Central European Weekly

Monday, 26 October 2015

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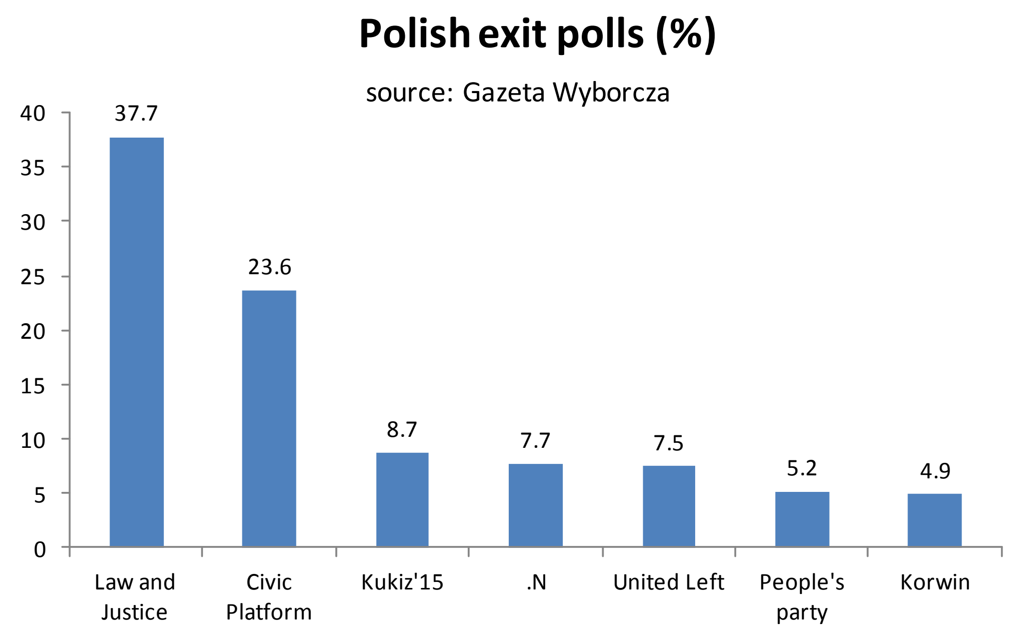
Weekly Highlights:

- Polish elections: absolute majority for Law and Justice?
- Polish markets still in a wait-and-see mode, but the zloty appears under modest pressure

Chart of the Week: Polish vote to Sejm



It is still uncertain, who will actually enter into the new polish Parliament.
The entry threshold is set at 5%, while it is 8% for coalitions(that is why United Left might not be in Sejm)

Market's editorial

Main opposition party might get majority in Polish Sejm

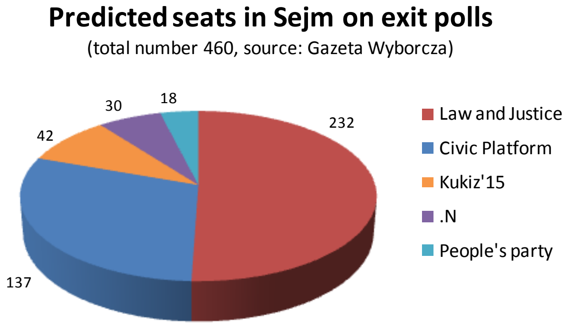
Sunday´s parliamentary elections in Poland vindicated pre-election expectations. Exit-polls suggested clear victory of the main opposition party,(Law and Justice (PiS), which may even gain the absolute majority in the Sejm (the Lower House of the Polish Parliament) and thus form a government of its own without need to look for a coalition partner (See the chart below).

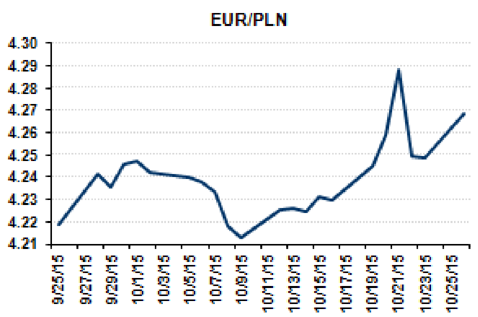
Polish markets calm, but awaiting policy decisions

Markets absorbed news about preliminary election results calmly, shrugging off the fact that PiS can be most likely empowered to implement measures that may irritate them. Let us recall that PiS´ fiscal plans outlined ahead of the vote could worsen budget deficit to GDP ratio by 1 - 2 percentage points. Moreover, the PiS reconfirmed its intention to impose a Hungary-like special tax on the banks (0.39% of their assets). In addition, the PiS are also likely to resolve a long-standing issue of Swiss-franc mortgages in a way less favourable from banks' perspective (compared to competitive alternatives). The latter two measures may undermine bank lending activity and adversely impact Polish economic growth. Obviously, markets will be on alert to see how far the PiS will follow the Hungarian way of interfering in selected sectors of the economy.

Zloty's should be vigilant ahead of changes in MPC

Poland's elections were not just about fiscal policy but also about the central bank. The new Polish Parliament will appoint 6 out of the 10 members of the NBP leadership early next year. In addition, the recently elected President Duda (also from the PiS) and the Sejm will jointly appoint a new NBP Governor in 2016, and it is no secret that the current Governor Marek Belka will not be among their favourites. Thus, if the NBP leadership is completely replaced, the zloty can, at least temporarily, suffer of the fear that central bank's monetary policy would become dependent on government's policy. However, as the well-established inflation-targeting regime will not be affected, the fear of changes at the helm of the NBP should fade away. On the other hand, given the PiS´ euro-sceptic stance, the zloty will not be replaced by the euro in foreseeable future.





EUR/PLN, last 22 days. Source: Reuters

	Last	Change 1W
EUR/CZK	27.1	0.15%
EUR/HUF	311	0.26%
EUR/PLN	4.26	0.36%

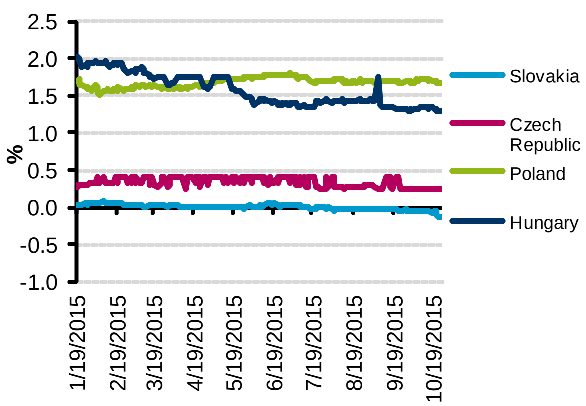
	Last	Change 1W
10Y CZK	0.83	-10.75
10Y HUF	2.76	-2.30
10Y PLN	2.35	-2.63

Calendar

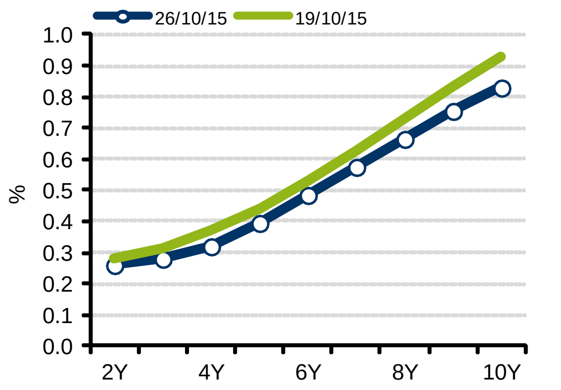
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	10/28/2015	9:00	Unemployment rate	%	09/2015			6.6		6.7	
HU	10/30/2015	9:00	PPI	%	09/2015					-0.5	-0.8
CZ	10/30/2015	10:00	Money supply M2	%	09/2015						6.4

Fixed-income in Charts

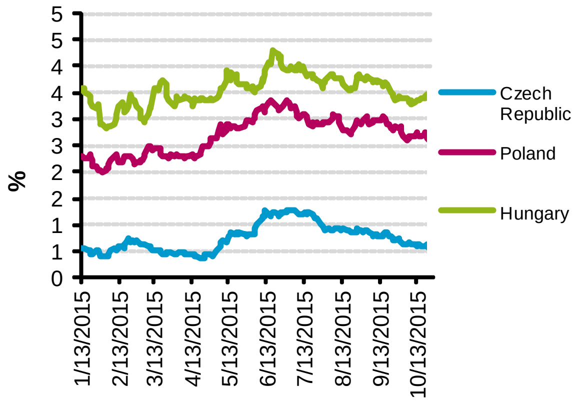
FRA 3x6



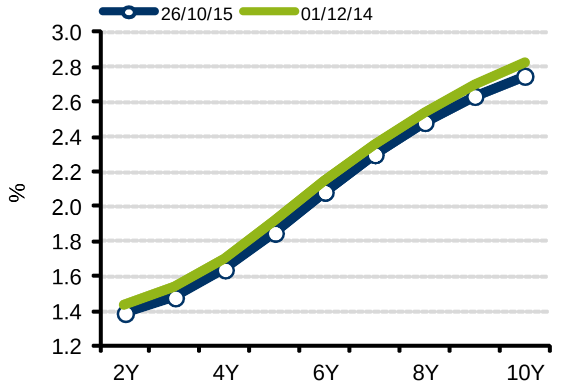
CZ IRS



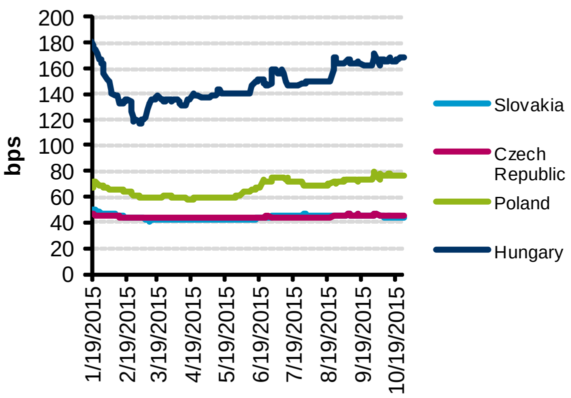
10Y GB Yields



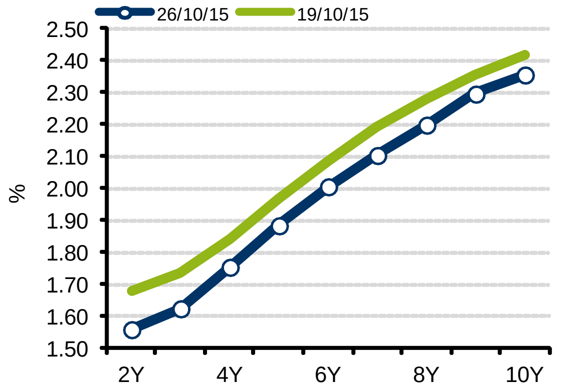
HU IRS



CDS 5Y



PL IRS



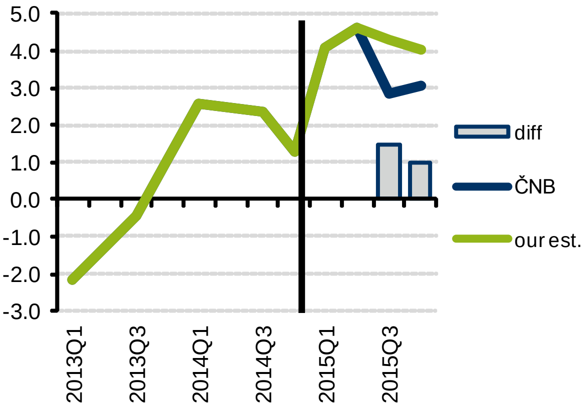
Source: Reuters

Medium-term Views & Issues

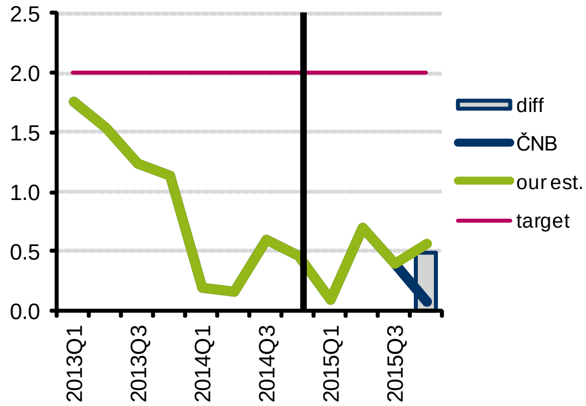
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – encouraged by growing real wages and employment – becoming a strong stimulus. At the moment, we cannot expect any fundamental economic changes or reforms, except for the abolition of the pension reform and the introduction of the electronic registration of sales. Progress in the country's preparations for joining the euro area is not expected in this electoral term either.	The Hungarian economy has continued to record solid growth this year as the working day adjusted GDP grew by 3.4% Y/Y in the first quarter. Looking ahead the GDP growth might slow down slightly in the coming quarters, but the favourable European conjuncture and the increasing net real wage and employment increase might provide a stable base for the growth so we expect that Hungarian economy may grow by about 3% Y/Y in 2015.	Although the overall positive economic developments in Europe and the long-term eased monetary policy should translate into growth of the Polish economy within the range of 3.5-4% this year as well as the next, we put our outlook on hold unless there is a clear view on the economic policy of the new government. .This should be based on an economic program of the opposition party - Law and Justice.
Outlook for official & market rates	The CNB's monetary policy continues to be based on record-low interest rates and the weak koruna. The exchange rate policy, not allowing the koruna to strengthen beyond (below) EUR/CZK 27.0, is most likely to remain in place at least until the second half of 2016, and low interest rates probably even longer. The reason is that inflation remains below the 2% target and will most likely remain there next year, and will only slowly approach the target.	The NBH surprised the market as it shifted the interest rate corridor of overnight (O/N) instrument by 25bp downward, so the new interest rate is 0.1% (base rate minus 125bp) for deposit and 2.1% (base rate plus 75bp) for loans. This move means practically a 25bp rate cut and is clear the NBH is fully committed to force out money from NBH so it cannot be excluded that further steps may come in the future. We think the NBH will cut further its base rate, if the ECB loosen further its monetary policy and the EUR/HUF moves closer to 300. In that case the base rate might be cut below 1%, while we think that with the previous speed, namely by 15bp per meetings.	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. This promise will probably be hold, while we should wait how the MPC will be changed in 2016 as new President and Sejm will appoint almost all Board members.
Forex Outlook	Relatively strong economic growth, current and capital account surpluses and ongoing QE in the euro zone have been the key factors behind the recent strength of the koruna. We believe the Czech National Bank will meet its "pledge" and won't terminate its intervention regime before the second half of 2016. The above mentioned factors should however keep the koruna close to EURCZK 27.0 in the months ahead. Possible start of tightening of US monetary policy poses negative risks for the koruna. We however think the fallout should only be limited.	We think that any strengthening of the HUF is rather temporary and the NBH's commitment to the long time low interest rate (just like the gradual push out of foreign holding from Hungarian government bonds) may lead to a HUF weakening in the coming weeks and months. It is also clear that the NBH has no problem with the HUF weakening, so rate hike driven by a temporary HUF devaluation is out of picture.	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 euro-zone. 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. On the other hand, the zloty might afraid of personal changes in the NBP, which might lead to more dovish policy stance of the MPC.

CBs' Projections vs. Our Forecasts

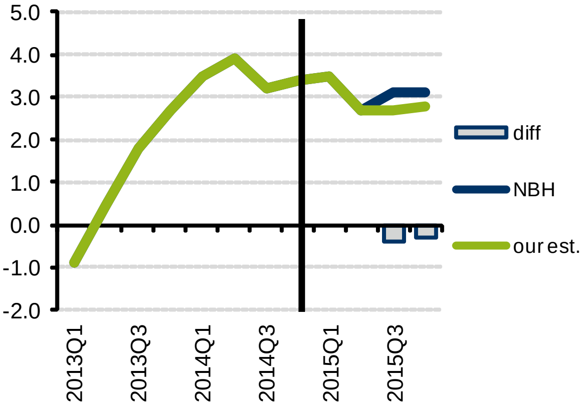
CZ: GDP outlook (Y/Y, %)



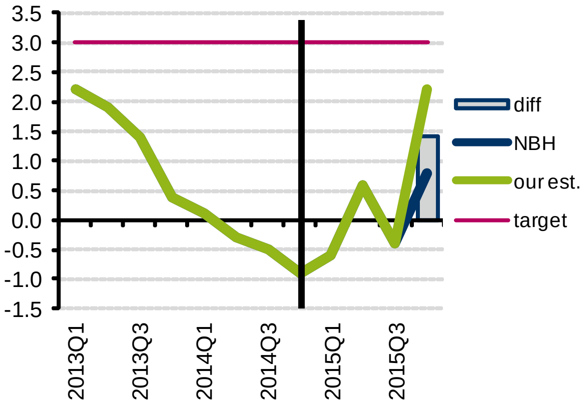
CZ: Inflation outlook (Y/Y, %)



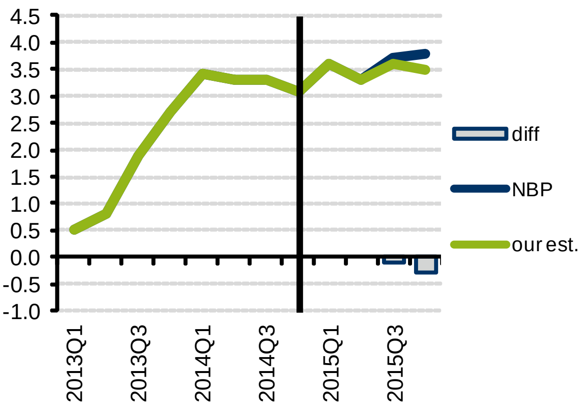
HU: GDP outlook (Y/Y, %)



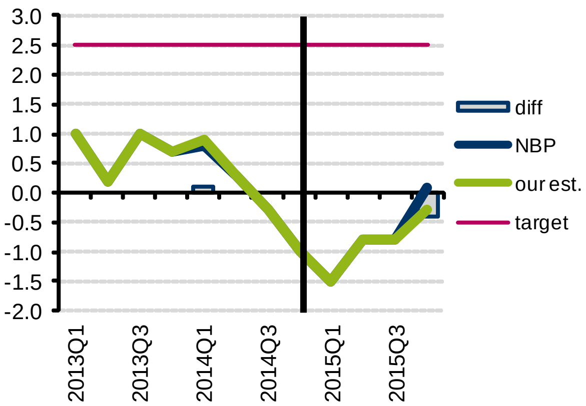
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outllok (Y/Y, %)



Source: CNB, NBP, MNB, 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.	*1.35*	1.95	1.50	1.35	2.00	2.25	-10 bps	7/21/2015
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	*0.00*	0.30	0.29	0.26	0.28	0.28
Hungary	BUBOR	*1.35*	1.89	1.41	1.35	2.10	2.40
Poland	WIBOR	*1.73*	1.65	1.72	1.73	1.65	1.67

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	CZ10Y	*0.83*	0.64	1.30	0.98	1.15	1.20
Hungary	HU10Y	*2.75*	2.71	3.45	2.93	3.60	3.80
Poland	PL10Y	*2.36*	2.12	3.01	2.50	2.40	2.80

Exchange rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	EUR/CZK	*27.13*	27.57	27.35	27.19	27.05	27.00
Hungary	EUR/HUF	*311*	300	315	314	315	310
Poland	EUR/PLN	*4.26*	4.07	4.19	4.25	4.15	4.10

GDP (y/y)

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	2.4	1.3	4.1	4.6	4.3	4.1	2.3
Hungary	3.2	3.4	3.5	2.7	2.7	2.8	2.2
Poland	3.3	3.1	3.6	3.3	3.6	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	0.8	0.4	0.9	1.5
Hungary	-0.5	-0.9	-0.6	0.6	-0.4	2.2	2.7
Poland	-0.3	-1.0	-1.5	-0.8	-0.8	-0.3	0.2

Current Account

	2015	2016
Czech Rep.	1.5	1.5
Hungary	6.0	4.5
Poland	-1.2	-2.0

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-1.6	-1.3
Hungary	-2.3	-2.1
Poland	-3.0	-2.5

Source: KBC, Bloomberg

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