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Central European Weekly

Monday, 24 March 2014

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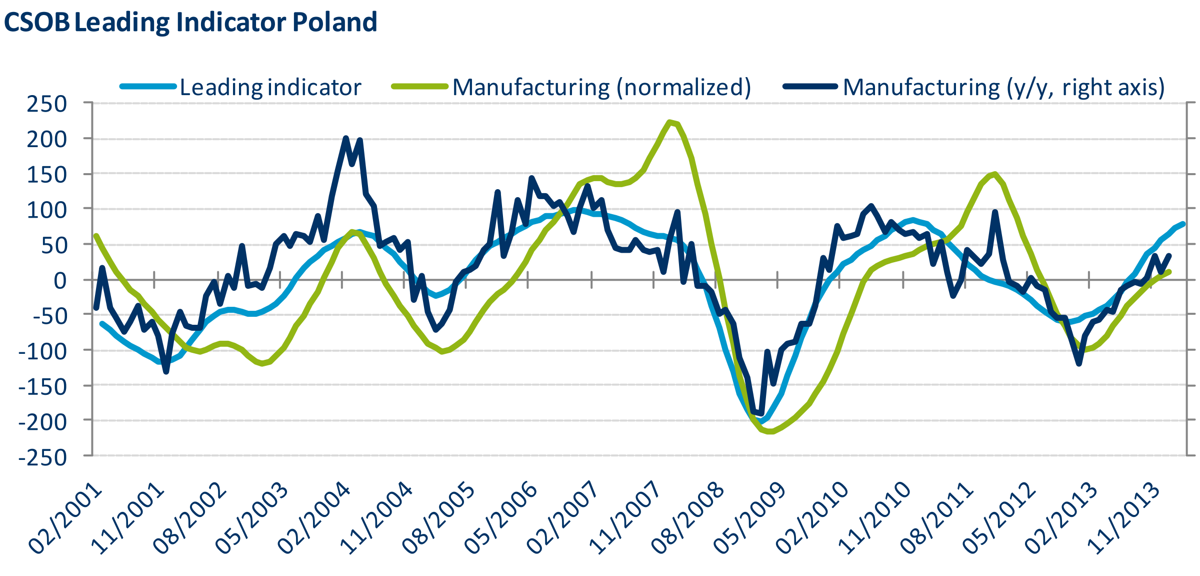
- Hard data and leading indicators point to stronger recover of the Polish industry
- The NBH is going to cut its base rate to fresh lows
- The CNB meeting - nothing new, just satisfaction

Chart of the Week: Polish leading indicator



Polish leading indicator hits 2-year highs, similarly to the Czech one. The recovery is getting up a head of steam.

Market's editorial

Lorem ipsum dolor sit amet

A somewhat surprising Fed meeting will be followed by central bank meetings in Central Europe this week. The first meeting will be that of the National Bank of Hungary on Tuesday, followed by the Czech National Bank two days later.

The NBH Board meeting may certainly be a more noteworthy event, because the bank is very likely to cut its base rate to new all-time lows. In addition, it will be intriguing to see what signal the NBH will send to the market regarding the future of its policy, notably in the context where the Fed is continuing to normalise its monetary policy and the ECB no longer seems to be willing to continue to ease its policy. We beleive that either the Fed or ECB will not influence substantially NBH's decision matrix. Still inflation plays the main role, and as the NBH doesn't sees any inflationary pressure on 6Q time horizon the most likely outcome of the next MPC meeting (held on 25 March) 10bp cut from 2.7% to 2.6%. The tone of the statement may be more hawkish and even the end of the rate cut cycle may be mentioned.

We do not expect this year's second CNB Board meeting, unlike that of the NBH, to make any changes to the monetary strategy it established in November last year. The central bank is likely to express its satisfaction with the intervention regime (against the koruna), appreciate the economic growth and, perhaps, highlight persisting downside risks to inflation. The CNB has signalled a couple of times that the regime will remain in place throughout this year, and thus the question still is whether and, more specifically, when in 2015 the bank will wish to leave it. Likewise, we do not believe that the central bank will begin to raise rates as quickly as suggested by the currently valid forecast (with the first rate hike to take place as early as in the first quarter of next year).

The Hungarian constitutional court rules on FX loans

The Hungarian constitutional court made decision in case of the foreign currency denominated loans. The contract can be changed by new law in specific cases, but it can be changed only according to the current practice of the courts. The constitutional court also highlighted that only such a law can be approved, which takes in consideration both the banks' and clients' interest.

The first reactions from the Fidesz were that after the election they will abolish the problem of the foreign currency household debt and the loss may be allocated in the same ratio as it was when the government allowed paying back the foreign currency denominated loans. But the government will wait for the decision made by highest court and the European court, so new law may be approved only in May-June the earliest. The constitutional court's decision doesn't mean a radical change compared to the already existing and available legal processes.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.5	0.24%	➔	➚
EUR/HUF	313	0.33%	➔	➔
EUR/PLN	4.19	-0.88%	➔	➔

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.91	3.53	➔	➚
10Y HUF	5.23	-1.13	➔	➚
10Y PLN	4.08	0.37	➔	➚

Review of Economic Figures

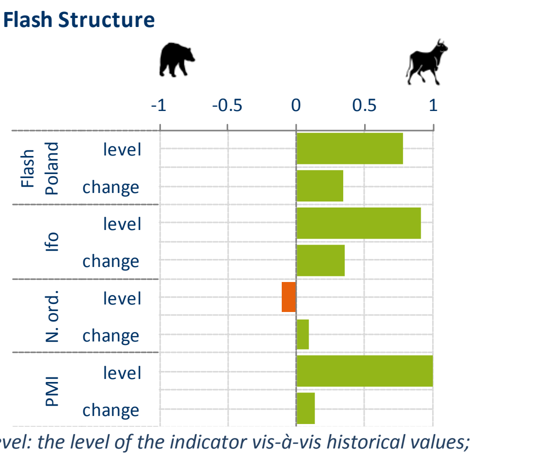
Polish industry has decelerated but key sectors are performing well.

The Polish economic data released last week indicated a persisting economic recovery in Poland. Good news came from the labour market in particular, with faster wage growth as well as rising employment. By contrast, February's performance of industry was slightly lower than January's, but this was largely attributable to a decline in electricity production and distribution (-9.3% m/m). On the year-on-year basis and after a seasonal adjustment, industry rose by 5.6%, with a decline seen not only in the above-mentioned sector of electricity production but also in the mining industry. On the other hand, strong year-on-year increases persisted in some of the large sectors of industry, such as plastics and rubber manufacturing (+16.2%).

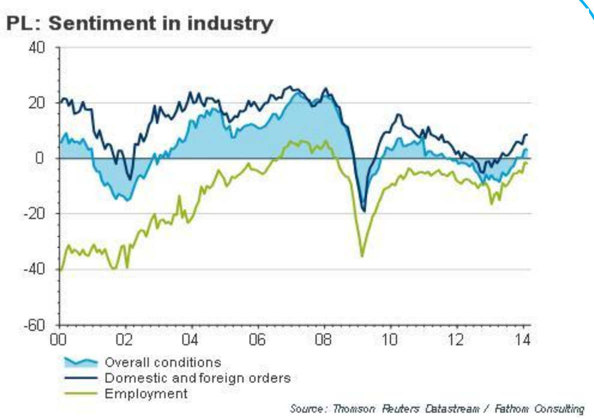
The Polish Flash leading indicator hits 2-year highs and confirms the good condition of Polish industry.

The good prospects of the Polish manufacturing industry are also signalled by our forward-looking indicator, the Flash – our leading indicator. It was updated in early 2014, along with the other forward-looking indicators for Central Europe. The newly updated Flash includes new orders and no longer includes the PMI (production) sub-index.

The Polish Flash currently stands at two-year highs of 78 points. It has been rising for 16 consecutive months. All components contribute to its improvements but not quite equally. While Ifo, the German business mood index, and Polish PMI are not far from their highs, new orders are still fairly low. The rate of the Flash improvements has slowly eased in the last six months, but, given its high values, this is not unusual or disconcerting. In the months to come, it will be more intriguing to watch whether or not the prospects of Polish industry will be affected by the escalation of tension between Russia and the European Union.



Notes: level: the level of the indicator vis-à-vis historical values; change: the change in the indicator vis-à-vis historical values; (1 = the current value is the maximum historical value; -1 = the current value is the minimum historical value)



Weekly preview

TUE 14:00 NBH base rate

	This meeting	Last change
rate level (in %)	**2.60**	2/2014
change in bps	**-10**	-15

HU: the NBH base rate to fall to fresh all-time lows

Very low inflation plays the main role in the NBH decision making, So, the central bank doesn't sees any inflationary pressure on 6Q time horizon the most likely outcome of the next MPC meeting 10bp cut from 2.7% to 2.6%. The tone of the statement may be more hawkish and even the end of the rate cut cycle may be mentioned.

THU 13:00 CNB base rate

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

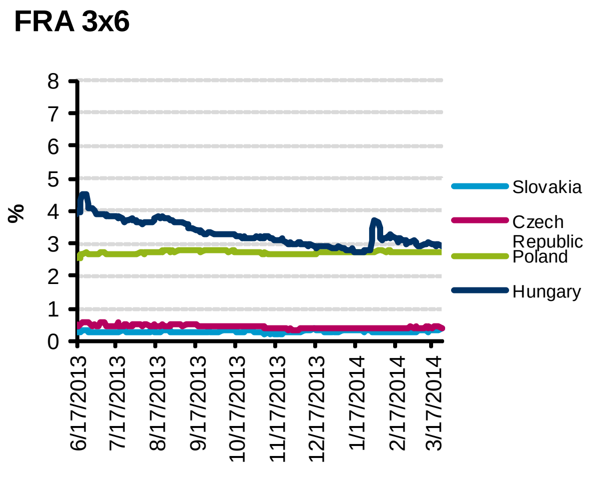
CZ: the CNB - nothing new, just satisfaction

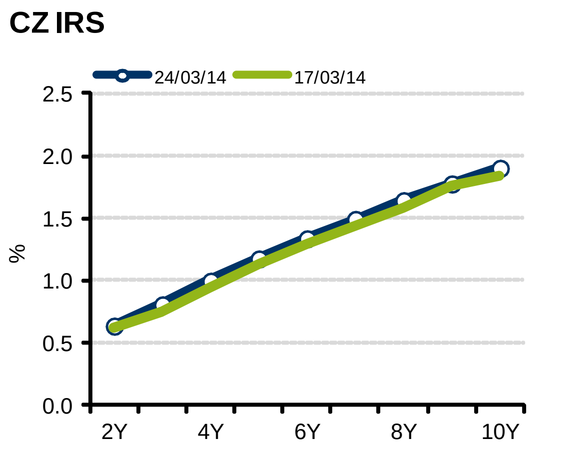
At its second meeting of this year, we do not expect the CNB Board to make any changes to rates or the exchange rate regime established in November last year. The central bank is likely to express its satisfaction with the intervention regime, appreciate economic growth and, perhaps, highlight persisting downside risks to inflation. The CNB has signalled a couple of times that the regime will remain in place throughout this year, and thus the question still is whether and, more specifically, when in 2015 the bank will wish to leave it. Likewise, we do not believe that the central bank will begin to raise rates as quickly as suggested by the currently valid forecast. By and large, we therefore expect no surprises from the next CNB Board meeting.

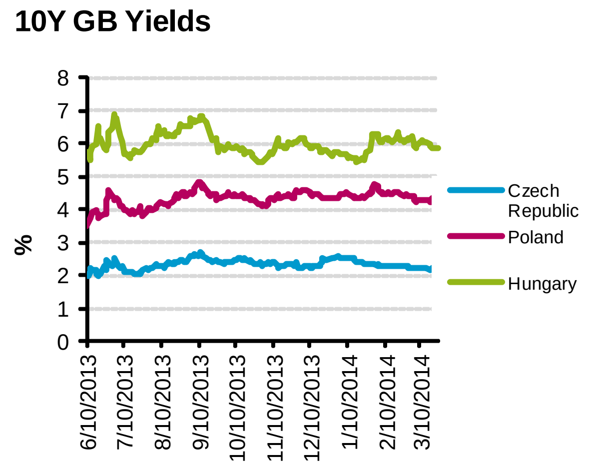
Calendar

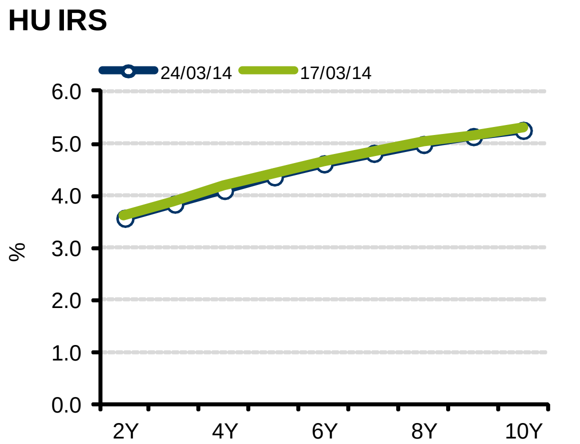
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	03/25/2014	10:00	Retail sales	%	02/2014			-1.5	6	-21.3	4.8
PL	03/25/2014	10:00	Unemployment rate	%	02/2014			14.1		14	
HU	03/25/2014	14:00	NBH meeting	%	03/2014	2.6		2.6		2.7	
CZ	03/27/2014	13:00	CNB meeting	%	03/2014	0.05		0.05		0.05	
HU	03/28/2014	9:00	Unemployment rate	%	02/2014			9		8.9	

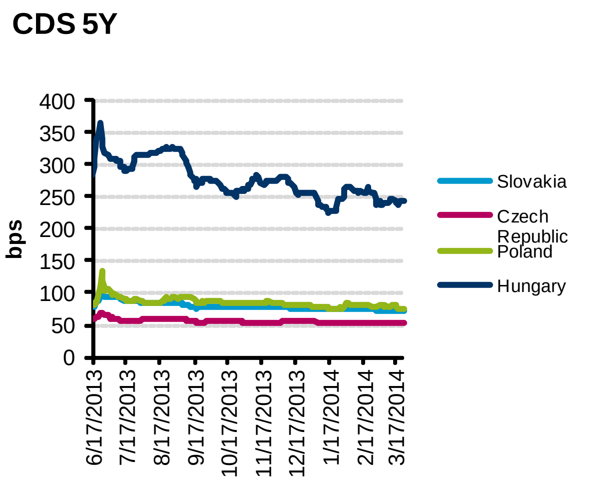
Fixed-income in Charts

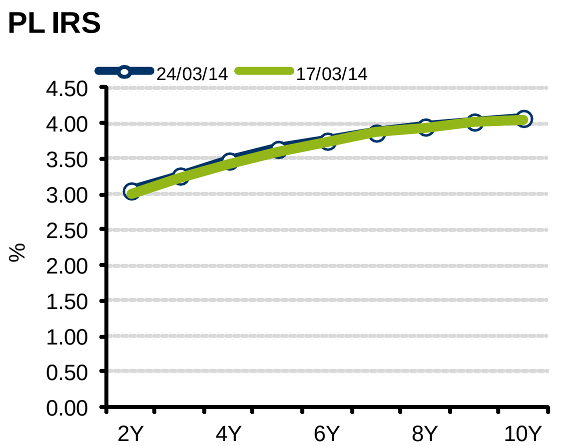












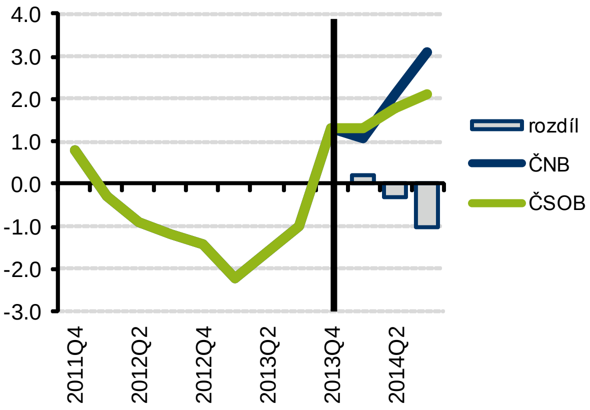
Source: Reuters

Medium-term Views & Issues

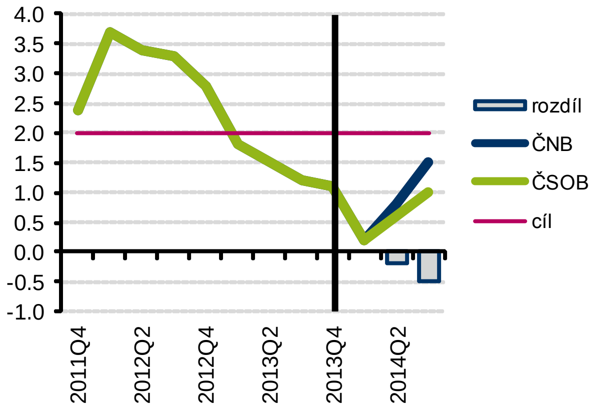
	The Czech Republic	Hungary	Poland
Growth & key issues	The president appointed a new coalition government a few months after the election. The programme of the future government is likely to be consistent with the concluded coalition agreement, which envisages keeping the government deficit below 3% of GDP throughout the government's electoral term. Statistics for the last six months confirm that the worst is over for the economy. The economy is being driven by the manufacturing industry, notably passenger car production, while construction, as well as many of services, are struggling to bottom out.	As elections are coming in 2014, the government may do everything to maintain the relatively good performance. The NBH's funding for lending program may boost the economy by 0.2-0.4% Y/Y in the following quarters; the net real wage growth may help the domestic consumption, while public investments are likely to continue at least till mid-2014. as GDP growth accelerated on quarter-on-quarter basis in Hungary's main trading partners and also in the CEE region – that Hungary's economic growth slowed (from 0.8% Q/Q in 3Q13 to 0.6% Q/Q in 4Q13) less than expected. It confirms our view that economy may grow by 2% Y/Y in 2014.	According to the GUS estimates the Polish economy grew by 2.7% in 2013Q4. For this year, the growth should significantly exceed 3%. Household consumption should support growth, owing to the improving labor market situation as well as to low inflation. Investment should also develop favorably, owing to the replenishment of inventories as well as to gross capital formation In addition, lower government debt could also give a greater lift to the economy. By contrast, net exports are likely to curb rather than boost growth.
Outlook for official & market rates	The CNB has completely 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 CZK 27 per EUR. 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. The CNB believes that the depreciation of the koruna should enable the economy to avoid deflationary pressures and boost its growth up to 2.2% this year. The CNB is very unlikely to change rates, and just as likely to maintain its intervention regime throughout this year.	The next interest-rate-setting meeting will be held on 25 March. In a case of the EUR/HUF remains close to 310 we expect a rate cut may be delivered, but if it breaks out from the range of the weak side it may lead to a stop of the rate cut cycle. Interestingly, although the forint is under pressure, the long-end of the yield curve remained relatively stable and e.g. 10-year bond is around 30bp lower than it was in mid-February, when the EUR/HUF was traded around 314. Additionally the yield curve is also flatter than it was 3 weeks ago especially the 3-15 year spread. So, we expect that in a case of the EUR/HUF breaks out from the above mentioned range it may cause a sudden sell-off on the long-end of the bond curve and the curve may steepen significantly.	Inflation pressures in Poland remain subdued and year-on-year prices growth is seen well below the lower tolerance band of the inflation target. Although the recent development has supported our bets on faster economic recovery in Poland (in 2014, the central bank expects 3.6% growth while we estimate 3.4% with upside risks), outlook for persistently low inflation and NBP's strong emphasis on forward guidance along with the fact that all members of the Monetary Policy Council agreed upon it, made us review our scenario and we newly expect that the first rate hike (25 bps) may come at the end of 2014 at earliest.
Forex Outlook	The CNB has started FX interventions and we expect the koruna to stay within the regime at least till the mid 2015. Hence the currency should stay above 27.00 EUR/CZK at least in 12-month horizon. When the FX targeting regime is set to be abandoned, the CNB will have to intervene on the market much more aggressively to stop the spot koruna from appreciation. As a side effect, the forward koruna can appreciate significantly before the regime is abandoned.	The fast and sudden weakening of the HUF and the fact, that in the last 6 weeks HUF was able to strengthen less and less, increase the chance the EUR/HUF may break out from the range of 308 and 314 upward. The next resistance levels are around 317, 320 and 324.	Low inflation pressures and improving prospects of the economy may support the zloty in months ahead. The Polish currency might perform particularly well in comparison with the koruna as the room for koruna's appreciation remains virtually closed and the economic recovery in Poland is likely to continue. In our view, Fed's QE tapering remains the main risk for the zloty. The Zloty is also more vulnerable to the emerging markets sell offs due to higher CA deficit and lower FX reserves as well as to development in Ukraine.

CBs' Projections vs. Our Forecasts

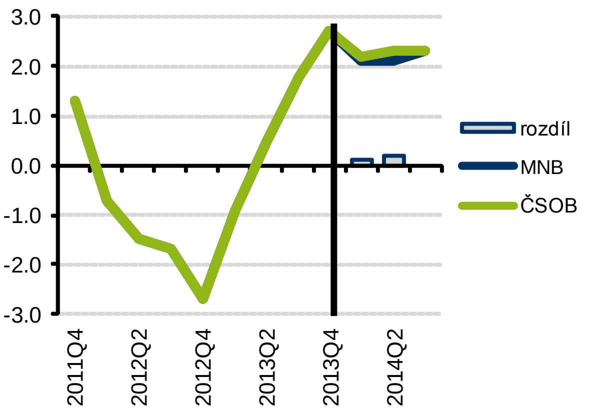
CZ: GDP outlook (Y/Y, %)



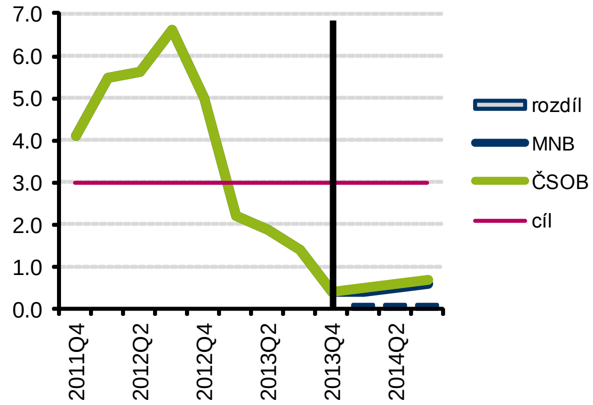
CZ: Inflation outlook (Y/Y, %)



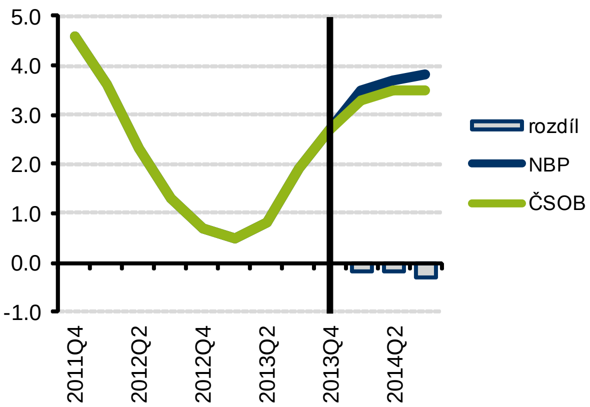
HU: GDP outlook (Y/Y, %)



HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outllok (Y/Y, %)

Source: CNB, NBP, MNB, CSOB

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	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.	*2.70*	3.60	3.00	2.60	2.50	2.50	-15 bps	2/18/2014
Poland	2W inter. rate	*2.50*	2.50	2.50	2.50	2.50	2.50	-25 bps	7/3/2013

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

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	PRIBOR	*0.37*	0.42	0.38	0.37	0.36	0.36
Hungary	BUBOR	*2.75*	3.56	2.99	2.70	2.50	2.50
Poland	WIBOR	*2.71*	2.67	2.71	2.75	2.75	2.75

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

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	CZ10Y	*1.905*	2.06	2.09	1.90	2.10	2.30
Hungary	HU10Y	*5.23*	5.17	5.25	5.40	5.00	5.30
Poland	PL10Y	*4.08*	4.24	4.25	4.10	4.10	4.45

Exchange rates (end of the period)

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	EUR/CZK	*27.5*	25.7	27.3	27.4	27.2	27.2
Hungary	EUR/HUF	*313*	297	297	300	300	300
Poland	EUR/PLN	*4.19*	4.22	4.16	4.20	4.10	4.00

GDP (y/y)

	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	-2.2	-1.6	-1.0	1.3	1.3	1.8	2.1
Hungary	-0.9	0.5	1.8	2.7	2.2	2.3	2.3
Poland	0.5	0.8	1.9	2.7	3.3	3.5	3.5

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

	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	1.7	1.6	1.0	1.4	0.3	0.6	1.2
Hungary	2.2	1.9	1.4	0.4	0.5	0.6	0.7
Poland	1	0.2	1.0	0.7	0.9	1.4	1.0

Current Account

	2013	2014
Czech Rep.	-1.1	-1.2
Hungary	2.0	2.2
Poland	-1.6	-1.6

Public finance balance as % of GDP

	2013	2014
Czech Rep.	-2.5	-2.7
Hungary	-2.7	-3.0
Poland	-4.4	4.5

Source: CSOB, Bloomberg

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