MUFG Bank Economic Brief

Visegrad: Growth set to moderate, as concerns about inflation and higher interest rates rise

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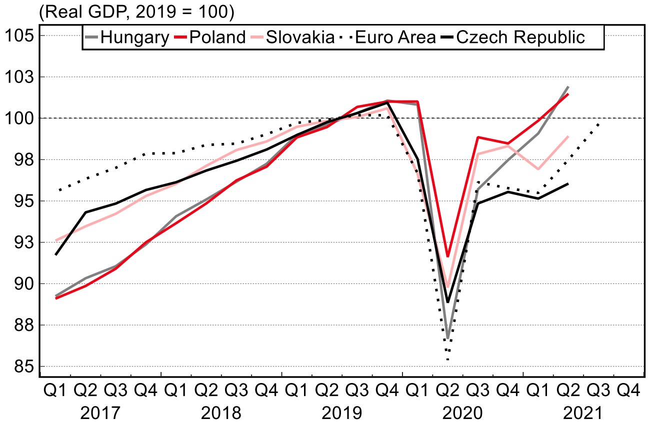
11 NOVEMBER 2021

Inflationary Pressures Intensify as Recovery Starts to Moderate

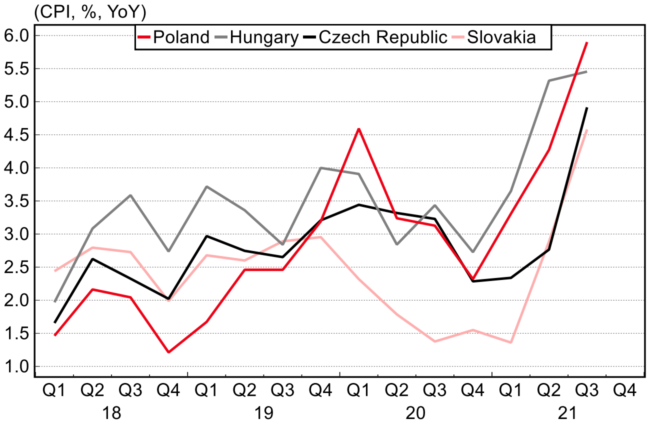
Several quarters of strong growth have seen real GDP recover back to pre-pandemic levels in both Poland and Hungary, with Slovakia and Czech Republic not far behind. The recovery is now set to moderate. Persistent supply-side problems such as a shortage of semiconductors, scarcity of skilled labour and rising energy prices mean manufacturers are likely to continue to struggle to increase output in the near-term. Meanwhile, private consumption should remain firm but its rate of growth will be more modest. Households' balance sheets remain healthy but they could feel more of the pain from rising goods, food and energy costs. Central banks have raised policy rates but inflationary pressures are set to remain high for a couple of quarters at least, while rate hikes could also increase costs for households and the private sector. As a result, real GDP growth is set to slow and could be more service-sector led.

Real GDP



Source: Eurostat, MUFG Bank Economic Research Office

Rising Inflation



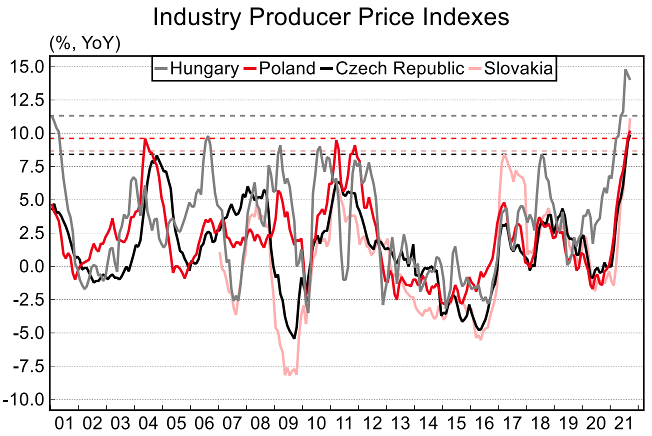
Source: Macrobond, MUFG Bank Economic Research Office

Manufacturers have had a Torrid Time in 2021 and Pressures Could Increase

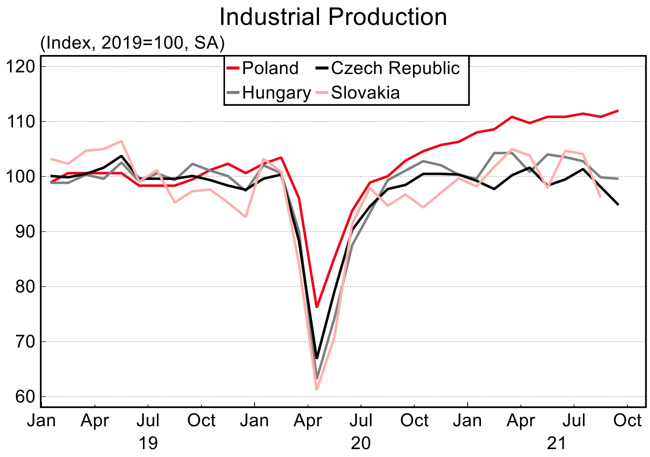
Manufacturers have come under increasing pressure in recent quarters. Strong post-lockdown demand has often outstripped supply, leading to well-documented shortages of inputs such as semiconductors and labour.

The effect is clearly shown in industrial producer price indices (PPIs), which track changes to the cost of production. PPI inflation rates in Visegrad countries are at their highest at any time over the last twenty years – and have been firmly in double-digit territory in Hungary since the start of 2021. There are several reasons for the increase of producer prices, but the rebound of energy prices earlier this year has been a major driver. The recent increase of gas prices (due to strong global demand) has affected manufacturing, especially in energy-intensive industries such as chemicals and metals[1].

Surging energy prices are compounding the wider supply-side problems facing industry. Production in the automobile sector has declined over the first eight months of this year relative to 2019 due to a shortage of semiconductors. Up to August 2021, cumulative vehicle production figures were down by 28.1% in Poland, 17.6% in Slovakia, 16.4% in Hungary and 12.2% in Czech Republic[2]. Vehicle production has continued to decline in month-on-month terms since June 2021[3]. Meanwhile, there has also been a wider loss of momentum as seen in industrial production figures for Hungary, Czech Republic and Slovakia.



Note: Horizontal lines indicate previous highs over last two decades
Source: National Sources, Macrobond, MUFG Bank Economic Research Office



Source: World Bank, Macrobond, MUFG Bank Economic Research Office

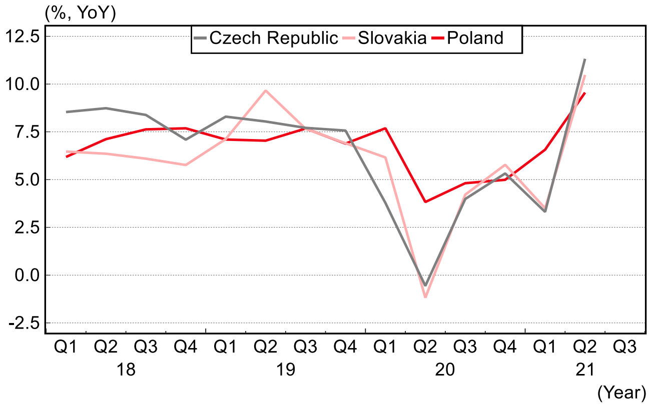
Labour shortages are also contributing to higher costs. Nominal wages have been increasing rapidly recently as employers have increased wages in order to attract workers. These pressures have intensified over recent months as a result of strong demand. Job vacancy rates have surged in Czech Republic, while job listings in Poland and Hungary have been above average. There is evidence that wages may have to continue to increase to fill positions. According to survey data, around 40% of firms in Poland and Hungary are now reporting that labour shortages are affecting production, while around 25% of firms are reporting the same issues in Czech Republic and Slovakia.

Context is important – these figures have not yet reached the highs seen in recent years – but there is little sign of current labour shortage issues abating. Indeed, survey data suggests

[1] In H1 2021, manufacturers of petroleum and chemical products in Hungary had the highest PPI inflation which drove the wider increase of indices. More recently, pressures in these sectors have moderated but still remain elevated, while there has been a broader-based rise of input prices for other manufacturers.
[2] While the Czech Republic is one of the least affected in pure production numbers, the Auto Industry Association (AutoSAP) estimates that by end-2021 the computer chip shortage will have reduced automobile production in the Czech Republic by 250-thousand fewer vehicles, and wiped off CZK 200 billion (USD 9.1 billion) in sales.
[3] Before COVID-19, the sector represented ~13% of GDP in Slovakia and 9% in both the Czech Republic and Hungary, and 2.5% in Poland. It is also a major source of employment, labour productivity and exports.

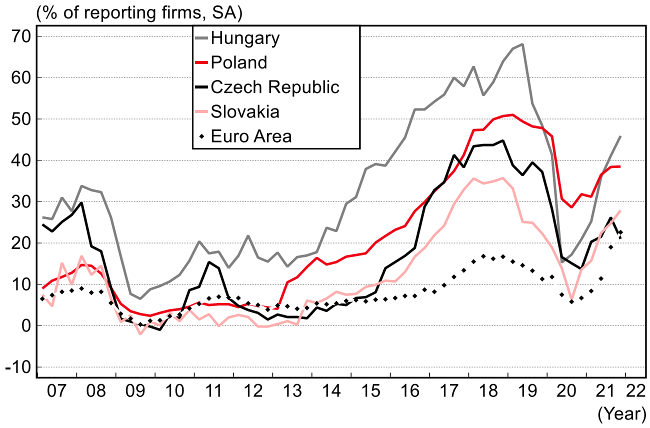
competition for employees is growing as companies increasingly offer higher wages on top of non-wage bonuses to keep employees. Some sectors are likely to face much more acute labour shortage pressures than others, but we expect that this will drive higher wage pressures across the economy as a whole over coming quarters.

Nominal Wages



Note: Nominal wage growth for Hungary is not shown for consistency reasons
Source: Macrobond, MUFG Bank Economic Research Office

Factors Limiting the Production, Labour



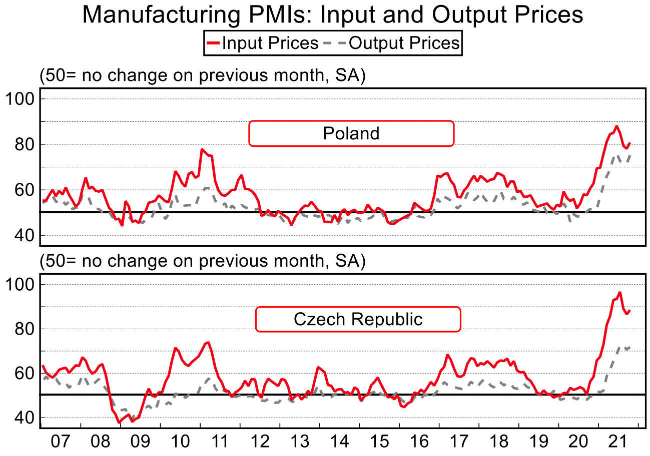
Source: DG ECFIN, Macrobond, MUFG Bank Economic Research Office

Plenty of Scope for Services Sector Expansion, But Rising Pressures Likely to Drag on Consumer Demand

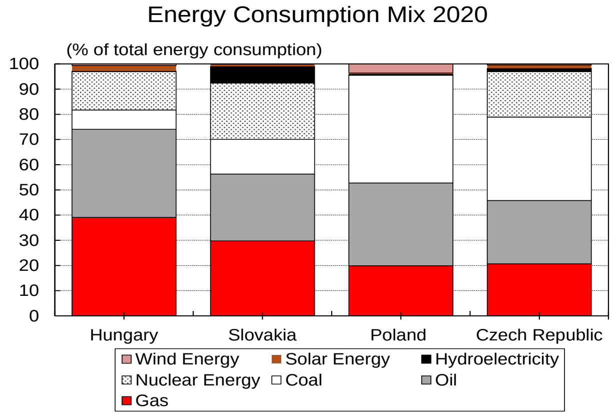
So far, price pressures have been much more muted in the services sector. As a result, while manufacturing is currently struggling to increase output, a pivot to higher demand for services could support the economic recovery. Household balance sheets remain healthy as they have accumulated precautionary savings over the last year, while higher nominal wages have shielded balance sheets from higher prices at supermarkets and petrol stations. This said, while we still expect firm private consumption over coming quarters, households will be faced with a number of headwinds.

Producer price growth currently outstrips consumer price growth. Hungary is the most extreme case where producer price growth rates are three times the rate of consumer price inflation. Given the fact that pressures, such as higher energy costs, are likely to remain with us over the medium-term, it will become increasingly likely that companies will eventually pass these costs on to consumers. PMI data for both Poland and Czech Republic suggest that manufacturers have already started to narrow the gap between input prices and output prices.

Households will also face higher utility bills. The front-month contract for Dutch TTF, a European natural gas benchmark, still remains some 280% higher than the start of the year (despite recent positive news on gas supply from Russia). Hungary looks the most vulnerable given the fact that gas accounts for less than 40% of total energy consumption (with oil consumption also accounting for another 30% of consumption). However, other countries may face higher CPI due to different weightings. For example, household energy costs alone comprise 10.5% of the total CPI index in Poland, 8.1% in Czech Republic and 6.0% in Hungary.



Source: IHS Markit, Macrobond, MUFG Bank Economic Research Office



Source: BP Statistical Review of World Energy, MUFG Bank Economic Research Office

At the same time, higher interest rates are also likely to have an effect on consumer demand as borrowing costs increase. Three out of the four central banks have raised policy rates as a result of higher inflation[4] with further moves quite likely. Inflationary pressures are likely to remain for several quarters to come as energy costs seem set to remain high. Meanwhile, the external backdrop may be less benign as the US Fed announced tapering of asset purchases from November. Further rate increases in Hungary, the Czech Republic or Poland would affect both households and private sector balance sheets.

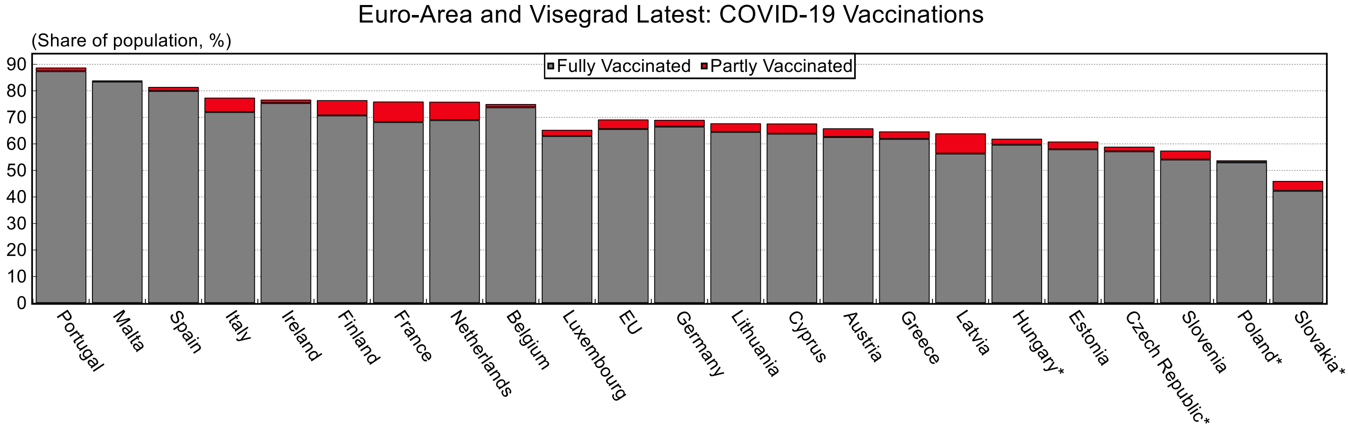
Real GDP Growth set to moderate

The lengthy list of medium-term worries is further exacerbated by the lingering threat of further waves of COVID-19. As stated previously[5], vaccination coverage has increased after a slow start, but further work still needs to be done with the number of adults having had at least one dose below 70% in all four countries (versus a figure of 80% for the EU/EEA as a whole). Slovakia is most exposed with just 54% adult vaccine coverage – the lowest in Europe – and has also seen a sharp increase in daily cases through October.

The net result of pressures is likely to be moderation in quarterly real GDP growth figures from Q4 2021, after a rapid rebound from the COVID-19 shock over the first half of 2021. The main risk is that an increase in COVID caseloads will prompt a return to some degree of lockdown measures during the winter which might prevent any rotation towards services. This said, manufacturers will continue to face a tough environment given price pressures and supply-side issues. While consumers face a number of headwinds in the medium-term, from higher pass-through of manufacturers input costs to higher utility bills, as well as potential slowing real

[4] The National Bank of Hungary (NBH) has increased its main policy rate the most times so far this year after 5 separate hikes, the most recent of which was a 15-basis points (bps) increase to 1.8% in October. Meanwhile, the Czech National Bank (CNB) has raised its key policy rate four times since June 2021; the latest increase has been the biggest of them all with a 125 bps increase to 2.75% in November. The National Bank of Poland (NBP) has also now increased rates twice, with the latest rise a 75 bps increase to 1.25% this month. In the case of Slovakia, the European Central Bank (ECB) is unlikely to hike rates any time soon.
[5] Visegrad: Steady real GDP recovery expected, as Delta variant highlights continued COVID-19 risks (published 4th August 2021): https://www.bk.mufg.jp/report/ecoeu2021e/MUFG-Economic-Brief-20210804.pdf

wage growth[6], all of which are likely to drag on economic activity and private consumption. As a result, our base case is that real GDP will moderate over coming quarters but a rotation towards services-consumption could offset some of the slowdown in the manufacturing sector.

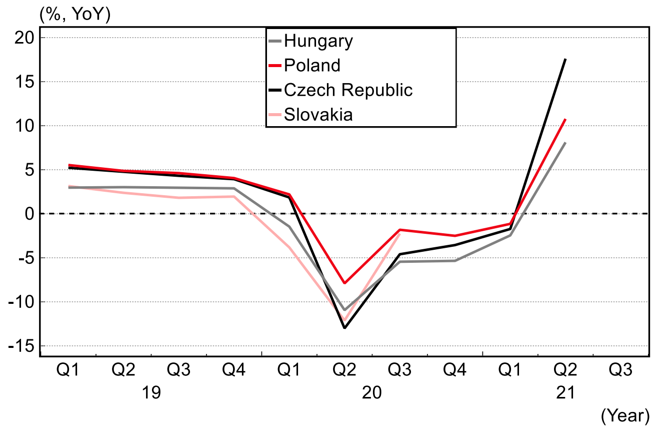


Note*: Visegrad members
Source: Our World in Data, Macrobond, MUFG Bank Economic Research Office

[6] Real wages grew by 8.5% YoY in Czech Republic, 7.7% in Slovakia, and 7.0% in Poland in Q2 2021, but given the fact that inflation has surged, even if nominal wage growth remains as strong in Q3 2021, real wage growth would be nearer the 5-6.0% YoY mark in Q3 2021.

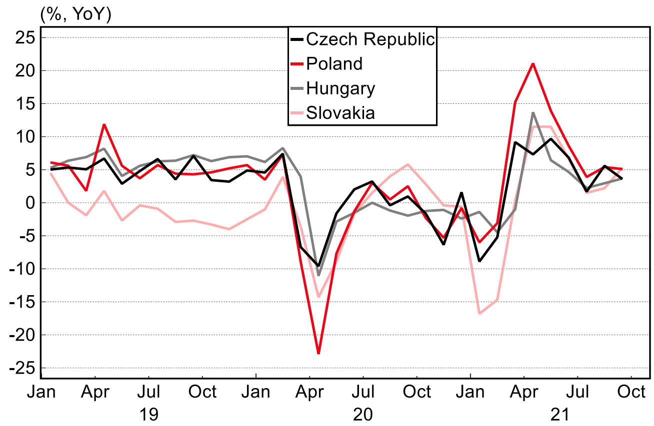
Economic Snapshot: Select Charts

Real GDP Growth



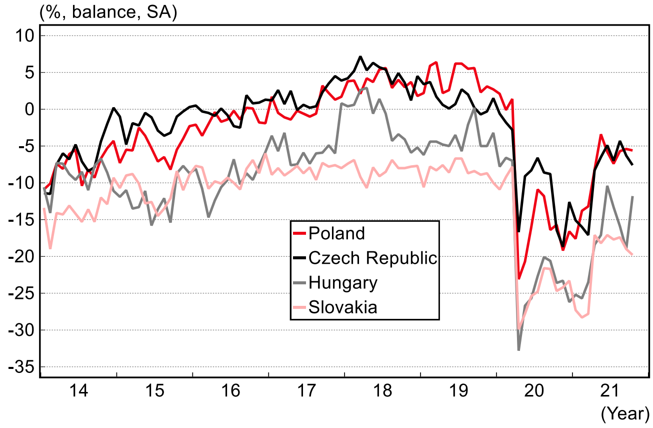
Source: Eurostat, MUFG Bank Economic Research Office

Retail Trade



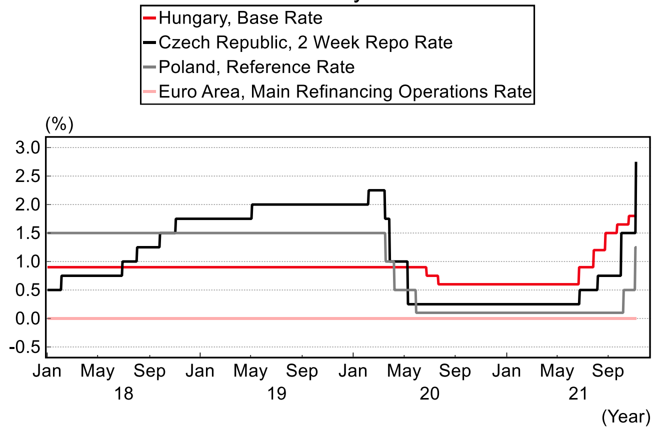
Source: National Sources, Macrobond, MUFG Bank Economic Research Office

Consumer Confidence



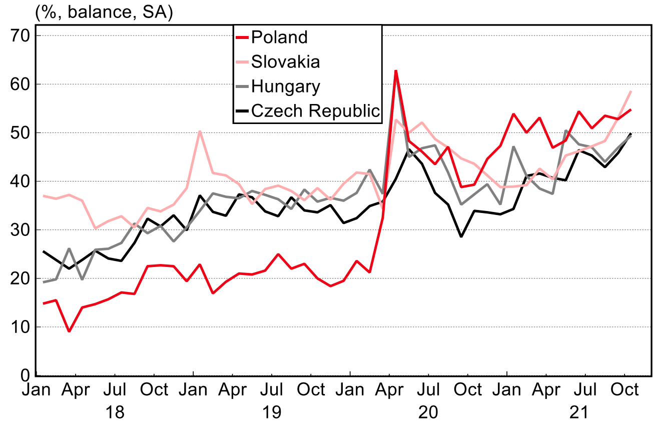
Source: DG ECFIN, Macrobond, MUFG Bank Economic Research Office

Main Policy Rates



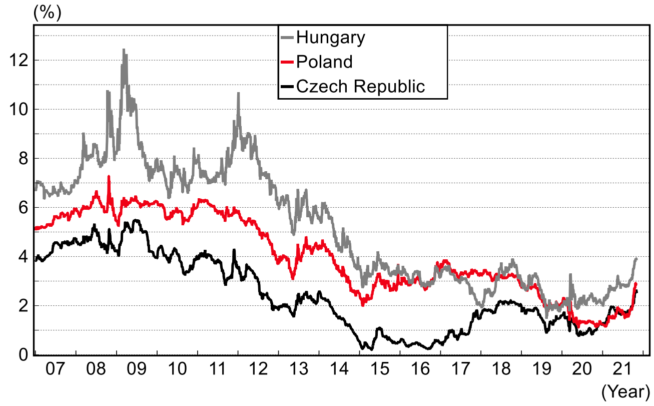
Source: Macrobond, MUFG Bank Economic Research Office

Consumer Price Expectations Over Next 12-months



Source: DG ECFIN, Macrobond, MUFG Bank Economic Research Office

Government Benchmarks, 10 Year Yields



Source: Eurostat, Macrobond,
MUFG Bank Economic Research Office