citi handlowy
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Central Europe Economics

Reciprocal tariffs – impact on CEE

OUR TAKE

Higher than expected reciprocal tariffs imply larger negative hit to GDP growth in Central Europe mainly due to their negative impact on global and euro area growth. Even if the EU were to retaliate by introducing 20% tariffs on all US goods (not our scenario) the net impact on inflation would still be negative. Weaker growth and lower inflation path creates space for CEE central banks to cut rates.

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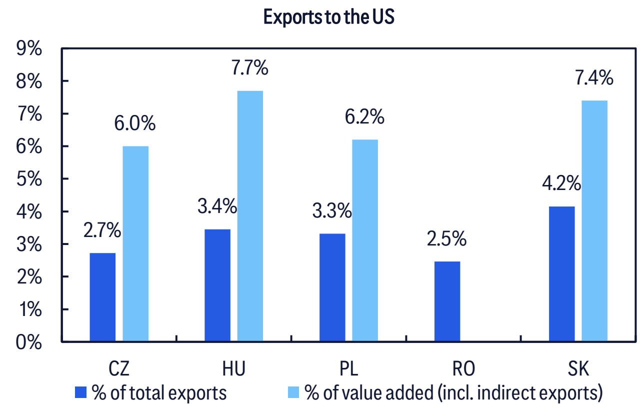
As members of the EU, Central European economies are covered by new 20% reciprocal tariffs imposed by US administration on all goods imported from the EU. The 20% tariff is significantly larger than our 10% assumption and places EM Europe somewhere in between the most hit Asian economies and less affected LATAM. CEE exports to the US are relatively small and account for roughly 3% of exports (including indirect routes, i.e. value added exported to the EU and then re-exported in some form to the US, the share rises to ~7% - Figure 1). This means that the direct impact of new tariffs on activity will be limited, though indirect effects are harder to ignore.

Given the tariff announcement Citi European economists raised their estimate of the negative effect on Eurozone GDP to around 1pp. In our view, using the usual elasticities this would imply approximately 0.7 pp hit to GDP growth in Czechia and Hungary and approximately 0.4 pp in Poland. Half of that impact is already baked into our forecasts and therefore potential immediate incremental revisions to our growth scenarios for CEE countries would be moderate and generally should not exceed 0.35 pp.

Figure 1. Approximately 3% of CEE exports and around 7% of value added is directed towards the US market



Source: Eurostat, OECD TiVA, Citi Handlowy

Figure 2. The share of imported US goods in CEE consumer baskets is so low that EU's counter tariffs would have negligible impact on inflation

Source: Eurostat, Citi Handlowy

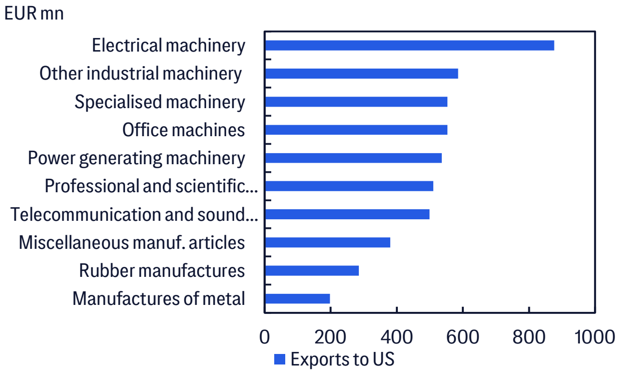
Potential for more negative scenarios – What worries us is that large changes in tariffs could have nonlinear effect on activity and therefore we may be currently underestimating the overall impact. First, it may be easy for companies to absorb small or moderate changes in tariffs/costs, but in case of new 20% tariffs the impact on firms' and consumers' decision can be disproportionally larger. Second, simultaneous increase in tariffs in all major economies creates an additional potential for non-linearities or unexpected effects. Producers from other countries, in particular Asia, may redirect some of exports towards the EU market. We also believe that the environment of escalating trade wars, raising barriers to trade and the de-globalization is not supportive for CEE, one of regions that has so far benefited from integration into global supply chains.

The net inflationary impact is likely to be negative – The EU is still considering how to retaliate but it seems the response will be weaker than the US tariff decision itself. In our view, even if the EU was to implement 20% tariffs on all consumer goods imported from the US and even if these tariffs were fully passed into consumer prices, this would hardly change the overall CPI path. Given low level of imports of US consumer goods to the region, inflation rates in CEE countries would rise by less than 0.05pp. In turn, the impact of a potential recession in the US and the euro area and more importantly potential trade diversion from third countries could have a much more significant (negative) impact on prices in the CEE.

Case for more dovish central banks - The monetary policy reaction will depend not only on how tariffs affect growth and inflation, but also how they affect risk premium/currencies. A scenario of a serious downturn or recession in the US usually is not supportive for EM FX, but CEE currencies tend to be more correlated with the euro than USD. Furthermore, moderate depreciation can be accepted by central banks in the region as a natural response of these economies to the deteriorating global growth outlook. Taking into account potentially more favourable inflation prospects, we would expect central banks in CEE to turn more dovish as compared to our previous base case.

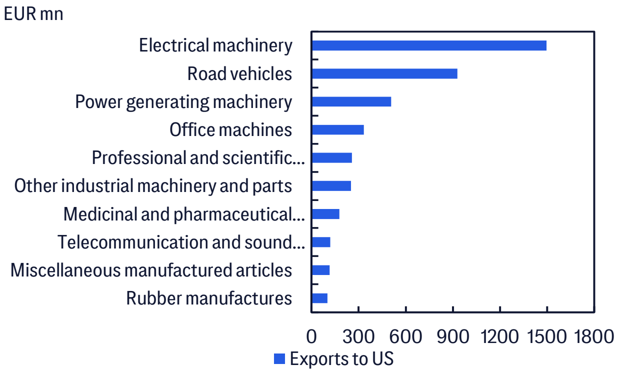
This is likely to be most visible in Poland, where the central bank kept rates on hold for long and where we see room for 200bps of rate cuts, possibly even more. Also the CNB may now be less concerned about core inflation outlook, which should allow the authorities to continue with rate cuts in the coming months (we expect additional 50bps in the current cycle). In both cases we think the risk on the side of even more easing as in new circumstances it will be easier for policymakers to lower rates below respective neutral levels. Among CEE central banks, the NBH is likely to be the most cautious, but even there the deteriorating growth outlook can allow for some easing, though probably only by the end of 2025.

Figure 3. Czech exports to the US – major categories (2-digit SITC classification)



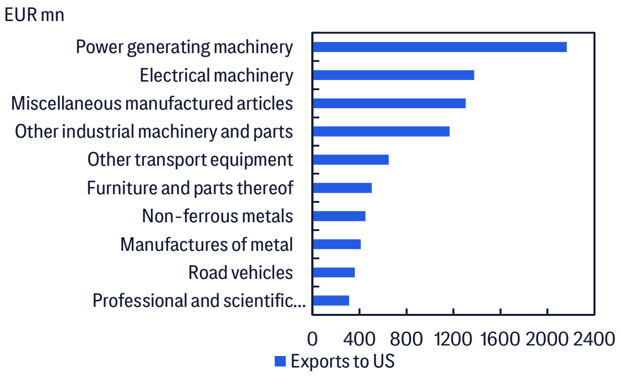
Source: Citi Handlowy, Eurostat

Figure 4. Hungarian exports to the US – major categories (2-digit SITC classification)



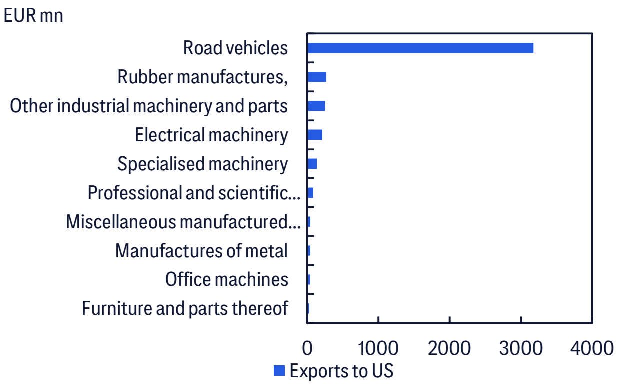
Source: Citi Handlowy, Eurostat

Figure 5. Poland's exports to the US – major categories (2-digit SITC classification)



Source: Citi Handlowy, Eurostat

Figure 6. Slovakia's exports to the US – major categories (2-digit SITC classification)



Source: Citi Handlowy, Eurostat

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