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Central Europe Economics

FX passthrough – how big a problem for central banks?

OUR TAKE

FX depreciation in recent months have made CEE central banks more concerned about inflation outlook. We show that long-term FX pass-through in the region increased substantially in 2022, but this was more due to inflation inertia, rather than higher sensitivity to FX moves. With lower current inflation the willingness of firms to reprice in response to past inflation is smaller, which suggests that the current long-term passthrough is probably weaker than in 2022-2023.

Higher passthrough — Hungarian central bank has turned hawkish in recent months, emphasizing inflation risks resulting from the HUF weakness. Our estimates for CEE economies show that the pass-through from FX moves to prices of non-energy goods has increased since 2022. This is particularly true for Hungary, where the long-term pass-through reached 26% (Figure 1), implying that 10% depreciation of the forint vs. a basket of currencies adds 2.6 pp to inflation of non-energy goods. The impact on overall inflation index would be smaller as non-energy goods constitute ~25% of the HICP (and all goods constitute ~65%). Our estimates suggest that currency moves could have significant impact also on Polish inflation, while Czech inflation appears more resilient.

Inflation inertia plays a role — What we find striking is that the immediate (i.e., one quarter ahead) impact of FX moves on prices increased only moderately (Figure 2 and 3). Instead, the key driver behind the rise in long-term pass-through has been the increase in inflation inertia in recent years. In other words, after 2022 companies in CEE became more willing to adjust prices if inflation was high in preceding quarters (Figure 4). This fact means that any FX moves could be to a relatively bigger extent passed to prices.

Past may not be the best guide for future — It is important to emphasize that high pass-through estimates are heavily affected by data from 2022, when exceptional shocks were quickly passed into prices. We are convinced that situation changed in 2H23 and 2024, as suggested for example by much lower and less volatile month-on-month CPI increases. This means also that the actual inflation inertia is now lower than estimates based on 2022-23 data would suggest, as the need for backward-looking repricing is diminishing in the world of low/moderate CPI. Taking this into account, we currently work with an assumption of 8-10% passthrough to headline CPI in Czechia, 10-12% in Poland and 15-17% in Hungary. The above arguments also suggest that fears of inflation getting out of control because of recent CEE FX depreciation are overdone.

Piotr Kalisz, CFA

+48-22-692-9633

piotr.kalisz@citi.com

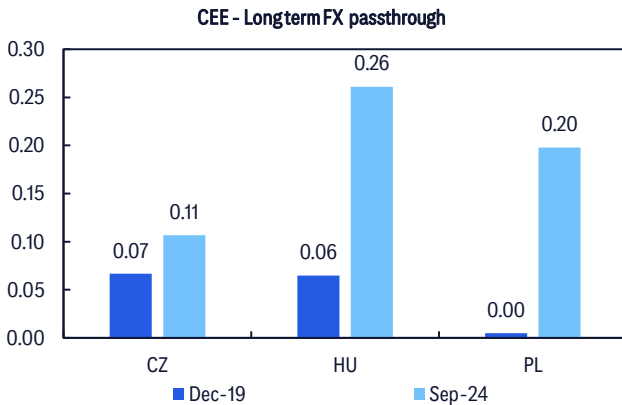
Arkadiusz Trzciolek

+48-22-657-7750

arkadiusz.trzciolek@citi.com

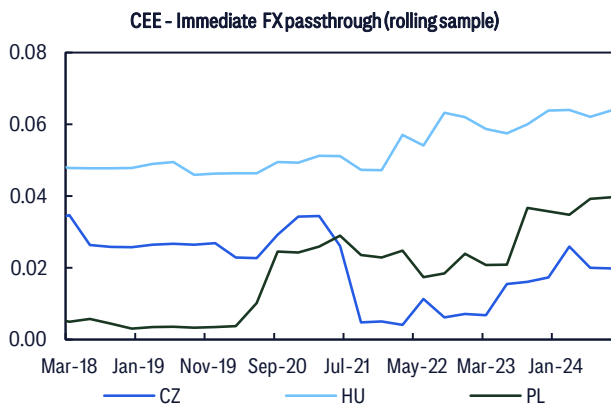
Aleksandra Siuzdakaleksandra.siuzdak@citi.com

Figure 1. FX pass-through to non-energy goods increased considerably, especially in Hungary and Poland



Source: Citi Handlowy Estimates

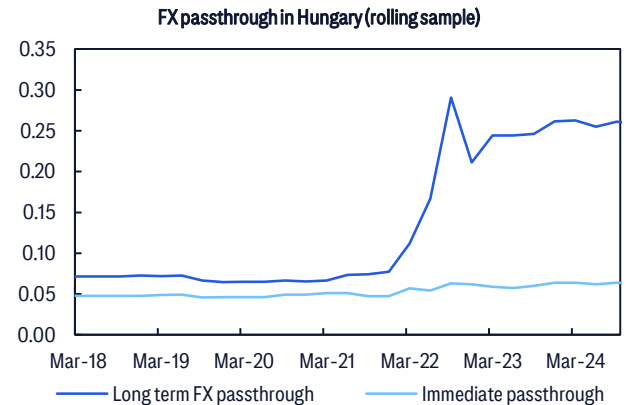
Figure 3. Short-term pass-through rose in CEE only moderately...



The data sample used for estimates starts in 3q14 and the end of sample is gradually extended up until 3Q24.

Source: Citi Handlowy Estimates

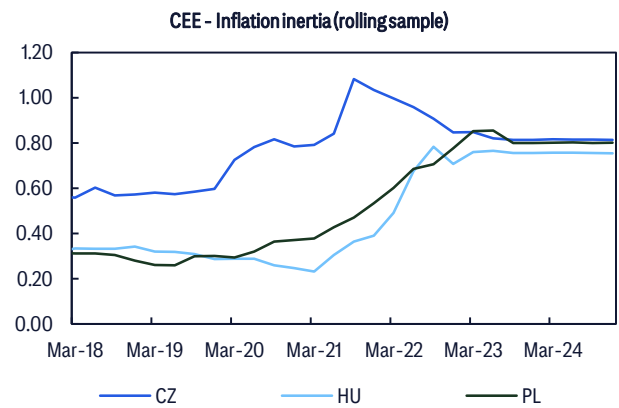
Figure 2. In Hungary inflation became more sensitive to FX moves starting form 2022



The data sample used for estimates starts in 3q14 and the end of sample is gradually extended up until 3Q24.

Source: Citi Handlowy Estimates

Figure 4. ... while the key driver behind the rise in long term FX passthrough was increased CPI inertia



The data sample used for estimates starts in 3q14 and the end of sample is gradually extended up until 3Q24.

Source: Citi Handlowy Estimates

Chief Economist Office

Piotr Kalisz, CFA

Chief Economist
+48 (22) 692-9633
piotr.kalisz@citi.com

Arkadiusz Trzciółek, CFA

Senior Economist
+48 (22) 657-7750
arkadiusz.trzciolok@citi.com

Aleksandra Siuzdak

Intern
aleksandra.siuzdak@citi.com

Citi Handlowy

Senatorska 16, 00-923 Warszawa, Polska

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