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Central European Weekly

Monday, 13 April 2015

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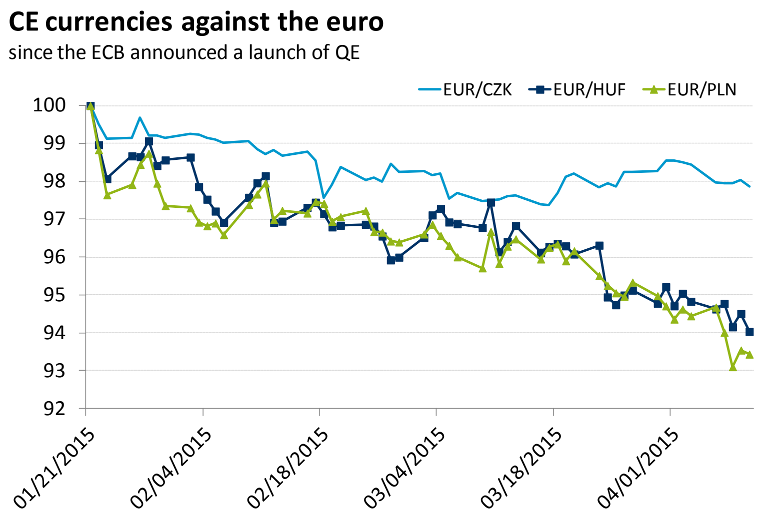
Weekly Highlights:

- GDP upward revision are looming in the Czech Republic and Hungary after February's data show
- Czech and Hungarian inflation tick higher in March
- NBP will stay on hold, but markets eye Belka's comments related to strong zloty.

Chart of the Week: CE currencies v. €uro



The CE currencies have strengthened significantly against the euro since the ECB announced its QE programme in January...
(Source: Bloomberg, CSOB)

Market's editorial

Regional currencies are riding on a bullish wave

Central European currencies have remained in a bullish bullish mode. Last week the Hungarian forint reached its strongest levels since the end of 2014 and the Polish zloty was testing the EUR/PLN 4.00 level, which is actually close to its four-year highs. One of the reasons for this is the positive Central European macroeconomic figures – the economies are going to perform decently this year (2-3%) and the balance with the rest of the world (for Hungary in particular) has improved significantly in the past years (see the next page). Another factor, which is no less important, is the ongoing quantitative easing in the euro area and the policy of negative interest rates at most European central banks (Switzerland, Sweden, Denmark, as well as the euro area). Given such an environment, any positive yield strongly attracts cash into the region.

Strong HUF and PLN make life harder for NHB and NBP

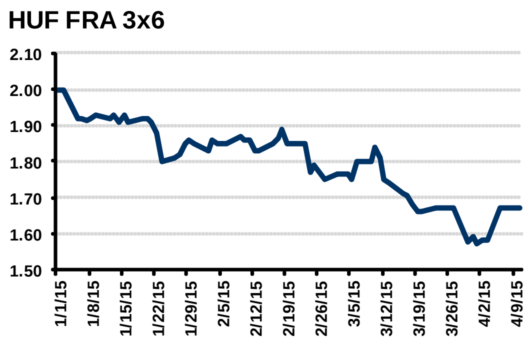
In the Hungarian case - the market alerady knows that the NBH was not happy with EUR/HUF levels below 300, so the current strong level of exchange rate increases the chance even of a rate cut of 25bp from 1.95% to 1.70% on 21 April, despite strictly the inflationary and economic developments may not call for such a massive rate cut. So, it looks like now that the market tries to force the NBH into a more aggressive rate cut cycle than it needed from a fundamental perspective.

However, the first confrontation between strong currency and central bank's policy targets might be felt in Poland already this week as the NBP holds its interest-rate settoing meeting.

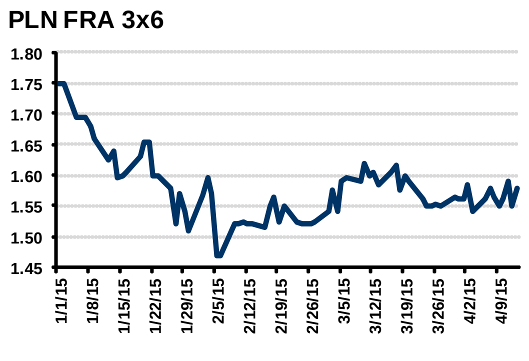
As markets generally expect rate stability, most attention will be paid to the subsequent press conference. Let us recall that since the rate cut by 50 bps early in March, the NBP has declared itself strongly committed not to go with interest rates further down in the following months. The commitment belongs, in our view, among key factors responsible for recent appreciation of the zloty. It will be interesting to hear if and how the NBP comments on the zloty, whose appreciation not only further suppresses inflation (CPI for March will be released next Wednesday, too) but it could also lower inflation expectations. From this perspective, it will not be much surprising, if some form of verbal intervention against the strong zloty happens on Wednesday.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.4	-0.36%	→	→
EUR/HUF	297	-0.74%	→	→
EUR/PLN	4.02	-1.57%	→	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	0.59	-6.35	→	↘
10Y HUF	2.64	-2.58	↘	↘
10Y PLN	2.07	-1.08	→	↘



HUF FRA 3x6, last 72 days. Source: Reuters



PLN FRA 3x6, last 75 days. Source: Reuters

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Review of Economic Figures

Upward Czech and Hungary's GDP revisons are in the cards

The series of excellent figures from the Czech industry was extended in February, when production in the most important Czech sector grew by 4.5% y/y. In addition, the strong growth in orders also suggests very decent figures for the months to come. It is probably no surprise that the strong industrial growth has been primarily driven by car production. This has already been a trend persisting there for two years. Carmakers are driving the entire sector, thanks to the improving European demand for new cars, and are encouraging this trend through their strong innovation efforts. By contrast, the decline in the mining industry, which has also become typical, is no surprise either. In addition to strong growth in production, growing orders are more good news. The 10% increase in orders also holds hopes for very good performance from industry in the months to come. For carmakers alone this increase exceeds 20% and hence this year may see another new record after the record-breaking 2014.

The positive performance of the Czech industry is also continuing to improve demand for new staff. Thus industry continues to be the greatest contributor to the improving situation on the domestic labour market. Nonetheless, not even the growing employment in this sector is significantly increasing wage pressures, and thus wage growth remains very moderate there. New data from industry suggest that industry will still drive the economy this year. This is one of the reasons why we will probably have to revise our GDP growth prediction for this year from the current 2% by a few tenths upwards.

In **Hungary, the working day adjusted industrial production increased by 5.8% Y/Y** in February, slightly down from the January 7.7% Y/Y growth level, but it was in line with our expectation and confirms our view the industrial output may be up by around 6% Y/Y in 2015.

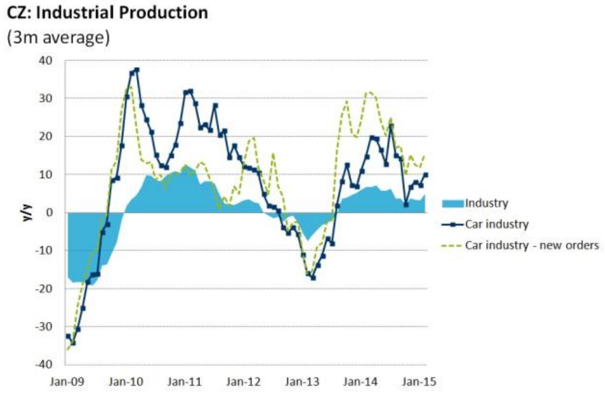
Taking into account strong retail sales (and households consumption) and the industrial sector (driven by exports) we believe that the Hungarian GDP growth might be around 4% Y/Y in 1Q15.

Inflation speeds up slightly in Hungary and Czech Republic

Lots of macro figures were published **last week in Hungary, but the main surprise came from inflation.** consumer price index decreased only by 0.6% Y/Y in March up from -1% Y/Y in February. Interestingly, the increasing domestic consumption is reflected in the rising tradable goods and market services prices (up by 0.3% M/M and 0.2% M/M respectively). The above mentioned figures confirm our view that CPI may increase further in the coming months and may step back into the positive territory in August, while it may accelerate above 2% Y/Y in December, which is already in the tolerance range of NBH's inflation target of 3% +/-1%pt.

The **Czech consumer price index** rose by 0.1% last month, mainly as a result of an increase in cigarette excise duties and a moderate increase in fuel prices. Year-on-year inflation also rose by 0.1% to 0.2%. Completely unsurprisingly the CPI went up in March and thus the Czech Republic again avoided 'deflation', or negative inflation. The main contributors to inflation growth included cigarettes – the prices of which had already grown in February – and fuels. The reason is that the recent increase in global oil prices has started to influence petrol and diesel prices, thus slightly offsetting the previous dramatic slump in those prices. Even so, fuel prices are much lower than last year, thus positively contributing to the improving real financial position of businesses as well as households. Prices are obviously growing only as concerns cigarettes and alcohol and, above all, clothing and shoes, which are still affected by the weak koruna because of the country's dependence on the imports of those goods. By contrast, food prices are declining and, notwithstanding the exchange rate of the koruna against the dollar, prices of imported electronics have also been falling over the long term. Inflation for March slightly exceeded the CNB's forecast, which envisaged CPI growth of only 0.1%. Inflation will remain at much the same level for the next few months..

Source: Thomson Reuters Datastream / Fathom Consulting



Weekly preview

FRI 14:00 — PL Inflation (change in %)

	Mar-15	Feb-15	Mar-14
CPI y/y	**-1.5**	-1.6	0.7

PL: Deflation persists

After greater than expected slumps in Polish prices in both January and February we expect the Polish economy to remain in deflation and the trend not to change significantly in March. According to our forecasts, prices of consumer goods fell by 1.5% y/y, which would mean a month-on-month rise by 0.2%. Just as in previous periods, the price fall was attributable to low oil prices as well as the high comparative baseline of food prices after last year's good harvest. Not even the current appreciation of the zloty is helping to mitigate deflationary pressures in the Polish economy.

WED 14:00 — NBP rate (in %)

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

PL: NBP - no changes at the moment

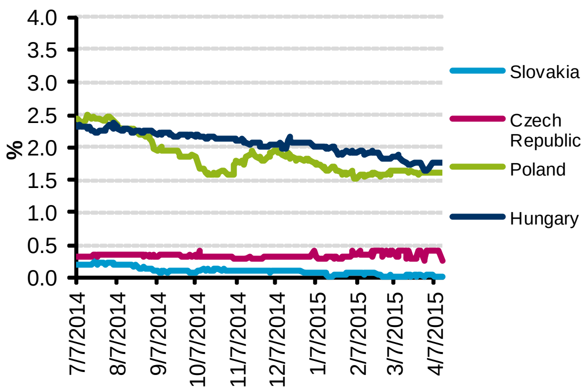
The National Bank of Poland is likely to leave rates unchanged at its April meeting. After the last forecast, released in March, Governor Belka made it clear that monetary easing is over. However, the zloty has strengthened quite significantly since. The question is whether the NBP, if facing a significant inflow of funds from abroad, will change its mind in the end – the strong zloty may continue to keep the economy in deflation (we anticipate -1.5% y/y in March) and drive inflation expectations downwards. Therefore we cannot rule out another rate cut in the next

Calendar

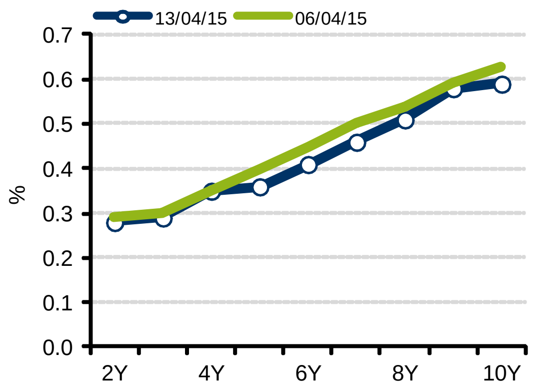
Country	Date	Time	Indicator		Period	Forecast m/m	Forecast y/y	Consensus m/m	Consensus y/y	Previous m/m	Previous y/y
CZ	04/13/2015	10:00	Current account	CZK B	02/2015	25		25		33.58	
PL	04/13/2015	14:00	Current account	EUR M	02/2015			142		56	
PL	04/13/2015	14:00	Trade balance	EUR M	02/2015			753		1021	
PL	04/14/2015	14:00	Money supply M3	%	03/2015			1	8.5	0.8	8.8
PL	04/15/2015	14:00	CPI	%	03/2015	0.2	-1.5	0.3	-1.3	-0.1	-1.6
PL	04/15/2015	14:00	NBP meeting	%	04/2015	1.5		1.5		1.5	
PL	04/15/2015	15:00	Budget balance	PLN M	03/2015					-11331	
PL	04/16/2015	14:00	Core CPI	%	03/2015			0.2	0.4	0	0.4
CZ	04/17/2015	9:00	PPI	%	03/2015	0.2	-3.3	0.1	-3.3	-0.1	-3.6
PL	04/17/2015	14:00	Wages	%	03/2015			4.3	3.4	1	3.2

Fixed-income in Charts

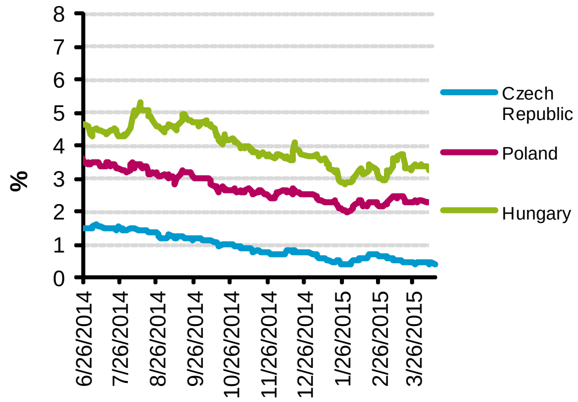
FRA 3x6



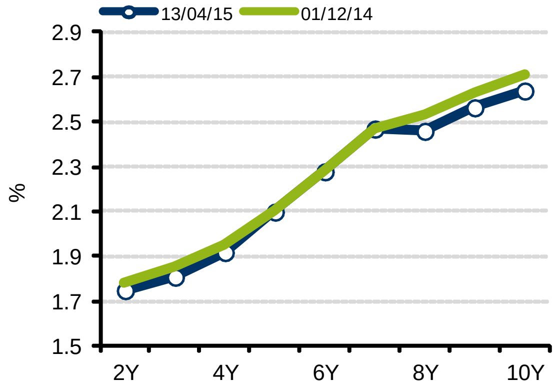
CZ IRS



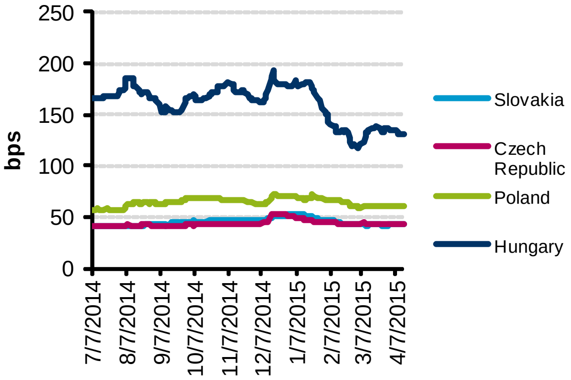
10Y GB Yields



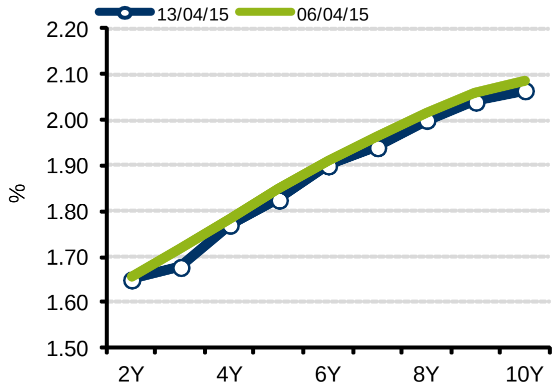
HU IRS



CDS 5Y



PL IRS



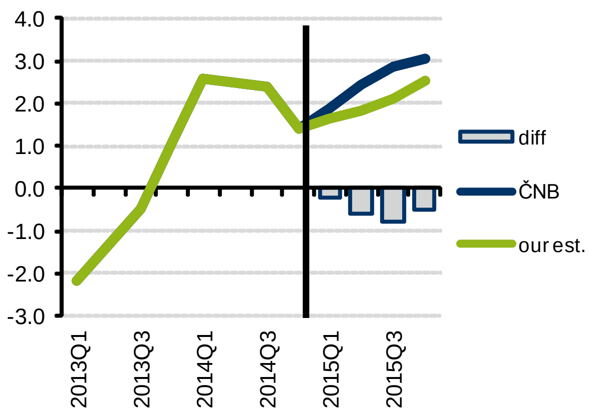
Source: Reuters

Medium-term Views & Issues

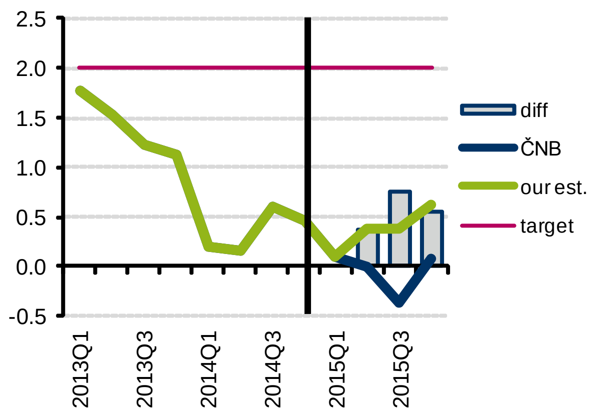
	The Czech Republic	Hungary	Poland
Growth & key issues	The current economic recovery is primarily based on the outstanding performance of the automotive industry on the one hand and restored investment and consumption growth on the other. Economic growth has also been encouraged by the deficit financing of the public sector, which is, however, generating no pressures on the capital market thanks to fairly low debt and reserves. The government policy has not delivered any fundamental economic changes so far, perhaps except for the planned abolition of the pension reform and partial modifications of certain taxes and social security benefits. The issue of euro adoption is still on ice in the CR.	Hungary's economy may slow down, but probably less than previously expected thanks to the improving international environment and the stable and strong domestic demand. So economy may grow around 2.5% y/y in 2015 and now we see rather positive risk in this forecast. We recognized in the last couple of months that exchange rate has very low effect on the inflation, so the NBH cannot easily accelerate the CPI with the depreciation of the currency. We see this year's inflation around 0% Y/Y, but CPI may be around 2% Y/Y in December.	According to the GUS estimates, the Polish economy grew by 3.1% in 2014Q4 and by 3.3% in whole year. As in previous quarters, economic growth was driven mainly by strong domestic demand. Particularly encouraging was a high contribution of investment to economic growth. As for this year, we expect economic growth to slow down slightly below 3%.
Outlook for official & market rates	Interest rates remain at all-time lows and, given the positive inflation outlook, the CNB is unlikely to raise its base rate before 2017. In addition, the central bank will not proceed to such a move before it abandons its current exchange rate policy, which is based on maintaining the exchange rate above the EUR/CZK floor. Moreover, the decreasing inflationary expectations may even delay these two steps. This possibility is reflected by money market rates and, in particular, by IRS and government bond yields. Our outlook for inflation as well as short-term interest rates is still below the central bank's official forecasts.	The march rate cut form the NBH (by 15 bps) confirms our view that mainly the international environment may lead the next months' decisions, and the council may move with 10bp steps in the following months. We see relatively high chance for cuts in April and May, so the base rate might be moderated to 1.75% at the end of May.	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.
Forex Outlook	We believe a hike of EUR/CZK floor is still unlikely.. This would require deterioration of currently positive economic outlook. On the other hand the, the more aggressive verbal interventions may keep the Czech koruna on the defensive for a while. Hence it is probable that the pair forgets about testing the 27 EUR/CZK for now. Fundamentally, the Czech currency should be more sensitive to readings of major Czech macroeconomic indicators – inflation, wages, industry and, of course, GDP. The koruna may get more nervous ahead of May's CNB Board meeting, where a new inflation forecast will be submitted.	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.	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.

CBs' Projections vs. Our Forecasts

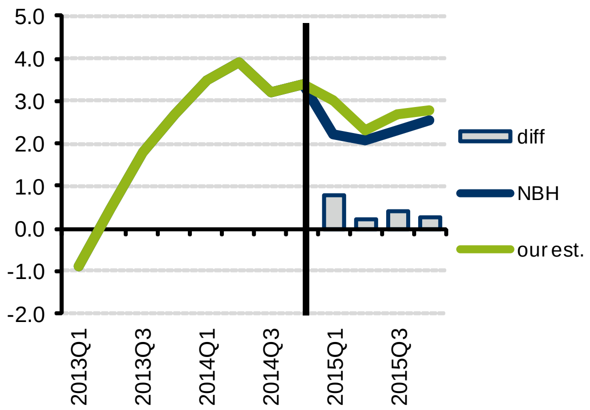
CZ: GDP outlook (Y/Y, %)



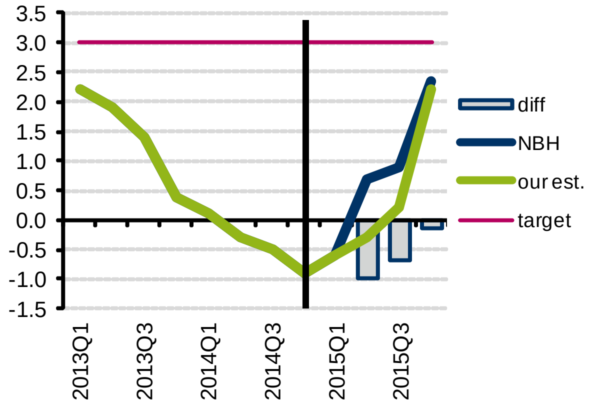
CZ: Inflation outlook (Y/Y, %)



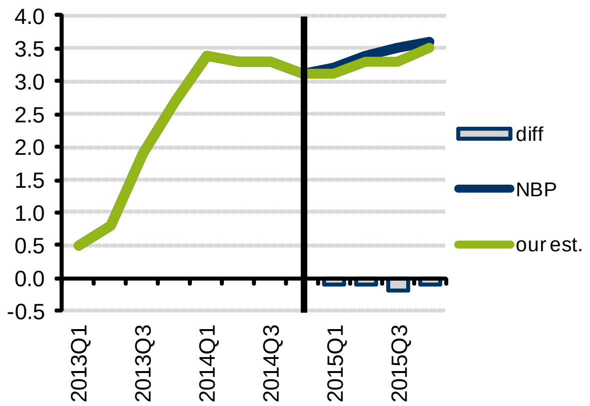
HU: GDP outlook (Y/Y, %)



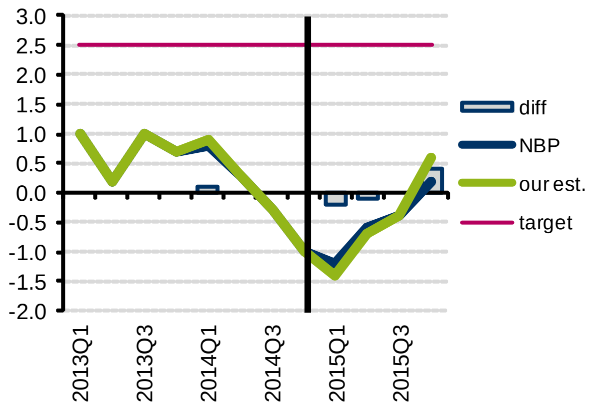
HU: Inflation outlook (Y/Y, %)



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	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.	*1.95*	1.95	1.70	1.70	2.00	2.25	-10 bps	3/24/2015
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	*0.31*	0.30	0.32	0.33	0.33	0.33
Hungary	BUBOR	*1.84*	1.89	1.70	1.70	2.10	2.40
Poland	WIBOR	*1.65*	1.65	1.55	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	*0.59*	0.64	0.90	0.95	1.10	1.15
Hungary	HU10Y	*2.64*	2.71	3.20	3.40	3.60	3.80
Poland	PL10Y	*2.07*	2.12	2.10	2.20	2.40	2.80

Exchange rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	EUR/CZK	*27.39*	27.57	27.50	27.80	27.50	27.50
Hungary	EUR/HUF	*297*	300	310	317	315	310
Poland	EUR/PLN	*4.02*	4.07	4.05	4.00	4.10	4.05

GDP (y/y)

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	2.4	1.4	1.7	1.8	2.1	2.5	2.5
Hungary	3.2	3.4	3.0	2.3	2.7	2.8	2.2
Poland	3.3	3.1	3.1	3.3	3.3	3.5	3.5

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

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	0.7	0.1	0.2	0.5	0.4	0.9	1.0
Hungary	-0.5	-0.9	-0.6	-0.3	0.2	2.2	2.7
Poland	-0.3	-1.0	-1.4	-0.7	-0.4	0.6	1.5

Current Account

	2015	2016
Czech Rep.	1.8	1.7
Hungary	4.0	3.8
Poland	-1.2	-2.0

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-2.4	-2.3
Hungary	-2.2	-2.0
Poland	-3.0	-2.5

Source: KBC, Bloomberg

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