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Global Economics &  
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# No means no

## EM FX Watch

Hungarian PM Orban and his Polish counterpart Morawiecki aligned and solidified objections to the rule of mechanism during their meeting in Budapest on Thursday. The joint declaration signed by both PMs implies that they are not willing to make substantial concessions to overcome the impasse caused by their veto and unlock hundreds of billions of euros which are urgently required by EU countries to start rebuilding their economies from a recession caused by the coronavirus pandemic.

*"Our objective is to prevent a mechanism which would not strengthen, but undermine the Rule of Law within the Union by degrading it to a political instrument. The proposed conditionality circumvents the Treaty, applies vague definitions and ambiguous terms without clear criteria which sanctions can be based and contains no meaningful procedural guarantees",* defiant Hungarian and Polish prime ministers wrote in their joint statement.

To reiterate the point we have made on previous occasions, reaching a compromise over the contentious issue of linking the EUR 1.8 trillion financial package (the seven-year budget and the recovery fund) and democratic standards is likely to prove difficult. For the governing Fidesz in Hungary and the ruling Law & Justice in Poland it is not about EU funds, but preventing the European Commission from interfering in their domestic policies and maintaining their grip on power. Hungary's PM Orban reportedly said that it would be a political suicide to agree to the rule of law mechanism.

EU leaders are scheduled to meet on December 10-11 and we remain of the view that tensions between Hungary/Poland and the rest of the EU may escalate in the coming weeks. We do see a risk of a brief spike higher in EUR/PLN and EUR/HUF amid growing market realisation that it may take much longer to solve this dispute and the redistribution of EU funds could be substantially delayed which would be negative for European assets in the short-term.

**Figure 1: EUR/PLN edges above the downside trendline which capped gains since mid-November**



Source: Rabobank/Bloomberg

The price action in EUR/PLN has started to look more bullish as the downside trendline - which capped gains since the middle of November - has been cleared (Figure 1). A close above the 4.50 pivot would be another indication that the short-term bias has shifted to the upside.

A period of consolidation in EUR/HUF should be followed by another leg higher towards the October high at 369.25 (Figure 2).

Figure 2: EUR/HUF consolidates its recent gains – this should be followed by another leg higher.



Source: Rabobank/Bloomberg

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