



# Central European Weekly

Monday, 10 November 2014

## Table of contents

Weekly Highlights:	1
Chart of the Week	1
Market's editorial	2
Review of Economic Figures	3
In Focus	4
Weekly preview	5
Calendar	6
Fixed-income in Charts	7
Medium-term Views & Issues	8
CBs' Projections vs. Our Forecasts	9
Summary of Our Forecasts	10
Contacts	11

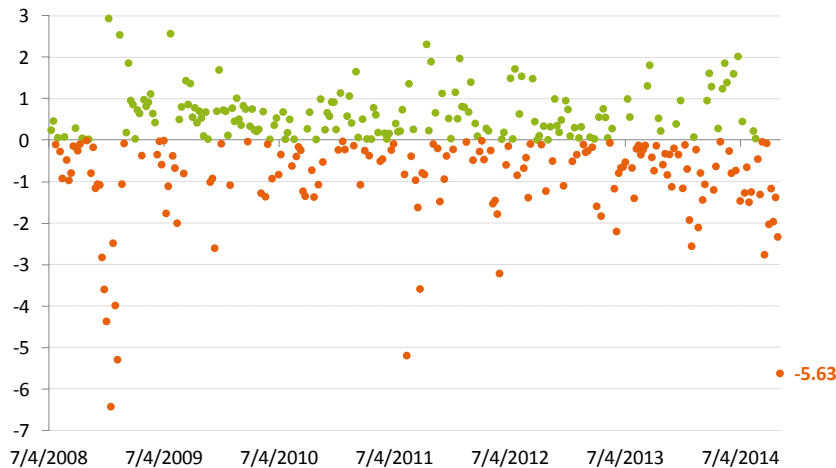
## Weekly Highlights:

- The NBP surprises again – this time by holding interest rates flat
- Hungarian and Czech industries in a good shape
- In Focus. New CNB's projection and its policy implications
- Preview: October's inflation and GDP flash estimates

## Chart of the Week

### Ruble basket

weekly average, change in %, negative figures denote ruble depreciation



Ruble posted the largest losses since early 2009 last week... (Source: Bloomberg, CSOB)

# Market's editorial

## The NBP surprises again and leaves rates unchanged

The Polish central bank (NBP) surprised the markets (and us as well) for the second time in a row in October as it left its rates unchanged yesterday.

Though a new forecast showed that inflation is likely to remain below the target in 2015 and 2016 and GDP growth estimate has also been lowered, the bank said that disinflation pressures are mainly driven by external factors (falling commodity and food prices) which NBP policy cannot do anything about.

At the same time, NBP President Belka said at the press conference that the economy did not show negative secondary effects of below-zero-inflation and stressed (like other members of the Monetary Policy Council who were present at the press conference) that the real economy was, despite some slowdown, doing quite well. More specifically, Belka said that development in labour market had been positive and wage growth had shown a healthy growth as well (in 2014, by nearly 4 % Y/Y on average with inflation being around zero). Moreover, one of the most dovish members of the Monetary Policy Council (RPP) - Elzbieta Chojna-Duch - said that the recent economic slowdown may prove to be only temporary as suggested by the PMI returning above the 50 points level in October.

Nevertheless, because the balance of risks is anti-inflationary, the overall tone of the meeting is clearly dovish. According to the press release, "the Council highlights that uncertainty regarding the economic conditions in the environment of the Polish economy persists. Therefore, the Council does not rule out further adjustment of monetary policy, should the incoming data point to a risk of deterioration in economic growth outlook". We therefore do not exclude further monetary policy easing in the first quarter of the next year.

## Ruble's free-fall interesting but GDP a inflation figures too

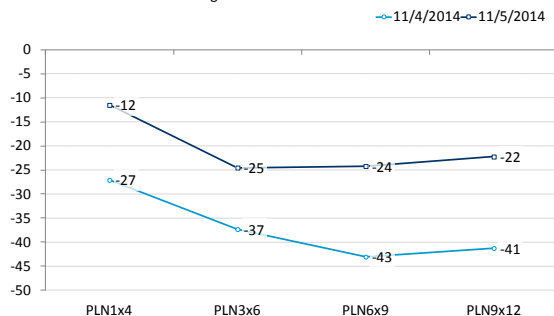
Interestingly, the biggest regional attention grabbed the Russian ruble and its heavy sell-off. Last week, ruble's slide against the basket of the dollar and the euro triggered a response from the Russian central bank, which said on Friday that it stood ready to intervene in favour of the ruble without prior warning.

Still, the extreme ruble's volatility had only limited spill-over effects on regional markets. They are going to focus on key domestic macro figures, which will be released this week – these include the October inflation and flash GDP estimates for the third quarter.

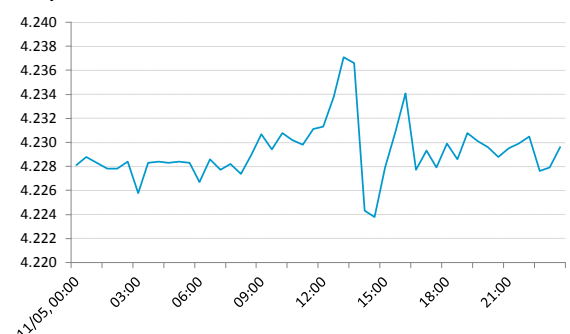
	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.7	-0.24%	↘	↘
EUR/HUF	309	-0.18%	→	→
EUR/PLN	4.22	-0.14%	↘	↘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.10	-1.35	↗	↗
10Y HUF	3.34	-1.18	↗	↗
10Y PLN	2.48	4.42	↗	↗

**PL: FRA against 3M interbank offered rate (bps)**  
before and after the NBP meeting



**EUR/PLN**



# Review of Economic Figures

## Hungarian industry: "Audi effect" is back

In September 2014 – according to preliminary data – Hungary’s industrial output rose by 7.6% compared to the same month of 2013. Adjusted by working days and seasonal effects, the growth amounted to 2.7% versus last month. Year-on-year, output increased by 8.6% in the first nine months of this year. Data shows that setback in August derived from an individual impact, namely the factory shutdown of Audi and restrained production of Suzuki. Therefore it cannot talk about a permanent decline or an economic shock. Detailed data has not been published but it appears likely that rise in September was attributed to production restart of Audi factory. Although the output is gaining pace, the increase seems to slow down. Main reasons for that might be the economic slowdown in the Euro-area that reduces factory orders and slower production of Suzuki factory owing to a model-change. All in all the increase is good news, but chances for a two digits improvement seen before August faded: rise in this year may amount to around 8% this year and 6% year. However several factors might alter this scenario such as global economic growth.

## Czech inflation flat in October

The year-on-year consumer inflation remained stable at 0.7 % as expected, while the month-on-month CPI growth reached 0.2 %, mainly thanks to rising clothes and footwear prices. This item of the consumer basket has shown the highest sensitivity towards currency devaluation over the last twelve months. Quite interestingly, a sharp decline in oil prices, has only had a limited impact on gasoline prices so far and thus has weighed only marginally on inflation. We expect, however, that the cheap oil will play a more substantial role in lowering inflation during the months. This development will, nevertheless, hardly bother the central

bank, as lower commodity prices are, in fact, a positive supply shock from the perspective of the economy. We think that the CPI inflation can go up slightly at the beginning of the next year, mainly due to a slower decline in electricity prices. Still, we expect inflation to stay below the central bank’s target (2 %) throughout 2015.

## Industry again gains momentum after a short break

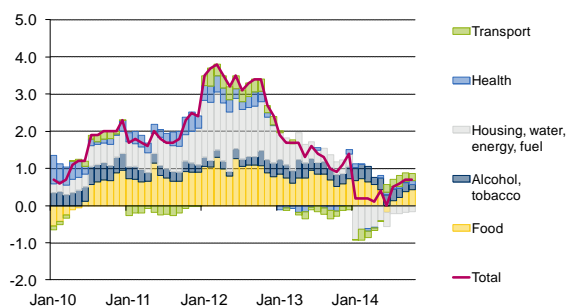
September’s output of this, the largest sector, rose by 8.3% y/y. The one extra business day in the month also contributed to September’s industrial output. Adjusted for this effect, industrial output still rose by a respectable 5.6%. In line with expectations, industry is recovering, being primarily boosted by extremely successful passenger car production this year. Figures from the energy sector and, as usual, engineering are also positive. The favourable development of industry and its very decent prospects are enabling businesses to recruit new staff; making industry the dominant contributor to improvements in the labour market. Industry is also likely to perform well in the months to come because new orders are significantly rising again.

## Czech Exports again rise at a double-digit rate.

September’s rate of exports exceeded the 14% mark while imports rose by only slightly above 11%. September’s trade balance surplus almost doubled on a year-on-year basis and climbed to CZK 19.3 bn (according to national methods) and CZK 47.3 bn according to the previously used cross-border statistics. We can still see the two most evident trends in the foreign trade: the persisting strong rise in exports of cars and car parts on the one hand and the positive effect of the falling prices of imported raw materials on the other. The foreign trade is heading towards new record-breaking results. Thus trade, that is to say exports, will very likely continue to contribute to the solid economic growth.

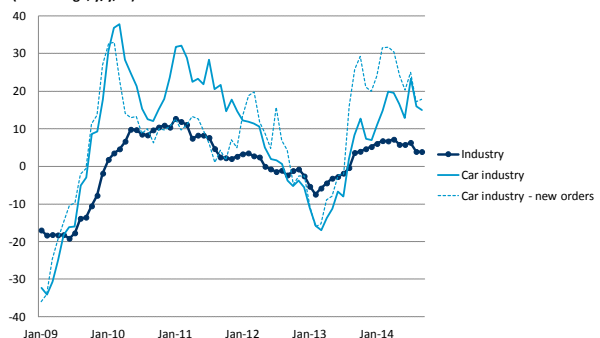
**CZ: Inflation**

(consumer basket decomposition in percentage points)



**CZ: Industrial Production**

(3m average, y/y, %)



# In Focus: CNB's outlook – no policy change

## No change of CNB's on the horizon

The eagerly awaited meeting of the CNB Board one year after the devaluation of the koruna was concluded with a clear message. The Czech National Bank is not considering any change to its exchange rate regime, not even in the wake of the current reduction in the inflation outlook and the economic growth forecast for next year. Thus, further easing through targeted CZK's depreciation is not on the agenda and, as stated in the press conference after the meeting, it was not even considered as a possible alternative.

## Low inflation, but influenced by a positive supply shock

The CNB seems to be very satisfied with the results of the devaluation, both in terms of inflation and in terms of the overall economic situation. Although the bank has lowered its forecast, it sees the primary reasons for this deterioration abroad, including lower inflationary pressures in the euro area, lower than expected economic growth and lower EURIBORs. By contrast, the bank regards the low price of oil – which will also certainly curb inflation in the Czech Republic – as a positive cost shock to the Czech economy.

In its latest forecast the CNB expects economic growth of 2.5% this year and the next, which is approximately 0.5% below the previous outlook; the bank has also cut its inflation forecast for the end of next year by the same value.

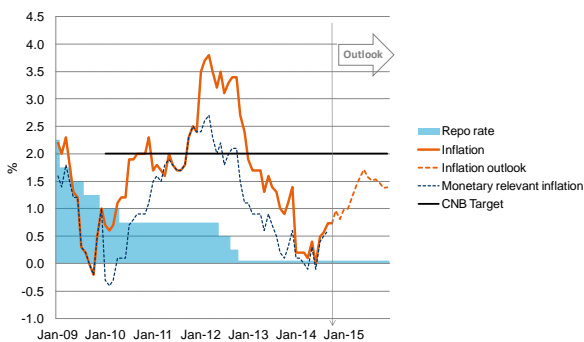
In addition, the forecast – unlike the previous one – envisages a termination of the exchange rate regime slightly later (in early 2016 as opposed to the originally envisaged third quarter of 2015), thus aligning it with the CNB Board's previous position. Short-term market interest rates will also rise later (according to this forecast). The rates should not go up before the second quarter of 2016, when the 3M PRIBOR should break through 1%.

## We have doubts about 2016 hikes and strong wage growth

As a matter of fact, the central bank's outlook has been put in line with the real situation. Nevertheless, we still consider it to be fairly optimistic, at least as concerns interest rates. We believe that it will not be so easy to abandon the exchange rate commitment and raise interest rates immediately. This is why we expect both of these events to occur later, with the time between the two steps to be somewhat longer. Therefore we believe that interest rates will be 'normalised' over a longer period and more slowly.

Another doubt is raised by the central bank's conviction of significant wage growth acceleration in the business sector. Although the Czech economy is already faring well this year, wage growth is still very moderate and we do not believe that it will significantly accelerate as early as next year.

CZ: Inflation and interest rates



CNB's prognosis

		Nov-14	Jul-14	change
GDP (y/y, %)	2014	2.5	2.9	↓
	2015	2.5	3.0	↓
	2016	2.8	2.8	
Inflation (y/y, %)	2014Q4	0.7	0.9	↓
	2015Q4	1.5	2.0	↓
	2014Q4	0.4	0.7	↓
Monetary relevant inflation	2015Q4	1.6	1.9	↓
	2014	0.4	0.4	
	2015	0.4	0.5	↓
PRIBOR 3M (%)	2016	1.2	1.6	↓

Source: CNB

# Weekly preview

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

	Oct-14	Sep-14	Oct-13
CPI y/y	-0.3	-0.3	0.8
Food (ex Alc.) y/y	-1.7	-2.0	1.9
Transport (including fuel)	-3.2	-3.2	-2.3

## PL: Inflation still negative in October

Poland's inflation remained in negative territory in October, hitting -0.3% y/y according to our forecasts. Just as in previous months, this was primarily due to the external factors of falling food and fuel prices. Low inflation is good news for Polish households – at least temporarily, because wage growth remains very decent and real disposable household income is consequently rising.

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

	Q3-14	Q2-14	Q3-13
GDP (q/q)	0.5	0.3	0.4
GDP (y/y)	2.6	2.5	-0.5

## CZ: GDP driven by carmakers

The first GDP forecast for the third quarter could confirm the good condition of the manufacturing industry and carmakers in particular. Tobacco stockpiling will likely play a 'positive' role on the demand side. Otherwise, we believe that there is a continuing moderate rise in consumption and continuing acceleration of investment. We predict overall economic growth for 2014 at 2.4%.

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

	Q3-14	Q2-13	Q3-13
GDP	2.7	3.3	2.0

## PL: The Polish economy posts solid growth

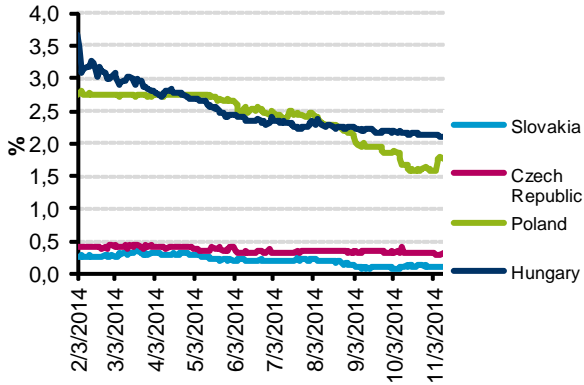
The flash forecast of Poland's GDP growth, in spite of its noticeable deceleration vis-à-vis previous quarters, should point to continued very solid growth by the Polish economy (at least in the European context). According to our forecasts, Polish GDP grew by 2.7% y/y in the third quarter, with domestic demand being the primary growth factor (just as in the second quarter) in our opinion. Domestic demand has been primarily encouraged by solidly rising household income.

# Calendar

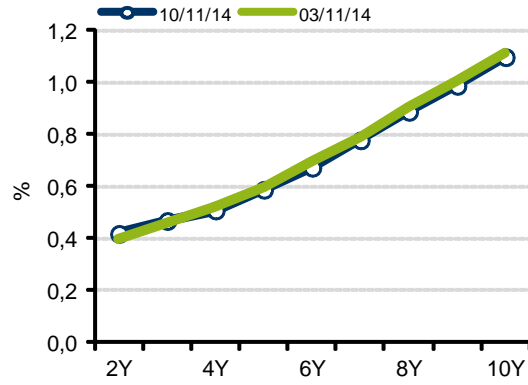
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	11/10/2014	9:00	CPI	%	10/2014	0.1	0.7	0.1	0.6	-0.2	0.7
CZ	11/10/2014	9:00	Unemployment rate 15-64	%	10/2014	7.2		7.1		7.3	
HU	11/11/2014	9:00	CPI	%	10/2014			-0.2	-0.3	-0.2	-0.5
HU	11/12/2014	9:00	Industrial output	%	09/2014 *F					2.7	5.2
CZ	11/13/2014	10:00	Current account		CZK B 09/2014	-7		-9		-15.54	
PL	11/13/2014	14:00	Current account		EUR M 09/2014			-460		-986	
PL	11/13/2014	14:00	Trade balance		EUR M 09/2014			400		-64	
PL	11/13/2014	14:00	CPI	%	10/2014	0.2	-0.3	0.2	-0.4	0	-0.3
CZ	11/14/2014	9:00	GDP	%	3Q/2014 *A	0.5	2.6	0.4	2.5	0.3	2.5
HU	11/14/2014	9:00	GDP	%	3Q/2014 *P			0.3	2.9	0.8	3.9
PL	11/14/2014	10:00	GDP	%	3Q/2014 *P		2.7	0.5	2.7	0.6	3.3
PL	11/14/2014	14:00	Money supply M3	%	10/2014			0.9	7.9	0	7.8

# Fixed-income in Charts

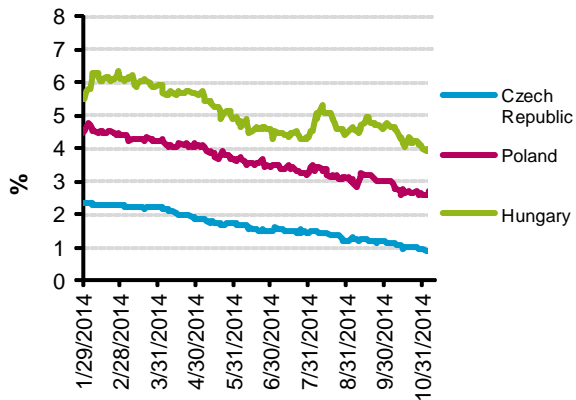
**FRA 3x6**



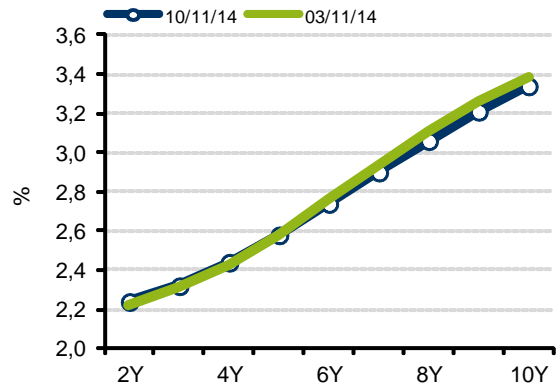
**CZ IRS**



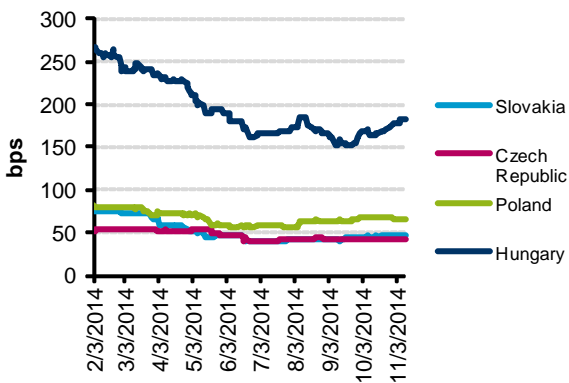
**10Y GB Yields**



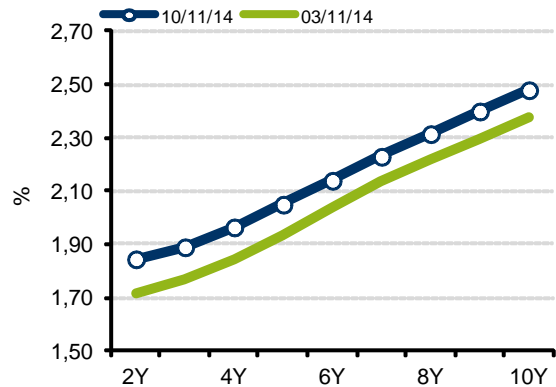
**HU IRS**



**CDS 5Y**



**PL IRS**



Source: Reuters

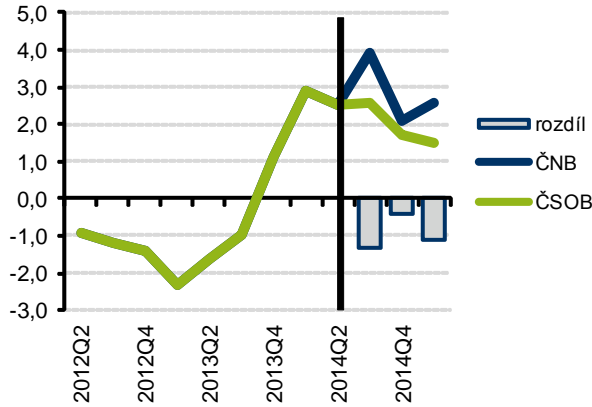
# Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	<p>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.</p>	<p>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.</p>	<p>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 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. We therefore expect a significant slowdown in economic growth in the second half of the year and in 2014 expect overall growth slightly below but close to 3%.</p>
Outlook for official & market rates	<p>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 EUR/CZK 27. 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 (during the second half of 2016), and that the move will certainly not be accompanied by a rise in interest rates, as suggested by the official forecast.</p>	<p>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.</p>	<p>Inflation pressures in Poland remain subdued and year-on-year prices growth is seen well below the lower tolerance band of the inflation target. After surprising markets by cutting interest rates by 50 basis points in October, the NBP surprised in November as well, this time by leaving rates unchanged. The overall tone of the meeting was, however, dovish and we therefore not exclude additional rate cut in the beginning of the next year.</p>
Forex Outlook	<p>We anticipate clearly lower growth and inflation in the euro area, and therefore we also predict, on the whole, a slower rate of Czech inflation. In 2015, inflation will again be below the CNB's 2% target, and the question is how the CNB Board will react to this. The recollection of the negative response from the Czech public to the last devaluation of the currency and the fact that inflation will remain in positive territory should be the main arguments against a further targeted weakening of the currency. Yet we see an approximately 40% likelihood of this scenario, which might happen in 2015.</p>	<p>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.</p>	<p>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.</p>

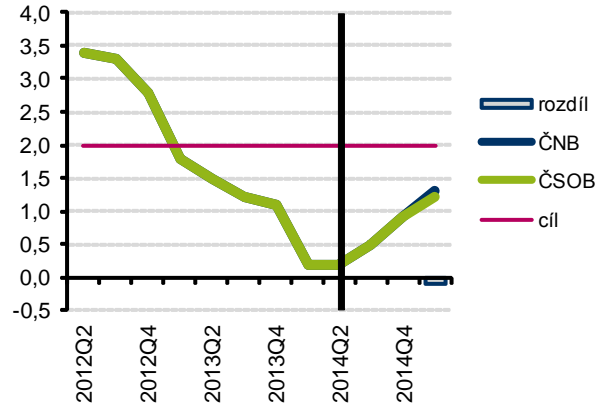


# CBs' Projections vs. Our Forecasts

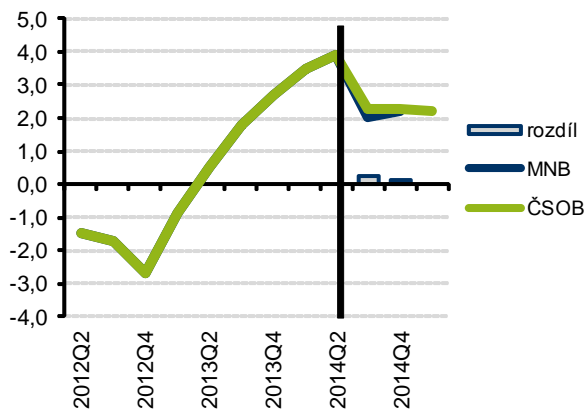
**CZ: GDP outlook (Y/Y, %)**



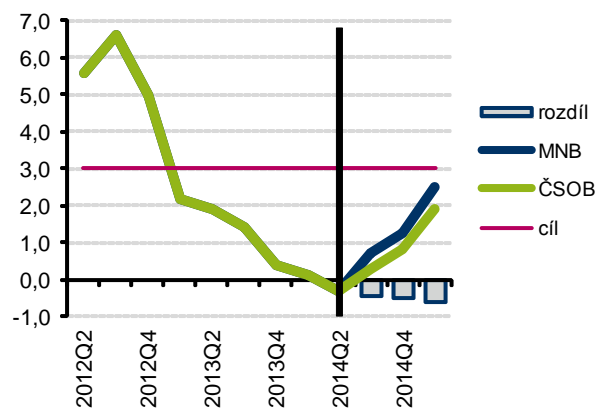
**CZ: Inflation outlook (Y/Y, %)**



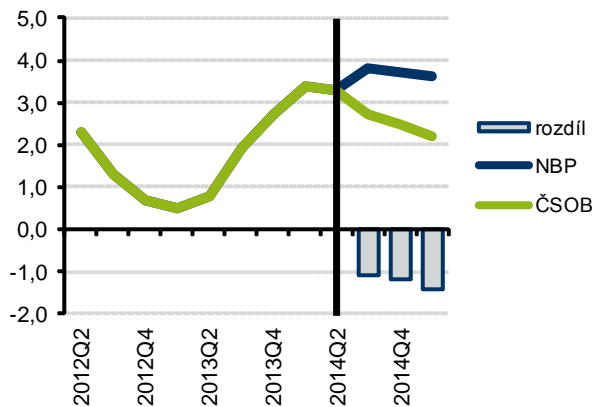
**HU: GDP outlook (Y/Y, %)**



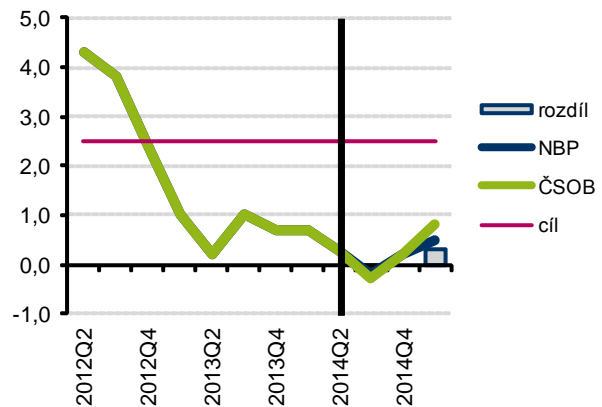
**HU: Inflation outlook (Y/Y, %)**



**PL: GDP outlook (Y/Y, %)**



**PL: Inflation outlook (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	2.00	2.50	2.50	2.50	1.75	1.75	-25 bps	10/8/2014

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

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	PRIBOR	0.34	0.37	0.35	0.34	0.35	0.35
Hungary	BUBOR	2.10	2.67	2.34	2.09	2.15	2.15
Poland	WIBOR	2.03	2.71	2.68	2.28	2.00	2.00

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

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	CZ10Y	1.1	1.84	1.34	1.22	1.25	1.30
Hungary	HU10Y	3.34	4.95	3.77	3.92	3.50	3.65
Poland	PL10Y	2.48	4.03	3.39	2.87	2.60	2.60

## Exchange rates (end of the period)

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	EUR/CZK	27.7	27.4	27.4	27.5	27.9	27.7
Hungary	EUR/HUF	309	307	310	311	310	310
Poland	EUR/PLN	4.22	4.17	4.16	4.18	4.17	4.17

## GDP (y/y)

	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	-1	1.1	2.9	2.5	2.6	1.7	1.5
Hungary	1.8	2.7	3.5	3.9	2.3	2.3	2.2
Poland	1.9	2.7	3.4	3.3	2.7	2.5	2.2

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

	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	1	1.4	0.2	0.0	0.7	1.0	1.3
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	-2.0
Hungary	-2.7	-3.0
Poland	-4.4	-3.5

Source: CSOB, Bloomberg

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