Central European Weekly

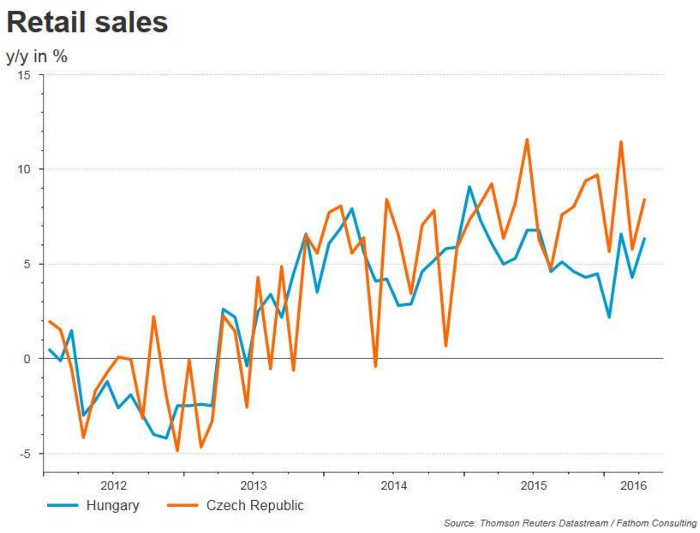
Monday, 06 June 2016

Table of contents

Weekly Highlights:

- Private consumption grow quickly in the Czech Rep. and Hungary thank to strong gains of real wages
- Poland still tries to find a solution for the forex mortgages issue
- Weekly preview: watch inflation data in Hungary and NBP rate-setting meeting

Chart of the Week: Retail sales are surging



Czech and Hungarian sales have been growing quickly this year.

Market's editorial

New proposal for Polish FX mortgages: still no big deal

Poland's latest FX mortgage solution proposal, in the form reported by Friday press, would be negative for the banking sector, but is still an mild improvement over the January proposal. In the amended bill, Poland would reportedly like to convert FX mortgage loans at the origination FX rate, but would make borrowers return gains generated to date on lower instalments resulting from lower interest rates vis-a-vis equivalent PLN loans. Apart of that, banks that would suffer losses would be able to issue shares which would be acquired by a state-owned financial institution - state-owned bank BGK or, more probably, central bank NBP. This would allow banks to eliminate the capital gap caused by the conversion. In our view the headlines of the proposed bill seems to be broadly similar to the January presidential proposal and the concept of the fair exchange rate, but there wasn't mentioned anything to the second part of the case - the potential return of spreads. If the bank were not forced to return the spreads, the impact would be smaller by some PLN 6bn compared to last proposal (approx. 3.5% of total Polish bank equity). Still, the conversion of FX loans would be negative for banks and potentially for the economy too (through pressure on lower leverage). Let us add that the presidential team will meet for the last time tomorrow, after that we will see more details.

	Last	Change 1W
EUR/CZK	27.1	0.00%
EUR/HUF	312	-0.75%
EUR/PLN	4.38	-0.33%

	Last	Change 1W
10Y CZK	0.69	-1.43
10Y HUF	2.32	-2.52
10Y PLN	2.41	0.10

Review of Economic Figures

GDP details confirms strong Czech growth in 2016Q1

The detail GDP data for the first quarter of the 2016 are borne out by the previously released flash forecast by the Statistical Office. In the first quarter of this year, the economy grew by 0.4% q/q and 3% y/y, thus confirming the expectations of the gradual disappearance of the effects that stimulated GDP last year. The completion of the absorption of money from EU Funds was probably the most evident factor; however, the creation of a very high comparative baseline in industry, which is hard to continue to increase to the same extent, was much more important – all the more so when certain segments of industry are struggling with production suspensions or strong competition from the east.

Consumption ands wages are driving the Czech economy

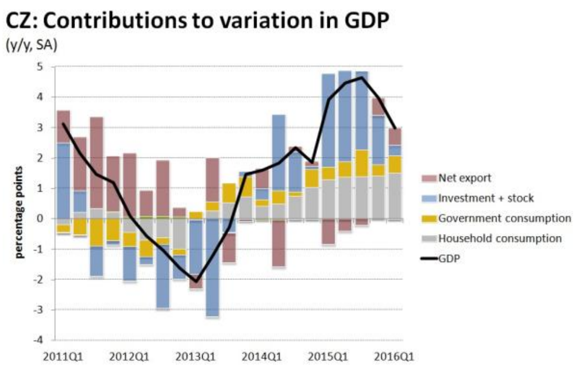
It is probably no surprise that the growth structure is changing from investment to household consumption, which is positively influenced by the decline in unemployment and real wage growth reflected in the improving financial position of households. As a matter of fact, as much as half of growth is attributable to households and their willingness to buy durable goods in particular, i.e., cars. And this is actually not at all surprising if we take into account the development of retail sales over the last twelve months. Last year's investment boom is receding, but this is happening because investments were very strong in the last two years rather than because of fear of the future that would lead to fewer investments. In addition, European money and one-off purchases of army equipment have been responsible for some recent investments. Businesses are also investing to a lesser extent, but they have substantially increased and renovated their production capacities in recent years and are slowly starting to face a lack of skilled workforce.

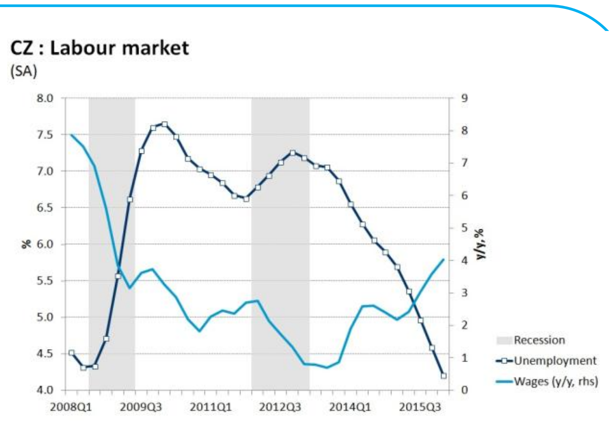
That is why they have to increase wages and salaries as it wa confirmend by wage statistics for the firts quarter. According to this report Czech real wages grew strongly by 3.9% y/y in the first quarter, which is clear evidence that the economy is doing pretty well. Such a strong growth should also satisfy the CNB, which had expected even slightly lower wage growth. Hence, the need for relax monetary policy is definitely lower now, because the wage-inflation is finally back in the Czech economy.

Robust retail sales point to solid growth in Hungary

Private consumption still grows very strongly in Hungary Calendar adjusted retail sales figure was up by 6.4% Y/Y in April vs. 4.3% Y/Y in March. The main driver of the growth was the non-food products consumption, which increased by 10.3% Y/Y. The food retail sales grew by 3.9% Y/Y, which is above the YTD average level. The fuel consumption continued its moderation as it was up by only 3.5% Y/Y in April vs. 5% Y/Y in March and 9.1% Y/Y in February. The reason behind the slowdown is the high base and the increasing fuel prices.

The figure fits into our picture that the 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. The continuously strong 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.





Weekly preview

TUE 9:00 **CZ Industry (y/y change in %)**

	Apr-16	Mar-16	Apr-15
Monhtly	**2.4**	0.6	4.5
cummulative (YTD)	**2.4**	2.4	4.7

CZ: Industrial growth is still driven by carmakers

Inflation may at last slightly recover for the first time after spending several months close to zero. It should be encouraged, in particular, by an increase in food prices at the beginning, a rise in certain housing-related costs, and clearly also by the seasonal increase in package tour prices. Inflation will be curbed by fuel prices – just as in late 2015. We believe that month-on-month as well as year-on-year inflation may reach approximately 0.6%, i.e., just 0.1% below the Czech National Bank's forecast. Apart from these factors, which depict month-on-month price developments, we expect the effect of a low comparative baseline to be evident this year. Even so, we do not expect inflation – whether headline inflation, monetary policy inflation or even what is known as core inflation – to reach the CNB's 2% target.

WED 9:00 **HU Inflation (change in %)**

	May-16	Apr-15	May-15
CPI y/y	**0.2**	0.2	0.5

HU: Annual inflation flat thanks to a base effect

The fuel price increased further in May thanks to the global price of oil and the strengthening USD. Additionally the weather was bad in April causing freeze in Agriculture so there might be a surprise price jump in case of local fruits. The relatively strong domestic consumption may push market services prices, while the weak HUF the tradable goods prices slightly up in May. On the other hand the base effect works against the accelerating inflation so we expect that the consumer price may remain roughly unchanged at 0.2% Y/Y like in April.

WED 14:00 **NBP rate (in %)**

	This	Last change
rate level	**1.50**	3/2015
change in bps	**0**	-50

PL: Rate stability still proffered

NBP President Belka, whose term of office is drawing to a close, has made it clear several times that the National Bank of Poland prefers interest rate stability notwithstanding a negative inflation rate. Besides, the NBP sees the Brexit referendum in the United Kingdom (June 23) as a great risk, which is another reason for not changing the monetary policy in Poland.

THU 9:00 **CZ Inflation (change in %)**

	May-16	Apr-16	May-15
CPI m/m	**0.1**	0.6	0.3
CPI y/y	**0.3**	0.6	0.7
Monetary relevant inflation y/y	**0.2**	0.4	0.5

CZ: A temporary inflation fall

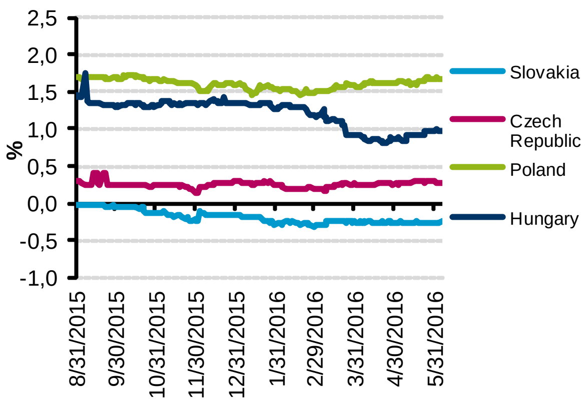
After its previous surprisingly higher growth, inflation may again fall slightly for a while. Its anticipated year-on-year decline is attributable to last year's higher comparative baseline. Nevertheless, we do not believe that this inflation fall will take too long. Prices will start to reflect – to a greater extent – the increases in fuel prices in the wake of the rising oil prices on global markets, which – along with the rising prices of services – will push inflation to the vicinity of 1% in the autumn. Even so, the inflation target cannot be hit before 2017.

Calendar

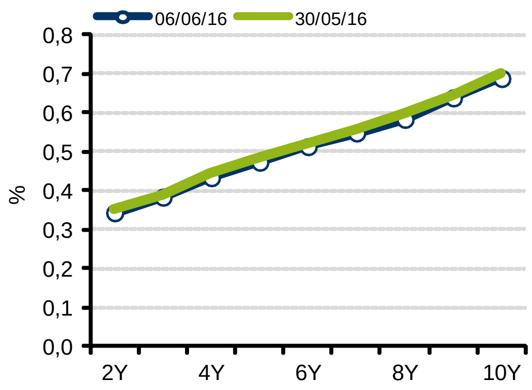
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	06/06/2016	9:00	Real wages	%	1Q/2016		3.8		3.8		3.8
CZ	06/06/2016	9:00	Retail sales	%	04/2016		6		6.4		5
CZ	06/07/2016	9:00	Trade balance (national)	CZK B	04/2016	20		18.9		21.7	
CZ	06/07/2016	9:00	Construction output	%	04/2016						-12.5
CZ	06/07/2016	9:00	Industrial output	%	04/2016		2.4		4		0.6
HU	06/07/2016	9:00	Industrial output	%	04/2016				0.7	-1.1	-2.4
HU	06/07/2016	9:00	GDP	%	1Q/2016 *F					-0.8	0.9
HU	06/07/2016	16:00	Budget balance	HUF B	05/2016					-144.9	
CZ	06/08/2016	9:00	Unemployment rate 15-64	%	05/2016	5.4		5.4		5.7	
HU	06/08/2016	9:00	CPI	%	05/2016		0.2	0.6	0.1	0.8	0.2
HU	06/08/2016	9:00	Trade balance	EUR M	04/2016 *P			525		952	
PL	06/08/2016	14:00	NBP meeting	%	06/2016	1.5		1.5		1.5	
CZ	06/09/2016	9:00	CPI	%	05/2016	0.1	0.3	0.1	0.4	0.6	0.6

Fixed-income in Charts

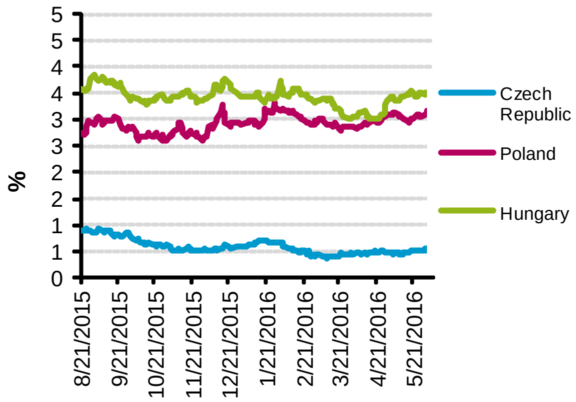
FRA 3x6



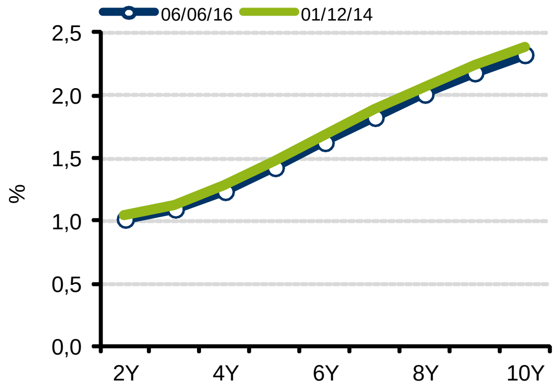
CZ IRS



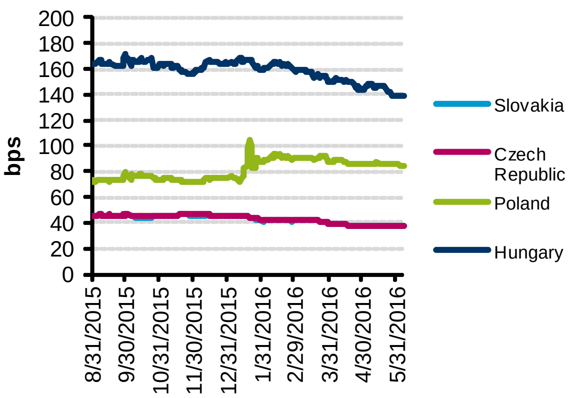
10Y GB Yields



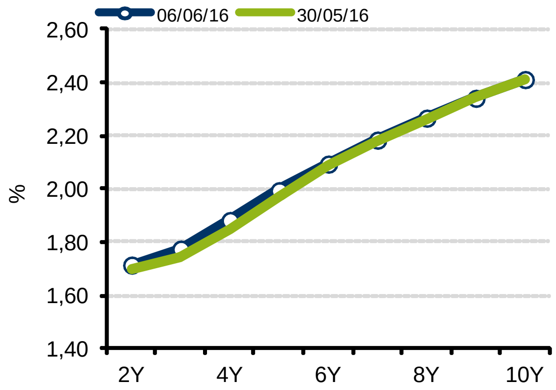
HU IRS



CDS 5Y



PL IRS



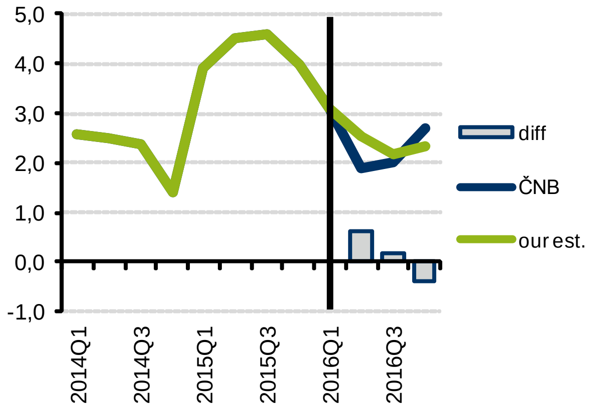
Source: Reuters

Medium-term Views & Issues

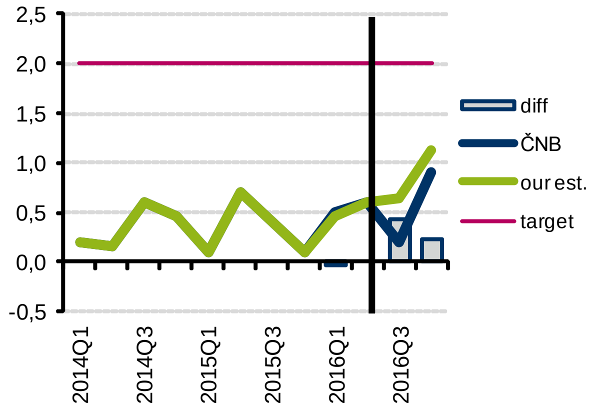
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption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

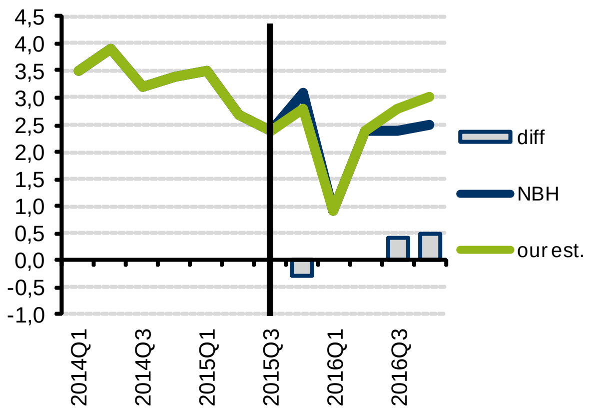
CZ: GDP outlook (Y/Y, %)



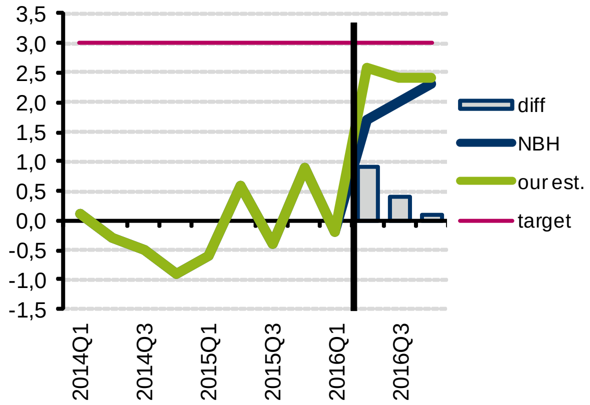
CZ: Inflation outlook (Y/Y, %)



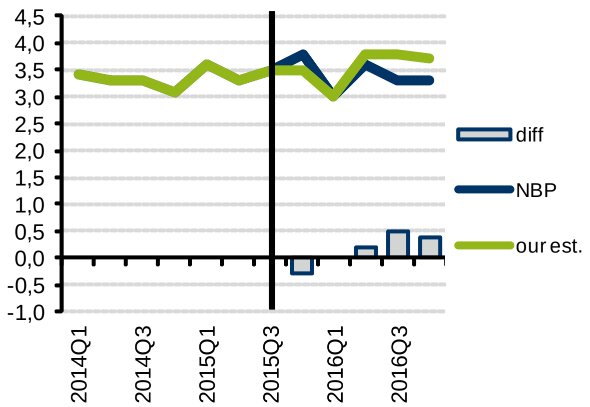
HU: GDP outlook (Y/Y, %)



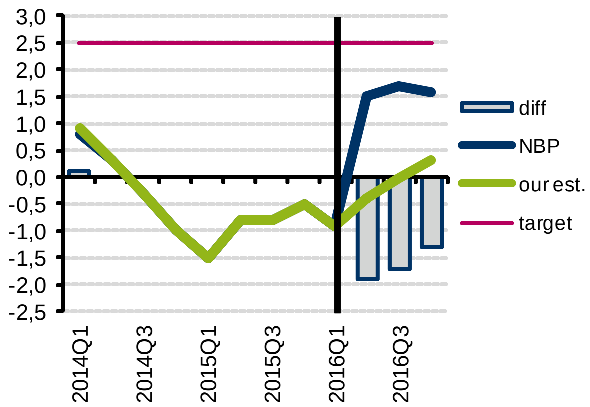
HU: Inflation outlook (Y/Y, %)



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	*1.02*	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	*0.69*	0.73	0.81	1.00	1.10	1.20
Hungary	HU10Y	*2.32*	4.00	4.20	3.40	3.60	3.80
Poland	PL10Y	*2.41*	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	*27.06*	27.02	27.02	27.00	26.50	26.20
Hungary	EUR/HUF	*312*	308	305	315	310	305
Poland	EUR/PLN	*4.38*	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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