



Central European Weekly

Monday, 22 February 2016

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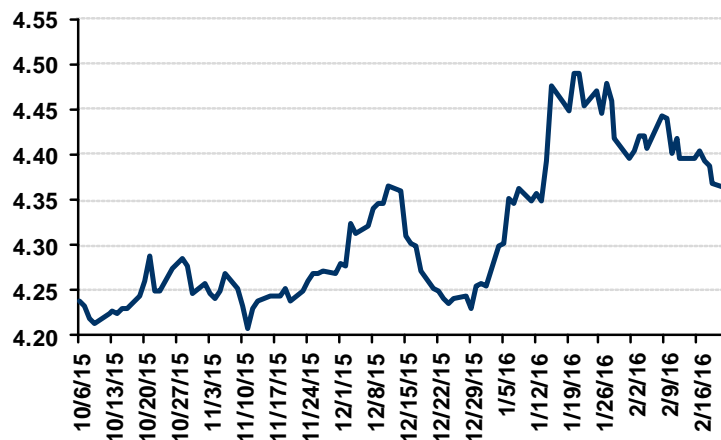
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Weekly Highlights:

- The Czech economy and Hungarian grew strongly last year. More to come...
- Is the worst over for the Polish zloty?
- Weekly preview: the NBH on hold, but it should sound dovish

Chart of the Week: Zloty's come-back

EUR/PLN



It seems that the worst might be over for the Polish zloty.

Market's editorial

Is the worst over for the Polish zloty?

The Polish zloty has strengthened and it seems that its greatest depreciation pressure – relating to the change of the Polish government and the subsequent changes to the Monetary Policy Council (MPC) members – is over for Poland. If we disregard the improved developments on emerging markets, with which the Polish currency correlates to a significant extent, we find that the uncertainty about the new government's policy and the new leadership of the National Bank of Poland (NBP) is evidently waning. Poland's new ministers have already experienced unfavourable market reactions (e.g., after the rating downgrade by S&P), the state budget prepared by the new government has already been approved by the Senate, and half the MPC members have been replaced. In addition, it seems that, in the end, the government may be more market-friendly regarding the politically sensitive topic of converting household mortgages denominated in Swiss francs.

Seen purely from the Polish perspective, the zloty should stand a chance of continuing to appreciate. However, much will depend on external conditions; after all, this was also mentioned in the Minutes of the last MPC meeting. The NBP leadership, and obviously also its new members (whose views are more dovish), reflects the fact that emerging market developments and the interest rates set by the Fed and the ECB determine the domestic monetary policy more than they seemed to. Therefore, unless the sentiment on risky asset markets substantially improves, we cannot expect the NBP to dare proceed to another easing action (a rate cut) even though the Polish deflation is deepening and this year's new 'hard' macroeconomic data have not been persuasive so far.

The NBH should sound dovish, but no rate cut expected

The National Bank of Hungary holds rate setting meeting this Tuesday. Although there is not a huge question about the outcome of the decision, the market expects no rate cut (keeping base rate at 1.35%), the stance of the statement will be important. The last month the Council highlighted that the loose monetary policy may remain for an extended period and the future steps will depend on the March inflationary report and the ECB's and FED's March meeting as well.

The Hungarian inflation orbit may be lower compared to the December report due to the falling oil prices at the beginning of the year. Recall that the increasing employment and the wage growth dynamic may boost the domestic consumption pushing core inflation up., so the March inflationary report may highlight still that the inflation target may be achieved only at the end of the forecast horizon (end 2017).

All in all the stance of the council may remain rather dovish, but the statement is likely to highlight that the base rate planned to be unchanged till middle or end of 2017, and the NBH is rather focusing on unconventional tools. But we still not rule out fully possible rate cut especially in case ECB cuts further and FED postpones the tightening cycle. Additionally the planned zero deficit of fiscal balance together with a possible upgrade of Hungary's rating in May and June may push the EUR/HUF below the 305 level, which might be uncomfortable for the NBH. So if there will be a rate cut, than we expect it for around May.

	Last	Change 1W
EUR/CZK	27.1	0.09%
EUR/HUF	309	-0.39%
EUR/PLN	4.36	-0.77%

	Last	Change 1W
10Y CZK	0.63	1.61
10Y HUF	2.33	-1.42
10Y PLN	2.32	2.20

Review of Economic Figures

For 2015 as a whole the Czech growth was 4.3%

The Czech economy stopped growing, or actually contracted by 0.1%, in the last quarter - fortunately only on a quarter-on-quarter growth comparison. According to a preliminary forecast by the Statistical Office, GDP slightly declined on a quarter-on-quarter basis but grew by 3.9% year-on-year. For 2015 as a whole, the Czech Republic's economic growth was 4.3%, the best figure for the last eight years.

Late 2015 growth fell short of expectations for two main reasons. Firstly, this was a result of a production drop in the energy sector and the chemical industry, caused by surprisingly long temporary shutdowns. The second reason for the apparently less favourable data is probably a recalculation of previous figures.

Czech growth foundations remain solid and stable

Although the economy has already decelerated (on a year-on-year basis), which was not expected to occur before this year, the current figure is not that alarming – mainly because the generated value added in the economy continued to grow and the reasons for the deceleration result from extraordinary events. Thus there is no drop in demand – whether domestic or foreign.

The accurate structure of neither the supply side nor the demand side is not yet available but it is very likely that the

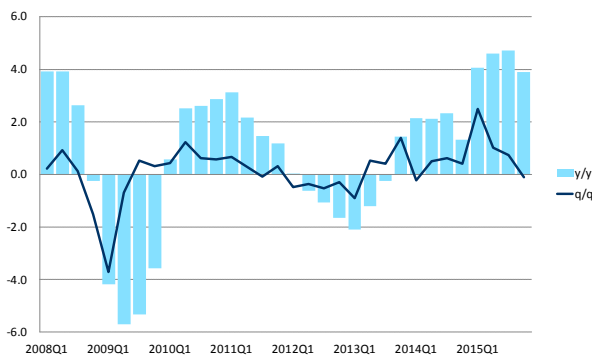
economic growth foundations have remained solid and stable. Even so we anticipate another growth deceleration this year, when the GDP rate should stabilise below 3%. Demand will be primarily driven by household consumption, while industry along with services will drive supply. The Czech economy may grow by approximately 2.5% overall this year.

Hungarian wages grew strongly in 2015

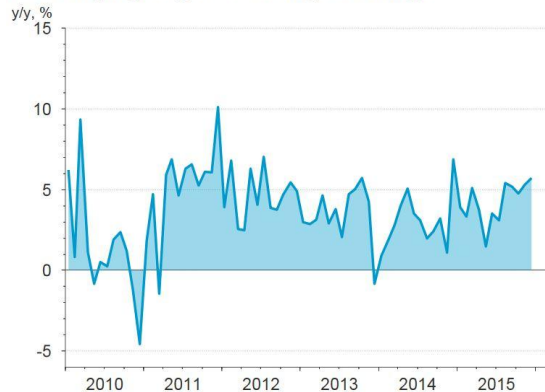
The latest release from the Hungarian statistical office related wages showed that gross salaries were up by 4.2% Y/Y in 2015, while net real wages increased by 4.3% Y/Y.

As the labor market is getting tight we expect that the gross salaries may rise faster than in 2015 (probably around 5-6% Y/Y) and taking in account the personal income tax cut (from 16% to 15%), the increase of tax allowance after two children and the still low inflation (below 1% YoY in 2016). the net real wages may be up by more than 6% YoY in 2016. It suggests that the underlying inflationary pressure may increase in 2016 due to the domestic consumption. But this pressure may just counterbalance the low oil prices in short-term

CZ: GDP Growth



HU: Employee gross average earnings



Source: Thomson Reuters Datastream / Fathom Consulting

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: NBH on hold again, but should sound dovish

Although there is not a huge question about the outcome of the decision, the market expects no rate cut (keeping base rate at 1.35%), the stance of the statement will be important. The last month the Council highlighted that the loose monetary policy may remain for an extended period and the future steps will depend on the March inflationary report and the ECB's and FED's March meeting as well.

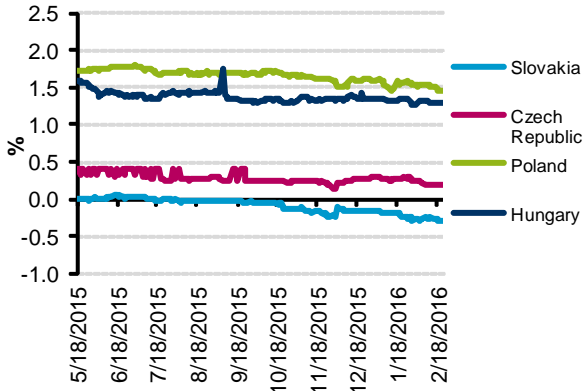
All in all the stance of the NBH might remain rather dovish, while the statement is likely to highlight that the base rate planned to be unchanged till middle or end of 2017, and the NBH is rather focusing on unconventional tools. But we still not rule out fully possible rate cut especially in case ECB cuts further and FED postpones the tightening cycle. Additionally the planned zero deficit of fiscal balance together with a possible upgrade of Hungary's rating in May and June may push the EUR/HUF below 305, which might be uncomfortable for NBH. So if there will be a rate cut, than we expect it for around May.

Calendar

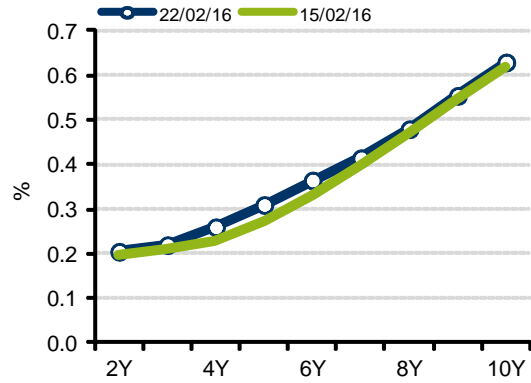
Country	Date	Time	Indicator	Period	Forecast		Consensus		Previous		
					m/m	y/y	m/m	y/y	m/m	y/y	
CZ	02/23/2016	9:00	PPI	%	01/2016			-0.4	-2.3	-0.4	-2.9
PL	02/23/2016	10:00	Unemployment rate	%	01/2016			10.3		9.8	
HU	02/23/2016	14:00	NBH meeting	%	02/2016	1.35		1.35		1.35	
HU	02/24/2016	0:00	Earnings MOL Group	HUF	4Q/2015						
CZ	02/24/2016	0:00	Earnings NWR	CZK	4Q/2015						
CZ	02/24/2016	12:00	CZ bond auction 2015-2023, x.xx%	CZK B	02/2016						
CZ	02/24/2016	12:00	CZ bond auction 2016-19, 0.00%	CZK B	02/2016						
HU	02/25/2016	0:00	Earnings Magyar Telekom	HUF	4Q/2015						
CZ	02/26/2016	0:00	Earnings Erste Group Bank	CZK	4Q/2015						
HU	02/26/2016	9:00	Unemployment rate	%	01/2016			6.4		6.2	

Fixed-income in Charts

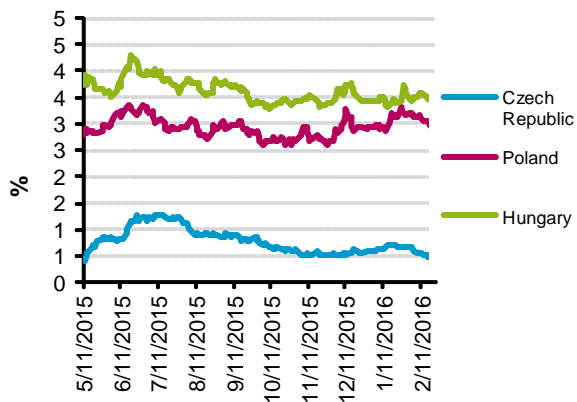
FRA 3x6



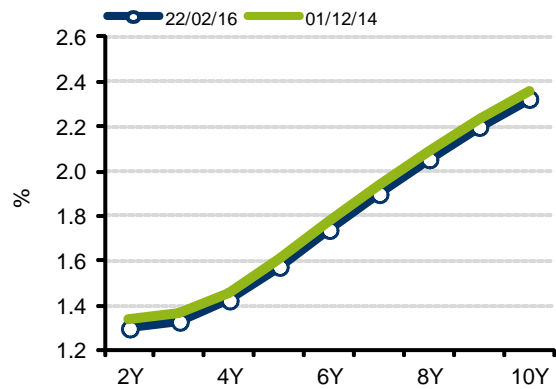
CZ IRS



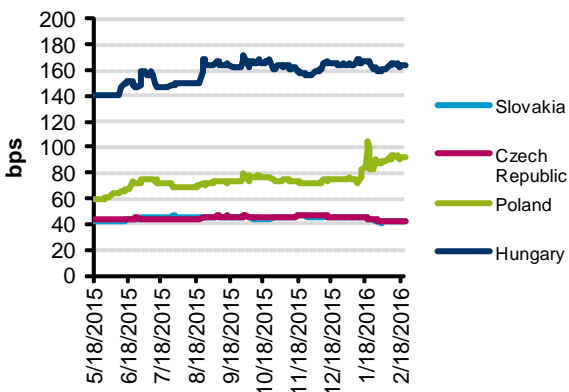
10Y GB Yields



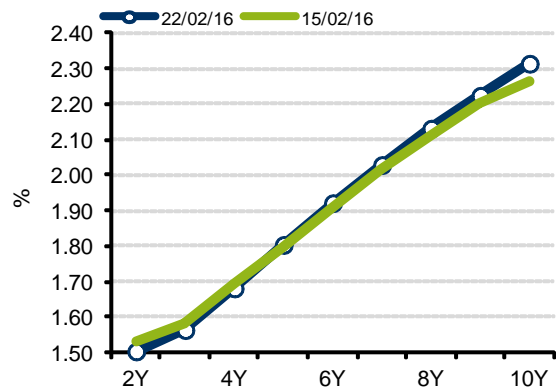
HU IRS



CDS 5Y



PL IRS



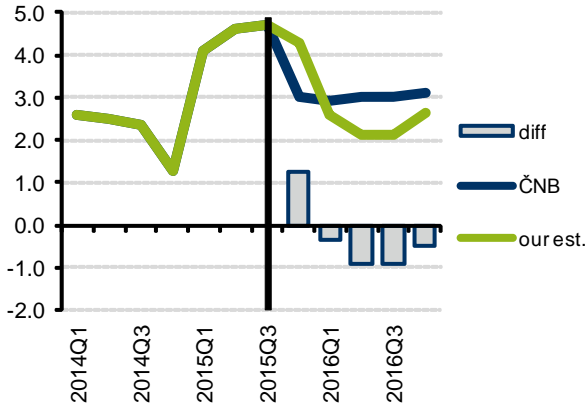
Source: Reuters

Medium-term Views & Issues

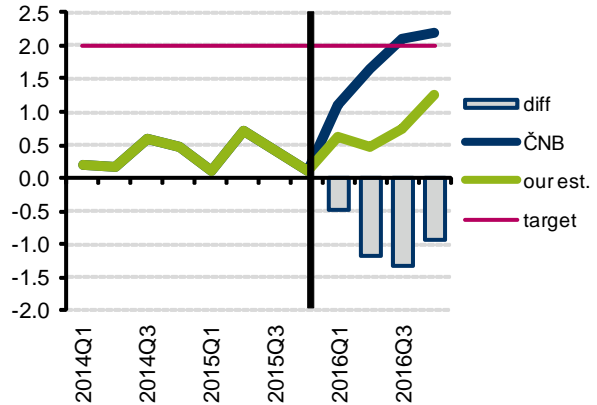
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private 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.</p>	<p>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.</p>	<p>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.</p>
Outlook for official & market rates	<p>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.</p>	<p>The NBH plans to keep base rate unchanged at 1.35% till the end of its forecasting period, which is 4Q17. It is more or less in synchrony with the ECB's monetary policy forward guidance. The main attention of NBH is decreasing FX reserve and the amount of money placed at the NBH. So the Council may change rather the monetary tools first, but in case HUF strengthens to around 300 base rate cut cannot be excluded either, although this is not our base case. We expect first rate hike only for 2017, as with the conversion of households' FC loans to HUF ones, the tolerance level of a weaker HUF jumped substantially.</p>	<p>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. This promise will probably be hold, while we should wait how the MPC will be changed in 2016 as new President and Sejm will appoint almost all Board members.</p>
Forex Outlook	<p>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.</p>	<p>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.</p>	<p>Although the new government may eventually turn out to be more market-friendly than had been expected, we think that pressures on zloty's depreciation may intensify again at the beginning of 2016 when most members of the Monetary Policy Council (MPC) will be replaced and probability of further monetary easing will rises. Although Fed hikes and weaker zloty could prevent the altered MPC from cutting rates again we target the EUR/PLN peak at 4.40.</p>

CBs' Projections vs. Our Forecasts

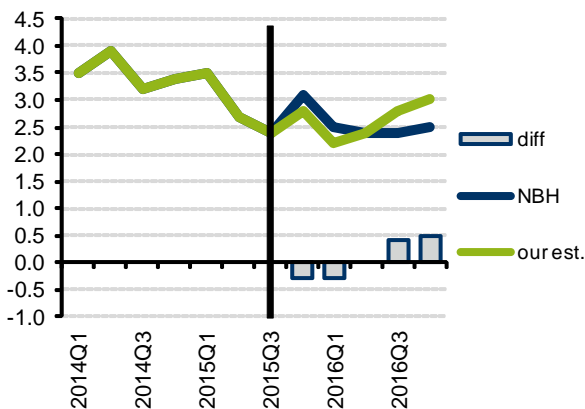
CZ: GDP outlook (Y/Y, %)



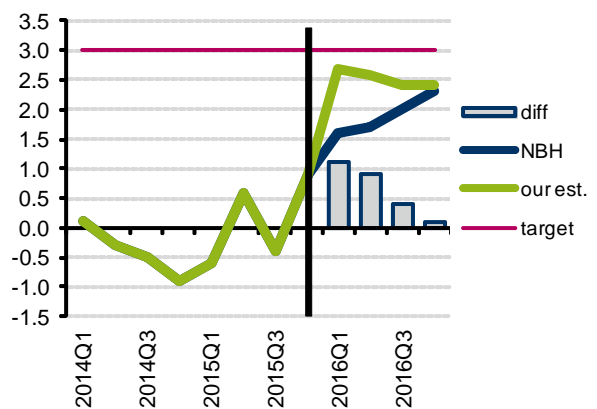
CZ: Inflation outlook (Y/Y, %)



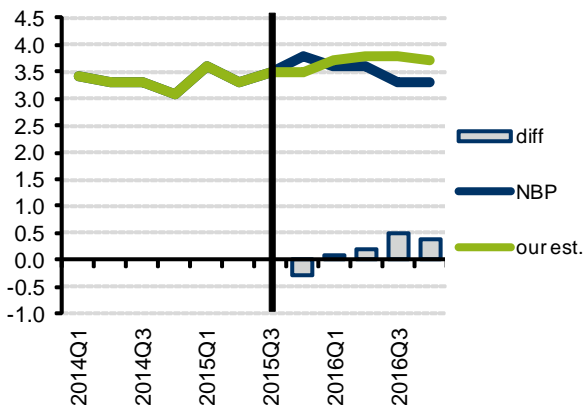
HU: GDP outlook (Y/Y, %)



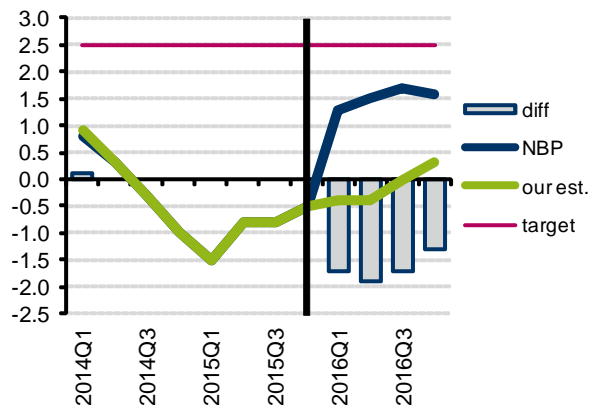
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outlook (Y/Y, %)



Source: CNB, NBP, MNB, KBC

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4	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	1.35	2.25	2.50	2.75	3.00	-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	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	PRIBOR	0.00	0.25	0.25	0.25	0.25	0.25
Hungary	BUBOR	1.35	1.35	2.40	2.60	2.90	3.10
Poland	WIBOR	1.69	1.72	1.65	1.65	1.65	1.65

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

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	CZ10Y	0.63	1.01	0.65	0.82	0.98	1.15
Hungary	HU10Y	2.33	2.91	3.80	4.00	4.20	4.40
Poland	PL10Y	2.32	2.47	2.50	2.50	2.60	2.75

Exchange rates (end of the period)

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	EUR/CZK	27.05	27.03	27.02	27.02	27.02	27.02
Hungary	EUR/HUF	309	316	310	308	305	300
Poland	EUR/PLN	4.36	4.27	4.40	4.30	4.26	4.25

GDP (y/y)

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	4.6	4.7	4.3	2.6	2.1	2.1	2.6
Hungary	2.7	2.4	2.8	2.2	2.4	2.8	3.0
Poland	3.3	3.5	3.5	3.7	3.8	3.8	3.7

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

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	0.8	0.4	0.1	0.7	0.6	0.8	1.5
Hungary	0.6	-0.4	0.9	2.7	2.6	2.4	2.4
Poland	-0.8	-0.8	-0.5	-0.4	-0.4	0.0	0.3

Current Account

	2015	2016
Czech Rep.	1.7	1.6
Hungary	6.0	5.1
Poland	-1.2	-1.5

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-1.4	-1.3
Hungary	-2.3	-2.0
Poland	-3.0	-2.9

Source: KBC, Bloomberg

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