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Central European Weekly

Monday, 21 March 2016

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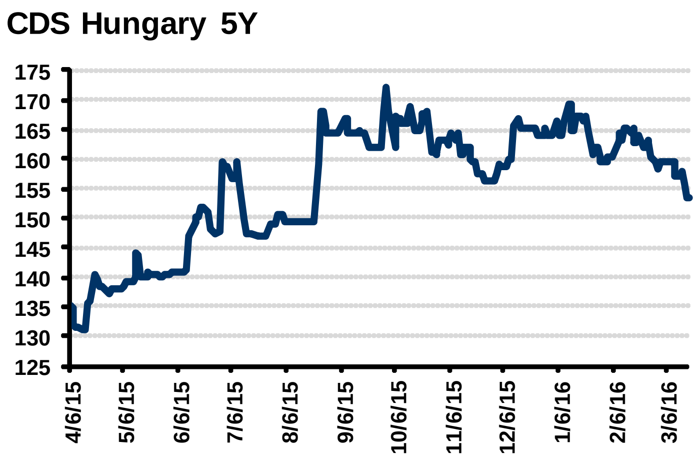
Chart of the Week



CDS Hungary 5Y, last 250 days. Source: Reuters

Although Hungary's sovereign ratings remain stable, country's credit risk has been falling some time.

Market's editorial

S&P leaves Hungary's rating unchanged

Hungarian markets waited for Standard&Poor's action on Fridays as the agency should re-asses country's sovereign rating. However, the S&P did not change the credit rating of Hungary (BB+) neither its outlook (stable) citing the maintained high level of the government debt and economic policy's uncertainty. As a result of that the country still remained in speculative (rating) grade. Hence, EUR/HUF's movements remained limited, the pair still wobbled around the level of 310. Movement of the course may be altered by tomorrow's session of the NBH where a potential monetary easing can bring more HUF volatility.

CHF mortgages could be expensive for Polish banks

The Polish regulator KNF commented on president-proposed CHF mortgage bill. In the base–case scenario (assuming FX & interest rates fixed at end-Dec 2015 level) KNF sees PLN 66.9bn hit to banks in 2016, while in the adverse scenario (FX & interest rates 25% above end-Dec 2015 level) banks could take PLN 74.2 to PLN 107.2bn hit in 2016. Hence, the assumed conversion costs are far above expectations, currently set at some PLN 30-50bn (even in case of base-case scenario). Hence, it supports our negative view on the whole Polish banking sector, however the presidential bill is likely to be soften at least a bit at the end and the banks shouldn't have been hurt too much in our view.

	Last	Change 1W
EUR/CZK	*27.0*	*-0.04%*
EUR/HUF	*311*	*0.08%*
EUR/PLN	*4.27*	*-0.34%*

	Last	Change 1W
10Y CZK	*0.63*	*-3.82*
10Y HUF	*2.09*	*-3.91*
10Y PLN	*2.24*	*-0.80*

Review of Economic Figures

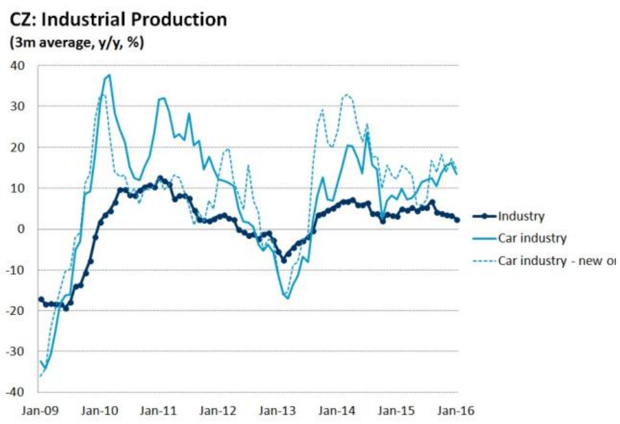
A good start for the Czech industry in 2016

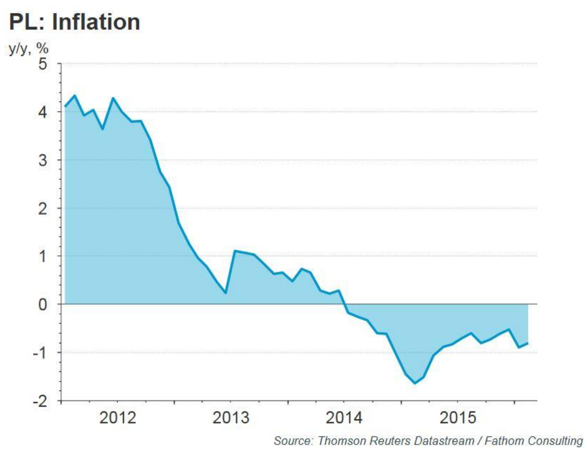
The Czech inndustry continued to perform surprisingly well early this year. In January, industrial output grew by 1% and even 3.5% with the lower number of business days in the month taken into account. Thus industry still maintains its privileged position among all sectors of the Czech economy and, without doubt, it will continue to be the main driver of GDP growth, exports, as well as employment this year. The main contributor in January was again the record-breaking passenger car production, which grew by almost 11%, followed by the production of metal products and plastics. As is becoming usual, the mining industry and the energy sector performed poorly, with the latter still affected by the problem of an extended temporary shutdown at a nuclear power plant.

The prospects for industry also look promising for the months to come. Not only what is known as the soft indicators of confidence or mood at industrial firms but also new orders indicate the continuation of the growth trend. While the year-on-year rate of orders decelerated slightly (+2.2%), demand in key industries is still improving at double-digit rates, providing firms with work for approximately the next six months. With strong demand, i.e., orders, industrial businesses are creating more and more new jobs, thus contributing to a long-term unemployment fall in the Czech Republic. Remarkably, despite the complaints of a relative shortage of skilled employees, wage growth is not accelerating significantly because wages grew by less than 2% in January.

The Polish economy still remains in deflation territory

The Polish markets noticed that consumer prices fell to -0.8% Y/Y in February. As expected, fuel prices were again the key driver behind very low inflation figures. In this respect it is worth noting that the Polish Statistical Office will release another set of related data today – wages and core inflation, but we do not expect any reaction this time. All Central European markets should focus on the FOMC meeting. We expect the Fed to lower 2016 rate hike projections from 4 to 3 in the dot plot while reinserting the “balanced risks” phrase in the statement. That opens the way to a June rate hike.





Weekly preview

TUE 14:00	NBH base rate	
	This meeting	Last change
rate level (in %)	**1.35**	7/2015
change in bps	**0**	-15

HU: A stable forint should keep the NBH on hold

The ECB's massive monetary easing and the FED's slower than expected rate hike cycle also provides more room for NBH to ease the monetary policy in Hungary. The only question is that the MPC uses the non-conventional tools – as it was highlighted several times in the last months – or starts to cut the base rate. As it is quite clear that the NBH doesn't want to see the EUR/HUF exchange rate around 305, we still think that one of the main driving factors of its decision is the exchange rate (although the council will never declare it clearly). EURHUF around 310 is still acceptable for NBH, so we rather think that the council may wait for another month, before it starts the rate cut cycle, but the chance of moderating the base rate to around 1% in 2Q16 increased substantially.

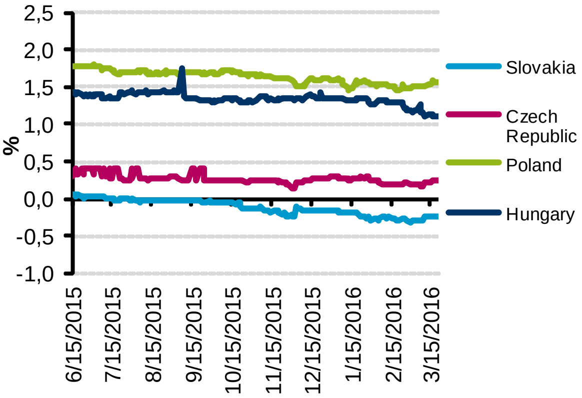
The new quarterly inflationary report will be published also. It may include a substantial lower CPI outlook for this year, because of the sharp drop of oil price since beginning of December. The NBH forecasted 1.7% YoY average inflation for 2016 and 2.6% YoY for 2017, but the former may be moderated to around 0.5% YoY. Nevertheless the inflation report definitely gives NBH a good opportunity for the MPC to restart the rate cut cycle.

Calendar

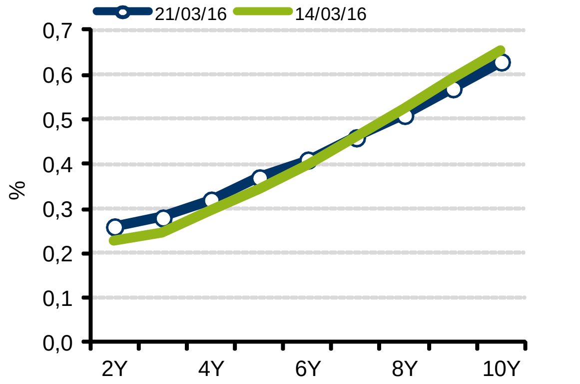
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	03/22/2016	14:00	NBH meeting	%	03/2016	1.35		1.35		1.35	
PL	03/23/2016	10:00	Unemployment rate	%	02/2016			10.3		10.3	
HU	03/24/2016	8:30	Current account	HUF B	4Q/2015			1075		1725	

Fixed-income in Charts

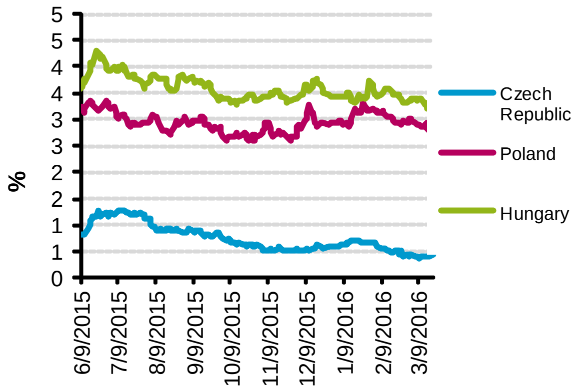
FRA 3x6



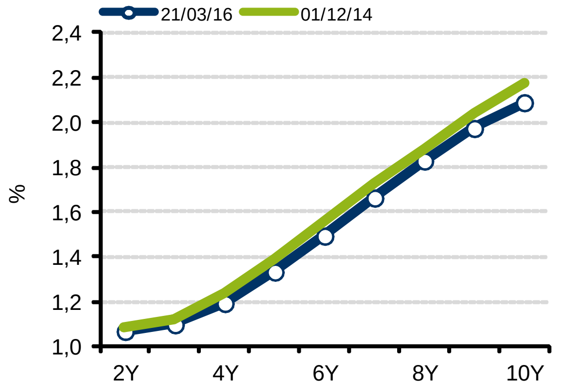
CZ IRS



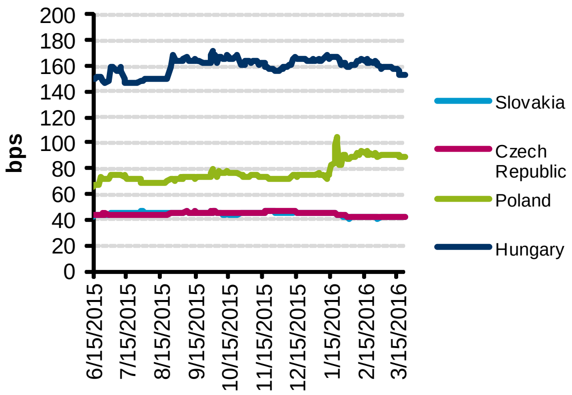
10Y GB Yields



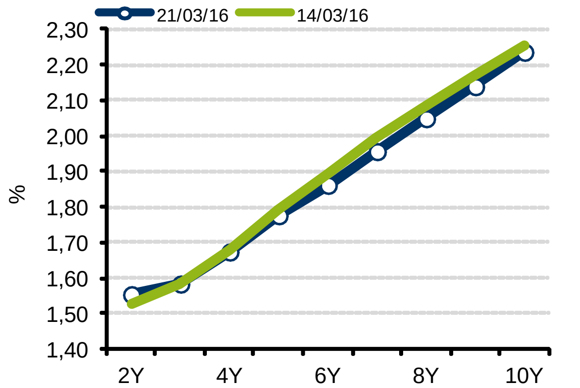
HU IRS



CDS 5Y



PL IRS



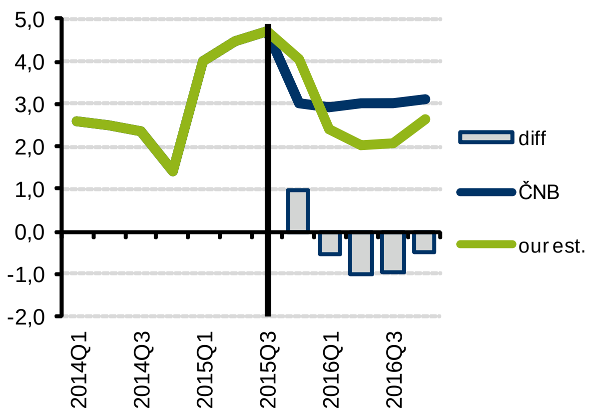
Source: Reuters

Medium-term Views & Issues

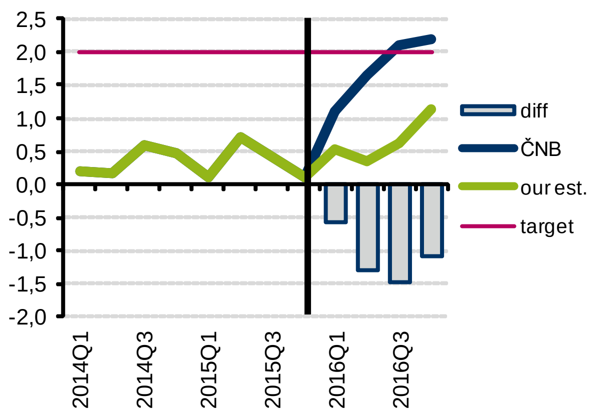
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – 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 4Q15 GDP growth might bounce back closer to 3% Y/Y, as EU funds money use was accelerated, the government increased the spending and the industrial production and domestic consumption might be stronger, so the growth might be around 2.7% Y/Y in 2015. The outlook is less favorable. The investments started to fall, the EU funds money use may substantially lower in this year due to the new budgetary period. The government tries to boost the construction via new government program, which targets new homes for households. The domestic consumption may remain strong thanks to the increasing wage mass. In case there is no substantial slowdown of international growth and the agriculture provides an average harvest, the economic growth might be around 2.3% Y/Y in 2016.	Prospects of the Polish economy remain good in our view. For the whole year 2016 we expect GDP growth may reach 3.5 - 4.0 percent. Apart from low interest rates (further cuts cannot be excluded) and a relatively weak zloty, we expect the economy to draw additional support from policy measures of the new government (stimuli for private consumption). The risks thus stem mainly from a possible deterioration in the external environment, most notably in China.
Outlook for official & market rates	The latest forecast does not envisage the return of inflation to the target before early 2017, with inflation not significantly diverging from it afterwards either. The CNB has extended its exchange rate commitment until the first half of 2017. The possibility of introducing negative interest rates has been increasing, in light of the widening of the interest rate differential vis-à-vis the euro area and developments in domestic financial markets. But we still don't expect negative CNB's rates. There are two main preconditions for negative official rates: 1) significant ECB's rate cut, 2) continuing large monthly fx interventions of the CNB.	The last NBH statement and Mr. Nagy's words full fit into our expectation. The NBH may cut the overnight deposit rate to zero or to -0.1% in March from the current level of 0.1%. The NBH also tries to push down the Bubor rates (the loans are priced with the Bubor), because they said the real rates on the secondary market are below the official Bubor levels. As concerns the base rate – a rate cut is unlikely in Mach or April. Our view that NBH may cut the key rate after Hungary is over of the heavy refinancing need of government debt in the first 5 months this year, and in case Hungary is upgrade in May or June and additionally the EUR/HUF is traded around or below 305.	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. This promise will probably be hold, while we should wait how the MPC will be changed in 2016 as new President and Sejm will appoint almost all Board members.
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. With regard to the inflation outlook and ECB's policy, we anticipate an exit from the fx regime in the first quarter of 2017. The above mentioned factors should however keep the koruna close to EURCZK 27.0 in the months ahead. Current turmoil on the Chinese market poses negative risks for the Central Europe. We however think the impact on the koruna should only be limited.	We think that the NBH's commitment to the long time low interest rate may lead to short-term HUF weakening. Although compared to other emerging markets HUF looks like quite stable, the fears of Chinese hard lending scenario pushed EURHUF trading range between 313 and 318. Although the huge trade and current account balance supports HUF in medium term, the ongoing foreign sell-off of HUF denominated gov. bonds and the uncertain sentiment keeps weakening pressure on HUF, so we see bigger risk on the weak side on short term, which means that EURHUF may be pushed towards 325.	Although the new government may eventually turn out to be more market-friendly than had been expected, we think that pressures on zloty´s depreciation may intensify again at the beginning of 2016 when most members of the Monetary Policy Council (MPC) will be replaced and probability of further monetary easing will rises. Although Fed hikes and weaker zloty could prevent the altered MPC from cutting rates again we target the EUR/PLN peak at 4.40.

CBs' Projections vs. Our Forecasts

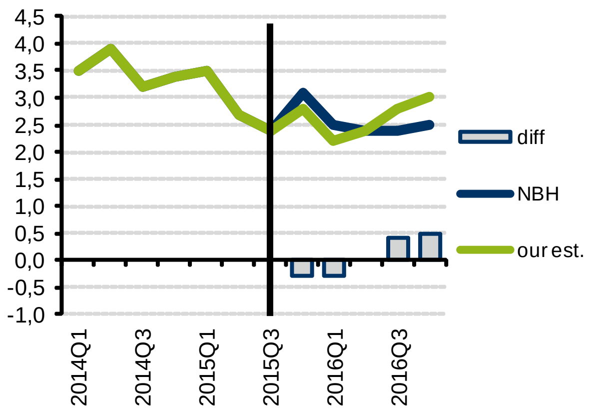
CZ: GDP outlook (Y/Y, %)



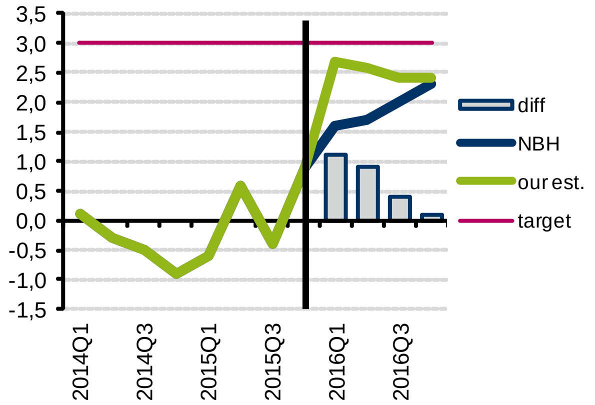
CZ: Inflation outlook (Y/Y, %)



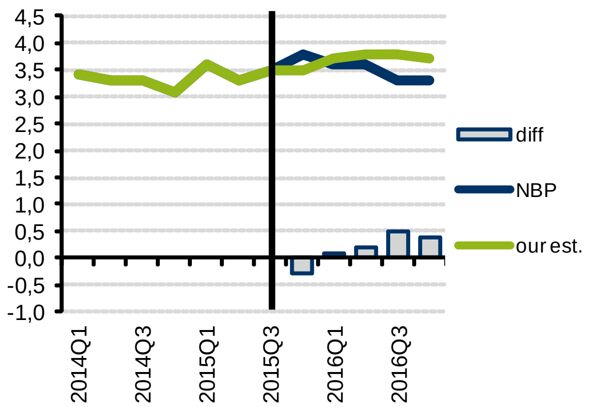
HU: GDP outlook (Y/Y, %)



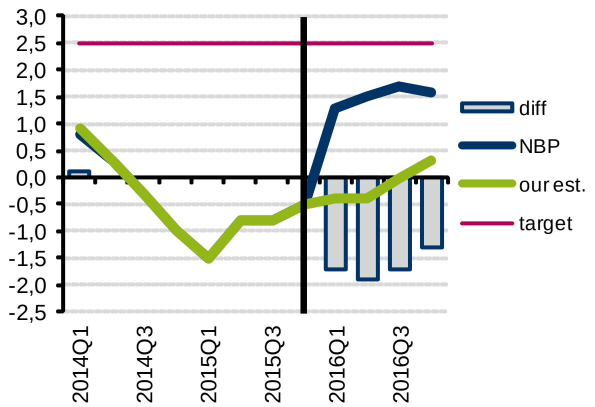
HU: Inflation outlook (Y/Y, %)



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	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4	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*	1.35	2.25	2.50	2.75	3.00	-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	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	PRIBOR	*0.00*	0.25	0.25	0.25	0.25	0.25
Hungary	BUBOR	*1.34*	1.35	2.40	2.60	2.90	3.10
Poland	WIBOR	*1.67*	1.72	1.65	1.65	1.65	1.65

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

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	CZ10Y	*0.63*	1.01	0.60	0.73	0.87	1.00
Hungary	HU10Y	*2.09*	2.91	3.80	4.00	4.20	4.40
Poland	PL10Y	*2.24*	2.47	2.50	2.50	2.60	2.75

Exchange rates (end of the period)

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	EUR/CZK	*27.05*	27.03	27.02	27.02	27.02	27.02
Hungary	EUR/HUF	*311*	316	310	308	305	300
Poland	EUR/PLN	*4.27*	4.27	4.40	4.30	4.26	4.25

GDP (y/y)

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	4.5	4.7	4.0	2.4	2.0	2.1	2.6
Hungary	2.7	2.4	2.8	2.2	2.4	2.8	3.0
Poland	3.3	3.5	3.5	3.7	3.8	3.8	3.7

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

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	0.8	0.4	0.1	0.6	0.5	0.7	1.4
Hungary	0.6	-0.4	0.9	2.7	2.6	2.4	2.4
Poland	-0.8	-0.8	-0.5	-0.4	-0.4	0.0	0.3

Current Account

	2015	2016
Czech Rep.	1.7	1.6
Hungary	6.0	5.1
Poland	-1.2	-1.5

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-1.4	-1.3
Hungary	-2.3	-2.0
Poland	-3.0	-2.9

Source: KBC, Bloomberg

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