence, points

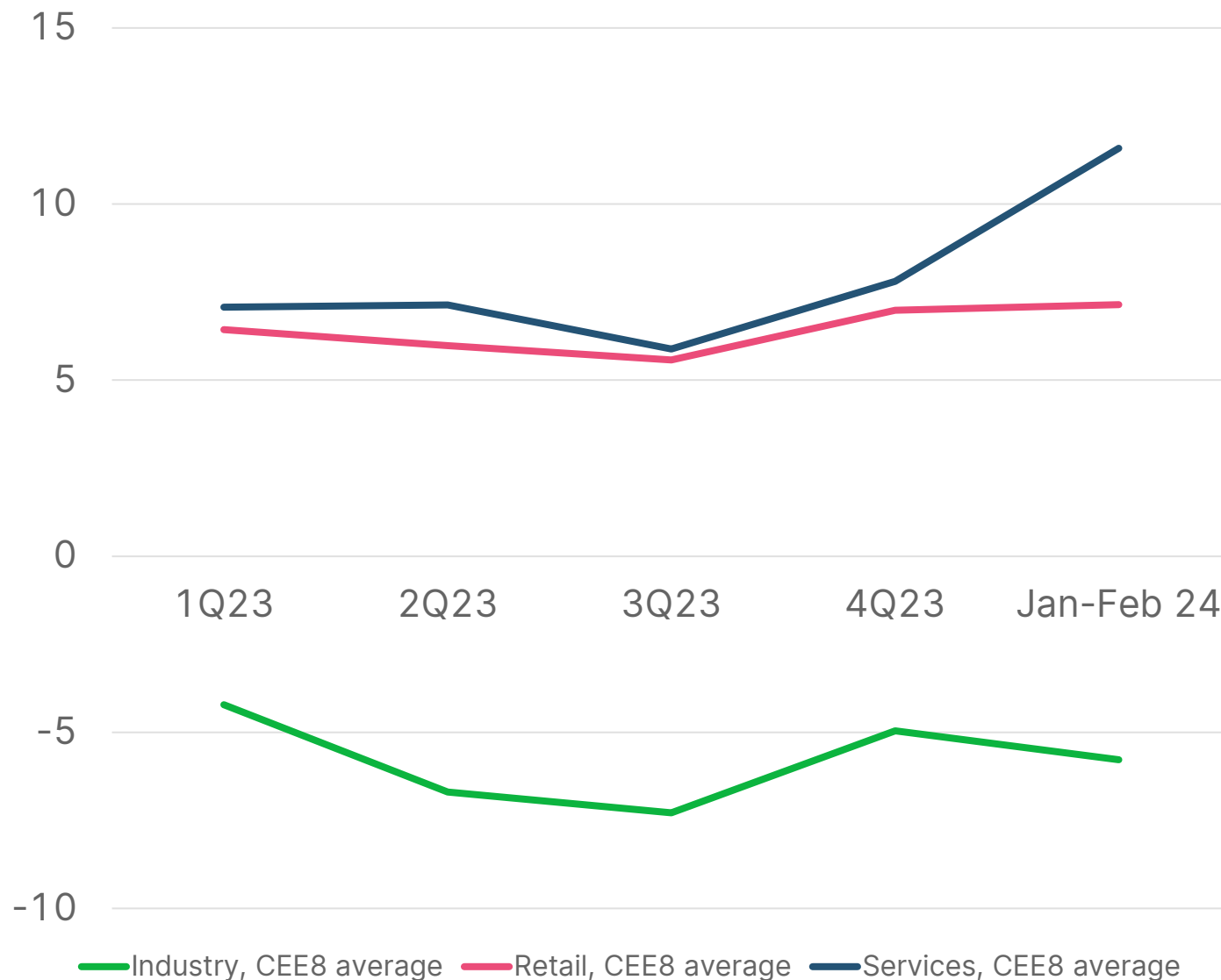


Sentiment indicators allow for moderate optimism only

The Economic Sentiment Indicator (ESI) in the region dropped from January's two-year peak of 100.2 to 99.4 in February.

The consumer confidence indicator saw a more significant drop in February, indicating that consumers have lost some of the confidence they had gained in previous months.

Economic Sentiment Indicators across sectors, points



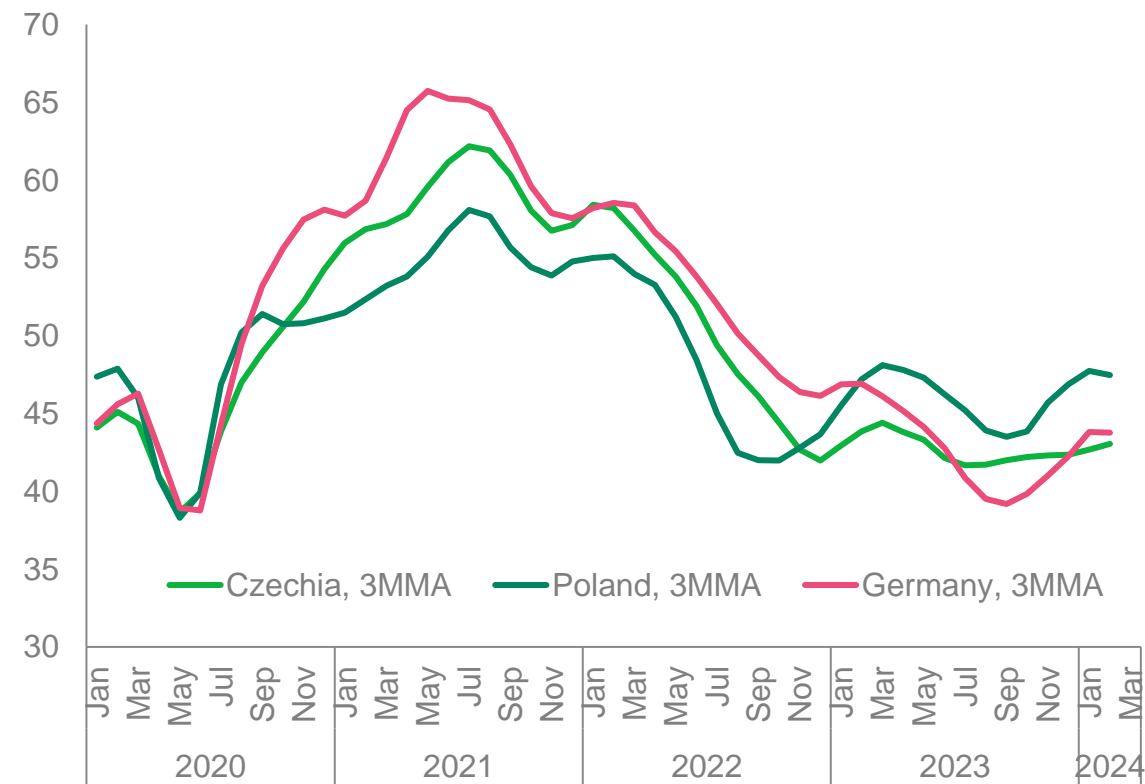
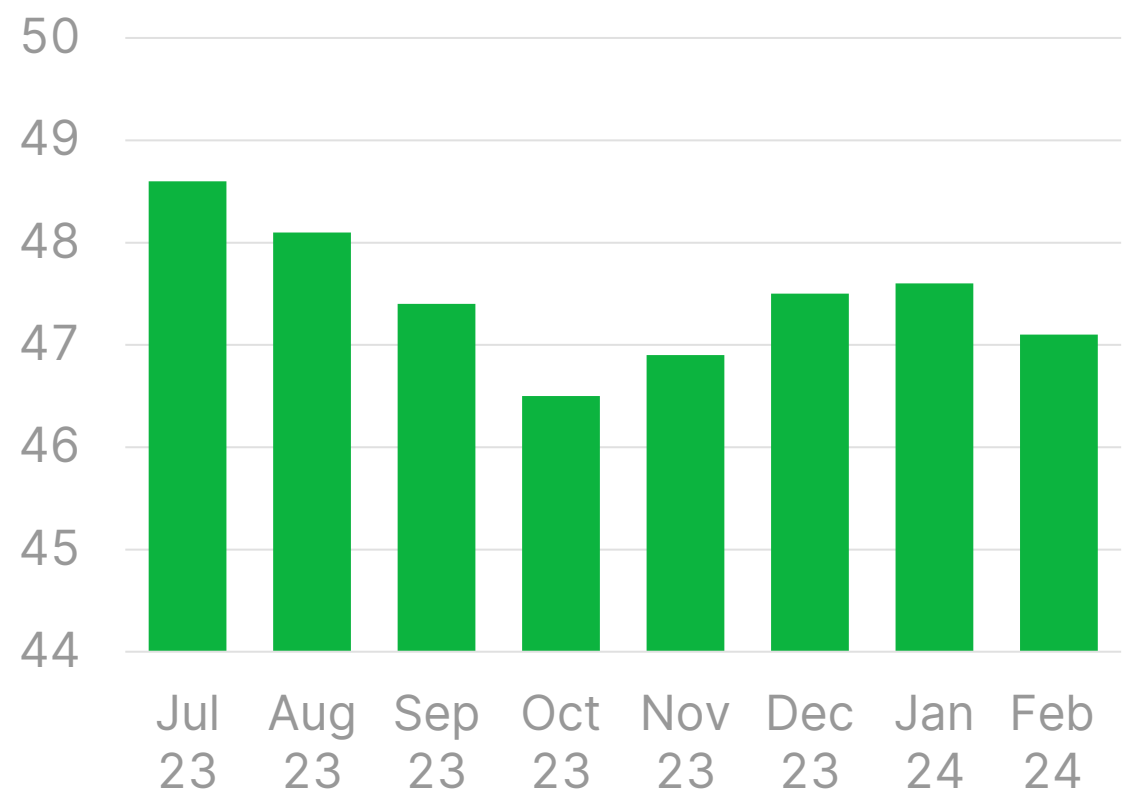
Industry and retail lack the impulse to recover more visibly

When it comes to sector-specific sentiment, the beginning of the year has brought slightly worse sentiment in industry compared to the fourth quarter of 2023. However, the confidence indicator for the retail sector saw virtually no change.

On the other hand, the services sector experienced a noticeable improvement in sentiment during this period.

Manufacturing PMI indices remain in 'contraction zone' in region, suggesting underlying weakness of industry

Manufacturing PMI Index launched in March in Romania Manufacturing PMI Index in Czechia, Poland and Germany



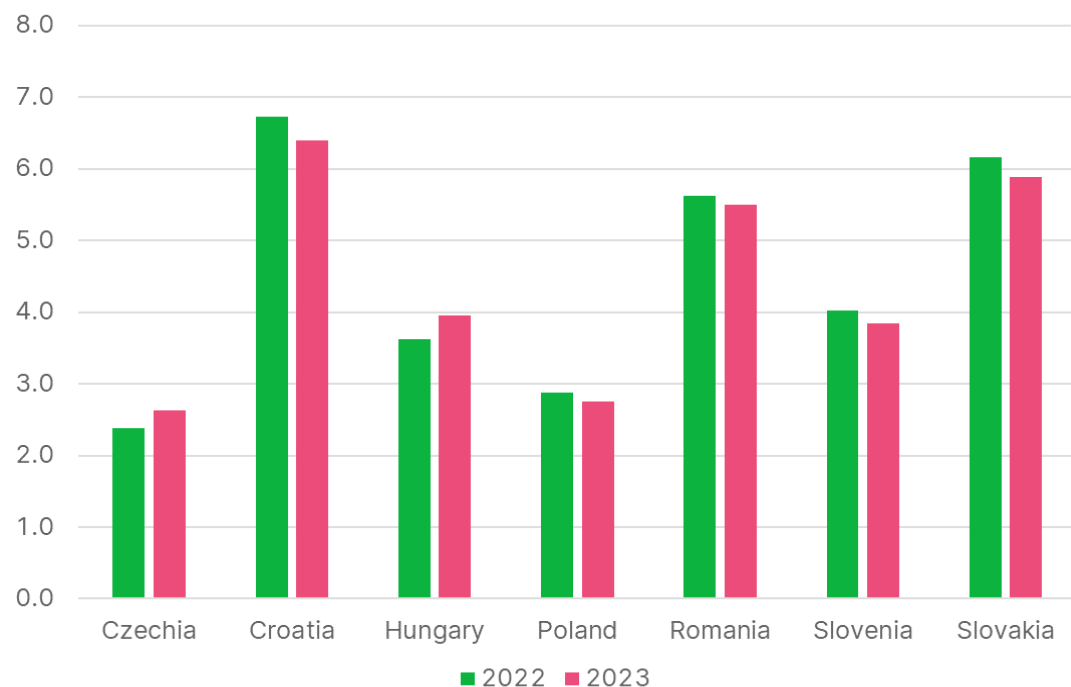
Inflation and labor market

Average inflation in 2024 is expected to be lower in all CEE countries. Meager economic recovery is supporting lower inflationary pressure in the region on top of easing supply-side factors (food prices). On the other hand, cost pressure may rise in the months to come.

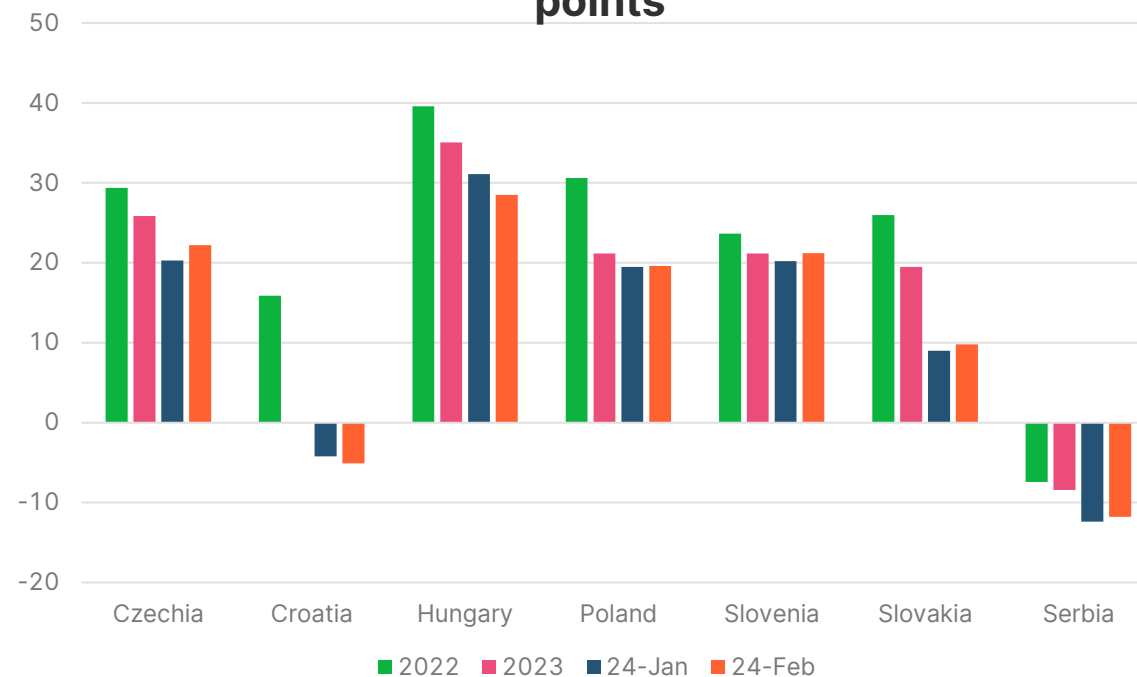


Labor market conditions remain tight, despite weak growth

Unemployment rate, LFS percent

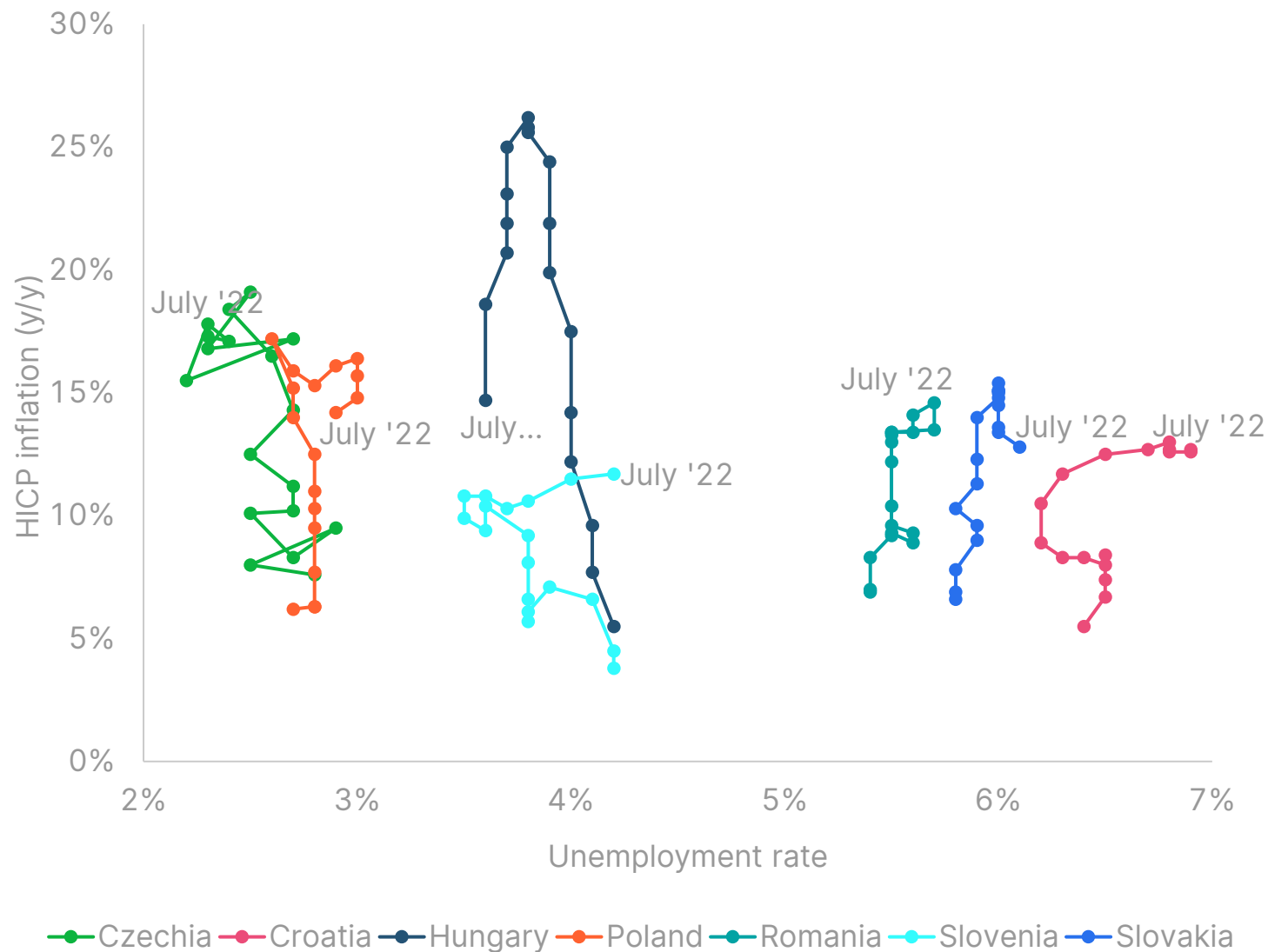


Unemployment expectations over next 12 months points



In 2023, the unemployment rate (based on Labor Force Survey data) increased in only two countries: Czechia (from 2.4% in 2022 to 2.6% in 2023) and Hungary (from 3.6% in 2022 to 4.0% in 2023). Conversely, in all other countries, unemployment rates dropped, despite some countries experiencing relatively low economic growth (such as Poland). The labor market remains tight throughout the region, even in Czechia and Hungary, as the increases in unemployment rates were rather marginal on average. Additionally, expectations for increasing unemployment rates have dropped, indicating that the labor market in the CEE region is continuing to improve.

Inflation vs. unemployment rate, percent

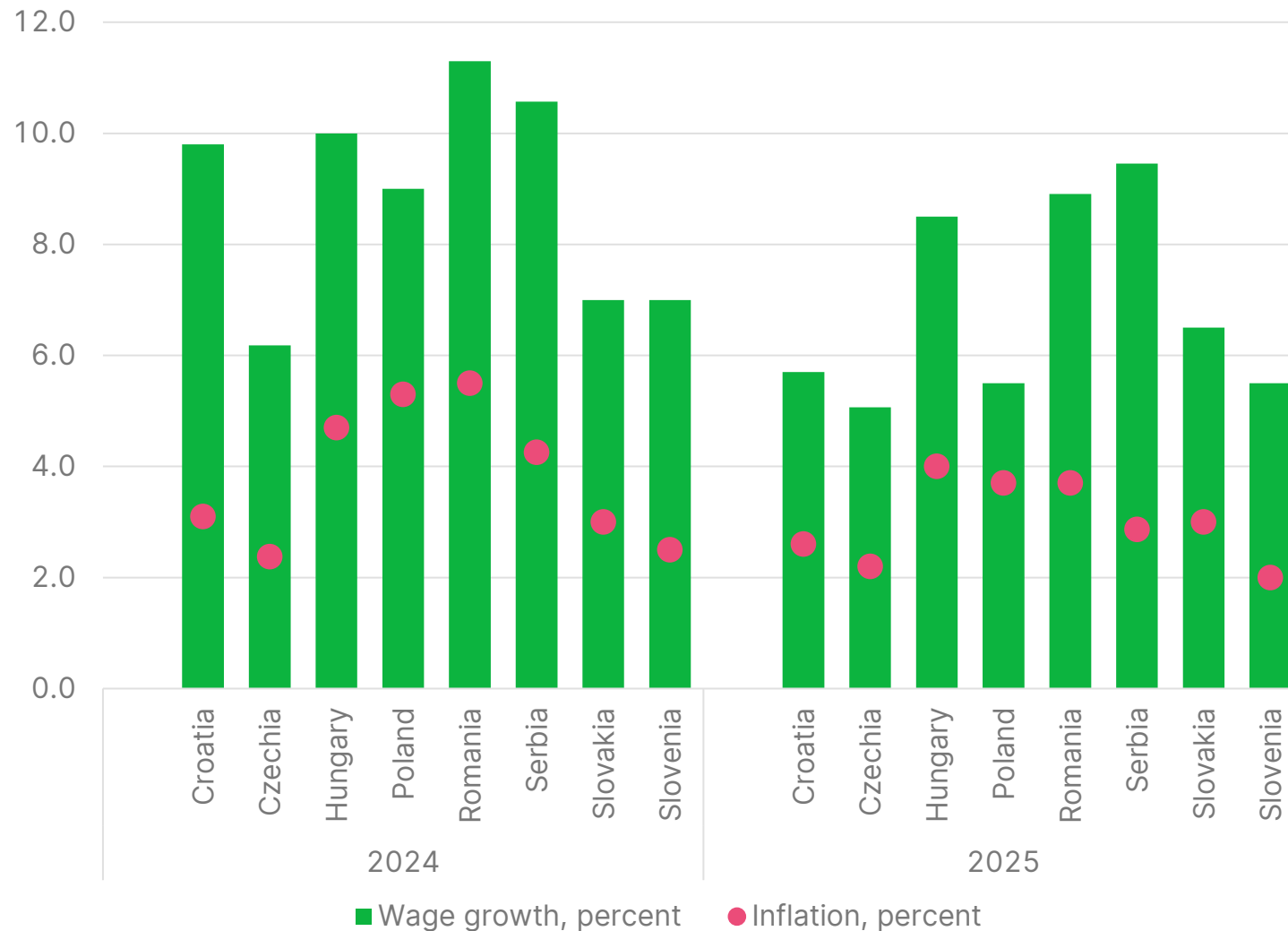


Labor market did not bear any costs of disinflation, either

The effect of a tight monetary policy and disinflation on unemployment, as described in the basic form of the Phillips curve, is not really visible in CEE.

Despite monetary policies that reduced inflation and added to the slowdown of the economy, unemployment stayed relatively stable in most of the countries in the region. Only in Hungary, which also faced the worst recession in CEE, did the unemployment rate rise from 3.6% to just 4.2%. Other countries in CEE have a rather vertical line in the scatterplot.

Nominal wage growth and inflation forecast, percent

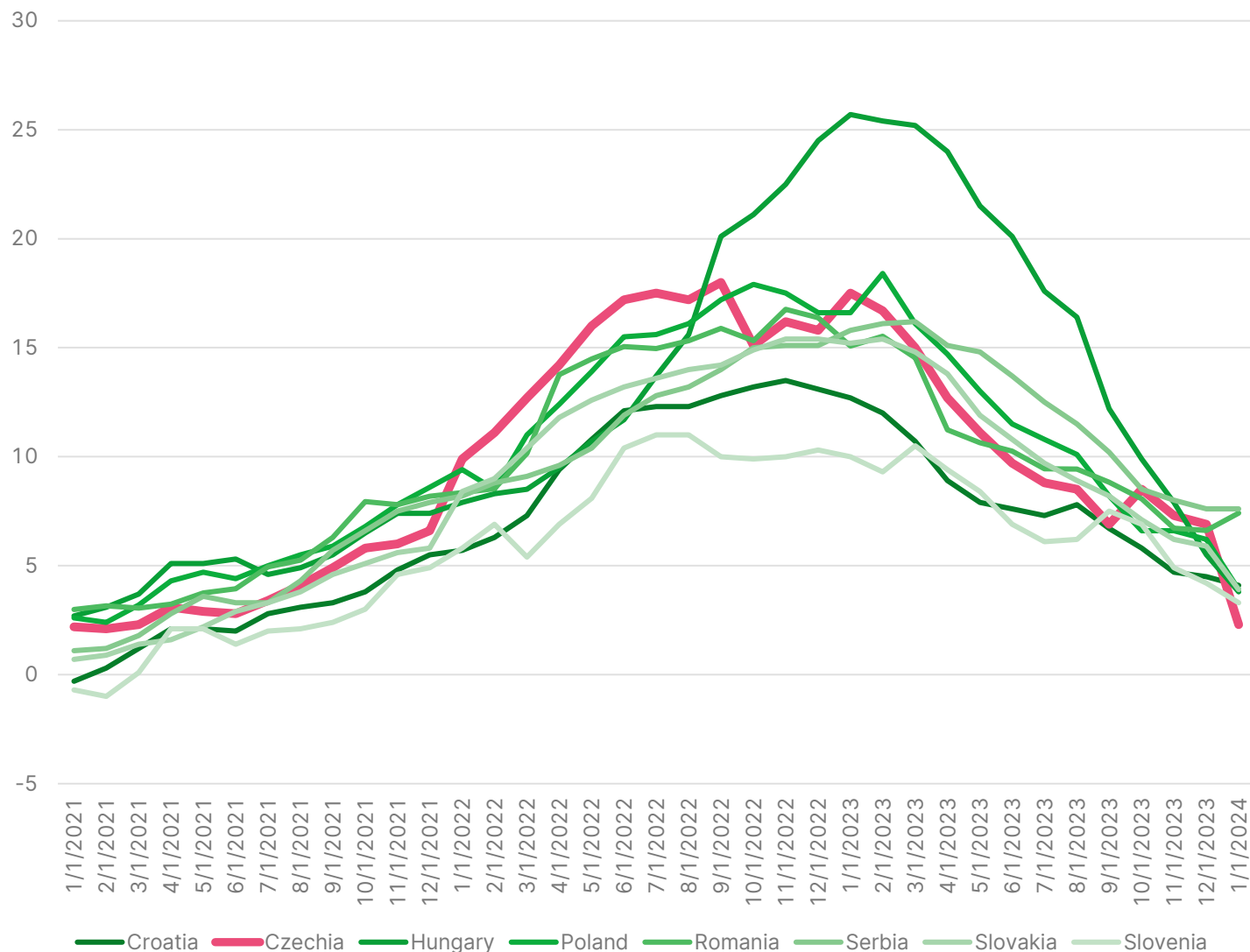


Nominal wage growth should be more dynamic than inflation

Real wage growth turned positive in the course of 2023. It should be accelerating further throughout the year (amid falling inflation and still solid nominal growth of wages), supporting households' spending.

We see private consumption growth as a key driver of economic recovery in 2024.

Inflation development, percent

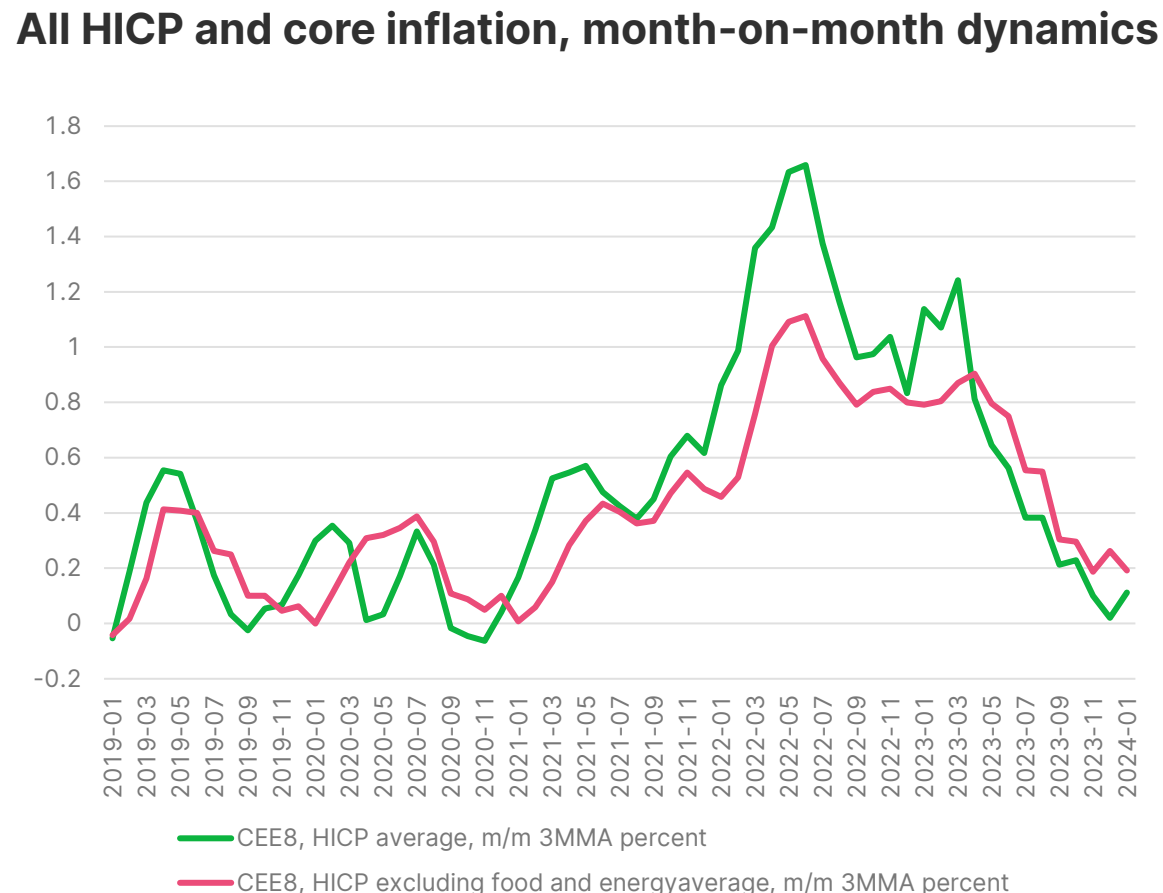
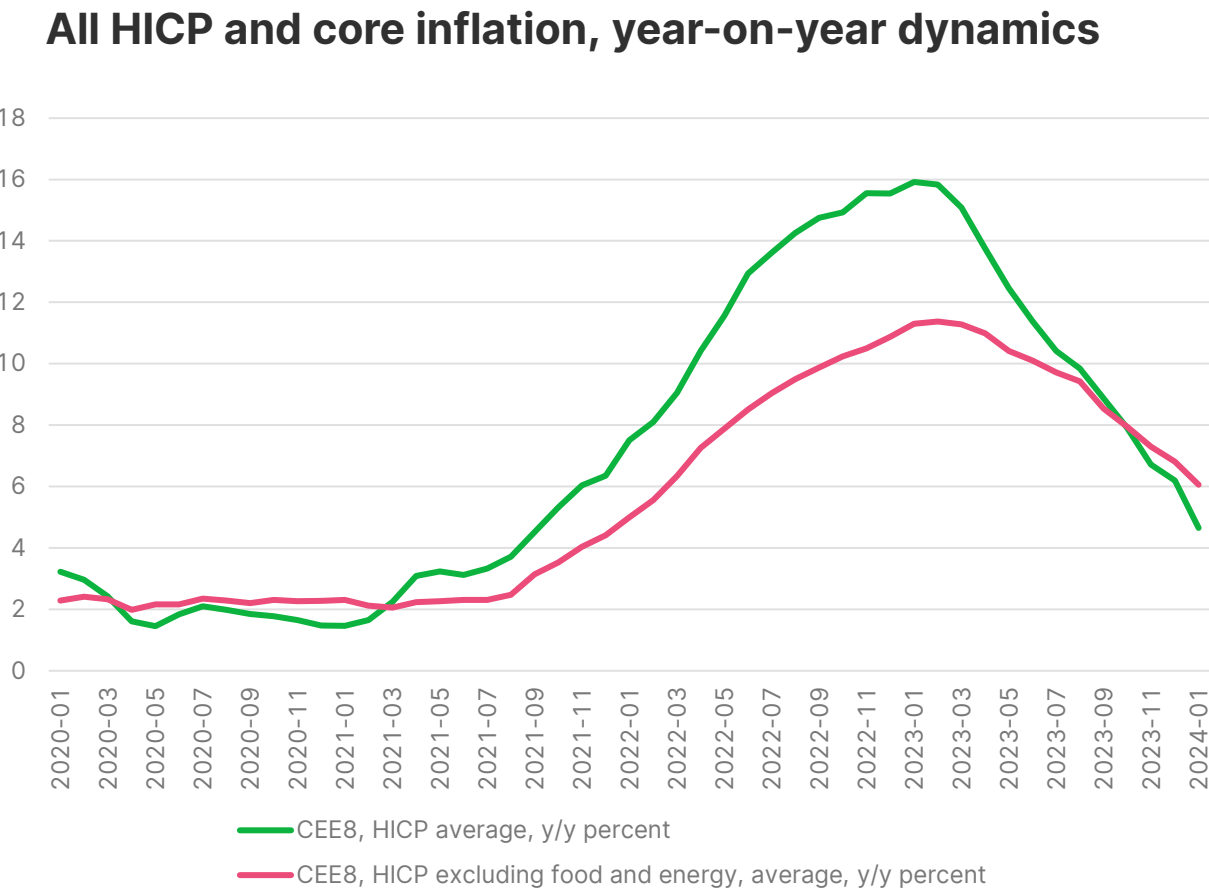


Inflation falling toward target

In Czechia, January's inflation fell to 2.3% y/y, almost at the 2% central bank target. In Hungary, January's footprint at 3.8% y/y is within the tolerance band. The highest inflation in the CEE region (and the whole EU) is in Romania: above 7%.

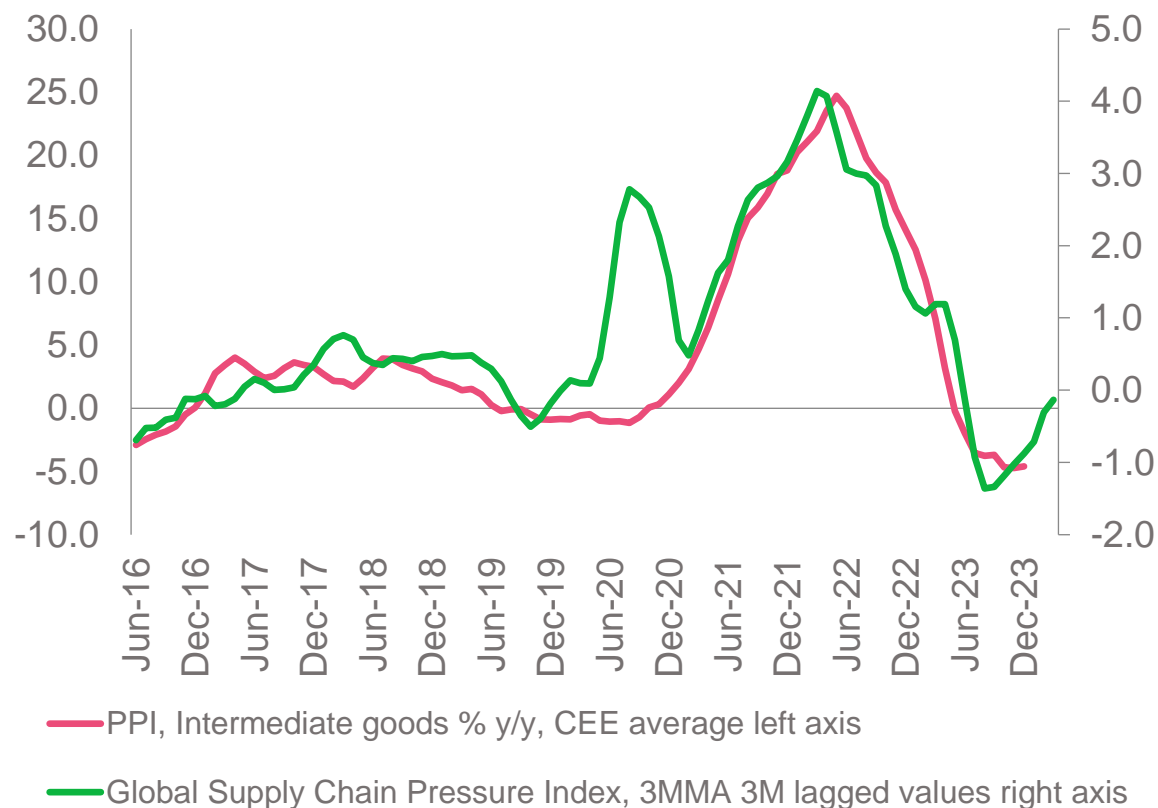
In Hungary, inflation is not likely to stay around the target for too long. From May, the positive base effects will come to an end, and inflation is likely to rise in the following months. In Poland, the development is likely to be similar. Only in Czechia should inflation remain close to the central bank target for most of the year.

Core inflation expected to remain above headline inflation. Monthly dynamics returned to pre-pandemic pattern

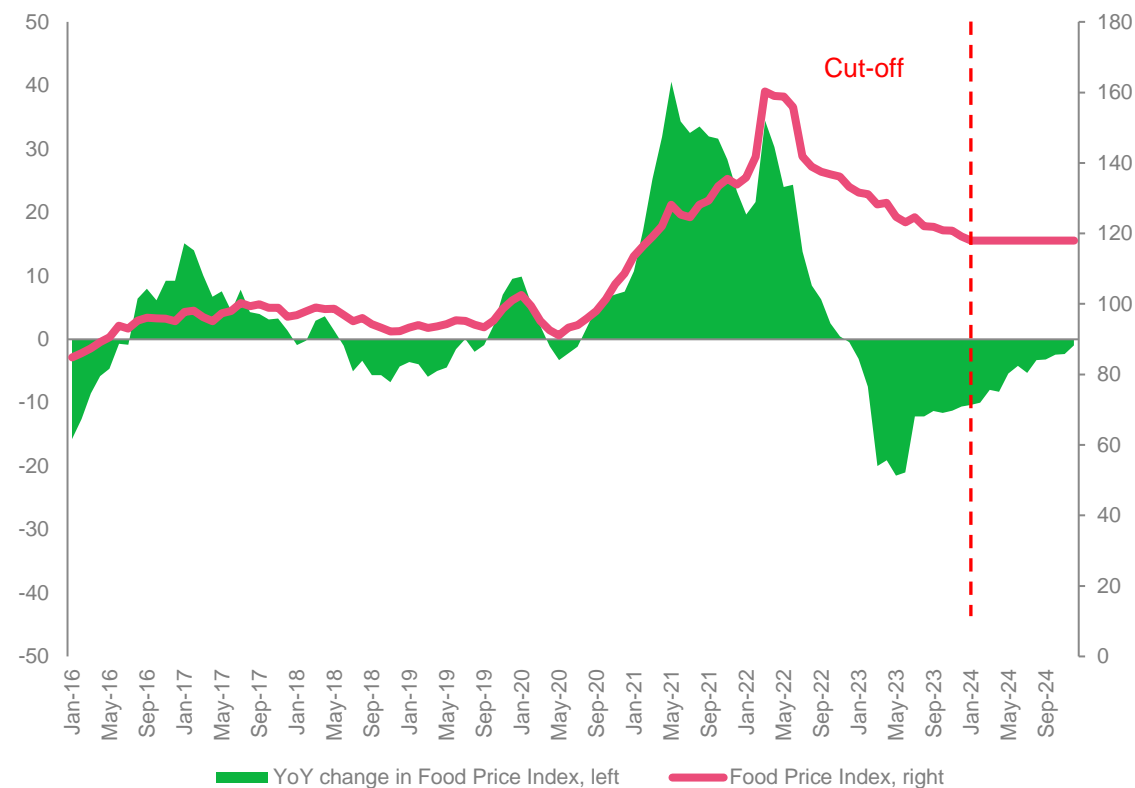


External factors to provide mixed bag of effects

Producer price and Global Supply Chain Pressure Index

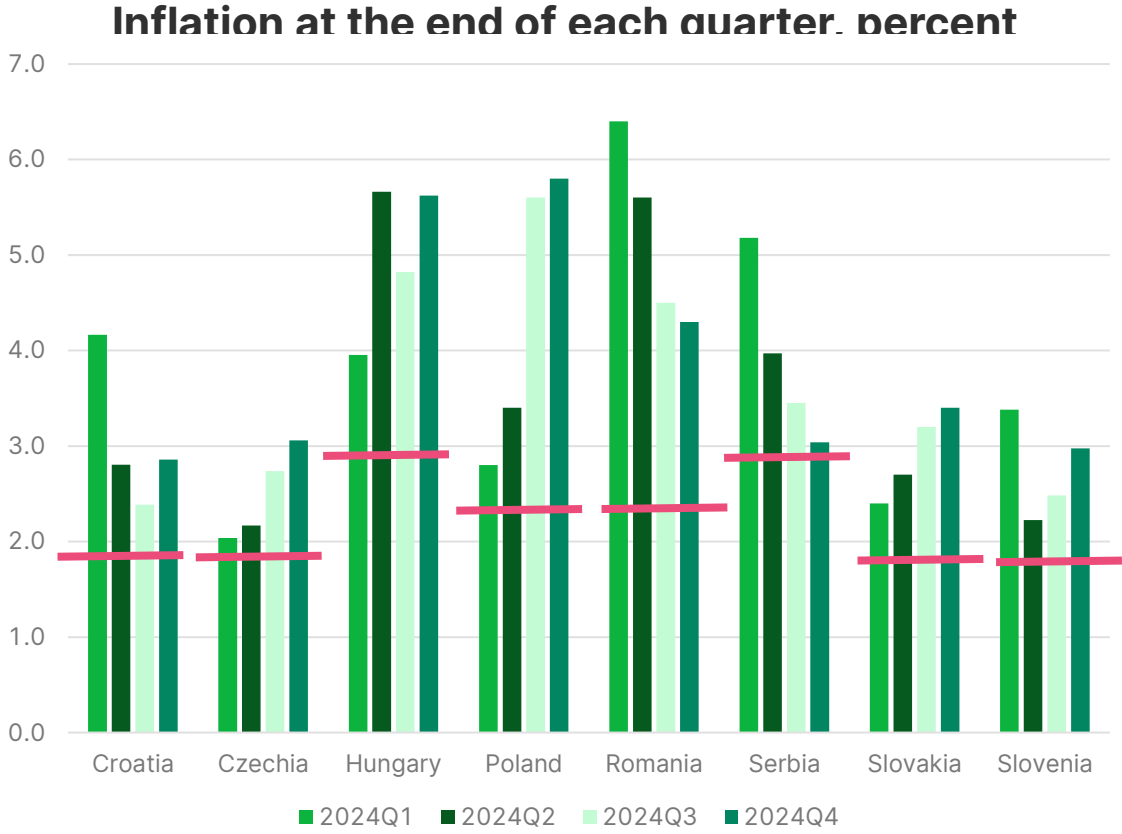
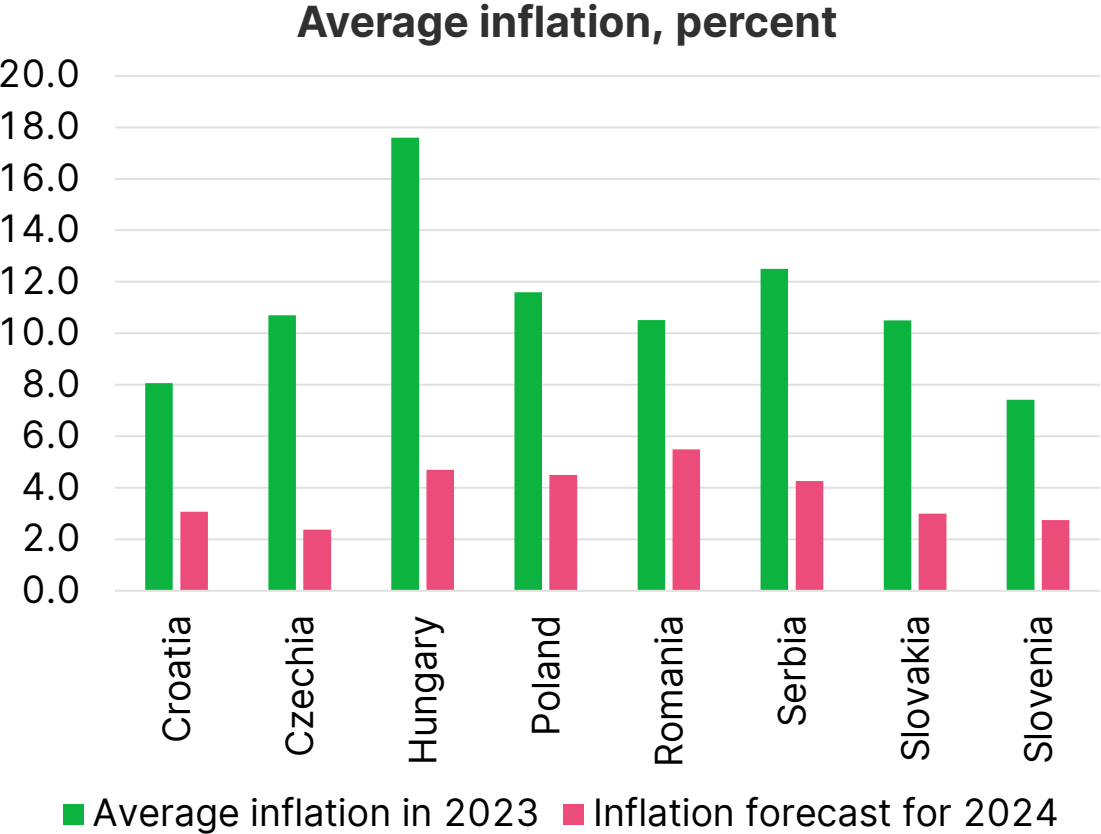


Food prices should continue to be disinflationary



As for the cost pressure, recent increase in Global Supply Chain Pressure suggest the change in the recent downward trend of producer prices. Food prices, on the other hand, should remain a disinflationary factor throughout the year.

Inflation will be on average lower in 2024 but it will move in different directions in second half of 2024



Croatia, Romania and Serbia should see inflation falling throughout the year. In Czechia, Hungary and Poland, on the other hand, inflation is expected to be higher compared to the beginning of 2024. Such a development will be driven by the base effect to some extent.

Monetary policy

The Czech central bank surprised with a 50 basis point cut in February and should continue with monetary easing in the months to come.

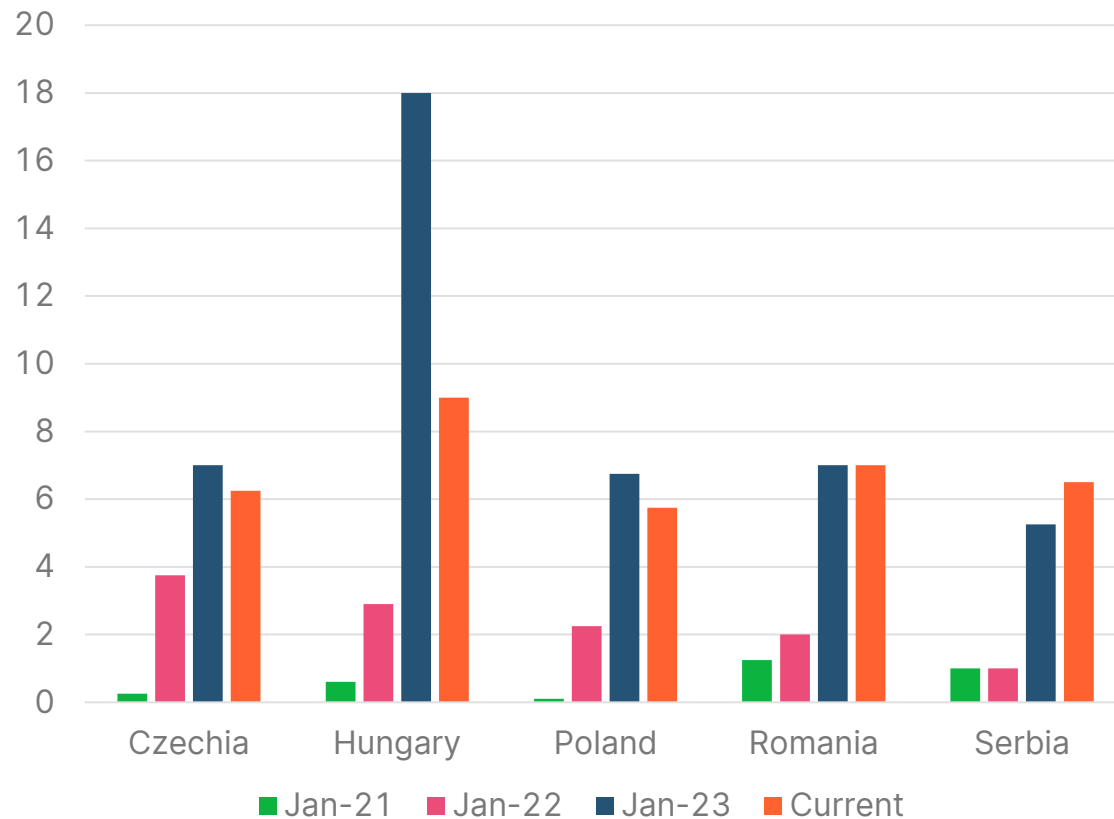
Hungary lowered the policy rate to 9.0% at the last meeting and we expect it to fall to 6.5% by mid-2024 and remain unchanged afterwards.

Romania and Serbia should begin with monetary easing only in the course of 2024. Serbia is expected to wait until the Fed begins with monetary easing.

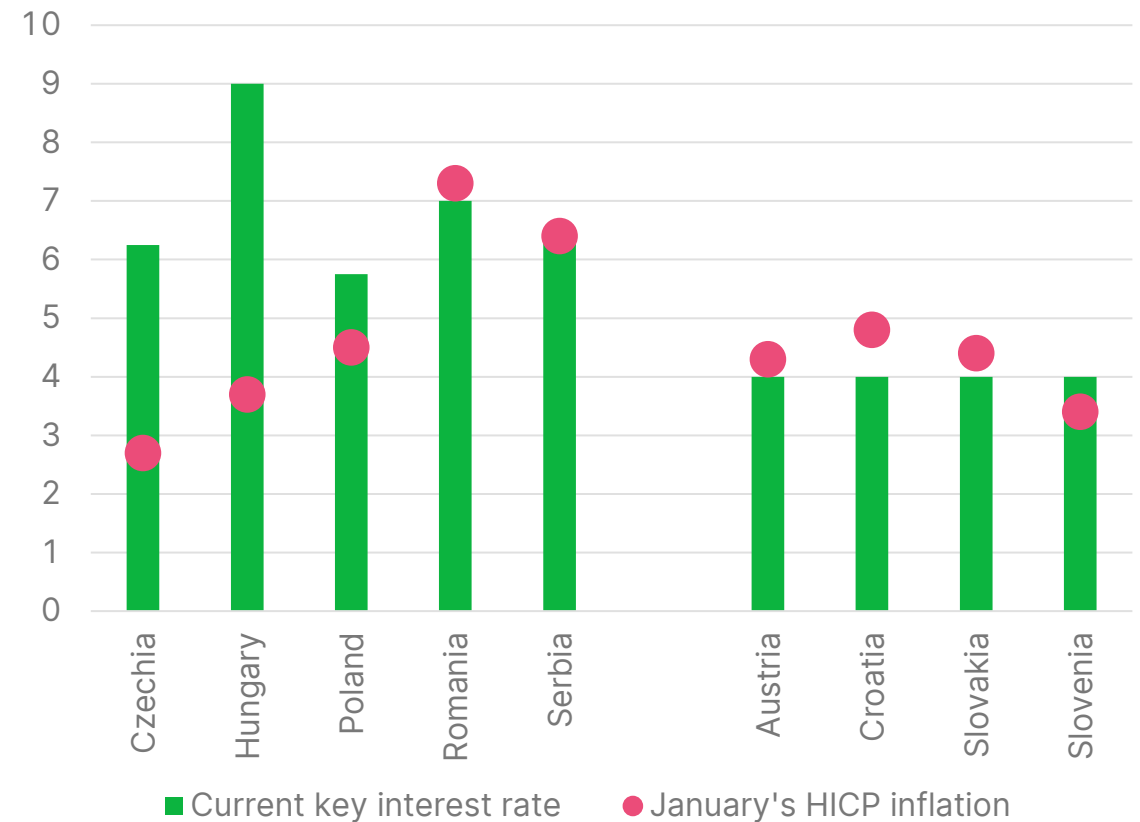


CEE central banks reacted quickly and decisively and were first to cut interest rates

Key Interest Rates (%)

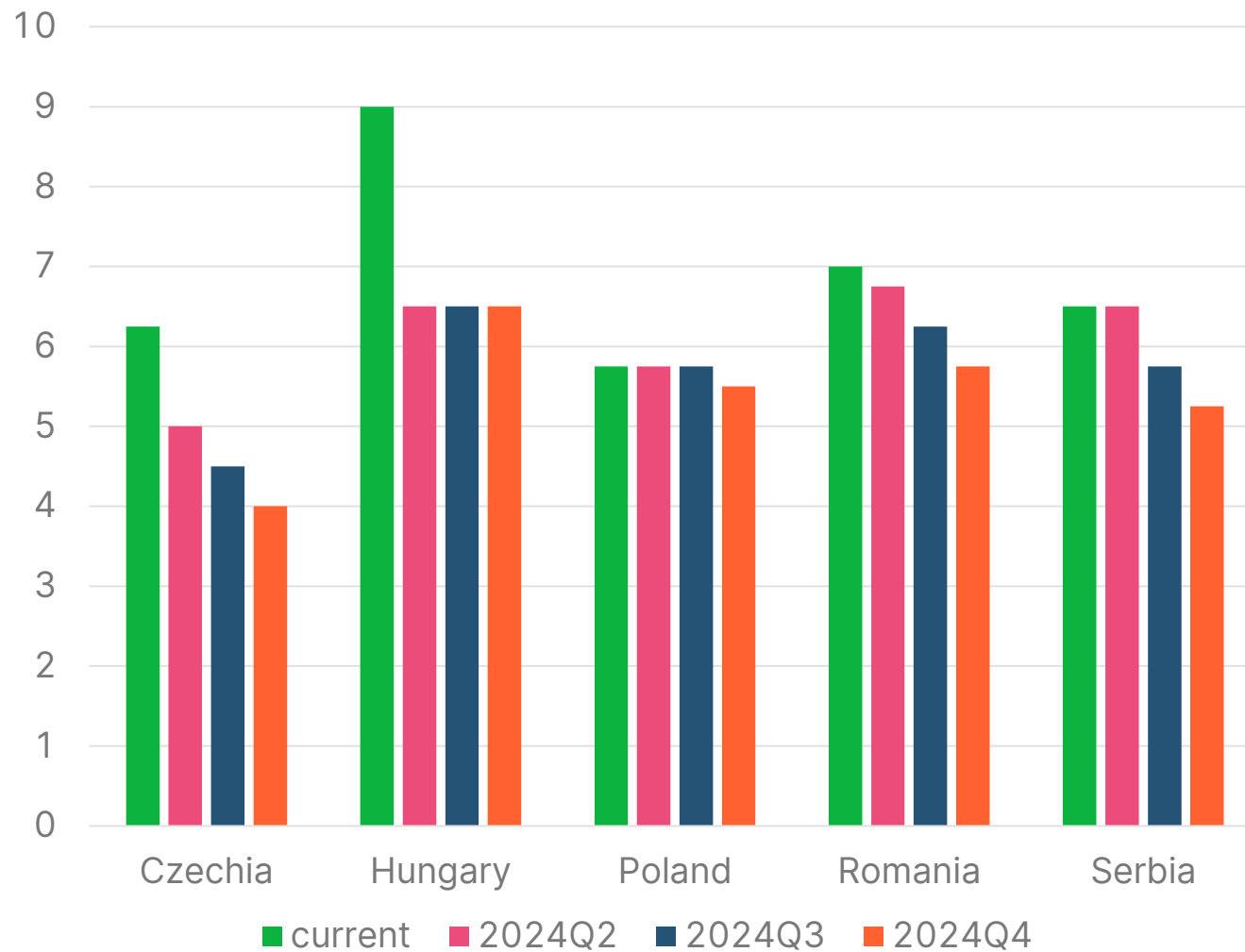


Interest Rates vs. Inflation (%)



Source: Erste Group Research

CEE: key interest rate forecasts (%)

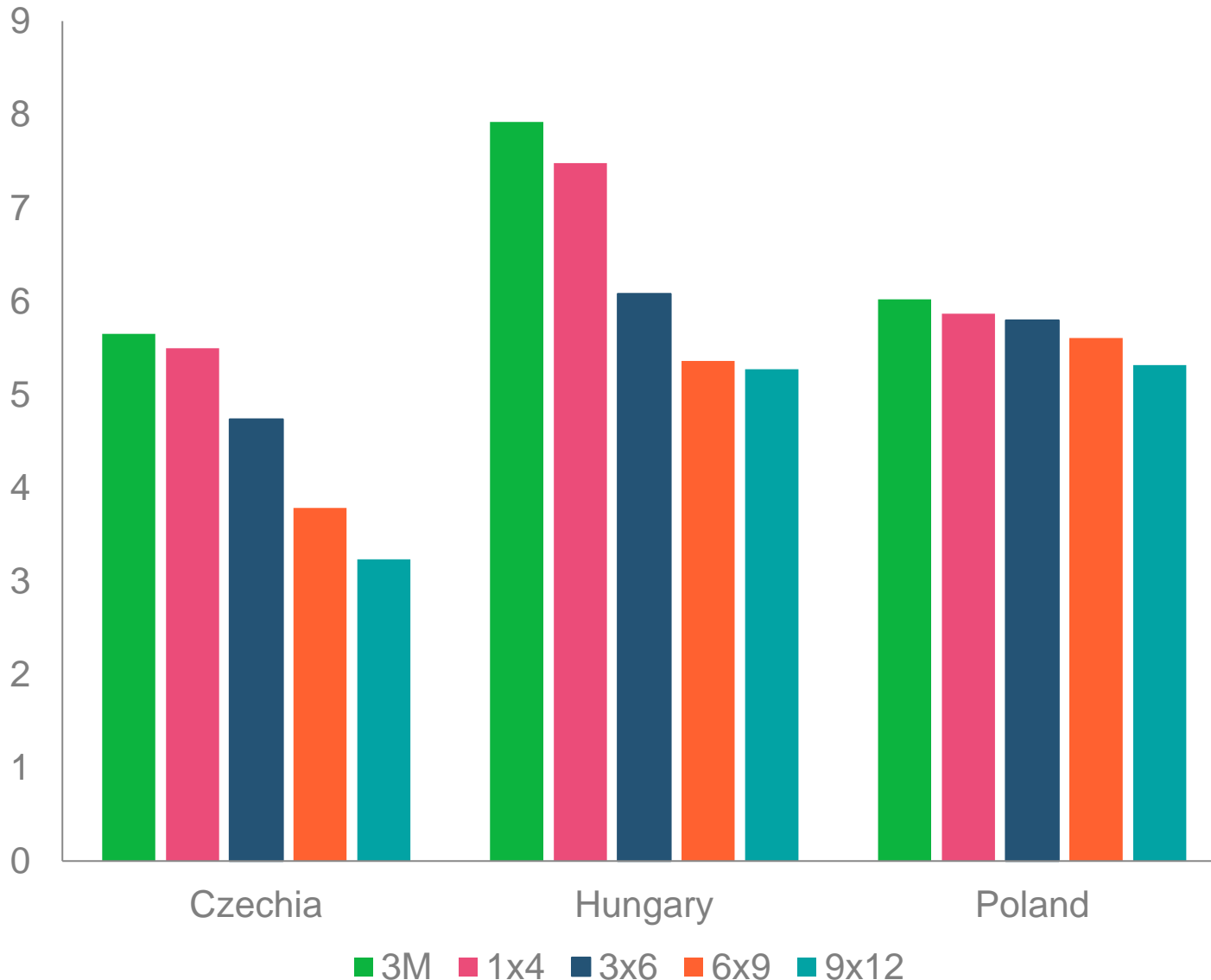


Key interest rates to fall everywhere by mid-2024

Czechia and Hungary should continue with monetary easing. Hungary is likely to frontload rate cuts before the inflation trend becomes less favorable in the second half of the year. In Czechia, inflation close to the central bank's target supports monetary easing. Poland is likely to take a pause, while Romania and Serbia will not cut interest rates until later in 2024.

Source: Erste Group Research

Market prices in biggest interest rate cuts in Czechia



FRAs suggest most sizable easing in Czechia

Currently, the market expects the most extensive monetary easing in Czechia, with the key policy rate around 3.5% at the end of the year. We believe in a more cautious approach by the central bank.

In Hungary, market expectations regarding monetary easing also go beyond our baseline scenario of the key policy rate at 6.5% in mid-2024 and flat afterwards.

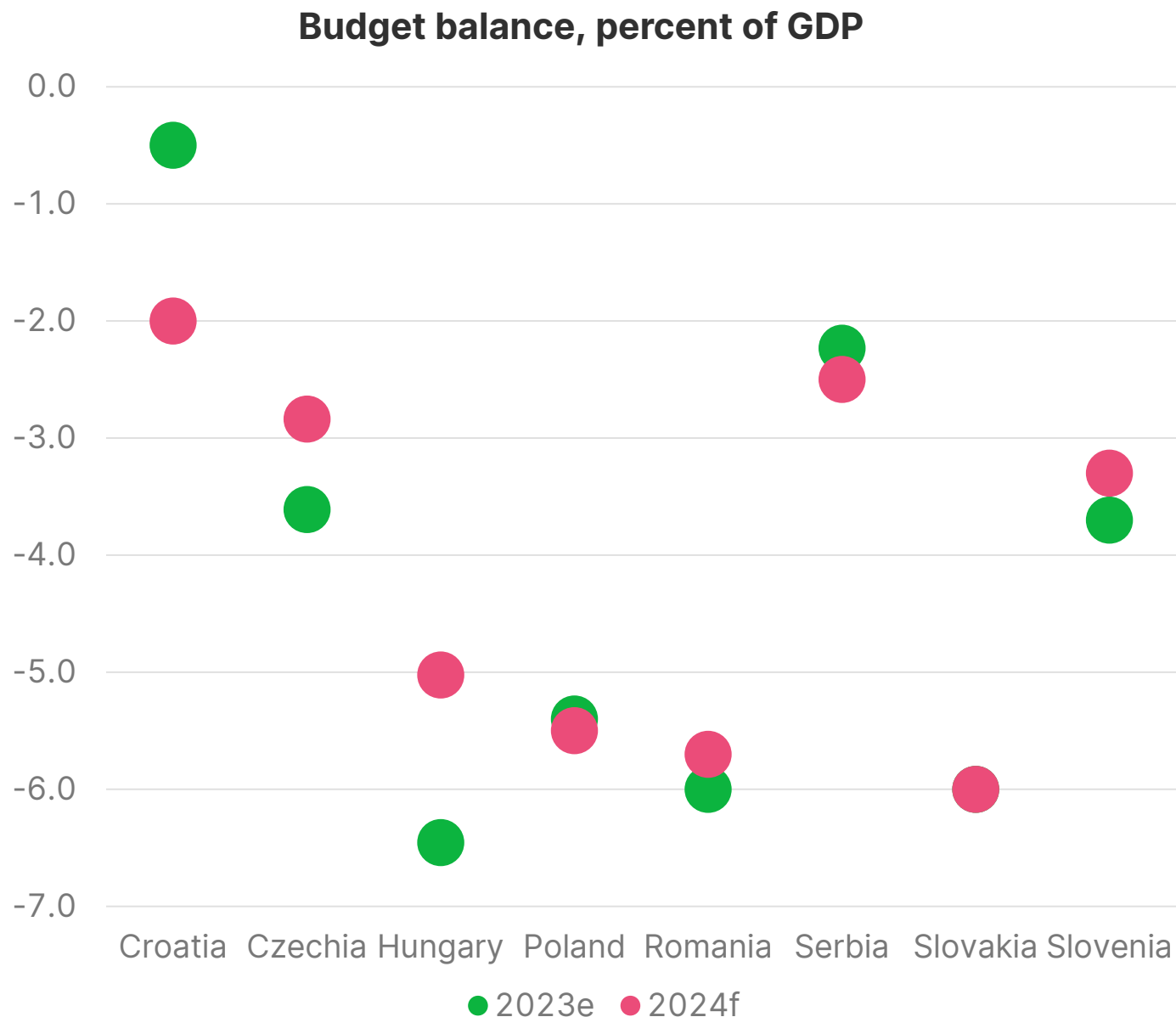
In Poland, monetary easing in 2024 remains a big question and will heavily depend on the inflation development in the second half of the year.

Source: Erste Group Research

March 2024

Fiscal stance, bond market and exchange rate development





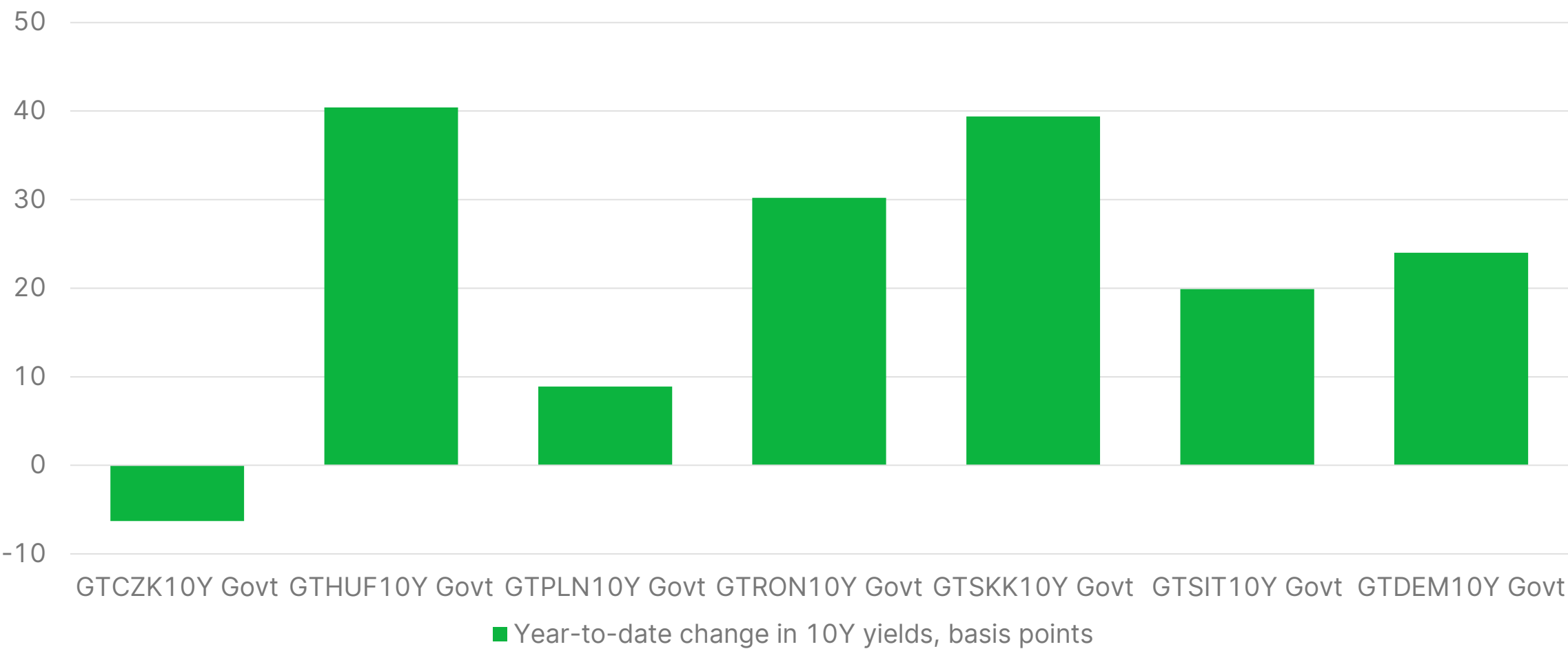
Most CEE countries to have budget deficit above 3% of GDP

Croatia has space for fiscal expansion, especially as 2024 is an election year.

Czechia and Hungary plan fiscal consolidation in 2024, while all other countries are likely to see similar budget deficits as in 2023.

In Romania, the budget deficit reached 1.67% of GDP at the end of February. Such a development makes our forecast of the 2024 budget deficit at 5.7% look quite optimistic (even if we overlook one-offs such as military spending).

Yields in CEE have moved north since beginning of year everywhere but Czechia, where sizeable monetary easing seems to dominate bond market development



Spread vs. German Bunds, basis points



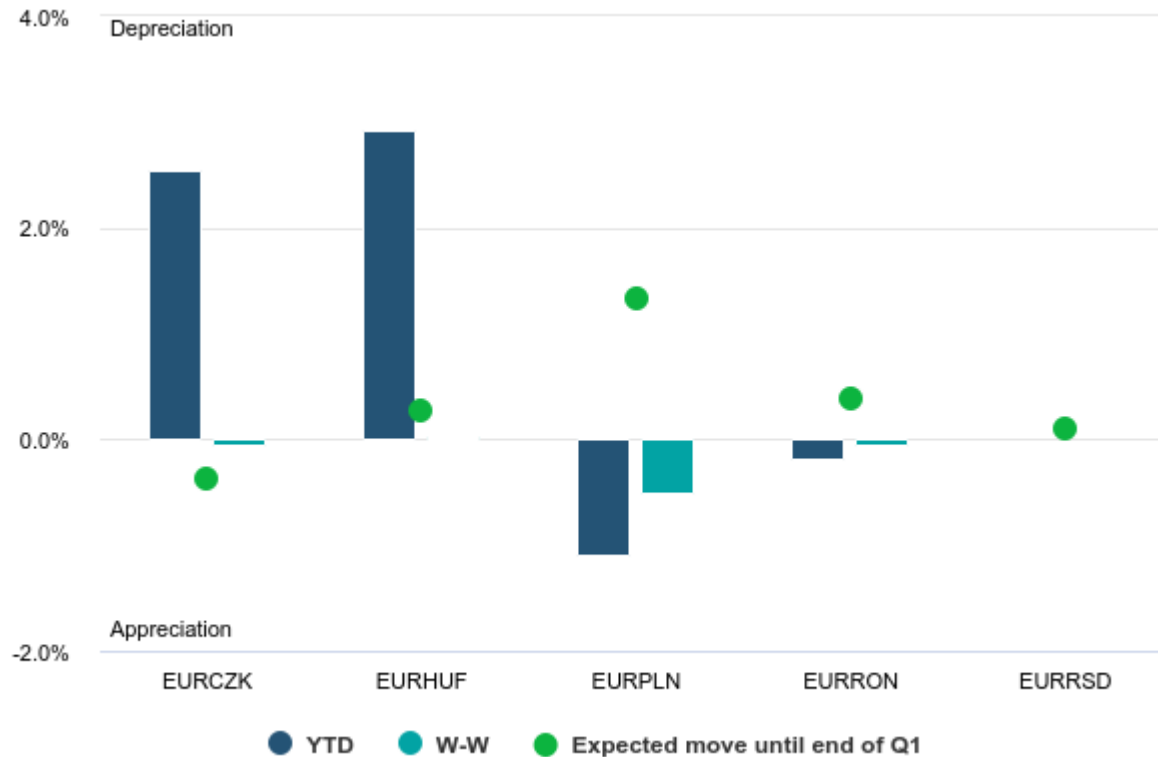
Spread compression everywhere but Slovakia

Expectations for the Hungarian central bank to cut rates, coupled with some other factors led to a spectacular bond rally, with 10Y reference yields dropping well below 6% at end-2023. The spread over the 10Y German Bund yield declined below 400bp.

At the end of 2023, Fitch downgraded Slovakia's rating by one notch in response to the worsened fiscal stance and neglect of structural challenges. Other rating agencies may follow. Spreads widened to 120-130 basis points recently.

FX market

Year-to-date development



Source: Erste Group Research, Refinitiv

Development since pandemic outbreak



Since the beginning of the year, the Czech koruna and Hungarian forint have depreciated against the euro, while the Polish zloty, on the contrary, has strengthened. The markets are keeping a close eye on the comments of central bankers to see whether weaker currencies could not be mentioned as a hurdle for the continuation of monetary easing at the current pace. This is especially valid for Czechia.

Political landscape in region



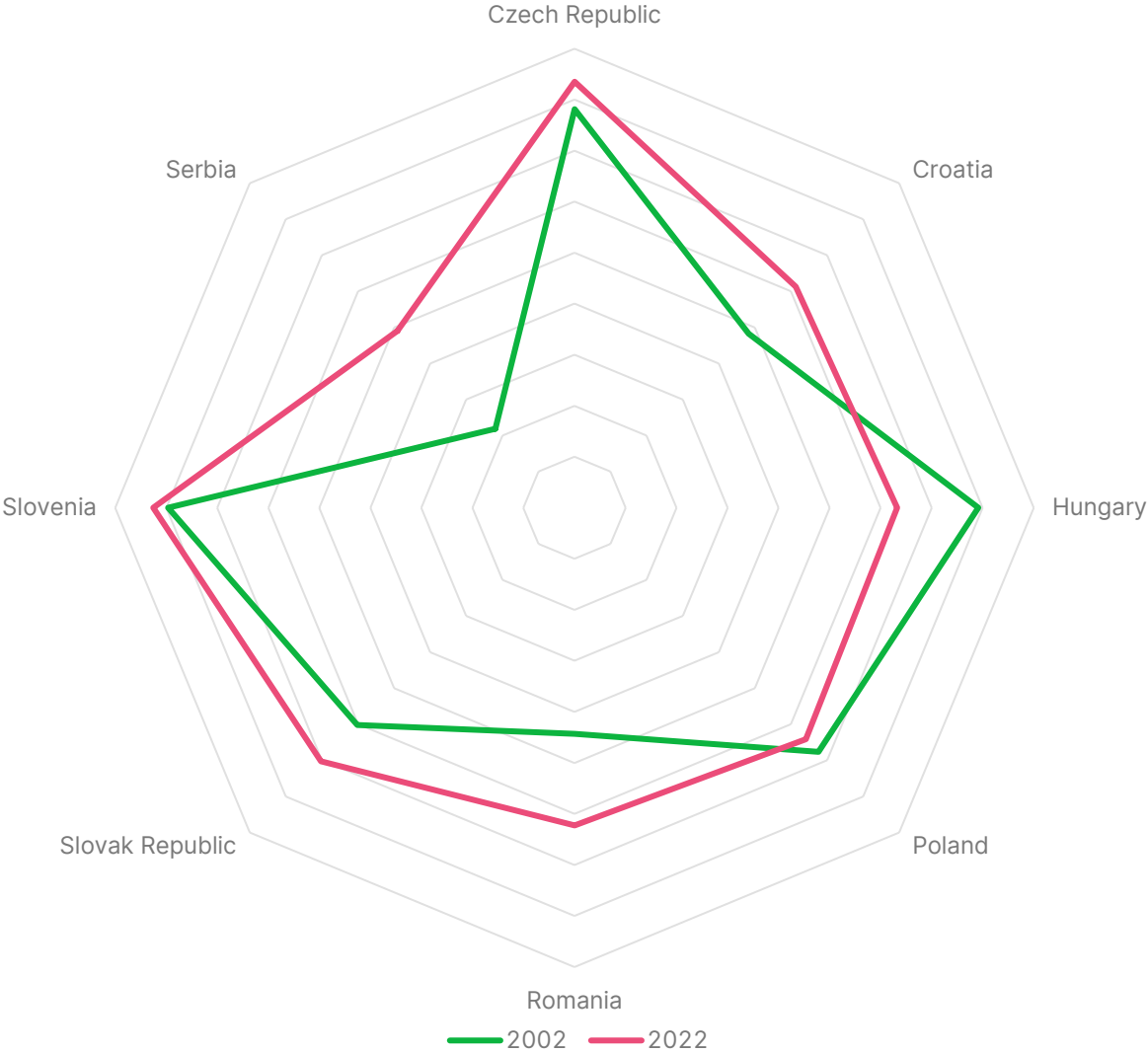
Main political developments in region

- Czechia remains politically stable and has recently opened discussions on the costs and benefits of adopting the euro currency.
- In Croatia, the parliamentary election procedure has been put in motion, as Prime Minister Plenkovic announced that the current parliament will be dissolved on March 14, paving the way for elections to be held sometime between mid-April and mid-May. Ahead of the official campaign start, polls suggest that the two largest parties have firmed up their positions recently (HDZ 26.5% and SPD 17.9%), while other top-3 parties all score very close to 8%.
- The European Commission recognized Hungary's judicial reforms as meeting fundamental requirements for judicial independence in December 2023, allowing Hungary to request reimbursement of EUR 10.2bn from the roughly EUR 22bn allocated in Cohesion funds. However, concerns still linger, and recent government crises and conflicts with the central bank are negatively impacting the Hungarian currency.
- Poland is benefitting from a change of government, with the European Commission confirming its participation in the European Public Prosecutor's Office (EPPO) and efforts to restore the rule of law, unblocking up to EUR 137bn in EU funding towards future economic development. The Polish zloty has gained positive investor sentiment, despite significant budget deficits and financing needs, and even disputes with the central bank over the potential removal of Governor Glapinski have not affected the currency negatively.

Main political developments in region

- In Romania, the grand government coalition between the Social Democrats (PSD) and Liberals (PNL) has functioned smoothly, offering political stability, which has been praised by rating agencies. Opinion polls suggest government continuity beyond the 2024 elections, with the Socialists likely to be the main coalition party. The general elections are scheduled for the end of the year, with the European elections and local elections taking place on June 9 serving as the first test for political parties. The two main parties are running as an alliance for the European elections and have garnered almost 44% of vote intentions.
- Unlike Poland, Slovakia faces a return of Robert Fico and his populist government. On the fiscal side, no meaningful consolidation is planned, raising eyebrows at the European Commission and prompting rating agencies to consider their assessments. The ruling coalition in Slovakia has sought to push through radical changes to the judicial system, despite protests and diplomatic clashes with long-term allies such as Czechia. The amendment to the judicial system violates specific European directives named by the European Commission and could lead to European funds being stopped. The law was signed by the president, but the Constitutional Court suspended the effectiveness of some parts of the amendment to the Criminal Code. In Slovakia, the upcoming presidential elections in April feature frontrunners Pellegrini, supported by the ruling coalition, and Korcok, associated with the opposition parties. The presidential elections may become a turning point for the fiscal policy in Slovakia.
- In Serbia, the parliamentary elections in December 2023 resulted in the Serbian Progressive Party (SNS) winning the majority of seats in parliament. Most recently, Serbian President Aleksandar Vucic announced that Ana Brnabic will step down as prime minister, after leading the government for almost seven years, to become parliamentary speaker.

Rule of law improved everywhere but in Hungary and Poland, according to Worldwide Governance Indicators



Macro Forecasts

Real GDP growth (%)				
	2022	2023e	2024f	2025f
Croatia	6.3	2.8	3.1	2.6
Czechia	2.4	-0.4	1.0	3.2
Hungary	4.6	-0.9	2.0	3.4
Poland	4.9	0.2	2.8	3.5
Romania	4.1	2.1	2.6	3.9
Serbia	2.5	2.5	3.3	3.5
Slovakia	1.8	1.1	2.0	2.7
Slovenia	2.5	1.6	2.3	2.5
CEE8 avg	4.0	0.6	2.4	3.4

Public debt (% of GDP)				
	2022	2023e	2024f	2025f
Croatia	68.2	61.3	59.5	58.0
Czechia	44.2	44.8	45.4	45.7
Hungary	73.9	73.5	73.1	72.1
Poland	49.1	50.0	53.0	55.0
Romania	47.3	48.4	49.7	49.5
Serbia	55.2	52.5	51.1	50.9
Slovakia	57.8	58.2	60.0	61.3
Slovenia	72.3	69.1	68.6	67.4
CEE8 avg	52.8	53.0	54.5	55.2

Average inflation (%)				
	2022	2023e	2024f	2025f
Croatia	10.8	8.1	3.1	2.6
Czechia	15.1	10.7	2.4	2.2
Hungary	14.5	17.6	4.7	4.0
Poland	14.3	11.6	4.5	4.0
Romania	13.7	10.5	5.5	3.7
Serbia	11.9	12.5	4.3	2.9
Slovakia	12.8	10.5	3.0	3.0
Slovenia	8.8	7.4	2.7	2.5
CEE8 avg	13.8	11.6	4.1	3.5

C/A (%GDP)				
	2022	2023e	2024f	2025f
Croatia	-2.8	1.3	0.8	0.3
Czechia	-6.1	1.2	0.5	0.9
Hungary	-8.2	0.2	0.7	1.1
Poland	-3.3	1.6	0.0	-1.0
Romania	-9.2	-7.2	-6.9	-6.8
Serbia	-6.9	-2.6	-3.9	-4.8
Slovakia	-7.4	0.2	-1.7	-3.0
Slovenia	-1.0	4.4	2.9	2.6
CEE8 avg	-5.6	-0.3	-1.1	-1.6

Unemployment (%)				
	2022	2023e	2024f	2025f
Croatia	7.0	6.3	6.0	5.7
Czechia	2.2	2.6	3.4	3.9
Hungary	3.6	4.0	3.9	3.6
Poland	5.1	5.2	5.0	5.0
Romania	5.6	5.6	5.6	5.6
Serbia	9.4	9.5	8.8	8.6
Slovakia	6.1	6.0	5.9	5.7
Slovenia	4.0	3.8	3.7	3.6
CEE8 avg	4.8	4.9	4.9	5.0

Budget Balance (%GDP)				
	2022	2023e	2024f	2025f
Croatia	0.1	-0.5	-2.0	-1.5
Czechia	-3.2	-3.6	-2.8	-2.2
Hungary	-6.2	-6.5	-5.0	-4.1
Poland	-3.4	-5.4	-5.5	-4.0
Romania	-6.2	-6.0	-5.7	-4.0
Serbia	-3.1	-2.2	-2.5	-2.3
Slovakia	-2.0	-6.0	-6.0	-5.0
Slovenia	-3.0	-3.7	-3.3	-2.5
CEE8 avg	-3.9	-5.0	-4.8	-3.6

Market Forecasts

LCY Government bond yields

	Latest	2024Q2	2024Q3	2024Q4	2025Q1
Czechia 10Y	3.64	3.85	3.67	3.50	3.36
Hungary 10Y	6.16	6.34	6.23	6.14	6.05
Poland 10Y	5.31	5.00	4.90	4.80	4.70
Romania10Y	6.52	6.70	6.60	6.50	5.90
Serbia 10Y	6.02	5.90	5.70	5.60	5.50

Spreads vs. German Bunds (bps)

Croatia 10Y	93.00	100.00	100.00	100.00	100.00
Slovakia 10Y	118.00	130.00	130.00	130.00	130.00
Slovenia 10Y	66.00	80.00	80.00	80.00	80.00
DE10Y yields	2.30	2.30	2.30	2.30	2.30

3M Money Market Rate

	Latest	2024Q2	2024Q3	2024Q4	2025Q1
Czechia	5.92	4.94	4.44	3.95	3.85
Hungary	8.10	6.60	6.60	6.60	6.35
Poland	5.86	5.65	5.50	5.30	5.15
Romania	6.08	5.97	5.47	4.97	5.42
Serbia	5.69	5.65	5.00	4.56	4.15
Eurozone	3.93	3.79	3.40	2.92	2.45

FX

	Latest	2024Q2	2024Q3	2024Q4	2025Q1
EURCZK	25.30	24.90	24.75	24.60	24.47
EURHUF	394.45	390.00	390.00	390.00	390.00
EURPLN	4.28	4.30	4.30	4.30	4.30
EURRON	4.96	4.98	5.02	5.05	5.07
EURRSD	117.03	117.20	117.20	117.30	117.30
EURUSD	1.09	1.14	1.14	1.12	1.12

Key Interest Rate

	Latest	2024Q2	2024Q3	2024Q4	2025Q1
Czechia	6.25	5.00	4.50	4.00	3.75
Hungary	9.00	6.50	6.50	6.50	6.25
Poland	5.75	5.75	5.75	5.50	5.00
Romania	7.00	6.75	6.25	5.75	5.50
Serbia	6.50	6.50	5.75	5.25	4.75
Eurozone	4.50	4.25	4.00	3.50	3.00

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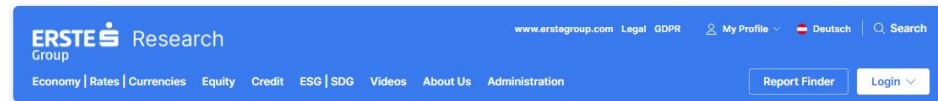


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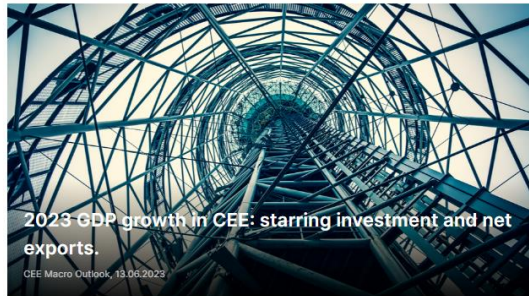


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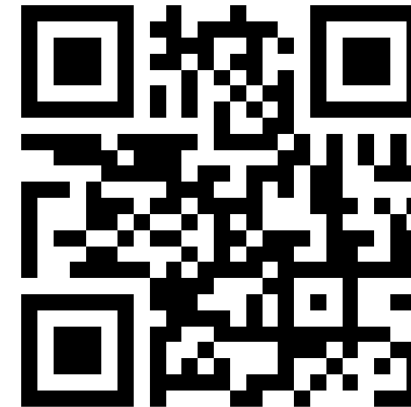
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