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Central European Weekly

Monday, 01 June 2015

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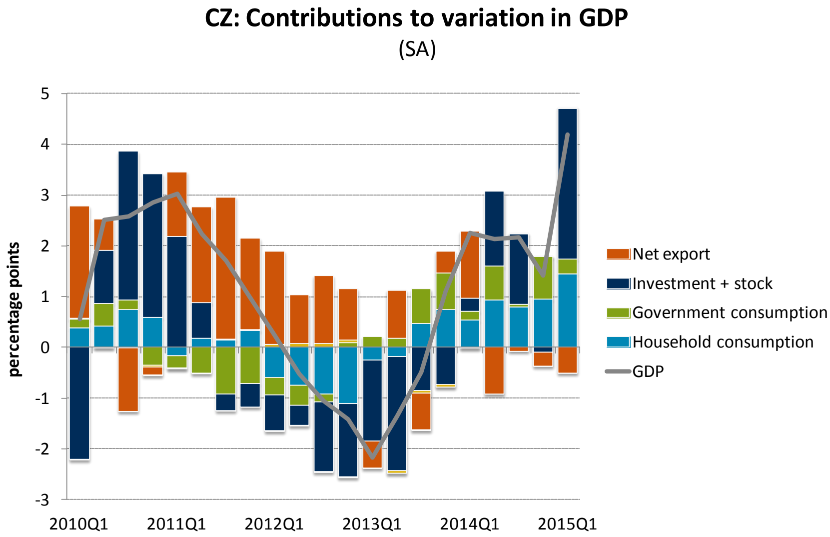
- The NBP on hold this week as the easing cycle is over

Chart of the Week: Czech GDP in details



The Czech economy is growing thanks to the manufacturing industry, carmakers in particular, whose positive performance is spilling over to growing exports as well as investments. But inventories make up exactly half the 4.2% y/y growth.

Market's editorial

The NBH cuts to fresh lows – no trigger for market volatility

An expected rate cut of the National Bank of Hungary to new lows and the details of GDP data in the Czech Republic and Poland were last week's key macroeconomic events, although they left no significant traces on regional markets. This could remain the case in the days to come, as neither the regional PMI business sentiment indices nor the meeting of the National Bank of Poland are likely to be key sources of regional volatility.

While writting about regional central banks it is worth reminding that that The National Bank of Hungary cut base rate by 15bp from 1.8% to 1.65% as expected last week. Although the statement mentioned these changes, it doesn't give main importance to it. In our view the last sentence: 'Cautious easing of the policy rate may continue as long as it supports the achievement of the medium-term inflation target' confirms that the NBH is determined to moderate the base rate to the Polish level of 1.5%, which is likely to be achieved already in June. We expect that it might be the end of the rate cut cycle as fundamentally we see less and less reasons to continue the cycle, while the stability risk aspect is increasing.

The NBP on hold this week as the easing cycle is over

Regarding, we really beleive that the monetary easing cycle is over as it had been previously communicated by the Polish Monetary Policy Council, Thus, the NBP will leave rates unchanged at an all-time low of 1.5% on Wednesday. Although inflation will remain below zero in the near future and will not climb into positive territory before late this year, Polish central bankers are satisfied with the economic growth and labour market improvements.

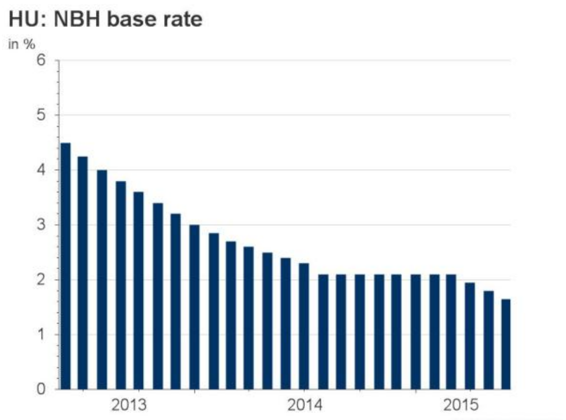
In fact, Central European markets must carefully monitor events on core markets in particular, and attention must be paid to possible financial contagion from emerging markets, which may be generated, for example, by the Turkish lira, the Russian rouble or Chinese shares. Nevertheless, the main stimuli for volatility may come from as the situation regarding Greece is entering its final stage, while US economi will deliver some key data his week (personal expenditures, ISM, ADP, ISM non-manufacturing ISM, payrolls).

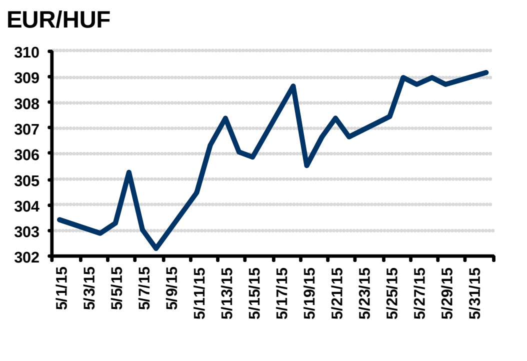
Euro adoption - still non-issue in the Czech Republic

Sunday's top-level discussion about introduction of the common European currency in the Czech Republic showed again that political consensus has been still minssing in this issue. Probably the most interesting comment was that uttered by finance minister Babis (opponent of an early euro adoption) who pulled out obscure idea of a non-binding referendum about the euro adoption proposed to coincide with 2017 parliamentary elections. PM Sobotka cast doubt on usefulness of such a referendum and emphasized that the country had already committed itself to adopt the single currency at the moment of its EU-accession.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.4	0.13%	→	→
EUR/HUF	310	0.64%	→	→
EUR/PLN	4.12	0.26%	→	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.03	-1.44	→	↘
10Y HUF	3.06	-1.45	→	→
10Y PLN	2.72	3.23	→	→





EUR/HUF, last 22 days. Source: Reuters

Review of Economic Figures

Strong Czech GDP: An economic wonder or just inventories?

The Czech Statistical Office released details on the Czech Republic's economic growth for the first quarter of the year. Moreover, it even increased the already high forecast for the Czech economy for that period from the original 3.9% y/y to 4.2% y/y, and from 2.8% q/q to 3.1% q/q.

The key assumptions have been met. The economy is growing thanks to the manufacturing industry, carmakers in particular, whose positive performance is spilling over to growing exports as well as investments. In line with expectations, households have also increased their spending and are also improving the demand for new passenger cars. Moreover, 3% growth in household consumption is something we have not seen here at all since 2008.

Investment, with growth also exceeding 3%, is more good news. The primary investment targets currently include new cars, structures and housing. For that matter, this was already evident from the construction performance early this year. The recovered appetite for building and investing is obvious in both the public and private sectors. Money is actually the cheapest it has ever been and is also easily available, and thus the only thing left to do is find projects with good prospects that have already been technically prepared.

However, a curb to the optimism stemming from the latest figures is the strong share of inventories in overall economic growth. According to data from the Statistical Office, inventories make up exactly half the above-mentioned 4.2%. This is a very high share, which may certainly not reoccur, and thus we believe that inventories will have an adverse impact on GDP in the quarters to come. Hence the 4% growth is an exception rather than a new economic wonder. This is why we believe that the first digit of the rate of economic growth will certainly be '2' for the rest of the year.

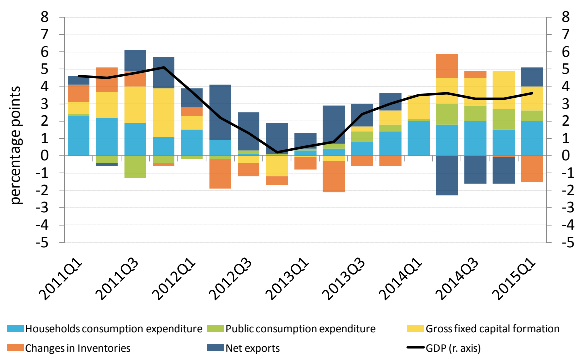
The Polish GDP revised slightly upwards

Polish GDP was also revised upwards compared to the original forecast, albeit only slightly (from 3.5% y/y to 3.6% y/y). Regarding its structure, the most surprising facts were probably a highly positive contribution by net exports on the one hand and a negative contribution from the change in inventories on the other. Household consumption and, in particular, investment continue to develop well. Full-year economic growth may be 3.5-4%.

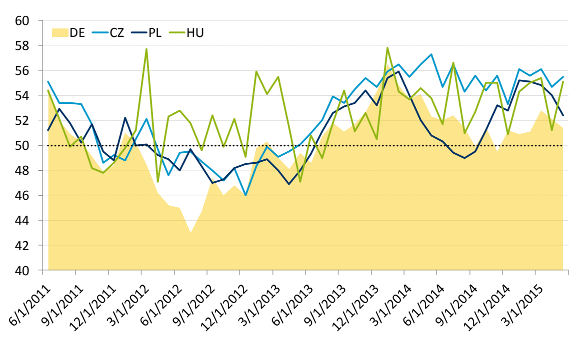
Regional PMIs – Poland down, Czech Rep. and Hungary up

Fresh regional PMI figures for May showed that the Polish index remains well above 50 points level and it still indicates improving conditions in manufacturing. Howeverver, the drop of the healine figure to the lowest level in 8 months might indicate some loss of momentum. On the contrary, the Czech PMI came out a bit stronger than expected. Particularly encouraging is a further improvement in employment index which increased at the strongest rate in more than four years. The same story revealed the Hungarain PMI report as the headline figure jumped to 55.1 points in May from 51 recorded in April.

PL: Contributions to GDP growth



PMI: CE vs Germany



Weekly preview

WED 14:00 NBP rate (in %)

	This	Last change
rate level	**1.50**	3/2015
change in bps	**0**	-50

PL: NBP will leave rates unchanged

The MPC will leave rates unchanged at an all-time low of 1.5%. Although inflation will remain below zero in the near future and will not climb into positive territory before late this year, Polish central bankers are satisfied with the economic growth and labour market improvements. Moreover, the current Monetary Policy Council has previously communicated that the monetary easing cycle is over. We can hardly expect a revolutionary change in attitudes, especially since the term of office of numerous MPC members expires soon. A new governor and six new MPC members will be appointed within the next two years.

FRI 9:00 CZ Retail sales (y/y change in %)

	Apr-15	Mar-15	Apr-14
Monhtly	**7.0**	8.8	6.3
cummulative (YTD)	**7.4**	7.6	6.6
Montly cars excl.	**5.7**	5.9	4.6
cummulative (YTD)	**5.7**	5.7	3.1

CZ: Retail boom continues

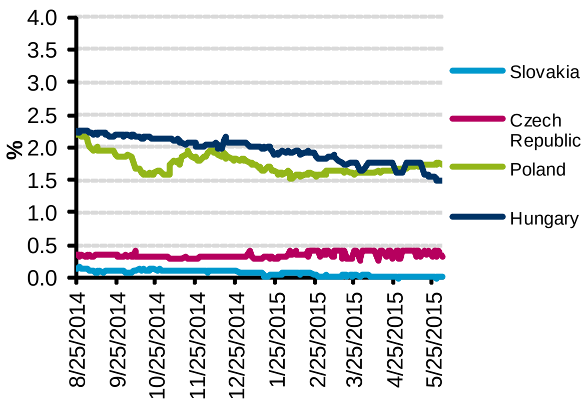
We expect that retail sales in the Czech Republic continued to grow rapidly in April. And just as in previous months, their growth was primarily driven by strong sales of passenger cars. However, other retailers are not lagging significantly behind either, particularly those operating in e-commerce, which are likely to show growth of more than 20%. We predict strong demand for electronics, household equipment and, finally, also fuel. The growing retail sector reflects strong consumer demand, which has, however, generated no visible inflationary pressures so far. Nevertheless, over the months to come we expect retail sales growth to decelerate slightly from its current 7%.

Calendar

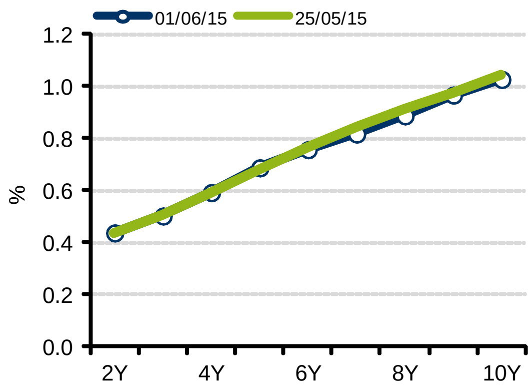
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	06/01/2015	9:00	PMI manufacturing		05/2015			53.4		54	
HU	06/01/2015	9:00	Trade balance	EUR M	03/2015 *F					929	
HU	06/01/2015	9:00	PMI manufacturing		05/2015					51	
CZ	06/01/2015	9:30	PMI manufacturing		05/2015			54.8		54.7	
CZ	06/01/2015	14:00	Budget balance	CZK B	05/2015					-0.4	
HU	06/03/2015	9:00	Retail sales	%	04/2015				5.4		5.1
PL	06/03/2015	14:00	NBP meeting	%	06/2015	1.5		1.5		1.5	
CZ	06/05/2015	9:00	Real wages	%	1Q/2015				2.6		1.8
CZ	06/05/2015	9:00	Retail sales	%	04/2015		7		7.3		8.8
HU	06/05/2015	9:00	Industrial output	%	04/2015				5.8	2.6	9
HU	06/05/2015	9:00	GDP	%	1Q/2015 *F					0.6	3.4

Fixed-income in Charts

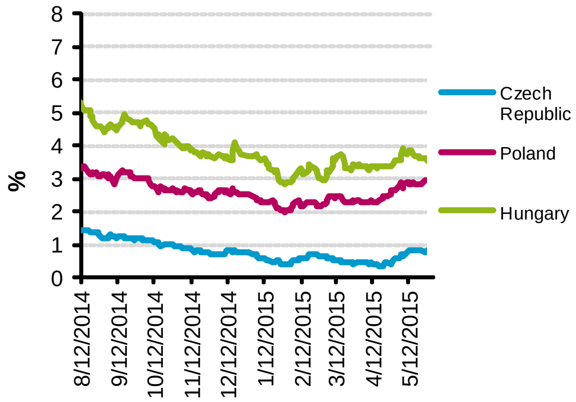
FRA 3x6



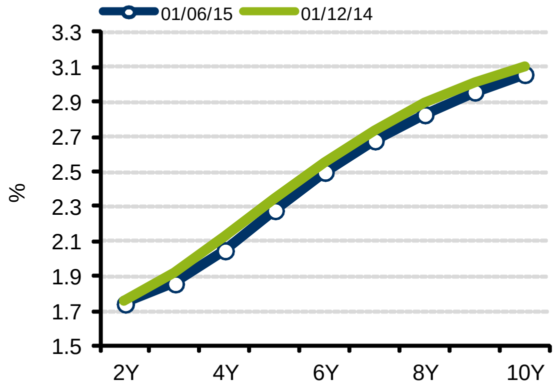
CZ IRS



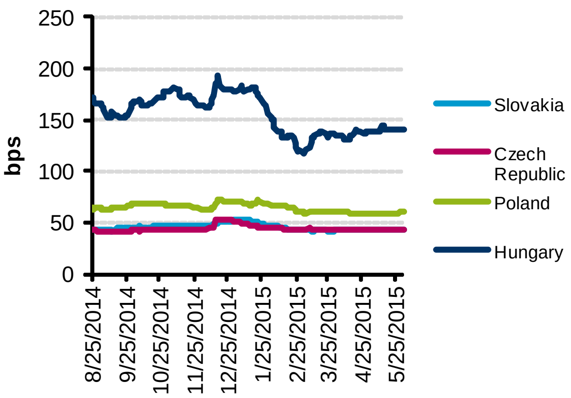
10Y GB Yields



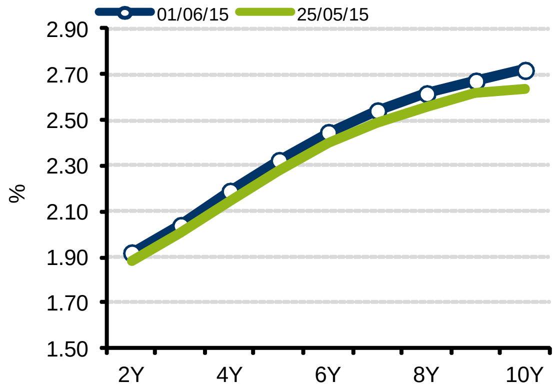
HU IRS



CDS 5Y



PL IRS



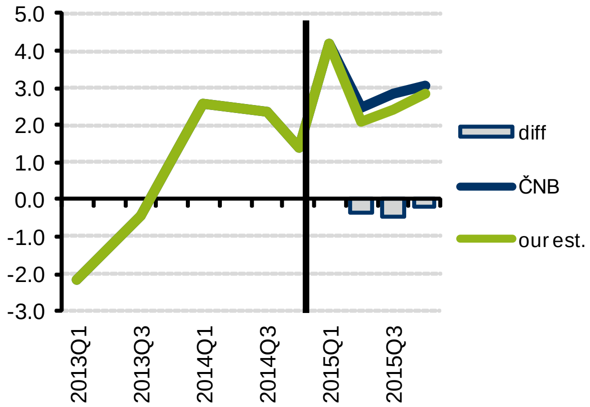
Source: Reuters

Medium-term Views & Issues

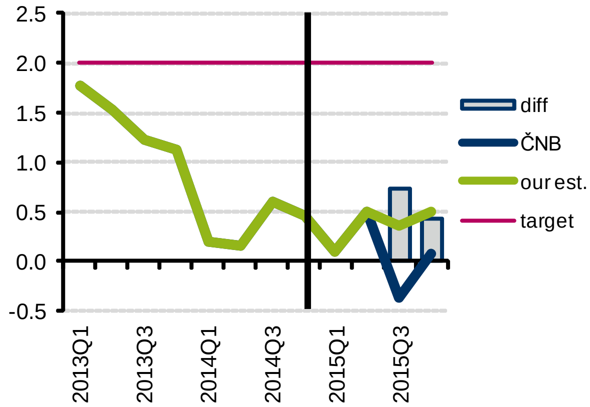
	The Czech Republic	Hungary	Poland
Growth & key issues	The current economic recovery is primarily based on the outstanding performance of the automotive industry on the one hand and restored investment and consumption growth on the other. Economic growth has also been encouraged by the deficit financing of the public sector, which is, however, generating no pressures on the capital market thanks to fairly low debt and reserves. The government policy has not delivered any fundamental economic changes so far, perhaps except for the planned abolition of the pension reform and partial modifications of certain taxes and social security benefits. The issue of euro adoption is still on ice in the CR.	The Hungarian economy has continued to record solid growth this year as the working day adjusted GDP grew by 3.4% Y/Y in the first quarter. Looking ahead the GDP growth might slow down slightly in the coming quarters, but the favourable European conjuncture and the increasing net real wage and employment increase might provide a stable base for the growth so we expect that Hungarian economy may grow by about 3% Y/Y in 2015.	According to the GUS, the Polish economy grew by 3.6% in 2015Q1. As in previous quarters, economic growth was driven mainly by strong domestic demand. We suspect households consumption was again the key driver of economic growth in Poland. As for this year, we expect economic growth may be 3.5-4%.
Outlook for official & market rates	Interest rates remain at all-time lows and, given the positive inflation outlook, the CNB is unlikely to raise its base rate before 2017. In addition, the central bank will not proceed to such a move before it abandons its current exchange rate policy, which is based on maintaining the exchange rate above the EUR/CZK floor. Moreover, the decreasing inflationary expectations may even delay these two steps. This possibility is reflected by money market rates and, in particular, by IRS and government bond yields. Our longer term outlook for inflation is still below the central bank's official forecasts.	The National Bank of Hungary cut base rate by 15bp from 1.8% to 1.65%. Although the statement mentioned these changes, it doesn't give main importance to it. In our view the last sentence: 'Cautious easing of the policy rate may continue as long as it supports the achievement of the medium-term inflation target' confirms that the NBH is determined to moderate the base rate to the Polish level of 1.5%, which is likely to be achieved already in June. We expect that it might be the end of the rate cut cycle as fundamentally we see less and less reasons to continue the cycle, while the stability risk aspect is increasing.	We expect the NBP to keep rates at new lows (1.50%) this year, but we cannot completely rule out the likelihood of further rate cuts. The main reason is the combination of the "inflow of cheap euros from the ECB" to markets and the unusually open commitment by the NBP not to continue to cut rates. In addition, if we take account of this year's inflation rate, which is likely to be negative for the year as a whole, such a climate will probably attract investments in Polish assets. In that event, additional pressure for the appreciation of the zloty and consequently for an inflation fall can be expected.
Forex Outlook	We believe a hike of EUR/CZK floor is still unlikely. This would require deterioration of currently positive economic outlook. On the other hand the, the more aggressive verbal interventions may keep the Czech koruna on the defensive for a while. Hence it is probable that the pair forgets about testing the 27 EUR/CZK for now. Fundamentally, the Czech currency should be more sensitive to readings of major Czech macroeconomic indicators – inflation, wages, industry and, of course, GDP. The koruna may get more nervous ahead of May's CNB Board meeting, where a new inflation forecast will be submitted.	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.	We expect the zloty to gain on growing capital inflows exploiting the positive interest rate differential at the time short term yields are mostly negative in the eurozone. Given the NBP pledge to end the rate cutting cycle, the market may feel temptation to test the willingness of the central bankers to tolerate further gains of the Polish currency.

CBs' Projections vs. Our Forecasts

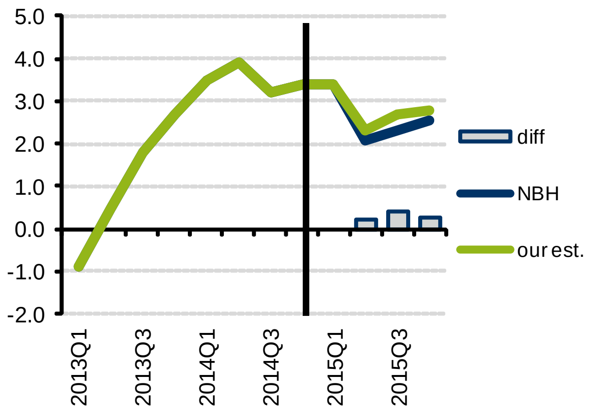
CZ: GDP outlook (Y/Y, %)



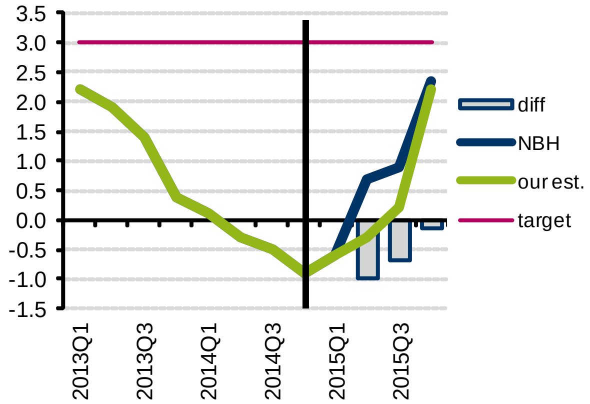
CZ: Inflation outlook (Y/Y, %)



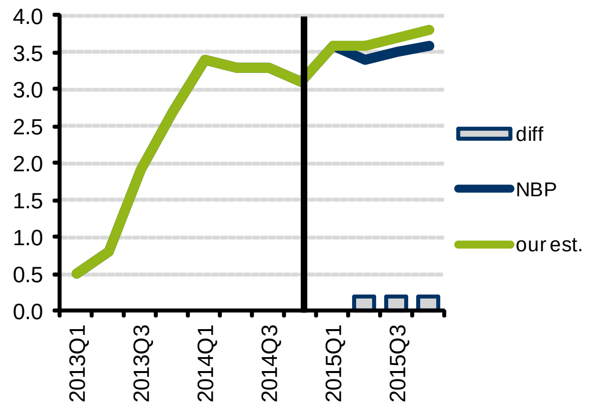
HU: GDP outlook (Y/Y, %)



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	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	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.	*1.65*	1.95	1.70	1.70	2.00	2.25	-10 bps	5/26/2015
Poland	2W inter. rate	*1.50*	1.50	1.50	1.50	1.50	1.50	-50 bps	3/4/2015

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	PRIBOR	*0.31*	0.30	0.30	0.30	0.30	0.30
Hungary	BUBOR	*1.54*	1.89	1.70	1.70	2.10	2.40
Poland	WIBOR	*1.68*	1.65	1.55	1.60	1.65	1.67

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	CZ10Y	*1.03*	0.64	0.80	0.75	0.80	0.80
Hungary	HU10Y	*3.06*	2.71	3.20	3.40	3.60	3.80
Poland	PL10Y	*2.72*	2.12	2.10	2.20	2.40	2.80

Exchange rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	EUR/CZK	*27.43*	27.57	27.30	27.60	27.30	27.30
Hungary	EUR/HUF	*310*	300	310	317	315	310
Poland	EUR/PLN	*4.12*	4.07	4.05	4.00	4.10	4.05

GDP (y/y)

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	2.4	1.4	4.2	2.1	2.4	2.8	2.5
Hungary	3.2	3.4	3.4	2.3	2.7	2.8	2.2
Poland	3.3	3.1	3.6	3.6	3.7	3.8	3.8

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

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	0.7	0.1	0.2	0.6	0.3	0.8	1.5
Hungary	-0.5	-0.9	-0.6	-0.3	0.2	2.2	2.7
Poland	-0.3	-1.0	-1.5	-1.1	-0.8	-0.1	0.4

Current Account

	2015	2016
Czech Rep.	1.6	1.5
Hungary	4.0	3.8
Poland	-1.2	-2.0

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-2.4	-1.9
Hungary	-2.2	-2.0
Poland	-3.0	-2.5

Source: KBC, Bloomberg

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