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Central European Weekly

Monday, 07 December 2015

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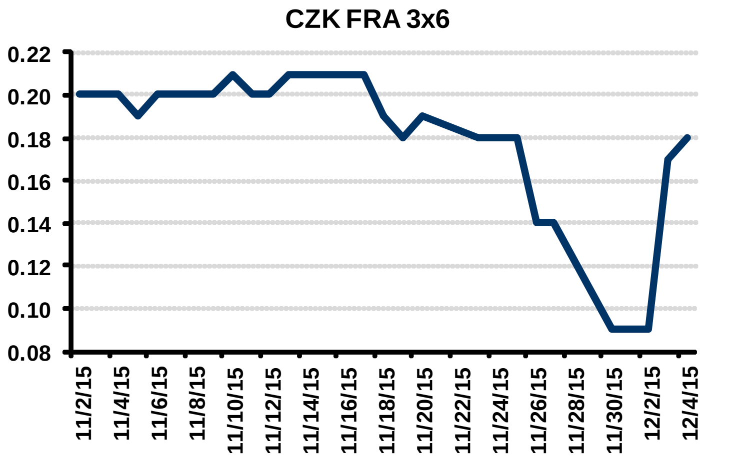
- Weekly preview: Czech and Hungarian inflation will move up to positive territory

Chart of the Week: CZK rate-cut expectations



CZK FRA 3x6, last 25 days. Source: Reuters

Rate-cut expectations in the Czech money markets have been trimmed down following the ECB meeting.

Market's editorial

ECB's disappointment will influence regional central banks

The disappointment brought by ECB President Mario Draghi on afternoon Thursday not only applied to the core markets but also hit Central Europe quite significantly. The ECB's less aggressive expansion and a stronger euro do and will have an impact on the policies of central banks in the Central European region.

The zloty has appeared the weakest reagional spot

Above all, both the zloty pareticularly reacted to the ECB negatively. Given the fact that the ECB as the main monetary authority in the region looks less dovish, it seems that further considerations that the NBP will continue to ease their monetary policies early next year may be re-rewritten. Still we should bear in mind that an overwhelming majority of the Monetary Policy Council (MPC) members will be replaced (with members who will be more dovish) early next year. On the other hand if the zloty continues to weaken (which our baseline scenario with a target 4.40 fro the EUR/PLN pair), the new MPC members may completely lose their appetite to cut rates.

Positive news: Hungarian bonds survied sell-off

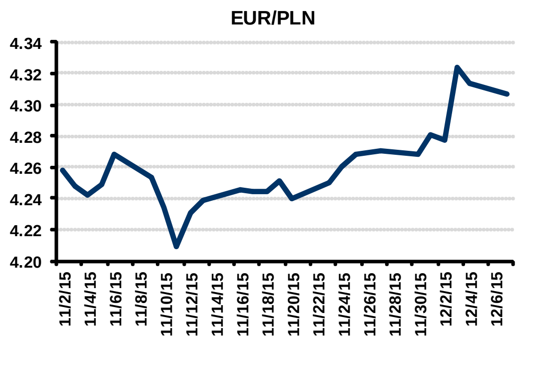
As the ECB didn't increased the monthly purchasing amount of bonds it pushed up the Hungarian bond yields, but less than the Spain or the Italian ones. The ECB's cut of deposit rate may suggest that the National Bank of Hungary may use also first the tool of cutting further the deposit rate rather than cutting the base rate in the coming meeting. The good news is that as the ened of last wewek showed Hungary looks less sensitive on international sentiment than one or two years ago.

Implication for the CNB from the ECB: no need to cut further

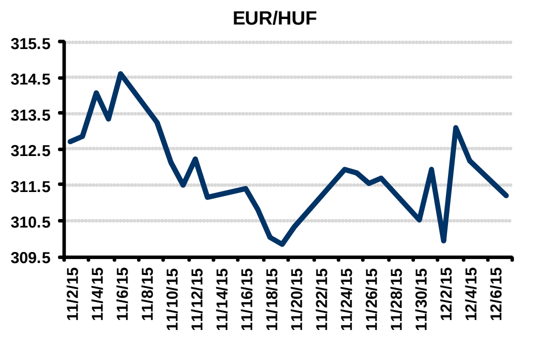
For the Czech National Bank the most important outcome of Thursday's spectacle by the ECB is the extension of its quantitative easing policy beyond 2016 (specifically until March 2017). In our opinion this means that the CNB will not abandon its interventions against the koruna before the first quarter of 2017. As concerns the CNB rates, a cut in the ECB deposit rate by 'only' 10 basis points will not force the CNB to cut its rates into negative territory as well. Thus, official interest rates should remain unchanged as the Czech Central Bank might continue to argue that the economy actually heats up.

	Last	Change 1W
EUR/CZK	*27.0*	*-0.04%*
EUR/HUF	*312*	*0.33%*
EUR/PLN	*4.31*	*0.94%*

	Last	Change 1W
10Y CZK	*0.94*	*23.68*
10Y HUF	*2.88*	*5.96*
10Y PLN	*2.39*	*5.88*



EUR/PLN, last 26 days. Source: Reuters



EUR/HUF, last 26 days. Source: Reuters

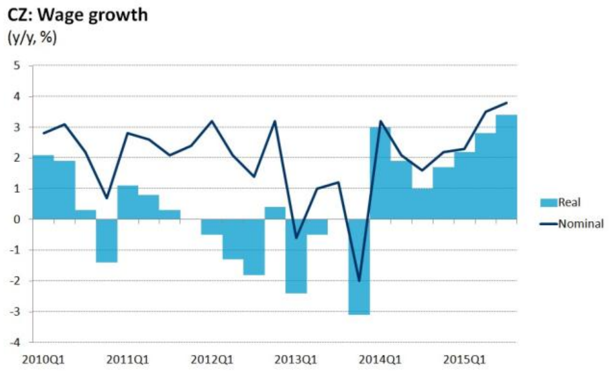
Review of Economic Figures

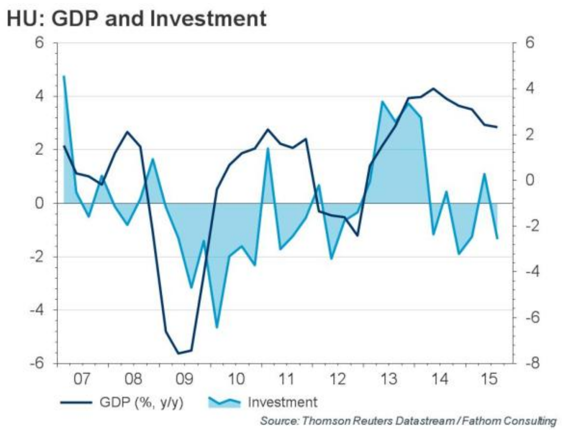
The Czech recovery still appears quite strong

Czech soft and hard data continue to support our view that the economy stands on strong footing. Recall that business confidence in Czech manufacturing remained at high levels (at 54 points) in November. This positive feelings about the Czech recovery was also confirmed by higher-than-expected wage readings for the third quarter of 2015 (real wages grew 3.4% y/y – see the chart below)) and also by recent release of the Czech industrial production for October (see the chart below).

GDP details from Hungary: domestic consumption rises

The Hungarian Statistical Office published the detailed GDP figure according to the Hungarian economy grew by 2.3% Y/Y (adjusted by seasonally and working day) in 3Q15 slightly down from 2.4% Y/Y in 2Q15. The structure of the growth changed in line with our expectation: the role of the domestic consumption is increasing (contributing 1.9%pt to the growth in 3Q15 up from 1.5%pt in 2Q15)), while the net export contributes to the GDP growth less than previous quarter (down from 2.1%pt in 2Q15 to 1.3%pt in 3Q15). The gross fixed capital formation contribution was -0.7%pt so the investment is still missing. Looking ahead the economic growth may slightly accelerate in last quarter thanks to the strengthening household consumption, so GDP growth may be 2.7% Y/Y in 2015, while it may slow to around 2.2% Y/Y in 2016 because of the missing investments.





Weekly preview

TUE 9:00 **HU Inflation (change in %)**

	Nov-15	Oct-15	Nov-14
CPI y/y	**0.6**	0.1	-0.7

HU: Inflation up on positive base effect

We expect some acceleration of inflation in November, so the headline index may jump to 0.6% YY in November from 0.1% Y/Y in October. The main reasons are the public utility cost reduction in last year will fall out from the base and the increasing domestic consumption is pushing up the trade able goods and market services prices. CPI may accelerate further in the coming months above 1.5% Y/Y.

TUE 9:00 **HU Industry (change in %)**

	Nov-15	Oct-15	Nov-14
Monthly	**8.5**	7.8	5.7
cummulative (YTD)			

HU: Industrial again very strong on car expeort

Industrial production might grow about 8.5% Y/Y in October. The driver of the sector is still the export (vehicle and electronic equipment production), but the base is also low as last year there was a model change at Suzuki factory due to the production was down substantially.

WED 9:00 **CZ Inflation (change in %)**

	Nov-15	Oct-15	Nov-14
CPI m/m	**-0.1**	0.0	-0.2
CPI y/y	**0.4**	0.2	0.6
Monetary relevant inflation y/y	**0.3**	0.1	0.5

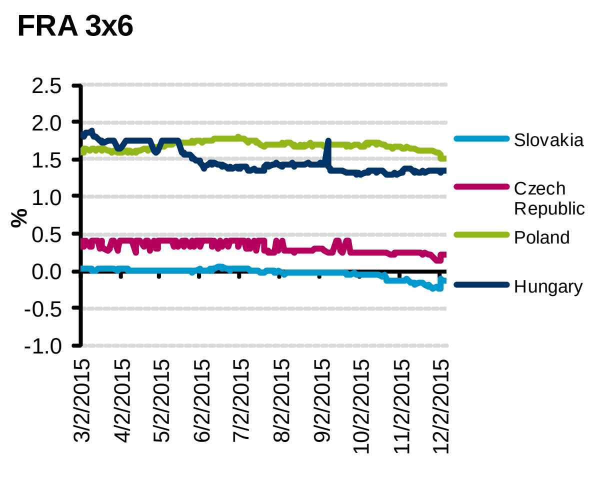
CZ: Inflation should move from zero territory

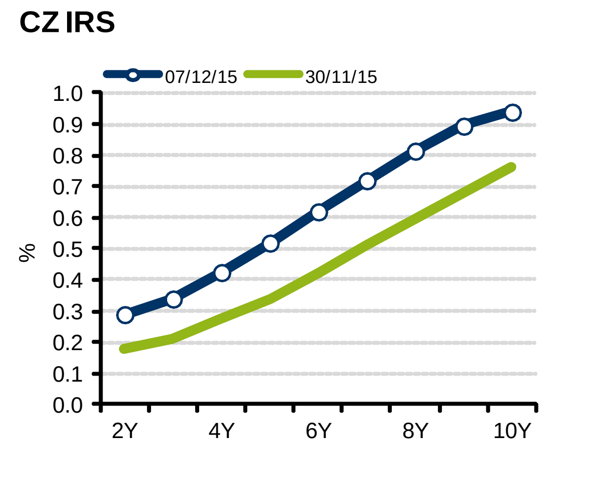
We expect the annual inflation grew from its previous extremely low 0.2% to 0.4%. In spite of that increase the inflation lags behind the central bank expectation by 0.2 percentage point. Compared to previous month the prices went down by 0.1% due to seasonal effects and lower fuel prices.

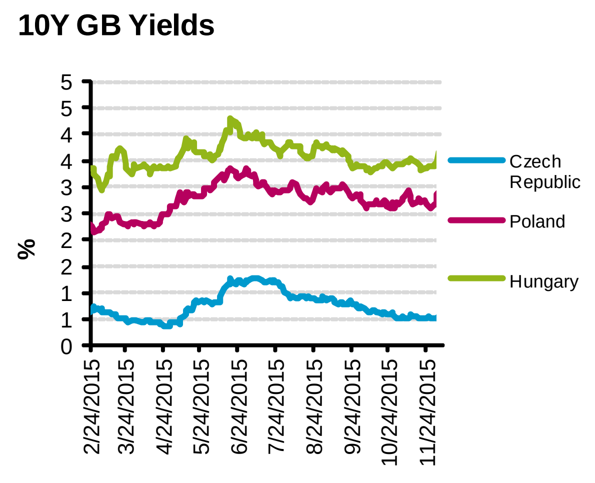
Calendar

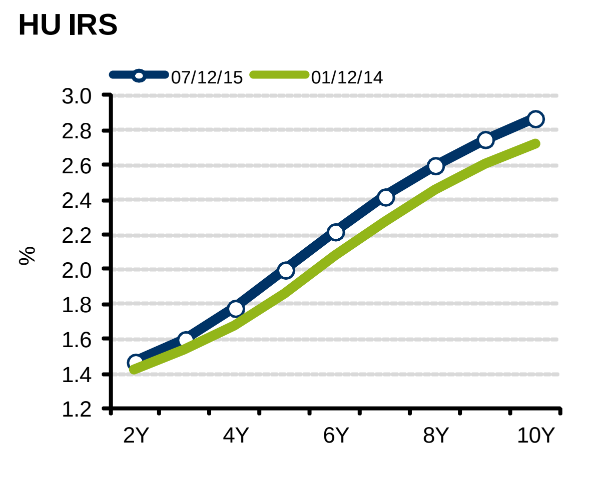
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	12/07/2015	9:00	Construction output	%	10/2015						2.4
CZ	12/07/2015	9:00	Trade balance (national)	CZK B	10/2015			12		19	
CZ	12/07/2015	9:00	Industrial output	%	10/2015				1		0.6
HU	12/07/2015	16:30	Budget balance	HUF B	11/2015					-816.2	
CZ	12/08/2015	9:00	Unemployment rate 15-64	%	11/2015			5.9		5.9	
HU	12/08/2015	9:00	Industrial output	%	10/2015		8.5		8.7	2.9	7.8
HU	12/08/2015	9:00	CPI	%	11/2015	0.1	0.6	0.2	0.6	0.2	0.1
CZ	12/09/2015	9:00	CPI	%	11/2015			-0.1	0.4	0	0.2
CZ	12/09/2015	12:00	CZ bond auction 2015-2017, 0.00%	CZK B	12/2015						
HU	12/10/2015	9:00	Trade balance	EUR M	10/2015 *P			480		855	

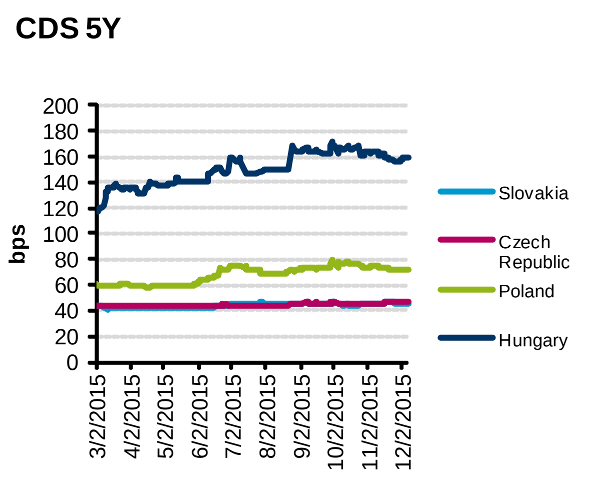
Fixed-income in Charts

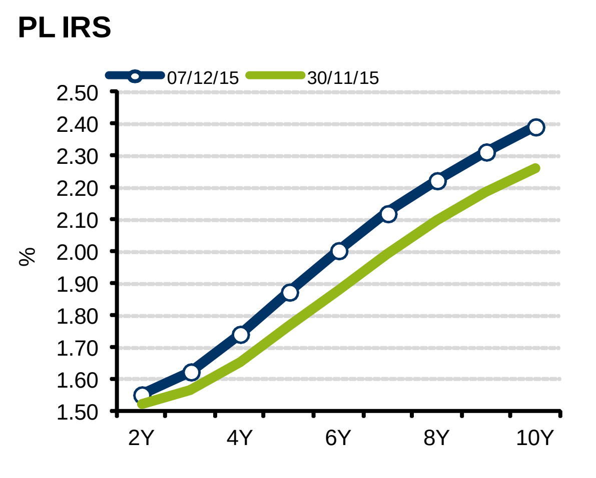












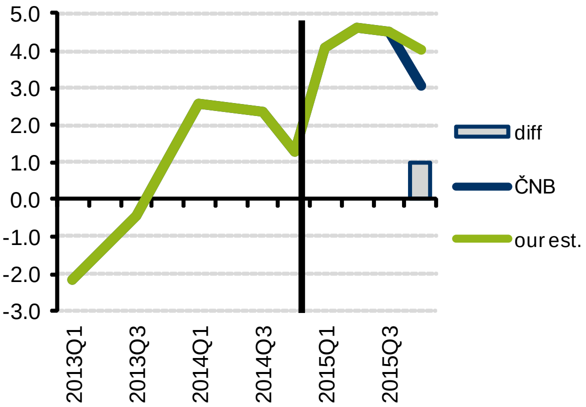
Source: Reuters

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 may bounce back closer to 3% Y/Y, as EU funds money use is accelerated and the industrial production and domestic consumption may be stronger this year as a year before, so the growth might be around 2.7% Y/Y in 2015. The bigger question what may happen next year, as the Q/Q figures reflects only 2% annualized economic growth for this year and the falling out EU funds money may push GDP growth below 2% Y/Y in some quarters. So GDP growth may be 2.7% Y/Y in 2015, while it may slow to around 2.2% Y/Y in 2016 because of the missing investments.	For a whole year 2015, we expect economic growth in Poland to reach 3.5 – 3.6 %. We do not expect growth to become an issue for policy makers in 2016 either (the growth could in our view accelerate to 3.8 %). The main risks that could undermine the overall positive development stems from an uncertain situation in emerging markets (most notably China) and their impact on the European Union countries.
Outlook for official & market rates	The CNB has implicitly postponed the deadline for discontinuing its intervention policy until late 2016 but, unlike its previous practice, it does not want to commit itself to any clearer deadline this time. With regard to the uncertainty surrounding the ECB's moves, we can only anticipate an exit sometime probably at the turn of 2016 to 2017. A scenario of negative rates is not on the agenda. Given the market developments, the CNB itself is even considering it to a lesser extent than it has done recently.	The NBH surprised the market as it shifted the interest rate corridor of overnight (O/N) instrument by 25bp downward, so the new interest rate is 0.1% (base rate minus 125bp) for deposit and 2.1% (base rate plus 75bp) for loans. This move means practically a 25bp rate cut and is clear the NBH is fully committed to force out money from NBH so it cannot be excluded that further steps may come in the future. We think the NBH will cut further its base rate, if the ECB loosen further its monetary policy and the EUR/HUF moves closer to 300. In that case the base rate might be cut below 1%, while we think that with the previous speed, namely by 15bp per meetings.	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. This promise will probably be hold, while we should wait how the MPC will be changed in 2016 as new President and Sejm will appoint almost all Board members.
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. We believe the Czech National Bank will meet its "pledge" and won't terminate its intervention regime before the second half of 2016 and can extend the pledge even further. The above mentioned factors should however keep the koruna close to EURCZK 27.0 in the months ahead. Possible start of tightening of US monetary policy poses negative risks for the koruna. We however think the fallout should only be limited.	We think that any strengthening of the HUF is rather temporary and the NBH's commitment to the long time low interest rate (just like the gradual push out of foreign holding from Hungarian government bonds) may lead to a HUF weakening in the coming weeks and months. It is also clear that the NBH has no problem with the HUF weakening, so rate hike driven by a temporary HUF devaluation is out of picture.	Although the new government may eventually turn out to be more market-friendly than had been expected, we think that pressures on zloty´s depreciation may intensify again at the beginning of 2016 when most members of the Monetary Policy Council (MPC) will be replaced. Also probability of further interest rate cuts by the Polish central bank rises under the new government. Nonetheless, we still keep our base-line scenario unchanged and bet on stable rates in Poland by the end of 2016. Fed hikes and weaker zloty could prevent the altered MPC from cutting rates again.

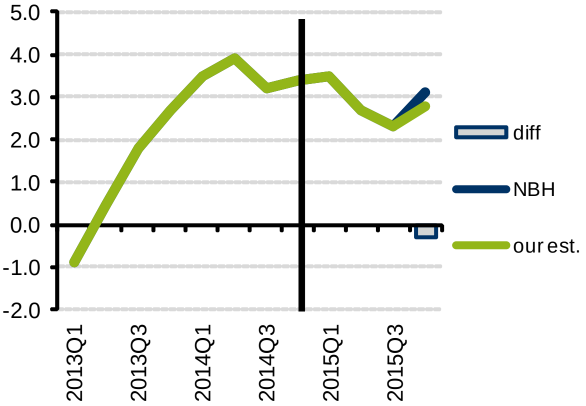
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

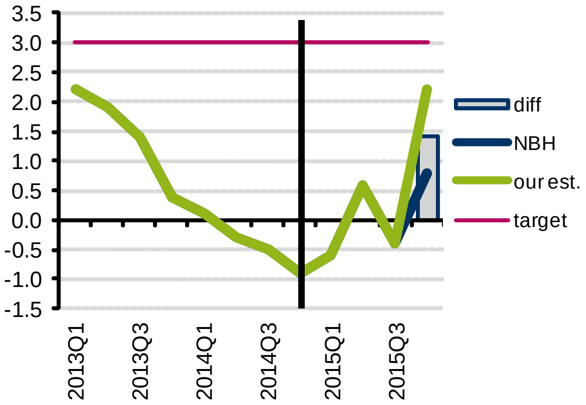


CZ: Inflation outlook (Y/Y, %)

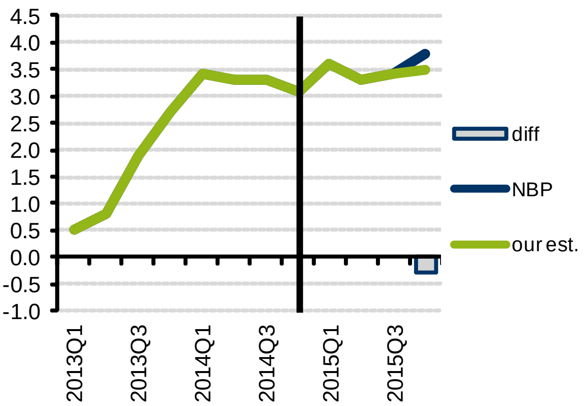
HU: GDP outlook (Y/Y, %)



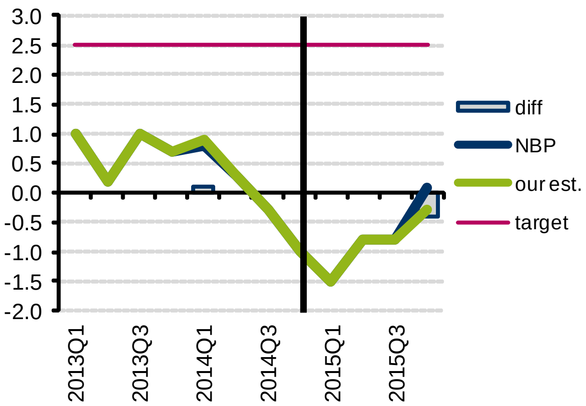
HU: Inflation outlook (Y/Y, %)



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.	*1.35*	1.95	1.50	1.35	2.00	2.25	-10 bps	7/21/2015
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	*0.00*	0.30	0.29	0.26	0.28	0.28
Hungary	BUBOR	*1.35*	1.89	1.41	1.35	2.10	2.40
Poland	WIBOR	*1.72*	1.65	1.72	1.73	1.65	1.67

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	CZ10Y	*0.94*	0.64	1.30	0.98	1.10	1.20
Hungary	HU10Y	*2.87*	2.71	3.45	2.93	3.60	3.80
Poland	PL10Y	*2.39*	2.12	3.01	2.50	2.40	2.80

Exchange rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	EUR/CZK	*27.04*	27.57	27.35	27.19	27.05	27.00
Hungary	EUR/HUF	*312*	300	315	314	315	310
Poland	EUR/PLN	*4.31*	4.07	4.19	4.25	4.15	4.10

GDP (y/y)

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	2.4	1.3	4.1	4.6	4.5	4.1	2.3
Hungary	3.2	3.4	3.5	2.7	2.3	2.8	2.2
Poland	3.3	3.1	3.6	3.3	3.4	3.5	3.5

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

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

Current Account

	2015	2016
Czech Rep.	1.5	1.5
Hungary	6.0	4.5
Poland	-1.2	-2.0

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-1.6	-1.3
Hungary	-2.3	-2.1
Poland	-3.0	-2.5

Source: KBC, Bloomberg

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