Written by ČSOB Prague and K&H Budapest

Central European Weekly

Monday, 30 May 2016

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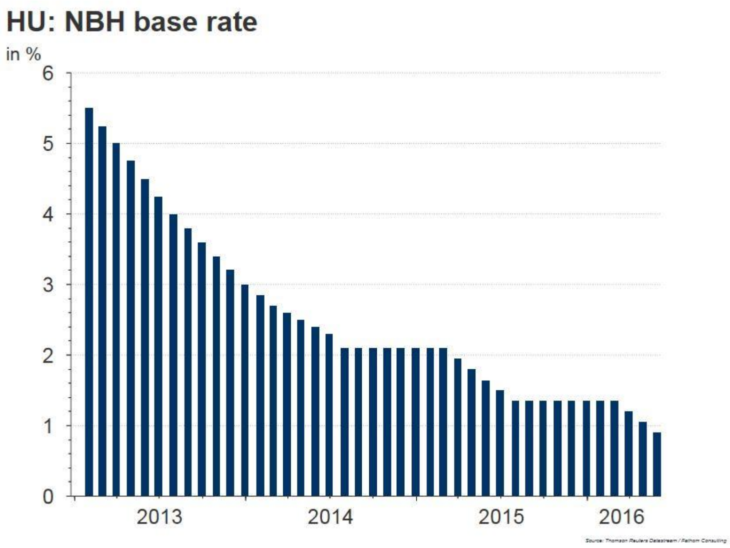
Weekly Highlights:

- The NBH cuts its base rate as expected, but it surprisingly signals an end of its easing cycle
- Weekly preview: Watch regional PMI's and Polish inflation for May

Chart of the Week: NBH's base rate



The NBH cuts its base to fresh all-time lows and singnals the end of the

Central Banks & Markets

The NBH easing cycle seems to be over

The **National Bank of Hungary cut base rate by 15bp from 1.05% to 0.9% in line with the expectations.** The O/N deposit rate was left unchanged again at -0.05%, while the O/N lending rate was moderated by 15bp to 1.15%, which also fits fully in our expectations.

The most important part of the statement was that the NBH fears less about the second round effects of the continuously low inflationary environment as the wage dynamic has accelerated. Also the looser fiscal policy helps to close the negative output gap. So the statement was finished with the sentence: "Based on available information, the inflation outlook and the cyclical position of the real economy point to maintaining the 0.9 per cent base rate for an extended period".

The MPC's comment is also with our expectation, as it is quite hawkish and the most likely outlook scenario is that there will be no more cut, rather the Council's intention is to maintain the current base rate level for an extended period, even for two years.

The 'no further' cut comment surprised the market as the HUF strengthen slightly on the statement. There might be some room for further strengthening to around 313, but there are strong resistance levels.

The CNB Board will become more 'pro-euro'

Czech President Zeman announced that he would appoint Mr. Oldrich Dedek a member of the Czech National Bank's (CNB) board. Mr. Dedek already served as CNB´s vice-Governor in the years 1999 - 2005. During that period he inclined to defend dovish rather than hawkish positions and presented himself as a staunch supporter of central bank´s independence as well as a proponent of the euro adoption in the Czech Republic. Mr. Dedek will join the Board in February, replacing either Mr. Rezabek or Mr. Lizal, whose terms are about to expire.

	Last	Change 1W
EUR/CZK	*27.1*	*0.18%*
EUR/HUF	*314*	*-1.15%*
EUR/PLN	*4.39*	*-1.19%*

	Last	Change 1W
10Y CZK	*0.70*	*1.45*
10Y HUF	*2.38*	*3.71*
10Y PLN	*2.41*	*-0.62*

Review of Economic Figures

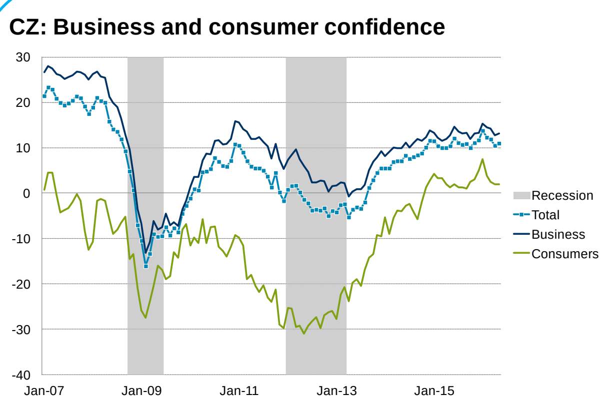
The Czech economy remains in upbeat mood

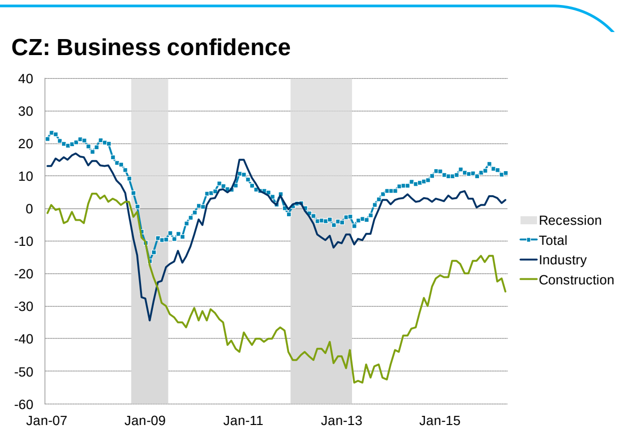
Both the business mood and the overall sentiment in the Czech economy again improved last month. This was primarily attributable to industrial businesses, which expect to fare better in the months to come than early this year. Even so, their expectations are more modest than last year. In a way this is logical if we take into account the boom that most industrial segments experienced last year, and the fact that foreign demand does not provide much latitude for growing faster. By contrast, confidence among building firms is falling. But this is no surprise either, given the development of orders over the last twelve months. New orders are now much scarcer after the strong expansion triggered by the completion of the absorption of EU Funds. Thus in the end, housing construction businesses in particular can take heart – if they obtain building permits.

Retailers are quite surprisingly viewing the months to come cautiously, although the retail sector is experiencing an incredible boom with domestic customers making record-breaking purchases of almost anything and everywhere. On the other hand, even this sector is likely to see its growth rates gradually decelerate – to 4-5%; this will also be more in line with this year's development of the financial position of households.

Consumer moods, unlike those in the business sector, remain unchanged. Consumers are optimistic – much more than last year – because of their positive expectations of the future development of the economy. While concern about unemployment has increased slightly, consumers are not afraid of inflation and do not even expect any deterioration of the economic development either.

The latest reports about sentiment in various segments of the economy are not surprising at all, and have not made us change our view of this year's development of the Czech economy. The Czech Republic's growth is returning to levels that correspond to developments abroad, and therefore we believe that the Czech economy will continue to be primarily driven by household consumption on the demand side and industry on the supply side.





Weekly preview

TUE 14:00 PL Inflation (change in %)

	May-16	Apr-16	May-15
CPI y/y	**-1.0**	-1.1	-0.9
Food (ex Alc.) y/y	**1.0**	0.0	-2.4
Transport (including fuel)	**-7.8**	-7.5	-8.0

PL: Annual inflation still down 1%

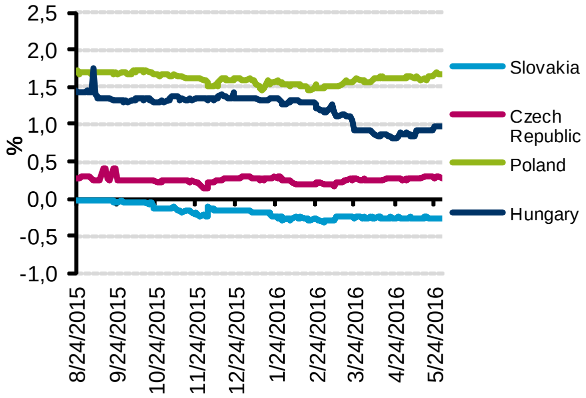
Poland's consumer prices fell by 1% y/y in May according to our forecasts, again primarily as a result of low oil prices. Nevertheless, their rise in May was the main reason why prices rose by 0.2% m/m. However, the Polish economy as a whole remains in deep deflation, but the central bank is comfortable with this because it cannot influence the reasons for deflation and the labour market is still developing well.

Calendar

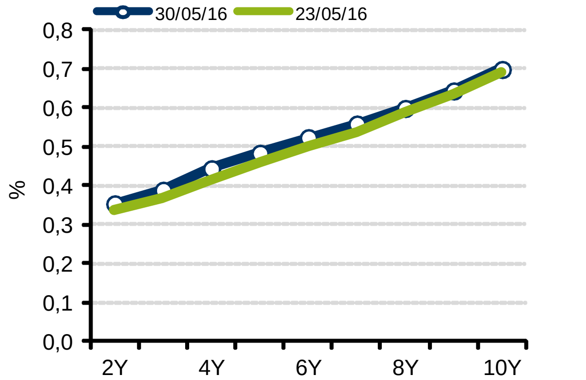
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	05/31/2016	9:00	PPI	%	04/2016					0.2	-1.6
PL	05/31/2016	10:00	GDP	%	1Q/2016 *F					-0.1	3
CZ	05/31/2016	10:00	Money supply M2	%	04/2016						9.5
PL	05/31/2016	14:00	CPI	%	05/2016 *P	0.1	-1	0.1	-0.9	0.3	-1.1
HU	06/01/2016	9:00	PMI manufacturing		05/2016					52.2	
PL	06/01/2016	9:00	PMI manufacturing		05/2016					51	
CZ	06/01/2016	9:30	PMI manufacturing		05/2016			54.2		53.6	
CZ	06/01/2016	14:00	Budget balance	CZK B	05/2016					30.5	
HU	06/02/2016	9:00	Trade balance	EUR M	03/2016 *F					966	
HU	06/03/2016	9:00	Retail sales	%	04/2016						4.2
CZ	06/03/2016	9:00	GDP	%	1Q/2016 *P					0.5	3.1

Fixed-income in Charts

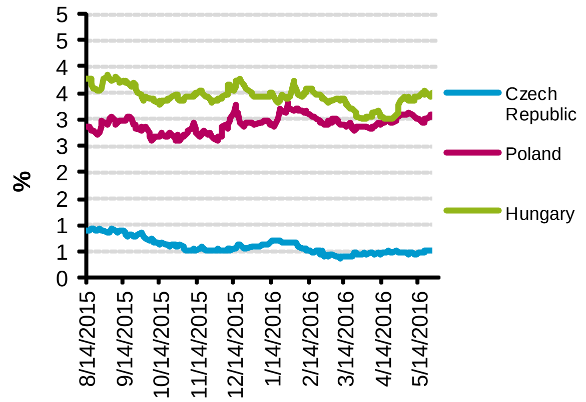
FRA 3x6



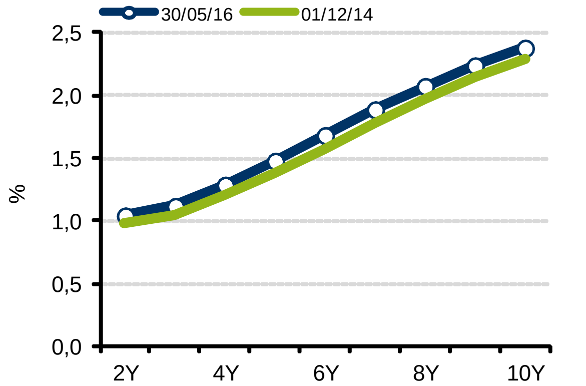
CZ IRS



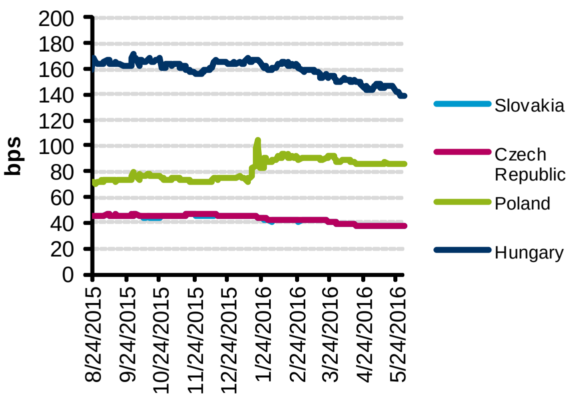
10Y GB Yields



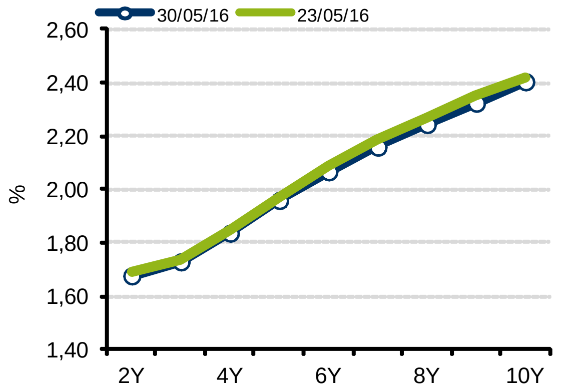
HU IRS



CDS 5Y



PL IRS



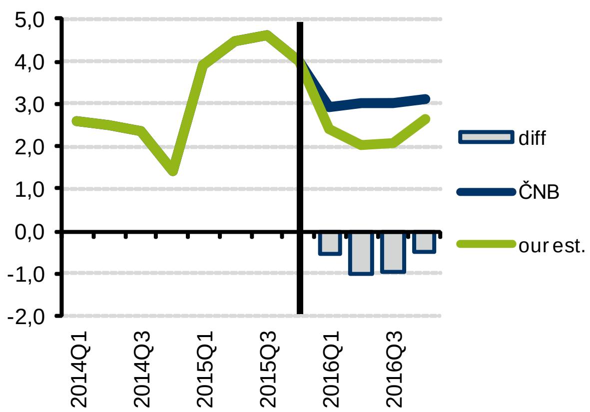
Source: Reuters

Medium-term Views & Issues

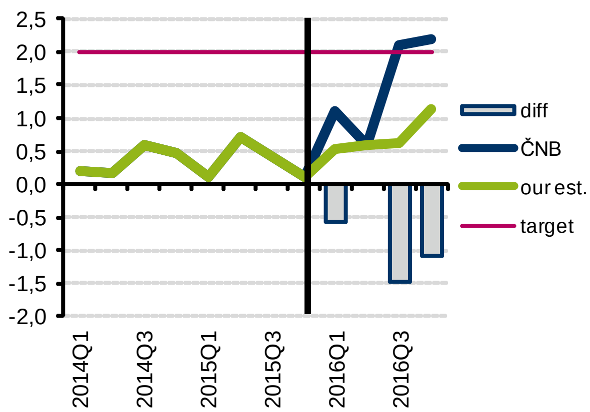
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – 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 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.	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.
Outlook for official & market rates	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.	Outlook under the review.	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.
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. 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.	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.	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.

CBs' Projections vs. Our Forecasts

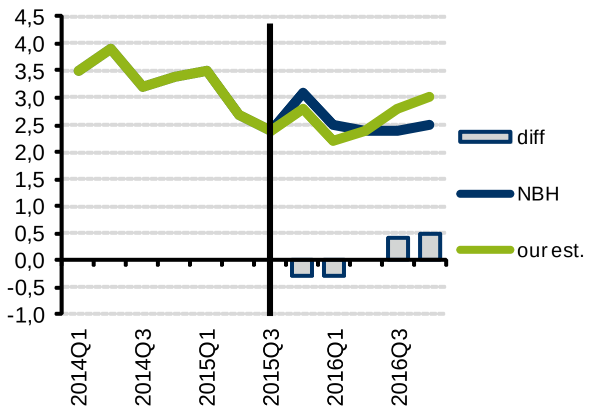
CZ: GDP outlook (Y/Y, %)



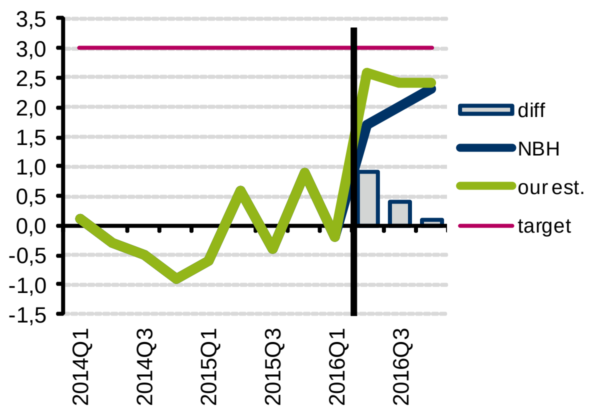
CZ: Inflation outlook (Y/Y, %)



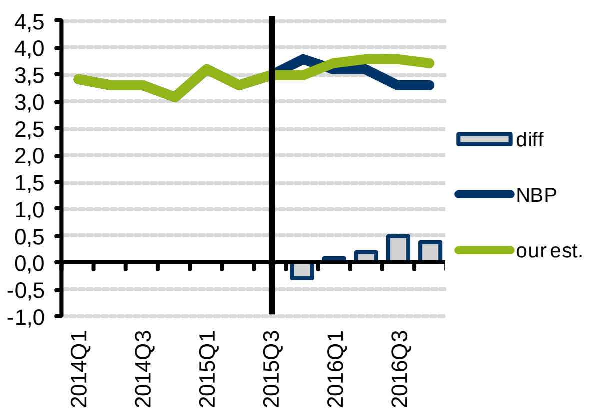
HU: GDP outlook (Y/Y, %)



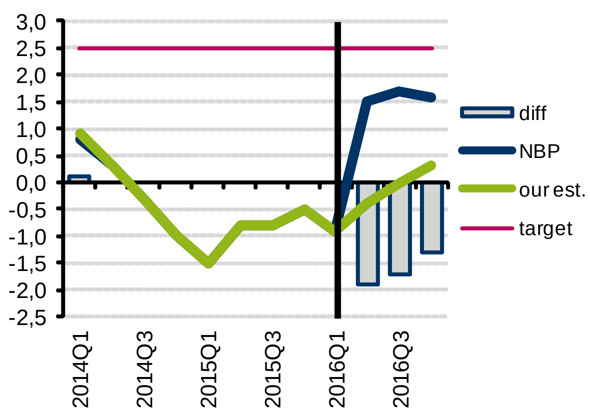
HU: Inflation outlook (Y/Y, %)



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	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	*1.00*	2.60	2.90	1.00	1.05	1.10
Poland	WIBOR	*1.68*	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	*0.70*	0.73	0.81	1.00	1.10	1.20
Hungary	HU10Y	*2.38*	4.00	4.20	3.40	3.60	3.80
Poland	PL10Y	*2.42*	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	*27.03*	27.02	27.02	27.00	26.50	26.20
Hungary	EUR/HUF	*314*	308	305	315	310	305
Poland	EUR/PLN	*4.40*	4.39	4.27	4.25	4.24	4.23

GDP (y/y)

	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Czech Rep.	2.5	2.2	2.3	2.3	2.3	2.2	2.3
Hungary	2.4	2.8	3.0	3.0	2.8	3.3	3.1
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.	0.5	0.7	1.4	1.8	1.5	1.7	1.9
Hungary	2.6	2.4	2.4	2.8	3.2	3.0	2.7
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	5.1	5.5
Poland	-1.5	-1.3

Public finance balance as % of GDP

	2016	2017
Czech Rep.	-0.8	-1.1
Hungary	-2.0	-1.7
Poland	-2.9	-3.0

Source: KBC, Bloomberg

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