



# Central European Weekly

Monday, 20 June 2016

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## Weekly Highlights:

- While Polish hard macro figures disappointed in April and May, Hungarian data point to robust growth
- NBH on hold as it eyes Brexit vote

## Chart of the Week: Polish zloty



EUR/PLN, last 30 days. Source: Reuters

*Volatility of the Polish zloty has surged as the Brexit referendum is getting closer.*

# Review of Economic Figures

## Polish eco figures disappointed across the board

A fresh set of Poland's economic data from the second quarter of this year brought a clear disappointment.

While the Polish employment grew as expected, wages growth was weaker than markets had foreseen. We should keep in mind, though, that the wage growth was the strongest since 13 months in April and wages still grew by 4.1 % Y/Y in May. This means that wages in the third quarter may grow at the fastest pace since 2012Q1, which should have a stabilizing effect on monetary policy of the NBP (bear in mind that core CPI has been trending downside since the end of 2011).

The Polish statistical office delivered also fairly poor data from May – in this case we are talking about the industrial output and retail sales. The former showed a month-on-month decline (3.6%) in industrial production in May. In year-on-year terms, however, the growth has still remained relatively strong and its 12-month moving average (NSA) has been set just shy below the 5 % measured in the recent months. Thus, despite observed signs of deceleration, we still keep our outlook for the Polish GDP growth in 2016 at 3.3 %.

## Hungarian monthly figures still point to robust growth

Details of the Hungarian industrial production figures for April suggest a promising beginning of economic performance for 2Q16. The industrial sector was up by 5.3% Y/Y in April in line with the preliminary figure. The export was the main driver of production, while some subsectors of industry pulled back the domestic growth. The best positive news is that the only 2 from the 13 subsectors showed a decrease, while the remaining 11 subsectors rose by

between 2.6% Y/Y and 15% Y/Y. The highest growth rate belongs to the computer, electronic and optical equipment productions (the share of this sector within the production is 12%). The biggest subsector, the vehicle production (32% market share) increased by 7% after a fall in the first quarter. So the detailed figure confirmed our view that the Hungarian 1Q16 GDP growth figure of only 0.9% Y/Y growth was rather an outlier and economic growth may accelerate to around 2% Y/Y already in 2Q16, while close to 3% in 4Q16.

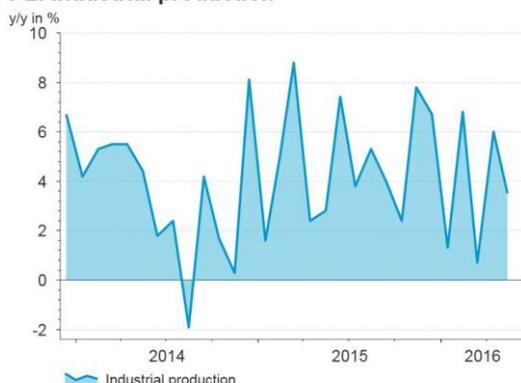
## Costlier raw materials are starting to curb the Czech PPI fall

While cheap oil drove refining prices and ultimately petrol station prices down in previous months, the trend has been reversed recently. Naturally, this must have influenced the overall price developments in Czech industry. Thus most of May's PPI rise (0.4%) was attributable to the increased prices of produced fuels.

Despite its latest increase, the producer price index continues to be well below last year's level – by 4.8% at the moment. If we look at who can currently afford to raise the prices of their products, we find that this group includes producers of building materials, farming machines, glass and electrical components.

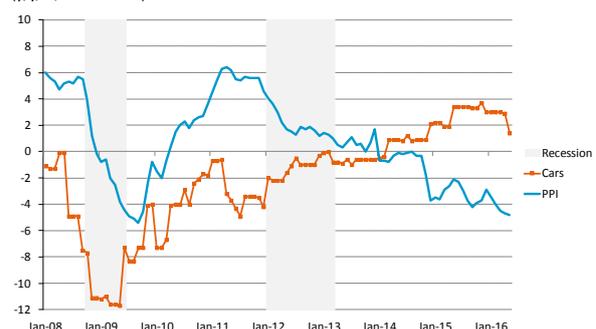
The PPI developments have not suggested any visible inflationary pressures so far, perhaps excepting the impacts of volatile oil. With a few specific exceptions, there is certainly no pressure on the PPI to rise due to any product shortage or excess of demand. After all, we need look no further than at the expanding automotive industry, which will most probably hit a new production record this year while raising new car prices by only 1.4%. By contrast, prices of automotive parts continue to fall.

PL: Industrial production



CZ: PPI

(y/y, %; Source: ČSÚ)



## Weekly preview

TUE 14:00

NBH base rate

	This meeting	Last change
rate level (in %)	0.90	5/2016
change in bps	0	-15

### HU: Overshadowed by Brexit, NBH stays on hold

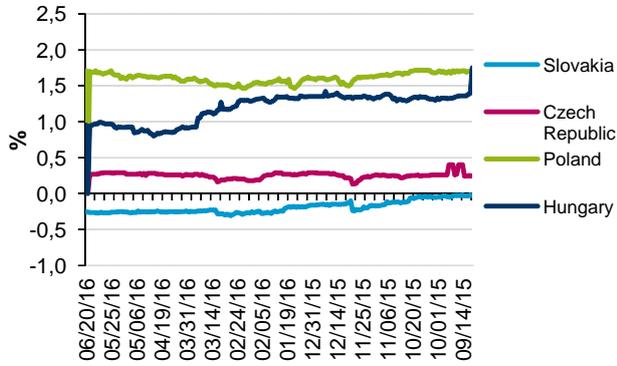
While Hungarian central bankers have already indicated that they have terminated their rate cut mini-cycle, the upcoming Brexit referendum, which is also introducing uncertainty into Central European markets, is the primary factor that will not allow the National Bank of Hungary to take any action.

## Calendar

Country	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	06/21/2016	14:00	NBH meeting	%	06/2016	0.9		0.9		0.9
PL	06/23/2016	10:00	Unemployment rate	%	05/2016			9.1		9.5
HU	06/24/2016	8:30	Current account	HUF B	1Q/2016					1010

# Fixed-income in Charts

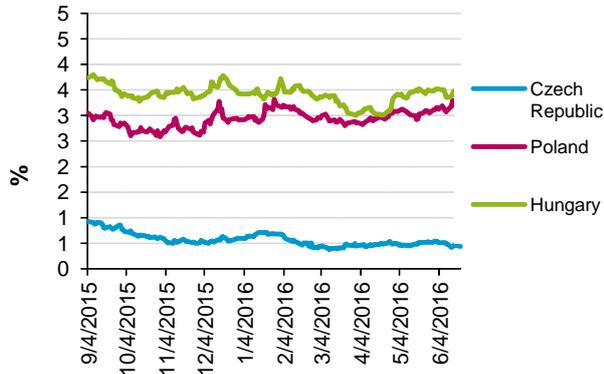
**FRA 3x6**



**CZ IRS**



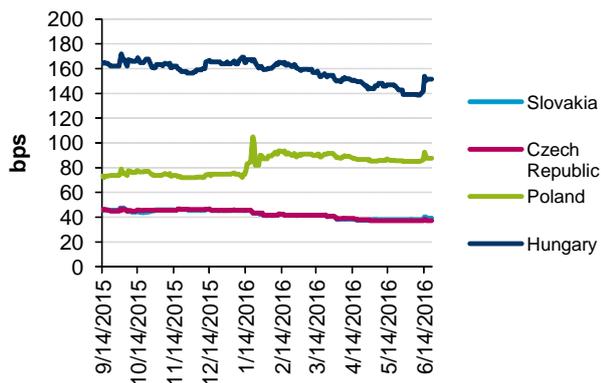
**10Y GB Yields**



**HU IRS**



**CDS 5Y**



**PL IRS**



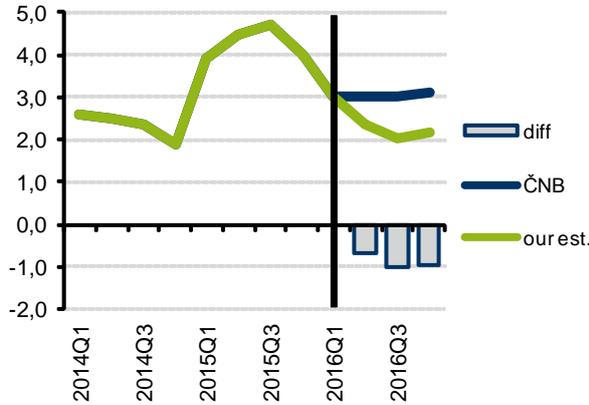
Source: Reuters

# Medium-term Views & Issues

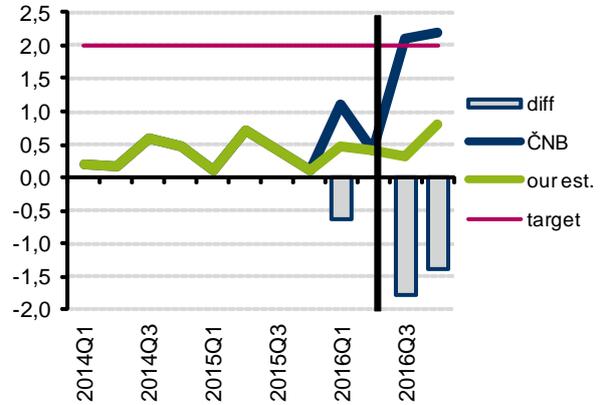
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The Czech economy entered a stage of moderately decelerating growth, at the mercy of household consumption and exports. Inflation remains subdued despite the anticipated solid GDP rate, and will unlikely approach the CNB's inflation target before 2017, thus enabling the central bank to continue its exchange rate policy. 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>Growing net real wages and the postponed consumption since the crises (we calculate around 5% of GDP under consumption) boost the retail sales and it may be the main driver of this year's economic growth of around 2% Y/Y.</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, Russia and other emerging markets.</p>
Outlook for official & market rates	<p>The latest forecast does not envisage the return of inflation to the target before early 2017, with inflation not significantly diverging from it afterwards either. The CNB has extended its exchange rate commitment until the first half of 2017. The possibility of introducing negative interest rates has been increasing, in light of the widening of the interest rate differential vis-à-vis the euro area and developments in domestic financial markets. But we still don't expect negative CNB's rates. There are two main preconditions for negative official rates: 1) significant ECB's rate cut, 2) continuing large monthly fx interventions of the CNB.</p>	<p>A relatively strong and continuously robust consumption is expected to push inflation gradually higher. So this figure suggests that NBH won't cut the base interest rate (0.9%) further in June despite of the surprise drop in inflation back to negative territory.</p>	<p>We expect the NBP to keep official rates stable, but we think that risks for of further rate cuts have increased. The main reason is the combination of the "inflow of cheap euros from the ECB", ongoing deflation and stronger currency (PLN). Hence, should the zloty get strong there could be a window of opportunity for the NBP to ease its policy in the second quarter of this year. Nevertheless this is not our main scenario yet.</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>Looking ahead the areas around 312.5 and 311 are strong support levels for the EUR/HU, which might stop the current rally especially in case of strong US data releases afternoon. Also the uncertainties around Brexit vote may not support further strengthening of the forint in the near-term , so we see bigger chance for some correction followed by side moves, but it will highly depend on global risk taking willingness before the Brexit vote.</p>	<p>We think that zloty's sell-off related to markets' fears coming from appointment of new members of the Monetary Policy Council (MPC) is over now. Nevertheless, while domestic fundamentals should be relatively supportive for the zloty, the currency should be mostly driven by sentiment in emerging markets and the ECB or the Fed policy actions respectively.</p>

# CBs' Projections vs. Our Forecasts

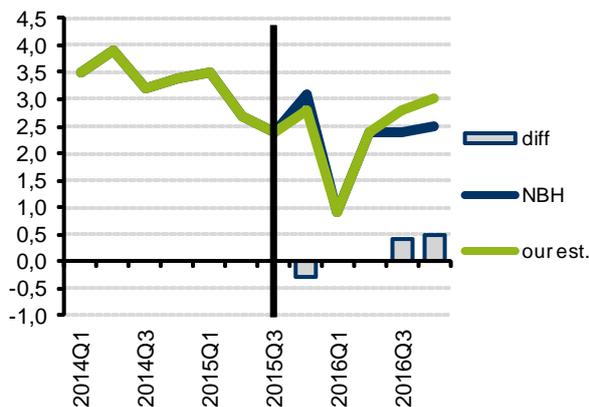
**CZ: GDP outlook (Y/Y, %)**



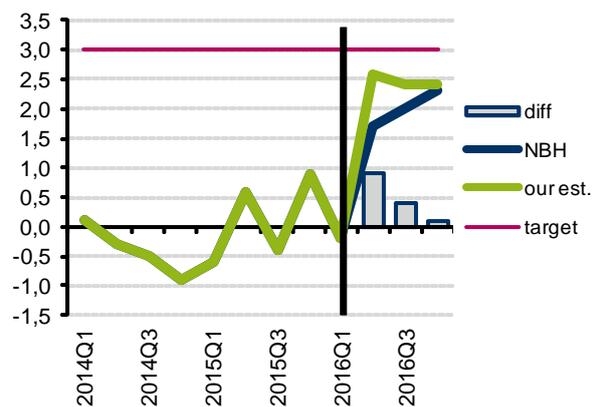
**CZ: Inflation outlook (Y/Y, %)**



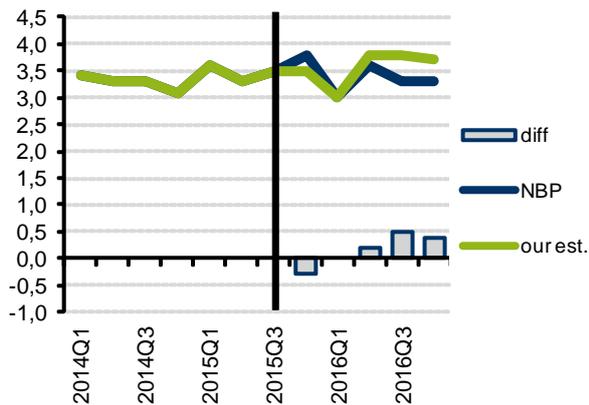
**HU: GDP outlook (Y/Y, %)**



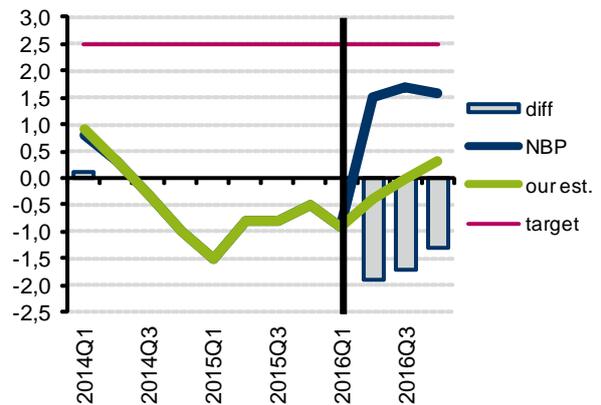
**HU: Inflation outlook (Y/Y, %)**



**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	2016Q2	2016Q3	2017Q1	2017Q2	2017Q3	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	2.50	2.75	0.90	0.90	0.90	-10 bps	7/21/2015
Poland	2W inter. rate	1.50	1.50	1.50	1.50	1.50	1.50	-50 bps	3/5/2015

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

		Current	2016Q2	2016Q3	2017Q1	2017Q2	2017Q3
Czech Rep.	PRIBOR	0.00	0.28	0.28	0.27	0.28	0.28
Hungary	BUBOR	0.99	2.60	2.90	0.90	0.90	0.90
Poland	WIBOR	1.7	1.65	1.65	1.70	1.70	1.70

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

		Current	2016Q2	2016Q3	2017Q1	2017Q2	2017Q3
Czech Rep.	CZ10Y	0.59	0.60	0.69	1.03	1.15	1.28
Hungary	HU10Y	2.28	4.00	4.20	2.80	2.80	2.90
Poland	PL10Y	2.39	2.50	2.40	2.50	2.70	2.80

## Exchange rates (end of the period)

		Current	2016Q2	2016Q3	2017Q1	2017Q2	2017Q3
Czech Rep.	EUR/CZK	27.08	27.02	27.02	27.00	26.50	26.20
Hungary	EUR/HUF	313	308	305	315	310	313
Poland	EUR/PLN	4.41	4.39	4.27	4.25	4.24	4.23

## GDP (y/y)

	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Czech Rep.	2.4	2.0	2.2	2.3	2.3	2.2	2.3
Hungary	2.4	2.8	3.0	3.6	3.2	2.8	3.3
Poland	3.8	3.8	3.7	3.8	3.7	3.6	3.5

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

	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Czech Rep.	0.2	0.4	1.1	1.5	1.5	1.6	1.8
Hungary	2.6	2.4	2.4	2.5	2.1	2.2	2.4
Poland	-0.4	0.0	0.3	0.6	0.9	1.2	1.5

## Current Account

	2016	2017
Czech Rep.	1.2	1.1
Hungary	4.1	3.5
Poland	-1.5	-1.3

## Public finance balance as % of GDP

	2016	2017
Czech Rep.	-0.8	-1.1
Hungary	2.0	2.5
Poland	-2.9	-3.0

Source: KBC, Bloomberg

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