Central European Weekly

Monday, 12 May 2014

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- The Czech inflation falls back close to zero in April
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Table of the Week: CNB's new eco forecast

CNB's prognosis

		May	February	change
GDP (y/y, %)	2014	2.6	2.2	↑
	2015	3.3	2.8	↑
Inflation (y/y, %)	2014Q4	1.6	2.1	↓
	2015Q2	2.3	2.8	↓
Monetary relevant inflation	2014Q4	1.4	1.9	↓
	2015Q2	2.0	2.6	↓
PRIBOR 3M	2014Q4	0.4	0.4	
	2015Q2	0.9	1.1	↓
		May	**February**	**change**
GDP - euro area (y/y, %)	2014	1.6	1.5	↑
	2015	2.0	2.0	
Inflation - euro area (y/y, %)	2014	1.1	1.5	↓
	2015	1.7	1.9	↓
EURIBOR 3M (average, %)	2014	0.3	0.3	
	2015	0.3	0.5	↓

Source: CNB

The CNB is much more optimistic about economic growth now, anticipating 2.6%, rather than the original 2.2% predicted for this year.

Market's editorial

The ECB pleases Central Europe too

Despite ongoing tensions in eastern ukraine all Central European currencies last week stronger. Recall the forint for instance - despite the fact it weakened by around 0.3% on Friday, it strengthened against the euro by more than 1.2% last week. A similar pattern developed regional bond markets: while Polish and Hungarian bonds which were under mild pressure on Friday, they bond yields still managed to fall by 20 bps and 13 bps respectively last week. We think that positive performance of regional markets benefited rising bets that the ECB might trigger futher esing in June as Mr Draghi suggested on Thursday.

Slould the ECB act it might challenge the CNB too

Not only Hungarian and Polish markets enjoyed the dovish outcome of the ECB meeting. Let us add that Czech bond yields fell by 10 bps, while the Czech currency were firmer too. But more might to come in the case of the koruna as a possible ECB's action might chalange the CNB policy (which pegs the EUR/CZK pair above the 27.0 level). Clearly, the immediate effect of the ECB's additional monetary expansion on the exchange rate of the Czech koruna would be positive. The prospects for lower EURIBOR rates might turn the attention of certain foreign investors to Central Europe's assets and partly also to the Czech koruna. This could drive the currency pair closer to the EUR/CZK 27.00 level, in the months to come.

Now, should the ECB decide for a stronger action, i.e., a launch of a large scale quantitative easing (QE), this may also delay the moment of departure from the intervention regime. The CNB would certainly not hasten to tighten its monetary policy. Timing the end of the interventions for the moment when the ECB supplies new euros to the market would not be very fortunate. It would simply spur the koruna to strengthen abruptly, and this is certainly not something the CNB Board would like.

Regional GDP and inflation releases on focus

As far as the week ahead is concerned, the regional calendar is dominated by the release of GDP growth figures for the first quarter on Thursday (flash estimates). In this regard, it would be interesting to watch whether the tensions between Ukraine and Russia could already have some impact on GDP growth in the Central Europe. On the other hand, a broader picture of ongoing recovery will probably remain intact and a possible impact on regional monetary policy makers should be from this perspective limited (dovish mood in the regional central banks prevails anyway). Apart from GDP figures, the April inflation readings for Poland and Hungary will be released which should also support current policy stance of both the NBP and the NBH.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.4	-0.24%	➚	➔
EUR/HUF	304	-1.69%	➚	➚
EUR/PLN	4.18	-0.59%	➚	➔

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.62	-3.57	➘	➚
10Y HUF	4.58	-2.97	➘	➚
10Y PLN	3.83	-2.30	➘	➚

Review of Economic Figures

The Czech inflation back to a technical zero in April

The April Czech inflation figures fell (gain) short of market expectations as inflation hit only 0.1% Y/Y and 0.0% M/M in April due to falling food prices. This decline offset seasonal increase in prices of footwear and clothes. All in all, the reading suggests that inflation will remain subdued in following months as well and more visible inflation pressures will not be apparent until the second half of the year. This would in turn allow the central bank to maintain its (FX) intervention regime for longer than anticipated by just released inflation forecast (see below).

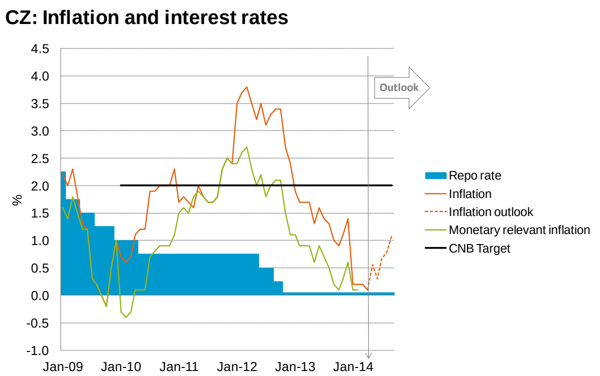
New CNB's forecast signals later exit

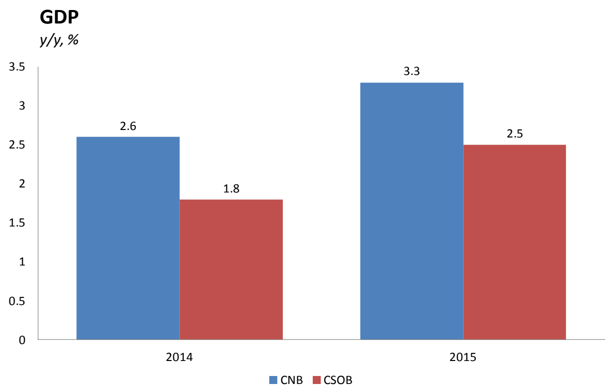
Lower inflation, higher growth, a later departure from the exchange rate regime, and a slower rise in interest rates next year: such could be the summarised outcome of the most recent CNB Board meeting, where the second inflation forecast of the year was on the agenda.

The inflation forecast was adjusted significantly downwards. Within a one-year horizon, it was cut by 0.5 percentage point to 2.3%, which is more or less in line with our expectations. The Czech National Bank is much more optimistic about economic growth now, anticipating 2.6%, rather than the original 2.2% predicted for this year. The board members are clearly more cautious than the official forecast. According to the governor "the probability of a later exit from the exchange rate commitment is increasing". We believe this makes the CNB's approach realistic, because, until May's meeting, the bank was thinking that it would leave the exchange rate regime and concurrently begin to hike rates in early 2015. This conclusion – albeit of crucial importance – is certainly not surprising at all. Likewise, we should not be surprised by the usual stressing of the downside risks to the inflation forecast either. By and large, nothing has changed for this year – the exchange rate regime as well as low rates will most likely remain in place. Next year is likely to see the central bank abandon its exchange rate commitment as well as raise rates, but this will happen later in 2015, more likely in the second half of the year.

The NBP maintains status quo

Regarding the meeting of the Polish central bank, its conclusions were in line with market expectations in all important aspects. Interest rates remained unchanged as well as the "promise" to keep interest rates at current levels at least until the end of the third quarter. NBP President Marek Belka reiterated that the perfect timing for changing the forward guidance (i.e., for extension of the indicated period of rate stability) will be July meeting when the new inflation report will be released. Belka again mentioned possible negative impact of tensions in Ukraine on GDP growth in following quarters which has already been indicated by surprisingly weak April PMIs. This factor in combination with his emphasis put on quarter-on-quarter dynamics of the economy rather than on year-on-year growth figures stressed by Belka made the overall impression slightly more dovish than last month in our view.





Weekly preview

WED 14:00 **PL Inflation (change in %)**

	Apr-14	Mar-14	Apr-13
CPI y/y	**0.6**	0.7	0.8
Food (ex Alc.) y/y	**1.1**	1.2	1.7
Transport (including fuel)	**-1.9**	-2.7	-2.2

PL: inflation pressures remain subdued

Poland's inflation could have slightly decelerated to 0.6% y/y in April according to our estimates. In month-on-month terms, 0.3% inflation was likely caused by a seasonal increase in clothing and footwear prices (+3.3%). On the other hand, food prices growth was likely smaller than is usual in April. Likewise, the decline in oil prices and relative stability of the exchange rate of the zloty against the dollar probably stabilized fuel prices last month.

THU 9:00 **CZ GDP (change in %)**

	Q1-14	Q4-13	Q1-13
GDP (q/q)	**-0.9**	1.8	-1.3
GDP (y/y)	**1.6**	1.2	-2.3

CZ: Extraordinary effects will reduce GDP in Q1

While the end of last year saw robust GDP growth, due partly to stockpiling, this should lead to a completely contrary effect early this year. The predicted quarter-on-quarter GDP decline will not at all change the positive trend of the economy, as it should mean just an adjustment of the above-mentioned stockpiling. However, any evaluation of a preliminary GDP forecast should take into account that the figure will likely be subject to change, and that the detailed GDP structure, to be released in June, will not yet be available.

THU 10:00 **PL GDP (y/y change in %)**

	Q1-14	Q4-13	Q1-13
GDP	**3.2**	2.7	0.4

PL: Economic recovery continues

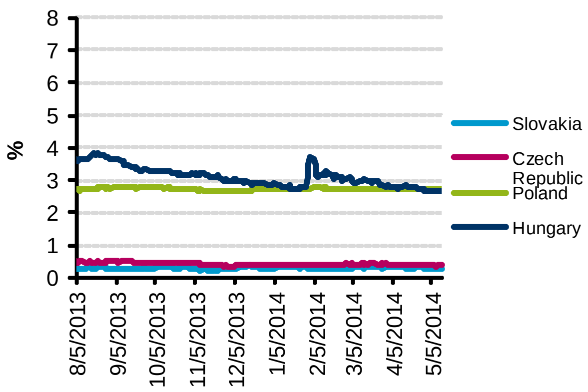
Polish GDP growth further accelerated in the first quarter and according to our estimates reached 3.2% Y/Y. Monthly economic figures released throughout the first quarter indicated continuing recovery, be it manufacturing (which grew by about one percent M/M on average in the first quarter) or construction that grew - also thanks to mild winter - by 4.20 M/M on average in the first three months of this year (which indicates further pick-up in investment). Main question thus remains whether slowdown in retail sales dynamics could have significantly influenced GDP as well as if recent outbreak of tensions between Russia and Ukraine could have somehow weighed on exports.

Calendar

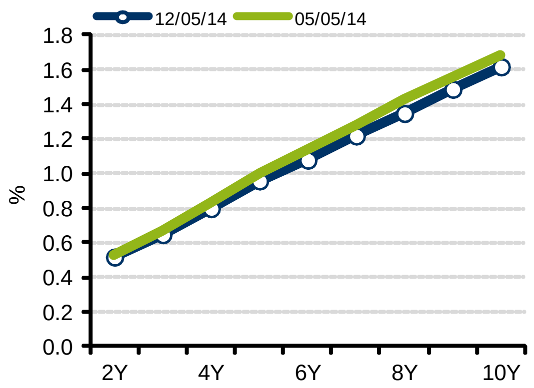
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	05/12/2014	9:00	CPI	%	04/2014	0.2	0.3	0.2	0.3	0	0.2
CZ	05/12/2014	9:00	Unemployment rate 15-64	%	04/2014	8		7.9		8.3	
HU	05/13/2014	9:00	CPI	%	04/2014			0.3	0.2	0.2	0.1
HU	05/14/2014	9:00	Industrial output	%	03/2014 *F					0.4	8.1
CZ	05/14/2014	12:00	CZ bond auction 2014-18, 0.85%	CZK B	05/2014						
CZ	05/14/2014	12:00	CZ bond auction 2014-25, 2.40%	CZK B	05/2014						
CZ	05/14/2014	12:00	CZ bond auction 2014-2027, floating rate	CZK B	05/2014						
PL	05/14/2014	14:00	Money supply M3	%	04/2014			0.2	5	1.1	5.1
PL	05/14/2014	14:00	CPI	%	04/2014	0.3	0.6	0.3	0.7	0.1	0.7
CZ	05/15/2014	9:00	GDP	%	1Q/2014 *P	-0.9	1.6	-0.4	2.3	1.8	1.2
HU	05/15/2014	9:00	GDP	%	1Q/2014 *P			0.8	2.7	0.5	2.7
PL	05/15/2014	10:00	GDP	%	1Q/2014 *P		3.2	0.9	3.1	0.6	2.7
CZ	05/15/2014	10:00	Current account	CZK B	03/2014	0		9		22.08	
PL	05/15/2014	14:00	Core CPI	%	04/2014			0.5	1	0.3	1.1
PL	05/15/2014	14:00	Current account	EUR M	03/2014			-313		-572	
PL	05/15/2014	14:00	Trade balance	EUR M	03/2014			-57		179	
PL	05/15/2014	15:00	Budget balance	PLN M	04/2014					-17493	

Fixed-income in Charts

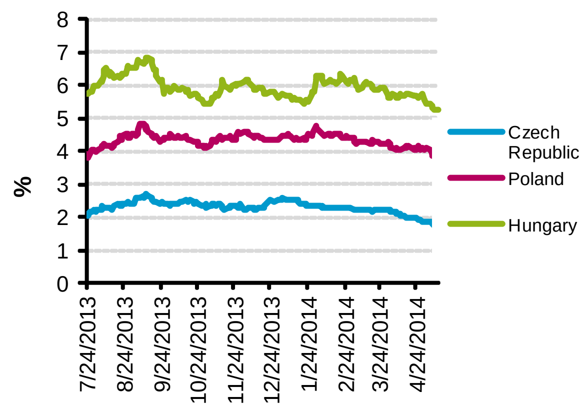
FRA 3x6



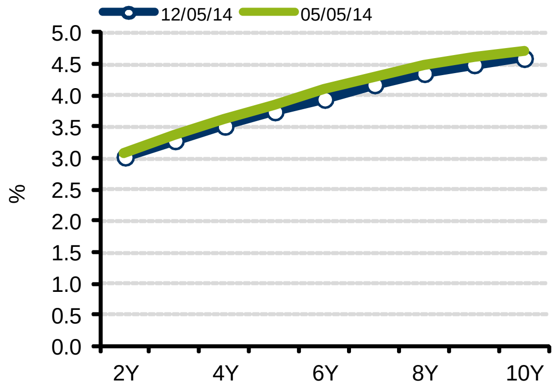
CZ IRS



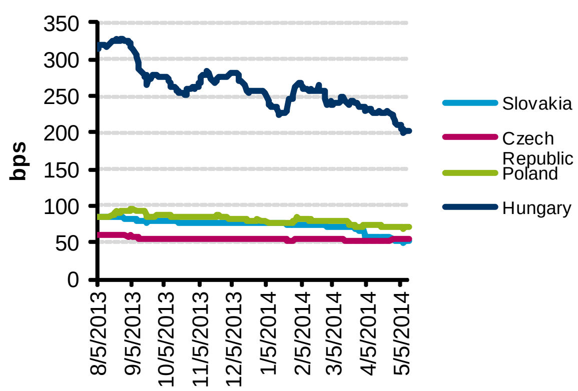
10Y GB Yields



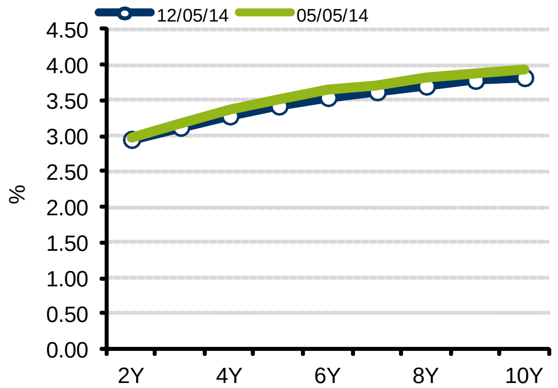
HU IRS



CDS 5Y



PL IRS



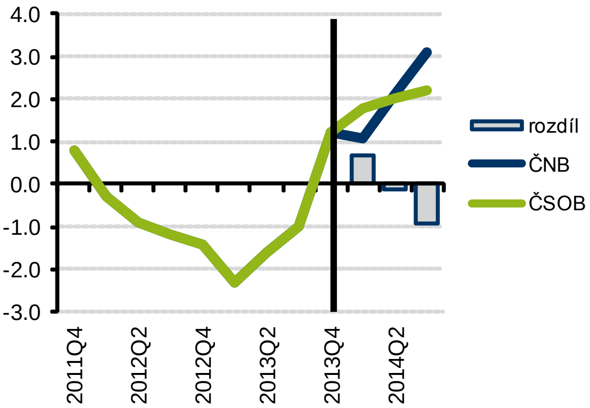
Source: Reuters

Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	The president appointed a new coalition government a few months after the election. The programme of the future government is likely to be consistent with the concluded coalition agreement, which envisages keeping the government deficit below 3% of GDP throughout the government's electoral term. Statistics for the last six months confirm that the worst is over for the economy. The economy is being driven by the manufacturing industry, notably passenger car production, while construction, as well as many of services, are struggling to bottom out.	We don't expect radical changes of Fidesz/government policy after April's election. The NBH's funding for lending program may boost the economy by 0.2-0.4% Y/Y in the following quarters; the net real wage growth may help the domestic consumption, while public investments are likely to continue at least till mid-2014. as GDP growth accelerated on quarter-on-quarter basis in Hungary's main trading partners and also in the CEE region – that Hungary's economic growth slowed (from 0.8% Q/Q in 3Q13 to 0.6% Q/Q in 4Q13) less than expected. It confirms our view that economy may grow by 2% Y/Y in 2014.	According to the GUS estimates the Polish economy grew by 2.7% in 2013Q4. For this year, the growth should significantly exceed 3%. Household consumption should support growth, owing to the improving labor market situation as well as to low inflation. Investment should also develop favorably, owing to the replenishment of inventories as well as to gross capital formation In addition, lower government debt could also give a greater lift to the economy. By contrast, net exports are likely to curb rather than boost growth, especially in view of recent crisis in Ukraine.
Outlook for official & market rates	The CNB has exhausted the possibility of easing its monetary policy through interest rates, and therefore it has decided to weaken the koruna and keep it close to CZK 27 per EUR. Statements from the CNB representatives indicate that the CNB would like to maintain that level for a prolonged period, until strong inflation pressures become evident in the economy. The CNB believes that the depreciation of the koruna should enable the economy to avoid deflationary pressures and boost its growth up to 2.6% this year. The CNB is very unlikely to change rates, and just as likely to maintain its intervention regime throughout this year.	The tone of the statement is definitely more hawkish than previous months and it suggests strongly that the NBH may stop the rate cut cycle in May, although it still leaves open the door for another 10bp cut in case of the international sentiment improves further. We think that the more cautious tone is also because of the new monetary policy tools and regulations the NBH announced yesterday and last week (there will be two-week deposit despite of two-week NBH bill from 1 August and banks has to use above 1-year financing tools for funding of long-term foreign currency loans). We expect that in case of no change of Hungary's risk premium and no strengthening of HUF, NBH may keep base rate unchanged in May.	Inflation pressures in Poland remain subdued and year-on-year prices growth is seen well below the lower tolerance band of the inflation target. Although the recent development has supported our bets on faster economic recovery in Poland, outlook for persistently low inflation and NBP's strong emphasis on forward guidance along with the fact that all members of the Monetary Policy Council agreed upon it, made us review our scenario and we newly expect that the official interest rates will remain stable in the rest of this year and that the first rate hike could come in the first half of next year.
Forex Outlook	The CNB has started FX interventions and we expect the koruna to stay within the regime at least till the mid 2015. Hence the currency should stay above 27.00 EUR/CZK at least in 12-month horizon. When the FX targeting regime is set to be abandoned, the CNB will have to intervene on the market much more aggressively to stop the spot koruna from appreciation. As a side effect, the forward koruna can appreciate significantly before the regime is abandoned.	We don't expect fast and substantial forint movement after the April election.	Low inflation pressures and improving prospects of the economy may support the zloty in months ahead. Albeit we expect only gradual strengthening against the euro, the Polish currency might perform well against the koruna as the room for koruna's appreciation remains virtually closed and the economic recovery in Poland is likely to continue at faster pace. In our view, Fed's QE tapering remains the main risk for the zloty. The Zloty is also more vulnerable to the emerging markets sell-offs such as to rising tensions in Ukraine.

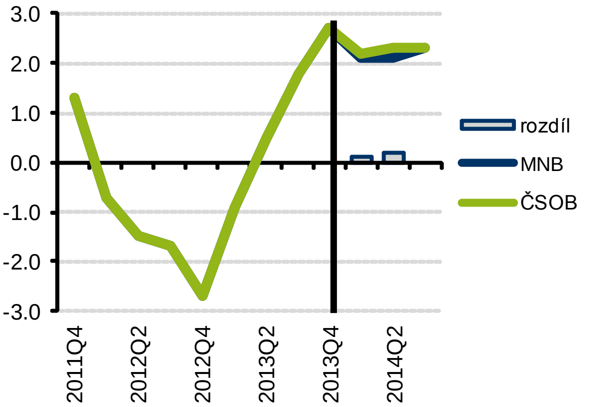
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

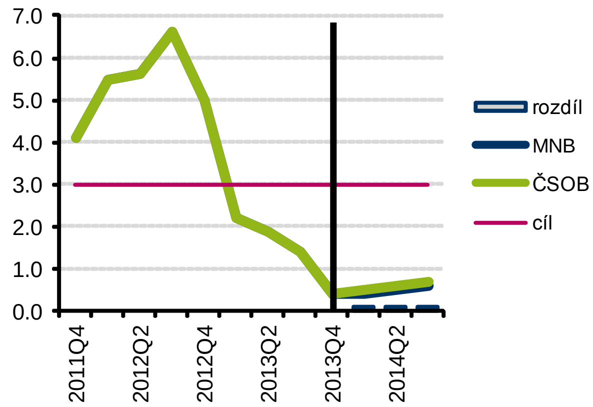


CZ: Inflation outlook (Y/Y, %)

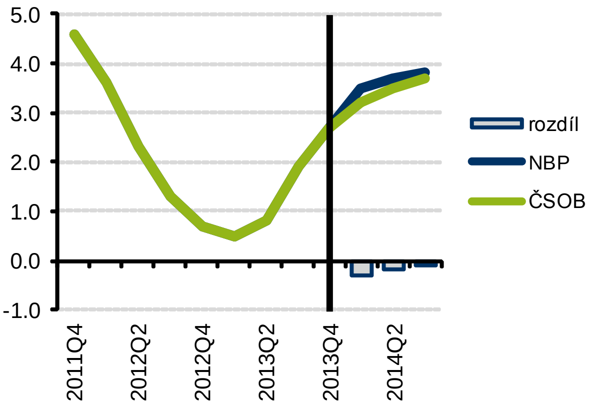
HU: GDP outlook (Y/Y, %)



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	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	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.	*2.50*	3.60	3.00	2.60	2.50	2.50	-15 bps	4/29/2014
Poland	2W inter. rate	*2.50*	2.50	2.50	2.50	2.50	2.50	-25 bps	7/3/2013

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

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	PRIBOR	*0.37*	0.42	0.38	0.37	0.36	0.36
Hungary	BUBOR	*2.53*	3.56	2.99	2.67	2.50	2.50
Poland	WIBOR	*2.72*	2.67	2.71	2.71	2.75	2.75

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

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	CZ10Y	*1.62*	2.06	2.09	1.84	1.75	1.90
Hungary	HU10Y	*4.58*	5.17	5.25	4.95	5.00	5.30
Poland	PL10Y	*3.83*	4.24	4.25	4.03	4.10	4.45

Exchange rates (end of the period)

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	EUR/CZK	*27.4*	25.7	27.3	27.4	27.2	27.2
Hungary	EUR/HUF	*304*	297	297	307	300	300
Poland	EUR/PLN	*4.18*	4.22	4.16	4.17	4.10	4.00

GDP (y/y)

	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	-2.3	-1.6	-1.0	1.2	1.8	2.0	2.2
Hungary	-0.9	0.5	1.8	2.7	2.2	2.3	2.3
Poland	0.5	0.8	1.9	2.7	3.2	3.5	3.7

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

	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	1.7	1.6	1.0	1.4	0.2	0.6	1.3
Hungary	2.2	1.9	1.4	0.4	0.5	0.6	0.7
Poland	1	0.2	1.0	0.7	0.9	1.4	1.0

Current Account

	2013	2014
Czech Rep.	-1.4	-1.4
Hungary	2.0	2.2
Poland	-1.2	-2.5

Public finance balance as % of GDP

	2013	2014
Czech Rep.	-1.4	-2.5
Hungary	-2.7	-3.0
Poland	-4.4	-3.5

Source: CSOB, Bloomberg

Contacts

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	**Brussels**	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Joke Mertens	+32 2 417 30 59	Institutional Desk	+32 2 417 46 25
Mathias van der Jeugt	+32 2 417 51 94	France	+32 2 417 32 65
Dublin Research		London	+44 207 256 4848
Austin Hughes	+353 1 664 6889	Frankfurt	+49 69 756 19372
Shawn Britton	+353 1 664 6892	Singapore	+65 533 34 10
Prague Research (CSOB)			
Jan Cermak	+420 2 6135 3578	**Prague**	+420 2 6135 3535
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)			
Marek Gabris	+421 2 5966 8809	**Bratislava**	+421 2 5966 8820
Budapest Research			
David Nemeth	+36 1 328 9989	**Budapest**	+36 1 328 99 85

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