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Central European Weekly

Monday, 21 September 2015

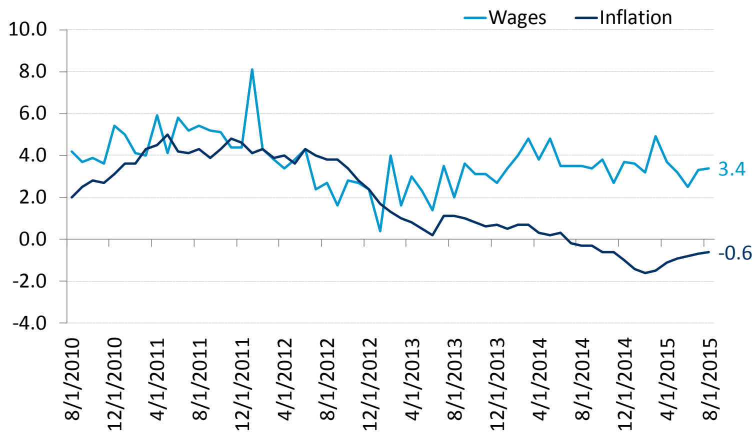
Table of contents

Weekly Highlights:

- By postponing liftoff Fed temporarily revives 'currency wars' - will Central Europe get involved?
- Polish monthly data on weaker side
- NBH meeting preview: on hold, but dovish
- CNB meeting preview: FX commitment confirmed, while negative rates could be discussed

Chart of the Week

PL: Nominal gross wages vs. Inflation
Y/Y in %



Polish wages maintain relatively strong growth in spite of persisting deflation...(Source: Bloomberg, CSOB)

Market's editorial

Fed delays lifoff – what it means for regional central banks?

The postponement of Fed's liftoff, which means that the US official rates will remain steady for at least a quarter, may trigger a reaction in Central Europe too. To be more specific, the Fed's postponement of tightening cycle, which actually implies a temporary return of 'weaker dollar' policy, may also have an impact on the other central banks, which will have to accommodate relaxed US policy. The first central bank (in the neighbourhood of the Central Europe) that may come to mind in this context is the ECB. Just remember the dovish comment by its President Draghi following the last ECB meeting of early September. Hence another, even more aggressive form of quantitative easing might be on the cards, though in our view such a move by the ECB may be only triggered by the significant strengthening euro (e.g. EUR/USD to year-to-date highs).

After the ECB – the first in-line would be the CNB

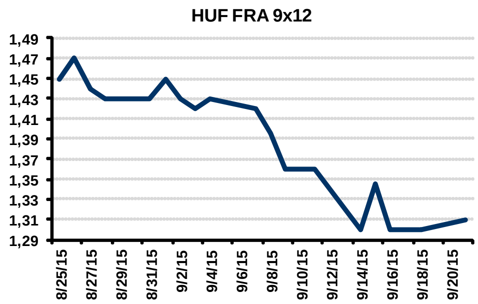
How could central banks in Central Europe react to a possible more aggressive form of QE from the ECB? While the bar for the National Bank of Poland may be willing to change its policy in the wake of further monetary easing is set high, the Czech National Bank - partly because almost all of the central bankers will be replaced in early 2016 - may be most liable to react. The CNB may significantly reduce its inflation outlook downwards in the autumn and an expansive move by the ECB might encourage the CNB to consider further easing of its monetary policy, and not only because of its own forecast. This would most likely take the form of extending the CNB's exchange rate commitment to not allow the currency pair to strengthen below the EUR/CZK 27.0 beyond 2016. Nevertheless, we cannot even rule out a cut in the official (deposit) interest rates into negative territory. In this respect, it will be definitely worth monitoring closely the outcome of the upcoming CNB meeting held on this Thursday.

The NBH stil on hold, but dovish talk will return

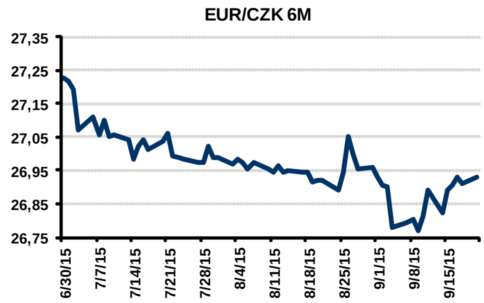
As concerns the National Bank of Hungary, everything will depend on the exchange rate of the forint, or in other words how the HUF could react to eventual additional easing action from the ECB. If the ECB is forced to act and the EUR/HUF currency pair approaches the EUR/HUF 300 even falls below this level, a cut by another 15 basis points will hang in the air. However, this will definitely not happen at the NBH meeting to be held this Tuesday, when the base interest rate should remain unchanged at 1.35%. Nonetheless, after the dovish Fed, the NBH is likely to accompany its decision by a clearly dovish comment too.

	Last	Change 1W
EUR/CZK	27.1	0.09%
EUR/HUF	311	-0.86%
EUR/PLN	4.20	-0.37%

	Last	Change 1W
10Y CZK	1.05	2.45
10Y HUF	2.92	-6.56
10Y PLN	2.49	-3.38



HUF FRA 9x12, last 20 days. Source: Reuters



EUR/CZK 6M, last 60 days. Source: Reuters

Review of Economic Figures

Polish hard mothly data slightly worse

Poland's important data released last week tended to spring negative surprises. In addition to a worse balance of payments figure for July, there were worse data from industry in particular. Industry's performance in August lagged behind expectations for a second consecutive month, and the significant deterioration of the business mood in the manufacturing industry last month was a warning signal. Thus labour market developments remain positive in particular, where the rise in employment in August was accompanied by very solid wage growth (even though it slightly disappointed the market). A remarkable fact in this context is that the rate of growth in retail sales has lagged behind the rate of wage growth recently, and the August figures also confirmed this. However, we should bear in mind that, expressed in real terms, the rise in retail sales continues to be decent, as the year-on-year inflation rate in Poland remains well below zero (-0.6% in August), thus contributing to rapid real wage growth.

By and large, the data for the third quarter of the year suggest that year-on-year economic growth in the third quarter probably slightly decelerated compared to the previous quarter. Nevertheless, we do not expect any reaction from the central bank (NBP) in the months to come. Its satisfaction with the current monetary policy settings was also confirmed by the minutes of the last NBP meeting (September 2). These minutes stressed the accumulation of downside risks to inflation, primarily related to the worsened prospects for the key emerging economies, led by China. We believe that these factors should contribute towards an abandoning of rate hike considerations, which again appeared in the minutes, rather than lead to a rate cut. Therefore we are still betting on rate stability, which should persist at least in the first half of next year in Poland.

Czech C/A posted a deficit for only the second time this year

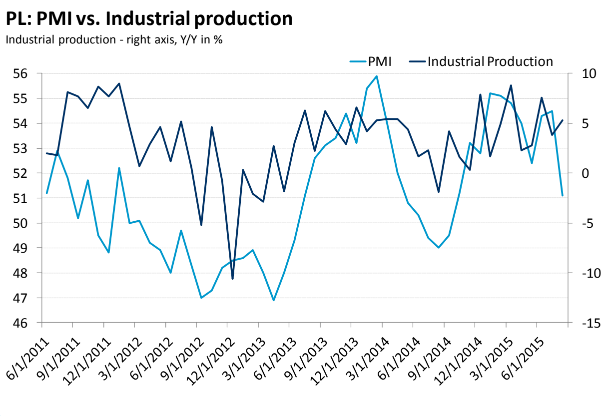
A significant dividend outflow in July meant that the current account posted a negative figure of CZK 21.5 bn. The dividends paid out in that month alone reached CZK 31.3 bn according to the CNB.

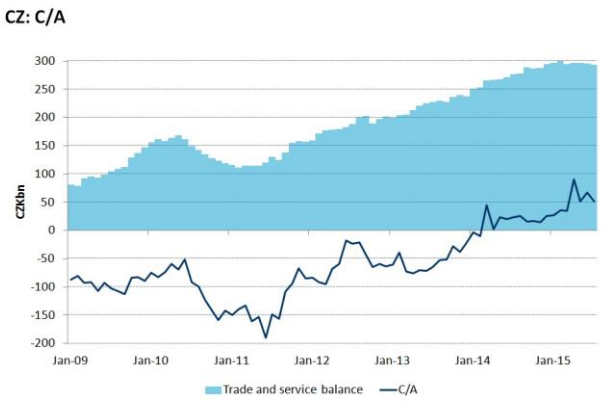
While this is a very high amount at first glance, this year's dividend season has been delayed, and therefore these are actually no dramatic developments. In addition, the delayed start of the dividend outflow played into the hands of those companies which could take advantage of a more favourable development of the exchange rate of the koruna when the koruna approached its intervention threshold.

The other components of the current account sprang no more surprises. They indicate a reasonable surplus of foreign trade in goods and services and a small deficit in contributions to EU Funds. The trade balance is starting to reflect the increased imports, driven by domestic investment as well as consumer demand on the one hand, and by cheap commodities on the other.

Two basic trends are worth paying attention to on the financial account: a decreasing inflow of foreign direct investment and improving demand by foreign investors for Czech government bonds. Regarding investment, such developments are certainly interesting now that the economy is performing very well and the overall willingness to invest is on the rise in Europe. Perhaps only a large investment to stir the figures up is lacking, but it is still true that the amount of non-invested money in the Czech economy is definitely not low compared to neighbouring countries.

The balance of payments is continuing to develop well notwithstanding July's deficit. The summer dividend months will not change anything about the fact that the Czech Republic's external balance will remain positive in 2015 and its surplus may even be around 2% of GDP. After all, this is a fairly logical trend for an export-oriented economy.





Weekly preview

TUE 14:00 **NBH base rate**

	This meeting	Last change
rate level (in %)	**1.35**	7/2015
change in bps	**0**	-15

HU: On hold, but with dovish comments

We expect that the NBH will keep base rate unchanged at 1.35% on Tuesday. The comment might be rather dovish as inflation fell from 0.4% Y/Y in July to 0% Y/Y in August and EUR/HUF moved below 310 after the FED decision. Additionally the short-end of the curve is well below the base rate level. But they will still emphasize that the current interest rate condition may be maintained for an extended period. I don't expect any rate hike before 4Q16.

THU 13:00 **CNB base rate**

	This meeting	Last change
rate level (in %)	**0.05**	11/2012
change in bps	**0**	-20

CZ: CNB to confirm its FX commitment

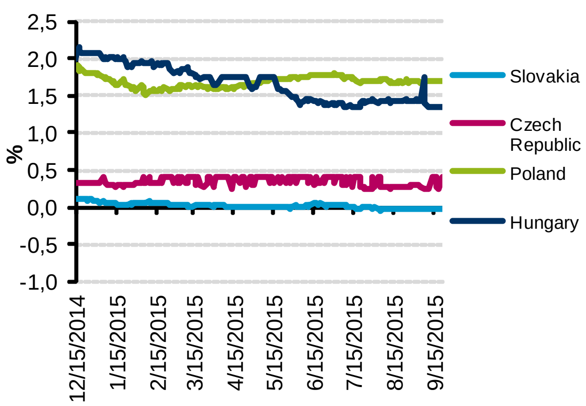
Neither a change to the exchange rate policy settings, nor a rate change can be expected from the upcoming CNB Board meeting. The meeting will be held in the interim between two forecasts, the last of which has not yet been fulfilled in terms of inflation, while the preparations for the next are yet to begin. We expect the CNB to simply reiterate its determination to prevent the koruna from strengthening below the EUR/CZK 27.0. The CNB will most likely stress that its position on the forex market is strong and that the bank is ready to continue facing speculative attacks to an unlimited extent. It will certainly be interesting to see whether its comment will include a mention of a possible introduction of negative rates or at least of the necessity for further monetary easing. Nonetheless, in view of market rate developments, it is evident that not even a negative repo rate of -0.5% would have any hope of changing the position of 'speculators' to any great extent, as the real impact of such a measure would also affect those who are essentially not even present on the FX market households.

Calendar

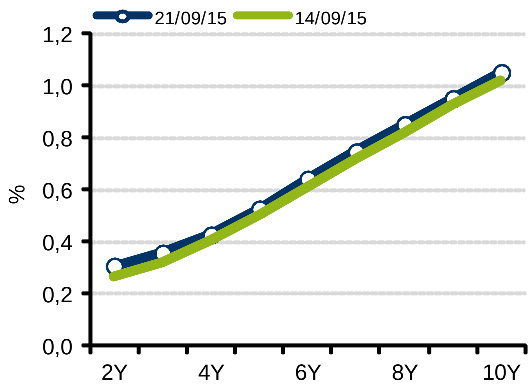
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	09/22/2015	14:00	NBH meeting	%	09/2015	1.35		1.35		1.35	
HU	09/23/2015	8:30	Current account	HUF B	2Q/2015			1800		1981	
PL	09/23/2015	10:00	Unemployment rate	%	08/2015			10		10.1	
CZ	09/23/2015	12:00	CZ bond auction 2014-2020, floating rate	CZK B	09/2015						
CZ	09/23/2015	12:00	CZ bond auction 2013-2028, 2.50%	CZK B	09/2015						
CZ	09/23/2015	12:00	CZ bond auction 2015-2023, x.xx%	CZK B	09/2015						
CZ	09/24/2015	13:00	CNB meeting	%	09/2015	0.05		0.05		0.05	

Fixed-income in Charts

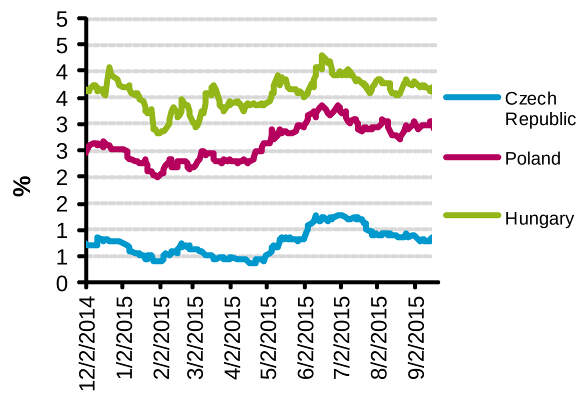
FRA 3x6



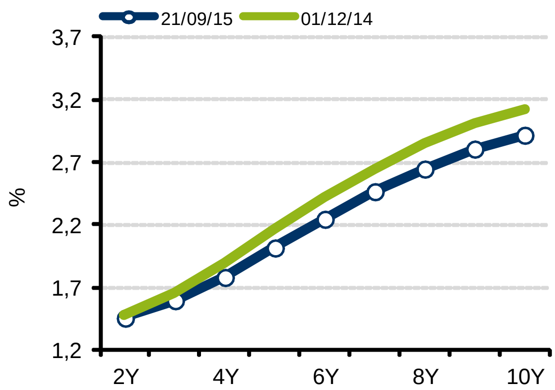
CZ IRS



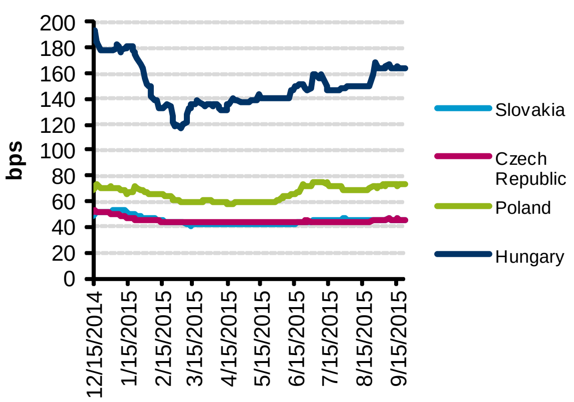
10Y GB Yields



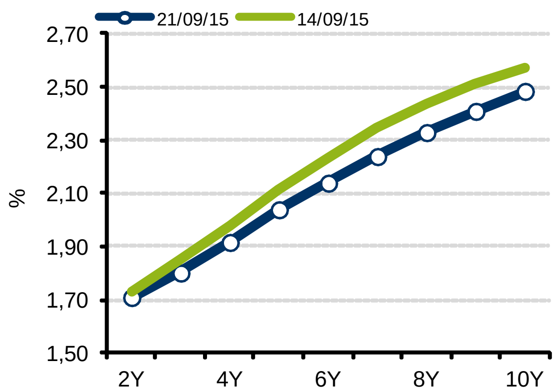
HU IRS



CDS 5Y



PL IRS



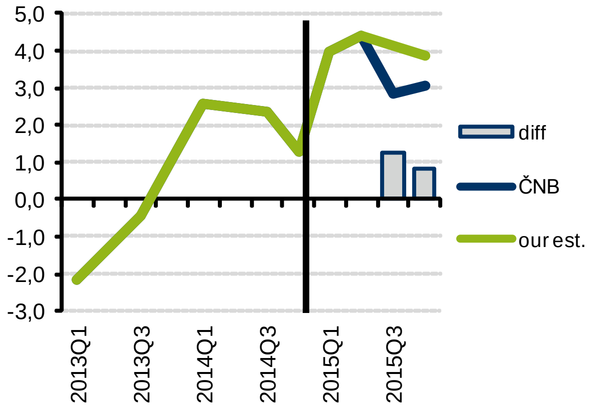
Source: Reuters

Medium-term Views & Issues

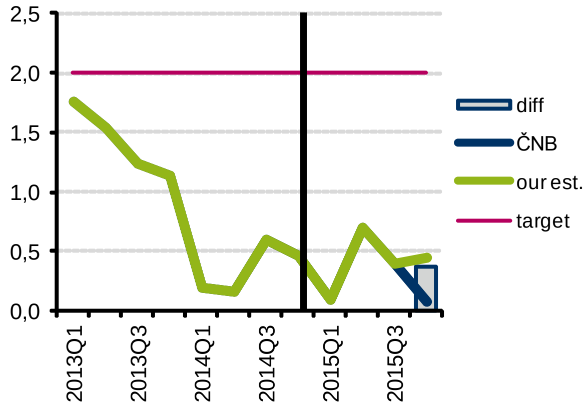
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – 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 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.	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.
Outlook for official & market rates	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.	The NBH 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. The NBH will cut further its base rate, if the ECB loosen further its monetary policy and the EUR/HUF moves closer to 300. In that case the base rate might be cut below 1%, while we think that with the previous speed, namely by 15bp per meetings.	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	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.	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.	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.

CBs' Projections vs. Our Forecasts

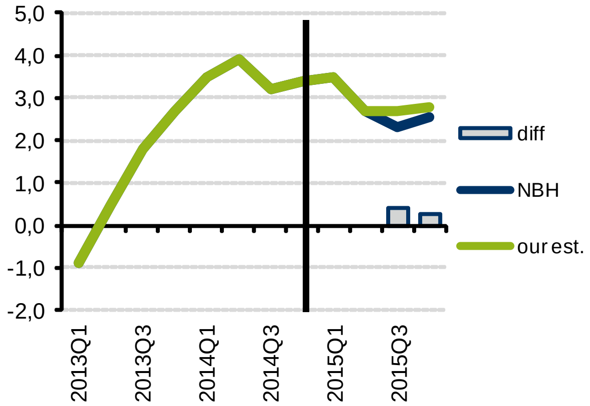
CZ: GDP outlook (Y/Y, %)



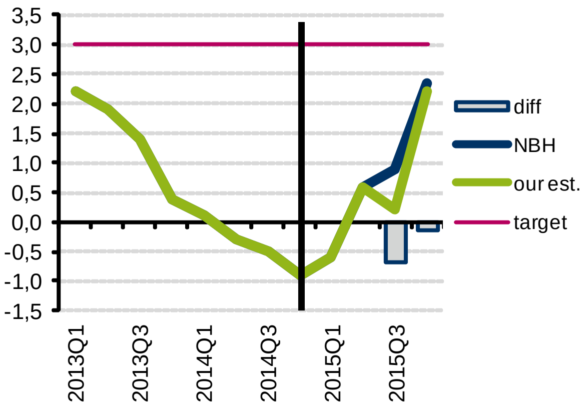
CZ: Inflation outlook (Y/Y, %)



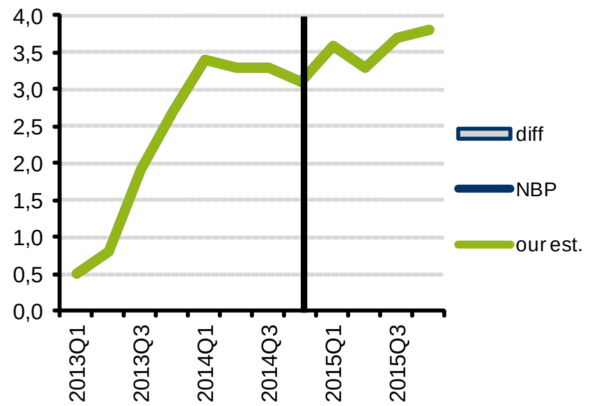
HU: GDP outlook (Y/Y, %)



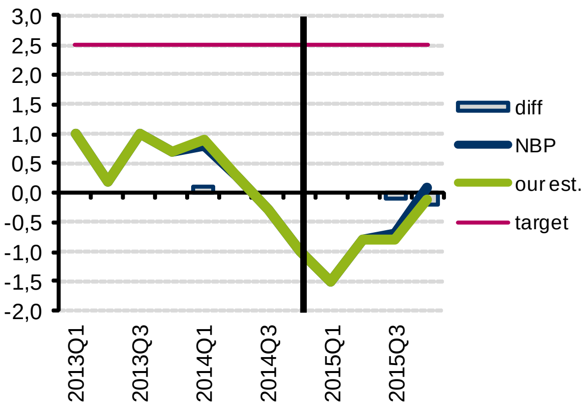
HU: Inflation outlook (Y/Y, %)



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.	*1.35*	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	*1.06*	0.64	1.30	1.25	1.30	1.40
Hungary	HU10Y	*2.92*	2.71	3.45	3.40	3.60	3.80
Poland	PL10Y	*2.49*	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	*27.07*	27.57	27.35	27.10	27.05	27.00
Hungary	EUR/HUF	*311*	300	315	317	315	310
Poland	EUR/PLN	*4.20*	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	4.1	3.9	2.2
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	0.2	0.7	1.5
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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