



Central European Weekly

Monday, 20 April 2015

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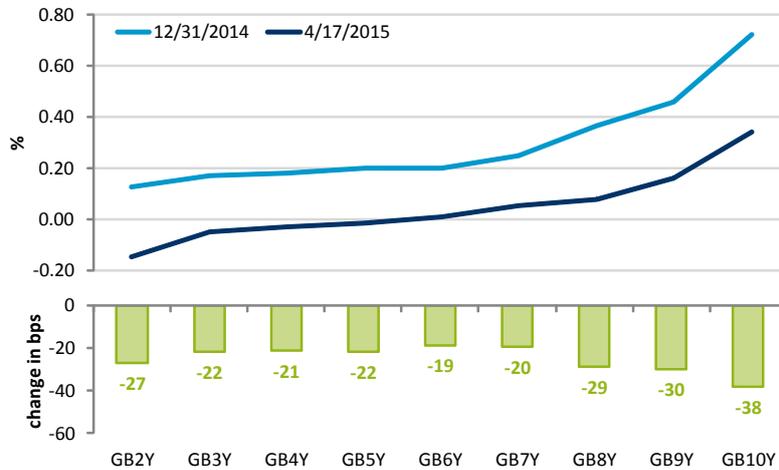
Weekly Highlights:

- ECB's quantitative easing hits Central Europe in full
- Deflation period in Poland persists but wages grow very rapidly
- NBP not worried by strengthening of the zloty
- Forint weakens, so do pressure on NBH to ease its policy

Chart of the Week

CZ: yield curve

government bonds



Czech government bond yields continue to decline... (Source: Bloomberg, CSOB)

Market's editorial

ECB's quantitative easing hits Central Europe in full

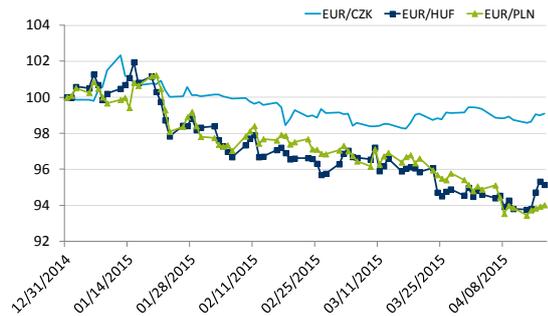
The huge printing of euros by the ECB has hit Central European forex and bond markets in full, and this has made itself felt in several ways. Firstly, the zloty and the forint are strengthening; secondly, government bonds over the whole region appear to be highly attractive; and thirdly, anomalies have occurred on the money and derivative koruna markets, when implicit market interest rates (generated cross-currency swaps) are falling into negative territory.

All of the above may directly or indirectly put pressure on regional central banks to continue to ease their respective monetary policies by cutting their official interest rates – in

the Czech Republic even into negative territory. Although central bankers in Poland and the Czech Republic are denying any plans for more rate cuts, if the effect of the ECB's quantitative easing grows we are far from seeing the end of rate cuts yet.

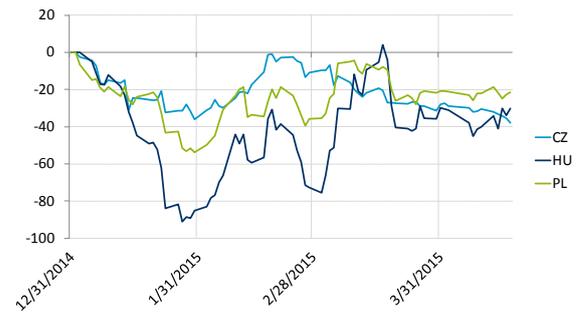
The National Bank of Hungary will probably not have a problem cutting its interest rates again, and will do so (after one month) this Tuesday. Negative inflation and the fairly strong forint will be good pretexts for the NBH to cut its base rate to new all-time lows.

CE currencies against the euro
in 2015



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.5	0.37%	→	→
EUR/HUF	302	1.60%	↗	↘
EUR/PLN	4.02	0.34%	→	↗

CE: government bonds yields change
10 year in basis points



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	0.52	-15.45	↘	↗
10Y HUF	2.69	0.94	↘	↗
10Y PLN	2.09	-0.85	↘	↗

Review of Economic Figures

Deflation period in Poland persists but wages grow very rapidly

March data have confirmed that the Polish economy is not currently faced with inflationary pressures. On the other hand, very rapid wage growth suggests that the situation may change in the months to come. The inflation rate surprised markets on the downside and remained well below zero. While the year-on-year price fall is primarily attributable to commodity prices, not even core components (0.2% y/y) currently indicate the existence of inflationary pressures.

Remarkably, the latest developments on the labour market have been very positive. These include not only falling unemployment but also rapid wage growth of 3.9% y/y on average in the first quarter of the year. Thus real wage growth in Poland exceeded 5% in the first quarter. Along with the anticipated stability of (or a possible rise in) commodity prices, this means that inflation probably hit bottom in the first quarter.

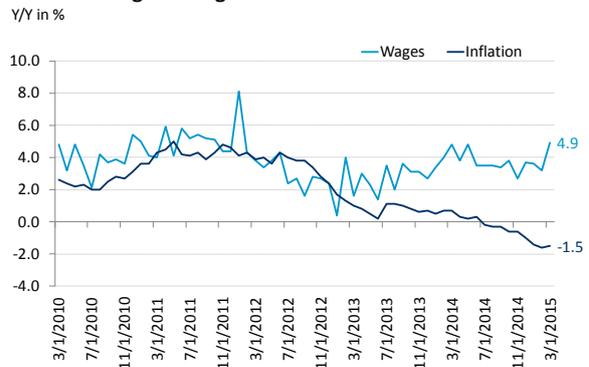
The satisfaction with the current monetary policy settings in Poland was also confirmed by the meeting of the National Bank of Poland. Given the fairly strong announcement of the end of the monetary easing cycle made at its last meeting, the rate stability probably did not surprise anyone. Attention was primarily focused on the subsequent press conference, i.e., on the NBP's attitude towards the relatively fast appreciation of the zloty in recent weeks. Nevertheless, there was no information about any dissatisfaction felt by the NBP (although numerous questions on this were posed). Governor Belka stated that exchange rate fluctuations of free-floating currencies are normal. Thus the NBP probably considers the March rate cut by 50 bps to be a sufficient measure against excessive appreciation of the zloty.

However, we still believe that the combination of high (real) rates in Poland and the quantitative easing in the euro area will probably make Polish assets an attractive target for investors. The zloty should have too few reasons to reverse the trend of recent weeks.

EUR/PLN



PL: Nominal gross wages vs. Inflation



Weekly preview

TUE 14:00

NBH base rate

	This meeting	Last change
rate level (in %)	1.80	3/2015
change in bps	-15	-15

Forint weakens, so do pressure on NBH to ease its policy

The forint started to weaken suddenly after the EUR/HUF pair was not able to break the resistance level of 296 and jumped to 302 within two days. Although it was not simply an Hungarian event as the EUR/PLN strengthening stopped at 4 and moved to 4.035, HUF was effected slightly more so the PLN/HUF exchange rate increased from 73.8 to 75. The reasons behind the slightly bigger weakening of the HUF are the EU decision about freezing some developments funds money because of inappropriate decision making process and the broker companies default in the last couple of weeks. But this movement may suggest also that Hungary is more sensitive on the decreasing risk taking willingness, which happened because of the possible Greece insolvency problems in the near future. Technically, we see important resistance level between 302 and 303, while the next one is at around the EUR/HUF 305 level.

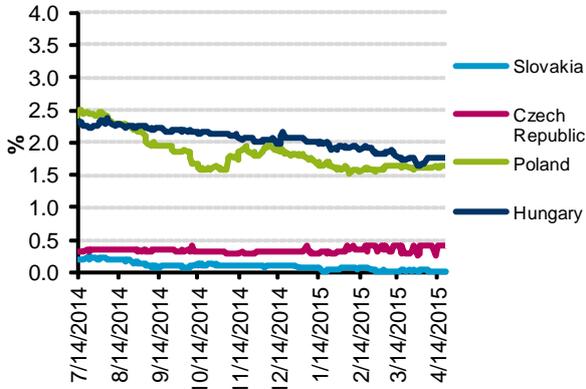
This movement might be important as the NBH will have the next rate setting meeting on Tuesday (21st April) and last week Mr. Balog, vice-governor of NBH said that Hungary may cut the base rate to the level of Polish one of 1.5%. We think that the current sudden weakening of the currency may return the NBH's attitude to a more cautious one. It is quite clear now that the NBH is happier with a EURHUF exchange rate between 305 and 310, so we think that the rate cut cycle may continue and most likely the Council may moderate the base rate by 15bp from 1.95% to 1.8%. Although the last inflation reading was still low with its level of -0.6% Y/Y in March it increased substantially in the last two months (from -1.4% Y/Y in January) and the further increase of fuel prices and the continuously high domestic demand may push inflation above 2% Y/Y at the end of the year. So we still think that there is less need for further rate cut and it is rather forced out by the markets.

Calendar

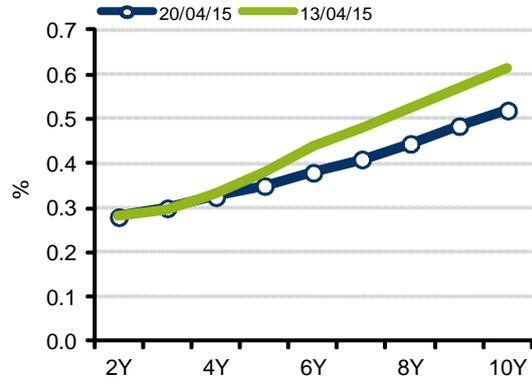
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	04/20/2015	14:00	Industrial output	%	03/2015			12.2	7.2	1.3	4.9
PL	04/20/2015	14:00	PPI	%	03/2015			0.1	-2.5	0	-2.7
PL	04/20/2015	14:00	Retail sales	%	03/2015			15.7	1.6	-2	-1.3
HU	04/21/2015	14:00	NBH meeting	%	04/2015	1.8		1.8		1.95	
CZ	04/22/2015	12:00	CZ bond auction 2014-25, 2.40%		CZK B 04/2015						
CZ	04/22/2015	12:00	CZ bond auction 2014-2020, floating rate		CZK B 04/2015						
PL	04/24/2015	10:00	Unemployment rate	%	03/2015			11.7		12	

Fixed-income in Charts

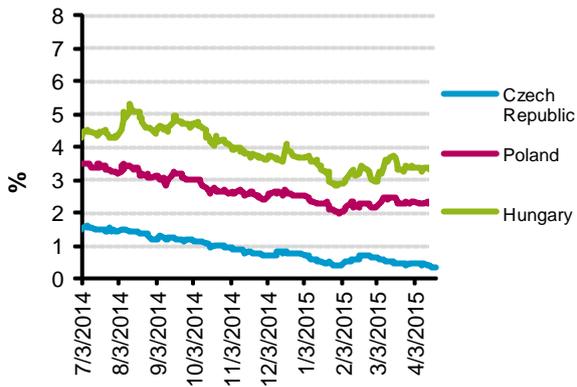
FRA 3x6



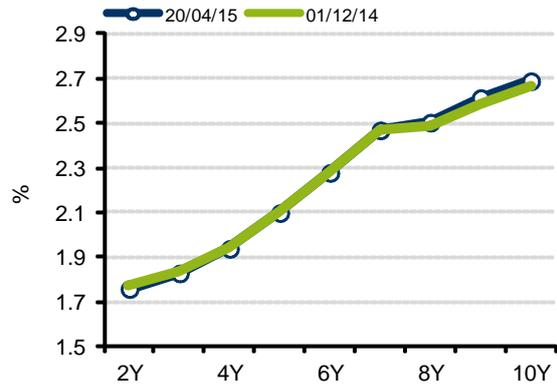
CZ IRS



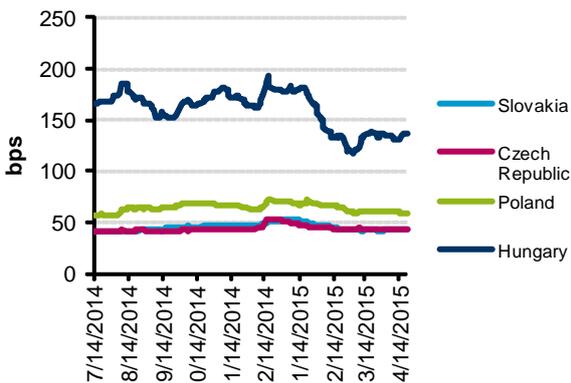
10Y GB Yields



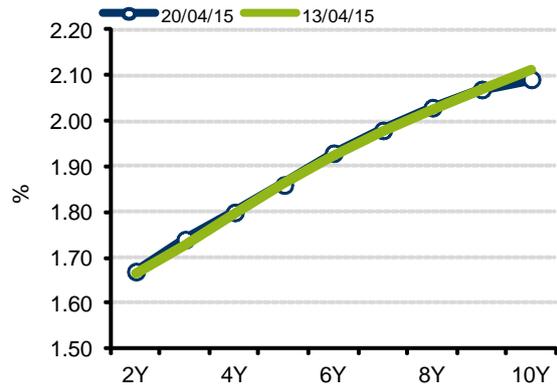
HU IRS



CDS 5Y



PL IRS



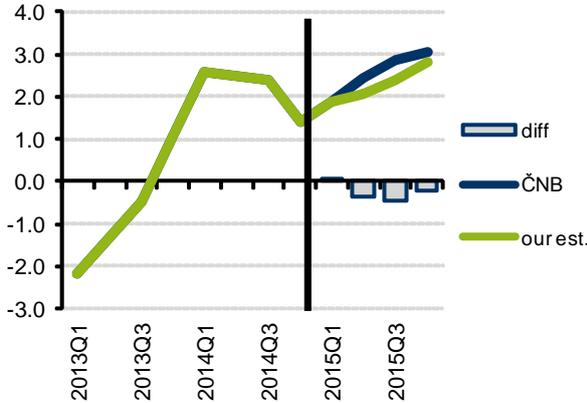
Source: Reuters

Medium-term Views & Issues

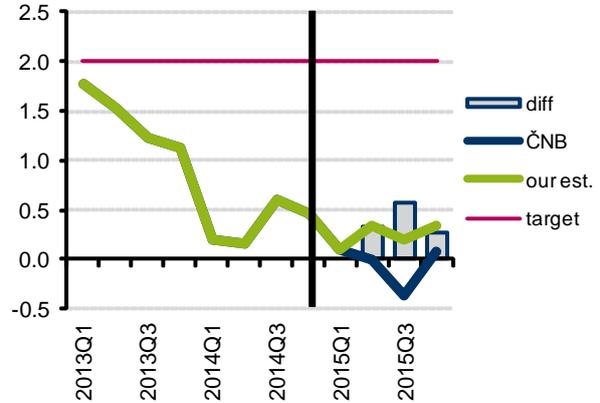
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The current economic recovery is primarily based on the outstanding performance of the automotive industry on the one hand and restored investment and consumption growth on the other. Economic growth has also been encouraged by the deficit financing of the public sector, which is, however, generating no pressures on the capital market thanks to fairly low debt and reserves. The government policy has not delivered any fundamental economic changes so far, perhaps except for the planned abolition of the pension reform and partial modifications of certain taxes and social security benefits. The issue of euro adoption is still on ice in the CR.</p>	<p>Hungary's economy may slow down, but probably less than previously expected thanks to the improving international environment and the stable and strong domestic demand. So economy may grow around 2.5% y/y in 2015 and now we see rather positive risk in this forecast. We recognized in the last couple of months that exchange rate has very low effect on the inflation, so the NBH cannot easily accelerate the CPI with the depreciation of the currency. We see this year's inflation around 0% Y/Y, but CPI may be around 2% Y/Y in December.</p>	<p>According to the GUS estimates, the Polish economy grew by 3.1% in 2014Q4 and by 3.3% in whole year. As in previous quarters, economic growth was driven mainly by strong domestic demand. Particularly encouraging was a high contribution of investment to economic growth. As for this year, we expect economic growth to slow down slightly below 3%.</p>
Outlook for official & market rates	<p>Interest rates remain at all-time lows and, given the positive inflation outlook, the CNB is unlikely to raise its base rate before 2017. In addition, the central bank will not proceed to such a move before it abandons its current exchange rate policy, which is based on maintaining the exchange rate above the EUR/CZK floor. Moreover, the decreasing inflationary expectations may even delay these two steps. This possibility is reflected by money market rates and, in particular, by IRS and government bond yields. Our outlook for inflation as well as short-term interest rates is still below the central bank's official forecasts.</p>	<p>The march rate cut from the NBH (by 15 bps) confirms our view that mainly the international environment may lead the next months' decisions, and the council may move with 10bp steps in the following months. We see relatively high chance for cuts in April and May, so the base rate might be moderated to 1.75% at the end of May.</p>	<p>We expect the NBP to keep rates at new lows (1.50%) this year, but we cannot completely rule out the likelihood of further rate cuts. The main reason is the combination of the "inflow of cheap euros from the ECB" to markets and the unusually open commitment by the NBP not to continue to cut rates. In addition, if we take account of this year's inflation rate, which is likely to be negative for the year as a whole, such a climate will probably attract investments in Polish assets. In that event, additional pressure for the appreciation of the zloty and consequently for an inflation fall can be expected.</p>
Forex Outlook	<p>We believe a hike of EUR/CZK floor is still unlikely.. This would require deterioration of currently positive economic outlook. On the other hand the, the more aggressive verbal interventions may keep the Czech koruna on the defensive for a while. Hence it is probable that the pair forgets about testing the 27 EUR/CZK for now. Fundamentally, the Czech currency should be more sensitive to readings of major Czech macroeconomic indicators – inflation, wages, industry and, of course, GDP. The koruna may get more nervous ahead of May's CNB Board meeting, where a new inflation forecast will be submitted.</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 maneuvering room.</p>	<p>We expect the zloty to gain on growing capital inflows exploiting the positive interest rate differential at the time short term yields are mostly negative in the eurozone. Given the NBP pledge to end the rate cutting cycle, the market may feel temptation to test the willingness of the central bankers to tolerate further gains of the Polish currency.</p>

CBs' Projections vs. Our Forecasts

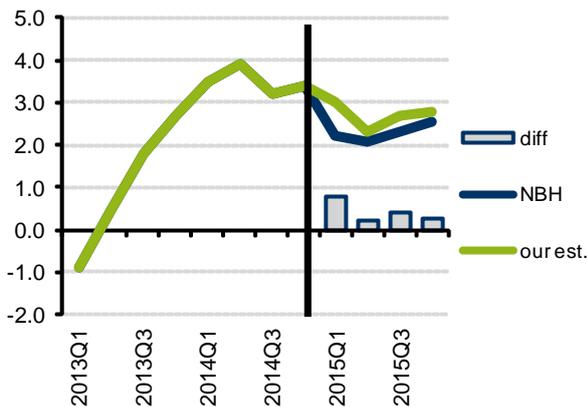
CZ: GDP outlook (Y/Y, %)



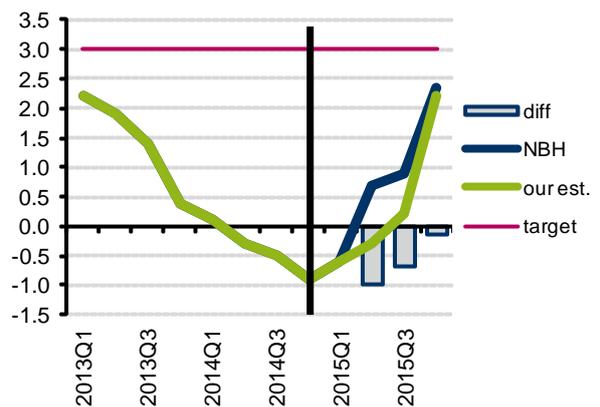
CZ: Inflation outlook (Y/Y, %)



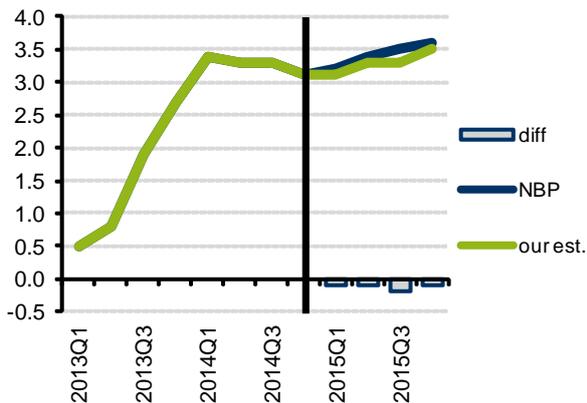
HU: GDP outlook (Y/Y, %)



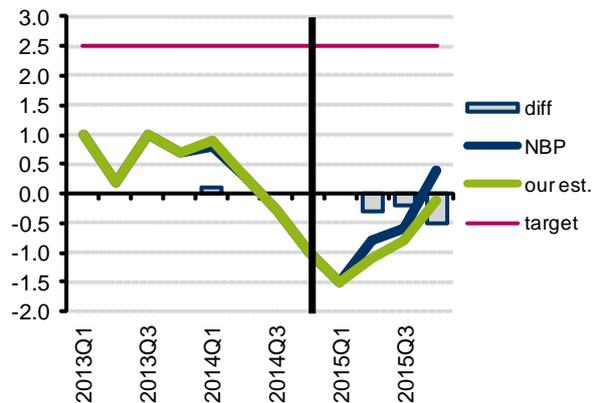
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outlook (Y/Y, %)



Source: CNB, NBP, MNB, KBC

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	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.	1.95	1.95	1.70	1.70	2.00	2.25	-10 bps	3/24/2015
Poland	2W inter. rate	1.50	1.50	1.50	1.50	1.50	1.50	-50 bps	3/4/2015

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	PRIBOR	0.31	0.30	0.30	0.30	0.30	0.30
Hungary	BUBOR	1.84	1.89	1.70	1.70	2.10	2.40
Poland	WIBOR	1.65	1.65	1.55	1.60	1.65	1.67

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	CZ10Y	0.52	0.64	0.50	0.60	0.75	0.90
Hungary	HU10Y	2.69	2.71	3.20	3.40	3.60	3.80
Poland	PL10Y	2.09	2.12	2.10	2.20	2.40	2.80

Exchange rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	EUR/CZK	27.46	27.57	27.30	27.60	27.30	27.30
Hungary	EUR/HUF	302	300	310	317	315	310
Poland	EUR/PLN	4.02	4.07	4.05	4.00	4.10	4.05

GDP (y/y)

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	2.4	1.4	1.9	2.1	2.4	2.8	2.5
Hungary	3.2	3.4	3.0	2.3	2.7	2.8	2.2
Poland	3.3	3.1	3.1	3.3	3.3	3.5	3.5

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

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	0.7	0.1	0.2	0.5	0.1	0.6	1.4
Hungary	-0.5	-0.9	-0.6	-0.3	0.2	2.2	2.7
Poland	-0.3	-1.0	-1.5	-1.1	-0.8	-0.1	0.4

Current Account

	2015	2016
Czech Rep.	1.6	1.5
Hungary	4.0	3.8
Poland	-1.2	-2.0

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-2.4	-1.9
Hungary	-2.2	-2.0
Poland	-3.0	-2.5

Source: KBC, Bloomberg

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