Central European Weekly

Monday, 30 June 2014

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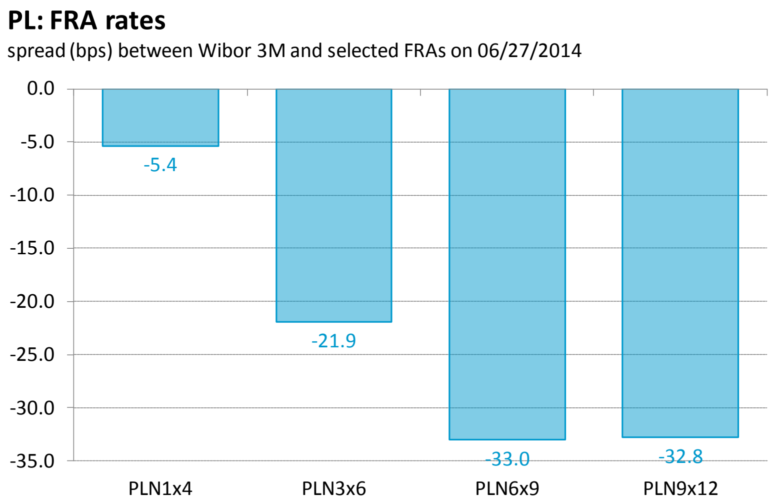
Chart of the Week: Rate bets in Poland



Markets bet on an interest rate cut in Poland in a three months horizon... (Source: Bloomberg, CSOB)

Market's editorial

The wiretapping affair is gone but the NBP continues to grab the spotlight

Last week's most interesting events were likely those in Poland, where the affair concerning recordings made of conversations among leading politicians and other top representatives of the country continued to prevail. While the most recently published recordings have not directly applied to economic topics (they mostly included conversations involving Foreign Minister Sikorski), they still had an evident impact on markets. The increasing media pressure even made Prime Minister Tusk ask the deputies of the Lower House of Polish Parliament (Sejm) for a vote of confidence in the government. Nevertheless, this sprang no surprise and the government won the vote, meaning that the immediate risk to the country's political stability has probably disappeared. Thus, in the weeks or months to come, markets will again primarily focus on whether the central bank will proceed to cut its official interest rates.

The CNB postpones the departure from its FX regime

Nonetheless, Poland is not the only country in the region where the central bank is exposed to increasing pressure to ease its monetary policy even more. Last week, the Czech National Bank sent a signal that we had anticipated – the departure from its current exchange rate regime was postponed from the originally intended date (early 2015). Naturally, the exchange rate of the koruna against the euro (above the EUR/CZK level) and, of course, interest rates will remain at their current levels until at least early in the second quarter of next year. In addition, Governor Singer admitted that, mainly with regard to downside inflationary pressures abroad, the status quo of the exchange rate and monetary policy might be extended beyond the above-mentioned date. The next CNB Board meeting (August 31) will certainly tell us more about a more precise timing of the 'departure'; a new forecast will be on the agenda and the CNB Board will have to take a position on the postponement of the departure from its exchange rate regime. With inflationary pressures in the euro area still negligible and unlikely to be surmounted soon by the ECB's latest moves, there is a risk that the departure from the intervention regime may be postponed by a few quarters: at the moment, the question is as to how many – we continue to stick to the timing of the departure for the summer of 2015, but the macroeconomic (inflation) reality is increasing the likelihood that it will be later.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.5	0.00%	➔	➔
EUR/HUF	310	1.42%	➚	➘
EUR/PLN	4.16	-0.18%	➚	➘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.36	-5.88	➚	➚
10Y HUF	3.79	-8.23	➚	➚
10Y PLN	3.39	-4.23	➚	➚

Review of Economic Figures

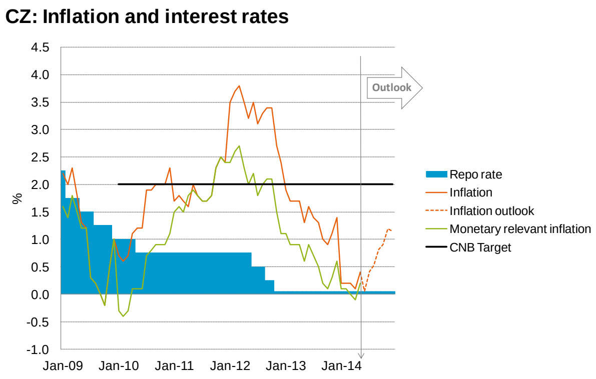
CNB postpones the departure from its exchange rate regime

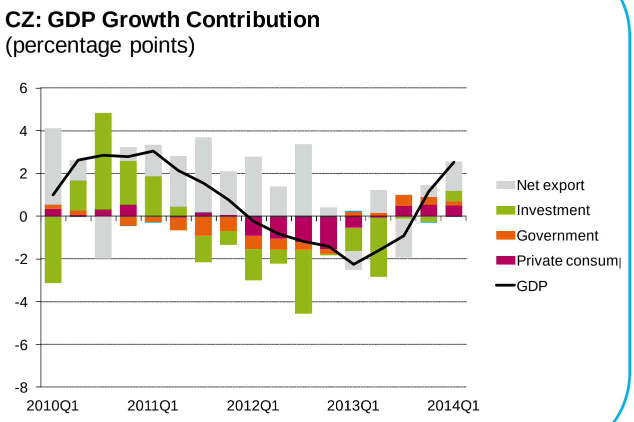
In line with expectations, the CNB Board made it clear that it would leave its existing exchange rate regime later than has been indicated thus far in the current forecast, which still applies. The statement from June's CNB Board meeting indicated that the CNB "…would not discontinue the use of the exchange rate as a monetary policy instrument before Q2 2015, and it did not rule out a further shift of the exit from this regime" (see the CNB Board's statement at the press conference after the end of its monetary policy meeting). This is no shocking change, as the previously stated first quarter of next year seemed to be too early to leave the exchange rate regime in any event. Moreover, the exit – at least according to the forecast – should be accompanied by a significant rise in market interest rates. Both seemed unlikely.

The CNB Board questions the forecast again

CNB leaders again assessed the risks of the current inflation forecast as being slightly on the downside, because inflation still falls behind the projected level, mainly as a result of slower increases in food prices and, after all, also because of a better development of consumer prices abroad. In addition, it will also be more difficult for inflation to return to its target level. Given the planned changes to regulated and administratively set prices, inflation will head towards the 2% level much more slowly. Moreover, we believe that inflation will also be curbed by another decline in energy prices, which is likely to occur early next year. Furthermore, this outlook is encouraged by weaker inflationary pressures abroad. Nonetheless, not even a slower inflation rise has made the central bank entirely seriously consider a further weakening of the koruna thus far. For this to happen, the CNB Board would need to find "a much more pronounced increase in anti-inflationary risks". This is why we do not see the possibility of a change to the current intervention level of EUR/CZK 27 as too realistic either.

While inflation is still unable to jump towards the forecast, not to mention the target, the real economy is tending to develop in accordance with central bank's expectations. What is more, certain areas of the economy even stand a good chance of surpassing the CNB's expectations. Thus the real economy is somewhat counterbalancing insufficient inflation, which troubles the central bank. We primarily mean favourable labour market trends, which are important for household consumption in particular.





Weekly preview

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

	This	Last change
rate level	**2.50**	7/2013
change in bps	**0**	-25

PL: NBP will not cut rates but may sound dovish

Even though the macroeconomic statistics (retail, industry) for May that were released in the last two weeks lagged behind expectations and Poland's inflation rate is likely to fall below zero during the summer, the National Bank of Poland should leave rates unchanged at its early July meeting. This meeting will be more interesting than those of previous months, because a new forecast will be available to the bank, which will have to significantly re-evaluate its inflation prediction downwards in that forecast. The question still is the bank's outlook for economic growth in the second quarter, notably in light of the latest statistics. Nevertheless, we still believe that the chances of a rate cut in July are small and if the bank eventually decided to cut interest rates, September meeting, when the GDP data for the second quarter is available, is far more likely timing. More details on a possible autumn rate cut, which we however still see as rather unlikely, will be hinted at in the new forecast, the accompanying comments from the NBP, and in the macroeconomic figures to be released during the summer.

FRI 9:00 **CZ Retail Sales (change in %)**

	May-14	Apr-14	May-13
Sales	**2.0**	6.0	1.5
cummulative (YTD)	**5.5**	6.5	-0.8

CZ: Deceleration of car sales reduces retail sales

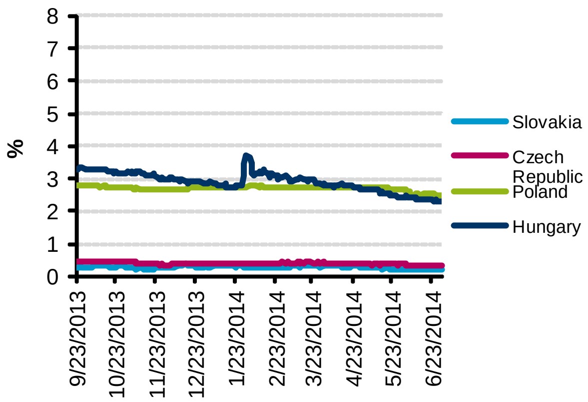
To date, Czech retail sales have been primarily driven upwards by the sales of new cars. However, this trend should slowly change, as also indicated by registrations of new vehicles in the domestic market. Hence we might see the double-digit increases in car sales slowly become a thing of the past, with sales outside the automotive segment to become the primary driver again. Moreover, there was one less business day in May, and this must have influenced the overall figure to the extent of approximately 1%. After the automotive surge (partly influenced by re-exports of vehicles through showrooms) fades away, signals from the retail sector may become closer to the reality of the Czech consumer.

Calendar

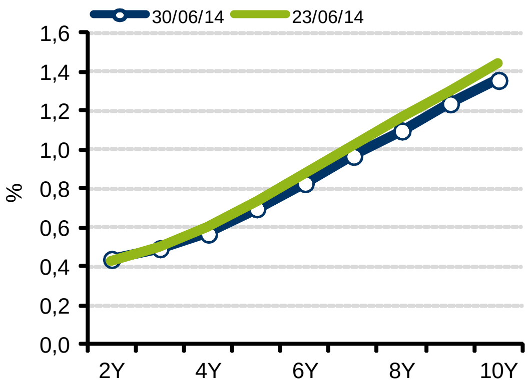
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	06/30/2014	9:00	PPI	%	05/2014				-0.7	-0.8	-1.5
CZ	06/30/2014	10:00	Money supply M2	%	05/2014						4.8
PL	06/30/2014	14:00	Current account	EUR M	1Q/2014			-771		-1071	
CZ	07/01/2014	9:00	GDP	%	1Q/2014 *F					0.4	2.5
HU	07/01/2014	9:00	PMI manufacturing		06/2014					53.9	
PL	07/01/2014	9:00	PMI manufacturing		06/2014			51.1		50.8	
CZ	07/01/2014	9:30	PMI manufacturing		06/2014			56.2		57.3	
CZ	07/01/2014	14:00	Budget balance	CZK B	06/2014					-9.5	
PL	07/02/2014	14:00	NBP meeting	%	07/2014	2.5		2.5		2.5	
HU	07/03/2014	9:00	Retail sales	%	05/2014				6.5		6.6
HU	07/03/2014	9:00	Trade balance	EUR M	04/2014 *F					625.3	
CZ	07/04/2014	9:00	Retail sales	%	05/2014		2		3.1		6
HU	07/04/2014	9:00	Industrial output	%	05/2014 *P				11.1	2.4	10.1

Fixed-income in Charts

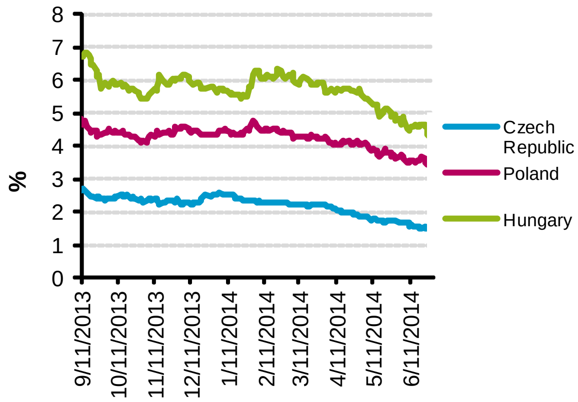
FRA 3x6



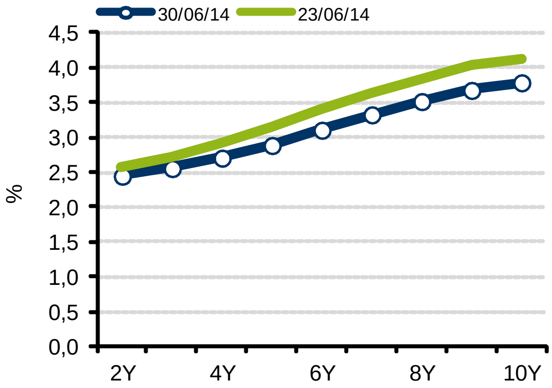
CZ IRS



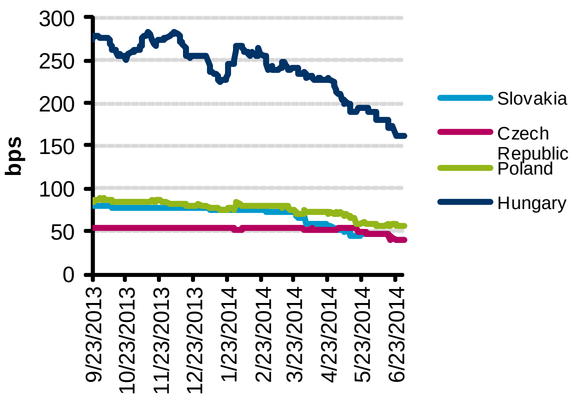
10Y GB Yields



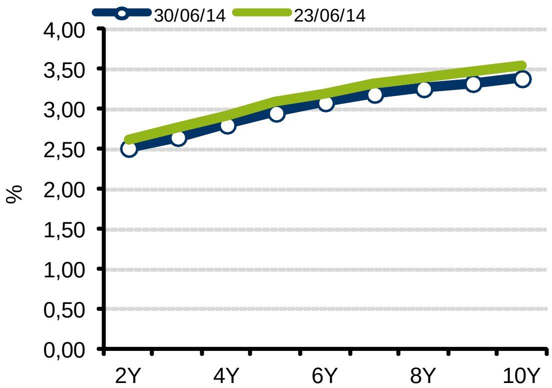
HU IRS



CDS 5Y



PL IRS



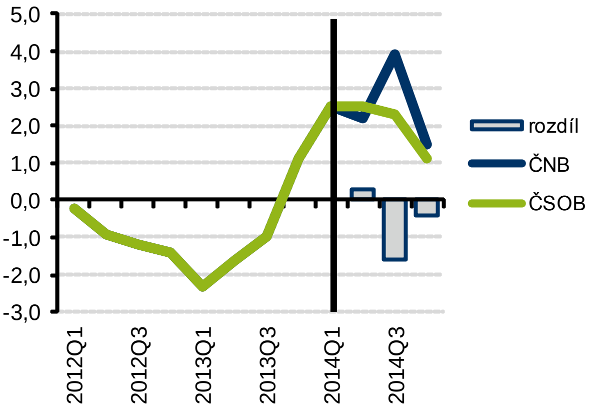
Source: Reuters

Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	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.	Based on the first quarter figure and the recent trends in the economy, Hungary's GDP may grow above 2.5% Y/Y in 2014 and it cannot be excluded that the growth might be close to 3% Y/Y level. The low base supports this economic growth level in short term, but without a substantial rise of investments in the private sector this year, economy may slow down to around 2% Y/Y level in 2015. On the other hand, in spite of growing domestic demand, inflation appears well anchored and inflationary expectations stick close to 3 %. Moreover, as this year's harvest may be good, food processing industry hardly escalates price pressures in the economy.	According to the GUS estimates the Polish economy grew by 3.4% in 2014Q1. For this year, the growth should significantly exceed 3%. Household consumption should support growth, owing to the improving labor market situation as well as to low inflation. Investment should also develop favorably, owing to the replenishment of inventories as well as to gross capital formation In addition, lower government debt could also give a greater lift to the economy. By contrast, net exports are likely to curb rather than boost growth, especially in view of recent crisis in Ukraine.
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 CZK 27 per EUR. 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 (not before the second half of 2015), and that the move will certainly not be accompanied by a rise in interest rates, as suggested by the official forecast.	The NBH Monetary Council envisaged further cautious rate cuts considering the country's CPI outlook, risk premium, expected GDP growth and narrowing of the output gap. However the Council emphasized that the base rate is substantially close to a level that ensures the middle term inflation target (3%). Based on that, we may make new conclusions about the bottom of the rate cut cycle. The latest available figures and information suggest that the MPC might cut the base rate two more times by 10bp in which case the easing cycle ends at 2.2%. We expect that the NBH may increase the base rate in 2015 after Fed fully reduces its asset purchases. Worsening of the currently high risk appetite of the markets may induce a Hungarian rate hike as well.	Inflation pressures in Poland remain subdued and year-on-year prices growth is seen well below the lower tolerance band of the inflation target. Although the recent development has supported our bets on faster economic recovery in Poland, outlook for persistently low inflation should play in favor of stable official interest rates in the rest of this year. The main risk in this regard stems from the ECB MP easing and its possible impact on the zloty exchange rate. If the zloty continued to strengthen, it would not be welcome news for the NBP, especially with inflation hovering well-below the target and risk of slower growth due to Ukraine.
Forex Outlook	The CNB has started FX interventions and we expect the koruna to stay within the regime at least till the mid 2015. Hence the currency should stay above 27.00 EUR/CZK at least in 12-month horizon. When the FX targeting regime is set to be abandoned, the CNB will have to intervene on the market much more aggressively to stop the spot koruna from appreciation. As a side effect, the forward koruna can appreciate significantly before the regime is abandoned.	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.	Low inflation pressures and improving prospects of the economy may support the zloty in months ahead. Albeit we expect only gradual strengthening against the euro, the Polish currency might perform well against the koruna as the room for koruna's appreciation remains virtually closed and the economic recovery in Poland is likely to continue at faster pace. The main risk as regards the zloty is the ECB decision to ease MP which could further support the currency.

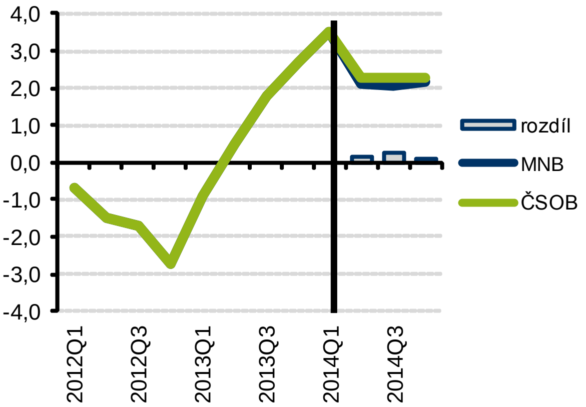
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)



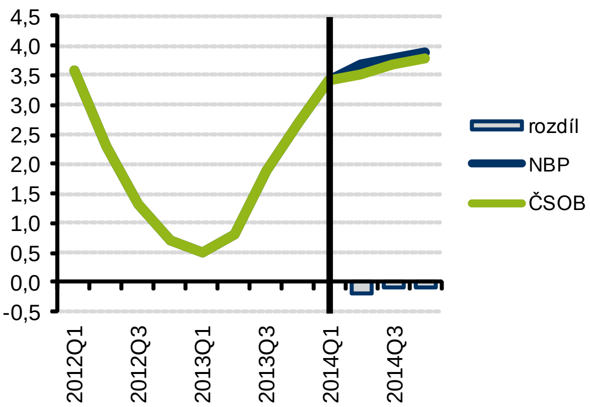
CZ: Inflation outlook (Y/Y, %)

HU: GDP outlook (Y/Y, %)

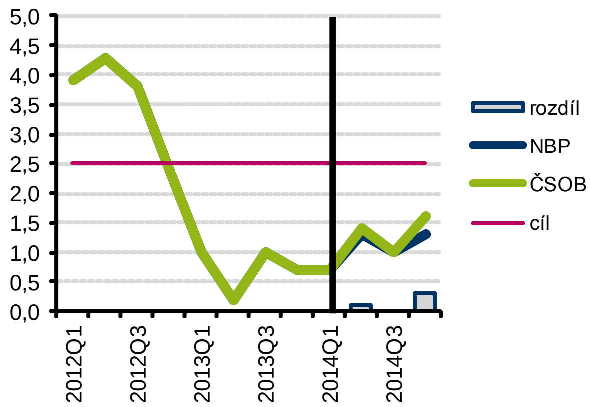


HU: Inflation outlook (Y/Y, %)

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	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	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.	*2.30*	3.00	2.60	2.50	2.50	2.50	-15 bps	6/24/2014
Poland	2W inter. rate	*2.50*	2.50	2.50	2.50	2.50	2.75	-25 bps	7/3/2013

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

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	PRIBOR	*0.35*	0.38	0.37	0.36	0.36	0.36
Hungary	BUBOR	*2.35*	2.99	2.67	2.50	2.50	2.50
Poland	WIBOR	*2.68*	2.71	2.71	2.75	2.75	3.00

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

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	CZ10Y	*1.36*	2.09	1.84	1.55	1.70	1.85
Hungary	HU10Y	*3.79*	5.25	4.95	5.00	5.30	5.70
Poland	PL10Y	*3.39*	4.25	4.03	4.10	4.45	4.70

Exchange rates (end of the period)

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	EUR/CZK	*27.5*	27.3	27.4	27.2	27.2	27.2
Hungary	EUR/HUF	*310*	297	307	305	298	295
Poland	EUR/PLN	*4.16*	4.16	4.17	4.16	4.15	4.09

GDP (y/y)

	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	-1.6	-1.0	1.1	2.5	2.5	2.3	1.1
Hungary	0.5	1.8	2.7	3.5	2.3	2.3	2.3
Poland	0.8	1.9	2.7	3.4	3.5	3.7	3.8

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

	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	1.6	1.0	1.4	0.2	0.2	0.9	1.5
Hungary	1.9	1.4	0.4	0.1	0.6	0.7	0.8
Poland	0.2	1.0	0.7	0.7	1.4	1.0	1.6

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.	-1.5	-2.5
Hungary	-2.7	-3.0
Poland	-4.4	-3.5

Source: CSOB, Bloomberg

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