Central European Weekly

Monday, 31 August 2015

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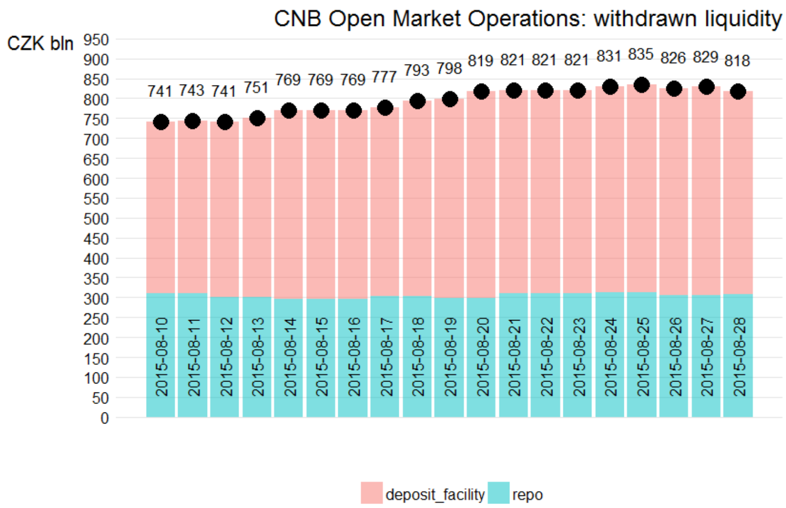
- NBP to leave rates unchanged

Chart of the Week



Rising volume of free liquidity pushed Czech government bond yield (3Y) below zero for the first time ever during the auction last week... (Source: CNB, CSOB)

Market's editorial

The first Czech auction with a negative yield

The turbulence in China has also affected Central Europe. Early last week the greatest losses were sustained by the Polish zloty, which hit PLN 4.26 per EUR at one moment (a loss of around 1.5%). As usual, the Czech koruna, which itself is already trading at undervalued levels because of interventions, was the least affected currency. Yet we saw moderate depreciation pressures early last week. These were probably related to the closing of long koruna positions by foreign players in reaction to the growing risk aversion on global markets. Nevertheless, the koruna only stayed at CZK 27.10 per EUR for a very short period.

Thus the Czech National Bank could have taken at least temporary respite from having to defend the intervention threshold of CZK 27.00 per EUR. Although we do not yet know the amount by which the central bank would have to intervene, one thing is certain: the liquidity in the Czech banking sector has increased significantly over the last month as a result of interventions and conversions of euros from the EU. This is also probably why a Czech government bond (due in 2018) was sold with a negative yield for the first time ever.

	Last	Change 1W
EUR/CZK	27.0	-0.06%
EUR/HUF	314	-0.03%
EUR/PLN	4.22	-0.87%

	Last	Change 1W
10Y CZK	1.15	10.05
10Y HUF	3.15	0.32
10Y PLN	2.64	2.93

Review of Economic Figures

Growing consumption and investment drive the Czech economy up.

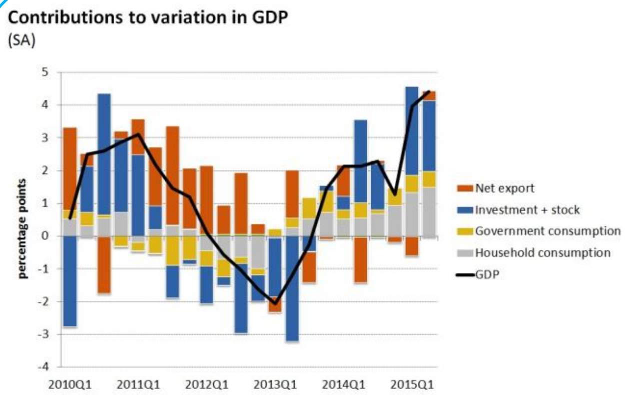
As suggested by a preliminary GDP forecast, the Czech economy surprisingly grew at a very strong rate in the second quarter of the year. The latest data released by the Statistical Office actually confirm this first forecast. Czech economic growth was 1% q/q and 4.4% y/y, thus achieving its best performance since 2007. The good news is not limited only to growth, which is probably the highest in Europe, but includes its sound foundations. On the demand side the economy is being driven by household consumption, encouraged by the improving financial position of consumers and their positive mood, as well as by investment. The year-on-year investment increase of 6% is primarily attributable to the construction of infrastructure and commercial real estate, followed by purchases of means of transport, machinery and equipment, which however lag significantly behind. It is evident that, thanks to the improved prospects for demand on the foreign as well as domestic market, businesses are now more willing to invest in their existing as well as new projects. Their record-breaking profitability and strong liquidity are facilitating these efforts. Housing investment also contributed positively to growth; in the last two years such investment has enjoyed a wave of demand, encouraged by low interest rates, affordable mortgages, and the increased willingness of households to tackle their housing situations.

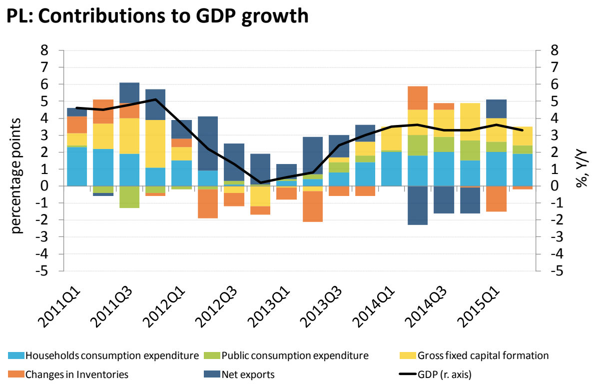
Industry still maintains its role of driver of the economy

On the supply side the contributors to growth included all sectors, as was the case earlier this year. The dominant position is still held by manufacturing industry, followed by trade, transport and accommodation, which however lag significantly behind. Construction, which has already recovered from its previous multi-year recession, has also maintained a very solid rate. The Czech GDP figure for the first half of the year, along with good prospects for the second half, indicate that the full-year growth rate of the Czech economy will certainly begin with the digit ‘four’. Next year the Czech economy is likely to decelerate to less than 3%, but even this outlook can be seen as very favourable.

While Polish growth has slightly decelerated, its rate still remains very solid

The Polish Statistical Office kept its flash GDP forecasts for the second quarter of the year unchanged – this means growth of 3.3% y/y and 0.9% q/q. Thus the data for the second quarter fell short of expectations, but only slightly. Perhaps only the deceleration of the rate of investment may pose some issues; nevertheless, we are not overestimating this at the moment either. The overall positive economic developments in Europe and the long-term eased monetary policy should translate into growth of the Polish economy within the range of 3.5-4% this year as well as the next.





Weekly preview

WED 14:00 NBP rate (in %)

	This	Last change
rate level	**1.50**	3/2015
change in bps	**0**	-50

PL: NBP to leave rates unchanged

The National Bank of Poland is likely to leave interest rates unchanged. The minutes of its last meeting indicate that opinions within the Monetary Policy Council are not clear. Certain members are suggesting that the MPC may need to start considering a rate hike. However, given the significantly increased uncertainty in recent weeks and slightly worse figures from the Polish economy, we expect that such considerations will become secondary again. Rates are very likely to remain stable for the rest of this year. We believe that more serious rate hike discussions may occur in about twelve months' time. Nevertheless, the composition of the NBP will change significantly before then.

THU 9:00 CZ Retail Sales (change in %)

	Jul-15	Jun-15	Jul-14
Sales	**6.0**	11.1	6.5
cummulative (YTD)	**7.9**	8.2	5.9
Sales (cars excl.)	**5.5**	7.1	2.5
cummulative (YTD)	**5.8**	5.9	2.9

CZ: Another strong rise in retail sales

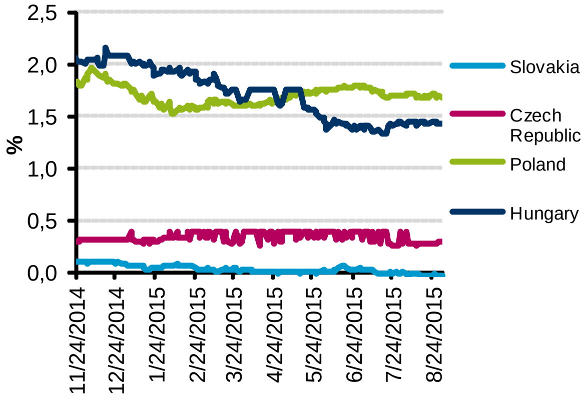
We believe that retail sales maintained their existing high rate in July. While the overall figure was slightly affected by a lower number of business days in the month, nothing has changed regarding the trend of improving consumer demand. Stores offering electronics and household equipment probably grew significantly, as did e-commerce as such, of course, which is still booming. We also expect strong sales growth in cars and fuels.

Calendar

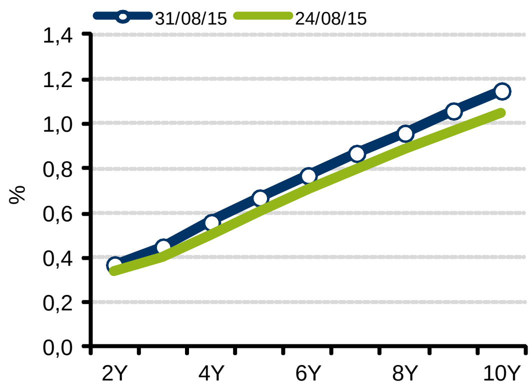
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	08/31/2015	9:00	PPI	%	07/2015					1.3	1.5
CZ	08/31/2015	10:00	Money supply M2	%	07/2015						5.8
PL	09/01/2015	9:00	PMI manufacturing		08/2015			54.1		54.5	
HU	09/01/2015	9:00	PMI manufacturing		08/2015					50	
CZ	09/01/2015	9:30	PMI manufacturing		08/2015			56.8		57.5	
CZ	09/01/2015	14:00	Budget balance	CZK B	08/2015					25.7	
HU	09/02/2015	9:00	Trade balance	EUR M	06/2015 *F					820	
PL	09/02/2015	14:00	NBP meeting	%	09/2015			1.5		1.5	
CZ	09/03/2015	9:00	Retail sales	%	07/2015		6		7.1		11.1
HU	09/03/2015	9:00	Retail sales	%	07/2015						6.2
CZ	09/04/2015	9:00	Real wages	%	2Q/2015				2		2.1
HU	09/04/2015	9:00	GDP	%	2Q/2015 *F					0.5	2.7

Fixed-income in Charts

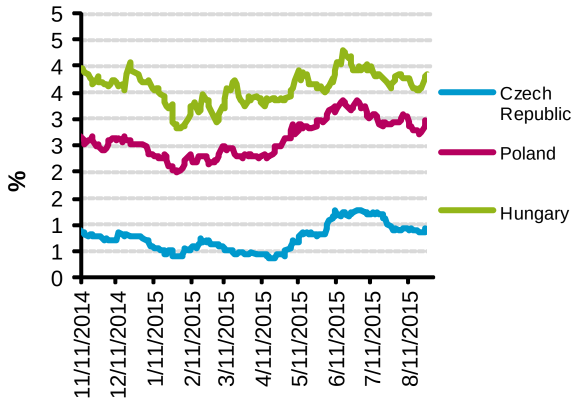
FRA 3x6



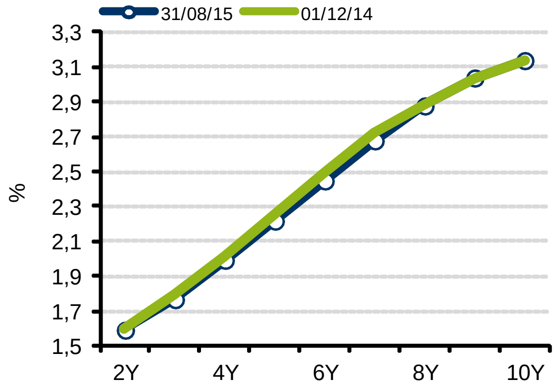
CZ IRS



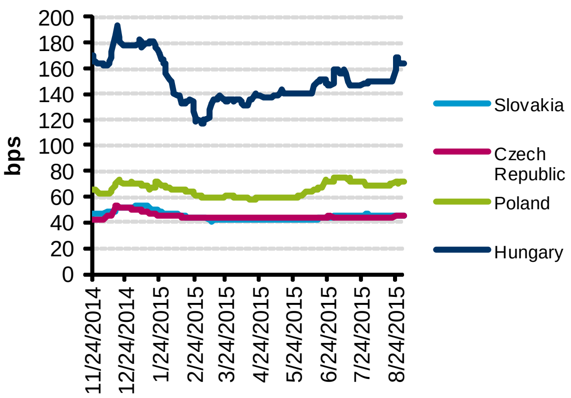
10Y GB Yields



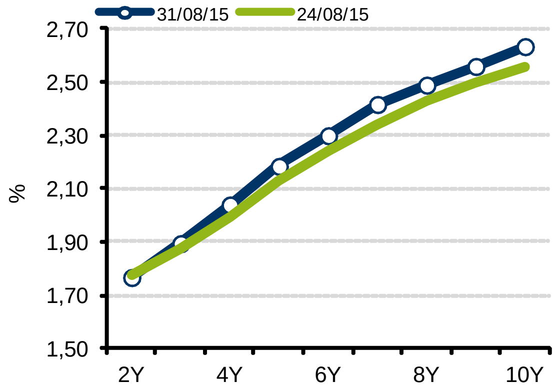
HU IRS



CDS 5Y



PL IRS



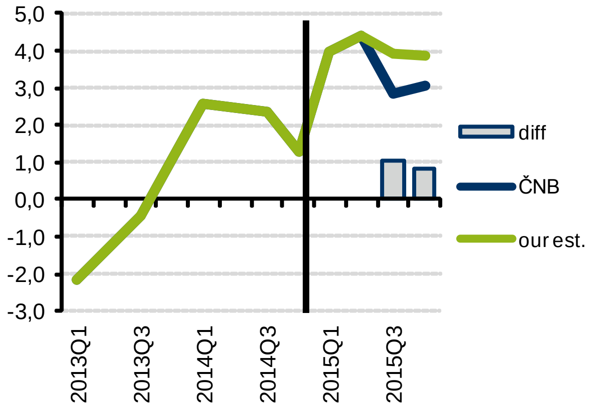
Source: Reuters

Medium-term Views & Issues

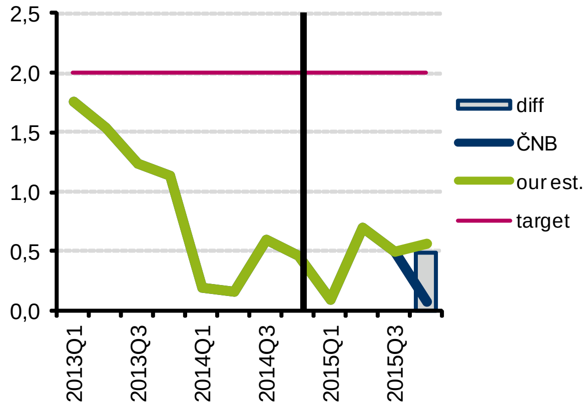
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – encouraged by growing real wages and employment – becoming a strong stimulus. At the moment, we cannot expect any fundamental economic changes or reforms, except for the abolition of the pension reform and the introduction of the electronic registration of sales. Progress in the country's preparations for joining the euro area is not expected in this electoral term either.	The Hungarian economy has continued to record solid growth this year as the working day adjusted GDP grew by 3.4% Y/Y in the first quarter. Looking ahead the GDP growth might slow down slightly in the coming quarters, but the favourable European conjuncture and the increasing net real wage and employment increase might provide a stable base for the growth so we expect that Hungarian economy may grow by about 3% Y/Y in 2015.	The Polish Statistical Office kept its flash GDP forecasts for the second quarter of the year unchanged – this means growth of 3.3% y/y and 0.9% q/q. Thus the data for the second quarter fell short of expectations, but only slightly. Perhaps only the deceleration of the rate of investment may pose some issues; nevertheless, we are not overestimating this at the moment either. The overall positive economic developments in Europe and the long-term eased monetary policy should translate into growth of the Polish economy within the range of 3.5-4% this year as well as the next.
Outlook for official & market rates	The CNB's monetary policy continues to be based on record-low interest rates and the weak koruna. The exchange rate policy, not allowing the koruna to strengthen beyond (below) EUR/CZK 27.0, is most likely to remain in place at least until the second half of 2016, and low interest rates probably even longer. The reason is that inflation remains below the 2% target and will most likely remain there next year, and will only slowly approach the target.	The MNB said in July it concluded its rate cut cycle. It is also clear that the NBH has no problem with the HUF weakening, so rate hike driven by a temporary HUF devaluation is out of picture, so the start of the rate hike cycle is depending on FED's and ECB's policy. Based on the current expectation we think that NBH may hike key rate in 2Q16 the earliest.	We expect the NBP to keep rates at new lows (1.50%) this year, but we cannot completely rule out the likelihood of further rate cuts. The main reason is the combination of the "inflow of cheap euros from the ECB" to markets and the unusually open commitment by the NBP not to continue to cut rates. In addition, if we take account of this year's inflation rate, which is likely to be negative for the year as a whole, such a climate will probably attract investments in Polish assets. In that event, additional pressure for the appreciation of the zloty and consequently for an inflation fall can be expected.
Forex Outlook	Relatively strong economic growth, current and capital account surpluses and ongoing QE in the euro zone have been the key factors behind the recent strength of the koruna. We believe the Czech National Bank will meet its "pledge" and won't terminate its intervention regime before the second half of 2016. The above mentioned factors should however keep the koruna close to EURCZK 27.0 in the months ahead. Possible start of tightening of US monetary policy poses negative risks for the koruna. We however think the fallout should only be limited.	We think that the first strengthening reaction of the HUF is rather temporary and the NBH's commitment to the long time low interest rate (just like the gradual push out of foreign holding from Hungarian government bonds) may lead to a HUF weakening in the coming weeks. It is also clear that the NBH has no problem with the HUF weakening, so rate hike driven by a temporary HUF devaluation is out of picture.	We expect the zloty to gain on growing capital inflows exploiting the positive interest rate differential at the time short term yields are mostly negative in the eurozone. Given the NBP pledge to end the rate cutting cycle, the market may feel temptation to test the willingness of the central bankers to tolerate further gains of the Polish currency. Polish general elections in autumn however pose a negative risk for the zloty.

CBs' Projections vs. Our Forecasts

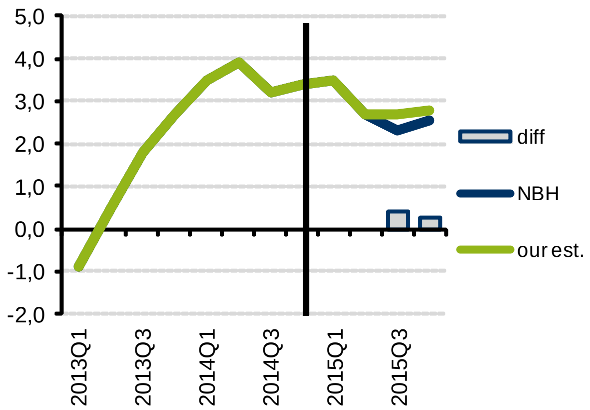
CZ: GDP outlook (Y/Y, %)



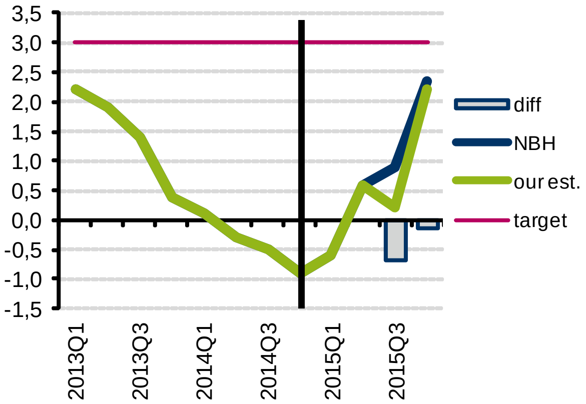
CZ: Inflation outlook (Y/Y, %)



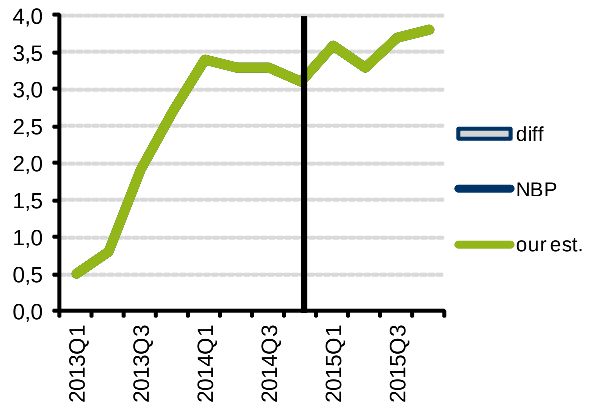
HU: GDP outlook (Y/Y, %)



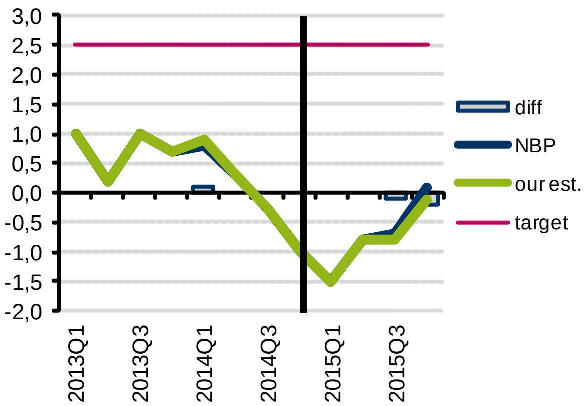
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outllok (Y/Y, %)



Source: CNB, NBP, MNB, KBC

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	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.	*1.35*	1.95	1.50	1.70	2.00	2.25	-10 bps	7/21/2015
Poland	2W inter. rate	*1.50*	1.50	1.50	1.50	1.50	1.50	-50 bps	3/4/2015

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	PRIBOR	*0.00*	0.30	0.29	0.30	0.30	0.30
Hungary	BUBOR	*1.36*	1.89	1.41	1.70	2.10	2.40
Poland	WIBOR	*1.72*	1.65	1.72	1.60	1.65	1.67

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	CZ10Y	*1.15*	0.64	1.30	1.25	1.40	1.65
Hungary	HU10Y	*3.15*	2.71	3.45	3.40	3.60	3.80
Poland	PL10Y	*2.64*	2.12	3.01	2.45	2.40	2.80

Exchange rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	EUR/CZK	*27.06*	27.57	27.35	27.10	27.05	27.00
Hungary	EUR/HUF	*314*	300	315	317	315	310
Poland	EUR/PLN	*4.22*	4.07	4.19	4.20	4.15	4.10

GDP (y/y)

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	2.4	1.3	4.0	4.4	3.9	3.9	2.1
Hungary	3.2	3.4	3.5	2.7	2.7	2.8	2.2
Poland	3.3	3.1	3.6	3.3	3.7	3.8	3.8

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

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	0.7	0.1	0.2	0.8	0.3	0.9	1.6
Hungary	-0.5	-0.9	-0.6	0.6	0.2	2.2	2.7
Poland	-0.3	-1.0	-1.5	-0.8	-0.8	-0.1	0.4

Current Account

	2015	2016
Czech Rep.	1.7	1.7
Hungary	4.0	3.8
Poland	-1.2	-2.0

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-1.6	-1.3
Hungary	-2.2	-2.0
Poland	-3.0	-2.5

Source: KBC, Bloomberg

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