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Central European Weekly

Monday, 07 April 2014

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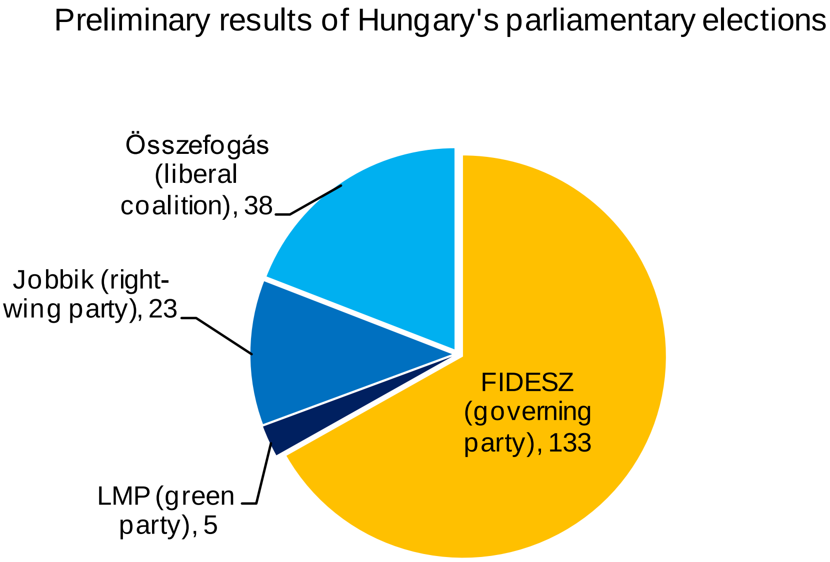
Chart of the Week: Hungary's elections



The recent preliminary result of Hungarian elections (133 mandate to Fidesz, 38 mandates to Összefogás, 23 mandates to Jobbik and 5 mandates to LMP) may still change to 132 to Fidesz and 39 to Összefogás.

Market's editorial

Regional economic recovery has been broadening

The generally positive macroeconomic data released in Central Europe in the last few weeks has in recent days been enhanced by fairly strong March retail sales figures in the Czech Republic and Hungary. While Czech sales were strongly encouraged by rapid car sales, which might be partly attributable to purchases by foreign consumers, the rise in Hungarian retail sales was more broadly based. Above all, however, Hungary's sales were not just about a single accidental figure, as they have been rising very decently for a few consecutive months.

Hungary's elections: the main question remains open

The result of the Hungarian parliamentary election was in line with the expectations. Fidesz (governing party) easily won the election, Jobbik (right wing party) strengthened and received slightly above 20% of the votes. LMP (green party) just received 5% of the votes, which is the minimum requirement to get into the parliament. Összefogás (coalition of social liberal parties) got 26% of the votes. The preliminary result is based on the 98.97% processed level of the votes.

According to the latest available figures Fidesz would have 133 mandates from maximum 199 mandates in the parliament, which means that it is just on the edge of two-third majority. Only two regions remained open in case of individual mandate (106 mandate is given based on the votes given on individual persons), both in Budapest. In the V. district the difference between Fidesz's and Összefogás's candidate is 253 votes, while there is 598 non-processed votes, which means that Összefogás has to collect 71% of the remaining votes to win this region. The tightest standing is in VIII. district, where Fidesz's candidate leads only by 22 votes, while there is 711 non-processed votes, so it means if Összefogás received 52% of the remaining votes their candidate wins the mandate. If Fidesz loses one of the above mentioned regions they won't have two-third majority in the parliament. As partly those votes were not calculated yet who are working not in Hungary there is relatively big chance for it that Fidesz may lose one mandate. So the recent preliminary part result (133 mandate to Fidesz, 38 mandates to Összefogás, 23 mandates to Jobbik and 5 mandates to LMP) may change to 132 to Fidesz and 39 to Összefogás.

This change may have more a symbolic effect as Fidesz will have a very strong majority in the parliament they still can make even fast and sudden decision, so losing the two-third majority in the parliament doesn't mean automatically that their policy may be more predictable or transparent. In case of two-third majority rules they may follow slightly more cooperative policy, but we think that they may find quite easily one representative from the 67 opposition delegates in case of two-third majority laws (e.g. constitutional law).

No sudden reactions were seen on the markets and we don't expect fast and substantial movement because of the election. The main question is who the tone of government's policy may change in the coming months. We think that Fidesz may focus on the domestic sectors and companies, tries to maintain a supportive environment for them. Probably, the government may deliver a reduction of the bank tax if the lending activity is increasing. Tight fiscal policy may be continued, the nationalization of foreign owned companies may slow down a little bit, but the risks remains that in case of worsening environment government may increase the tax wedge of multinational companies. So we don't expect radical changes of government policy, only some fine tune towards a slightly more predictable policy in case of there is no external shock coming.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.5	-0.01%	↗	↗
EUR/HUF	307	-0.32%	↗	↗
EUR/PLN	4.17	0.08%	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.81	-1.63	↗	↗
10Y HUF	4.87	-2.01	↗	↗
10Y PLN	3.93	-2.36	↗	↗

Review of Economic Figures

Cars drive the Czech retail and industrial sector upwards

Czech Retail sales continued to rise rapidly in February. They were up by 8.1% y/y, due in particular to the automotive segment, where sales went up by almost 20%.

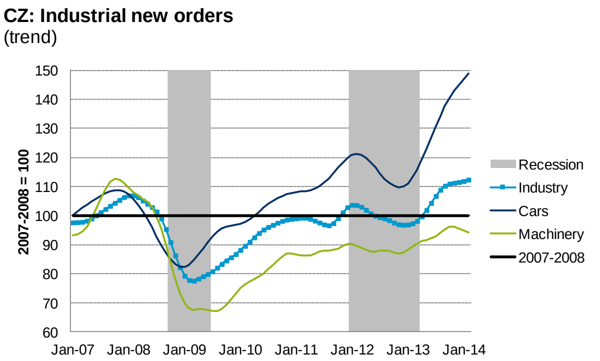
The automotive segment, i.e., car sales, is the main driver of the rise in retail sales, thus it is not surprising that the industrial production has been doing quite well this year (it grew 7.2% y/y in 2014Q1). The question is how many of the cars sold actually end up in the Czech market, i.e., the share of purchases by domestic customers as opposed to the share of purchases by foreign consumers, who are encouraged by the cheap koruna.

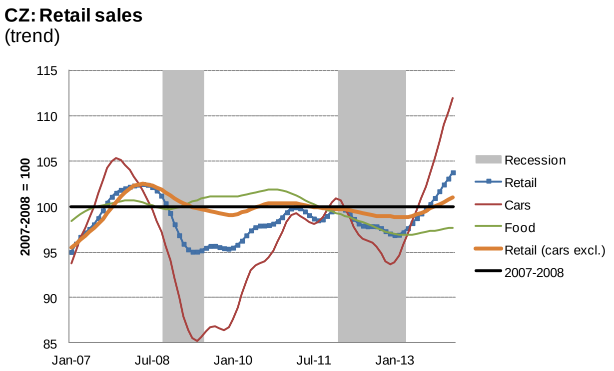
The performance of the retail sector excluding cars is not that impressive. Sales have most recently increased by 3.2%, due in particular to last year's low comparative baseline, as sales dropped by nearly 3% in February 2013. Thus the development of the retail sector excluding cars is much more stable and less turbulent.

E-commerce continued to expand rapidly in February. Its rise by almost 19% is evidence of its ever growing attractiveness to customers. Almost an unlimited offer, attractive prices, convenience, and the credibility of stable market players are irresistible for the Czech customer.

As concerns goods, Czech customers are primarily eager to buy home electronics, where prices have been falling in the long term. The purchases of handsets, mobile phones, and tablet computers clearly remain the most attractive goods this year.

The retail sector is still well in the black owing to cars, the prices of which are still attractive in the Czech market. Europe is struggling with a surplus of production capacities, and this has also affected the long-term price developments in the automotive segment. In addition, domestic sales have been encouraged by the weak koruna, which has cheapened the purchases by foreign customers.





In Focus: The CE recovery goes on

We have updated our CE leading indicators

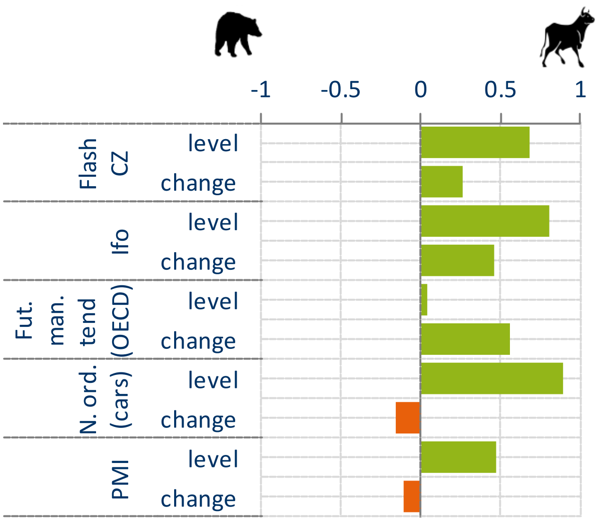
We have recently updated the composition of our forward-looking indicators (the Flashes) for Central European economies at the beginning of the year. For Poland, the index newly includes new orders and no longer the PMI (production) sub-index. For the Czech Republic, the PMI (foreign orders) sub-index was replaced with an overall PMI index. The Hungarian index remains unchanged.

The outlook remains bright for the near future despite higher geopolitical risks

All of the newly designed indices are at historically high levels in March, and have been rising for a number of consecutive months – the Polish Flash for 17 months, the Czech Flash for 16, and the Hungarian Flash for 11. The good performance of Ifo, the German business sentiment index, which is a component of each of the three forward-looking indicators, has contributed to this greatly. However, notably Poland and the Czech Republic have seen the positive accruals of their Flashes decelerate in recent months (6 and 7 consecutive months respectively). A moderate PMI decline contributed to this in both the Czech Republic and Poland last month. This may stem from the escalation of the Russian-Ukrainian crisis. Yet the deceleration is very moderate and, in both countries, from fairly high levels. Thus the Flashes still indicate a continuing recovery for all of the three Central European economies.

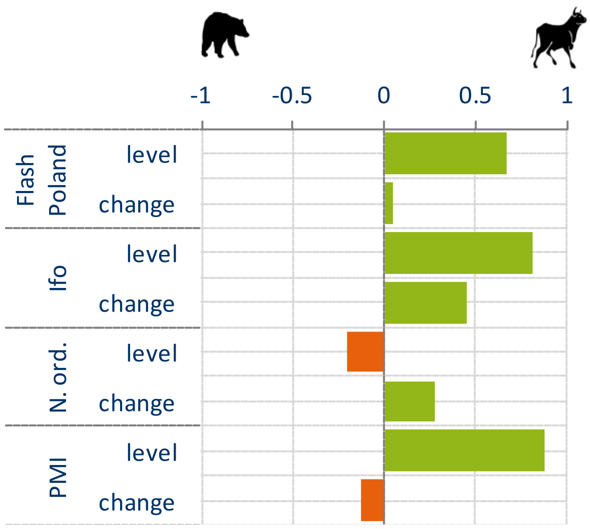
CE: Leading indicators

Flash Structure



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)

Flash Structure



Weekly preview

TUE 9:00 — CZ Unemployment Rate (in %)

	Mar-14	Feb-14	Mar-13
Rate	**8.4**	8.6	8.0

CZ: Weather speeds up seasonal jobs

The expected decline in unemployment will likely be attributable to the good weather, which sped up the commencement of seasonal jobs and the persisting stabilisation of the labour market. The number of unemployed will already fall significantly within the next few months, when work in agriculture, construction, and services gains momentum.

WED 9:00 — CZ Inflation (change in %)

	Mar-14	Feb-14	Mar-13
CPI m/m	**0.0**	0.2	0.1
CPI y/y	**0.2**	0.2	1.7
Monetary relevant inflation y/y	**0.1**	0.1	0.9

CZ: The period of low inflation continues

Inflation did not probably change in March either. On the one hand, food prices rose again, but this was counterbalanced by a decline in the prices of fuel, seasonal recreation and package tours. Year-on-year inflation, which is monitored by the central bank, is unlikely to change either, and will remain at the level of the previous two months. As far as the monetary policy is concerned, not even this outcome should imply any change to the Czech National Bank's existing approach; however, if inflation continues to lag behind the forecast in the future, the existing intervention regime may be extended, as may be the period of low interest rates.

WED 14:00 — NBP rate (in %)

	This	Last change
rate level	**2.50**	7/2013
change in bps	**0**	-25

PL: The NBP to maintain the status quo

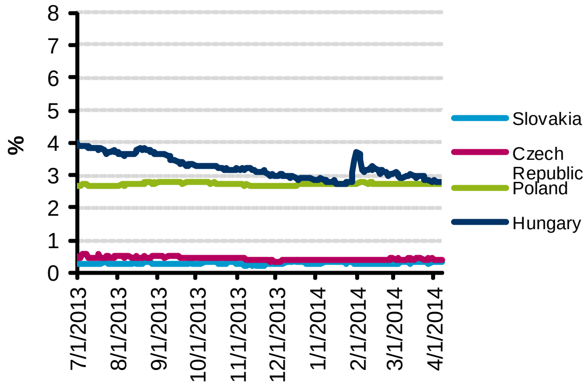
The meeting of the National Bank of Poland (NBP) will produce no substantial news. The NBP is likely to reiterate its 'commitment' to keep interest rates unchanged until at least the end of the third quarter of the year, with NBP President Belka to support the overall dovish tenor of the meeting by his comments at the subsequent press conference. The market is also slowly gearing up for the possibility that interest rates will remain unchanged this year, as this scenario is starting to be increasingly likely because of highly subdued inflation pressures.

Calendar

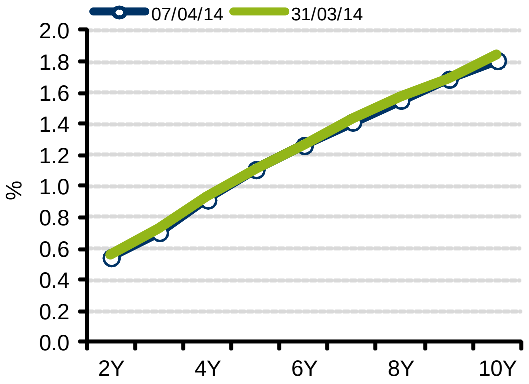
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	04/07/2014	9:00	Trade balance	CZK B	02/2014	43.8				44.6	
CZ	04/07/2014	9:00	Industrial output	%	02/2014		5.1		6.5		5.5
CZ	04/07/2014	9:00	Construction output	%	02/2014						5
CZ	04/07/2014	9:00	Trade balance (national)	CZK B	02/2014	26		21		15.5	
CZ	04/08/2014	9:00	Unemployment rate 15-64	%	03/2014	8.4		8.4		8.6	
HU	04/08/2014	9:00	Industrial output	%	02/2014 *P				6.7	3.1	6.1
CZ	04/09/2014	9:00	CPI	%	03/2014	0	0.2	0.1	0.2	0.2	0.2
HU	04/09/2014	9:00	Trade balance	EUR M	02/2014 *P			752.1		482.4	
CZ	04/09/2014	12:00	CZ bond auction 2014-18, 0.85%	CZK B	04/2014						
CZ	04/09/2014	12:00	CZ bond auction 2013-2028, 2.50%	CZK B	04/2014						
PL	04/09/2014	14:00	NBP meeting	%	04/2014	2.5		2.5		2.5	
HU	04/09/2014	17:00	Budget balance	HUF B	03/2014					-483.3	
HU	04/11/2014	9:00	CPI	%	03/2014			0.4	0.2	0.1	0.1
CZ	04/11/2014	10:00	Current account	CZK B	02/2014	20		22		25.93	
PL	04/11/2014	14:00	Current account	EUR M	02/2014			-480		-1135	
PL	04/11/2014	14:00	Trade balance	EUR M	02/2014			500		419	

Fixed-income in Charts

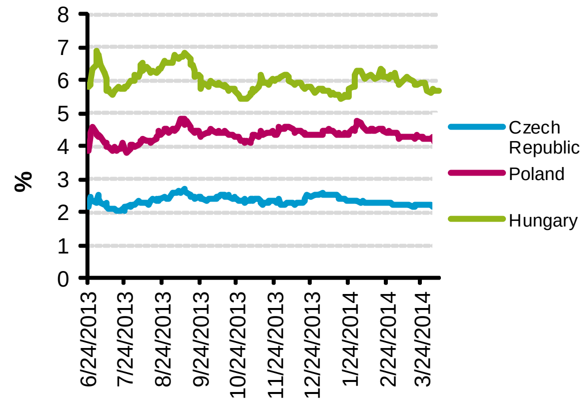
FRA 3x6



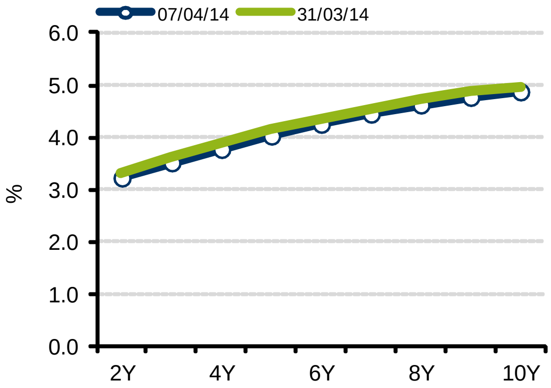
CZ IRS



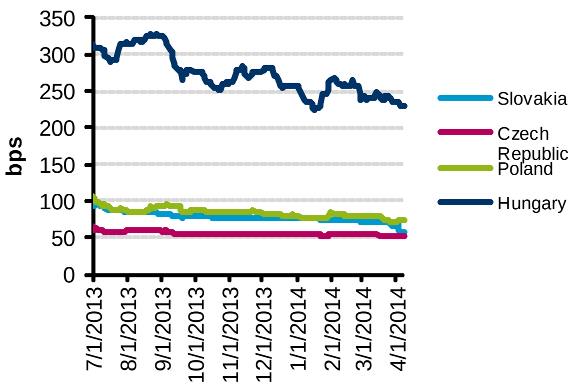
10Y GB Yields



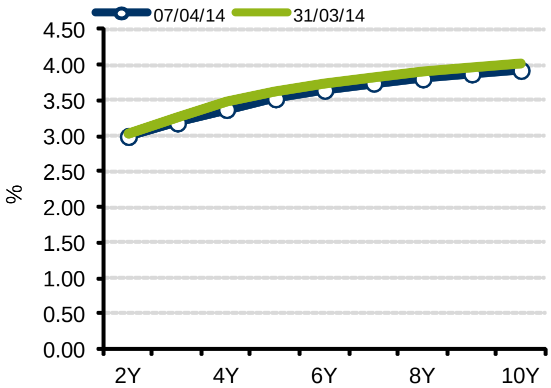
HU IRS



CDS 5Y



PL IRS



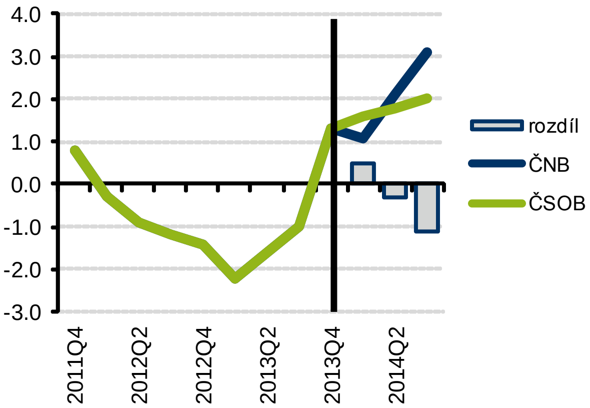
Source: Reuters

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.	We don't expect radical changes of Fidesz/government policy after April's election. 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.	We don't expect fast and substantial forint movement after the April election.	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.

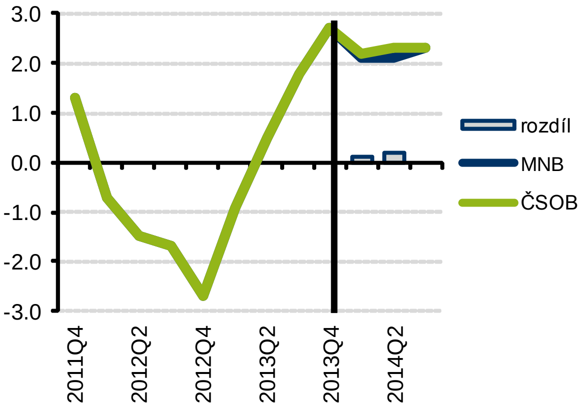
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

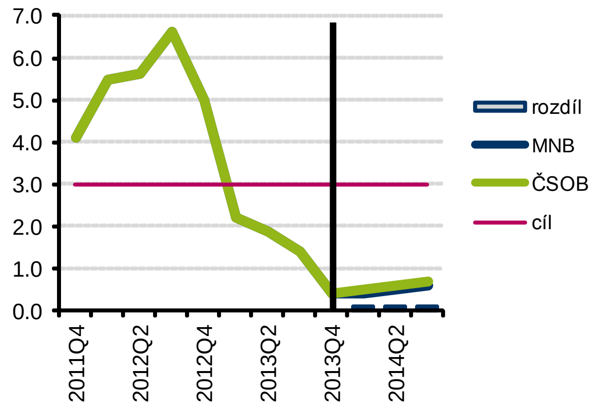


CZ: Inflation outlook (Y/Y, %)

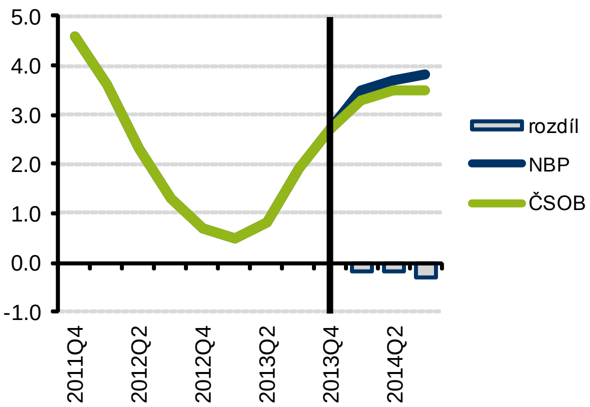
HU: GDP outlook (Y/Y, %)



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	*2.67*	3.56	2.99	2.70	2.50	2.50
Poland	WIBOR	*2.72*	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	*1.81*	2.06	2.09	1.90	2.10	2.30
Hungary	HU10Y	*4.87*	5.17	5.25	5.40	5.00	5.30
Poland	PL10Y	*3.93*	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	*307*	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	1.6	1.8	2.0
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	0.2	0.6	1.3
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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