



Central European Weekly

Monday, 07 September 2015

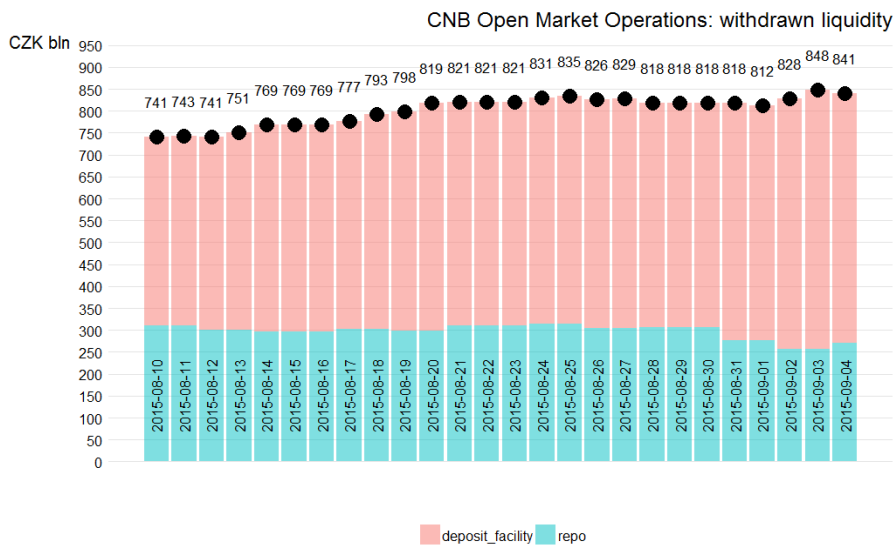
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Weekly Highlights:

- **CNB verbally intervenes and threatens to postpone the departure from its intervention policy**
- **Wage growth in the Czech economy slightly accelerates**
- **NBP on hold as expected**
- **Czech inflation recedes gain in August**

Chart of the Week



The Czech National Bank likely continues to intervene strongly against the appreciation of the koruna. As a result, EURCZK forward FX rates are seen well below the intervention threshold of EUR/CZK 27.0. (Source: CNB, CSOB).

Market's editorial

CNB verbally intervenes and threatens to postpone the departure from its intervention policy

Through its forex as well as verbal interventions the Czech National Bank has still been sturdily resisting pressure for the appreciation of the koruna. This is also why last week CNB Governor Singer talked and Deputy Governor Tomšík blogged on a possible extension of the exchange rate policy beyond the second half of next year. Most importantly, both of them resolutely ruled out an earlier termination of the intervention policy. Thus they have made it clear that speculations on an early appreciation of the koruna may be highly unrealistic; moreover, if the koruna is unleashed, such speculations may not necessarily involve a spontaneous currency appreciation – profitable for speculators. Mr Singer did not even rule out negative rates, albeit this is far from being a preferred option, and our outlooks still do not envisage this. As we believe that inflation will lag behind the CNB's existing forecast, the exchange rate policy is unlikely to be abandoned soon or dramatically rapidly, despite that fact that, for example, short-term forward EUR/CZK exchange rates already imply that the exchange rate will be below the intervention policy threshold (EUR/CZK 27.0) until the middle of the year.

On the other hand, the latest wage growth figures from the Czech Republic must have pleased the Czech central bank because the macroeconomic data are developing well. Bear

in mind that the CNB's forecast for the second quarter of the year envisaged wage growth of 2.5% in nominal terms and 1.7% in real terms. The reality surpassed both of these predictions, indicating at last that wages are starting to emerge from their lethargy and their growth is gaining momentum. Nevertheless, this does not mean that we will see demand-pull inflation soon, which would put price growth closer to the CNB target. Competitive pressure in manufacturing as well as sales is so strong that it is curbing inflation across the whole continent. The August data are likely to corroborate this, as we believe that price growth decelerated to 0.3% y/y in August.

NBP on hold as expected, but it does not like government plans to convert FX mortgage loans into zlotys

Last Wednesday, a regional eye catcher was a meeting of the Polish central bank (NBP). The meeting, however, brought no surprises. The NBP left interest rates unchanged as expected and hinted that it should stay so in the rest of this year (which is, in our view, likely scenario). The most interesting news could thus have been a relatively strong critique of government plans to convert FX mortgage loans of Polish households into zlotys; let us recall that government plans that banks should bear the majority of conversions costs which could, according to NBP President Belka, undermine the stability of Polish banking sector.

	Last	Change 1W
EUR/CZK	27.0	-0.05%
EUR/HUF	314	0.16%
EUR/PLN	4.24	0.01%

	Last	Change 1W
10Y CZK	1.13	-0.44
10Y HUF	3.23	2.71
10Y PLN	2.63	0.00

Review of Economic Figures

Wage growth in the Czech economy slightly accelerates

While real wages in the whole economy grew by only 2.2% in the first quarter, the real wage growth rate accelerated to 2.7% in the second quarter, when the economy reached its highest growth rate for approximately the last eight years. The nominal average wage grew by 3.4% to approximately CZK 26,300. This time wages again grew faster in the public sector, especially in public administration and healthcare. The latest data on wage developments in the economy can be seen as very favourable, although these are still average values that two-thirds of employees fail to reach. The median wage is also gaining momentum, yet it lags behind the average wage by more than CZK 4,000. We can see that the economic recovery is also starting to gradually influence wages, i.e., employee income. Nevertheless, the current wage acceleration is far from being strong enough to trigger demand-pull inflation. The Czech Republic is not by any means the only country exposed to pressure on consumer goods prices to fall, whether such pressure stems from growing competition among retailers or manufacturers. Hence the latitude for inflation to fall continues to be highly curbed, although the improvement in the financial position of households is clearly evident in their willingness to spend money. A steady rise in retail sales, sales of new cars and fuel bears this out.

Retail sales continue to grow very strongly

Retail sales continued to grow very strongly in July. The consumer appetite for spending money is not losing momentum, with sales having increased by 6.7% y/y (adjusted for the differing number of jobs). Given the existing trend, this figure comes as no surprise. It is not even a surprise that e-commerce is booming the most (+19%) and that consumers are focusing their demand on electronics,

household equipment and fuel. We can see the falling electronics prices improving demand for replacing these products in households. Cheaper fuel is working in a similar way. With fuel prices going down, people are more willing to travel.

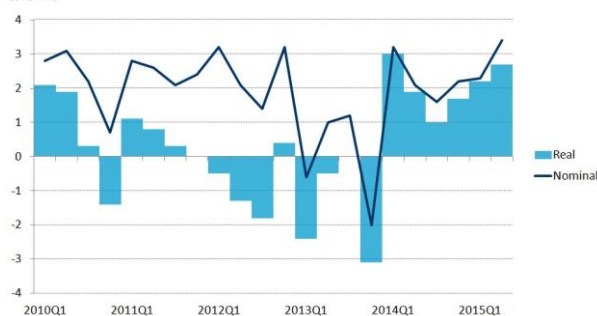
Remarkably, not even the improving demand in stores is leading to price growth. Thus demand-pull inflation is not yet evident, mainly because of strong competition and clearly also as a result of the 'fight' between e-commerce and traditional stores. Hence retail prices are continuing to decline. The strong rise in sales, including the demand for new cars, suggests that household consumption will continue to contribute strongly to the Czech Republic's economic growth in the second half of the year. High consumer confidence, falling unemployment and recovering wage growth should be the main stimuli to further growth in retail sales.

Hungarian growth supported by consumption

The Statistical office confirmed the 2.7% YoY growth of Hungarian economy in 2Q15 (from 3.5% YoY in 1Q15). Although the economy has slowed down, the swing may carry on this year. The detailed figure shows that the agriculture was the main reason of the deteriorating economic performance, which fell by 16.8% YoY in 2Q15. The other sectors on supply side were still increasing, although both industry and construction slowed down (the former from 7.8% YoY to 6.1%, while the latter from 9.5% YoY to 6.5% YoY). The service sector dynamic was almost the same as in the previous quarter; it increased by 2.4% YoY up from 2.3% Y/Y. It reflects that the domestic consumption is relatively stable and strong.

Looking ahead the detailed figure confirms our view that economy may grow by around 3% in this year.

CZ: Wage growth
(y/y, %)



CZ: Retail sales & Confidence
(3m average)



Weekly preview

TUE 9:00

HU Inflation (change in %)

	Aug-15	Jul-15	Aug-15
CPI y/y	0.4	0.4	-0.5

HU: Inflation again recedes

The headline inflation should remain at 0.4% Y/Y due to the low fuel prices, but core inflation may increase slightly further, thanks to the stable domestic demand. It may confirm the NBH's view that the base rate can be kept at 1.35% for an extended period.

WED 9:00

CZ Inflation (change in %)

	Aug-15	Jul-15	Aug-15
CPI m/m	-0.3	-0.1	-0.1
CPI y/y	0.3	0.5	0.6

CZ: Inflation again recedes

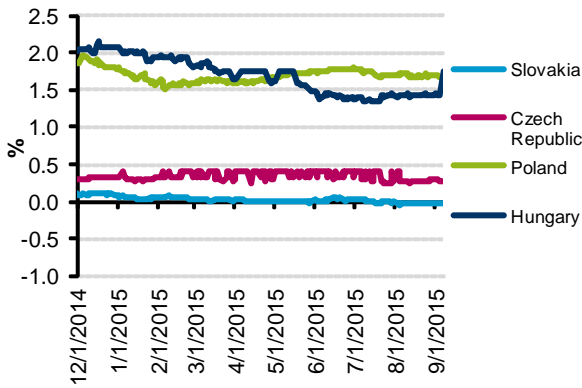
The lower food prices and falling fuel prices have most likely cut inflation again, further from the central bank's forecast. This means that downside inflation tendencies still persist, now additionally augmented by cheap commodities. We believe that inflation will approach the target much more slowly than expected by the CNB, in particular when energy prices fall again early next year.

Calendar

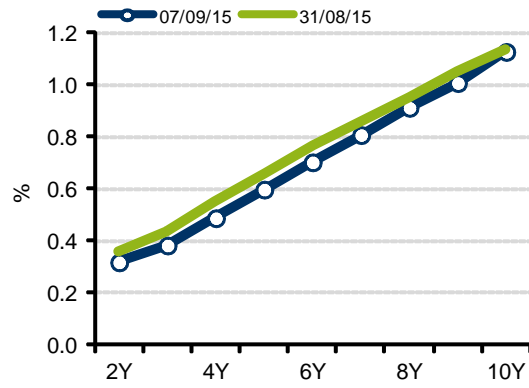
Country	Date	Time	Indicator	Unit	Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	09/07/2015	9:00	Construction output	%	07/2015						7.8
CZ	09/07/2015	9:00	Trade balance (national)	CZK B	07/2015	11.4		12.5			17.8
CZ	09/07/2015	9:00	Industrial output	%	07/2015		1		2.8		8.1
HU	09/07/2015	16:00	Budget balance	HUF B	08/2015						-894.1
CZ	09/08/2015	9:00	Unemployment rate	%	08/2015	6.2		6.3			6.3
HU	09/08/2015	9:00	Industrial output	%	07/2015					1.1	6
HU	09/08/2015	9:00	CPI	%	08/2015			-0.2	0.4	0	0.4
CZ	09/09/2015	9:00	CPI	%	08/2015	-0.3	0.3	-0.2	0.4	-0.1	0.5
HU	09/09/2015	9:00	Trade balance	EUR M	07/2015 *P						
CZ	09/09/2015	12:00	CZ bond auction 2014-2020, floating rate	CZK B	09/2015						
CZ	09/09/2015	12:00	CZ bond auction 2014-25, 2.40%	CZK B	09/2015						
CZ	09/09/2015	12:00	CZ bond auction 2015-2017, 0.00%	CZK B	09/2015						
CZ	09/14/2015	10:00	Current account	CZK B	07/2015	-4		0			13.26
PL	09/14/2015	14:00	Money supply M3	%	08/2015					0.9	8.6
PL	09/14/2015	14:00	Current account	EUR M	07/2015						-849
PL	09/14/2015	14:00	Trade balance	EUR M	07/2015						56
PL	09/15/2015	14:00	CPI	%	08/2015					-0.1	-0.7
PL	09/15/2015	15:00	Budget balance	PLN M	08/2015						-26592
CZ	09/16/2015	9:00	PPI	%	08/2015			-0.4	-3.4	-0.4	-3

Fixed-income in Charts

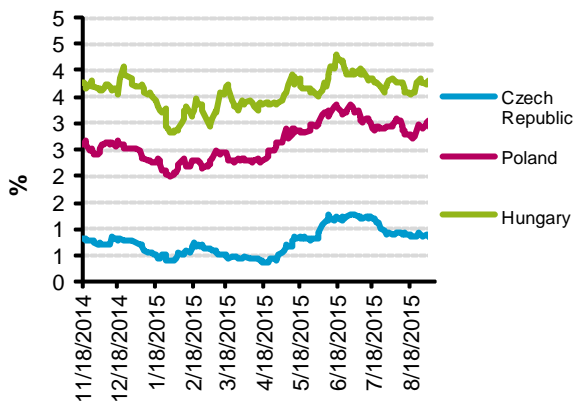
FRA 3x6



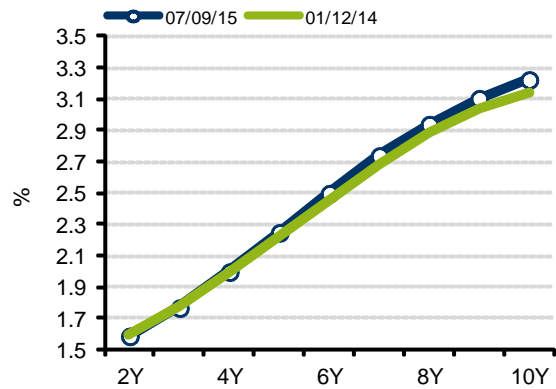
CZ IRS



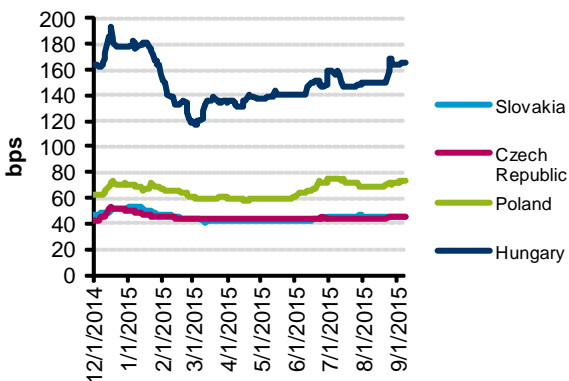
10Y GB Yields



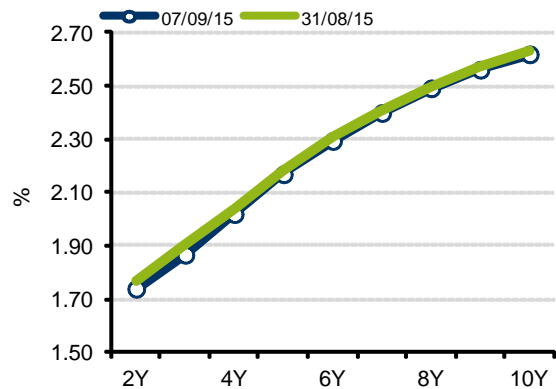
HU IRS



CDS 5Y



PL IRS



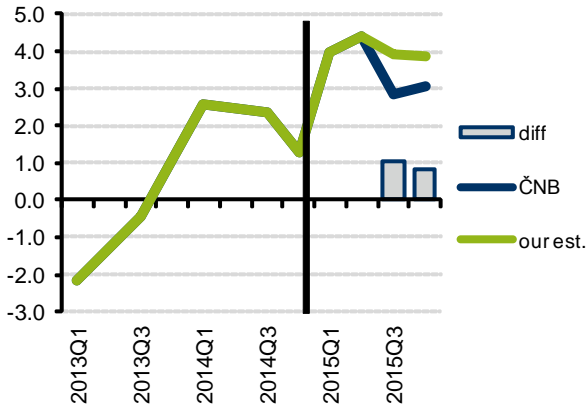
Source: Reuters

Medium-term Views & Issues

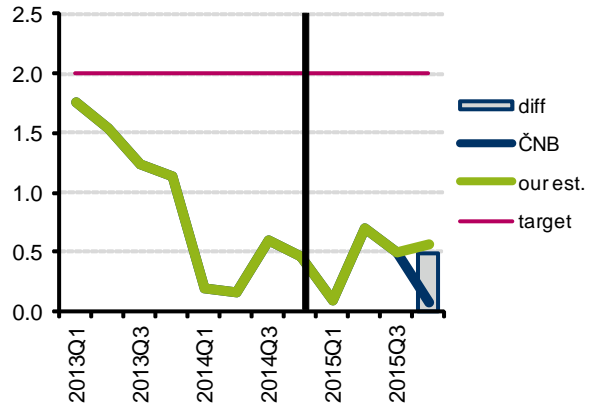
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private 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 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.</p>	<p>The Polish Statistical Office kept its flash GDP forecasts for the second quarter of the year unchanged – this means growth of 3.3% y/y and 0.9% q/q. Thus the data for the second quarter fell short of expectations, but only slightly. Perhaps only the deceleration of the rate of investment may pose some issues; nevertheless, we are not overestimating this at the moment either. 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.</p>
Outlook for official & market rates	<p>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.</p>	<p>The MNB said in July it concluded its rate cut cycle. 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, so the start of the rate hike cycle is depending on FED's and ECB's policy. Based on the current expectation we think that NBH may hike key rate in 2Q16 the earliest.</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. In addition, if we take account of this year's inflation rate, which is likely to be negative for the year as a whole, such a climate will probably attract investments in Polish assets. In that event, additional pressure for the appreciation of the zloty and consequently for an inflation fall can be expected.</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. 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.</p>	<p>We think that the first strengthening reaction 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. 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.</p>	<p>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 eurozone. 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. Polish general elections in autumn however pose a negative risk for the zloty.</p>

CBs' Projections vs. Our Forecasts

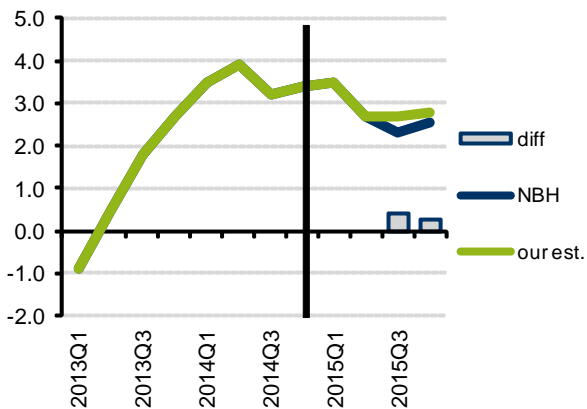
CZ: GDP outlook (Y/Y, %)



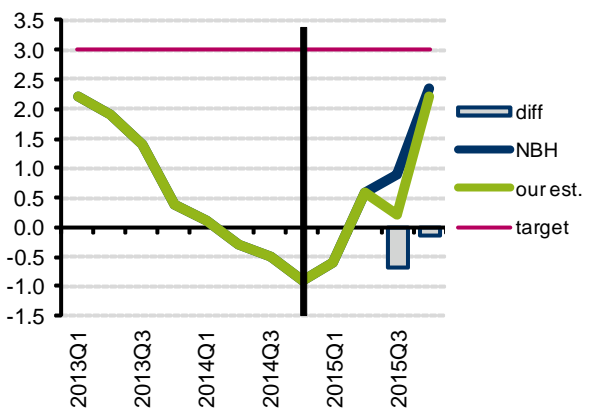
CZ: Inflation outlook (Y/Y, %)



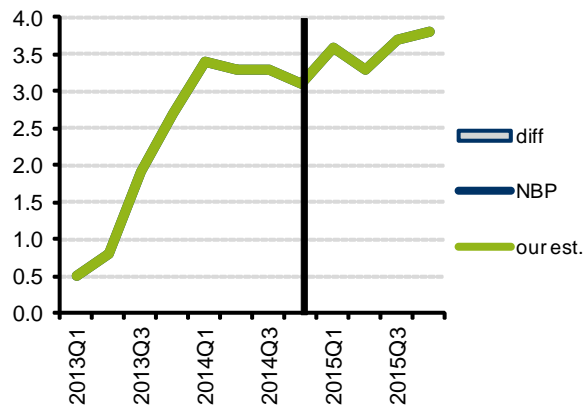
HU: GDP outlook (Y/Y, %)



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	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	1.70	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	0.30	0.30	0.30
Hungary	BUBOR	1.36	1.89	1.41	1.70	2.10	2.40
Poland	WIBOR	1.72	1.65	1.72	1.60	1.65	1.67

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	CZ10Y	1.13	0.64	1.30	1.25	1.40	1.65
Hungary	HU10Y	3.23	2.71	3.45	3.40	3.60	3.80
Poland	PL10Y	2.62	2.12	3.01	2.45	2.40	2.80

Exchange rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	EUR/CZK	27.06	27.57	27.35	27.10	27.05	27.00
Hungary	EUR/HUF	314	300	315	317	315	310
Poland	EUR/PLN	4.24	4.07	4.19	4.20	4.15	4.10

GDP (y/y)

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	2.4	1.3	4.0	4.4	3.9	3.9	2.1
Hungary	3.2	3.4	3.5	2.7	2.7	2.8	2.2
Poland	3.3	3.1	3.6	3.3	3.7	3.8	3.8

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	0.3	0.9	1.6
Hungary	-0.5	-0.9	-0.6	0.6	0.2	2.2	2.7
Poland	-0.3	-1.0	-1.5	-0.8	-0.8	-0.1	0.4

Current Account

	2015	2016
Czech Rep.	1.7	1.7
Hungary	4.0	3.8
Poland	-1.2	-2.0

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-1.6	-1.3
Hungary	-2.2	-2.0
Poland	-3.0	-2.5

Source: KBC, Bloomberg

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