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Central European Weekly

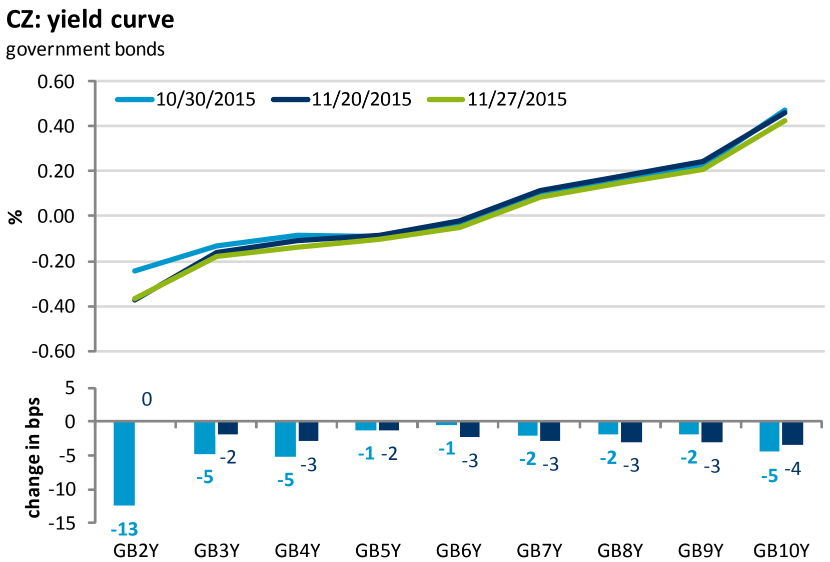
Monday, 30 November 2015

Table of contents

Weekly Highlights:

- The ECB will set the bar for regional central banks
- The Polish inflation at a one-year high in November
- Structure of Polish economic growth remains robust
- The first Czech 5Y government bond ever sold with negative yield in primary auction
- In Focus: Impacts of the VW diesel affair on the Czech economy

Chart of the Week



The Czech government bond yield curve steepened in November as demand for bonds at the short-end remained strong. (Source: Bloomberg, CSOB)

Market's editorial

ECB will set the bar for regional central banks

The countdown until the next crucial ECB meeting has begun. Thursday's ECB meeting will be important not only for the euro area but also for central banks and consequently markets in Central Europe.

The Czech National Bank – whose replication of the policy of the euro area's central bank through a quasi-fixed exchange rate is probably closest to the ECB – is likely to pay the greatest attention to the ECB meeting. The ECB's decision will be very important for the CNB – after all, this was also confirmed by future Governor Rusnok last week. The CNB Board will be most interested in whether and until when the ECB will extend the timing of the end of its quantitative easing policy. If the ECB policy (QE) is extended beyond 2016, the CNB will have to act accordingly, i.e., it will also have to extend its intervention policy up to 2017. In other words, it will be clear that the EUR/CZK spot exchange rate will not drop below the 2016 level in 27.0 either.

For the National Bank of Poland and the National Bank of Hungary it will be primarily important whether the ECB will surprise markets from the quantitative perspective. If the ECB cuts its deposit rate by 20 or more basis points and possibly raises the volumes of bonds it buys by EUR 20 bn a month or even more, the short-term impacts on the zloty, the forint and Central European markets will be clearly positive. Nevertheless, we strongly doubt whether the rise in asset prices in Hungary and Poland, implied by more aggressive expansion by the ECB, may immediately (i.e., until the end of the year) influence the policy of the NBP and the NBH. As concerns the beginning of next year, the NBH may only follow the example of the ECB if the forint sustainably strengthens by a few percent. For the NBP the composition of its Monetary Policy Council after the great replacement of its members scheduled for early next year will be decisive.

Czech 5Y government bonds with negative yields in auction

Speculation about aggressive ECB easing measures to be passed at the next ECB meeting in December definitevely influance bond markets in Central Europe. In this respect the Czech government bonds are clearly a shining asset class in Central Europe. The favorable position of the Czech government debt was confirmed by yesterday's auction once again where the 5Y bond was sold with a negative yield for the first time in history. Buyers on the primary market accepted the average yield as low as -0.08 % for the government paper maturing in 2020. No wonder that the Czech MinFin indicated that it considered adjustments in its issuance plan in order to take maximum advantage of the current market situation. In this respect, it is worth noting that according to the head of the FinMin´s debt department, Mr. Pavelek, his ministry would concentrate on maturities of up to six years in its issuance activity at the beginning of 2016.

	Last	Change 1W
EUR/CZK	27.0	-0.12%
EUR/HUF	312	-0.03%
EUR/PLN	4.27	0.49%

	Last	Change 1W
10Y CZK	0.80	-5.33
10Y HUF	2.74	1.48
10Y PLN	2.22	-4.31

Review of Economic Figures

The Polish inflation at a one-year high

The fresh November inflation figures released in Poland came out in line with our expectations at -0.5 % Y/Y. Even though it is the best result in more than 12 months from the perspective of the central bank, inflation still remains well below the inflation target (2.5 %). The main reason for the falling prices continues to be cheaper oil in particular. By contrast, food prices probably grew slightly by 0.8% y/y. We still expect inflation to return above zero in the first quarter of the next year.

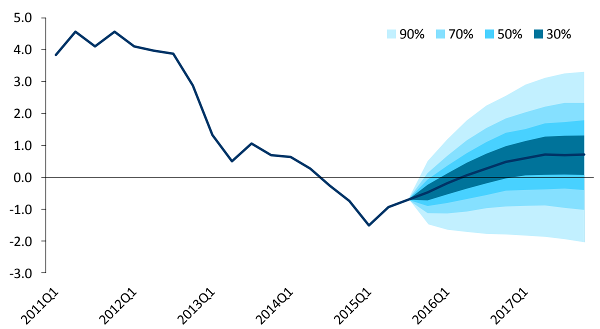
The sructure of Polish economic growth remains robust

The Polish statistical office (GUS) also released a more precise estimate of 2015Q3 GDP along with its details. Apart from a slight upgrade of growth estimate (form 3.4% Y/Y to 3.5% Y/Y), the details confirmed that Polish economic growth is set on solid footing. With the exception of inventories, all major components of demand contributed positively to GDP growth. The most notable contribution again came from households consumption which reflects improving labour market conditions.

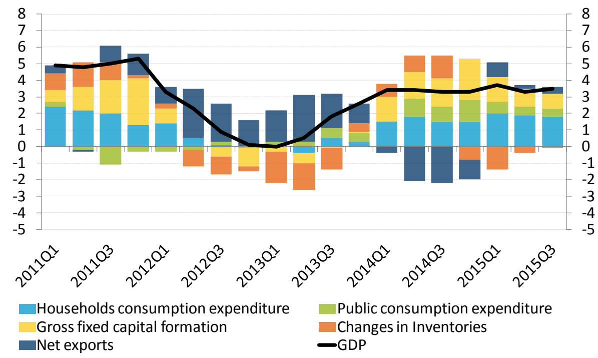
For a whole year 2015, we expect economic growth in Poland to reach 3.5 – 3.6 %. We do not expect growth to become an issue for policy makers in 2016 either (the growth could in our view accelerate to 3.8 %). The main risks that could undermine the overall positive development stems from an uncertain situation in emerging markets (most notably China) and their impact on the European Union countries.

PL: CPI

Y/Y, %, target = 2.5%



PL: Contributions to GDP growth



Central European Daily

In Focus: Impacts of the VW diesel affair on the Czech economy

The VW affair is a sensitive one for Central Europe but has occurred at a fairly good time.

The emissions tests scandal is a sensitive matter for the entire Central European region. The share of the automotive industry in the Czech economy is one of the greatest in the European Union. Just as in Slovakia the automotive industry in the Czech Republic makes up 20% of the added value generated in industry, with the industrial sector as a whole making up approximately one-third of Czech GDP.

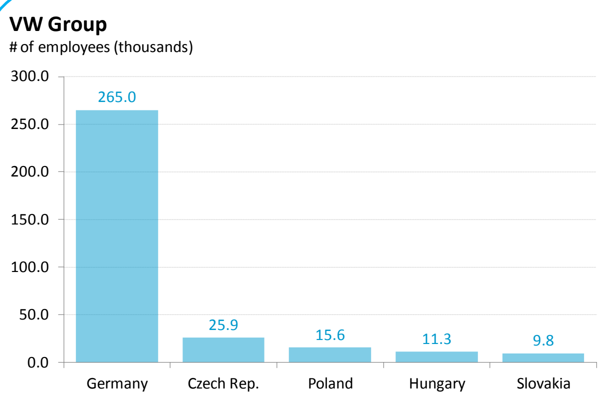
Nevertheless, the entire affair has occurred at a fairly good time. The European economy is performing well, unemployment is falling, wages are growing in numerous sectors, and people simply want to buy cars. According to a survey conducted by the European Commission, the willingness to buy cars across European countries is currently one of the highest over the last ten years. This is also why carmakers in the Czech Republic and Germany are reporting one of the highest utilisations of their existing capacities since 2008. Therefore, it is unlikely that overall car sales will start to fall and the automotive sector as a whole will have to reduce its output.

The possible adverse impacts on the growth rate of the Czech GDP should not exceed 0.4%.

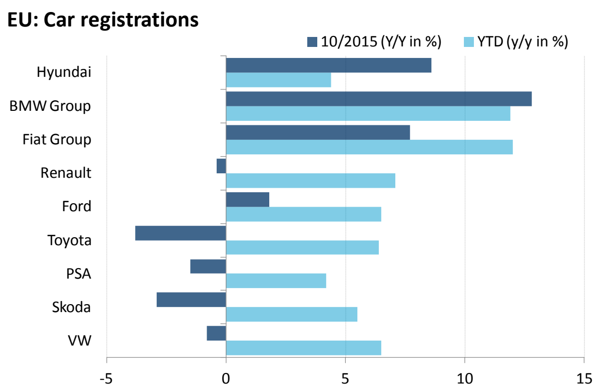
The Czech Republic and the region may more likely be adversely affected by structural changes in the European automotive industry – a departure from diesel engines or from the Volkswagen brand. Given that Škoda has a much lower share of diesel engines that usual in Europe and that diesel engines are not manufactured in the Czech Republic (unlike Hungary), a possible departure from diesel engines may not necessarily have any stronger impact on the Czech economy. However, unlike its neighbours, the Czech Republic is linked with the Volkswagen Group to a much greater extent. A simulation of the impact of a drop in Volkswagen sales (with Škoda excluded as well as included; a structural VAR model) shows that a deceleration of VW sales poses the greatest threat to the Czech automotive industry, followed by the Slovak and then Hungarian.

Based on this model, we estimate that if the deceleration of VW sales is within 10% (excluding Škoda), the domestic automotive industry should not lose more than 3%. Thus the overall losses expressed as a share of GDP should not exceed 0.4%. In that event we do not even expect the Czech Republic to be severely affected by the accompanying austerity steps taken by the group, such as the planned reductions in investment and its model line-ups, or pressure on suppliers to cut their prices. We believe that Volkswagen sales, including Škoda, would have to drop to a greater extent to have stronger impacts, including layoffs.

VW Group



EU: Car registrations



Weekly preview

WED 14:00 NBP rate (in %)

	This	Last change
rate level	**1.50**	3/2015
change in bps	**0**	-50

PL: Outgoing central bankers will not change central bank policy

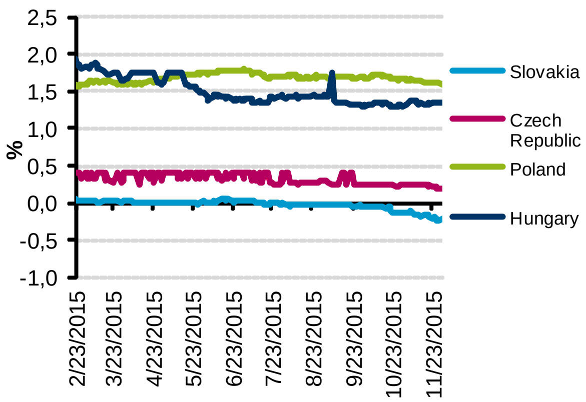
The depreciation of the zloty and the fairly small endorsement of the new government's ideas among the current members of the Monetary Policy Council should ensure that interest rates will remain stable and that comments from Governor Belka (who will be replaced in the middle of next year) will be relatively neutral.

Calendar

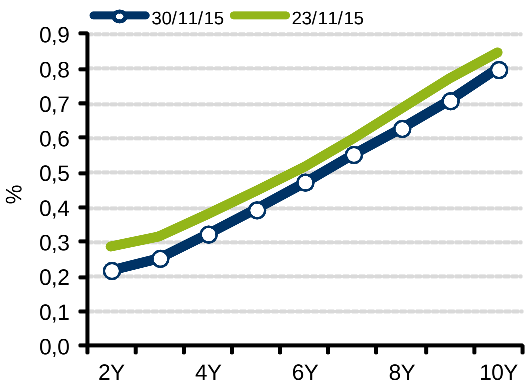
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	11/30/2015	9:00	PPI	%	10/2015					-0.5	-1.5
PL	11/30/2015	10:00	GDP	%	3Q/2015 *F					0.9	3.4
CZ	11/30/2015	10:00	Money supply M2	%	10/2015						7.7
PL	11/30/2015	14:00	CPI	%	11/2015 *P	0.1	-0.5	0.1	-0.4	0.1	-0.7
PL	12/01/2015	9:00	PMI manufacturing		11/2015			52.5		52.2	
HU	12/01/2015	9:00	PMI manufacturing		11/2015					55.3	
CZ	12/01/2015	9:30	PMI manufacturing		11/2015			54.5		54	
CZ	12/01/2015	14:00	Budget balance	CZK B	11/2015					-29.1	
PL	12/02/2015	14:00	NBP meeting	%	12/2015	1.5		1.5		1.5	
HU	12/03/2015	9:00	Trade balance	EUR M	09/2015 *f					814	
HU	12/03/2015	9:00	Retail sales	%	10/2015						5.1
CZ	12/04/2015	9:00	Real wages	%	3Q/2015				3.8		2.7
CZ	12/04/2015	9:00	Retail sales	%	10/2015				5.3		7
HU	12/04/2015	9:00	GDP	%	3Q/2015 *F					0.5	2.3

Fixed-income in Charts

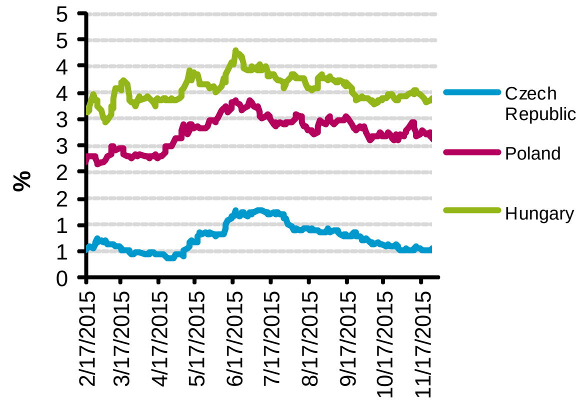
FRA 3x6



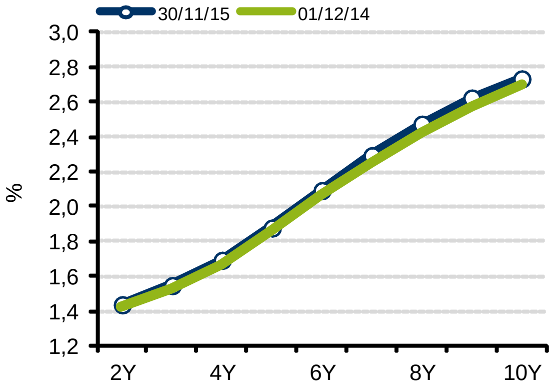
CZ IRS



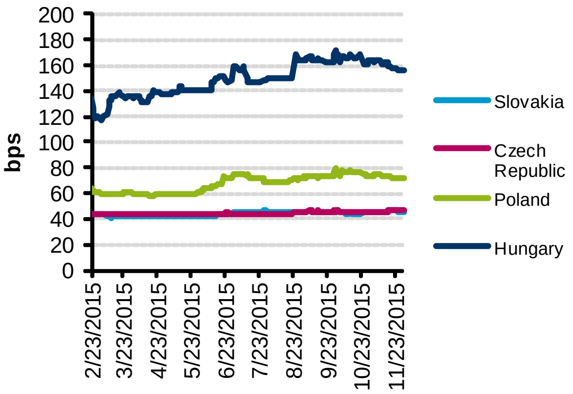
10Y GB Yields



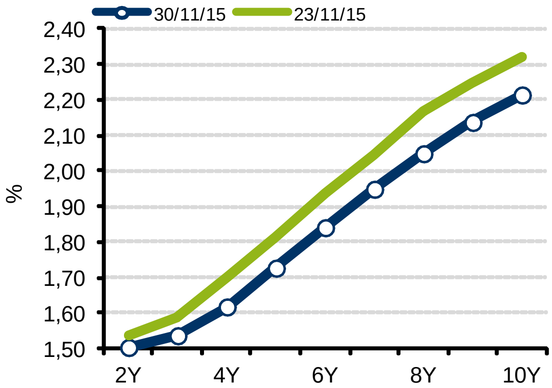
HU IRS



CDS 5Y



PL IRS



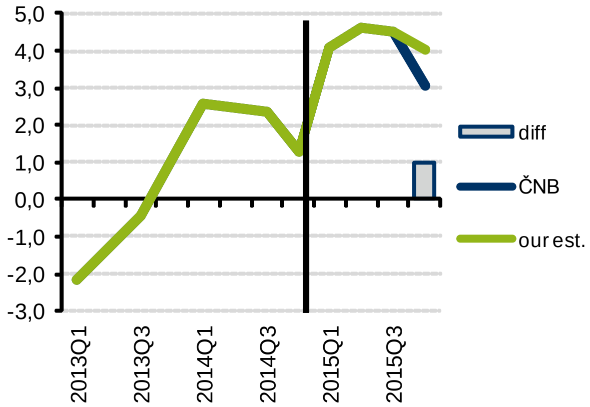
Source: Reuters

Medium-term Views & Issues

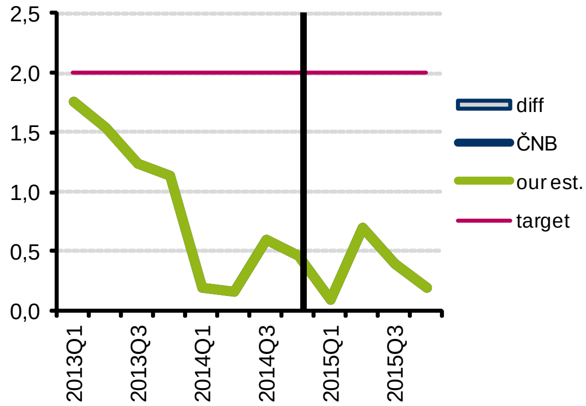
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – 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 4Q15 GDP growth may bounce back closer to 3% Y/Y, as EU funds money use is accelerated and the industrial production and domestic consumption may be stronger this year as a year before, so the growth might be around 2.7% Y/Y in 2015. The bigger question what may happen next year, as the Q/Q figures reflects only 2% annualized economic growth for this year and the falling out EU funds money may push GDP growth below 2% Y/Y in some quarters. We expect 2.3% Y/Y growth for 2016, but risks are rather on the downs side.	For a whole year 2015, we expect economic growth in Poland to reach 3.5 – 3.6 %. We do not expect growth to become an issue for policy makers in 2016 either (the growth could in our view accelerate to 3.8 %). The main risks that could undermine the overall positive development stems from an uncertain situation in emerging markets (most notably China) and their impact on the European Union countries.
Outlook for official & market rates	The CNB has implicitly postponed the deadline for discontinuing its intervention policy until late 2016 but, unlike its previous practice, it does not want to commit itself to any clearer deadline this time. With regard to the uncertainty surrounding the ECB's moves, we can only anticipate an exit sometime probably at the turn of 2016 to 2017. A scenario of negative rates is not on the agenda. Given the market developments, the CNB itself is even considering it to a lesser extent than it has done recently.	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 and can extend the pledge even further. 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.	Although the new government may eventually turn out to be more market-friendly than had been expected, we think that pressures on zloty´s depreciation may intensify again at the beginning of 2016 when most members of the Monetary Policy Council (MPC) will be replaced. Also probability of further interest rate cuts by the Polish central bank rises under the new government. Nonetheless, we still keep our base-line scenario unchanged and bet on stable rates in Poland by the end of 2016. Fed hikes and weaker zloty could prevent the altered MPC from cutting rates again.

CBs' Projections vs. Our Forecasts

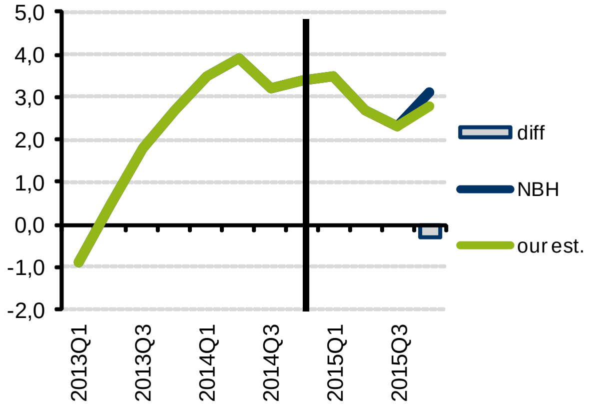
CZ: GDP outlook (Y/Y, %)



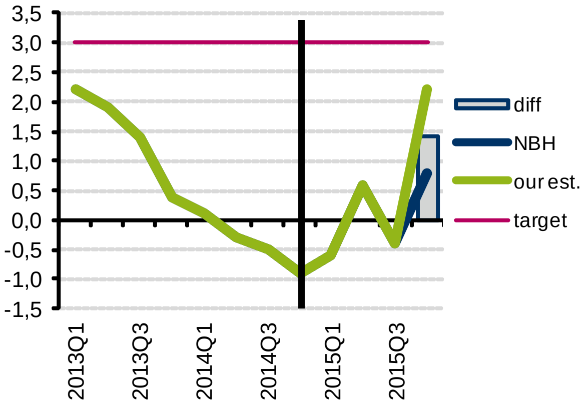
CZ: Inflation outlook (Y/Y, %)



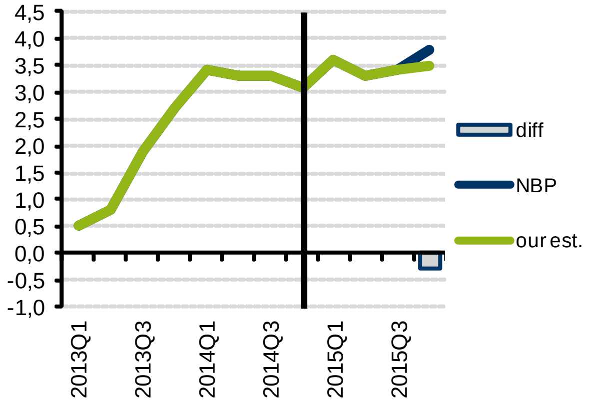
HU: GDP outlook (Y/Y, %)



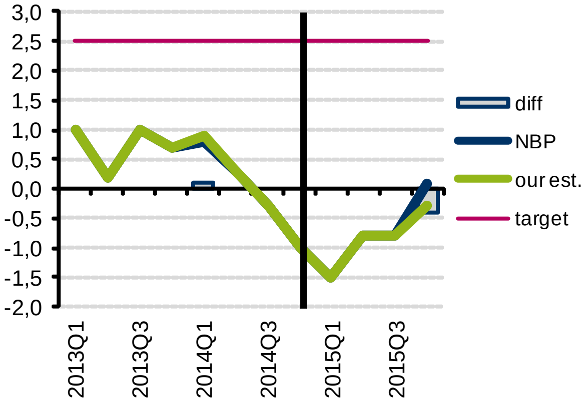
HU: Inflation outlook (Y/Y, %)



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	*0.80*	0.64	1.30	0.98	1.10	1.20
Hungary	HU10Y	*2.74*	2.71	3.45	2.93	3.60	3.80
Poland	PL10Y	*2.22*	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	*27.01*	27.57	27.35	27.19	27.05	27.00
Hungary	EUR/HUF	*312*	300	315	314	315	310
Poland	EUR/PLN	*4.27*	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	4.5	4.1	2.3
Hungary	3.2	3.4	3.5	2.7	2.3	2.8	2.2
Poland	3.3	3.1	3.6	3.3	3.4	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	0.8	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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