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Central European Weekly

Monday, 01 February 2016

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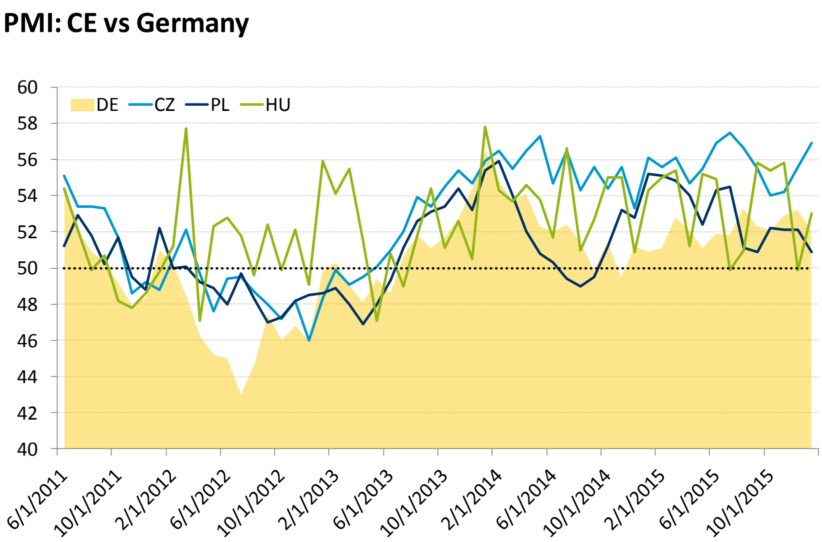
Chart of the Week: Regional PMIs for Jan.



Regional PMIs indices for January were a mixed bag.

Market's editorial

Regional PMIs mixed, central banks' meetings eyed

Markets in Central Europe have started the week with a fresh look at business sentiment indices in manufacturing this morning. They have delivered a mixed picture from the region as the Czech industry improved in January (PMI grew to 56.6pts) while Polish disappointed again with very low readings (PMI slipped to 50.9). In addition to PMI data, regional markets will primarily pay attention to the two other regional events - the meetings of the NBP and the CNB this week.

What the modified MPC will say about the weak zloty?

As concerns the NBP meeting this week, the partly modified Monetary Policy Council (MPC) will certainly not be changing rates. While the deflationary environment in the Polish economy persists, the significant depreciation of the zloty does not provide the NBP with latitude to react by easing its monetary policy. The references to the zloty included in the commentary on the NBP's decision, or those uttered at the press conference by Governor Belka, may be the most interesting outcomes for the market. In this context it is worth mentioning that the newly appointed MPC members are very well aware that they cannot let the zloty fall completely, as this would significantly increase the costs of financing the Polish government debt.

Will the CNB extend its FX commitment?

The Czech koruna has to pay close attention to Thursday's CNB meeting. A new forecast will be available to the CNB Board, and we expect the CNB's new outlook to slightly reduce the short-term as well as the medium-term inflation outlook in the Czech Republic, and align it with commodity market developments. Of course, we cannot even rule out subsequent implications regarding the central bank's exchange rate commitment, which is still in force. Until stated otherwise, the CNB might abandon its current exchange rate policy sometime in the second half of this year, respectively at the end of it. Given the probable reduction of the inflation outlook and further easing of the ECB policy, a moderate postponement of the exchange rate commitment beyond 2016 appears to be a possible move. However, if the CNB fails to send such a signal this week, the risk of it abandoning its exchange rate commitment in 2016 will again increase somewhat, as will possible pressure on forward exchange rates to fall below the intervention threshold of EUR/CZK 27.00.

The NBH firmly on hold, but watching the ECB too

Just to have a comlete picture about CE markets central banks we should add that the National Bank of Hungary left base rate unchanged at 1.35% on Tuesday in line with the expectations. The stance of the statement didn't change substantially. The MPC emphasized that the inflation may return to the level of inflation target of 3% YoY only at the end of the forecasted horizon. The economy may slow down slightly this year, there are still unused capacities. So this environment confirms their view that he current loose monetary policy can be maintained for a long period.

Although the Hungarian assets prices and exchange rate were relatively stable in the last couple of week, the uncertain global sentiment requires a cautious monetary policy. The MPC left the door open for further loosening, but they highlighted that rather the unconventional tools will be used than a rate cut.

The first interesting meeting might be the March one, as both ECB's (10th March) and FED's (16th March) meeting will be held before the Hungarian one (22nd March). In case ECB increase the monetary stimulus and FED postpones the rate hike, NBH might change slightly the monetary conditions as well. Our base case scenario is still no base rate change in this year. But the dovish stance of ECB's, FED's and NBH's statements may push down slightly the Hungarian government bond yields in the coming weeks by 20bp.

	Last	Change 1W
EUR/CZK	27,0	-0,06%
EUR/HUF	311	-0,58%
EUR/PLN	4,41	-1,50%

	Last	Change 1W
10Y CZK	0,76	-11,63
10Y HUF	2,40	-10,95
10Y PLN	2,41	-4,94

Weekly preview

WED 14:00 **NBP rate (in %)**

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

PL: Modified MPC will not change policy

The partly modified Monetary Policy Council (MPC) will certainly not be changing rates. While the deflationary environment in the Polish economy persists, the significant depreciation of the zloty does not provide the NBP with latitude to react by easing its monetary policy. The references to the zloty included in the commentary on the NBP's decision, or those uttered at the press conference by Governor Belka, may be the most interesting outcomes for the market. In this context it is worth mentioning that the newly appointed MPC members are very well aware that they cannot let the zloty fall completely, as this would significantly increase the costs of financing the Polish government debt.

THU 9:00 **CZ Retail Sales (change in %)**

	Dec-15	Nov-15	Dec-14
Sales	**7.3**	8.7	5.8
cummulative (YTD)	**7.5**	7.5	5.5
Sales (cars excl.)	**6.0**	6.2	5.2
cummulative (YTD)	**5.5**	5.5	3.1

CZ: Strong retail sales on Christmas

We believe that retail sales for the last month of last year should have hit a record level. After all, this has also been shown by previous data – whether with or without the automotive segment included. The record level may not necessarily be that evident from the year-on-year comparison, but the absolute level of sales is likely to be the best ever. They were based on a very good consumer mood, encouraged by low unemployment and the improving financial position of domestic households, along with almost negligible inflation. We believe that sales grew in nearly all segments of the retail sector, in particular in the automotive segment and e-commerce. A strong improvement in demand will primarily be evident in home electronics, fuels, household equipment and clothing. The retail sector developed very well last year, and therefore we estimate its full-year increase at +7.5% in real terms.

THU 13:00 **CNB base rate**

	This meeting	Last change
rate level (in %)	**0.05**	11/2012
change in bps	**0**	-20

CZ: Will the CNB extend its FX commitment?

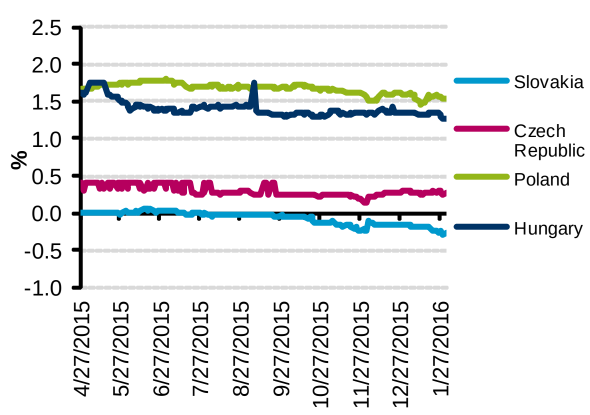
A new forecast will be available to the CNB Board at its first meeting of this year. This forecast may already reflect, to a greater extent, the favourable development of commodity prices and their subsequent positive impact on overall economic developments in the Czech Republic. The last (although still valid) forecast proved to have overrated the short-term inflation development significantly, and is already 0.7% below actual inflation. We expect the CNB's new outlook to slightly reduce the short-term as well as medium-term inflation outlook in the Czech Republic and align it with commodity market developments. Of course, we cannot even rule out subsequent implications regarding the central bank's exchange rate commitment, which is still in force. Until stated otherwise, the CNB might abandon its current exchange rate policy sometime in the second half of this year, respectively at the end of it. Given the probable reduction of the inflation outlook and further easing of the ECB policy, a moderate postponement of the exchange rate commitment beyond 2016 appears to be a possible move. This would certainly be good guidance for exporters – who are choosing the proper timing to hedge their exposure to exchange rate risk – as well as for the market. In spite of pressure on the koruna to strengthen, which the CNB is easily managing through its interventions, we still do not expect the central bank to put in place negative interest rates or to move the current lower threshold of the exchange rate.

Calendar

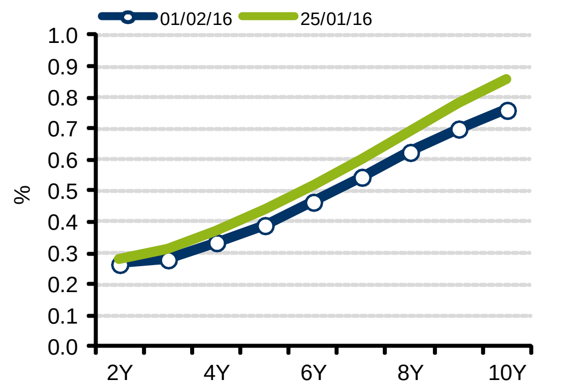
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	02/01/2016	9:00	PMI manufacturing		01/2016					49,1	
PL	02/01/2016	9:00	PMI manufacturing		01/2016			51,7		52,1	
CZ	02/01/2016	9:30	PMI manufacturing		01/2016			54,8		55,6	
CZ	02/01/2016	14:00	Budget balance	CZK B	01/2016					-62,8	
HU	02/02/2016	9:00	Trade balance	EUR M	11/2015 *F					673	
HU	02/03/2016	9:00	Retail sales	%	12/2015				4,8		4,4
PL	02/03/2016	14:00	NBP meeting	%	02/2016	1,5		1,5		1,5	
CZ	02/04/2016	9:00	Retail sales	%	12/2015		7,4		8		8,7
CZ	02/04/2016	13:00	CNB meeting	%	02/2016	0,05		0,05		0,05	
HU	02/05/2016	9:00	Industrial output	%	12/2015				7,2	-1,4	7

Fixed-income in Charts

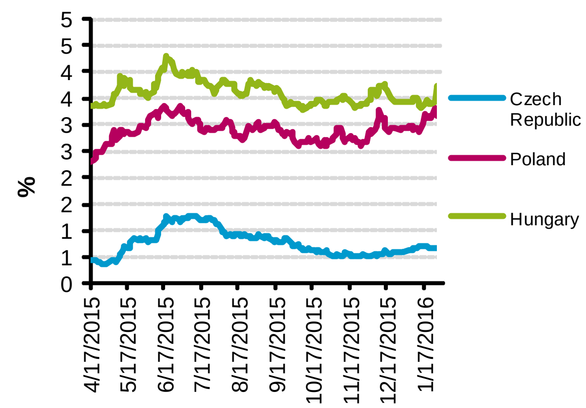
FRA 3x6



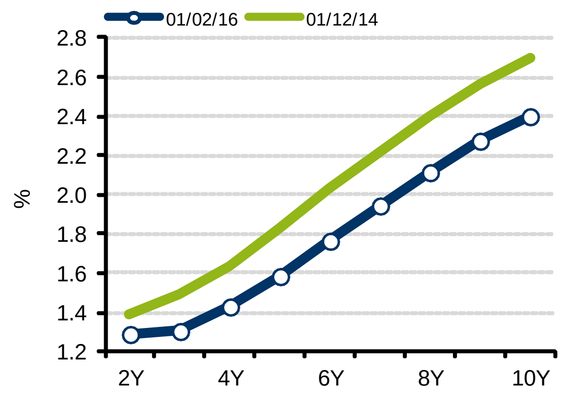
CZ IRS



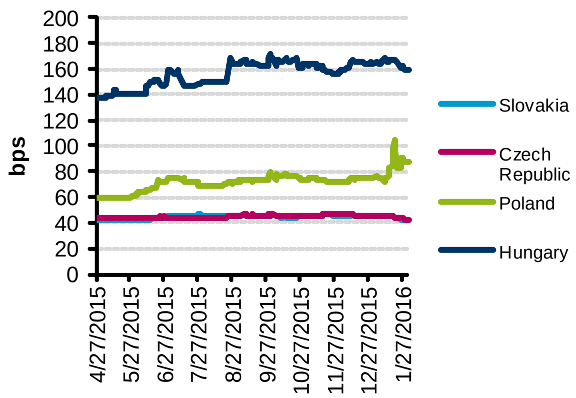
10Y GB Yields



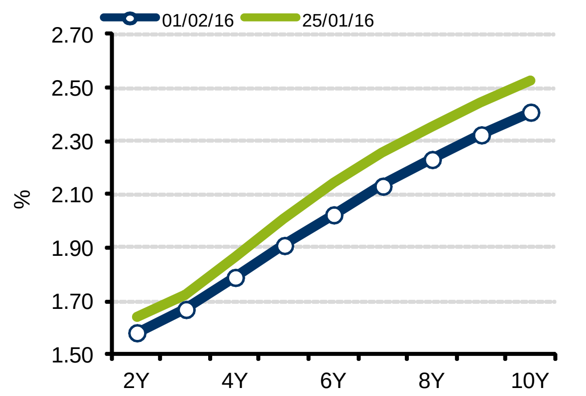
HU IRS



CDS 5Y



PL IRS



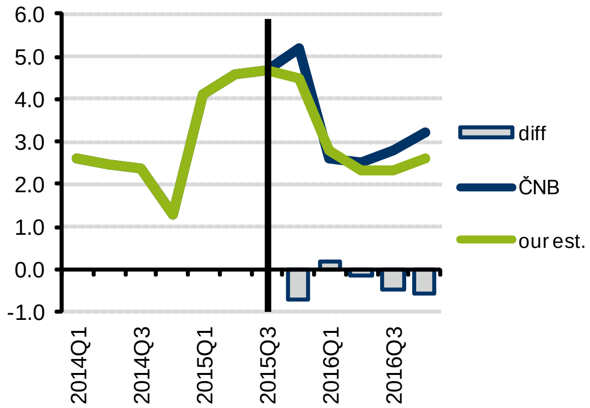
Source: Reuters

Medium-term Views & Issues

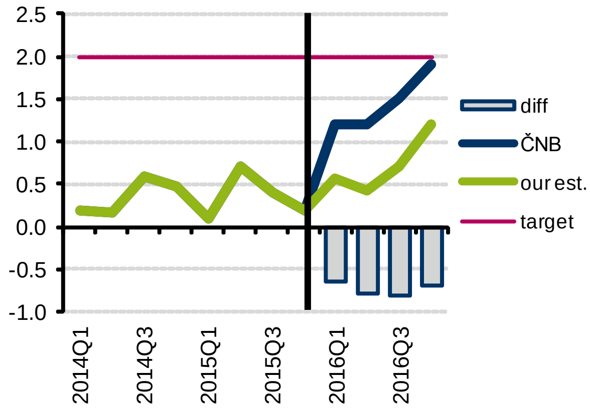
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – 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 might bounce back closer to 3% Y/Y, as EU funds money use was accelerated, the government increased the spending and the industrial production and domestic consumption might be stronger, so the growth might be around 2.7% Y/Y in 2015. The outlook is less favorable. The investments started to fall, the EU funds money use may substantially lower in this year due to the new budgetary period. The government tries to boost the construction via new government program, which targets new homes for households. The domestic consumption may remain strong thanks to the increasing wage mass. In case there is no substantial slowdown of international growth and the agriculture provides an average harvest, the economic growth might be around 2.3% Y/Y in 2016.	Prospects of the Polish economy remain good in our view. For the whole year 2016 we expect GDP growth may reach 3.5 - 4.0 percent. Apart from low interest rates (further cuts cannot be excluded) and a relatively weak zloty, we expect the economy to draw additional support from policy measures of the new government (stimuli for private consumption). The risks thus stem mainly from a possible deterioration in the external environment, most notably in China.
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. As we don't expect exit from the fx regime before Q1 2017, the first rate hike can occur in the H2 2017 or even latter. 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 plans to keep base rate unchanged at 1.35% till the end of its forecasting period, which is 4Q17. It is more or less in synchrony with the ECB's monetary policy forward guidance. The main attention of NBH is decreasing FX reserve and the amount of money placed at the NBH. So the Council may change rather the monetary tools first, but in case HUF strengthens to around 300 base rate cut cannot be excluded either, although this is not our base case. We expect first rate hike only for 2017, as with the conversion of households' FC loans to HUF ones, the tolerance level of a weaker HUF jumped substantially. So EURHUF around 320 and 325 won't force NBH to hike rate.	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. With regard to the inflation outlook and ECB's policy, we anticipate an exit from the fx regime in the first quarter of 2017. The above mentioned factors should however keep the koruna close to EURCZK 27.0 in the months ahead. Current turmoil on the Chinese market poses negative risks for the Central Europe. We however think the impact on the koruna should only be limited.	We think that the NBH's commitment to the long time low interest rate may lead to short-term HUF weakening. Although compared to other emerging markets HUF looks like quite stable, the fears of Chinese hard lending scenario pushed EURHUF trading range between 313 and 318. Although the huge trade and current account balance supports HUF in medium term, the ongoing foreign sell-off of HUF denominated gov. bonds and the uncertain sentiment keeps weakening pressure on HUF, so we see bigger risk on the weak side on short term, which means that EURHUF may be pushed towards 325.	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 and probability of further monetary easing will rises. Although Fed hikes and weaker zloty could prevent the altered MPC from cutting rates again we target the EUR/PLN peak at 4.40.

CBs' Projections vs. Our Forecasts

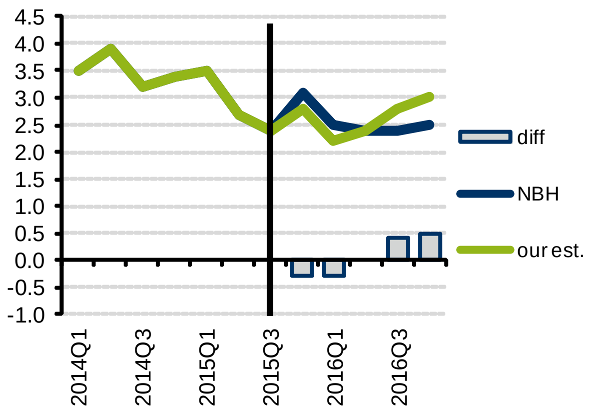
CZ: GDP outlook (Y/Y, %)



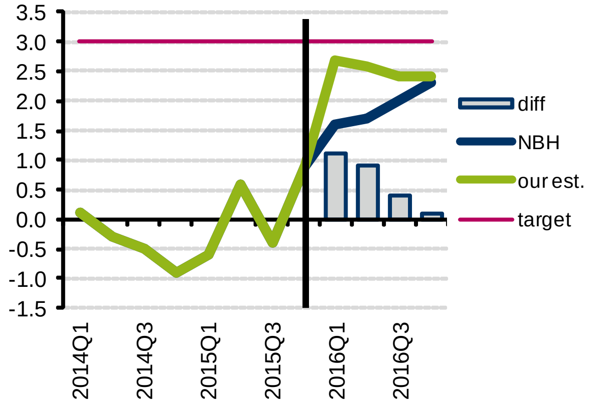
CZ: Inflation outlook (Y/Y, %)



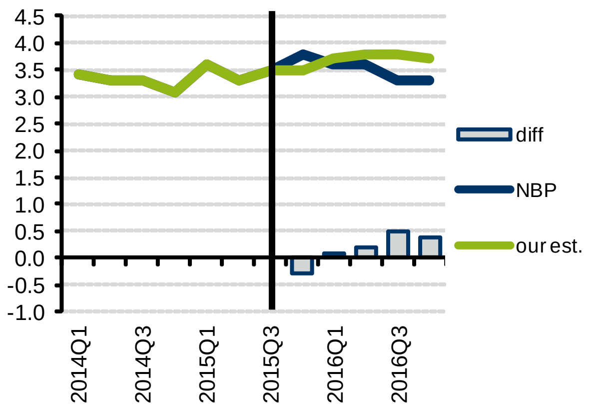
HU: GDP outlook (Y/Y, %)



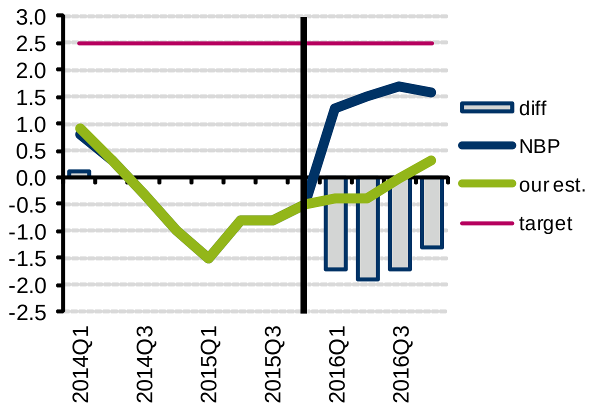
HU: Inflation outlook (Y/Y, %)



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	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4	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*	1,35	2,25	2,50	2,75	3,00	-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	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	PRIBOR	*0,00*	0,25	0,24	0,25	0,25	0,25
Hungary	BUBOR	*1,35*	1,35	2,40	2,60	2,90	3,10
Poland	WIBOR	*1,7*	1,72	1,65	1,65	1,65	1,65

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

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	CZ10Y	*0,76*	1,01	1,08	1,15	1,23	1,30
Hungary	HU10Y	*2,40*	2,91	3,80	4,00	4,20	4,40
Poland	PL10Y	*2,41*	2,47	2,50	2,50	2,60	2,75

Exchange rates (end of the period)

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	EUR/CZK	*27,02*	27,03	27,02	27,02	27,02	27,02
Hungary	EUR/HUF	*311*	316	310	308	305	300
Poland	EUR/PLN	*4,41*	4,27	4,40	4,30	4,26	4,25

GDP (y/y)

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	4,6	4,7	4,5	2,8	2,3	2,3	2,6
Hungary	2,7	2,4	2,8	2,2	2,4	2,8	3,0
Poland	3,3	3,5	3,5	3,7	3,8	3,8	3,7

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

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	0,8	0,4	0,1	0,6	0,5	0,7	1,5
Hungary	0,6	-0,4	0,9	2,7	2,6	2,4	2,4
Poland	-0,8	-0,8	-0,5	-0,4	-0,4	0,0	0,3

Current Account

	2015	2016
Czech Rep.	1,5	1,5
Hungary	6,0	5,1
Poland	-1,2	-1,5

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-1,4	-1,3
Hungary	-2,3	-2,0
Poland	-3,0	-2,9

Source: KBC, Bloomberg

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