SUERF 2018
Prospects for Policy Normalisation: CEE and Scandinavia

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What Are the Fault Lines?

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<tr>
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<th>Poland</th>
<th>Hungary</th>
<th>Czech Republic</th>
<th>Romania</th>
<th>Sweden</th>
<th>Norway</th>
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<td><strong>Cyclical Position –</strong></td>
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<td><strong>Signs of Overheating?</strong></td>
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Three Broad Categories

The ‘Frontrunners’

Central banks in the Czech Republic and Romania have started raising rates ahead of the pack, in response to a perceived threat from wage growth, and a desire to bring rates closer to neutral. Neither central bank is concerned about FX gains that may come from being ‘ahead of the pack’.

Enjoying ‘Goldilocks’

The National Banks of Poland and Hungary perceive no serious threat to the inflation outlook and believe that wage pressure is not serious enough to warrant tightening. They believe that the trade-off between growth and inflation is extremely favourable and does not require policy action. The NBH is particularly concerned about FX gains.

Getting the ‘House’ in Order

The Riksbank and Norges Bank show an intent to normalise policy from an extremely loose current stance; however, concerns about leverage, housing, soft core inflation and FX appreciation (especially Sweden) act as headwinds. Norges Bank appears headed for the exit more confidently than the Riksbank.
The ‘Frontrunners’
Enjoying Goldilocks
Getting the ‘House’ in Order
The CNB believes the Phillips curve is still working: The CNB started hiking rates from the ZLB last summer in response to faster wage growth. The bank wants to take rates towards neutral (c.2.8%), via a mix of higher rates and stronger FX. The ECB outlook influences the speed and timing of rate increases but does not determine what the CNB does.

Czech Republic: Labour Market Overheating Highlights Need for Normalisation

Wage growth at a post-crisis high

Where does the tightening come from?

Source: Haver Analytics, Morgan Stanley Research

Source: CNB, Morgan Stanley Research; chart assumes a 1% move in EURCZK is equivalent to a 25bp move in 3M PRIBOR
Romania: Monetary Policy Responds to CPI Overshoot

Excessively loose fiscal policy led to overheating: The NBR raised rates twice this year already in response to overheating and inflation headed to 5%Y, double its target. The NBR does not have to worry about the FX when it raises rates, given that the C/A deterioration represents a headwind to the currency.

Domestic demand has outpaced the rest of CEE...

...and Romania’s C/A gap has widened vs. peers

Source: Haver Analytics, Morgan Stanley Research
The ‘Frontrunners’

Enjoying Goldilocks

Getting the ‘House’ in Order
Poland: If it Ain’t Broke, Don’t Fix it

Even though the Phillips curve may have become flatter, this is still no reason for complacency: Despite strong growth, the NBP is now firmly in the camp of those who feel that strong growth and low inflation can coexist for a long time. The NBP has guided the market to expect no rate hikes this year (and possibly next), despite growth clearly above trend.

Pricing power subdued, core inflation has stalled

Polish RS deflator has been soft for some time vs. peers

Source: Haver Analytics, Morgan Stanley Research; March core CPI is MS estimate

Source: Haver Analytics, Eurostat, Morgan Stanley Research: The dark blue area represents the 25th-75th percentile range of the 28 EU member-states. The lighter blue area represents the whole range.
Hungary: Paradigm Shift?

No overheating, says the NBH: While real rates deep in negative territory may not seem appropriate for an economy running clearly above potential, the Hungarian central bank remains adamant that loose conditions need to stay in place and risks of overheating are negligible. Hungary’s large external surplus and improving fundamentals have bought the NBH significant leeway versus the past.

ULCs have been more contained than wages

CPI Expectations have diverged from CEE peers

Source: Haver Analytics, Morgan Stanley Research

Standard Deviations from average

Source: Haver Analytics, Morgan Stanley Research; the dark blue area represents the 25th-75th percentile range of the EU member states. The lighter blue area represents the whole range.
The ‘Frontrunners’
Enjoying Goldilocks
Getting the ‘House’ in Order
Sweden: Hesitant, Likely to Back-Pedal

A delay to the exit seems likely: Inflation has lost momentum, there are some concerns about housing and several members have indicated that a postponement of the first rate hike (right now 3Q18) is likely. Given repeated CPI disappointments, the Riksbank would probably rather err on the side of being too late rather than early.

‘Super’ core services CPI has lost momentum...

…and prompted a downgrade of the CPI outlook

Source: Haver Analytics, Eurostat, Morgan Stanley Research; The dark blue area represents the 25th-75th percentile range of the 28 EU member-states and Norway. The lighter blue area represents the whole range.

Source: Riksbank, Haver Analytics, Morgan Stanley Research
Norway: Headed for the exit

Getting more confident: Norges Bank has been paving the way for a rate hike by upgrading its growth outlook and its interest rate path. The recent lowering of the inflation target from 2.5%Y to 2%Y also implies somewhat tighter policy in the near term.

Norges Bank has consistently revised up its output gap estimates...

... which has led to a higher rates outlook

Source: Norges Bank, Haver Analytics, Morgan Stanley Research
Scandi: High House Prices but the Housing Market Is Cooling Off

Higher than the EU average price growth after the GFC…

... but house prices seem to have peaked

Recent data show prices have stabilised in Norway

This is also somewhat true in Sweden

Source for all charts: Haver Analytics, Eurostat, Morgan Stanley Research; the upper two charts show harmonised data from Eurostat ending in 3Q17 while the lower two charts are based on monthly national data. The dark blue area represents the 25th-75th percentile range of the 28 EU member-states and Norway. The lighter blue area represents the whole range.
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