



Central European Weekly

Monday, 20 March 2017

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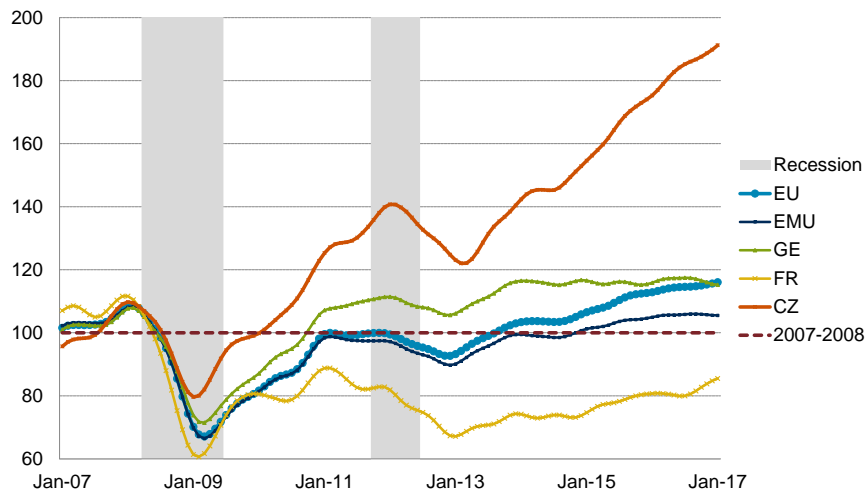
Weekly Highlights:

- Another verbal intervention from the CNB, and even more real interventions in the spot FX market
- Polish consumer and Czech producer inflation are heading up
- The Czech automotive industry still in a very good shape

Chart of the Week: Czech car industry

Car industry boom

(2007-2008=100; Source: Eurostat, CSOB)



Boom in the Czech car industry continues (for more see the page number 3).

Market's editorial

Another verbal intervention from the CNB...

The Czech central bank will “probably” end its cap on koruna gains at around mid-year reiterated Vice Governor Hampl, but he can “personally imagine that the exit can happen even a little later”. We do not overestimate Hampl’s words – actually we see it as an unsuccessful verbal intervention without any impact on the forex market (both spot and forward). Hence we stick to our base-line scenario -as the Czech inflation topped its target, we believe the end of forex interventions (against the koruna) could come in Q2 2017.

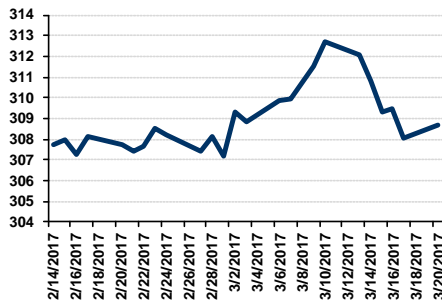
... and even more interventions in the spot FX market

The Czech National Bank continues to intervene heavily against the koruna appreciation. In March, the volume of excess liquidity that is being withdrawn from the Czech banking system has already increased by about CZK 220bn (approx. EUR 8.15bn). Speed of CNB liquidity accumulation has so far been only faster in January 2017.

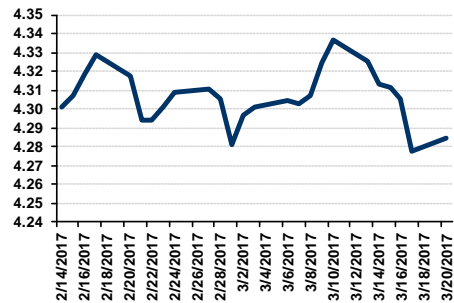
	Last	Change 1W
EUR/CZK	27.0	0.01%
EUR/HUF	309	-1.15%
EUR/PLN	4.29	-0.98%

	Last	Change 1W
10Y CZK	1.33	-2.21
10Y HUF	2.91	-1.69
10Y PLN	3.10	0.32

EUR/HUF



EUR/PLN



Review of Economic Figures

February's Polish inflation exceeded market expectations

Having slightly surpassed market consensus, **February inflation in Poland** got close to the NBP target of 2.5% y/y. It is well possible that tightening of so far neutral monetary policy may return on the agenda as early as by the end of the first half of this year. Higher rates would undoubtedly help the zloty regain positions lost at the end of 2016.

The Czech automotive superpower strengthens

After a short leisure break, which industry took in December, its pace is once again gaining momentum. And so in January, the **Czech industrial production** increased by 9.6%, which in addition to the excellent performance of the automotive industry was helped by two extra working days. After adjusting for the effect of the different number of working days, production rose by 4.3%, but even so this is basically an excellent result. The automakers continue to show the direction and strength of industry. This time, they managed to increase production by nearly 19% and are thus at new historical highs for the number of cars produced. After some time even the energy industry managed to increase its performance. The result in this case must not be overestimated because it only makes up for what it lost in the past year. This time not only the growth of production itself but also contracts brought a happy smile. They grew by 7%, with demand rising both at home and abroad. The statistics confirm the continuing interest in new cars, electrical equipment and chemical products. Expectations for the coming months are high. As shown by the PMI and confidence in the sector; we can look forward to acceleration in industrial production at least over the next three months. Industry thus retains its position as the main driver of the Czech economy, employment and living standards.

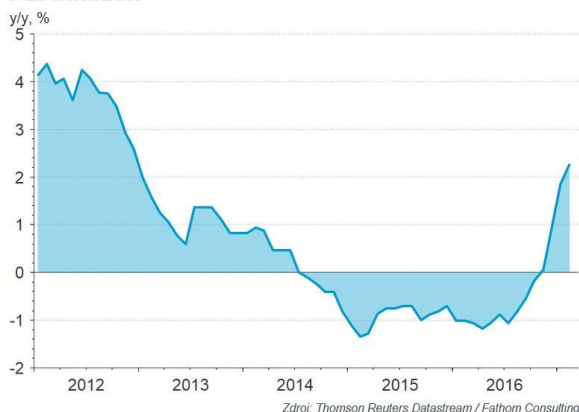
Manufacturing inflation gaining momentum

Last year, the Czech industry was mostly reducing the prices of products, however, since the beginning of this year the situation has changed dramatically. **Czech industrial producer prices** have currently risen by 3.1%; production prices are cheaper than last year in only five of the sixteen industries. Most businesses in the mining industry are pushing up prices in response to developments in commodity prices on world markets. However, the manufacturing industry is not lagging behind; prices there have risen on average by 4%, mainly due to rising prices of chemical products (the effect of more expensive oil), metal, furniture, electrical equipment and electronics (due to a stronger dollar used to pay for components). On the other hand, the automotive industry faces lower prices but not because it is discounting its final products but because of the declining cost of purchased parts and accessories for car production. The growth of industrial prices in the coming months has not peaked yet but is already beginning to put pressure on inflation. The current data reinforces the upside risks even for this year and supports an early end to the CNB's exchange rate regime.

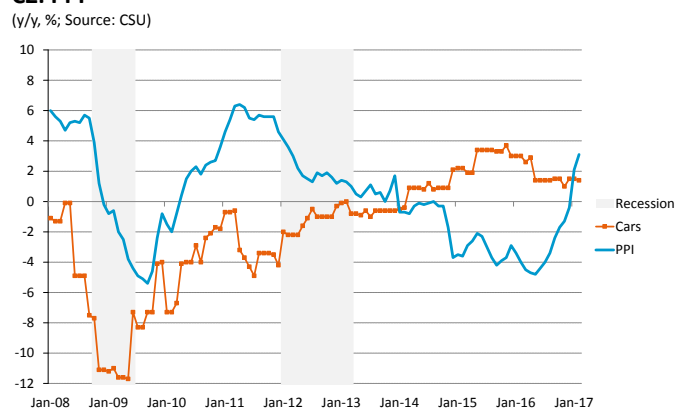
The Czech balance of payments in huge surplus in January

In line with expectations, the C/A of the **Czech balance of payments** closed with a large (CZK 29bn) surplus in January, mainly owing to exports higher than imports and weak net dividend outflow at the beginning of the year. For the whole of 2017, the C/A surplus may climb up to 1.2 % of GDP, supporting thereby CZK's strengthening in the medium term horizon.

PL: Inflation



CZ: PPI

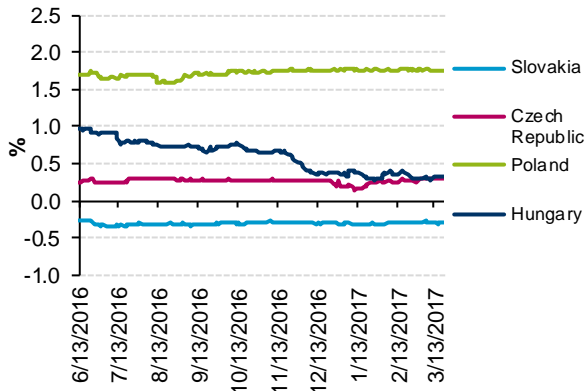


Calendar

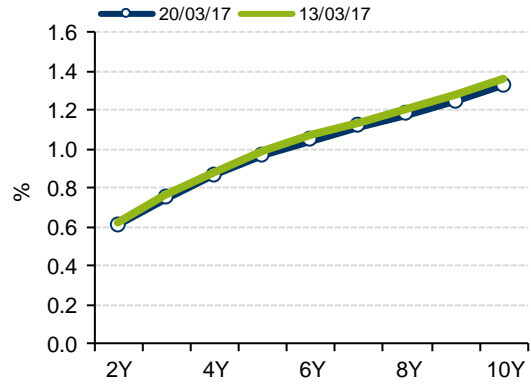
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	03/20/2017	0:00	Earnings Kofola		CZK	FY/2016					
HU	03/20/2017	9:00	Wages		%, ytd.	01/2017			9.5		5.7
CZ	03/21/2017	0:00	Earnings CEZ		CZK	FY/2016					
CZ	03/22/2017	12:00	CZ bond auction 2017-20, 0.00%		CZK B	03/2017			5		
CZ	03/22/2017	12:00	CZ bond auction 2017-27, 0.25%		CZK B	03/2017			4		
CZ	03/23/2017	0:00	Earnings Pegas NW		CZK	FY/2016					
HU	03/23/2017	8:30	Current account		HUF B	4Q/2016					1289
PL	03/23/2017	10:00	Unemployment rate		%	02/2017			8.6		8.6

Fixed-income in Charts

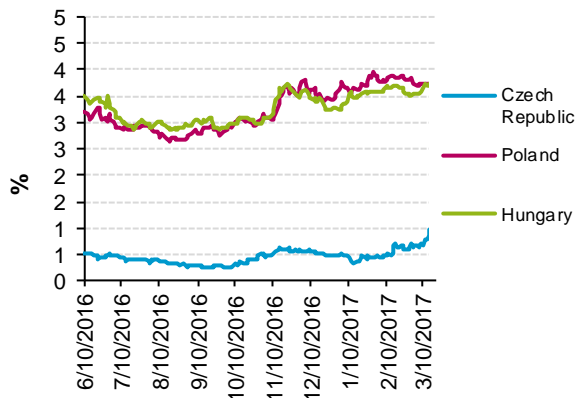
FRA 3x6



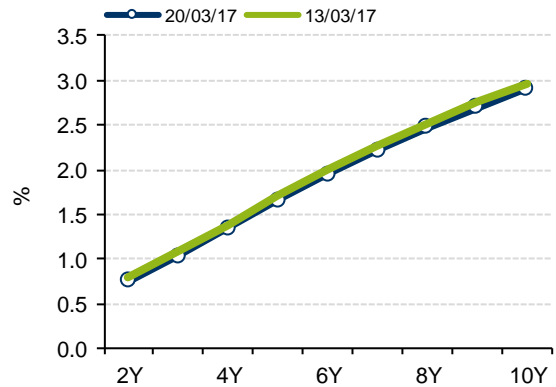
CZ IRS



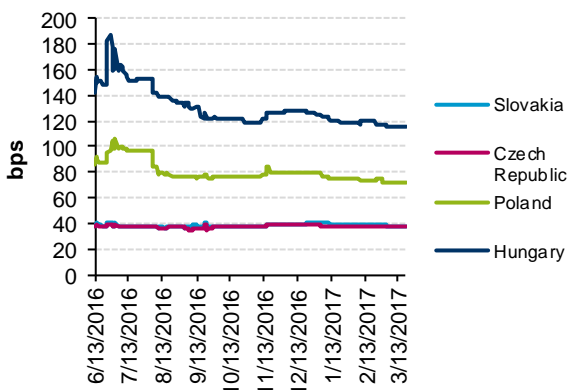
10Y GB Yields



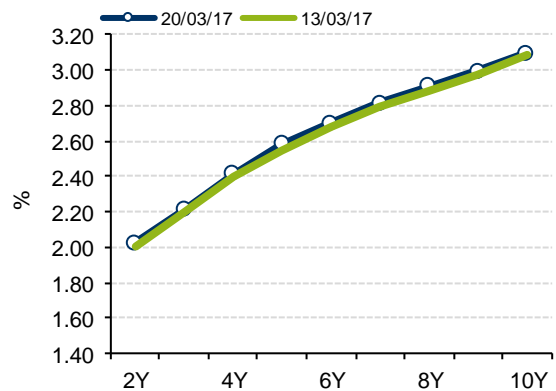
HU IRS



CDS 5Y



PL IRS



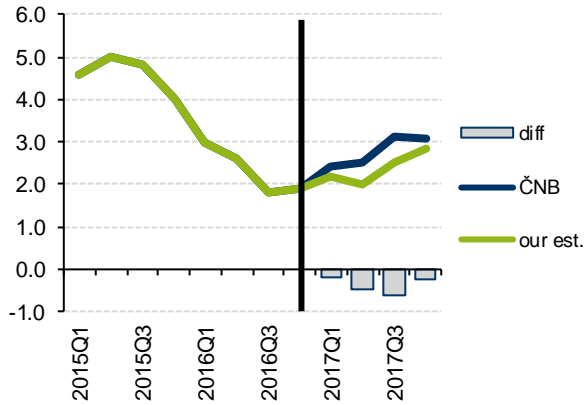
Source: Reuters

Medium-term Views & Issues

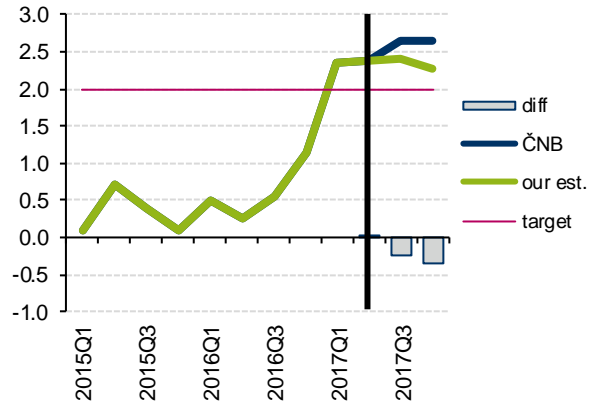
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>GDP growth remains primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see boom of consumption supported by the accelerating wages and positive consumers' expectations. At the moment, we cannot expect any fundamental economic changes or reforms because of the Autumn Parliamentary elections. Progress in the country's preparations for joining the euro area is not expected in this (as well next) electoral term either..</p>	<p>The Hungarian economy slowed down substantially in 2016, due to the lower use of EU funds money and lack of investment. The main driver of the growth was domestic consumption, which might still boost the economy in 2017. The household consumption is supported by massive wage increase and some government measures like moderation of VAT, social contribution fee, while investment may be supported by the new EU funds inflows and corporate income tax cut in 2017. We expect above 3.5% Y/Y growth for 2017 up from around 2% Y/Y growth in 2016.</p>	<p>The Polish economy slightly decelerated because the absorption of EU Structural Funds is not optimal, and investment is slowing down as a result. Thus, the economy should be driven by private consumption – thanks to persisting fiscal stimuli (increased child benefits) as well as decently growing wages.</p>
Outlook for official & market rates	<p>The CNB continues to stick to its hard commitment to intervene against the koruna till the end of Q1 2017. As the inflation reached the target about half a year earlier than the most recent CNB's forecast, we believe the end of the interventions could come already in Q2 2017. We assume the first interest rate hike to come not earlier than 6 month after the end of interventions – probably not sooner than in 2018. On the other hand CNB could theoretically adopt negative interest rates as a tactical tool to smooth the need of the interventions (although it is not preferred scenario).</p>	<p>The National Bank of Hungary kept base rate unchanged at 0.9%, but it continued to use the unconventional tools. The cap of 3-month deposit at HUF900bn was introduced as the end of 2016, while the ON lending rate was moderated to 0.9%. Although we don't expect any cut of base rate for the coming months, the NBH may moderate further the maximum amount can be placed in 3-month deposit in 1Q17, which means that the effective benchmark interest rate may be moderated further, which is already around 0.5%. The NBH actions may keep the short-end of the curve at the current low level, while we see some risk on the upside on the long-end of the curve at the beginning of 2017, so we expect some modest steepening.</p>	<p>The official interest rates of the National Bank of Poland should remain unchanged throughout the year, even though inflation will rise this year. Nevertheless, inflation is very unlikely to reach even the NBP's inflation target (2.5%). However, market interest rates with longer maturities may be very volatile during the year, especially if interest rates on key markets continue to rise.</p>
Forex Outlook	<p>As the inflation reached the target about half a year earlier than the most recent CNB's forecast, we believe the end of the interventions could come already in Q2 2017. We believe in subsequent gains of the koruna, which the CNB is probably going to limit around 26.00 EUR/CZK level. On the other hand, very strong speculative capital inflow prior the exit (similar to that one that was seen at the beginning of the January) could lead to overly optimistic bets on the koruna strengthening – these could finally end up in temporary losses of the koruna after the exchange rate regime is abolished.</p>	<p>The EURHUF moved suddenly from 304 to 315 partly parallel with polish zloty move, but it was effected also by the extra HUF liquidity pumped into the market by the NBH. Although fundamentally we see some pressure on real appreciation of the currency, the NBH may try to keep the exchange rate in the range of 307 and 315 in the coming months. The inflation is expected to accelerate to around 2% Y/Y, which is higher than in the Eurozone, which also means some real appreciation of the currency if it remain nominally unchanged around the current level.</p>	<p>While dollar market rates, driven by expectations of a rate hike by the Fed, may keep the zloty on the defensive, the ECB's eased policy may counterbalance such pressure. Moreover, Poland's continuing upturn and the NBP's very conservative monetary policy are fundamentally positive for the zloty from the medium-term perspective. Of the Polish macroeconomic fundamentals that should not allow the zloty to weaken significantly, we should mention the very well developing balance of payments and growing FX reserves.</p>

CBs' Projections vs. Our Forecasts

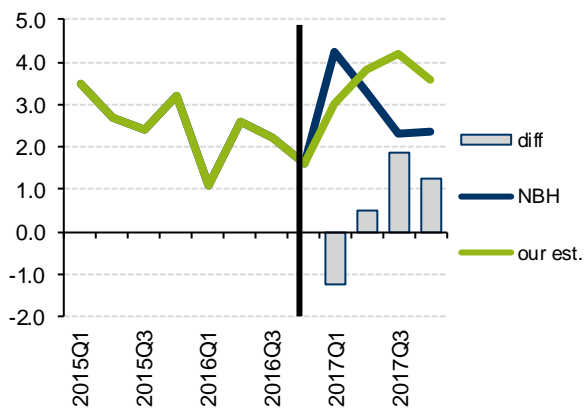
CZ: GDP outlook (Y/Y, %)



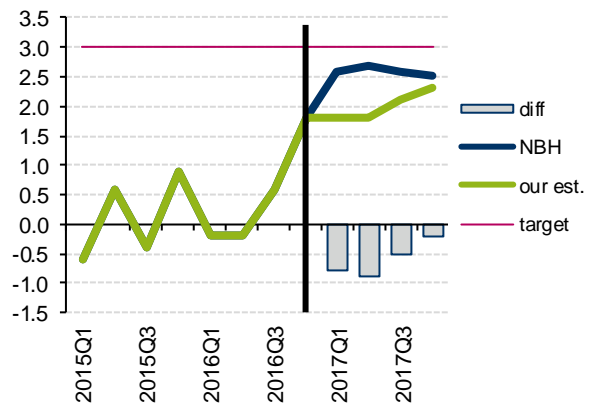
CZ: Inflation outlook (Y/Y, %)



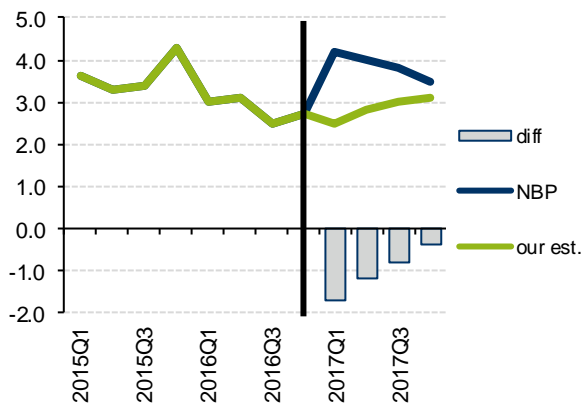
HU: GDP outlook (Y/Y, %)



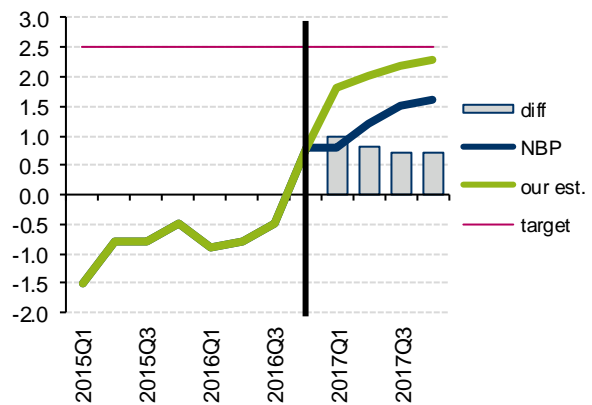
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outlook (Y/Y, %)



Source: CNB, NBP, NBH, KBC

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	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	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Czech Rep.	PRIBOR	0.28	0.25	0.28	0.28	0.28	0.28
Hungary	BUBOR	0.23	0.37	0.30	0.40	0.50	0.70
Poland	WIBOR	1.73	1.73	1.75	1.75	1.80	2.70

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

		Current	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Czech Rep.	CZ10Y	1.33	0.88	1.25	1.30	1.35	1.40
Hungary	HU10Y	2.91	2.39	2.50	2.60	2.80	3.00
Poland	PL10Y	3.10	3.00	3.10	3.20	3.30	3.50

Exchange rates (end of the period)

		Current	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Czech Rep.	EUR/CZK	27.03	27.02	27.02	26.90	26.60	26.20
Hungary	EUR/HUF	309	309	315	310	303	308
Poland	EUR/PLN	4.29	4.40	4.39	4.28	4.27	4.25

GDP (y/y)

	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2
Czech Rep.	1.9	2.2	2.0	2.5	2.8	#N/A	#N/A
Hungary	1.6	3.0	3.8	4.2	3.6	#N/A	#N/A
Poland	2.7	2.5	2.8	3.0	3.1	#N/A	#N/A

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

	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2
Czech Rep.	2.0	2.5	2.5	2.5	2.1	#N/A	#N/A
Hungary	1.8	1.8	1.8	2.1	2.3	#N/A	#N/A
Poland	0.8	1.8	2.0	2.2	2.3	#N/A	#N/A

Current Account

	2016	2017
Czech Rep.	1.6	1.8
Hungary	5.5	5.0
Poland	-1.5	-1.3

Public finance balance as % of GDP

	2016	2017
Czech Rep.	0.3	-0.7
Hungary	-1.5	-2.5
Poland	-2.9	-3.0

Source: KBC, Bloomberg

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