Central European Weekly

Monday, 24 November 2014

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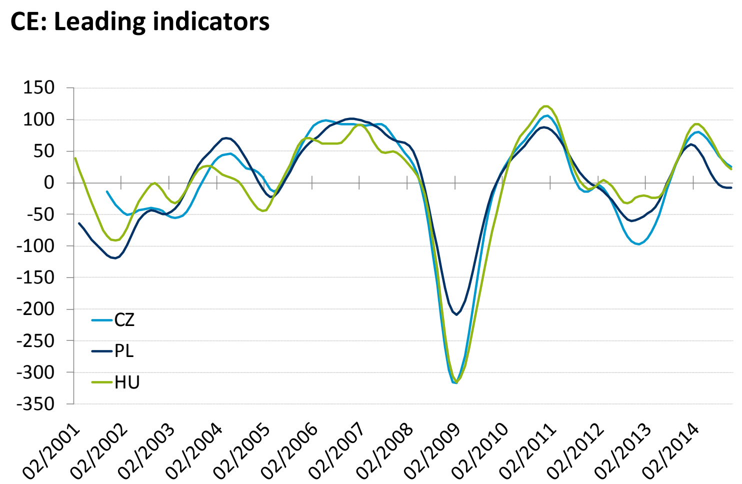
Weekly Highlights:

- Neither the NBH nor the NBP are likely to cut rates again before the end of the year
- While wage growth remain strong in Poland, it slows in Hungary
- In focus: our CE leading indicators tend to stabilise
- The NBP Monetary Council on hold despite very low inflation readings

Chart of the Week: CE Leading Indicators



After deterioration during recent months, CE leading indicators tend to stabilise.

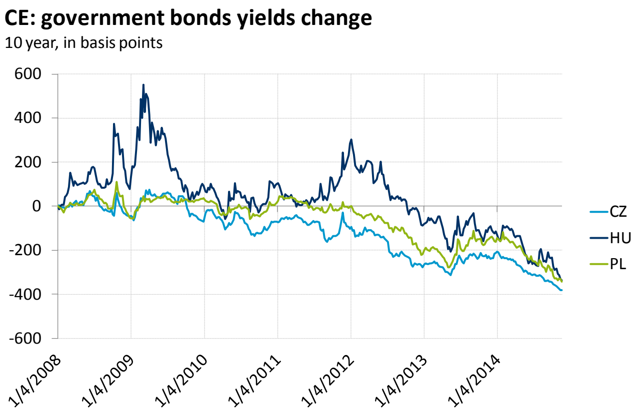
Market's editorial

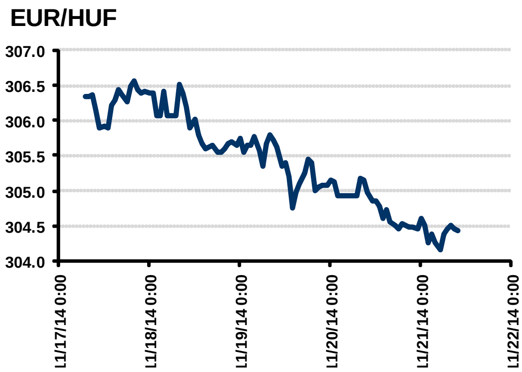
Neither the NBH nor the NBP are ready to cut rates, but...

Although Hungarian as well as Polish macroeconomic data have been mixed recently, fixed income markets are slowly starting to consider a scenario in which both the National Bank of Poland (NBP) and the National Bank of Hungary (NBH) might cut their base interest rates again. In addition, it is quite possible that if one of these central banks decides to do so, it will inspire the other to follow suit immediately. Naturally, this may be influenced by the exchange rates of the forint and the zloty as well as the behaviour of the ECB.

However, we do not expect the NBH and the NBP to cut rates before the end of this year at least. Apart from the ambiguous macroeconomic signals and central bankers' rhetoric, there is one seasonal factor that may counteract such a move. It is related to the annual reporting of the amount of public debt, which is largely denominated in foreign currencies in both countries. For this reputational reason, it may be important for both the NBH and the NBP, and for the Hungarian and Polish governments respectively, to maintain strong exchange rates for their local currencies until the end of the year (to reduce the total debt).

Nevertheless, the situation may change for the NBH and the NBP in early 2015, and therefore we do not rule out another cut in the Hungarian or Polish base rate at that time.





EUR/HUF, last 100 hours. Source: Reuters

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.7	-0.07%	↘	↘
EUR/HUF	305	-0.62%	↘	↘
EUR/PLN	4.20	-0.65%	↘	↘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.04	0.49	→	→
10Y HUF	3.08	0.16	→	↘
10Y PLN	2.32	-3.33	→	↘

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Review of Economic Figures

Poland: real wages growth resilent

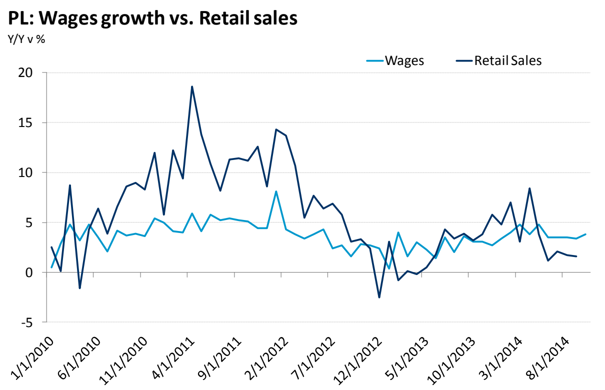
The bets on further monetary easing in Poland again decreased last week. This was primarily due to the encouraging data from the labour market, notably wage growth in the business sector. These wages grew by 3.8% y/y but real wage growth rate actually exceeded 4% (owing to falling prices). This is clearly good news for the growth structure of the Polish economy, as its growth is becoming more robust as it can continue to lean on solid household consumption (especially face to face with the economic deterioration in the EMU). Bear in mind that more good news in this regard is that the prospects for further developments in the Polish labour market remain good. This is signalled by the steady rise in employment (+0.8% y/y in October) as well as by soft indicators (PMI).

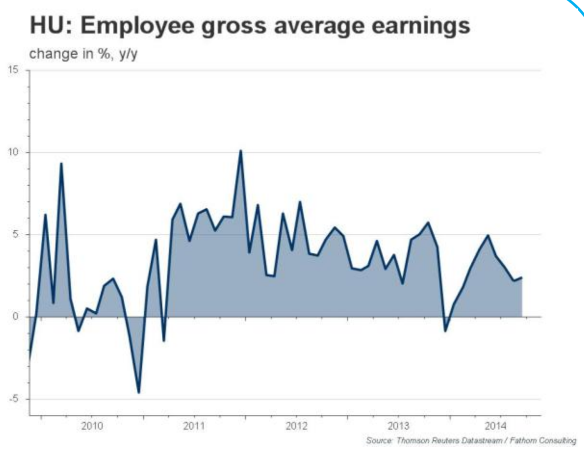
Regarding the industrial production, output rose by 1.6% y/y in October, which was essentially in line with expectations and thus the figure did not have a significant impact on markets. Nevertheless, the fact that soft indicators have stopped falling and Poland's PMI has even returned to more than 50 points for the first time in three months is good news from Polish industry. Our leading indicator also signals the stabilisation of conditions in industry.

Thus the primary question for the future continues to be the developments in external conditions, in the EMU in particular. Here we should point out that the prospects are rather deteriorating (as also signalled by the flash forecasts of business moods for November). This risk is sensitively appreciated by some of the members of Poland's Monetary Policy Council (MPC) because – as indicated by the minutes of its meeting released on Thursday – its members voted on rate cuts of 100, 50 as well as 25 bps in November. However, none of the proposals passed.

Hungary: wage growth slows

The Hungarian Statistical Office has published the September wage dynamic figure according to the gross wages increased by 2.4% Y/Y. No surprise - that was fully in line with our expectations. Wages filtered by the public fostered workers, the salaries went up by 4.4% Y/Y. The main massage of these figures is that the wage dynamic slowed down from around 6.5% Y/Y level to around 4% (this is without the fostered workers), so the economy started to defer to the lower inflationary environment, but still provides a substantial net real wage growth of about 2.5% Y/Y, which might be narrow to around 1.5% Y/Y in next year.



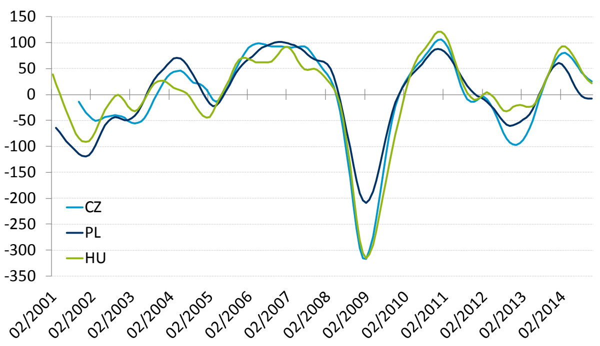


In Focus: CE leading indicators

Flash indicators tend to stabilise...

After deterioration in recent months, CE leading indicators tend to stabilize. In the Czech Republic and Hungary the negative momentum in the Flash leading indicators has improved since September. In Poland the Flash even posted a minor gain in November (still can be revised down with the new data).

CE: Leading indicators

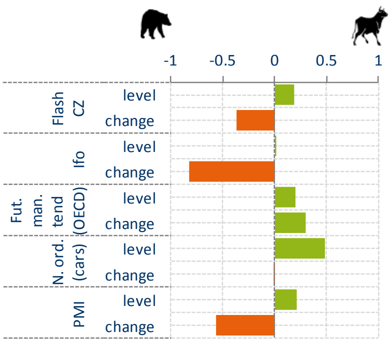


On the other hand one must keep in mind that the Flash indices have been declining for a while (especially in Poland since early 2014) and the bottoming process can take some time. As a result the indices are at more than one year lows and still point to a weaker end of 2014 and beginning of 2015.

The main outcome of the November reading is about the stabilisation for now. If confirmed in the months ahead, there is no reason to play more negative scenarios including significant downward revisions to the Central European GDPs. We expect Poland to grow around 3% and the Czech Republic and Hungary around 2% in 2015..

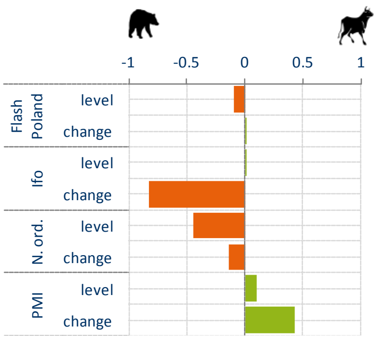
A deeper look at the structure of the leading indicators shows that external conditions are primarily responsible for the deterioration in previous months. The primary burden in the Czech Republic and Hungary is the drop in Ifo, the German business mood index, while domestic business moods and new orders remain stable or are improving slightly. Hence the key factor for the forthcoming months is whether a positive turnaround in expectations of German enterprises will occur. The most recent positive suprise in Ifo index is highly welcomed.

Flash CZ

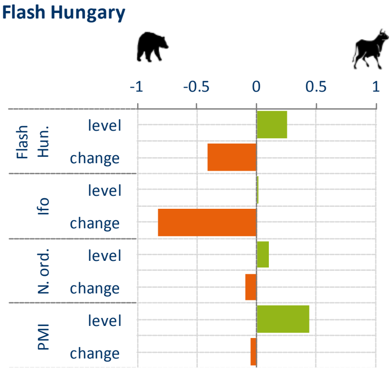


Notes: level: the level of the indicator vis-à-vis historical values; change: the change in the indicator vis-à-vis historical values; (1 = the current value is the maximum historical value; -1 = the current value is the minimum historical value)

Flash Poland



Flash Hungary



Weekly preview

TUE 14:00	NBH base rate	
	This meeting	Last change
rate level (in %)	**2.10**	7/2014
change in bps	**0**	-20

HU: Rates will not fall in spite of deflation

Although this decision looks to be quite obvious, namely the base rate may be kept unchanged at 2.1%, the market view started to change what may be the next movement of NBH. While the main expectations were that NBH may hike base rate in 4Q15, now the market started to price in 10bp cut for 1Q15.

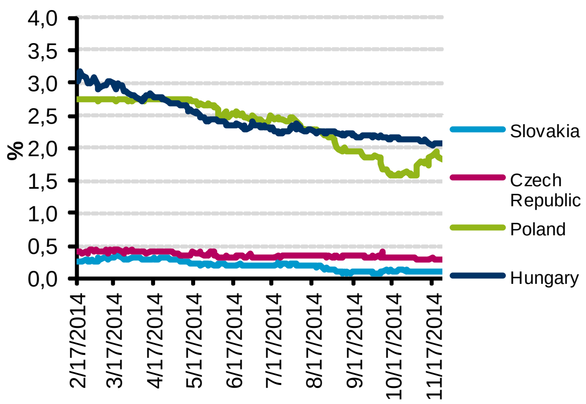
In the view of NBH it may mean, that there is no inflationary or deflationary risk till end-2015, so they are in a comfortable situation during their decision making. The positive international sentiment pushed EURHUF below 305, which also gives room for NBH to loosen the monetary policy, but before the year end it is unlikely as the public debt level has to be kept below last year's level of 77.2% of GDP. As the FC debt portion within the public debt is still high (around 38%) it is important that what the year-end exchange rate level is. In our view an ideal EUR/HUF rate from that perspective is around 302. Before the year-end NBH may not risk a base rate cut, because they may not want to weaken the currency. But the chance of rate cut in February increased especially if Poland cuts base rate and the international sentiment remains supportive at the beginning of next year..

Calendar

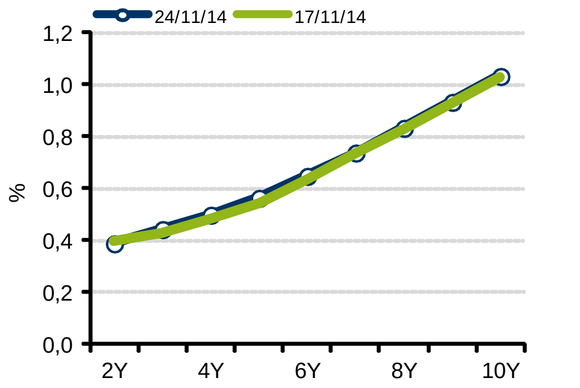
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	11/25/2014	10:00	Retail sales	%	10/2014			4.3	2.2	-0.9	1.6
PL	11/25/2014	10:00	Unemployment rate	%	10/2014			11.4		11.5	
HU	11/25/2014	14:00	NBH meeting	%	11/2014	2.1		2.1		2.1	
HU	11/26/2014	9:00	PPI	%	10/2014					0.1	-0.3
HU	11/27/2014	9:00	Unemployment rate	%	10/2014			7.3		7.4	
CZ	11/28/2014	9:00	GDP	%	3Q/2014 *P					0.3	2.3
PL	11/28/2014	10:00	GDP	%	3Q/2014 *F					0.9	3.3
CZ	11/28/2014	10:00	Money supply M2	%	10/2014						3.6

Fixed-income in Charts

FRA 3x6

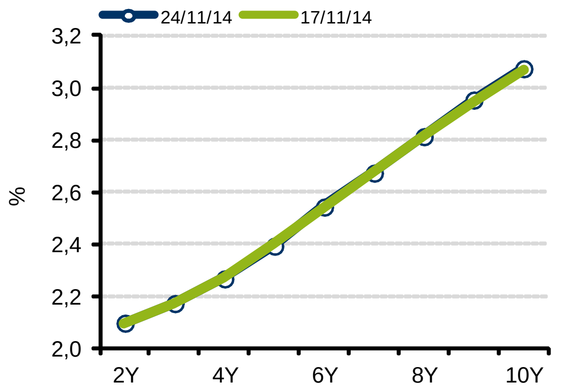


CZ IRS

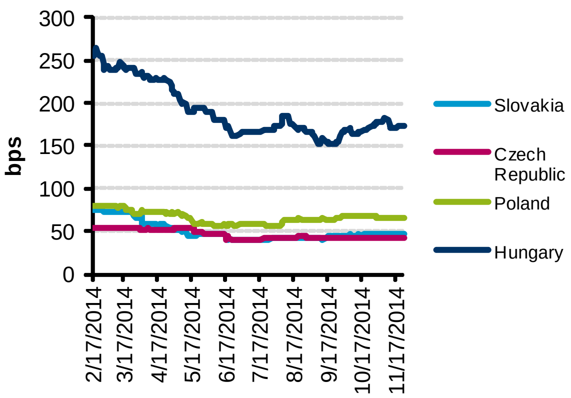


10Y GB Yields

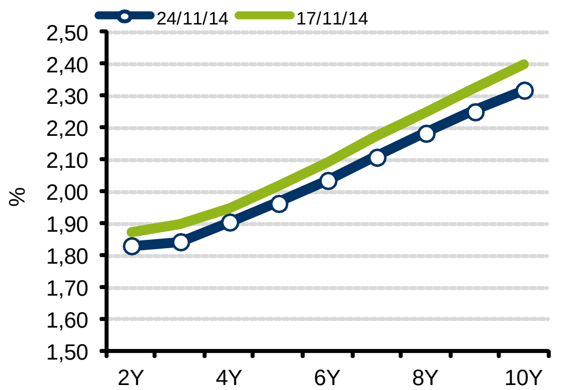
HU IRS



CDS 5Y



PL IRS



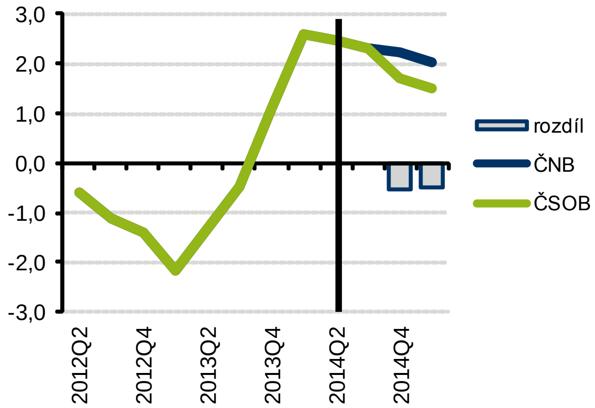
Source: Reuters

Medium-term Views & Issues

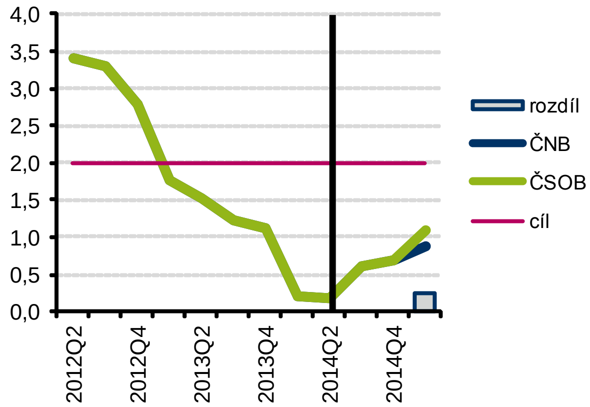
	The Czech Republic	Hungary	Poland
Growth & key issues	The economy is in a period of upswing. The key economic fundamentals remain very strong, with many of them even improving over the course of time. The new government, formed after the autumn 2013 election, is just gradually starting to carry out its programme. It should include not only savings but also greater tax relief for parents with children, a new VAT rate, and likely also the termination of the new funded pension system (called the 2nd pillar), set up in the last two years.	We expect that the economy may slow further in 4Q14 in the range of 2% Y/Y and 2.5% Y/Y, because the new orders in the construction sector is falling, there external demand is deteriorating, so the net external component of the growth is getting smaller. The average GDP growth may be at 3.3% Y/Y in 2014, while it may slow to around 2.2% Y/Y in 2015.	According to the GUS estimates, the Polish economy grew by 3.3% in 2014Q3. Although the structure is not known yet, we expect that the growth was again driven by domestic demand (possibly with strong contribution of inventories). Expectations of a slowdown of growth rates in the second half of the year may therefore not materialize. The recent figures suggest this year's economic growth will likely remain above 3%.
Outlook for official & market rates	The CNB has exhausted the possibility of easing its monetary policy through interest rates, and therefore it has decided to weaken the koruna and keep it close to EUR/CZK 27. Statements from the CNB representatives indicate that the CNB would like to maintain that level for a prolonged period, until strong inflation pressures become evident in the economy. We believe that the exchange rate targeting will be abandoned much later (during the second half of 2016), and that the move will certainly not be accompanied by a rise in interest rates, as suggested by the official forecast.	The NBH has finished its easing cycle in Hungary by cutting the base rate to the 2.1%. The NBH emphasized that the inflation may return to the inflation target (3% Y/Y level with the tolerance channel of +/-1%pt) at end-2015, but if the Monetary Council sees that the inflationary outlook is changing, they will adjust the monetary policy. Our base case is that first hike may come in summer 2015, but the cycle might be gradual a slow, so we expect that base rate might remain below 3% at end-2015.	Inflation pressures in Poland remain subdued and year-on-year prices growth is seen well below the lower tolerance band of the inflation target. After surprising markets by cutting interest rates by 50 basis points in October, the NBP surprised in November as well, this time by leaving rates unchanged. The overall tone of the meeting was, however, dovish and we therefore not exclude additional rate cut in the beginning of the next year.
Forex Outlook	We anticipate clearly lower growth and inflation in the euro area, and therefore we also predict, on the whole, a slower rate of Czech inflation. In 2015, inflation will again be below the CNB's 2% target, and the question is how the CNB Board will react to this. The recollection of the negative response from the Czech public to the last devaluation of the currency and the fact that inflation will remain in positive territory should be the main arguments against a further targeted weakening of the currency. Yet we see an approximately 40% likelihood of this scenario, which might happen in 2015.	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.	Less optimistic economic outlook and renewed monetary policy easing should cap room for prospective strengthening of the zloty in months to come. For the rest of the year, we therefore expect a stagnation of the zloty against the euro and consider risks as skewed slightly towards possible depreciation, even though Polish assets could draw support from further easing of monetary policy conditions in the euro zone.

CBs' Projections vs. Our Forecasts

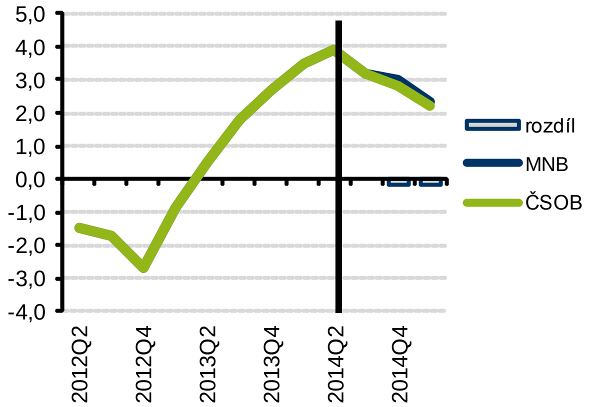
CZ: GDP outlook (Y/Y, %)



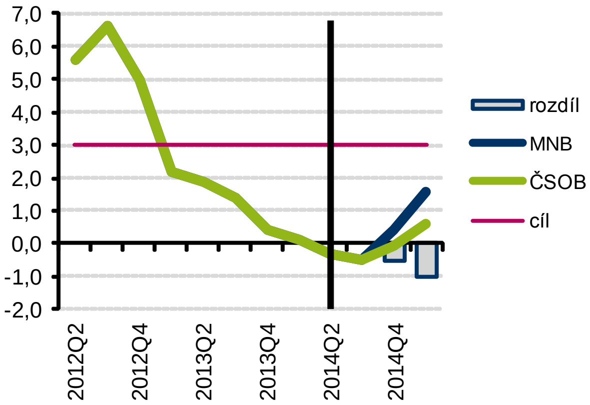
CZ: Inflation outlook (Y/Y, %)



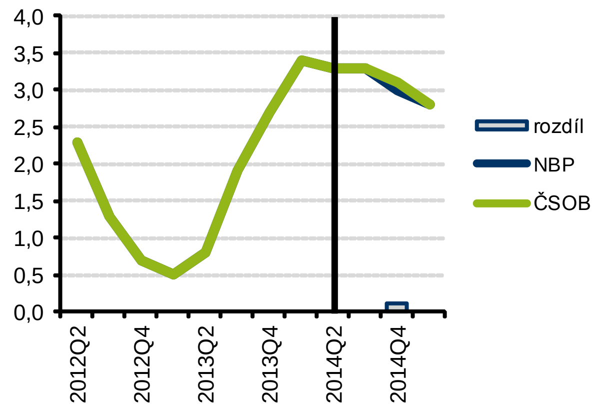
HU: GDP outlook (Y/Y, %)



HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outllok (Y/Y, %)

Source: CNB, NBP, MNB, CSOB

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	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.	*2.10*	2.60	2.30	2.10	2.10	2.10	-10 bps	7/22/2014
Poland	2W inter. rate	*2.00*	2.50	2.50	2.50	2.00	2.00	-50 bps	10/8/2014

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

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	PRIBOR	*0.34*	0.37	0.35	0.34	0.35	0.35
Hungary	BUBOR	*2.10*	2.67	2.34	2.09	2.15	2.15
Poland	WIBOR	*2.06*	2.71	2.68	2.28	2.00	2.00

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

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	CZ10Y	*1.035*	1.84	1.34	1.22	1.15	1.20
Hungary	HU10Y	*3.08*	4.95	3.77	3.92	3.50	3.65
Poland	PL10Y	*2.32*	4.03	3.39	2.87	2.60	2.60

Exchange rates (end of the period)

		Current	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	EUR/CZK	*27.7*	27.4	27.4	27.5	27.5	27.8
Hungary	EUR/HUF	*305*	307	310	311	310	310
Poland	EUR/PLN	*4.20*	4.17	4.16	4.18	4.20	4.20

GDP (y/y)

	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	-0.4591015	1.1	2.6	2.5	2.3	1.7	1.5
Hungary	1.8	2.7	3.5	3.9	3.2	2.8	2.2
Poland	1.9	2.7	3.4	3.3	3.3	3.1	2.8

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

	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1
Czech Rep.	1	1.4	0.2	0.0	0.7	0.8	1.2
Hungary	1.4	0.4	0.1	-0.3	-0.5	-0.1	0.6
Poland	1	0.7	0.9	0.3	-0.3	-0.4	0.0

Current Account

	2013	2014
Czech Rep.	-1.4	-1.4
Hungary	2.0	2.2
Poland	-1.2	-2.5

Public finance balance as % of GDP

	2013	2014
Czech Rep.	-1.3	-2.0
Hungary	-2.7	-3.0
Poland	-4.4	-3.5

Source: CSOB, Bloomberg

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