Central European Weekly

Monday, 25 April 2016

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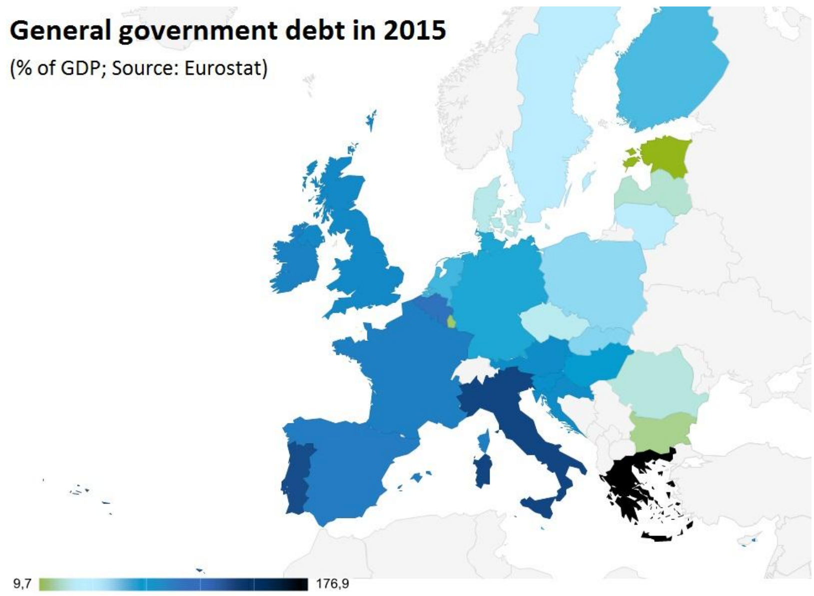
Weekly Highlights:

- NBP Minutes deliver dovish message, but we still think that external risks will force MPC to stay on hold
- Czech public finance improved significantly in 2015
- Weekly Preview: NBH should cut its base rate by another 15 basis points

Chart of the Week: Public debt-to-GDP in EU



Market's editorial

NBP's Minutes deliver dovish message

All members of the Polish Monetary Policy Council (MPC) except for Governor Belka and one member of the NBP leadership were replaced by the Government, President and Parliament early this year. The markets had been afraid of this but, in the end, as also shown by yesterday's detailed minutes of April's NBP meeting, the fear surrounding the replacement of the NBP leaders had been exaggerated. Nothing has changed in the conservative tenor of the monetary policy of the National Bank of Poland even after the replacement of nearly all the MPC members. Although Poland's inflation is still well in negative territory (and therefore under the inflation target), the interpretation of this macroeconomic phenomenon remains almost the same as in late 2015, i.e., deflation is seen as temporary, and triggered by external effects (low commodity prices in particular). Under these conditions, the MPC does not feel the need to change interest rates and prefers rate stability which, the NBP leaders believe, will also contribute towards financial stability. Thus the NBP rate-setters are evidently not going to run the risk of a rate cut triggering an outflow of portfolio capital from the country (and selling of the zloty and government bonds).

Nevertheless, a shift can be seen in the MPC's communication compared to late 2015 and early 2016, because the Minutes released yesterday state that the majority of Polish central bankers did not rule out the possibility of interest rate cuts in the event of an economic slowdown and deepening deflation. This dovish message is complemented with information that certain MPC members would recommend a sharper rate cut by the NBP in that event.

Despite this slightly dovish conclusion of the Minutes of April's NBP meeting, we are still betting on the stability of the official interest rates in Poland – inter alia because the NBP leaders are explicitly mentioning the uncertainty of the outlook and external risks such as the BREXIT (June 23rd). Nevertheless, this does not mean that we will not hear dovish calls for rate cuts from the MPC in the future. The money market (and consequently the FX market) may pay increased attention to such calls should hard cyclical data deteriorate significantly during 2016.

Key CNB´s figures see still limited room for negative rates

both the acting governor of the Czech National Bank (CNB) and his likely successor presented their views of negative official interest rates option. While Mr. Singer duly presented his well-known beliefs (though he mentioned he saw a good chance the regime could be extended beyond the half of the next year), Jiří Rusnok uttered a couple of fresh comments, too. Among them, he stressed, for instance, that negative official rates should be applied as an emergency tool in case sustainability of the intervention regime is endangered. Even more importantly, Mr. Rusnok can imagine negative rates to be imposed on just a fraction of banks´ reserves (probably on a portion to be accumulated from a certain moment on).

	Last	Change 1W
EUR/CZK	27.1	0.18%
EUR/HUF	311	-0.23%
EUR/PLN	4.39	1.87%

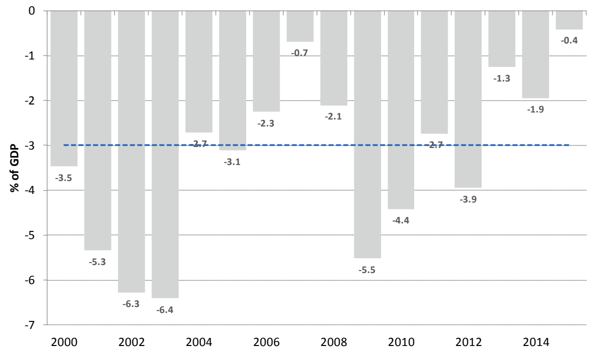
	Last	Change 1W
10Y CZK	0.66	11.86
10Y HUF	2.04	1.57
10Y PLN	2.36	2.03

Review of Economic Figures

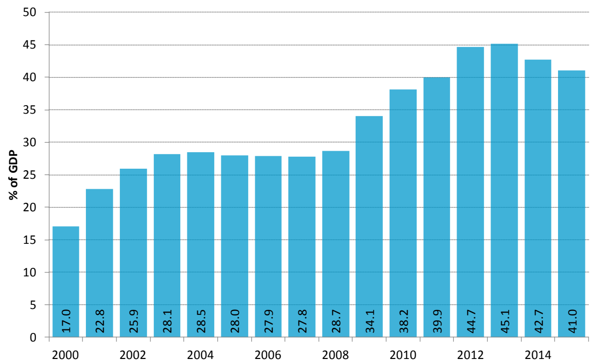
Public finance improvement in the Czech Republic

In 2015, the Czech Republic achieved the sixth best financial results of the EU as a whole, with a deficit of 0.4% of GDP and, just as in the previous year, the seventh lowest debt (41% of GDP). The main contributor to this achievement was surprisingly strong economic growth along with budget surpluses generated by municipalities and regions. In the end the state budget figure was also better than expected, benefiting from the huge cash inflow from EU Funds and higher tax revenue associated with the economic upturn. Expenditure decreased, driven by the reduced costs of debt servicing because of a significant fall in government bond yields, which even enabled the government to issue some bonds with a negative yield. Costs were also reduced thanks to the significant improvement on the domestic labour market, allowing the government to save some of the money allocated to its welfare policy.

CZ: General government deficit



CZ: General government debt



Weekly preview

TUE 14:00 NBH base rate

	This meeting	Last change
rate level (in %)	**1.05**	3/2016
change in bps	**-15**	-15

HU: Second 15 bps rate cut in a row

The latest inflation figure (falling from 0.3% Y/Y in February to -0.2% in March) gives the Monetary Council gunpowder for monetary easing, so we expect 15bp cut on 26th April, which might be followed with two more steps in May and June down to 0.75% from the current level of 1.2%.

FRI 14:00 PL Inflation (change in %)

	Apr-16	Mar-16	Apr-15
CPI y/y	**-0.9**	-0.9	-1.1
Food (ex Alc.) y/y	**0.8**	0.8	-2.5
Transport (including fuel)	**-8.6**	-8.4	-9.1

PL: Inflation still deeply in negative territory

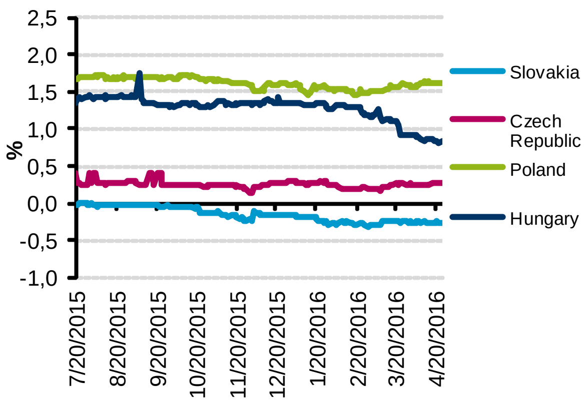
We believe that the preliminary forecast for Poland's inflation will indicate stagnation of the year-on-year inflation rate at -0.9%. While prices probably grew quite rapidly on the month-on-month basis (+0.4%), with a contribution from increased fuel prices, inflation in general is still well below the central bank's target, and we, just like the central bank, believe that a return to the target is nowhere to be seen at the moment.

Calendar

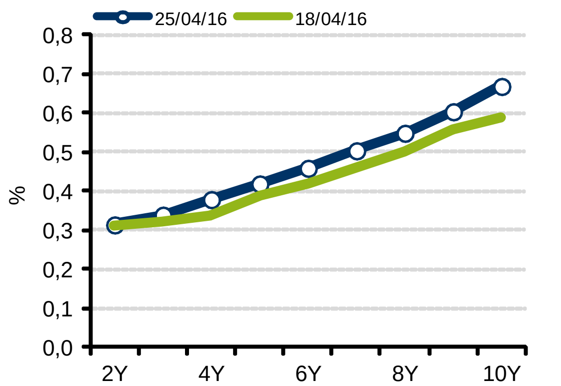
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	04/25/2016	0:00	Earnings Orange Polska	PLN	1Q/2016						
PL	04/25/2016	10:00	Unemployment rate	%	03/2016			10		10.3	
CZ	04/26/2016	0:00	Earnings O2 Czech Republic	CZK	1Q/2016						
HU	04/26/2016	14:00	NBH meeting	%	04/2016	1.05		1.05		1.2	
CZ	04/27/2016	12:00	CZ bond auction 2016-18, 0.00%	CZK B	04/2016						
CZ	04/27/2016	12:00	CZ bond auction 2015-2023, 0.45%	CZK B	04/2016						
CZ	04/27/2016	12:00	CZ bond auction 2014-25, 2.40%	CZK B	04/2016						
HU	04/28/2016	9:00	Unemployment rate	%	03/2016			6.2		6.1	
HU	04/29/2016	9:00	PPI	%	03/2016					-1.4	-1.6
CZ	04/29/2016	10:00	Money supply M2	%	03/2016						9
PL	04/29/2016	14:00	CPI	%	04/2016 *P	0.4	-0.9	0.3	-0.9	0.1	-0.9

Fixed-income in Charts

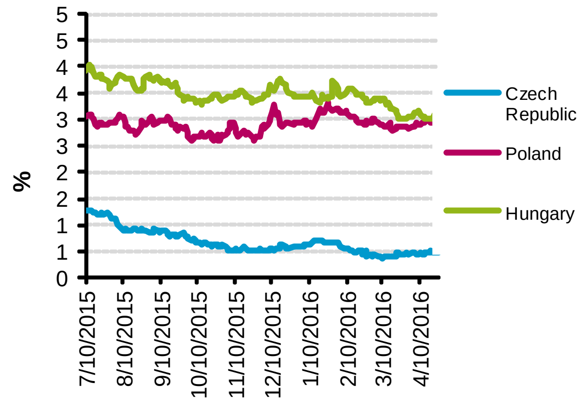
FRA 3x6



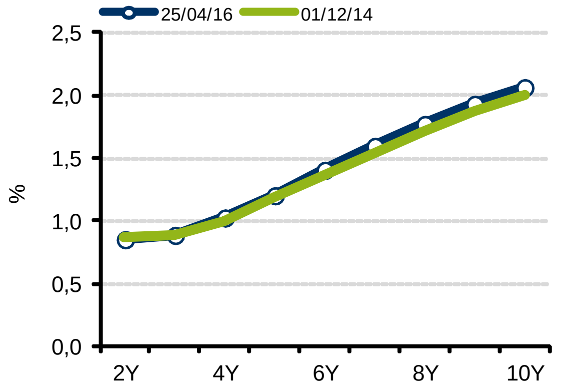
CZ IRS



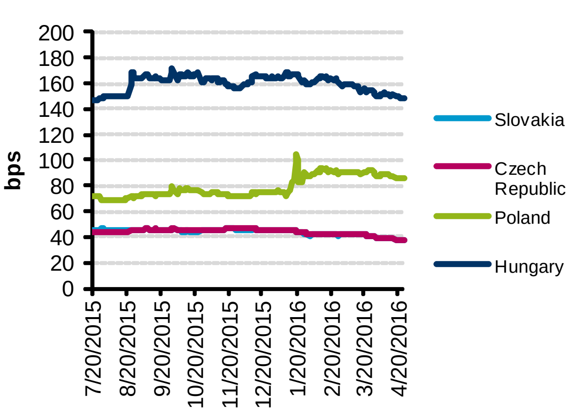
10Y GB Yields



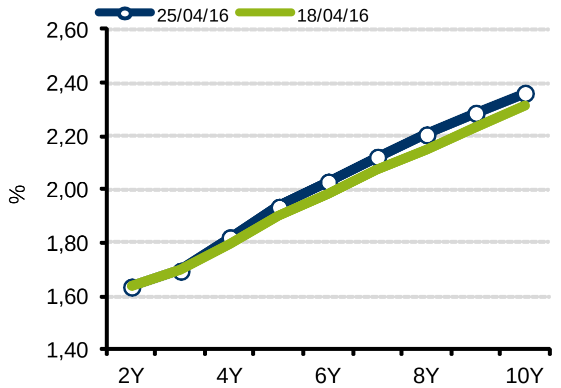
HU IRS



CDS 5Y



PL IRS



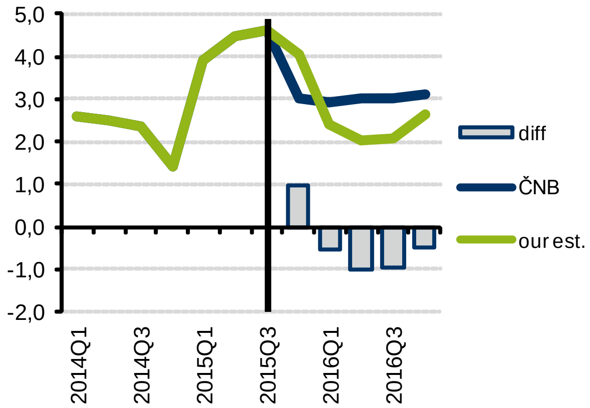
Source: Reuters

Medium-term Views & Issues

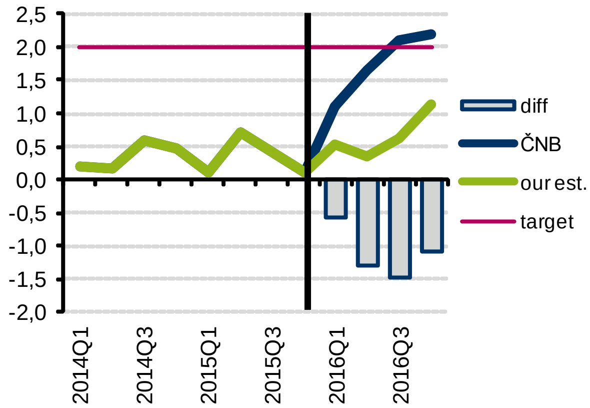
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – 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, Russia and other emerging markets.
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 Monetary Council continues the rate cut cycle in the following months. We believe that the easing cycle may be continued at least till June, when the next inflationary report will be published. The latest inflation figure (falling from 0.3% Y/Y in February to -0.2% in March) also gives gunpowder for monetary easing, so we expect 15bp cut on 26th April, which might be followed with two more steps in May and June down to 0.75% from the current level of 1.2%..	We expect the NBP to keep official rates stable, but we think that risks for of further rate cuts have increased. The main reason is the combination of the "inflow of cheap euros from the ECB", ongoing deflation and stronger currency (PLN). Hence, should the zloty get strong there could be a window of opportunity for the NBP to ease its policy in the second quarter of this year. Nevertheless this is not our main scenario yet.
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.	We think that zloty's sell-off related to markets' fears coming from appointment of new members of the Monetary Policy Council (MPC) is over now. Nevertheless, while domestic fundamentals should be relatively supportive for the zloty, the currency should be mostly driven by sentiment in emerging markets and the ECB or the Fed policy actions respectively.

CBs' Projections vs. Our Forecasts

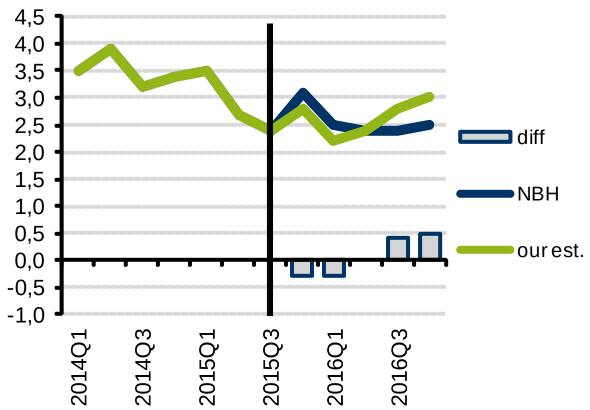
CZ: GDP outlook (Y/Y, %)



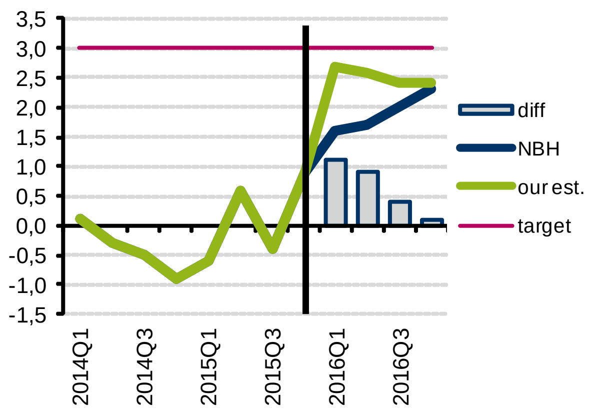
CZ: Inflation outlook (Y/Y, %)



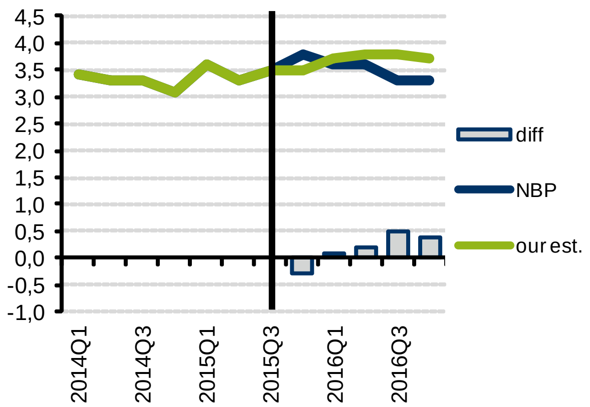
HU: GDP outlook (Y/Y, %)



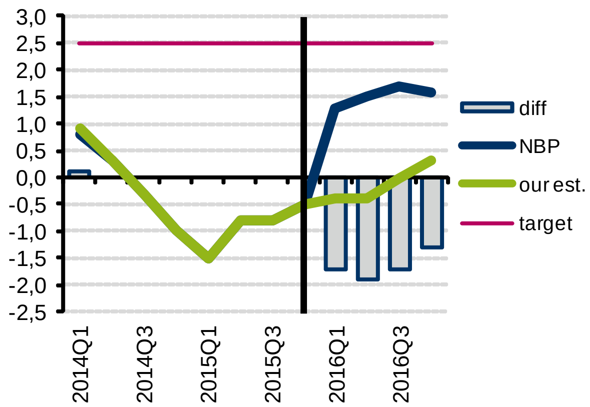
HU: Inflation outlook (Y/Y, %)



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	3/5/2015

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

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	PRIBOR	*0.00*	0.25	0.24	0.24	0.25	0.25
Hungary	BUBOR	*1.14*	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	*0.67*	1.01	0.64	0.73	0.81	0.90
Hungary	HU10Y	*2.04*	2.91	3.80	4.00	4.20	4.40
Poland	PL10Y	*2.36*	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	*27.07*	27.03	27.02	27.02	27.02	27.02
Hungary	EUR/HUF	*311*	316	310	313	305	310
Poland	EUR/PLN	*4.39*	4.27	4.40	4.30	4.26	4.25

GDP (y/y)

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	4.5	4.6	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.	0.9	0.8
Hungary	6.0	5.1
Poland	-1.2	-1.5

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-0.4	-1.0
Hungary	-2.3	-2.0
Poland	-3.0	-2.9

Source: KBC, Bloomberg

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