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Central European Weekly

Monday, 31 March 2014

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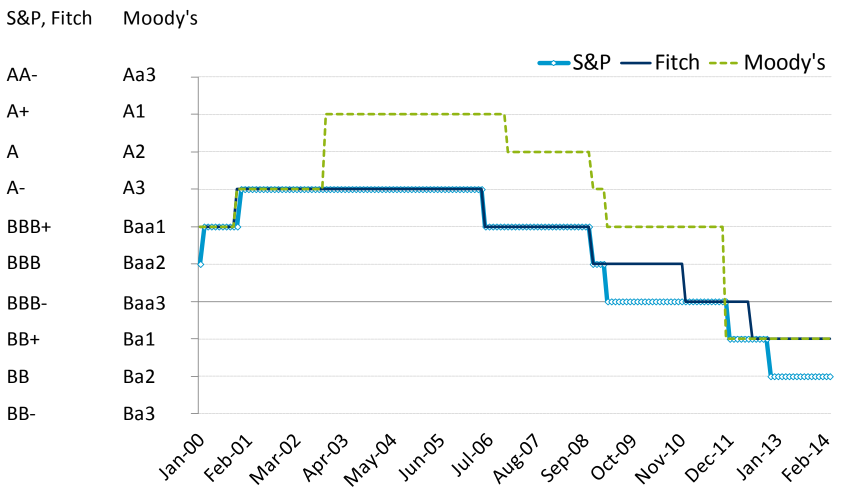
Chart of the Week? Hungary's ratings

HU: long-term FX sovereign credit ratings



S&P revised its Hungarian rating outlook from "negative" to "stable". (Source: Bloomberg, CSOB).

Market's editorial

Central Europe awaits the ECB's verdict

Core markets are again tensely awaiting a meeting of the European Central Bank. After some dovish comments and very low German and Spanish inflation figures a part of the market think that another monetary easing is on the agenda even though the reaction function of the ECB is quite unpredictable given the unchanged decision and the rather neutral tone at the press conference after the February meeting. Nevertheless what would any easing move imply for Central European markets?

Regional currencies would likely respond to any easing positively, as it would trigger the usual rush for higher yields, which would benefit the higher-interest-bearing zloty and forint in particular. Moreover, even the Czech koruna probably would also ride the wave of optimism. Nevertheless, we need to realise that the latitude for such appreciation is limited. The zloty and the forint strengthened quite decently last week – the latter by up to 2%. Some of those gains were triggered by the ECB's dovish statements. In addition, a continued appreciation of the forint would enable the National Bank of Hungary to continue to ease its monetary policy, and this would cool the forint's ambitions. The same applies to the Polish zloty to a lesser extent. Its appreciation will hardly lead to a cut in Polish rates at this stage of the economic cycle; however, such appreciation may extend the NBP's verbal commitment to keep rates at record-low levels.

The CNB is satisfied with the EUR/CZK exchange rate. Will this also be true after the ECB meeting?

Of course, the koruna is curbed by the Czech National Bank at the EUR/CZK 27.0. This commitment was again confirmed at the last Bank Board meeting. The CNB views that level as "appropriate and foresees this exchange rate commitment being maintained at least until the beginning of 2015".

As concerns the situation on seems to have been outlined for at least one year ahead by the central bank, which has pacified the market to such an extent that the large London banks (previously) speculating on the fluctuations of the Czech currency have completely left the market. The liquidity of the Czech forex market has decreased quite significantly, and the exchange rate is essentially generated only by entities that trade/hedge their real flows (revenues from exports or dividends). Given the CNB's strong position, the balanced exchange rate has settled a few tens of hellers above CZK 27 per EUR. However, as the liquidity is very low, the balance is fragile and may be easily affected even by a fairly low amount of korunas or euros poured into the market. Such an amount may appear in the market when, for example, a few successful exporters suddenly assume that they ought to get rid of a larger amount of euros, or when one of the London banks decides that it is time to speculate on the koruna.

Such a trigger could be for instance the introduction of a negative official deposit rate by the ECB. This may provoke certain banks to prefer moving some of their euro liquidity into korunas, with the immediate possible effect to be the appreciation of the koruna and its approaching the level defended by the CNB.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.4	0.03%	↘	→
EUR/HUF	308	-1.61%	↘	→
EUR/PLN	4.17	-0.76%	↘	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.83	-2.66	→	↗
10Y HUF	4.98	-5.14	→	↗
10Y PLN	4.01	-1.11	→	↗

Review of Economic Figures

S&P welcomes improving Hungarian fundamentals

The S&P rating agency changed Hungary's outlook from negative to stable, but the rating remained unchanged at BB level. Hungary's rating is one notch better (BB+) at the other two big rating agencies.

The main reasons behind the improvement are the below 3% of GDP budget deficit and the government's commitment to the tight fiscal policy, the decreasing external debt, stable export performance, improving growth outlook (they increased the GDP growth forecast from 1.3% Y/Y to 1.8% Y/Y for both 2014 and 2015) and the shift towards to local currency and domestic driven refinancing of public debt.

According to S&P, the main risks are the expanding public sector, the less transparent and predictable economic policy towards international investors and the high dependence on the European conjuncture. Also a risk is that Hungary receives gas mainly from Russia. Although from one perspective it is an advantage that financing of the Hungarian debt is diversified and 36% of the HUF denominated bonds are at foreign investors, it is also a risk in a case of a financial crisis.

A downgrade may come in case of substantially worse economic growth, accelerating deleveraging process or significantly deteriorating external or public financial situation. On the other hand an upgrade may come if the government follows an economic policy which supports investments meantime the structural reforms are also implemented or there is a permanent decrease of external debt.

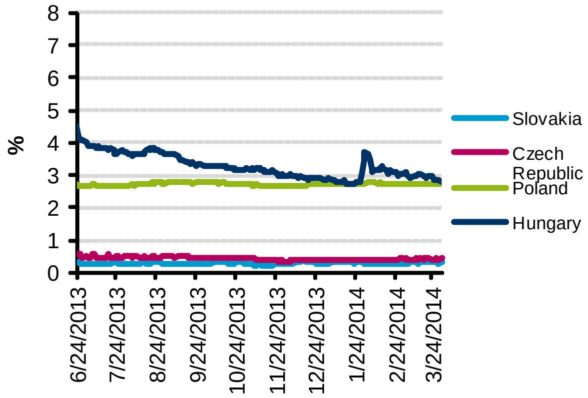
S&P's view fits into our expectations that parallel with the improvement of Hungarian imbalance problems rating agencies may give positive outlook and in case of no substantial deterioration of global economic environment Hungary may receive back the investment grade in 1H15.

Calendar

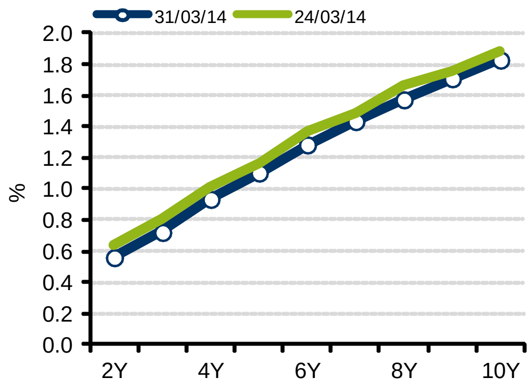
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	03/31/2014	8:30	Current account	HUF B	4Q/2013			452		1064	
HU	03/31/2014	9:00	PPI	%	02/2014				0.9	0.7	-0.1
CZ	03/31/2014	10:00	Money supply M2	%	02/2014						4.5
PL	03/31/2014	14:00	Current account	EUR M	4Q/2013					-2072	
PL	04/01/2014	9:00	PMI manufacturing		03/2014					55.9	
CZ	04/01/2014	9:00	GDP	%	4Q/2013 *F					1.9	1.3
HU	04/01/2014	9:00	PMI manufacturing		03/2014					54.3	
CZ	04/01/2014	9:30	PMI manufacturing		03/2014					56.5	
CZ	04/01/2014	14:00	Budget balance	CZK B	03/2014					50.1	
HU	04/02/2014	9:00	Trade balance	EUR M	01/2014 *F					461.4	
HU	04/03/2014	9:00	Retail sales	%	02/2014						3.9
CZ	04/04/2014	9:00	Retail sales	%	02/2014						6.4

Fixed-income in Charts

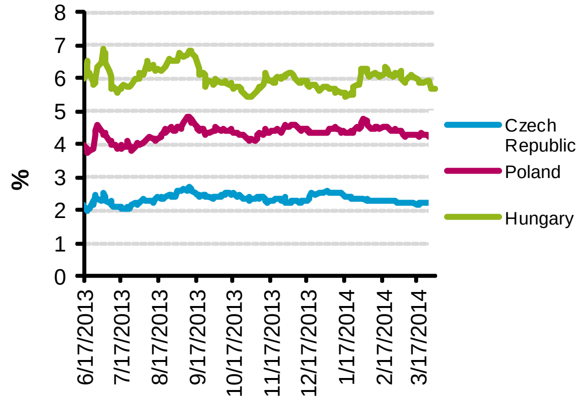
FRA 3x6



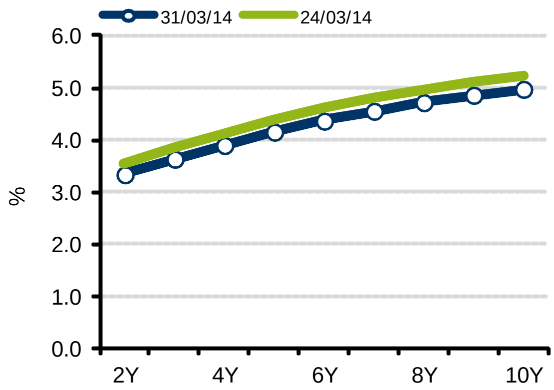
CZ IRS



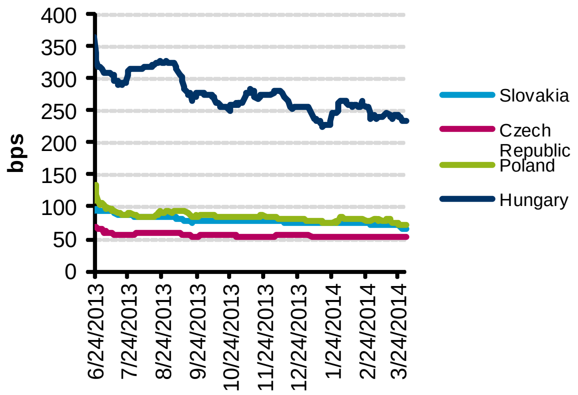
10Y GB Yields



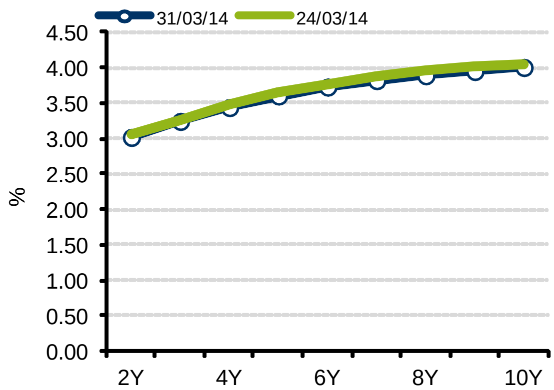
HU IRS



CDS 5Y



PL IRS



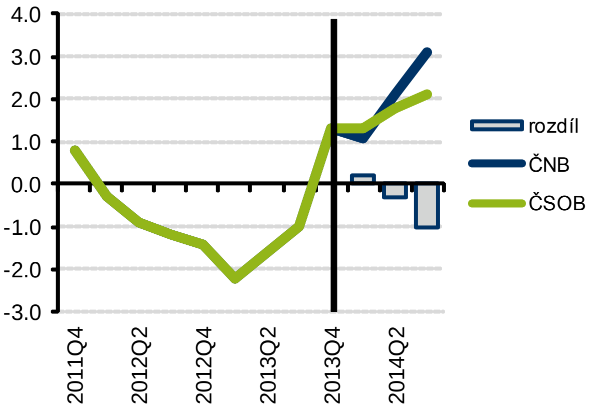
Source: Reuters

Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	The 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.	With respect to the last NBH action (a cut to 2.6%) as well as recent changes in international environment, the Council modified its tone and emphasized that the base rate was close to its optimal level and neither further worsening in international sentiment would trigger another rate cut automatically. In our view, the statement says that if the EUR/HUF and bond yields stay close to their current levels, another 10bps rate cut may be delivered in April and conclude the current rate cut cycle. However, if economic conditions deteriorate in the meantime, the last cut was already the last one.	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.	Our outlook for the forint is just under the review.	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.

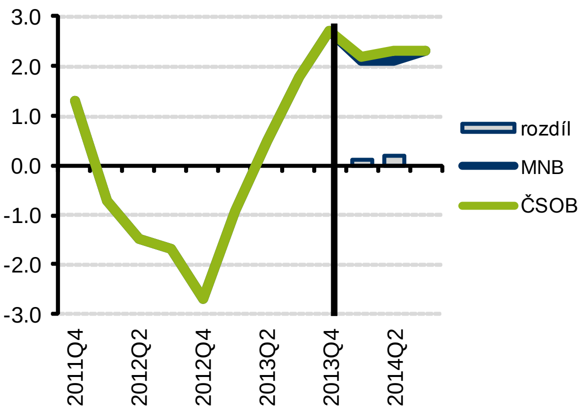
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

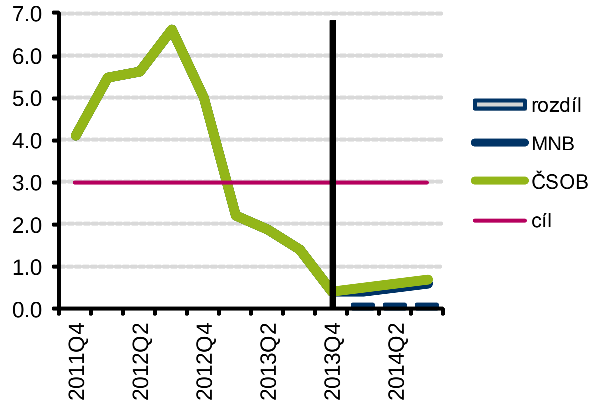


CZ: Inflation outlook (Y/Y, %)

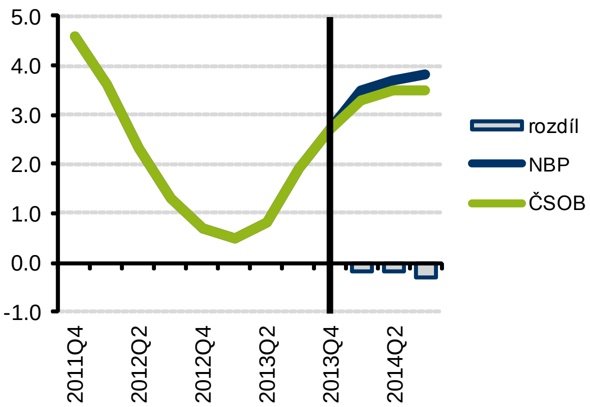
HU: GDP outlook (Y/Y, %)



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.	*2.60*	3.60	3.00	2.60	2.50	2.50	-15 bps	3/25/2014
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	*2.68*	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	*1.83*	2.06	2.09	1.90	2.10	2.30
Hungary	HU10Y	*4.98*	5.17	5.25	5.40	5.00	5.30
Poland	PL10Y	*4.01*	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	*27.4*	25.7	27.3	27.4	27.2	27.2
Hungary	EUR/HUF	*308*	297	297	300	300	300
Poland	EUR/PLN	*4.17*	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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