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Central European Weekly

Monday, 26 January 2015

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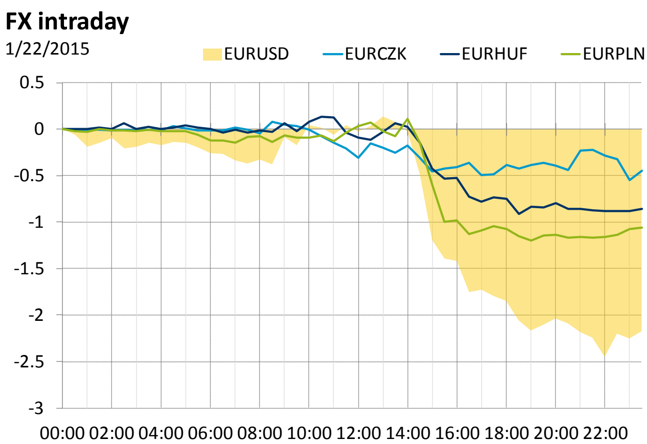
- Regional currencies and bonds benefit from the ECB aggressive easing. What about central banks?
- Hard Polish figures from industry as well as labour market were positive in December
- Will the NBH re-start its easing cycle? Not yet now

Chart of the Week



Central European currencies strengthened significantly after the ECB meeting last week...
(Source: Bloomberg, CSOB)

Lorem ipsum

Market's editorial

Regional markets benefit from ECB aressive easing

The ECB's decision to start buying large volumes of bonds has also had an impact on Central European markets, with regional currencies mostly appreciating against the euro. While the koruna strengthened only slightly, the appreciation of the zloty and the forint was more evident. Naturally, regional government bonds also fared well, with their yields falling dramatically, just like in the euro area.

The aftermath of the ECB's aggressive move may influence central banks in the region. This primarily applies to the National Bank of Poland and the National Bank of Hungary. The Hungarian and the Polish economies remain in deflation, and thus the ECB's surprisingly large expansive move may stand both the NBP and the NBH in good stead, as these central banks no longer need to be overly afraid that their own rate cuts would put the exchange rates of their respective local currencies at risk. Bear in mind that both the forint and, in particular, the zloty weakened significantly a week ago in reaction to the rapid appreciation of the Swiss franc, and this optically reduced the margin of discretion for further monetary easing. This has understandably changed now in the wake of the ECB move and we do not think that Left opposition party Syriza victory in the Greek elections would change this conclusion too much.

The NBH meetin as a first chance to respeond to ECB

Recall that our hypothesis would be already tested tomorrow when the NBH Monetary Council meets. Still, in our view is that the NBH would like to see the inflation figure for the January and how the ECB's decision influenced the Hungarian market. Thus, we think that a rate cut may rather come in February, if the market environment remains supportive. In that case the NBH may re-start an easing cycle with a 20bps rate (rather than just 10 bps).

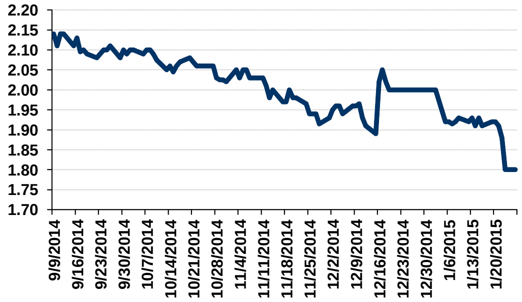
ECB's action implies less need to act for the CNB

The macroeconomic and market backroiund also changed for the Czech National Bank after Thursday's ECB meeting to the extent that the aggressive expansion in the euro area may be seen as a strong argument for demand eventually improving in the monetary union, and this, along with the weakened euro, will enable the Czech economy to import slightly more inflation. Thus the risk of further devaluation of the koruna as a result of the CNB's fight with deflation has decreased since the ECB's launch of quantitative easing.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*27.8*	*-0.76%*	↗	↗
EUR/HUF	*312*	*-2.38%*	↗	↗
EUR/PLN	*4.23*	*-2.24%*	→	→

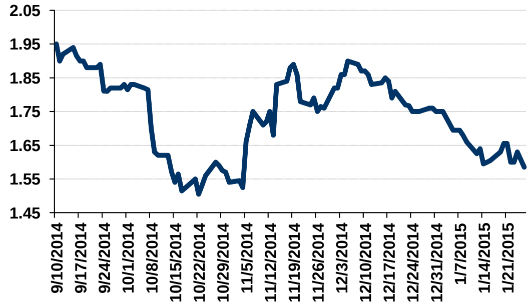
	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*0.72*	*1.42*	↘	↘
10Y HUF	*2.54*	*-7.97*	↘	↘
10Y PLN	*1.89*	*-7.50*	↘	↘

HUF FRA 3x6



HUF FRA 3x6, last 100 days. Source: Reuters

PLN FRA 3x6



PLN FRA 3x6, last 100 days. Source: Reuters

Review of Economic Figures

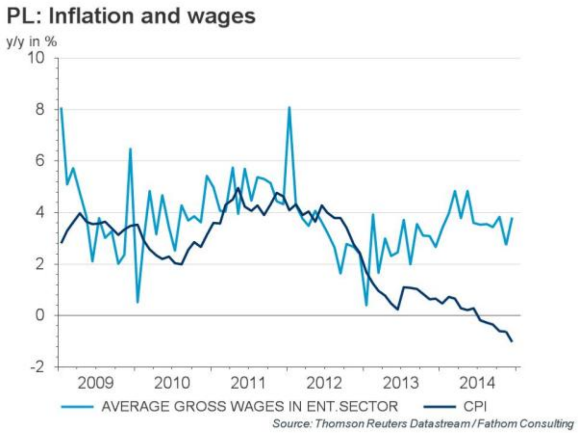
Hard Polish figures from industry as well as labour market were positive in December

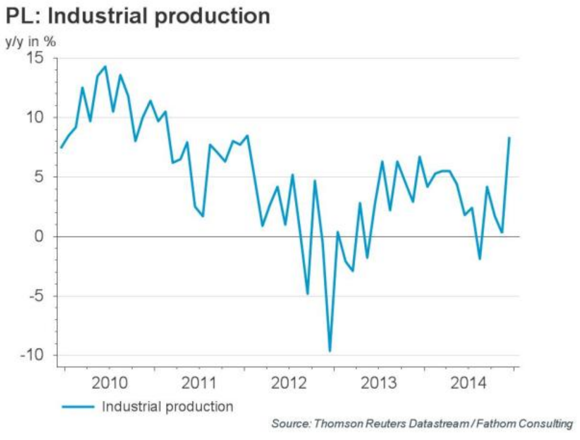
Poland's greatest economic surprise of recent days has probably been the rapid depreciation of the zloty against the Swiss franc, with this likely troubling numerous households given the persisting large volume of mortgages in this currency. Nevertheless, December's macroeconomic data, released last week, were not uninteresting either. Data from both the labour market and industry were good news from the perspective of the economy.

As concerns the former, the good news was primarily the persisting fast rate of wage growth. The rate was close to 4% in spite of last year's zero inflation. Bear in mind that economic growth was primarily driven by household consumption in the previous quarters of the year, and rapidly growing real household income will continue to support this trend in the future. The risk in this regard is the above-mentioned depreciation of the zloty against the Swiss franc.

After somewhat poorer figures for previous months, industry also performed well in December, with its output growing by 8.4% y/y. Compared to the previous year, the average growth rate accelerated to 3.3% in 2014 (from 2.2% in 2013). Perhaps the only negative factor from the central bank's perspective may come from the year-on-year decline in the producer price index of 2.5%.

Now the Polish central bankers are probably being kept busiest with the frequently mentioned depreciation of the zloty against the Swiss franc or Thursday's decision by their counterparts from the ECB, but December's data favour a decision to leave official rates unchanged at February's meeting. In addition, many of the bankers believe that the current nervousness on the markets also counteracts any rate change. Nevertheless, the deflationary period in Poland may even last longer than until the middle of 2015 (primarily depending on the development of commodity prices) and the risks to economic growth are also on the downside. Therefore we are betting on a total of two rate cuts in Poland this year, and the first one, by 25 bps, may take place as early as in March.





Weekly preview

TUE 14:00 NBH base rate

	This meeting	Last change
rate level (in %)	**2.10**	7/2014
change in bps	**0**	-20

HU: Re-start of a new easing cycle? Not yet now.

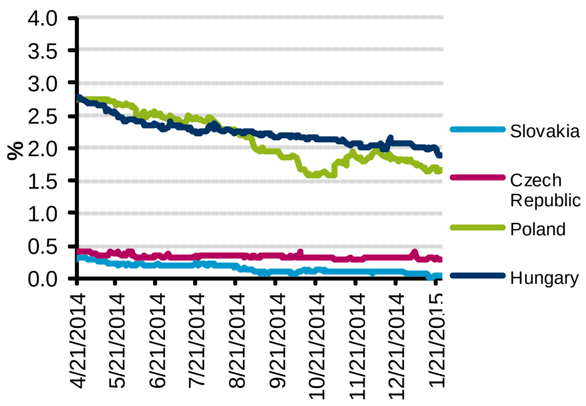
A chance of another rate cut has increased in Hungary, especially when the Council sees the massive HUF strengthening. Nevertheless, our view is that the NBH would like to see the inflation figure for the January and how the ECB's decision influenced the Hungarian market. Thus, we think that a rate cut may come rather in February, if the market environment remains supportive. In that case the NBH may re-start an easing cycle with a 20bps rate (rather than just 10 bps). Thus, the end of the re-started easing cycle might be around 1.6-1.7%.

Calendar

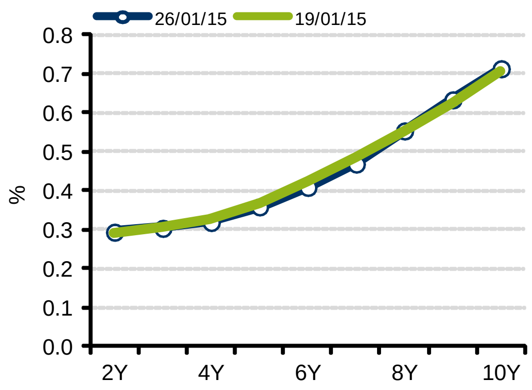
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	01/27/2015	10:00	Unemployment rate	%	12/2014			11.6		11.4	
PL	01/27/2015	10:00	Retail sales	%	12/2014			19.7	2.4	-8.1	-0.2
PL	01/27/2015	10:00	GDP	%	12/2014 *A				3.3		1.6
HU	01/28/2015	9:00	Unemployment rate	%	12/2014			7.3		7.2	
HU	01/30/2015	9:00	PPI	%	12/2014					-0.4	0.6
CZ	01/30/2015	10:00	Money supply M2	%	12/2014						3.9

Fixed-income in Charts

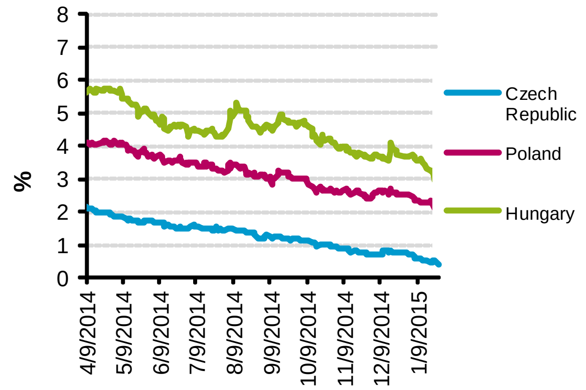
FRA 3x6



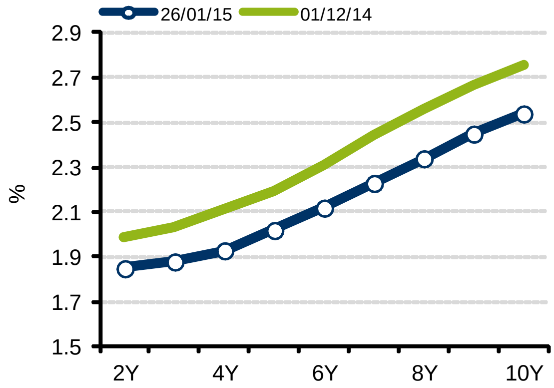
CZ IRS



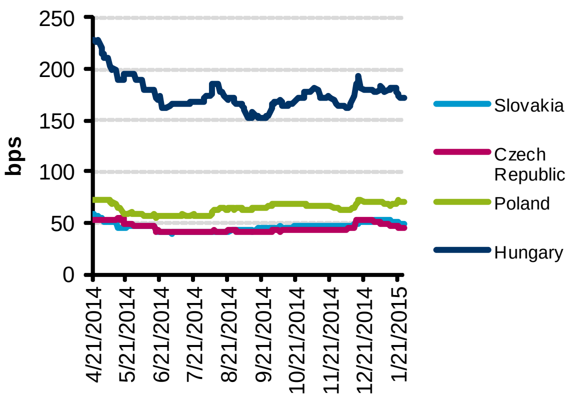
10Y GB Yields



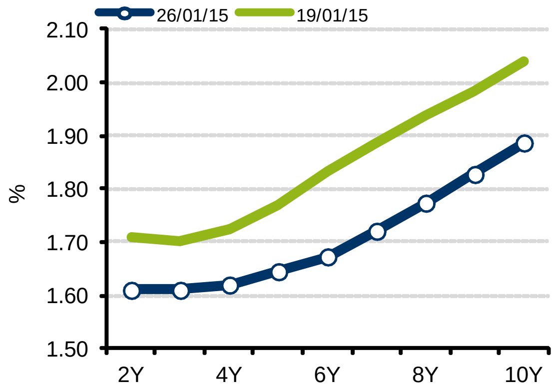
HU IRS



CDS 5Y



PL IRS



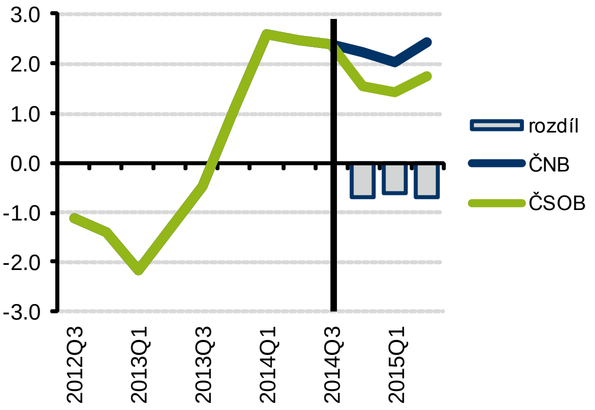
Source: Reuters

Medium-term Views & Issues

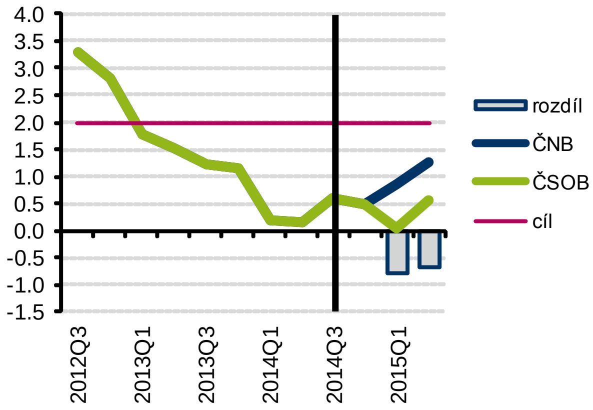
	The Czech Republic	Hungary	Poland
Growth & key issues	The current economic recovery is primarily based on the outstanding performance of the automotive industry on the one hand and restored investment and consumption growth on the other. Economic growth has also been encouraged by the deficit financing of the public sector, which is, however, generating no pressures on the capital market thanks to fairly low debt and reserves. The government policy has not delivered any fundamental economic changes so far, perhaps except for the planned abolition of the pension reform and partial modifications of certain taxes and social security benefits. The issue of euro adoption is still on ice in the CR.	We expect that the economy may slow further in 4Q14 in the range of 2% Y/Y and 2.5% Y/Y, because the new orders in the construction sector is falling, there external demand is deteriorating, so the net external component of the growth is getting smaller. The average GDP growth may be at 3.3% Y/Y in 2014, while it may slow to around 2.2% Y/Y in 2015. In light of the 2014 final data and the sharply falling oil prices, the new outlook is around 0.2% for average CPI in 2015. This means that CPI may remain in the negative territory for the following months and a figure above 1% is expected only around by the end of the year.	According to the GUS estimates, the Polish economy grew by 3.3% in 2014Q3. Moreover, the structure of growth was robust – it was driven by strong households' consumption and investment. Expectations of a slowdown of growth rates in the second half of the year may therefore not materialize. The recent figures suggest this year's economic growth will therefore almost certainly remain well above 3%.
Outlook for official & market rates	Interest rates remain at all-time lows and, given the positive inflation outlook, the CNB is unlikely to raise its base rate before late 2016. In addition, the central bank will not proceed to such a move before it abandons its current exchange rate policy, which is based on maintaining the exchange rate above the EUR/CZK floor. Moreover, the decreasing inflationary expectations may even delay these two steps. This possibility is reflected by money market rates and, in particular, by IRS and government bond yields. Our outlook for inflation as well as short-term interest rates is still below the central bank's official forecasts.	Following ECB's 'bazuka' our view fresh view on Hungary's monetary policy is that the NBH would like to see the inflation figure for the January and how the ECB's decision influenced Hungarian markets. Thus, we think that a fresh rate cut may come in February, if the market environment remains supportive. In that case the NBH may re-start an easing cycle with a 20bps rate (rather than just 10 bps). So, the end of the re-started easing cycle might be around 1.6-1.7%.	Inflation pressures in Poland remain subdued and year-on-year prices growth is seen well below the lower tolerance band of the inflation target. After surprising markets by cutting interest rates by 50 basis points in October, the NBP surprised in November as well, this time by leaving rates unchanged. The overall tone of the meeting was, however, dovish and we therefore not exclude additional rate cut during 2015.
Forex Outlook	We expect that the Czech central bank will not come up with any revolutionary changes at its eagerly expected February meeting. Nonetheless, the koruna will likely be weakening before the meeting. How far can the pair EUR/CZK weaken in the upcoming weeks? Markets remember that the November 2013 intervention pushed the EUR/CZK pair higher by about 5-6 %. It would not be surprising then, if we see the short-term peak in the EUR/CZK 28.7-29 territory (i.e. a roughly 5% devaluation against the 2014 average). After the February (5th) meeting, the crown should start trimming the loss.	In a longer term perspective, HUF is still in a weakening channel implying a 2-3% depreciation of the currency against EUR on a yearly basis. Taking into account the government's and NBH's statements, such a gradual depreciation of the currency is welcomed as it definitely not endangers the stability of the country. Additionally the government still wants to solve the problems of the foreign currency denominated loans in the households sector in autumn, which may give the National Bank of Hungary an even bigger room of maneuvering room.	The Polish zloty came under pressure at the end of the year in the low liquid trading. Although some of the losses were trimmed recently, the zloty continues to trade on the defensive side Market players seem to realize that inflation is to stay extremely low for considerable time and that NBP board can withsand weaker currency. The pair can sty around 4.25 EUR/PLN in both 3-month and 6-month horizon.

CBs' Projections vs. Our Forecasts

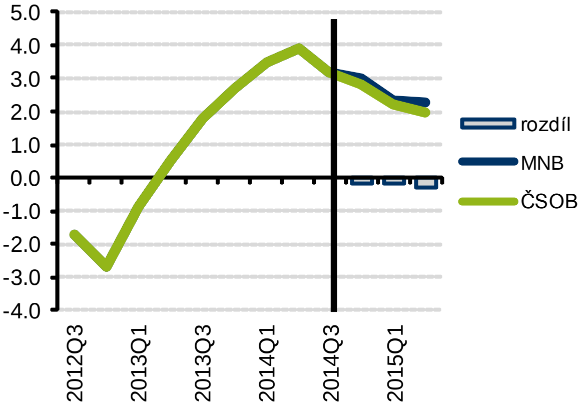
CZ: GDP outlook (Y/Y, %)



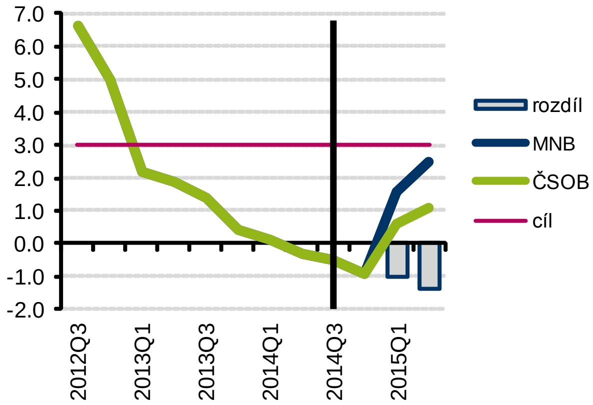
CZ: Inflation outlook (Y/Y, %)



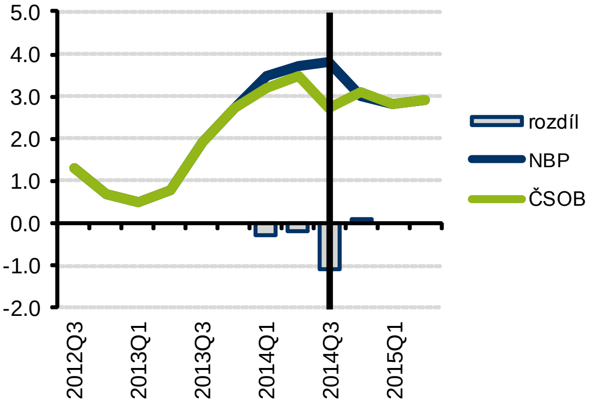
HU: GDP outlook (Y/Y, %)



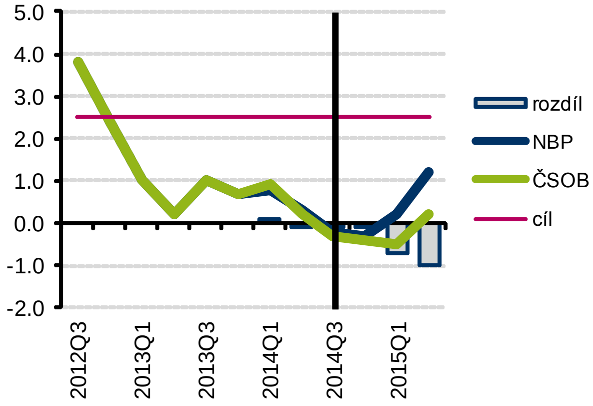
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outllok (Y/Y, %)



Source: CNB, NBP, MNB, CSOB

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	Last change	
Czech Rep.	2W repo rate	*0.05*	0.05	0.05	0.05	0.05	0.05	-20 bps	9/27/2012
Hungary	2W deposit r.	*2.10*	2.10	2.10	2.10	2.10	2.10	-10 bps	7/22/2014
Poland	2W inter. rate	*2.00*	2.50	2.00	2.00	2.00	2.00	-50 bps	10/8/2014

*Short-term interest rates 3M *IBOR (end of the period)*

		Current	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3
Czech Rep.	PRIBOR	*0.33*	0.34	0.33	0.33	0.32	0.33
Hungary	BUBOR	*2.10*	2.09	2.10	2.10	2.10	2.10
Poland	WIBOR	*2.02*	2.28	2.06	2.00	2.00	2.00

Long-term interest rates 10Y IRS (end of the period)

		Current	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3
Czech Rep.	CZ10Y	*0.715*	1.22	0.88	0.74	0.78	0.93
Hungary	HU10Y	*2.54*	3.92	3.25	3.50	3.50	3.65
Poland	PL10Y	*1.89*	2.87	2.23	2.20	2.10	2.20

Exchange rates (end of the period)

		Current	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3
Czech Rep.	EUR/CZK	*27.8*	27.5	27.7	28.0	27.7	28.1
Hungary	EUR/HUF	*312*	311	316	315	315	318
Poland	EUR/PLN	*4.23*	4.18	4.28	4.25	4.22	4.20

GDP (y/y)

	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3
Czech Rep.	2.6	2.5	2.4	1.6	1.4	1.7	2.0
Hungary	3.5	3.9	3.2	2.8	2.2	2.0	2.3
Poland	3.2	3.5	2.7	3.1	2.8	2.9	3.1

Inflation (CPI y/y, end of the period)

	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3
Czech Rep.	0.2	0.0	0.7	0.1	0.2	0.7	0.6
Hungary	0.1	-0.3	-0.5	-0.9	0.6	1.1	1.5
Poland	0.9	0.2	-0.3	-0.4	-0.5	0.2	0.5

Current Account

	2014	2015
Czech Rep.	0.0	1.8
Hungary	2.2	2.5
Poland	-2.5	-2.5

Public finance balance as % of GDP

	2014	2015
Czech Rep.	-2.0	-2.4
Hungary	-3.0	-3.0
Poland	-3.5	-3.0

Source: CSOB, Bloomberg

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