Emerging Insight

CEE: hawkish surprises – take them seriously

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GEM Fixed Income Strategy & Economics
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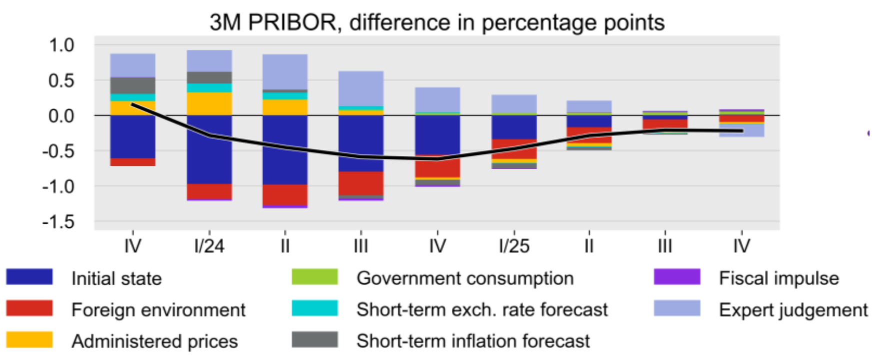
Key takeaways

- In Poland, we see no more cuts by NBP vs market pricing of over 100bp of easing next year. Higher rates should benefit PLN.
- In Czechia, we feel still weak sentiment in Prague for rate cut before Jan CPI. We delay first 25bp rate cut to February.
- Even with the delayed start to easing, CNB likely still reluctant to cut more than 25bp initially.

By Mai Doan

Exhibit 1: Czechia – breakdown of changes in CNB's interest rates forecasts
Rates much lower vs previous forecasts if excluding expert adjustments



Source: CNB

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Abbreviations

NBP: National Bank of Poland
PiS: Law and Justice party
PO: Civic Platform party
CNB: Czech National Bank

CEE in Focus

NBP done with easing, CNB in extended wait-and-see

In Poland, the NBP's on-hold decision on Wednesday marks a structural hawkish shift by Governor Glapinski. We now see a steady rates outlook at 5.75% through 2024. Higher rates would support the PLN. In Czechia, the sentiment in Prague following the CNB's on-hold decision suggests a still weak appetite to start the easing cycle soon. We push back our call for the first 25bp rate cut to February. We now have YE2023 policy rate at 7.0%, and maintain YE2024 forecast at 4.0%. Even with the delayed start to easing, we perceive a high reluctance by the CNB Board to cut more than 25bp initially.

Timestamp: 08 November 2023 05:00PM EST

NBP: on-hold decision marks structural hawkish shift

We believe that the NBP is done with easing, and now see a steady rates outlook at 5.75% through 2024. This hawkish shift from the ultra-dovish stance pre-election relates to the changeover in politics in the country, with a new PO-led coalition government taking over from mid-December. There are two key explanations for Governor Glapinski's motivation, in our view. First, Glapinski is very close to the outgoing PiS government, so he may now wish to be as least supportive to the incoming one as possible, by creating a less favourable condition for economic growth and budget financing via tight monetary policy.

Second, Governor Glapinski's likely increasing concerns about the threat by the left-wing politicians to bring him to the state tribunals probably emboldens his hawkish turn. PO's pledges for its first 100 days in the office include holding Glapinski accountable for "destroying the independence" of the NBP and "failing to implement the basic task" of fighting inflation. This call is echoed by several other politicians on the left. While we do not yet see any more concrete plan by the incoming coalition on this, the fear may be growing within the central bank as the power change is drawing closer, just about a month away.

NBP-government conflict unwelcome, PLN still net benefit from higher rates

Higher NBP rates would support the PLN, while the likely tensions between the central bank and the government may bring uncertainty that would undermine investors' sentiment – net we still see a positive impact for the PLN. The market is still pricing in over 100bp of rate cuts by YE2024 following the Wednesday's surprise on-hold decision vs our high conviction call that the NBP is done with cutting. Further pricing out of such signficant easing expectations should benefit the PLN materially. We remain paid in 1y swap rates, and long PLN. See EM Alpha: Go long PLNCZK and EM Alpha: pay 1y in Poland as a spread to 1y euro.

Any attempt by the government to remove the central bank's governor is generally not welcome by the markets. As long as the central bank conducts policy in an orthodox manner, the new administration is likely better off focusing on the budget and EU funds issues to build confidence in its electorate and the markets. Removing Glapinski in the next one and a half years would not bring any improvement to the relationship between the government and the central bank. The appointment of the Governor of NBP needs the approval of President Duda (from PiS), whose term lasts until spring 2025. And until a new Governor is appointed, the NBP will be run by the First Deputy Governor, who is a close associate of Glapinski. Uncertainty in the NBP leadership, and thus monetary policy, could bring market discomfort that hurts the PLN.

In case the new government decides to follow through with its pledges on Glapinski, we think it would take time to affect market sentiment, probably well into 2024 when it is more tangible that Glapinski would be suspended from his duties.

Macro justifies no rate change

Poland's monetary policy outlook has now become more consistent with the elevated inflation profile and solid growth prospects. The NBP in its new Inflation Report revises down 2024 average inflation to 4.7% from 5.2%, but raising 2025 CPI to 3.8% from 3.6%. The centrall bank is more optimistic on the GDP outlook, seeing 2024 growth at 2.9% and 2025 at 3.6%, from 2.4% and 3.3%, respectively. The statement introduces fiscal and regulatory price risks as the new hawkish arguments. The NBP also notes signal of "gradual recovery" in the economy, likely reflecting the message of the latest NBP's survey of the enterprise sector. The survey, which is highly valued by the central bank, notes that companies expect an improvement in 4Q in demand conditions, with the index of quarterly demand forecasts positive for the first time in since 3Q 2022.

CNB: wait-and-see mode extends

The sentiment in Prague following the CNB's surprise on-hold decision on 2 November suggests a still weak appetite to start the easing cycle without some visibility on the January CPI – we thus push back our call for the first 25bp rate cut to the February meeting. We now have YE2023 policy rate at 7.0% (from 6.75% previously), and maintain YE2024 forecast at 4.0%. Even with the delayed start to easing, we perceive a high reluctance by the CNB Board to cut more than 25bp initially. In addition, with January CPI likely not due until mid-February, there is likely a strong wish by the Board to have the February meeting on the 8th or the 15th. Our new rates forecasts and a likely later February decision support our FRA flattener recommendation in Czechia. The risk to our call is some substantial downside to November-December inflation, which the CNB expects around 7%.

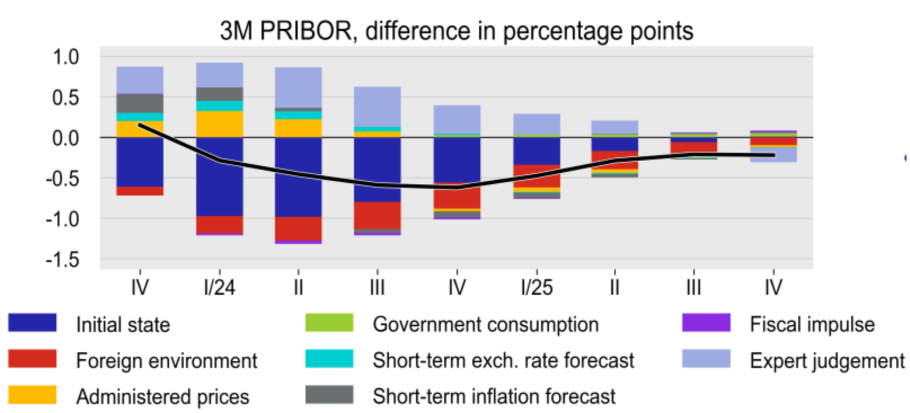
Dovish staff forecasts...

The Autumn Monetary Policy Report (MPR) send a dovish message, in our view. The staff notes that "the moment at which continuing with the current monetary policy stance would have an **excessively tight effect** has moved closer". Indeed, the interest rate profile is revised down by 0.5pp on average in 2024, and it would have been lower if it were not for c.40bp of positive expert adjustments (Exhibit 2). Headline inflation was upped by c.0.4pp on average in 2024, due mainly to higher administered prices. But core CPI is seen lower, by 50bp, to 3% in 2024. The downward revision to GDP and wage growth was substantial, by more than 1pp for next year, implying markedly weaker demand and cost push pressures from the domestic economy than the CNB's previous expectations.

...but policy makers still focus on reasons to delay cuts

The CNB's alternative scenario of unchanged rates is likely a signal that the Board is keen to wait for the January CPI. The scenario assumes inflation higher by 1pp in January vs the baseline, for which monetary policy responds with no rate cuts until end-1Q 2024. The rates path then shows around 50bp easing in 2Q 2024 and 100bp in 3Q 2024 – this may reflect the Board's preference to start the easing cycle with small, 25bp steps rather than a big 'catch-up' move. The tone of the analyst meeting suggests to us that the Board is still focusing more on finding reasons to delay the first cut, which should not be debatable at this stage in view of the macro backdrop and the staff forecasts.

Exhibit 2: Czechia – breakdown of changes in CNB's interest rates forecasts
Rates much lower vs previous forecasts if excluding expert adjustments



Source: CNB

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News and Views

Brazil: IGP-DI increases 0.51% mom in October, in line with expectations

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IGP-DI registered a 0.51% mom change in October (vs 0.45% mom in September), in line with market (0.54%) and our (0.50%) expectations. In the print, all three components accelerated. Wholesale prices increased 0.57% mom (from 0.51% mom in September), with cattle (8.33% mom) and iron ore (2,81% mom) being the main upward drivers. On the consumer side, the hike of 0.45% mom (vs -0.22% mom previously) was led by Education, Reading and Recreation (4.07% mom, vs 1.34% mom). For construction, prices continue to contribute to the upside (0.20% mom, vs 0.34% mom). In 12-months, IGP-DI accumulated -4.27% (vs. -5.34% in September).

- **To follow:** We expect a gradual acceleration of inflation, mainly in annual metrics due to base-effect.

Brazil: Public Sector primary deficit reached 1.0% of GDP in September

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The public sector posted a R$18.1bn primary deficit in September (from a R$22.8bn deficit in August), according to the Brazilian Central Bank (BCB). The result was well below market expectation of a R$11.2bn surplus. The Central Government contributed with a R$16.6bn deficit (vs R$26.2bn in August), while regional governments and state-owned companies posted deficits of R$1.1bn (vs -R$2.5bn previously) and R$0.5bn (-R$0.9bn) – respectively. The surprise came from the uncertainty on whether the Central Bank would recognize the BRL 26 billion from PIS/Pasep as a primary result, as the Treasury did. Apart from this difference, the result would have been much closer to the consensus.

In 12 month accumulated terms, the primary deficit rose to R$101.9bn (0.97% of GDP), from R$73.1bn in August (0.70% of GDP), while the nominal deficit went to R$801.6bn (7.62% of GDP, from 7.30%). Gross debt/GDP remained stable at 74.4% of GDP compared to previous month; with net debt moving slightly up to 60.0% of GDP (from 59.9%).

- **To follow:** We expect a public sector primary deficit of 0.8% of GDP by 2023YE, with the gross debt to GDP ratio at 76.1%.

Brazil: Core Retail Sales above estimates in September

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September Core Retail Sales increased by 0.6%momsa (from -0.1% momsa in August), above market expectations (0.0%). In the month, the main upward pressure come from Furniture and home appliances (2.1% momsa, vs -2.0%). Despite the positive result, 5 out of 8 groups posted monthly negative prints. In yoy terms, sales were up by 3.3%yoy (from 2.4% yoy). Meanwhile, broad sales, which includes Building Materials, Vehicles and wholesale food items, were up by 0.2% momsa (from 0.6% in August). In yoy terms, Broad sales decelerated to 2.9%yoy (from 3.7% yoy).

- **To follow:** For October, our preliminary forecast for core retail sales is running at 1.9%momsa.

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