



Central European Weekly

Monday, 23 June 2014

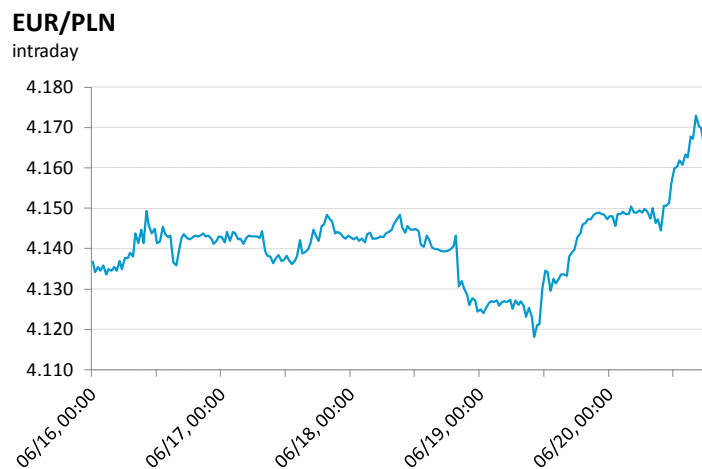
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Weekly Highlights:

- Pressure on PM Tusk's government and Polish assets is growing, still early elections are unlikely
- The Polish industry fell short of expectations in May
- The NBH will cut base rates to a new all-time low
- Will the CNB confirm a postponement of the 'exit'?

Chart of the Week



The zloty remained under pressure due to the wiretapping affair in Poland, which threatens PM Tusk's government.

Market's editorial

Pressure on PM Tusk's government and Polish assets grow

The zloty and newly Polish government bonds appeared under pressure as the latest affair of the wiretapping of the Head of the NBP Belka and (after the weekend) Foreign Minister Sikorski as the pressure on PM Tusk's government is mounting. In this respect, we still consider a scenario, which would lead to early parliamentary elections in Poland as unlikely.

In addition to the aftermath of the affair of the wiretapping in Poland, two more central banks in the region will grab the spotlight this week. The Board of the National Bank of Hungary as well as that of the Czech National Bank will hold their regular interest-rate setting meetings. This time, the meetings may result in quite important outcomes for their respective domestic markets.

The NBH will push its base rate to a new all-time low

Regarding the upcoming NBH meeting, we believe it will cut its base interest rate again to new all-time lows (by an additional 10 basis points).

Just recently, one of the vice-governors of NBH highlighted that rate cut cycle can be continued in June. Although the council is divided (7 members were voted again on 10bp cut and 2 members on hold in May) it is quite clear that the 7 members will vote together until NBH's governor, Mr. Matolcsy wants to cut the base rate. It was interesting that the two members, who didn't want to moderate the key rate highlighted that the continuation of rate cut cycle is getting more dangerous. In this respect it is worth noting

that the HUF underperformed regional currencies, which still suggests that the decreasing risk premium Hungary makes the currency more sensitive on external shocks.

Will the CNB confirm a postponement of the 'exit'?

As concerns the CNB the upcoming meeting will not include a new macroeconomic forecast; nevertheless, the Bank Board should already communicate more explicitly that it will certainly exit from its intervention regime later than early next year. While we expect that the CNB will only express its satisfaction with the exchange rate regime and interest rate settings, and, between the lines, it will mention that, unlike the previous forecast, the departure from the exchange rate regime is likely to take place later. The tone of comment referred to interest rates, if any, may contrast with the existing CNB forecast, envisaging a rapid rate hike as early as in the first quarter of next year. We still believe that the departure from the exchange rate regime will not take place before the second half of 2015 and that the CNB will not decide to begin to raise its rates immediately afterwards. After all, several CNB Board members have already mentioned the scenario of a later departure from the exchange rate regime, and thus it would certainly not come as any striking news to financial markets. We think that CNB Governor Singer is not yet likely to specify the number of months or quarters by which the regime would be extended (*vis-à-vis* February 2015); however, he should at least indicate the (time) units considered by the Bank Board for the extension (of the current monetary regime).

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.5	0.07%	↘	→
EUR/HUF	306	-0.62%	→	→
EUR/PLN	4.16	0.43%	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.46	-3.96	→	↗
10Y HUF	4.14	-0.24	→	↗
10Y PLN	3.57	0.71	→	↗

Review of Economic Figures

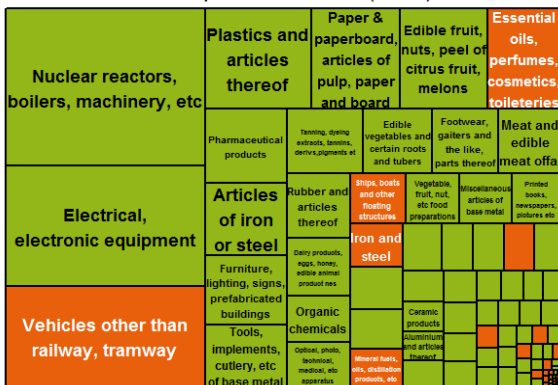
Polish industry fell short of expectations in May

Last week, political events completely overshadowed the other events in Poland, even as concerns the impacts on markets; however, markets had to absorb not only the affair of the recorded conversation between NBP Governor Belka and Interior Minister Sienkiewicz, but also a set of monthly data from the economy. May's statistics from Polish industry were probably the most interesting. The performance of industry fell short of market expectations in May. The actual figure was 1.5% worse than the anticipated rise by 5.9% y/y. Although the performance of the manufacturing industry was not entirely bad, the year-on-year growth rate of 5.7% means a moderate deceleration vis-à-vis previous months. Thus the performance of construction, in particular, remains positive (+10% y/y).

Is the worsened business sentiment preview fro hard data?

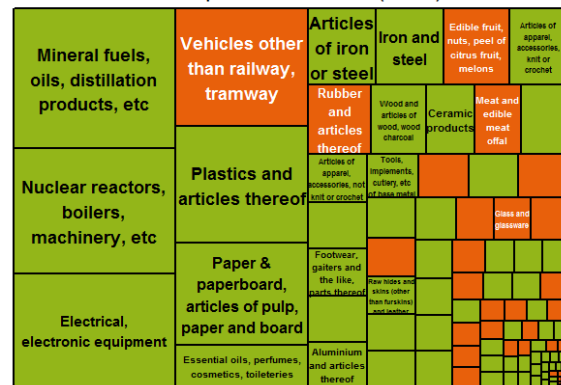
As we have noted, the relative importance of short-term statistics will grow in the months to come, as the central bank is considering another cut in its official interest rates because of low inflation. One of the main arguments for rate stability is very decent economic growth. Given the latest figures, the year-on-year growth rate is unlikely to accelerate to any great extent in the second quarter of the year vis-à-vis the first, and there is even a risk of a moderate deceleration. The latest data from industry suggests that the rapid deterioration of PMI in recent months, which has likely been related to the internal political crisis in Ukraine, may really translate into weaker macroeconomic statistics through lower exports. Hence the look into a more detailed structure of industrial output, once the details are available, may also catch the eye.

PL: Exports to Russia (2013)



Source: UN COMTRADE, CSOB

PL: Exports to Ukraine (2013)



Source: UN COMTRADE, CSOB

Weekly preview

TUE 14:00

NBH base rate

	This meeting	Last change
rate level (in %)	2.30	5/2014
change in bps	-10	-10

HU: NBH will cut base rates to a new all-time low

Just recently, one of the vice-governors of NBH highlighted that rate cut cycle can be continued in June. Although the council is divided (7 members were voted again on 10bp cut and 2 members on hold in May) it is quite clear that the 7 members will vote together until NBH's governor, Mr. Matolcsy wants to cut the base rate. It was interesting that the two members, who didn't want to moderate the key rate highlighted that the continuation of rate cut cycle is getting more dangerous. In this respect it is worth noting that the HUF underperformed regional currencies, which still suggests that the decreasing risk premium Hungary makes the currency more sensitive on external shocks..

THU 13:00

CNB base rate

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

CZ: CNB will confirm a postponement of exit

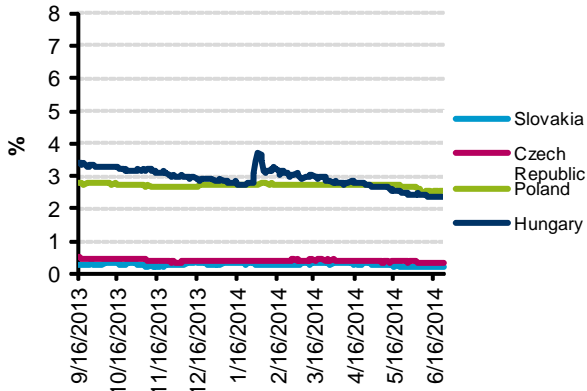
There is probably not much to expect from June's CNB Board meeting. We believe that new data will not lead to any change in the monetary policy settings at the forthcoming CNB Board meeting. We still believe that the departure from the exchange rate regime will not take place before the second half of 2015 and that the CNB will not decide to begin to raise its rates immediately afterwards.

Calendar

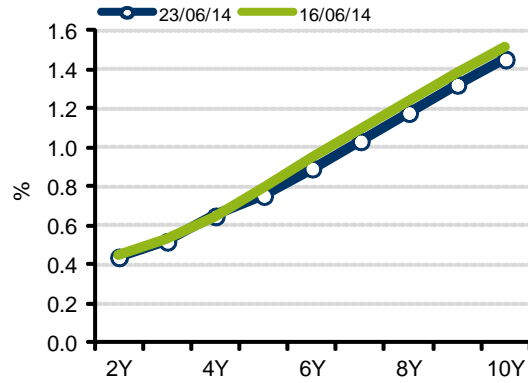
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	06/24/2014	8:30	Current account	HUF B	1Q/2014			544		637	
HU	06/24/2014	14:00	NBH meeting	%	06/2014	2.3		2.3		2.4	
PL	06/26/2014	10:00	Retail sales	%	05/2014			0.2	6.5	2.3	8.4
PL	06/26/2014	10:00	Unemployment rate	%	05/2014			12.5		13	
CZ	06/26/2014	13:00	CNB meeting	%	06/2014	0.05		0.05		0.05	
HU	06/27/2014	9:00	Unemployment rate	%	05/2014			7.7		8.1	

Fixed-income in Charts

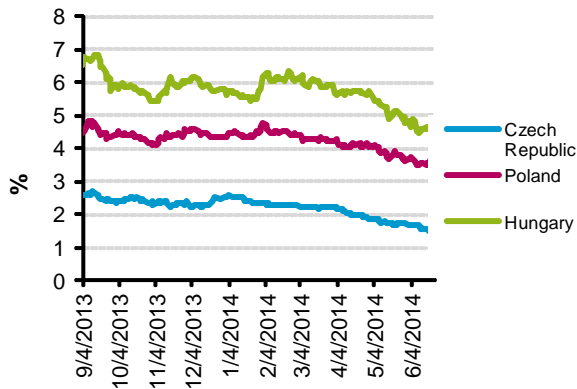
FRA 3x6



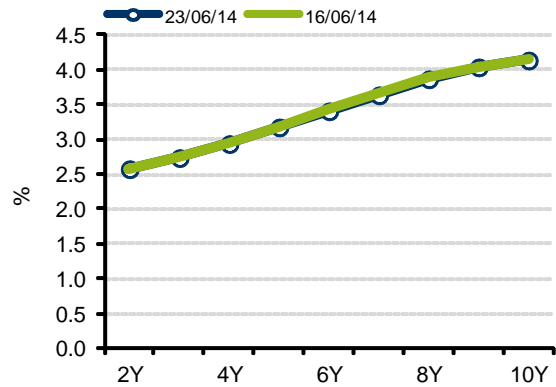
CZ IRS



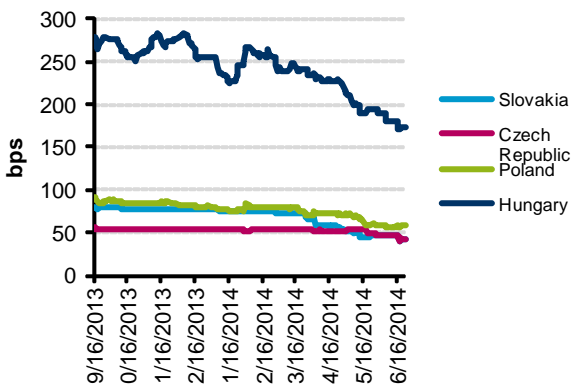
10Y GB Yields



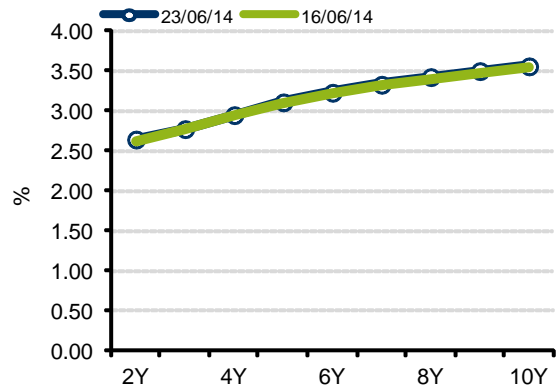
HU IRS



CDS 5Y



PL IRS



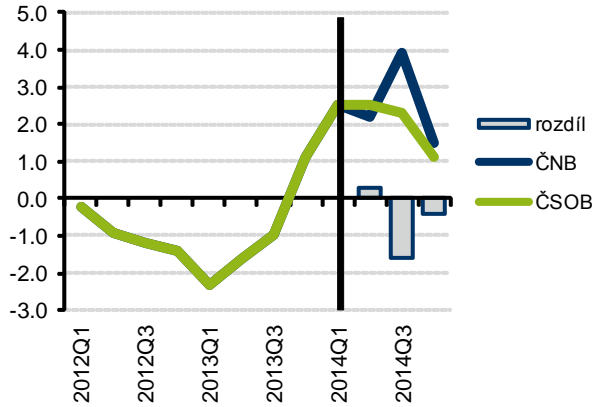
Source: Reuters

Medium-term Views & Issues

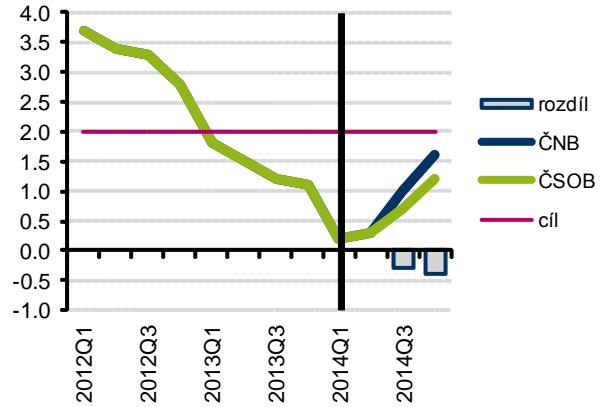
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The economy is in a period of upswing. The key economic fundamentals remain very strong, with many of them even improving over the course of time.</p> <p>The new government, formed after the autumn 2013 election, is just gradually starting to carry out its programme. It should include not only savings but also greater tax relief for parents with children, a new VAT rate, and likely also the termination of the new funded pension system (called the 2nd pillar), set up in the last two years.</p>	<p>Based on the first quarter figure and the recent trends in the economy, Hungary's GDP may grow above 2.5% Y/Y in 2014 and it cannot be excluded that the growth might be close to 3% Y/Y level. The low base supports this economic growth level in short term, but without a substantial rise of investments in the private sector this year, economy may slow down to around 2% Y/Y level in 2015.</p> <p>On the other hand, in spite of growing domestic demand, inflation appears well anchored and inflationary expectations stick close to 3%. Moreover, as this year's harvest may be good, food processing industry hardly escalates price pressures in the economy.</p>	<p>According to the GUS estimates the Polish economy grew by 3.4% in 2014Q1. 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, especially in view of recent crisis in Ukraine.</p>
Outlook for official & market rates	<p>The CNB has 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.</p> <p>We believe that the exchange rate targeting will be abandoned much later (not before the second half of 2015), and that the move will certainly not be accompanied by a rise in interest rates, as suggested by the official forecast.</p>	<p>Based on the stability report, the MPC's view on stability concerns is quite mitigated. Additionally, the HUF strengthened around 2% against EUR, so there is no pressure coming from the currency side either to stop the easing. It is quite difficult to figure out at which level the rate cut cycle will conclude, but the last statement of the MPC was quite dovish. The inflationary report (which will be released at the next rate setting meeting in June) may include very important details about how the NBH sees the macroeconomic background. Based on that, we may make new conclusions about the bottom of the rate cut cycle. The latest available figures and information suggest that the MPC might cut the base rate two more times by 10bp in which case the easing cycle ends at 2.2%.</p>	<p>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, outlook for persistently low inflation should play in favor of stable official interest rates in the rest of this year. The main risk in this regard stems from the ECB MP easing and its possible impact on the zloty exchange rate. If the zloty continued to strengthen, it would not be welcome news for the NBP, especially with inflation hovering well-below the target and risk of slower growth due to Ukraine.</p>
Forex Outlook	<p>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.</p>	<p>In a longer term perspective, HUF is still in a weakening channel implying a 2-3% depreciation of the currency against EUR on a yearly basis. Taking into account the government's and NBH's statements, such a gradual depreciation of the currency is welcomed as it definitely not endangers the stability of the country. Additionally the government still wants to solve the problems of the foreign currency denominated loans in the households sector in autumn, which may give the National Bank of Hungary an even bigger room of manoeuvring room.</p>	<p>Low inflation pressures and improving prospects of the economy may support the zloty in months ahead. Albeit we expect only gradual strengthening against the euro, the Polish currency might perform well against the koruna as the room for koruna's appreciation remains virtually closed and the economic recovery in Poland is likely to continue at faster pace. The main risk as regards the zloty is the ECB decision to ease MP which could further support the currency.</p>

CBs' Projections vs. Our Forecasts

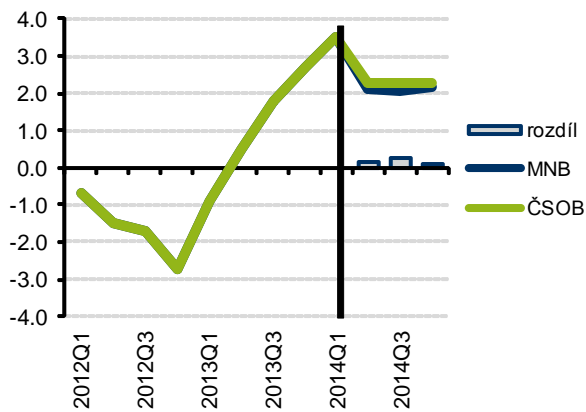
CZ: GDP outlook (Y/Y, %)



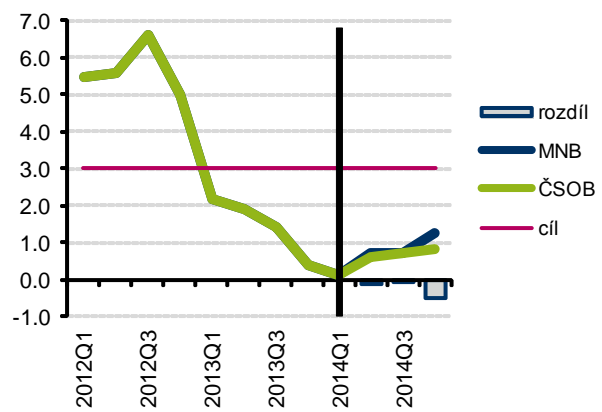
CZ: Inflation outlook (Y/Y, %)



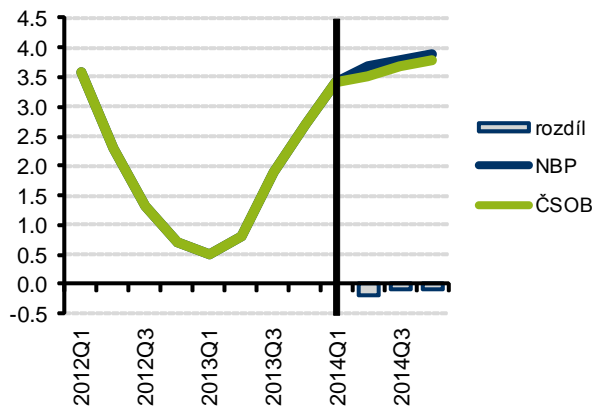
HU: GDP outlook (Y/Y, %)



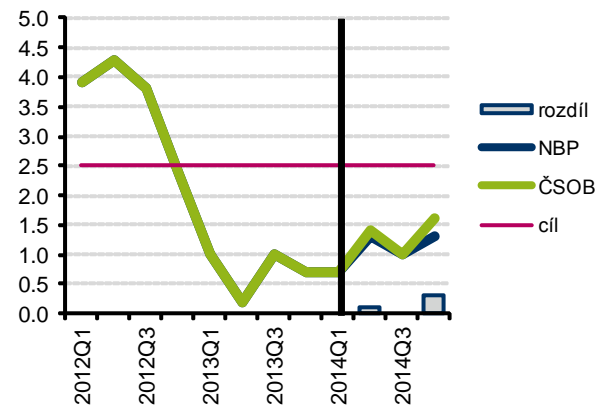
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outlook (Y/Y, %)



Source: CNB, NBP, MNB, CSOB

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	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.	2.40	3.00	2.60	2.50	2.50	2.50	-15 bps	5/27/2014
Poland	2W inter. rate	2.50	2.50	2.50	2.50	2.50	2.75	-25 bps	7/3/2013

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

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	PRIBOR	0.35	0.38	0.37	0.36	0.36	0.36
Hungary	BUBOR	2.43	2.99	2.67	2.50	2.50	2.50
Poland	WIBOR	2.68	2.71	2.71	2.75	2.75	3.00

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

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	CZ10Y	1.455	2.09	1.84	1.55	1.70	1.85
Hungary	HU10Y	4.14	5.25	4.95	5.00	5.30	5.70
Poland	PL10Y	3.57	4.25	4.03	4.10	4.45	4.70

Exchange rates (end of the period)

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	EUR/CZK	27.5	27.3	27.4	27.2	27.2	27.2
Hungary	EUR/HUF	306	297	307	305	298	295
Poland	EUR/PLN	4.16	4.16	4.17	4.16	4.15	4.09

GDP (y/y)

	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	-1.6	-1.0	1.1	2.5	2.5	2.3	1.1
Hungary	0.5	1.8	2.7	3.5	2.3	2.3	2.3
Poland	0.8	1.9	2.7	3.4	3.5	3.7	3.8

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

	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	1.6	1.0	1.4	0.2	0.2	0.9	1.5
Hungary	1.9	1.4	0.4	0.1	0.6	0.7	0.8
Poland	0.2	1.0	0.7	0.7	1.4	1.0	1.6

Current Account

	2013	2014
Czech Rep.	-1.4	-1.4
Hungary	2.0	2.2
Poland	-1.2	-2.5

Public finance balance as % of GDP

	2013	2014
Czech Rep.	-1.5	-2.5
Hungary	-2.7	-3.0
Poland	-4.4	-3.5

Source: CSOB, Bloomberg

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