Written by ČSOB Prague and K&H Budapest

Central European Weekly

Monday, 18 April 2016

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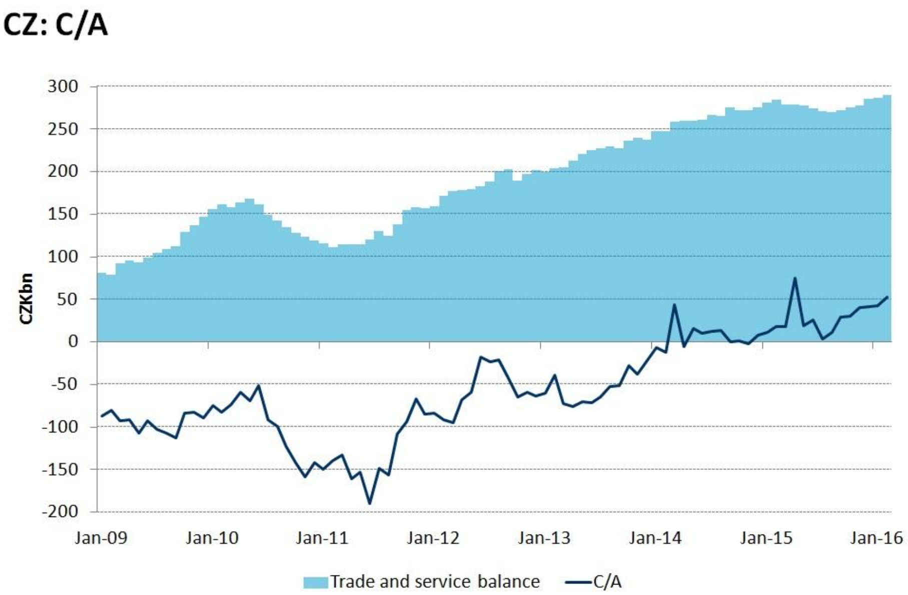
Chart of the Week: Czech C/A surplus



Strong EU demand for Czech exports, lower oil prices and dividend inflows brought the 12-months cumulative Czech current account balance to the surplus standing at 1.1% GDP.

Central Banks & Markets

The Hungarian budget draft sees a hugher deficit in 2017

The 2017 budgetary planning is in the finish in Hungary now; the budget draft was sent to the budgetary committee and will be at the Parliament at the end of the month. The Minister of Economy, Mr Varga said yesterday that the VAT would be moderated from 27% to 5% for milk, poultry and egg from 2017, while the VAT of the restaurant services will be cut from 27% to 18%. The government plans to increase the salary in the healthcare and education and to spend HUF100bn on the home building. The main surprises so far that the tax wedge on the labour force is not planned to reduce (although it was earlier one of the main policy target of the government and Hungary has one of the highest tax wedge in this segment) and that the Hungarian public budget might be planned with a higher deficit target (2.4% of GDP) than this year's level (2% of GDP) or last year's level of 1.9% of GDP. More details will come in 2-3 weeks' time.

In the respect of the Hungarian budget situation it is wort noting that Hungary successfully issued 3Y bond in CNY at 6.25% last week. Hence, Hungary was the first CE country, which issued its debt in the Chinese currency. The one billion off-shore yuan bond was two and a half oversubscribed. Interestingly, Hungary Economy minister Varga said that the country could issue 2 billion yuans on further bonds.

Minutes from NBH's last meeting confirm easing bias

the NBH Minutes from the last meeting was released yesterday. Although the Monetary Council uniformly decided for a rate cut, one member voted only for 10bp cut, while the remaining eight member for 15bp moderation. The former one would like to see first the success of the NBH's and ECB's policy actions, while the latter member argued in favour of launching a new rate cut cycle, so the minutes confirmed our view that the March cut was only the first step of the rate cut cycle. "The Monetary Council remained ready to use every instrument at its disposal to contain second-round inflationary effects. Interest rate cuts would continue as long as monetary conditions became consistent with the sustainable achievement of the inflation target." The latter sentence suggests that the easing cycle may be continued at least till June, when the next inflationary report will be published. The latest inflation figure (falling from 0.3% Y/Y in February to -0.2% in March) also gives gunpowder for monetary easing, so we expect 15bp cut on 26th April, which might be followed with two more steps in May and June down to 0.75% from the current level of 1.2%.

Key figures from the CNB still see no need for negative rates

Recent comments by the most likely candidate for the next Czech National Bank governorship, Jiří Rusnok, brought little surprise. Mr. Rusnok reconfirmed both his expectation of the CNB exit from the intervention regime happening around the middle of 2017 and unlikeliness of introduction of negative official interest rates. At the same time, though, he added that probability of the latter step does not equal zero and that the Bank would not hesitate to cut its rates if needed. In the course of the last weekend, incumbent CNB governor Singer, whose tenure ends next July, said that - under current circumstances - he saw no need for introduction of negative rates, either.

Let us recall that, in our view, probability of an interest rate cut below zero by the CNB by the end of this year still amounts to 30 %. At the same time, we expect this probability to increase with approaching exit from the intervention regime.

Neutral bias of the Polish MPC onfirmed

Polish central banker Grazyna Ancyparowicz said in its interview yesterday that a rate cut would be justified only if hot money from economies with negative interest rates flows into Poland. She added, however, she saw only low probability of such an action, while she considered the recent firming of the zloty as only temporary. We basically agree with Ancyparowicz's opinion, while we would like to remind that following the last MPC meeting, it has been quite clear there was no will for further monetary easing among Polish central bankers.

	Last	Change 1W
EUR/CZK	27.1	0.06%
EUR/HUF	311	-0.41%
EUR/PLN	4.30	0.39%

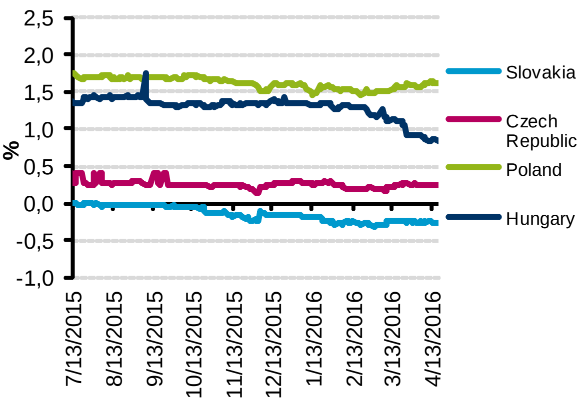
	Last	Change 1W
10Y CZK	0.59	2.61
10Y HUF	1.99	0.84
10Y PLN	2.31	2.56

Calendar

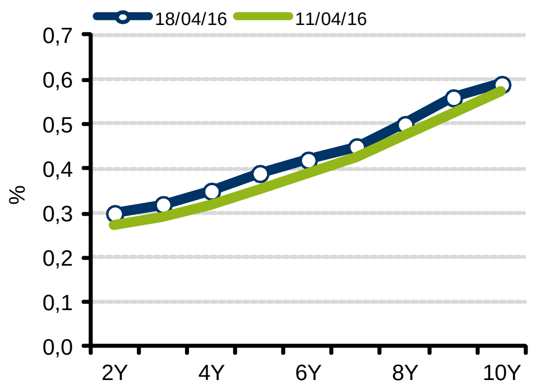
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	04/18/2016	9:00	PPI	%	03/2016			0.2	-4.3	-0.6	-4
PL	04/18/2016	14:00	Wages	%	03/2016			5.2	3.4	0.9	3.9
PL	04/19/2016	14:00	Industrial output	%	03/2016			10.4	3.9	6.8	6.7
PL	04/19/2016	14:00	PPI	%	03/2016			0	-1.4	-0.3	-1.4
PL	04/19/2016	14:00	Retail sales	%	03/2016			17.1	3.4	0.9	3.9
CZ	04/21/2016	0:00	Earnings Unipetrol	CZK	1Q/2016						
PL	04/21/2016	0:00	Earnings PKN Orlen	PLN	1Q/2016						

Fixed-income in Charts

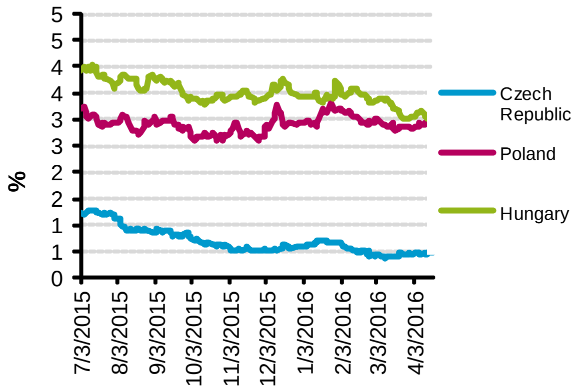
FRA 3x6



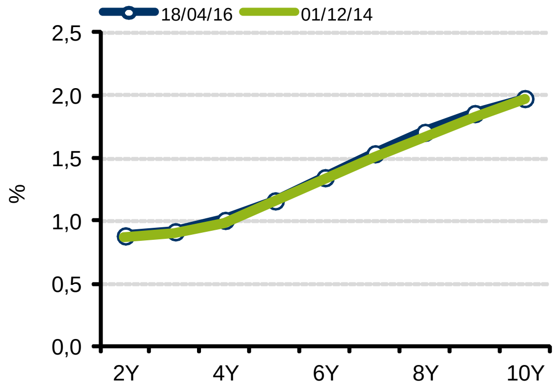
CZ IRS



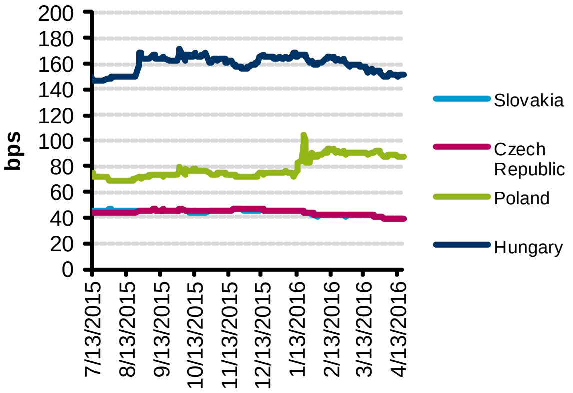
10Y GB Yields



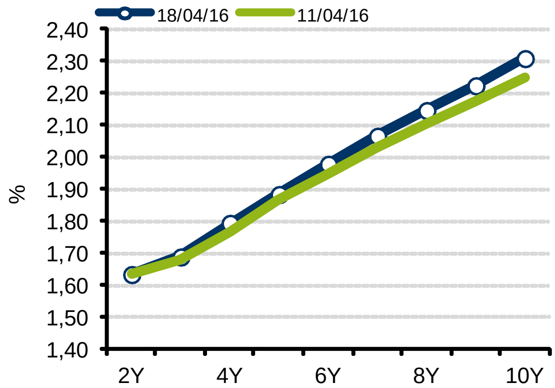
HU IRS



CDS 5Y



PL IRS



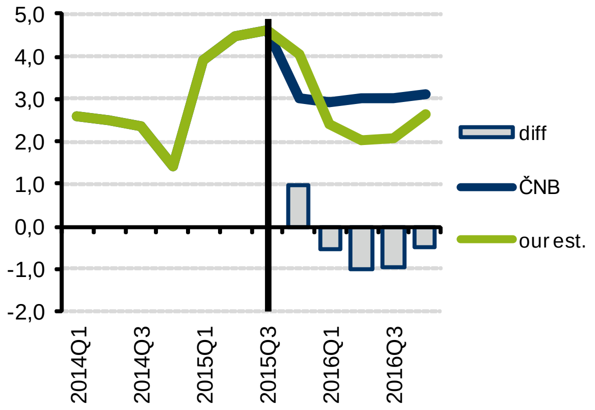
Source: Reuters

Medium-term Views & Issues

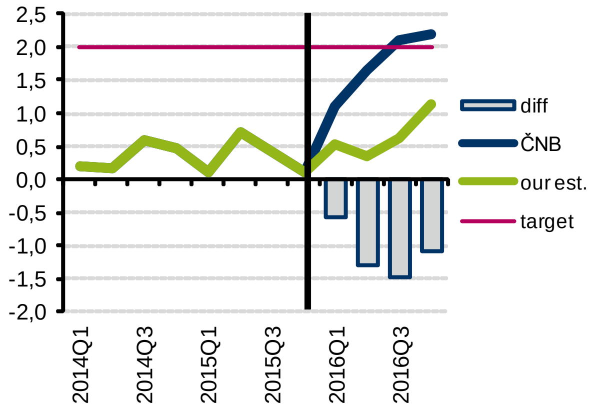
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – 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, Russia and other emerging markets.
Outlook for official & market rates	The latest forecast does not envisage the return of inflation to the target before early 2017, with inflation not significantly diverging from it afterwards either. The CNB has extended its exchange rate commitment until the first half of 2017. The possibility of introducing negative interest rates has been increasing, in light of the widening of the interest rate differential vis-à-vis the euro area and developments in domestic financial markets. But we still don't expect negative CNB's rates. There are two main preconditions for negative official rates: 1) significant ECB's rate cut, 2) continuing large monthly fx interventions of the CNB.	The Monetary Council continues the rate cut cycle in the following months. We believe that the easing cycle may be continued at least till June, when the next inflationary report will be published. The latest inflation figure (falling from 0.3% Y/Y in February to -0.2% in March) also gives gunpowder for monetary easing, so we expect 15bp cut on 26th April, which might be followed with two more steps in May and June down to 0.75% from the current level of 1.2%.	We expect the NBP to keep official rates stable, but we think that risks for of further rate cuts have increased. The main reason is the combination of the "inflow of cheap euros from the ECB", ongoing deflation and stronger currency (PLN). Hence, should the zloty get strong there could be a window of opportunity for the NBP to ease its policy in the second quarter of this year. Nevertheless this is not our main scenario yet.
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.	We think that zloty's sell-off related to markets' fears coming from appointment of new members of the Monetary Policy Council (MPC) is over now. Nevertheless, while domestic fundamentals should be relatively supportive for the zloty, the currency should be mostly driven by sentiment in emerging markets and the ECB or the Fed policy actions respectively.

CBs' Projections vs. Our Forecasts

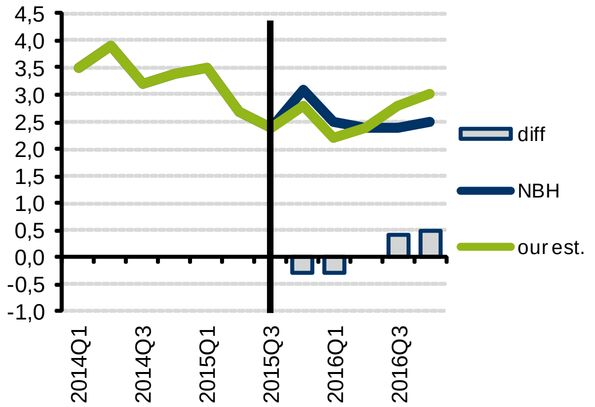
CZ: GDP outlook (Y/Y, %)



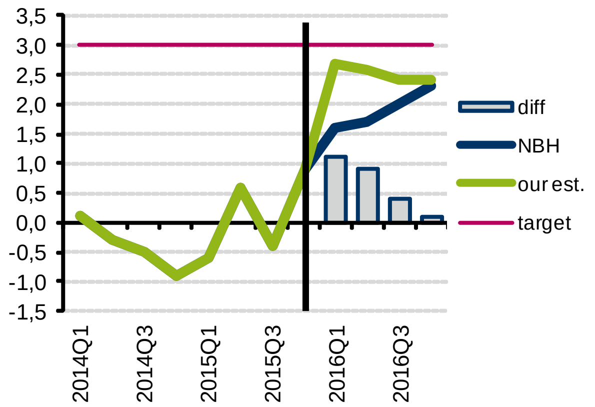
CZ: Inflation outlook (Y/Y, %)



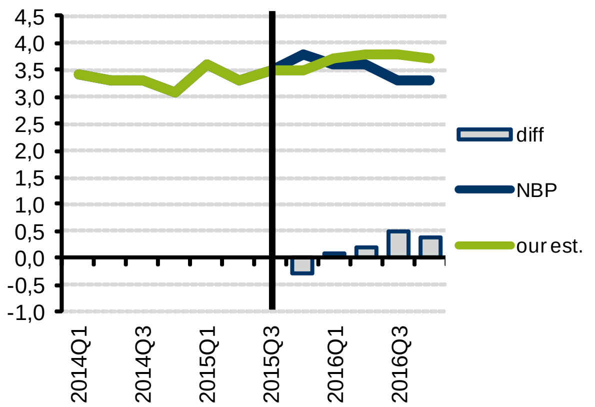
HU: GDP outlook (Y/Y, %)



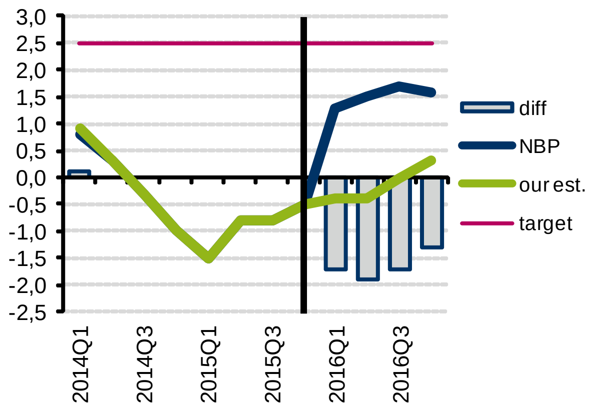
HU: Inflation outlook (Y/Y, %)



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	3/5/2015

*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	0.24	0.25	0.25
Hungary	BUBOR	*1.20*	1.35	2.40	2.60	2.90	3.10
Poland	WIBOR	*1.67*	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	*0.59*	1.01	0.64	0.73	0.81	0.90
Hungary	HU10Y	*1.99*	2.91	3.80	4.00	4.20	4.40
Poland	PL10Y	*2.31*	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	*27.03*	27.03	27.02	27.02	27.02	27.02
Hungary	EUR/HUF	*311*	316	310	308	305	300
Poland	EUR/PLN	*4.30*	4.27	4.40	4.30	4.26	4.25

GDP (y/y)

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	4.5	4.6	4.0	2.4	2.0	2.1	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	1.4
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.	0.9	0.8
Hungary	6.0	5.1
Poland	-1.2	-1.5

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-0.4	-1.0
Hungary	-2.3	-2.0
Poland	-3.0	-2.9

Source: KBC, Bloomberg

Contacts

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	**Brussels**	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Joke Mertens	+32 2 417 30 59	Institutional Desk	+32 2 417 46 25
Mathias van der Jeugt	+32 2 417 51 94	France	+32 2 417 32 65
Dublin Research		London	+44 207 256 4848
Austin Hughes	+353 1 664 6889	Singapore	+65 533 34 10
Shawn Britton	+353 1 664 6892		
Prague Research (CSOB)			
Jan Cermak	+420 2 6135 3578	**Prague**	+420 2 6135 3535
Jan Bures	+420 2 6135 3574		
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)			
Marek Gabris	+421 2 5966 8809	**Bratislava**	+421 2 5966 8820
Budapest Research			
David Nemeth	+36 1 328 9989	**Budapest**	+36 1 328 99 85

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