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Central European Weekly

Tuesday, 17 May 2016

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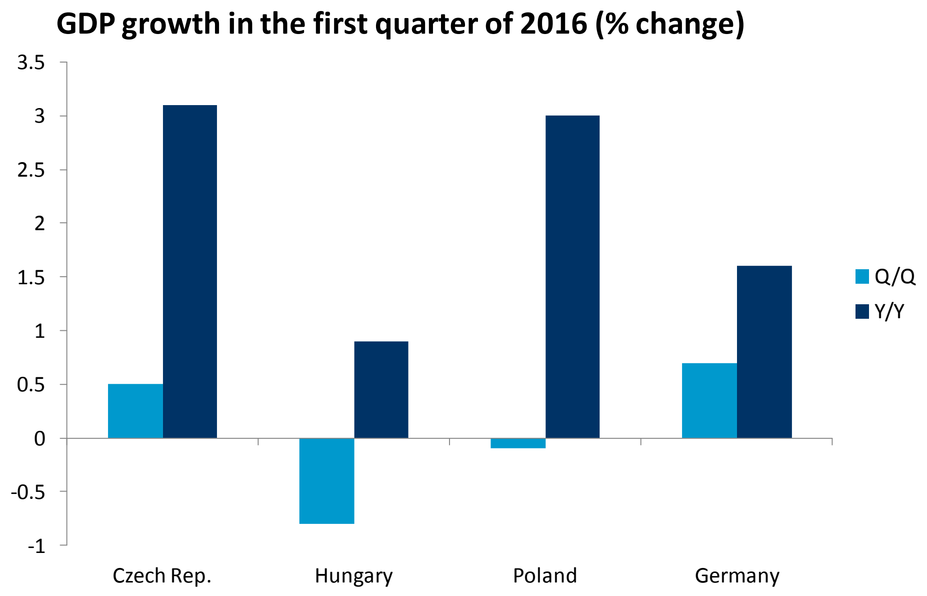
Chart of the Week: Regional GDP growth



Market's editorial

Moody's surprisingly affirms Poland's sovereign rating

The Polish zloty firmed strongly as Moody`s kept its sovereign rating on Poland surprisingly unchanged at 'A2' ahead of the weekend. Although the agency cut the rating outlook to negative from stable citing fiscal and policy risks, the market had expected a downgrade by (at least) one notch.

Recall that Moody's warned that fiscal risks related to a substantial increase in current expenditures as well as the intention to lower the retirement age, the latter raising age-related costs over time. Impairments to the investment climate from a shift towards more unpredictable policies and legislations, as reflected in the ambiguity with respect to the conversion of foreign-currency denominated mortgages and in the prolonged stalemate between the government and the country's constitutional court.

Two new men for the CNB Bank Board

Czech media announced that two new persons would be appointed by Czech president Zeman to the board of the Czech National Bank, while both have some connection relationship to current board member Rusnok (who is supposed to be the new CNB governor). New members will be Vojtěch Benda, who was chief economist of ING Bank and now advises Rusnok, and Tomáš Nidetzký, the commercial director at NN insurer, formerly part of ING (where Rusnok also worked). Recall that Benda and Nidetzký succeed board member Kamil Janáček and Governor Miroslav Singer, whose terms expire at the end of June. While we expect that Benda and Nidetzký will closely cooperate with Rusnok in the Bank Board, we do not alter our view on the CNB policy and possible timing of an exit from the current (FX) intervention regime.

	Last	Change 1W
EUR/CZK	27.0	0.01%
EUR/HUF	315	0.13%
EUR/PLN	4.36	-1.43%

	Last	Change 1W
10Y CZK	0.67	2.29
10Y HUF	2.30	-1.01
10Y PLN	2.26	-4.65

Review of Economic Figures

Hungarian and Polish GDP figures disappointed

The **Hungarian GDP delivered a huge negative surprise** as it rose only 0.9% YoY in 1Q16. The seasonally and working adjusted figures were even worse with its levels of 0.5% YoY and -0.8% Q/Q. The market expected a growth of around 2% YoY. So the question was not about the slowdown of growth, but about the size of the drag. The construction is in a free fall of 33% YoY just in March, the industry is only stagnating and although the consumption is increasing is not enough the counterbalance the other negative trends. It is also clear that the effect of accelerated use of EU funds money and state spending in the 4Q15 was extremely high. Although 1Q16 figure was very weak, we expect that the economy may accelerate in the following month thanks to the still increasing employment and wage growth which fuels the domestic consumption, and also to the slowly revitalization of construction and industry. But the government's projection of 2.5% YoY growth for this year is become less likely, we see now rather an economy expansion of around 2% YoY for 2016.

Regarding Poland, the economy recorded also slower growth on annual bassis (3% y/y), but it even declined compared to the pervious quarter (-0.1% q/q). the Hungarian gross domestic product data was particularly weak: GDP rose only 0.9% YoY in 1Q16. Like in the Hungarian case there could be signifcant slowdown (even decline) in investments, whcih could be related to lower utilisation of EU funds.

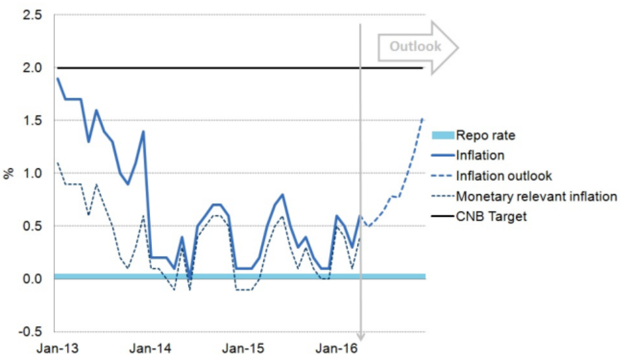
As concerns the Czech GDP - the data have surprised slightly on the upside, the GDP increased in the Q1 2016 by 3.1%, year-on-year; compared to the Q4 2015 it was 0.5% up. According the Czech Statistical Office the growth was supported by all components of the demand: by steadily growing consumption of households, slightly increasing investment activity, as well as external trade.

Alcohol and tobacco, fuels and seasonal clothing in particular were responsible **for April's rise in Czech consumer prices of 0.6%. This is a surprisingly high figure, which should certainly please the Czech National Bank.** Of course, the price rise applied not only to these items but this time people also had to pay more for food; in addition, housing costs are also on the rise. Year-on-year inflation was 0.6% in April, just as the month-on-month figure. Thus, after a short period of falling, inflation has returned to January's level. The current inflation is even above the central bank's latest forecast, which envisaged 0.3%. The last CNB Board meeting indicated that not only inflation alone but also wage growth would guide the central bank's future steps. If the current inflation data and anticipated wage growth are taken into account the central bank need not spring any more surprises this year. The CNB expects 4% wage growth in the business sector for this year, which is certainly attainable if we take into consideration the data for the last quarter of last year and the wage growth structure across sectors and professions.

The **Hungarian consumer price index unexpectedly jumped from -0.2% Y/Y in March to 0.2% Y/Y in April**, while the core inflation increased from 1.3% Y/Y to 1.4% Y/Y last month. The main reason behind the fast increase of headline CPI is fuel (up by 4.3% M/M), unprocessed fruits (up by 7.4% M/M) and long-range travel (up by 6.3% M/M). All three are out of core inflation. We also saw some increase of prices in tradable goods and market services, but we think that it is still quite subdued compared to the relatively strong household consumption, which is due to the low imported inflation.

Looking ahead we see year-end inflation around 2% Y/Y calculated with the current oil prices and the planned excise duty hike of tobacco from September. The average inflation might be around 0.5% Y/Y in 2016, slightly up from our previous expectation of 0.3% Y/Y. The difference comes from the sooner bounce back of oil price and the last week announced excise duty hike. We expect that inflation might remain around 2% Y/Y in 2017 as well, because of the planned VAT cut from January.

CZ: Inflation and interest rates

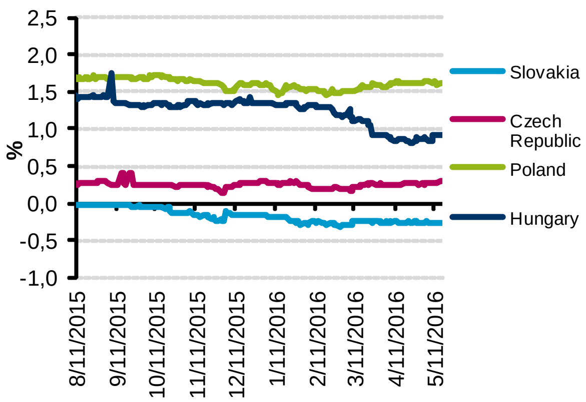


Calendar

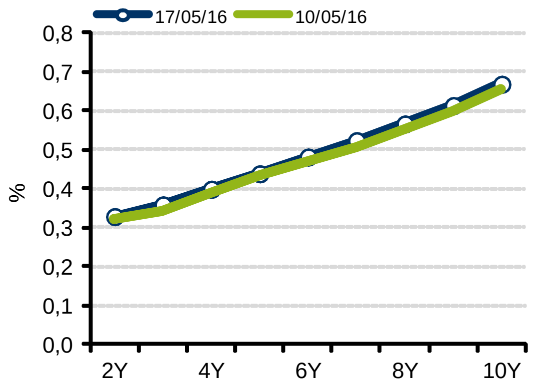
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	05/16/2016	9:00	PPI	%	04/2016			0.2	-4.6	0	-4.5
CZ	05/17/2016	0:00	Earnings Philip Morris	CZK	1Q/2016						
CZ	05/17/2016	9:00	GDP	%	1Q/2016 *A	1	2.6	0.8	2.6	0	4
CZ	05/18/2016	0:00	Earnings NWR	CZK	1Q/2016						
CZ	05/18/2016	12:00	CZ bond auction 2016-19, 0.00%	CZK B	05/2016						
CZ	05/18/2016	12:00	CZ bond auction 2013-2028, 2.50%	CZK B	05/2016						
PL	05/18/2016	14:00	Wages	%	04/2016			-1.7	3.8	5.2	3.3
PL	05/19/2016	14:00	Industrial output	%	04/2016			-5.3	3.4	6.8	0.5
PL	05/19/2016	14:00	PPI	%	04/2016			0	-1.2	-0.1	-1.7
PL	05/19/2016	14:00	Retail sales	%	04/2016			0.3	3	14	0.8

Fixed-income in Charts

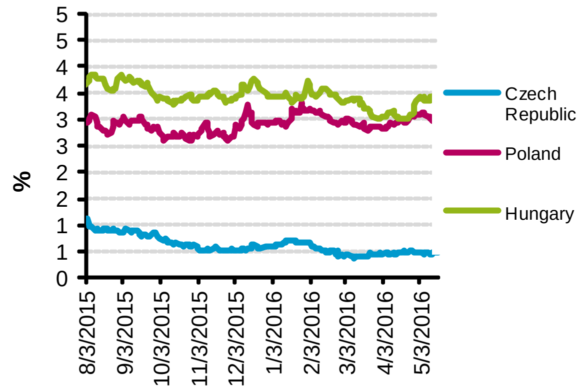
FRA 3x6



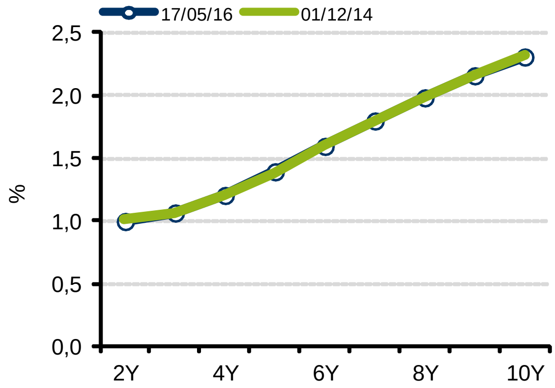
CZ IRS



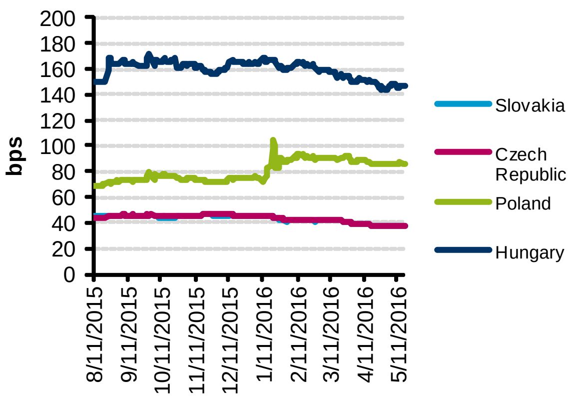
10Y GB Yields



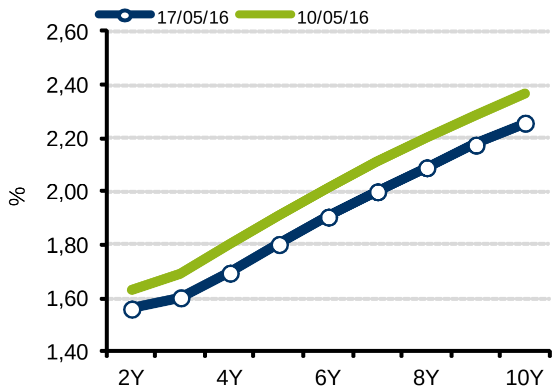
HU IRS



CDS 5Y



PL IRS



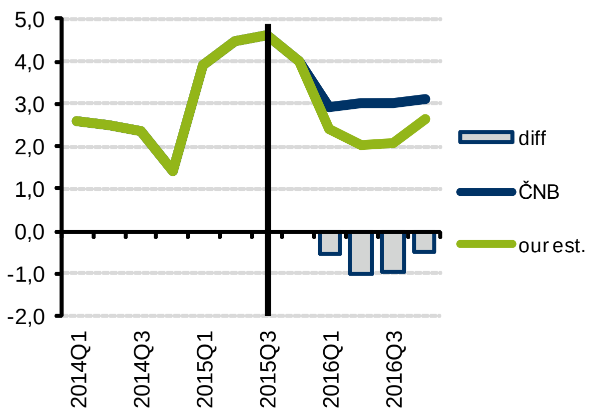
Source: Reuters

Medium-term Views & Issues

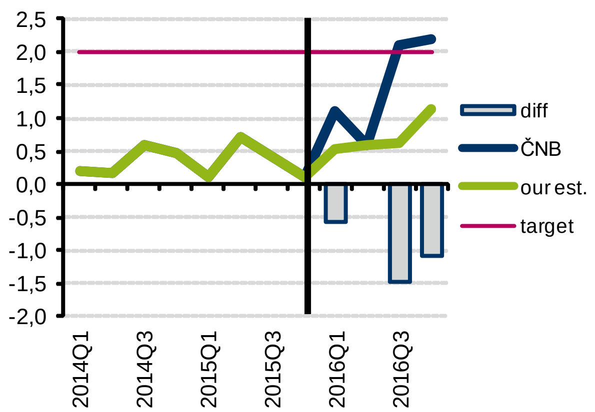
	The Czech Republic	Hungary	Poland
Growth & key issues	Growth significantly accelerated, primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see an investment boom by the private and public sectors, with private consumption – 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 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.	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.	The Monetary Council continues the rate cut cycle in the following months. We believe that the easing cycle may be continued at least till June, when the next inflationary report will be published. The latest inflation figure (falling from 0.3% Y/Y in February to -0.2% in March) also gives gunpowder for monetary easing, so we expect 15bp cut on 26th April, which might be followed with two more steps in May and June down to 0.75% from the current level of 1.2%.	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.	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.	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

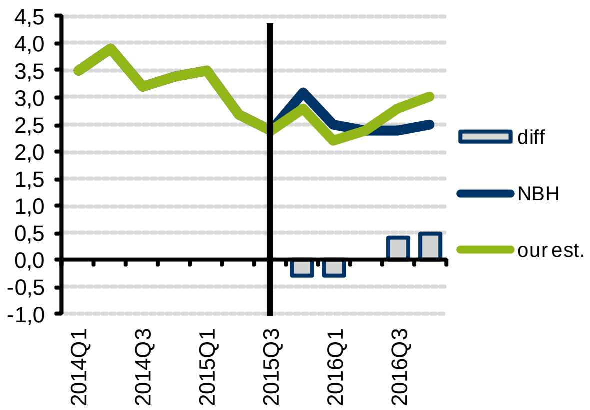
CZ: GDP outlook (Y/Y, %)



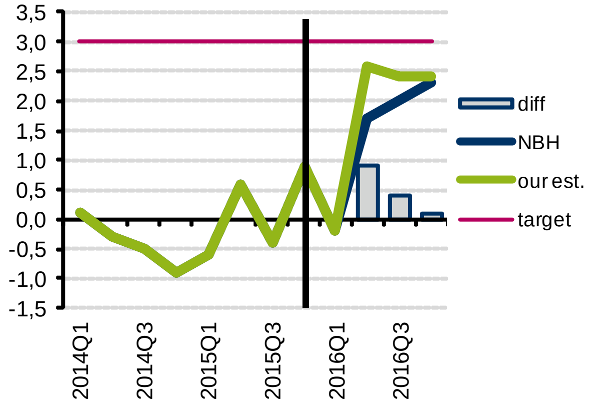
CZ: Inflation outlook (Y/Y, %)



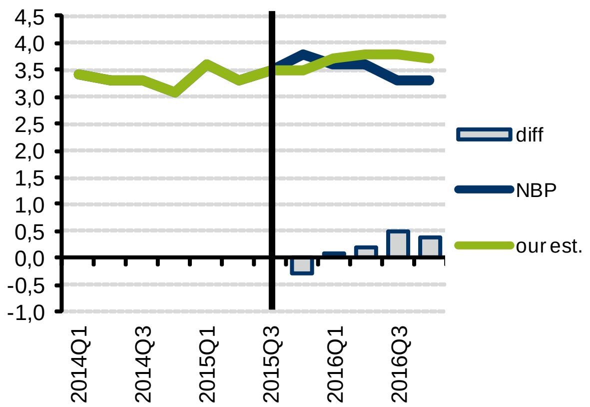
HU: GDP outlook (Y/Y, %)



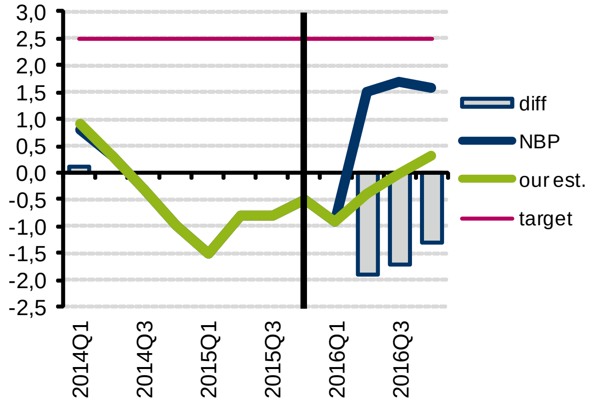
HU: Inflation outlook (Y/Y, %)



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	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	1.20	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	3/5/2015

*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	0.24	0.24	0.24
Hungary	BUBOR	*1.09*	1.35	1.20	2.60	2.90	3.10
Poland	WIBOR	*1.67*	1.72	1.67	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	*0.67*	1.01	0.63	0.73	0.81	0.90
Hungary	HU10Y	*2.30*	2.91	2.07	4.00	4.20	4.40
Poland	PL10Y	*2.26*	2.47	2.23	2.50	2.60	2.75

Exchange rates (end of the period)

		Current	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	EUR/CZK	*27.03*	27.03	27.05	27.02	27.02	27.02
Hungary	EUR/HUF	*315*	316	314	308	305	300
Poland	EUR/PLN	*4.36*	4.27	4.25	4.39	4.27	4.25

GDP (y/y)

	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
Czech Rep.	4.5	4.6	4.0	2.4	2.0	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	0.3	0.5	0.7	1.4
Hungary	0.6	-0.4	0.9	-0.2	2.6	2.4	2.4
Poland	-0.8	-0.8	-0.5	-0.9	-0.4	0.0	0.3

Current Account

	2015	2016
Czech Rep.	0.9	0.8
Hungary	6.0	5.1
Poland	-1.2	-1.5

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-0.4	-1.0
Hungary	-2.3	-2.0
Poland	-3.0	-2.9

Source: KBC, Bloomberg

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