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Central European Weekly

Monday, 05 December 2016

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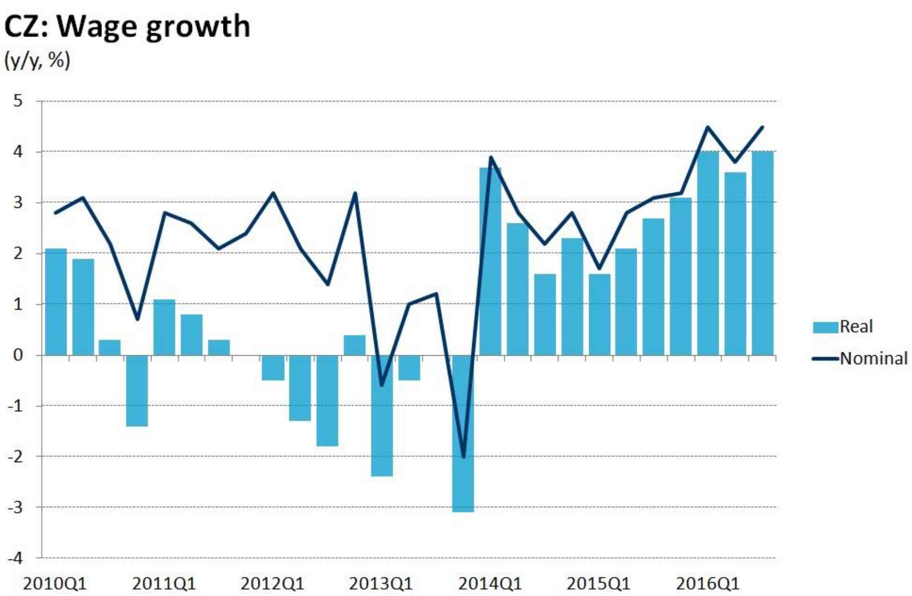
Chart of the Week: Czech wage growth



Review of Economic Figures

November PMIs were mixed

Just released November's PMI indices for manufacturing have been a mixed bag as the business confidence fell in the Czech Republic, while in Hungary remained high and it improved in Poland. This is finally a better message from the Polish industry as it output surprisingly dropped in October. On the other hand, it is worth noting (and watching) that the Czech PMI slips from October's five-month high driven by weaker new orders.

Polish inflation matches expectations

The Polish inflation matched expectation as the headline index was unchanged from a year ago in November, which marks the end of deflation period in Poland. For December, we expect that a year-on-year change of Polish consumer prices index will be clearly positive (our estimate stands at 0.2% y/y at the moment). The annual headline inflation in Poland should move further into positive territory at the beginning of next year, especially if oil prices and USD/PLN pair stay at recent high levels.

Czech GDP revision did not bring surprise

Revision of GDP figures for the third quarter of 2016 brought about no significant surprises. The growth remained at 1.9% Y/Y and in quarter-on-quarter terms it was revised down from 0.3% to 0.2%. Still, even the revised figures confirm marked slowdown of economic growth in the third quarter which was mainly caused by quarter-on-quarter decline exports. On the contrary, domestic demand, both for investment and consumption, increased.

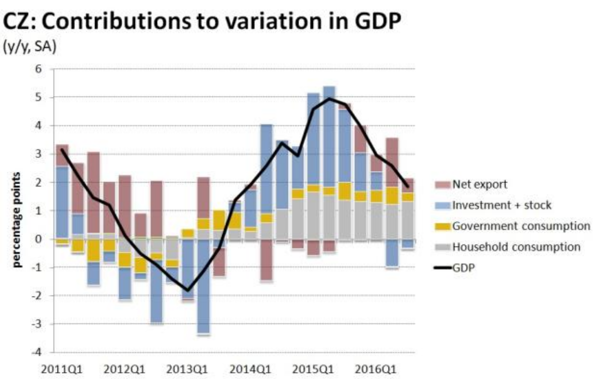
As for the fourth quarter, we expect economic growth at about 2%. This would mean full year growth around 2.5%. For 2017 we expect economic growth around 2.5% as well but the structure may differ as growth could be driven more by investment.

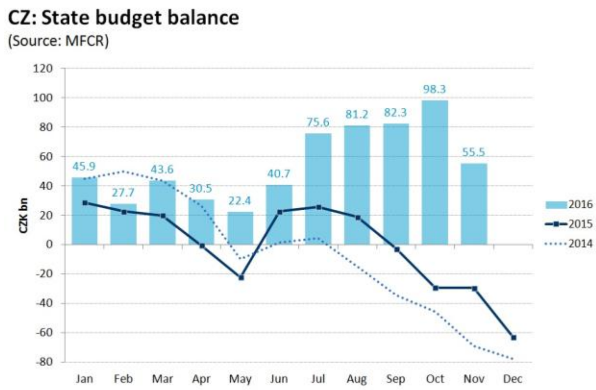
Czech wage pressures are more and more visible

Average real monthly wage growth accelerated to 4.0% Y/Y in the Czech Republic in the third quarter of 2016. In nominal terms, however, wages grew by 4.5% Y/Y. Even more important is that median wage growth again exceeded average which means that employees with lower income also participate on economic growth. This is good news from the perspective of the central bank; the figure is higher than anticipated by the last projection and it also means that (demand) inflation pressures should also be stronger. We expect wages growth to accelerate further and in 2017 it could exceed 5% (in nominal terms).

Czech Republic's state budget surplus shrinks by half

The state budget surplus fell by nearly half in a single month. As late as in October, the Czech Republic's budget surplus was almost CZK 100 bn. One month has passed and the budget surplus has shrunk to CZK 55.5 bn. Yet this was still the best November figure in the Czech Republic's history, but one not easy to evaluate. First of all, we can say that both sides of the budget have contributed to its surplus. Revenue shows a significant year-on-year rise in collected social security contributions and personal income tax, both clearly associated with the positive development of the whole economy, i.e. with record-breaking employment and accelerated wage growth. A decent increase is evident in corporate income tax, reflecting the record-breaking profitability of businesses and consequently the higher taxes they are paying.





Weekly preview

WED 9:00 CZ Industry (y/y change in %)

	Oct-16	Sep-16	Oct-15
Monhtly	**0.5**	2.7	3.7
cummulative (YTD)	**2.7**	2.9	4.8

CZ: Industry still driven by carmakers

Although the anticipated industrial output figure looks unimpressive at first glance, in our opinion it rose by approximately 3% in October if adjusted for the different number of business days in the month. Moreover, we can even expect a better figure from the manufacturing industry, while the mining and quarrying sector is likely to fall again. As usual, production of cars, plastics and engineering are likely to show very solid increases. Orders will suggest how industry will continue to develop going forward. The rate of orders is probably also decelerating – as signalled by the latest PMI data, after all. Yet industry will maintain its role as the main driver of the Czech economy.

WED 14:00 NBP rate (in %)

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

PL: NBP to highlight its neutral policy stance

The rise in the year-on-year inflation rate into positive territory and the depreciation of the zloty will reassure the Monetary Policy Council that the monetary policy of the National Bank of Poland should remain neutral. Therefore, we anticipate no monetary policy change and believe that the official interest rates are also likely to remain unchanged next year.

FRI 9:00 CZ Inflation (change in %)

	Nov-16	Oct-16	Oct-15
CPI m/m	**0.2**	0.3	-0.4
CPI y/y	**1.4**	0.8	0.1
Monetary relevant inflation y/y	**1.2**	0.6	0.0

CZ: Inflation within the CNB's tolerance band

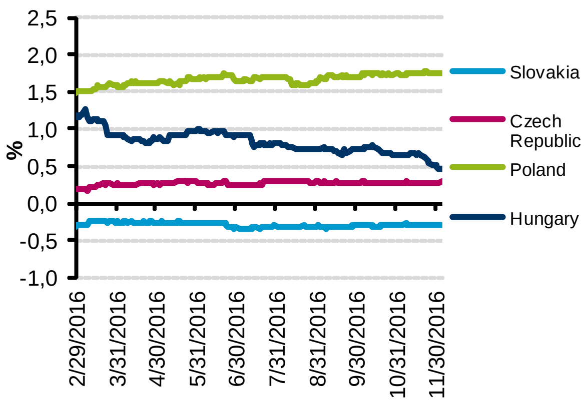
The Czech Republic's year-on-year inflation has returned to the central bank's tolerance band for the first time in almost three years. We estimate that November's consumer price index rose by 0.2%, mainly as a result of an increase in food prices. We cannot even rule out that some hotel and restaurant businesses raised their prices as part of their preparations for the electronic records of sales. Thus, given the low comparative baseline, the 0.2% will eventually raise year-on-year inflation from October's 0.8% to 1.4%, which will again exceed the CNB's forecast. And this should certainly not be the last strong inflation rise, because the turn of the year will see another inflation increase to the close vicinity of the central bank's target.

Calendar

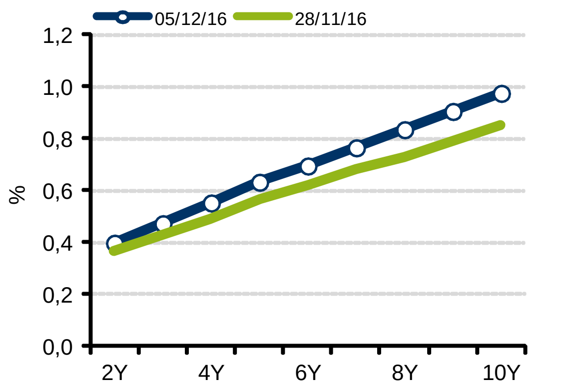
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	12/05/2016	9:00	Real wages	%	3Q/2016		4		3.7		3.7
HU	12/05/2016	9:00	Retail sales	%	10/2016				4.2		5.1
HU	12/06/2016	9:00	Industrial output	%	10/2016				-0.8	-3	-3.7
HU	12/06/2016	9:00	GDP	%	3Q/2016 *F				2	0.2	2
CZ	12/06/2016	9:00	Retail sales	%	10/2016		4		3.3		4.4
CZ	12/07/2016	9:00	Trade balance (national)	CZK B	10/2016	18.9		18.9		21	
CZ	12/07/2016	9:00	Construction output	%	10/2016		-5				-7.4
CZ	12/07/2016	9:00	Industrial output	%	10/2016		0.5		0.5		2.7
CZ	12/07/2016	10:00	FX reserves of the CNB	EUR B	10/2016					78.4	
HU	12/07/2016	11:00	Budget balance	HUF B	11/2016					57.3	
CZ	12/07/2016	12:00	CZ bond auction 2016-19, 0.00%	CZK B	12/2016			5			
CZ	12/07/2016	12:00	CZ bond auction 2014-2027, floating rate	CZK B	12/2016			3			
PL	12/07/2016	14:00	NBP meeting	%	12/2016	1.5		1.5		1.5	
CZ	12/08/2016	9:00	Unemployment rate 15-64	%	11/2016	5		5		5	
HU	12/08/2016	9:00	CPI	%	11/2016			0.1	1.2	0.6	1
HU	12/08/2016	9:00	Trade balance	EUR M	10/2016 *P					1005	
CZ	12/09/2016	9:00	CPI	%	11/2016	0.2	1.4	0.2	1.3	0.3	0.8

Fixed-income in Charts

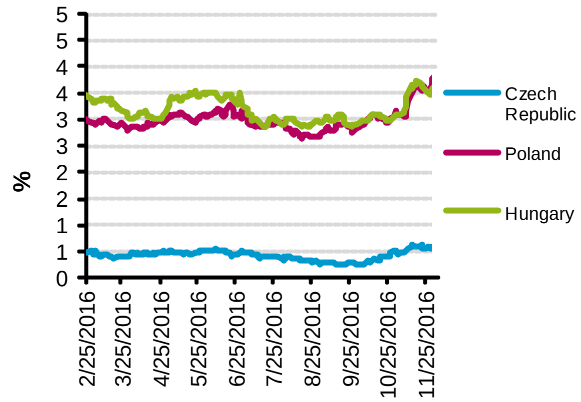
FRA 3x6



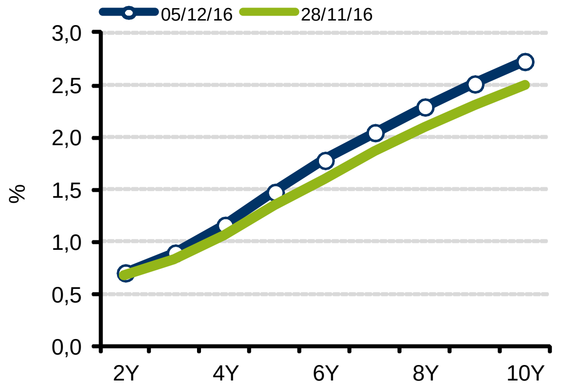
CZ IRS



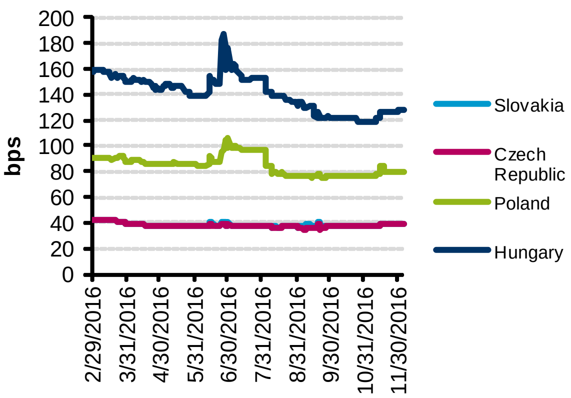
10Y GB Yields



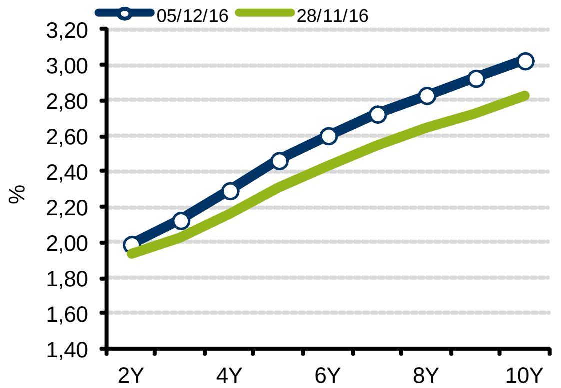
HU IRS



CDS 5Y



PL IRS



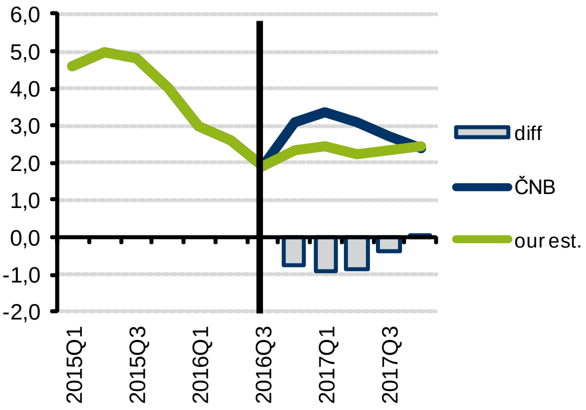
Source: Reuters

Medium-term Views & Issues

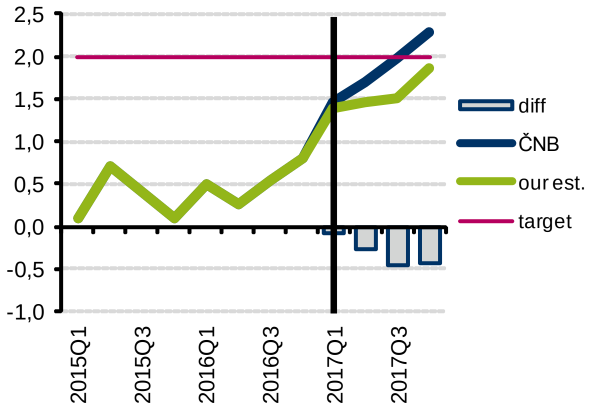
	The Czech Republic	Hungary	Poland
Growth & key issues	After last year's exceptionally strong GDP growth, the growth rate is gradually decelerating this year. The demand side is being primarily driven upwards by household consumption and exports. By contrast, investment activity has decelerated significantly. Despite record-breaking employment and wage growth acceleration, inflation remains well below the Czech National Bank's target. The current government is not expected to put in place any significant economic and political reforms or changes except the unified electronic records of sales. Likewise, the Czech Republic is unlikely to take any steps to adopt the euro in the near future.	Second quarter GDP figure confirmed our view that the household consumption provides a stable base for Hungarian economy as it increased by 5% Y/Y. The main driver of consumption is the increasing employment and growing real wages. Taking in account the tightness of Hungarian labor market, the elevated net real wage growth may remain in the next year, but the increase of employment may slow down. As the households maintained the relatively high level saving willingness so far, we see room for extra demand coming from the lower saving rate in next year. Although the GDP growth may be only around 2% Y/Y in this year, we expect a acceleration to around 3% Y/Y in 2017 driven by the EU funds money usages, but fundamentally the private investments are still missing, which deteriorates the medium term outlook of Hungarian economy.	Prospects of the Polish economy remain good in our view. For the whole year 2016 we expect GDP growth may reach 3.0 – 3.5 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 inflation forecast still envisages meeting the inflation target in the second half of 2017, thus freeing the CNB's hands to discontinue its exchange rate system, with the CNB Board expecting the discontinuation in the middle of next year. At the same time, the CNB predicts a significant rise in short-term market rates as early as in the third quarter, but we see this as very unlikely. Moreover, when timing the departure from its interventions and rate hikes, the CNB will also have to take the ECB policy into account to avoid unnecessarily triggering excessive inflows of speculative capital. For the sake of completeness, we can add that the idea of putting negative rates in place is not on the agenda at all.	The inflation is still well below the 3% Y/Y inflation target and it is unlikely to exceed that level in the next six quarters. It means that NBH may continue the loose monetary policy, although no further rate cut is expected, some unconventional tools may be introduced in the next months. The NBH focuses on pushing down the Bubor rate (the reference rate of lending), which policy was quite successful in previous months. The NBH also channels with its actions money into government bonds in the domestic financial sector, which may keep bond yields at historic low level in the following weeks, Also a possible upgrade of Hungarian rating may keep bonds yield low.	We expect the NBP to keep official rates stable in the foreseeable future as indicated by official statements and comments of members of the Monetary Policy Council. Although we expect the next move will be to the upside, we think short-term risks are tilted to the downside.
Forex Outlook	The development of the economy so far, including inflation, wages, and GDP growth, has been consistent with the CNB's forecast. This will enable the CNB to abandon its exchange rate commitment after the end of 201Q1 – if, of course, continued trends in the economy and the ECB policy so allow. We believe that slightly lower than expected inflation should not be a problem either, as it will still significantly approach the CNB's target. The timing of the exit will probably come as a surprise, in order to minimize further speculative capital inflows.	The EUR/HUF is traded in a relatively tight range, but it was able to break the 310 level. The fundamentals (high trade and current account balance, decreasing external debt etc.) suggests further HUF strengthening especially in the current low interest environment. We see strong resistance level around 307.5 and 305, and we think that NBH's action may stop the HUF strenghtening around that levels. In medium term we expect trading range between 305 and 313.	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

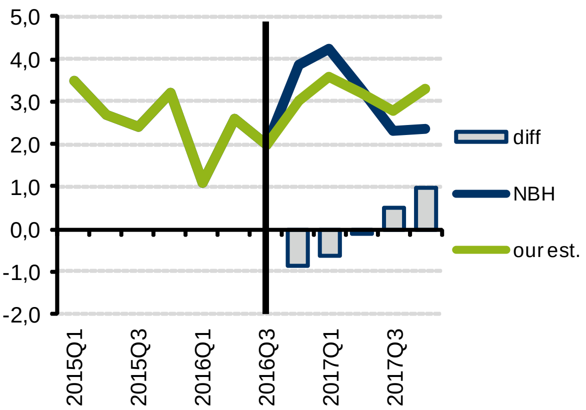
CZ: GDP outlook (Y/Y, %)



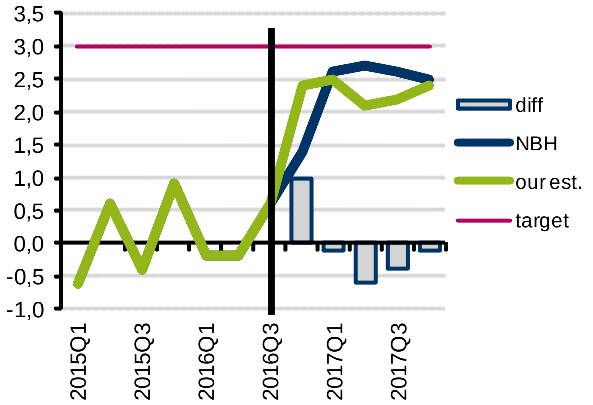
CZ: Inflation outlook (Y/Y, %)



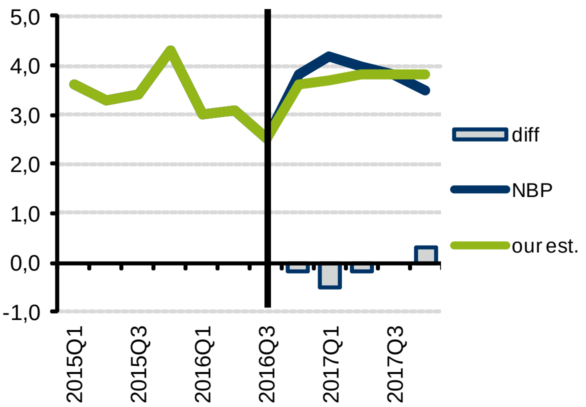
HU: GDP outlook (Y/Y, %)



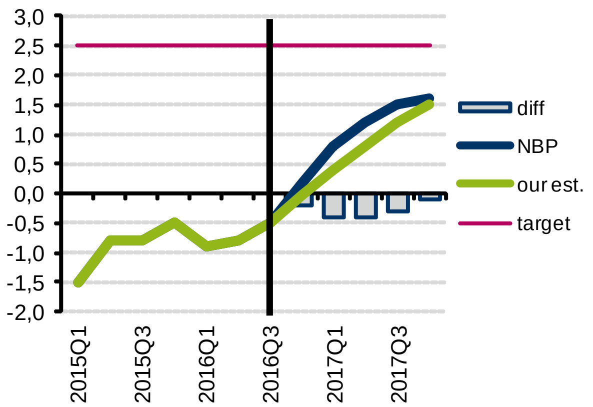
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outllok (Y/Y, %)



Source: CNB, NBP, NBH, KBC

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2016Q2	2016Q3	2017Q1	2017Q2	2017Q3	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.	*0.90*	0.90	0.90	0.90	0.90	0.90	-10 bps	5/24/2016
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	2016Q2	2016Q3	2017Q1	2017Q2	2017Q3
Czech Rep.	PRIBOR	*0.00*	0.25	0.25	0.29	0.29	0.28
Hungary	BUBOR	*0.51*	1.01	0.88	0.90	0.90	0.90
Poland	WIBOR	*1.73*	1.71	1.71	1.70	1.70	1.70

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

		Current	2016Q2	2016Q3	2017Q1	2017Q2	2017Q3
Czech Rep.	CZ10Y	*0.98*	0.50	0.53	1.05	1.10	1.15
Hungary	HU10Y	*2.72*	2.18	2.00	2.80	2.80	2.90
Poland	PL10Y	*3.03*	2.22	2.33	2.50	2.70	2.80

Exchange rates (end of the period)

		Current	2016Q2	2016Q3	2017Q1	2017Q2	2017Q3
Czech Rep.	EUR/CZK	*27.07*	27.06	27.02	27.02	27.02	26.60
Hungary	EUR/HUF	*314*	315	309	315	310	313
Poland	EUR/PLN	*4.49*	4.37	4.30	4.39	4.28	4.27

GDP (y/y)

	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Czech Rep.	2.6	1.9	2.3	2.4	2.2	2.3	2.4
Hungary	2.6	2.0	3.0	3.6	3.2	2.8	3.3
Poland	3.1	2.5	3.6	3.7	3.8	3.8	3.8

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

	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Czech Rep.	0.1	0.5	1.2	1.5	1.6	1.7	1.9
Hungary	-0.2	0.6	2.4	2.5	2.1	2.2	2.4
Poland	-0.8	-0.5	0.0	0.4	0.8	1.2	1.5

Current Account

	2016	2017
Czech Rep.	1.6	1.7
Hungary	4.1	3.5
Poland	-1.5	-1.3

Public finance balance as % of GDP

	2016	2017
Czech Rep.	-0.5	-0.7
Hungary	-2.0	-2.5
Poland	-2.9	-3.0

Source: KBC, Bloomberg

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