Central European Weekly

Monday, 23 May 2016

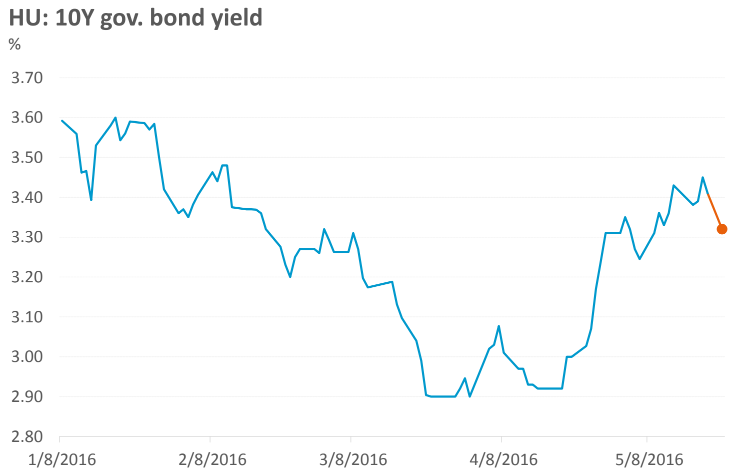
Table of contents

Weekly Highlights: 1
Chart of the Week 1
Market's editorial 2
Review of Economic Figures 3
Weekly preview 4
Calendar 5
Fixed-income in Charts 6
Medium-term Views & Issues 7
CBs' Projections vs. Our Forecasts 8
Summary of Our Forecasts 9
Contacts 10

Weekly Highlights:

- Fitch surprisingly upgrades Hungary
- Czech economy decelerates
- HU: NBH to cut by 15bps again

Chart of the Week



Hungarian bond yield falls sharply on a surprising Fitch decision to improve Hungarian rating to BBB-...

Market's editorial

Fitch surprisingly upgrades Hungary

Quite surprisingly, Fitch – a rating agency – decided to upgrade Hungarian sovereign rating last Friday (by a notch to the investment grade BBB-). While a reaction of the forint has been quite tepid, the yield on 10-year government bonds dropped by 10 bps in today´s early trading.

Forint´s underwhelming response to the upgrade may be explained by the fact that markets were more surprised by upgrade´s timing than by the move itself. Further reason may be that the Hungarian central bank meeting (Tuesday) is expected to deliver a 15 bps rate cut along with discussion about the length of the current rate cut cycle. The latter remains uncertain and Tuesday's meeting will certainly shed more light on the issue.

Polish rates reached bottom, NBP's Glapinski says

In addition to the latest developments in Hungary, also zloty's trading can catch markets´ attention this week, primarily owing to ongoing diplomatic dispute between the new Polish government and the European Commission. Apart from that, markets may react to comments of Mr. Glapinski, the probable successor to Mr. Belka at the helm of the central bank. According to Mr. Glapinski, official interest rates in Poland have already reached the bottom and their level has been appropriate. The statement is in line with our scenario although markets still bet on some easing in the months to come.

	Last	Change 1W
EUR/CZK	27.1	0.08%
EUR/HUF	316	0.16%
EUR/PLN	4.43	1.26%

	Last	Change 1W
10Y CZK	0.69	6.98
10Y HUF	2.26	-0.88
10Y PLN	2.36	4.54

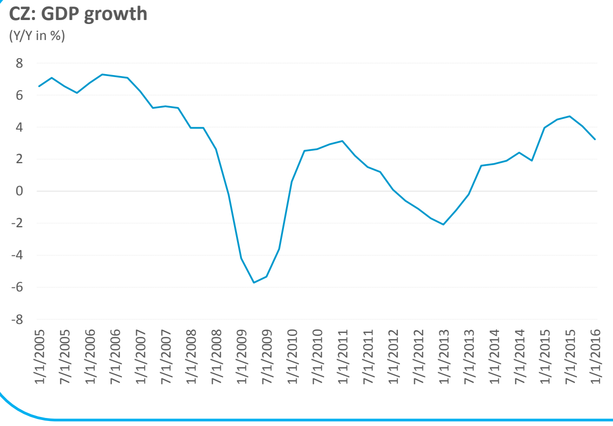
Review of Economic Figures

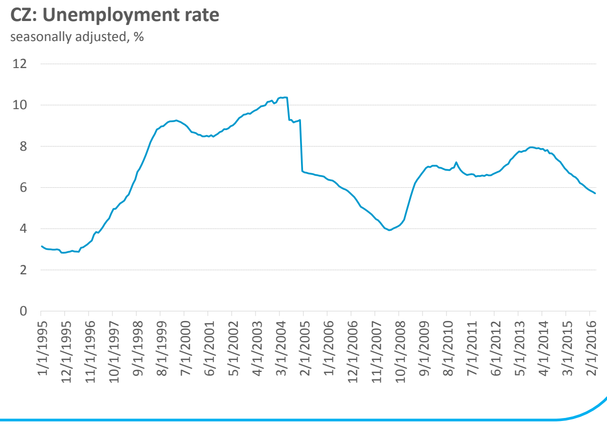
Czech economy decelerates…

… but not as much as implied by the preliminary GDP forecast for the first quarter of the year, released by the Statistical Office. According to the new data, GDP grew by 0.5% against the last quarter of 2015 and 3.1% y/y. As expected, early 2016 economic growth was primarily driven by domestic demand, specifically household consumption. With the falling number of jobless people and growing real wages, people are more willing to spend money. After all, this has been evident in consumer confidence and subsequently in retail sales for several months.

Investment and foreign trade also contributed to growth according to the Czech Statistical Office, but this time probably to a lesser extent. Bear in mind that maintaining last year's investment rate (+7.4%) is essentially impossible; moreover, many of the investments were associated with the completion of the absorption of money from EU Funds. While Friday's reports provided no details of the supply side of the economy, we can expect that the growth was primarily driven by the manufacturing industry, followed by certain sectors of services, probably led by retail and wholesale trade. By contrast, we anticipate no great performance from construction, which is slipping into a noticeable downturn after last year's boom.

The Q1 figures for the Czech economy were not the only news released, as they were accompanied by recalculated data for previous years, which differ greatly from those presented to date. While a downturn and then stagnation of the economy were reported late last year, the newly recalculated data show that the economy grew even in that period, albeit by only 0.4% q/q. These changes to previously released figures are attributable to refinements, as well as to a new set of seasonal adjustment methods put in place by the Statistical Office. The new data – though looking slightly better – have not changed our view of this year's development of the economy. We still believe that poorer figures will be released in the quarters to come and that the Czech economy as a whole will grow by 2.5% in 2016. This is a significant deceleration from last year's 4.3%, but the last data were largely based on extraordinary stimuli, which are already dissipating.





Weekly preview

TUE 14:00	NBH base rate	
	This meeting	Last change
rate level (in %)	**0.90**	4/2016
change in bps	**-15**	-15

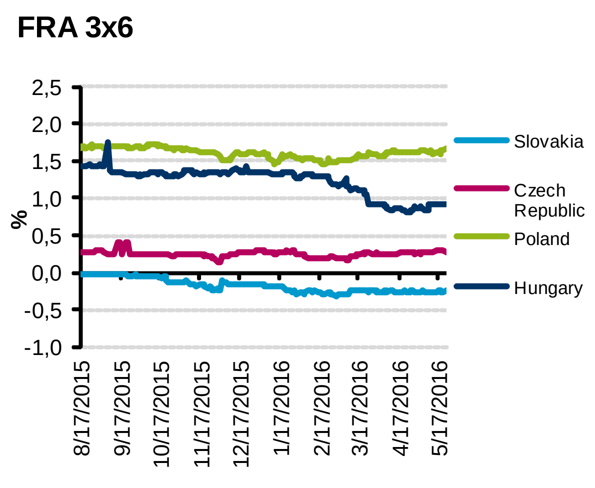
HU: NBH to cut by 15bps again

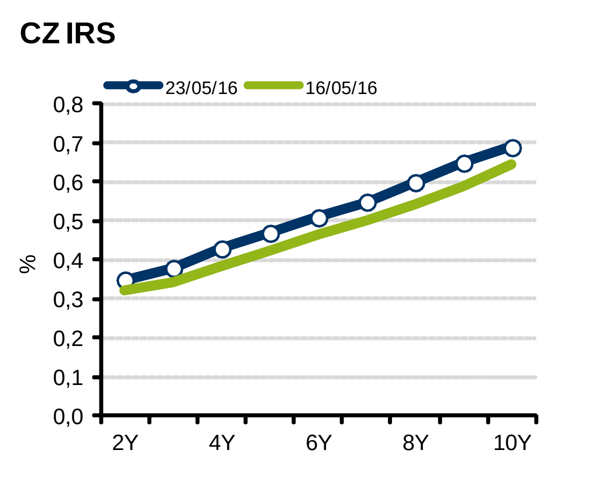
The National Bank of Hungary keeps rate-setting meeting on Tuesday. We expect that the base rate might be moderated by 15bp from 1.05% to 0.90%. The vice governor of NBH said in the last two weeks that he sees room for some monetary easing in May, but any step in June is strongly doubtful. It suggests that NBH may stop the rate cut cycle in June especially in case FED hikes base rate. The NBH may be happy with the current exchange rate level of EURHUF around 315 and with the higher than expected inflation in April, so it also confirms that no more rate cut is needed. Although the market started to price out the extreme expectation of monetary easing, only one more step would cause some negative surprise as the consensus is still rather two cuts to the level of 0.75%.

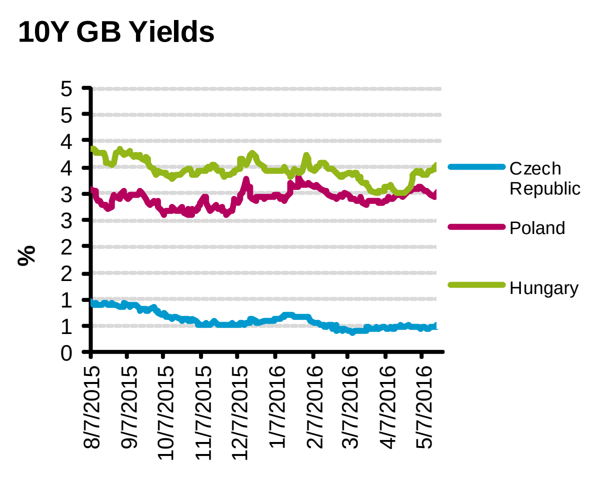
Calendar

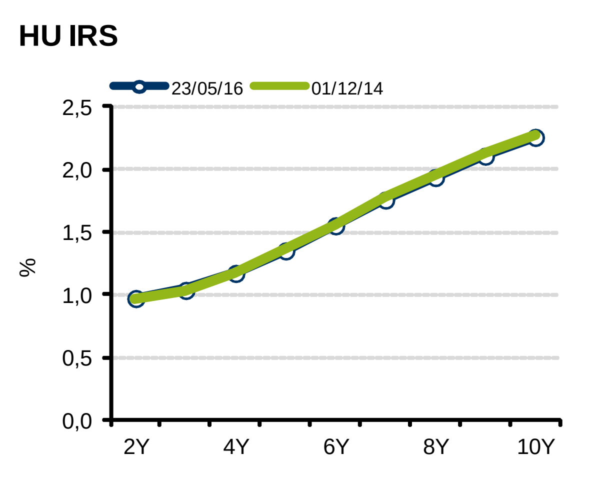
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	05/24/2016	0:00	Earnings VIG	CZK	1Q/2016						
HU	05/24/2016	14:00	NBH meeting	%	05/2016	0.9		0.9		1.05	
PL	05/25/2016	10:00	Unemployment rate	%	04/2016			9.6		10	
CZ	05/26/2016	0:00	Earnings Pegas NW	CZK	1Q/2016						
HU	05/26/2016	9:00	Unemployment rate	%	04/2016			5.9		6	
PL	05/27/2016	15:00	Budget balance	PLN M	04/2016					-9587	

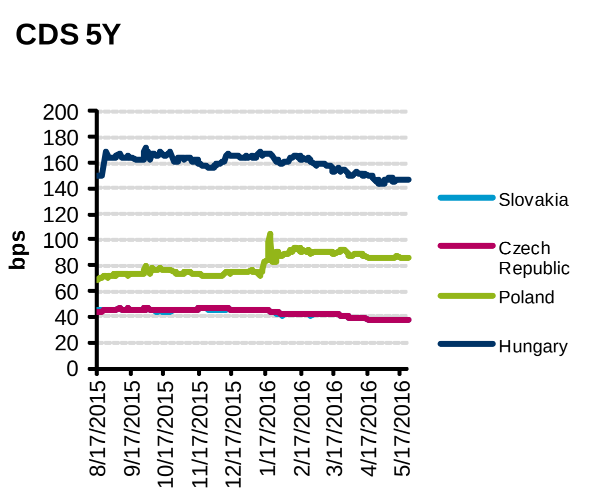
Fixed-income in Charts

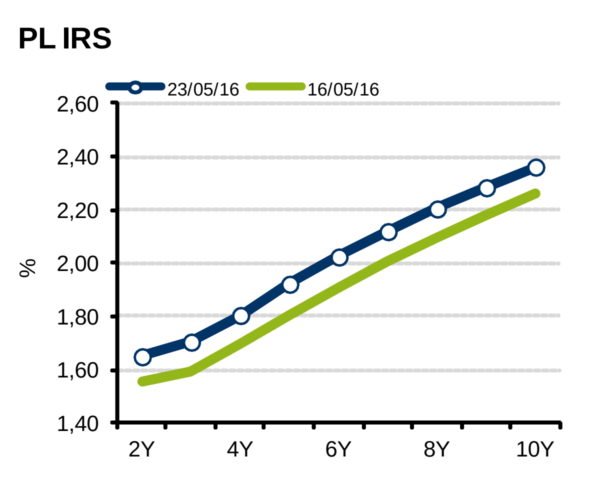












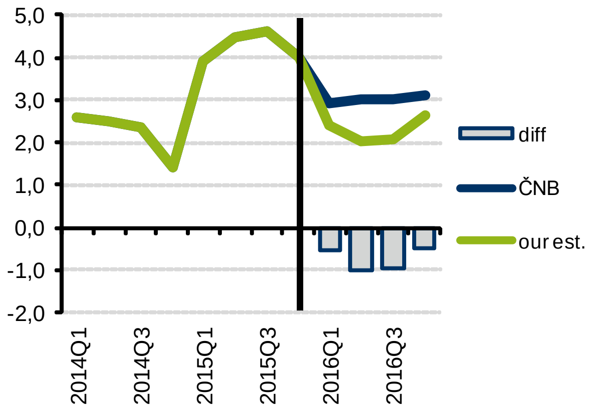
Source: Reuters

Medium-term Views & Issues

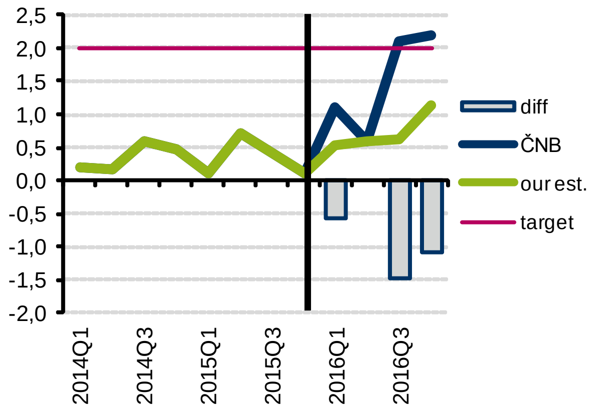
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – 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

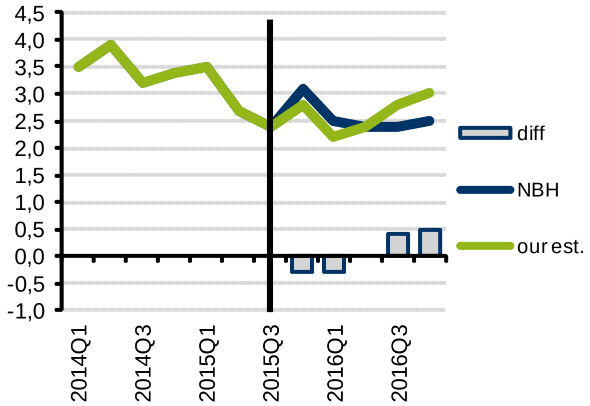
CZ: GDP outlook (Y/Y, %)



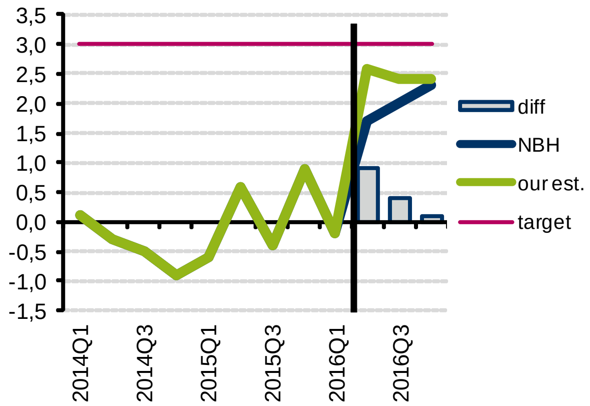
CZ: Inflation outlook (Y/Y, %)



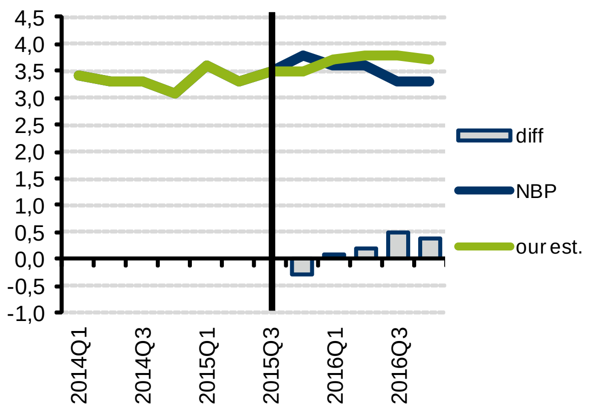
HU: GDP outlook (Y/Y, %)



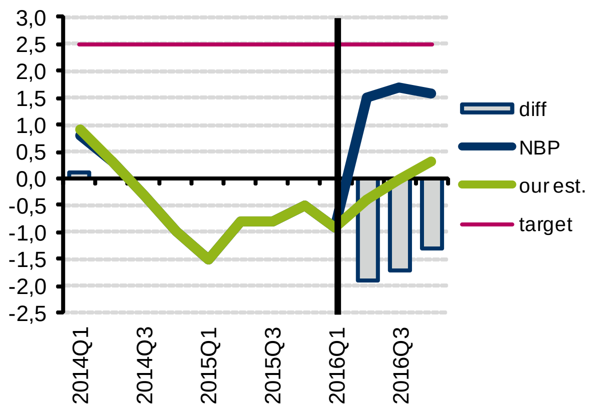
HU: Inflation outlook (Y/Y, %)



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	1.20	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	0.25	0.24	0.24	0.24
Hungary	BUBOR	*1.08*	1.35	1.20	2.60	2.90	3.10
Poland	WIBOR	*1.67*	1.72	1.67	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	*0.69*	1.01	0.63	0.73	0.81	0.90
Hungary	HU10Y	*2.26*	2.91	2.07	4.00	4.20	4.40
Poland	PL10Y	*2.36*	2.47	2.23	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	27.05	27.02	27.02	27.02
Hungary	EUR/HUF	*316*	316	314	308	305	300
Poland	EUR/PLN	*4.43*	4.27	4.25	4.39	4.27	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	0.3	0.5	0.7	1.4
Hungary	0.6	-0.4	0.9	-0.2	2.6	2.4	2.4
Poland	-0.8	-0.8	-0.5	-0.9	-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

Contacts

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