



# Central European Weekly

Monday, 25 January 2016

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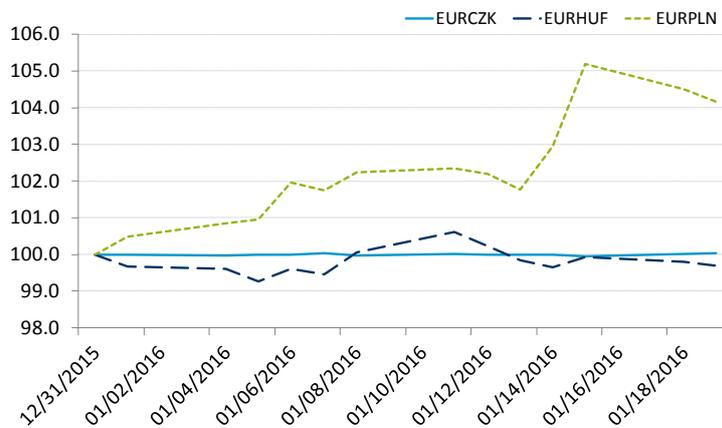
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## Weekly Highlights:

- **Politics and rating actions overshadow strong Polish fundamentals**
- **Zloty remains still relatively weak and eyes the Fed**
- **Satisfied NBH will stay on hold**

## Chart of the Week: PLN's underperformance

CE currencies against the euro



Fears of local politics have weighed on the zloty so far in 2016... (Source: Bloomberg, CSOB)

# Market's editorial

## FOMC meeting runs for this week's key 'regional' event

Renewed confidence in rebound on global markets lulled Central Europe at the end of the last week, Markets, however, have remained jittery and all eyes will be on the Fed now, which will communicate decisions of a FOMC meeting at Wednesday night (CET). The statement should sound more dovish than in December, which should help emerging markets (including Poland) to recover - at least temporarily.

## Satisfied NBH will stay on hold

As far as genuine regional events are concerned, the National Bank of Hungary will hold an interest rate policy meeting just a day ahead of the Fed meeting. We think that the NBH is happy now with the current situation and the Monetary Council won't change the base rate in the near future. We expect that the base rate may be kept unchanged on Tuesday (Jan 26th) and the statement might be just slightly dovish, putting more emphasize on the cautious monetary policy in the recent uncertain global environment. But the NBH may also emphasize that the low

oil price may push inflation down, so they will monitor closely the future development. We expect that in case EUR/HUF moves below 305 permanently in 2Q16, the NBH may cut the base rate in May or June, other case we don't expect rate change for 2016.

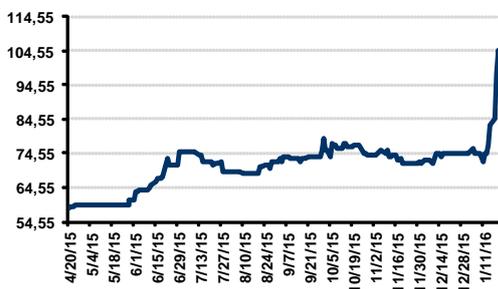
## New Polish central bankers take into account markets

Last, but not least, the Polish Parliament is going to appoint further top central bankers this week. The Senate (the Parliament's upper house) has already endorsed three candidates. All of them have lived up to our expectation that the new members of the Monetary Policy Council (MPC) do not intend to carry out bold policy changes and needn't modify the official interest rates as long as by the end of this year. Moreover, while ECB's dovish comments may seem to encourage new NBP leaders to consider further monetary easing, tendency of Mr. Jerzy Osiatyński, a prominent dove in the MPC, who will keep his position in the next Council, to talk of a rate hike rather than a rate cut in his comments, gives indirect evidence of how narrow actually is the margin of discretion available to NBP's policy-makers.

	Last	Change 1W
EUR/CZK	27.0	-0.02%
EUR/HUF	313	-0.93%
EUR/PLN	4.47	0.10%

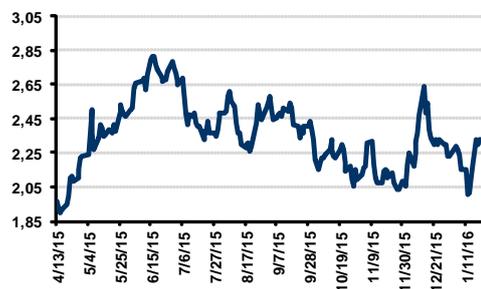
	Last	Change 1W
10Y CZK	0.86	1.78
10Y HUF	2.71	-0.37
10Y PLN	2.51	-2.52

CDS Poland 5Y



CDS Poland 5Y, last 200 days. Source: Reuters

PL GB 5Y



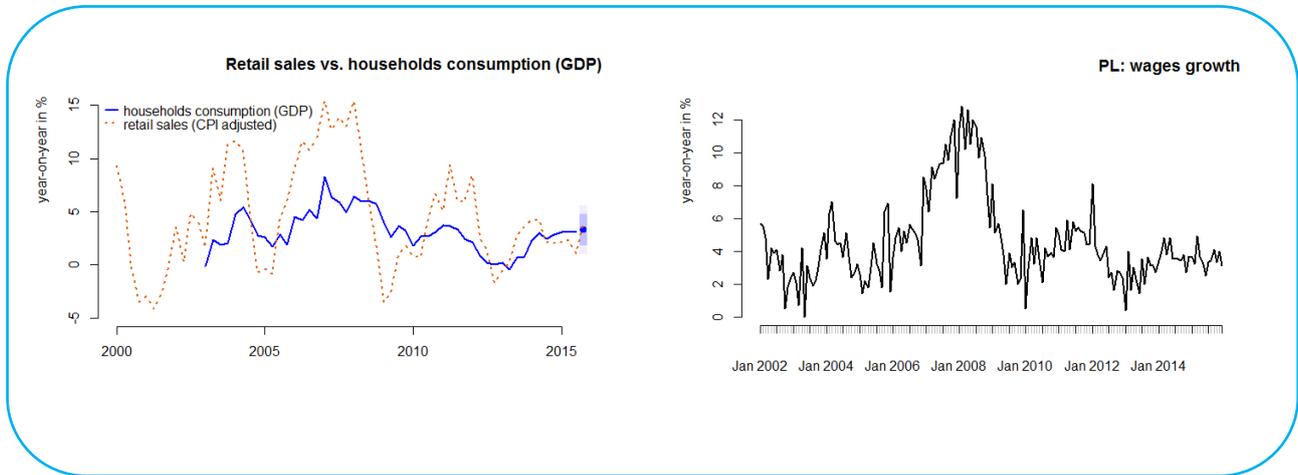
PL GB 5Y, last 200 days. Source: Reuters

# Review of Economic Figures

## Polish industry as well as retail sales keep growing strongly

December's macroeconomic data released in Poland last week confirmed the good fundamentals of the economy. The only indicator that disappointed slightly was wage growth, which fell short of market expectations. However, this unpleasant surprise was largely offset by the positive development of employment. Thus we still believe that household consumption remains the main driver of economic growth. By the way, another year-on-year

acceleration of household consumption late last year was confirmed by retail sales data last week. Retail sales turned out to be better than generally expected, as did the figures from industry. Therefore, we estimate Poland's GDP growth at 3.5-3.6% for last year. As far as this year is concerned, we anticipate moderate growth acceleration to 3.8-3.9%. Lorem ipsum dolor sit amet



# Weekly preview

TUE 14:00

NBH base rate

	This meeting	Last change
rate level (in %)	1.35	7/2015
change in bps	0	-15

## HU: Satisfied NBH will stay on hold

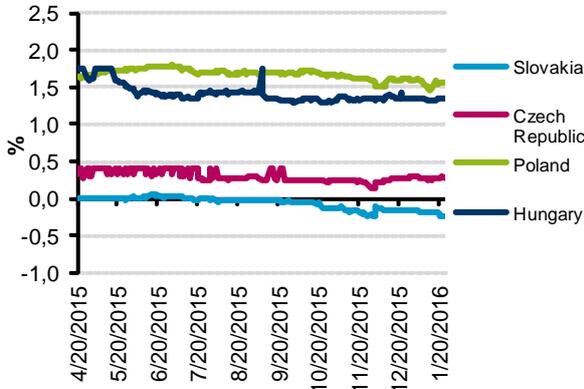
We think that the NBH is happy now with the current situation and the Monetary Council won't change the base rate in the near future. We expect that the base rate may be kept unchanged on Tuesday and the statement might be just slightly dovish, putting more emphasize on the cautious monetary policy in the recent uncertain global environment. But the NBH may also emphasize that the low oil price may push inflation down, so they will monitor closely the future development. We expect that in case EUR/HUF moves below 305 permanently in 2Q16, the NBH may cut the base rate in May or June, other case we don't expect rate change for 2016.

# Calendar

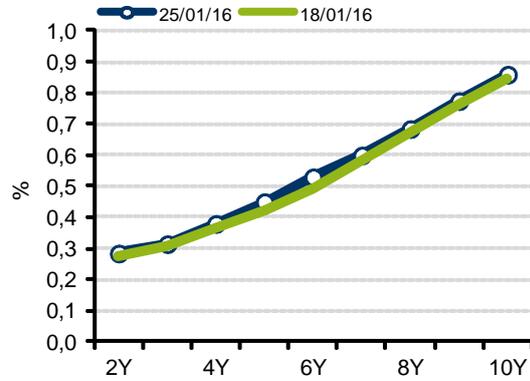
Country	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
PL	01/26/2016	10:00	Unemployment rate	% 12/2016			9.7		9.6	
PL	01/26/2016	10:00	GDP	% 4Q/2015 *A				3.5		3.4
HU	01/26/2016	14:00	NBH meeting	% 01/2016	1.35		1.35		1.35	
CZ	01/27/2016	12:00	CZ bond auction 2016-19, x.xx%	CZK B 01/2016						
CZ	01/27/2016	12:00	CZ bond auction 2014-2027, floating rate	CZK B 01/2016						
CZ	01/27/2016	12:00	CZ bond auction 2014-25, 2.40%	CZK B 01/2016						
HU	01/28/2016	9:00	Unemployment rate	% 12/2015			6.3		6.2	
HU	01/29/2016	9:00	PPI	% 12/2015					0.1	-0.8
CZ	01/29/2016	10:00	Money supply M2	% 12/2015						8.6

# Fixed-income in Charts

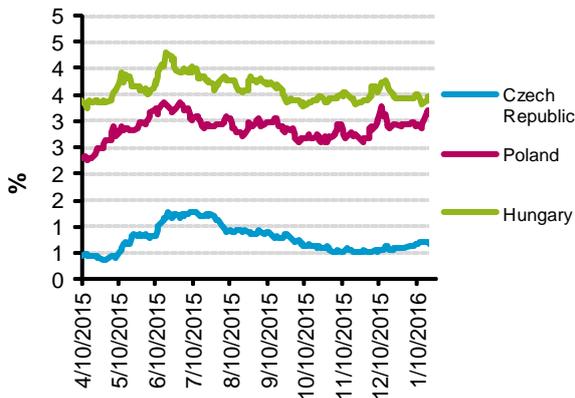
**FRA 3x6**



**CZ IRS**



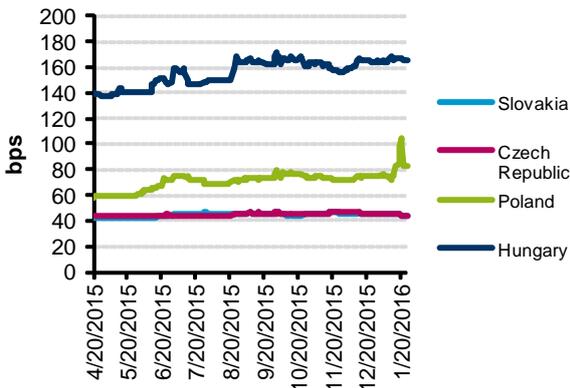
**10Y GB Yields**



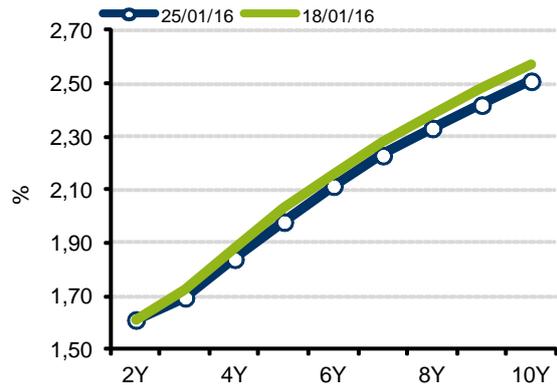
**HU IRS**



**CDS 5Y**



**PL IRS**



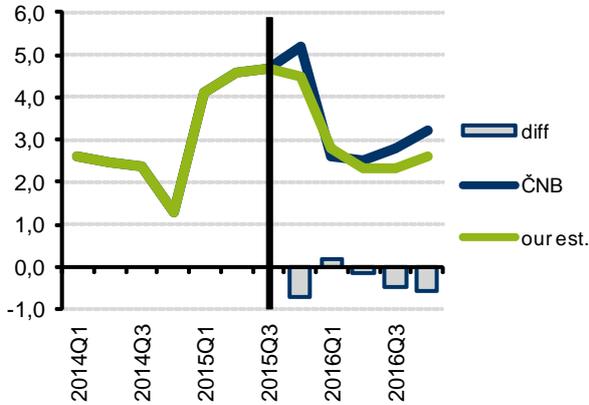
Source: Reuters

# Medium-term Views & Issues

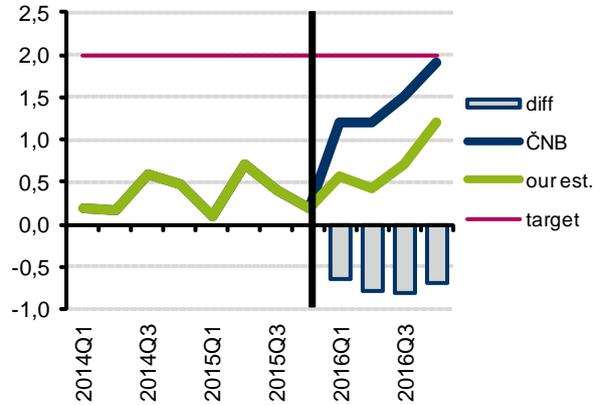
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private 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.</p>	<p>The 4Q15 GDP growth might bounce back closer to 3% Y/Y, as EU funds money use was accelerated, the government increased the spending and the industrial production and domestic consumption might be stronger, so the growth might be around 2.7% Y/Y in 2015. The outlook is less favorable. The investments started to fall, the EU funds money use may substantially lower in this year due to the new budgetary period. The government tries to boost the construction via new government program, which targets new homes for households. The domestic consumption may remain strong thanks to the increasing wage mass. In case there is no substantial slowdown of international growth and the agriculture provides an average harvest, the economic growth might be around 2.3% Y/Y in 2016.</p>	<p>Prospects of the Polish economy remain good in our view. For the whole year 2016 we expect GDP growth may reach 3.5 - 4.0 percent. Apart from low interest rates (further cuts cannot be excluded) and a relatively weak zloty, we expect the economy to draw additional support from policy measures of the new government (stimuli for private consumption). The risks thus stem mainly from a possible deterioration in the external environment, most notably in China.</p>
Outlook for official & market rates	<p>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. As we don't expect exit from the fx regime before Q1 2017, the first rate hike can occur in the H2 2017 or even latter. 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.</p>	<p>The NBH plans to keep base rate unchanged at 1.35% till the end of its forecasting period, which is 4Q17. It is more or less in synchrony with the ECB's monetary policy forward guidance. The main attention of NBH is decreasing FX reserve and the amount of money placed at the NBH. So the Council may change rather the monetary tools first, but in case HUF strengthens to around 300 base rate cut cannot be excluded either, although this is not our base case. We expect first rate hike only for 2017, as with the conversion of households' FC loans to HUF ones, the tolerance level of a weaker HUF jumped substantially. So EURHUF around 320 and 325 won't force NBH to hike rate.</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. 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.</p>
Forex Outlook	<p>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. With regard to the inflation outlook and ECB's policy, we anticipate an exit from the fx regime in the first quarter of 2017. The above mentioned factors should however keep the koruna close to EURCZK 27.0 in the months ahead. Current turmoil on the Chinese market poses negative risks for the Central Europe. We however think the impact on the koruna should only be limited.</p>	<p>We think that the NBH's commitment to the long time low interest rate may lead to short-term HUF weakening. Although compared to other emerging markets HUF looks like quite stable, the fears of Chinese hard lending scenario pushed EURHUF trading range between 313 and 318. Although the huge trade and current account balance supports HUF in medium term, the ongoing foreign sell-off of HUF denominated gov. bonds and the uncertain sentiment keeps weakening pressure on HUF, so we see bigger risk on the weak side on short term, which means that EURHUF may be pushed towards 325.</p>	<p>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 and probability of further monetary easing will rises. Although Fed hikes and weaker zloty could prevent the altered MPC from cutting rates again we target the EUR/PLN peak at 4.40.</p>

# CBs' Projections vs. Our Forecasts

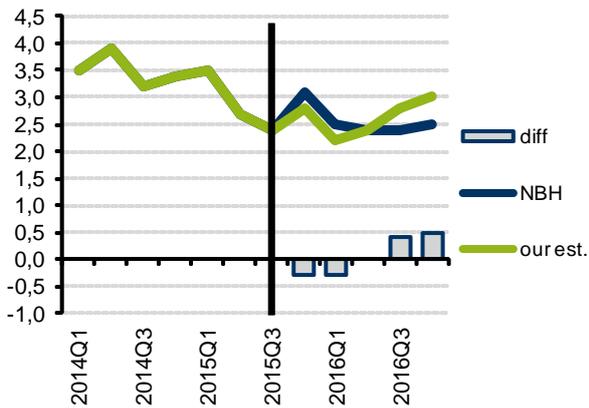
**CZ: GDP outlook (Y/Y, %)**



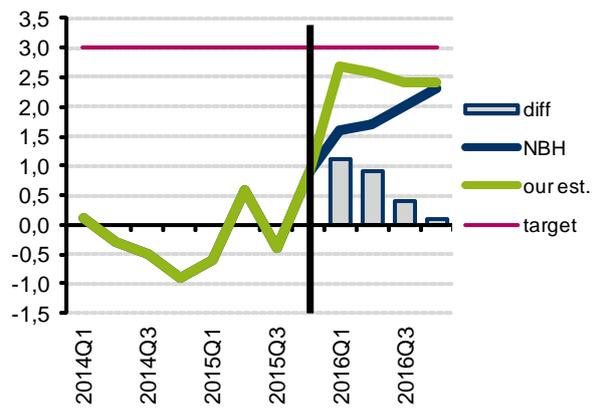
**CZ: Inflation outlook (Y/Y, %)**



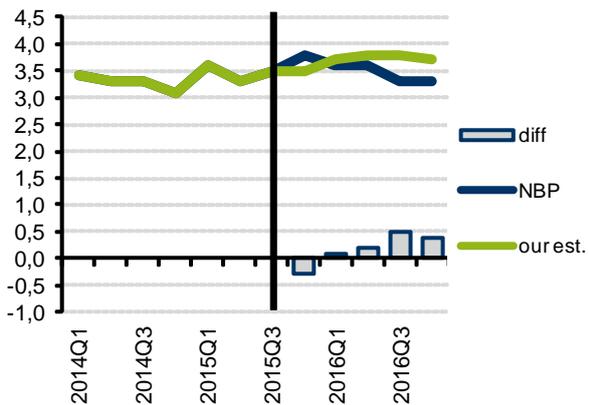
**HU: GDP outlook (Y/Y, %)**



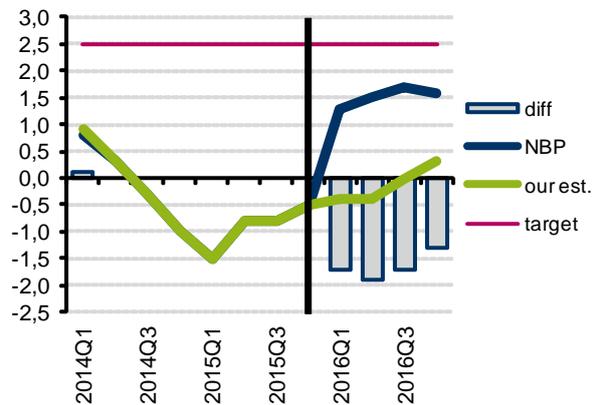
**HU: Inflation outlook (Y/Y, %)**



**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	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4	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	1.35	2.25	2.50	2.75	3.00	-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	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	PRIBOR	0.00	0.25	0.24	0.25	0.25	0.25
Hungary	BUBOR	1.35	1.35	2.40	2.60	2.90	3.10
Poland	WIBOR	1.7	1.72	1.65	1.65	1.65	1.65

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

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	CZ10Y	0.86	1.01	1.08	1.15	1.23	1.30
Hungary	HU10Y	2.71	2.91	3.80	4.00	4.20	4.40
Poland	PL10Y	2.51	2.47	2.50	2.50	2.60	2.75

## Exchange rates (end of the period)

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	EUR/CZK	27.06	27.03	27.02	27.02	27.02	27.02
Hungary	EUR/HUF	313	316	310	308	305	300
Poland	EUR/PLN	4.47	4.27	4.40	4.30	4.26	4.25

## GDP (y/y)

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	4.6	4.7	4.5	2.8	2.3	2.3	2.6
Hungary	2.7	2.4	2.8	2.2	2.4	2.8	3.0
Poland	3.3	3.5	3.5	3.7	3.8	3.8	3.7

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

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	0.8	0.4	0.1	0.6	0.5	0.7	1.5
Hungary	0.6	-0.4	0.9	2.7	2.6	2.4	2.4
Poland	-0.8	-0.8	-0.5	-0.4	-0.4	0.0	0.3

## Current Account

	2015	2016
Czech Rep.	1.5	1.5
Hungary	6.0	5.1
Poland	-1.2	-1.5

## Public finance balance as % of GDP

	2015	2016
Czech Rep.	-1.4	-1.3
Hungary	-2.3	-2.0
Poland	-3.0	-2.9

Source: KBC, Bloomberg

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