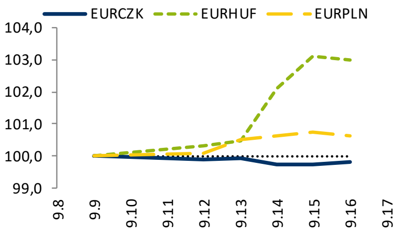
Written by ČSOB Prague and K&H Budapest

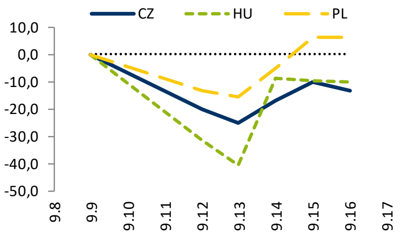
Friday, 16 September 2022

Forex markets (index)



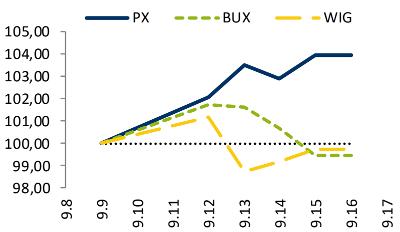
	LAST	PREVIOUS	CHANGE (%)
EURCZK	24,50	24,49	0,04
EURHUF	408,4	409,0	-0,15
EURPLN	4,721	4,726	-0,11

Gov. bonds 10 Y (bps change)



	LAST	PREVIOUS	CHANGE (bps)
CZGB 10Y	4,522	4,553	-3,1
HUGB 10Y	9,25	9,26	-0,1
PLGB 10Y	6,07	6,07	0,0

Equity indices (index)



	LAST	PREVIOUS	CHANGE (%)
PX	1246,5	1246,5	0,00
BUX	40691	40691	0,00
WIG	50572	50572	0,00

Regional insights

Fear of floating keeps real exchange rates stable in CE

The military conflict in Ukraine represents another significant negative external shock to Central European economies, coming just months after the region began to recover from the last wave of the pandemic. Unlike the pandemic and other negative external shocks that have hit Central European economies in the past, the war in Ukraine is clearly an asymmetric shock. Central Europe, together with the Baltic countries and Bulgaria and Romania, is facing not only high energy commodity prices, but also gas supply constraints, high migration and the need to significantly increase defence spending. The result is a dramatic increase in the twin deficits of all countries. In particular, the current account balance of payments balance of the Central European countries deteriorated in an unprecedented way in one year - by around 4% of GDP. At the same time, there is no significant post-pandemic improvement in public finances, despite the end of COVID-related subsidy programs.

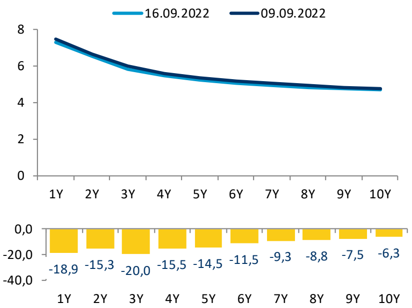
Thus, the Czech, Hungarian and Polish economies are facing record increases in the twin deficits, with all three economies operating with floating exchange rate regimes that should play the role of a shock absorber. In theory, not only the nominal but especially the real effective exchange rate of the koruna, forint and zloty should depreciate significantly. In reality, no real depreciation of these currencies has occurred since the start of the Russian invasion. Only the forint has depreciated in real terms since the start of the war, but even its losses are relatively small. How is this possible?

The relative stability of the real exchange rates of the Central European countries can be explained in large part by the policy of the regional central banks, which are not willing to tolerate a dramatic depreciation of the domestic currency in a situation when inflation hovers in double digits and approaching 20%. Specifically, the CNB is intervening massively in the forex market in favour of the koruna, Hungary's official interest rates are already at 11.75% and will rise further, and the NBP in Poland continues its tightening cycle and indicates that it wants a strong zloty.

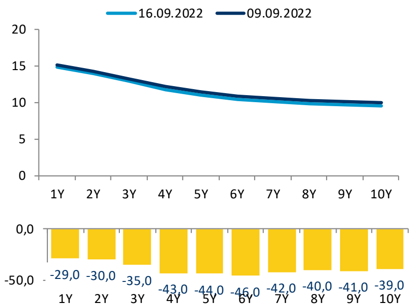
High inflation, coupled with the reluctance to let the real exchange rate depreciate when the economy is hit by a negative external shock, is reminiscent of the macroeconomic phenomenon called ‘fear of floating’. This is often mentioned in the context of the monetary policies observed in the past in some emerging markets or in Latin America. Here, however, the strategy of not letting one's own currency depreciate in the face of an external shock has often proven unsustainable in the long term, and the currencies concerned have eventually depreciated significantly anyway. Is this time different for Central Europe? The next several months will show. For example, in the Czech case, high FX interventions may act as a substitute for monetary restriction, but only temporarily, as FX reserves could be exhausted (although they are still above 60% of GDP). In the Hungarian case, aggressive defence of the forint via drastic interest rate hikes has its limits too, as it may lead to a significant deterioration of the fiscal situation and indebted households. As for Poland, the current NBP leadership and its loss function give more weight to growth and employment over inflation. Hence, if Poland, for example, falls into a deeper recession, the hiking cycle will be quickly halted with obvious negative (temporary) consequences for the zloty

Interest-rate Swap Curves

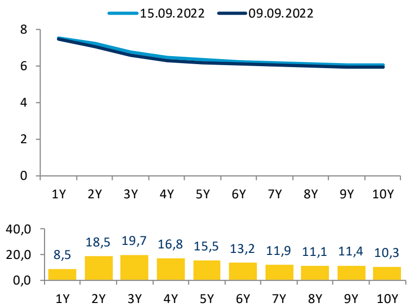
CZK *



HUF *



PLN *



* upper plot in each panel shows interest swap curve (%), lower plot shows change in interest rates in basis points (against previous Friday).

Calendar

Country	Date	Time	Indicator		Period	Forecast		Actual		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y	m/m	y/y
CZ	09.16	9:00	PPI	%	08/01/2022			-0,1	25,2	0,3	25,7	0,3	26,8
PL	09.16	14:00	Core CPI	%	08/01/2022					0,8	9,9	0,6	9,3
PL	09.20	10:00	Wages	%	08/01/2022							3,4	15,8
PL	09.20	10:00	Industrial output	%	08/01/2022							-6,5	7,6
PL	09.20	10:00	PPI	%	08/01/2022							0,9	24,9
PL	09.21	10:00	Retail sales	%	08/01/2022							1,2	2,0
CZ	09.21	12:00	CZ bond auction 2022-2028, 5.50%	CZK B	09/01/2022					6			
CZ	09.21	12:00	CZ bond auction 2022-2030, 5.00%	CZK B	09/01/2022					6			
CZ	09.21	12:00	CZ bond auction 2022-2035, 2.50%	CZK B	09/01/2022					2			
HU	09.22	8:30	Current account	HUF B	2Q/2022							-2345	
HU	09.22	9:00	Unemployment rate	%	08/01/2022							3,5	
HU	09.22	9:00	One week deposit rate	%	09/01/2022							11,75	
PL	09.22	14:00	Money supply M3	%	08/01/2022							0,7	6,2
HU	09.23	9:00	Wages	%, ytd.	07/01/2022								15,4
PL	09.23	10:00	Unemployment rate	%	08/01/2022							4,9	

Contacts

Brussels Research (KBC)		Global Sales Force	
Mathias van der Jeugt	+32 2 417 51 94	Brussels	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Mathias Janssens	+32 2 417 51 95	Institutional Desk	+32 2 417 46 25
		France	+32 2 417 32 65
Dublin Research		London	+44 207 256 4848
Austin Hughes	+353 1 664 6889	Singapore	+65 533 34 10
Shawn Britton	+353 1 664 6892		
Prague Research (CSOB)		Prague	+420 2 6135 3535
Jan Čermák	+420 2 6135 3578	Prague (Equities)	+420 2 2142 4216
Jan Bureš	+420 2 6135 3574		
Bratislava Research (CSOB)			
Marek Gabris	+421 2 5966 8809	Bratislava	+421 2 5966 8820
Budapest Research			
David Nemeth	+36 1 328 9989	Budapest	+36 1 328 99 85