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Central European Weekly

Monday, 29 September 2014

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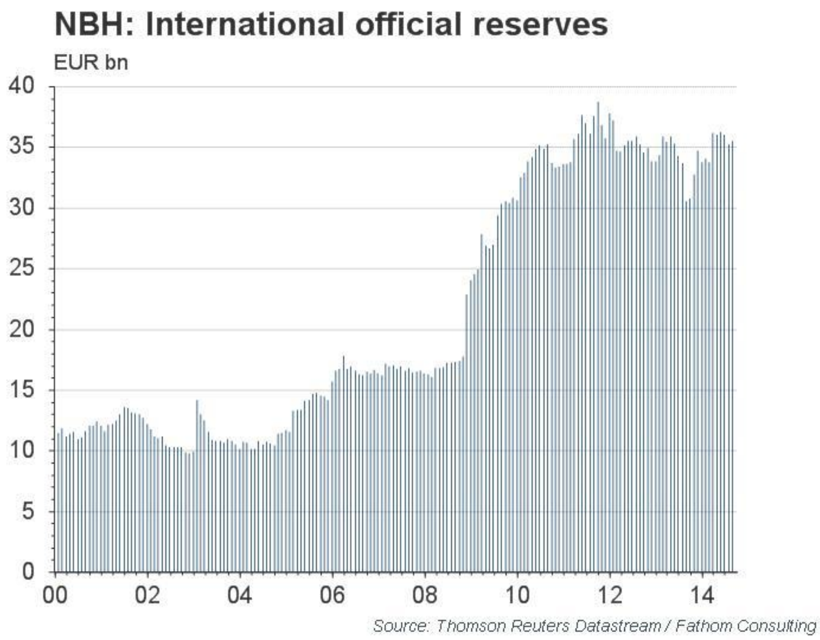
- NBH and CNB policy-meetings with no surprise
- Would regional PMI's follow deterioration in Germany and Euro-zone?

Chart of the Week: NBH's forex reserves



NBH's forex reserves stand at very high levels, so the Hungarian central bank might support the domestic banking to provide foreign currency to local banks to close their open FX positions while phasing out household FX loans.

Market's editorial

CNB's and NBH's meetings boring, Hungary's central bank ready to domestic banks with additonal forex liquidity

The last week in the Central European region, which was on the whole rather dull, was not at all stirred by central bank meetings, when both the National Bank of Hungary and the Czech National Bank essentially expressed their satisfaction with the current situation. Perhaps the only thing that may be worth mentioning was the decision of the NBH to support the plan for the (final) conversion of foreign currency household loans into forints by the required foreign exchange liquidity (from forex reserves) to ensure that the measure does not affect the domestic forex market. It worth noting that the current stock of total household FX debt is EUR 14 bn, while NBH's forex reserves stand around EUR 35 bn now (see the graph on the cover page).

After poor Ifo results in September, regional PMIs in focus

Although recent days in the region have been dull, European markets have been clearly interested in the news of the deteriorating business moods in the euro area, specifically in Germany. The results of PMI indices may be an attractive regional topic in the coming week. In recent months, the business optimism has completely disappeared in Poland in particular (its PMI remains below the level) and data from Germany (both Ifo and PMI) bode ill in this regard. Another country, in addition to Poland, where the business sentiment dropped in August is Hungary, but this type of data is very volatile in Hungary, and therefore no strong conclusions could be drawn from the data for a single month. Hence the Hungarian PMI index could also catch the eye. And finally, September's business mood index for Czech industry will also be worthy of attention. To date, the index has been essentially immune to the deterioration of 'soft' data in Germany, which seems rather peculiar, because Czech industry is most dependent on Germany's situation.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.5	0.04%	→	→
EUR/HUF	313	0.08%	→	→
EUR/PLN	4.19	0.05%	→	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.24	-1.59	↗	↗
10Y HUF	3.99	2.31	↗	↗
10Y PLN	2.85	-0.35	↗	↗

Review of Economic Figures

September's CNB Board meeting springs no surprises.

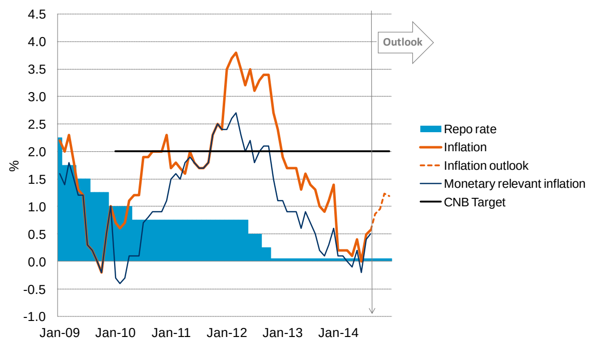
The Czech National Bank met expectations and left its interest rates unchanged, having again confirmed its commitment to keep the exchange rate of the koruna in its existing regime until at least 2016. Thus the most recent CNB Board meeting sprang no surprises. There is, after all, no reason to surprise anyone. The economy is growing more or less in line with the forecast. Inflation lags well behind the CNB's target, but at least it is 0.2 percentage points above the central bank's latest outlook, primarily owing to the weak koruna – as the central bank states. The CNB Board's statements again indicate that the inflation risks to the forecast are still on the downside, due to the current as well as anticipated developments abroad, specifically lower economic growth and lower foreign inflation in the euro area.

Consensus Forecast predictions, which influence the central bank forecast, show that GDP growth as well as the inflation rise in the euro area will be lower than the latest forecast envisaged for the rest of this year and particularly for 2015. Nevertheless, this should not yet imply any response from the CNB, because the divergences have been rather insignificant thus far. The same applies to the changed outlook for the three-month Euribor. This is why we expect the CNB Board to curb the koruna within the existing exchange rate regime until the second half of 2016, and only after the bank releases the koruna from the regime will it start to consider a rate hike. However, we do not believe that that the koruna should lack the ambition to strengthen at that time – as the central bank expects – and therefore the latitude for rate hikes will certainly not be large. After all, not even the ECB will feel like tightening its monetary policy at that time, and this will tie the Czech National Bank's hands all the more.

No remark about a weaker koruna this time.

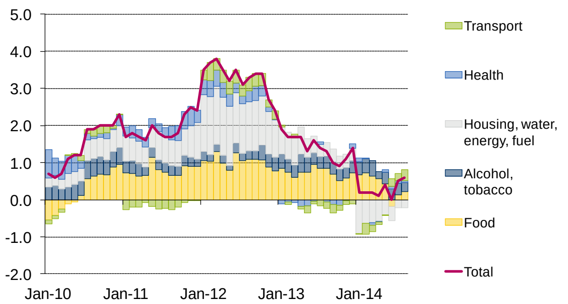
The CNB's approach may not necessarily change in the months to come either. The discussions on another possible weakening of the koruna have died down for the moment and were not even mentioned in the communiqué of September's CNB Board meeting. While at the meeting before last, such a possibility was mentioned, should the CNB Board find "a further noticeable increase in anti-inflationary factors", not a word was mentioned this time. Absolutely nothing can likely be ruled out next year, but neither the current developments nor the outlook favour such speculations. We believe that such a step may only be taken if the economic situation in Western Europe worsens significantly, possibly leading to strong downside pressures on inflation or even deflationary pressures. Although the current developments in the euro area economies are not very positive, we do not consider the scenario of a dramatic reversal to be the most likely one.

CZ: Inflation and interest rates



CZ: Inflation

(consumer basket decomposition in percentage points)

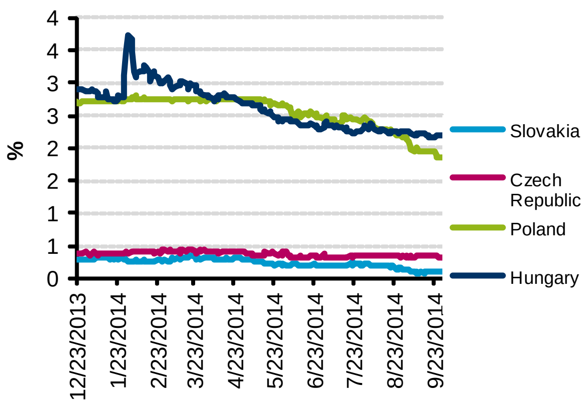


Calendar

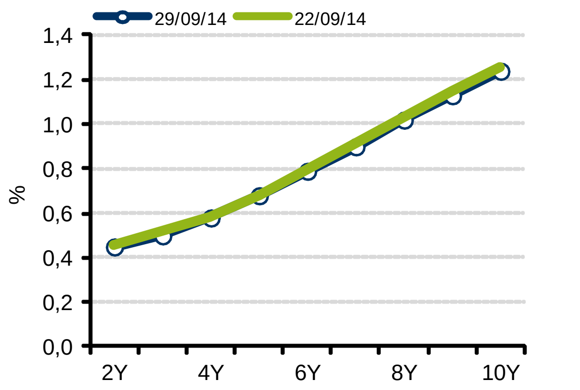
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	09/30/2014	9:00	GDP	%	2Q/2014 *F					0	2.7
HU	09/30/2014	9:00	PPI	%	08/2014					0.5	-0.3
CZ	09/30/2014	10:00	Money supply M2	%	08/2014						3.3
PL	09/30/2014	14:00	Current account	EUR M	2Q/2014			674		-766	
HU	10/01/2014	9:00	PMI manufacturing		09/2014					51	
PL	10/01/2014	9:00	PMI manufacturing		09/2014			48.6		49	
CZ	10/01/2014	9:30	PMI manufacturing		09/2014			53.8		54.3	
CZ	10/01/2014	14:00	Budget balance	CZK B	09/2014					-14.8	
HU	10/02/2014	9:00	Trade balance	EUR M	07/2014 *F					497.6	
HU	10/03/2014	9:00	Retail sales	%	08/2014						2.3

Fixed-income in Charts

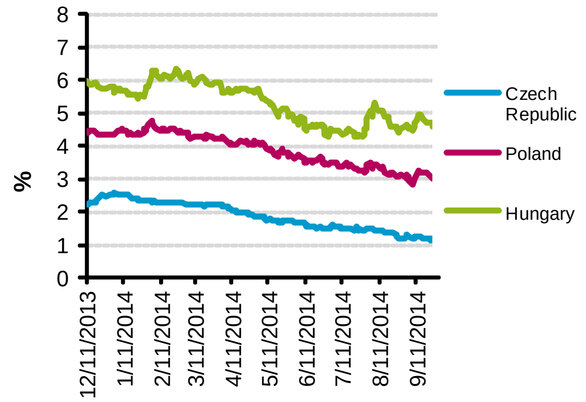
FRA 3x6



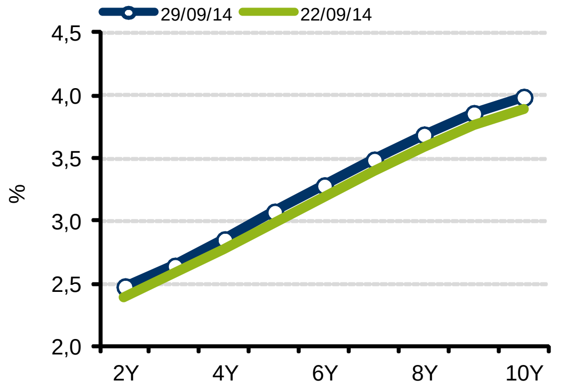
CZ IRS



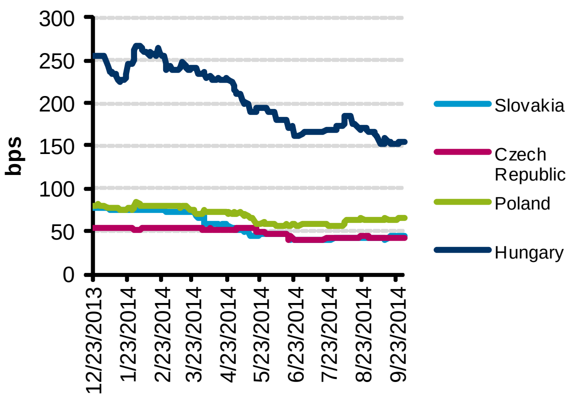
10Y GB Yields



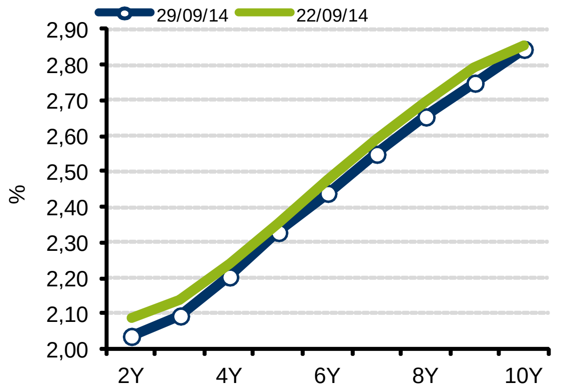
HU IRS



CDS 5Y



PL IRS



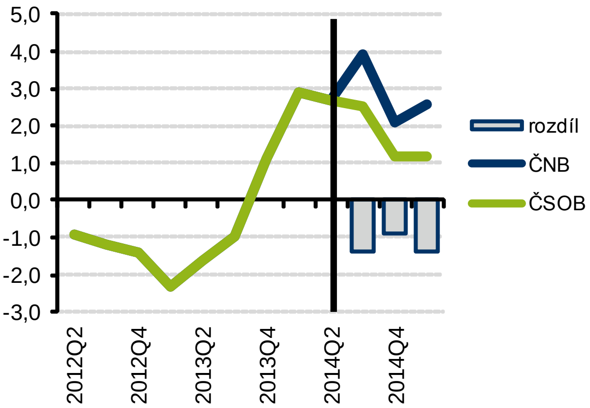
Source: Reuters

Medium-term Views & Issues

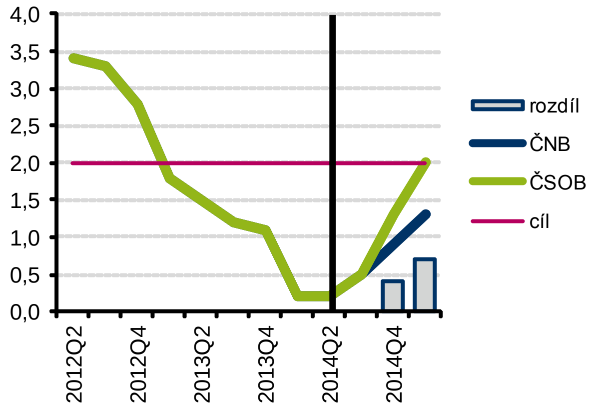
	The Czech Republic	Hungary	Poland
Growth & key issues	The economy is in a period of upswing. The key economic fundamentals remain very strong, with many of them even improving over the course of time. The new government, formed after the autumn 2013 election, is just gradually starting to carry out its programme. It should include not only savings but also greater tax relief for parents with children, a new VAT rate, and likely also the termination of the new funded pension system (called the 2nd pillar), set up in the last two years.	Based on the first quarter figure and the recent trends in the economy, Hungary's GDP may grow above 2.5% Y/Y in 2014 and it cannot be excluded that the growth might be close to 3% Y/Y level. The low base supports this economic growth level in short term, but without a substantial rise of investments in the private sector this year, economy may slow down to around 2% Y/Y level in 2015. On the other hand, in spite of growing domestic demand, inflation appears well anchored and inflationary expectations stick close to 3 %. Moreover, as this year's harvest may be good, food processing industry hardly escalates price pressures in the economy.	According to the GUS estimates, the Polish economy grew by 3.3% in 2014Q2. The data unveiled a strong contribution of domestic demand but also a high contribution of in inventories which somehow blurred overall good message. On the other hand, ongoing crisis in eastern Ukraine poses clear risks for the economic growth, especially in comparison with our expectations in the beginning of the year. Still, we expect the economy to expand by more than 3% in 2014.
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. We believe that the exchange rate targeting will be abandoned much later (not before the second half of 2015), and that the move will certainly not be accompanied by a rise in interest rates, as suggested by the official forecast.	The NBH has finished its easing cycle in Hungary by cutting the base rate to the 2.1%. The NBH emphasized that the inflation may return to the inflation target (3% Y/Y level with the tolerance channel of +/-1%pt) at end-2015, but if the Monetary Council sees that the inflationary outlook is changing, they will adjust the monetary policy. Our base case is that first hike may come in summer 2015, but the cycle might be gradual a slow, so we expect that base rate might remain below 3% at end-2015.	Inflation pressures in Poland remain subdued and year-on-year prices growth is seen well below the lower tolerance band of the inflation target. At the same time, anti-inflationary risks stemming from Ukraine crisis and ECB recent policy easing are mounting. We therefore expect NBP to cut interest rates by 25 bps in both October and November and risks are skewed towards even more pronounced policy easing in months to come.
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.	In a longer term perspective, HUF is still in a weakening channel implying a 2-3% depreciation of the currency against EUR on a yearly basis. Taking into account the government's and NBH's statements, such a gradual depreciation of the currency is welcomed as it definitely not endangers the stability of the country. Additionally the government still wants to solve the problems of the foreign currency denominated loans in the households sector in autumn, which may give the National Bank of Hungary an even bigger room of maneuvering room.	Less optimistic economic outlook and renewed monetary policy easing should cap room for prospective strengthening of the zloty in months to come. For the rest of the year, we therefore expect a stagnation of the zloty against the euro and consider risks as skewed slightly towards possible depreciation, even though Polish assets could draw support from further easing of monetary policy conditions in the euro zone.

CBs' Projections vs. Our Forecasts

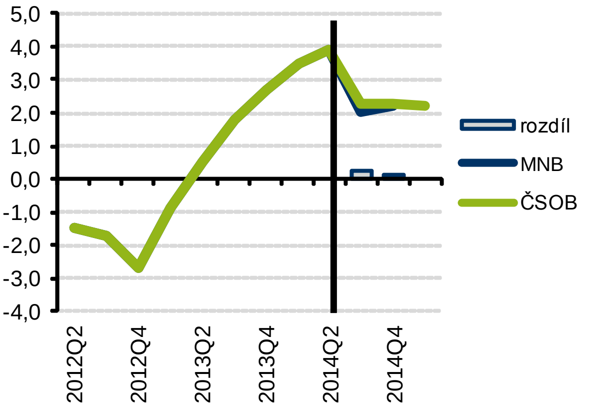
CZ: GDP outlook (Y/Y, %)



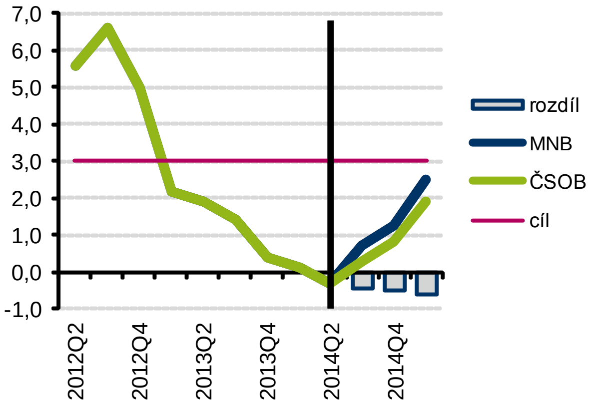
CZ: Inflation outlook (Y/Y, %)



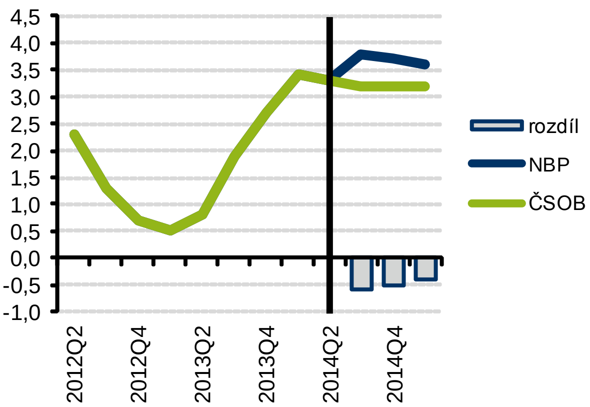
HU: GDP outlook (Y/Y, %)



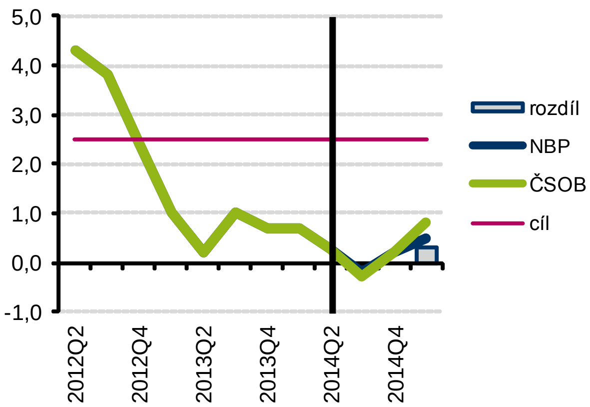
HU: Inflation outlook (Y/Y, %)



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	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	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.	*2.10*	2.60	2.30	2.10	2.10	2.10	-10 bps	7/22/2014
Poland	2W inter. rate	*2.50*	2.50	2.50	2.50	2.00	2.00	-25 bps	7/3/2013

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

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	PRIBOR	*0.35*	0.37	0.35	0.35	0.35	0.35
Hungary	BUBOR	*2.09*	2.67	2.34	2.15	2.15	2.15
Poland	WIBOR	*2.3*	2.71	2.68	2.45	2.20	2.20

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

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	CZ10Y	*1.24*	1.84	1.34	1.40	1.50	1.75
Hungary	HU10Y	*3.99*	4.95	3.77	3.50	3.50	3.65
Poland	PL10Y	*2.85*	4.03	3.39	2.75	2.60	2.60

Exchange rates (end of the period)

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	EUR/CZK	*27.5*	27.4	27.4	27.9	27.7	27.4
Hungary	EUR/HUF	*313*	307	310	310	310	310
Poland	EUR/PLN	*4.19*	4.17	4.16	4.19	4.17	4.17

GDP (y/y)

	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	-1	1.1	2.9	2.7	2.5	1.2	1.2
Hungary	1.8	2.7	3.5	3.9	2.3	2.3	2.2
Poland	1.9	2.7	3.4	3.3	3.2	3.2	3.2

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

	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	1	1.4	0.2	0.0	1.0	1.4	2.0
Hungary	1.4	0.4	0.1	-0.3	0.3	0.8	1.9
Poland	1	0.7	0.7	0.3	-0.3	0.2	0.8

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.	-1.5	-2.5
Hungary	-2.7	-3.0
Poland	-4.4	-3.5

Source: CSOB, Bloomberg

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