Central European Weekly

Monday, 24 April 2017

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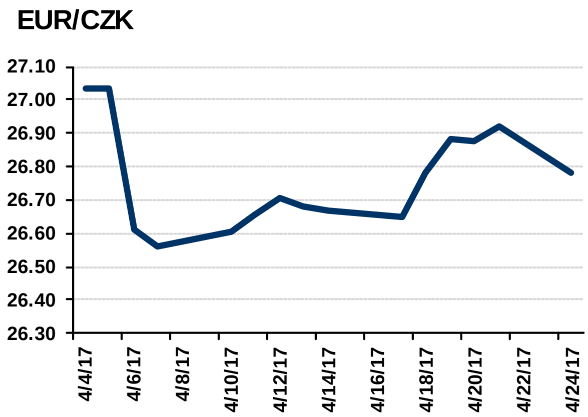
Chart of the Week: CZK slides back…



The EUR/CZK pair temporary moved back to the previous intervention floor 27.00.

Central European Daily

Monday, 24 April 2017

Market's editorial

The CZK slides back to intervention floor

The Czech koruna extended its losses yesterday as the EUR/CZLK moved closer to the previous intervention floor (27.00) abandoned recently by the Czech National Bank. It seems that uncertainty ahead of the first round of the presidential elections might play some role as speculators betting on koruna's gains (entering their short EUR/CZK positions ahead of the CNB exit) could feel shakier. Bear in mind that the Czech economy had enjoyed around EUR 50-60bn of hot money inflows in the first quarter of this year betting the Swiss-style exit from the intervention regime set-up by the Czech central bank.

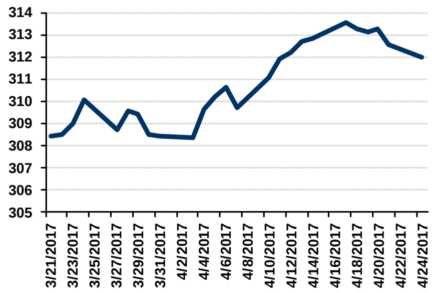
The S&P affirms Poland's sovereign rating

S&P rating agency confirmed its 'BBB+' sovereign rating of Poland, while it left the outlook stable on Friday. The agency, which had surprisingly downgraded country's ratings at the beginning of 2016, said that the ratings are supported by our view of Poland's flexible exchange rate regime and the National Bank of Poland's (NBP) independent and credible monetary policy. On the other hand according to the S&P the ratings were constrained by Poland's low income and wealth levels and an institutional framework that has weakened as a result of government measures undermining key institutions' ability to work as a check and balance on the government. In this respect it is worth noting that the S&P warned that it could lower the affirmed ratings if Polish public finances deteriorated beyond its base-case scenario (the agency sees the public budget deficit at 3% of GDP for 2017 and 2018) or it saw an increase in quasi-fiscal activities by state-owned institutions that could weaken the government's balance sheet or the NBP's independence is weakened.

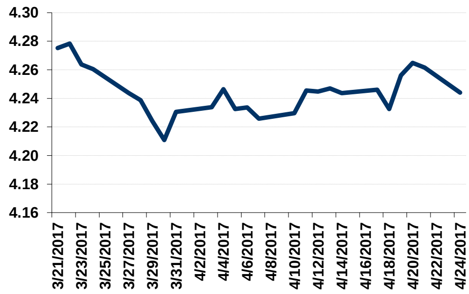
	Last	Change 1W
EUR/CZK	26.8	0.62%
EUR/HUF	312	-0.63%
EUR/PLN	4.25	-0.05%

	Last	Change 1W
10Y CZK	1.32	4.78
10Y HUF	2.67	4.10
10Y PLN	2.88	1.99

EUR/HUF



EUR/PLN

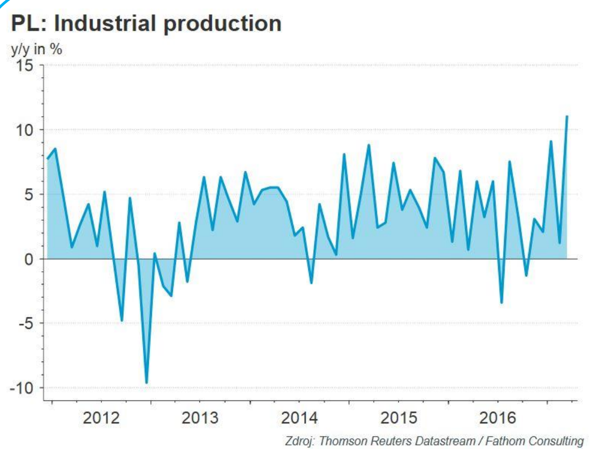


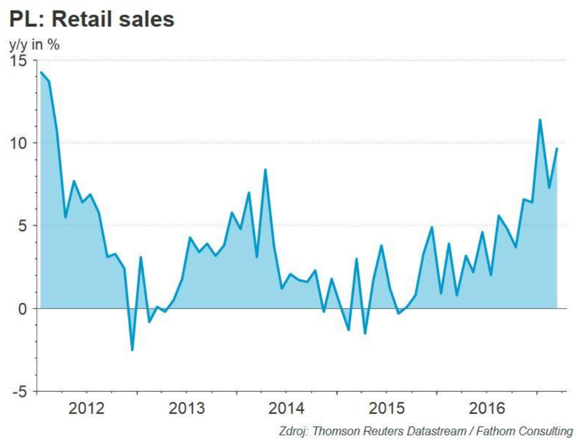
Review of Economic Figures

The Polish macro figures were very strong

The Polish labour market look still very strong as the March figures showed that that both employment and wages grow by around 5%. Hence, the labour market readings for the first quarter were also very strong, which points to solid performance of the economy.

The same message was brought by other importat sectors of the economy – industry and retail. While industrial production climbed by 11.1% y/y, retail sales grew by 9.7% y/y in March. Overall, **Polish macro figures** for March were very strong and support the bullish view on the GDP growth in the first quarter.





Weekly preview

TUE 14:00	NBH base rate	
	This meeting	Last change
rate level (in %)	**0.90**	5/2016
change in bps	**0**	-15

HU: The NBH on hold despite lower inflation

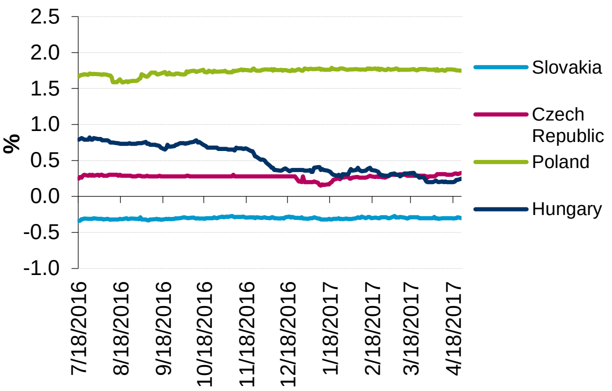
Although the consumer price index surprisingly moderated from 2.9% Y/Y in February to 2.7%Y/Y in March the National Bank of Hungary is now focusing mainly on the core inflation, we think that he overall picture doesn't change substantially compared to previous months. Moreover, the following months might bring further moderation of consumer price index (even close to 2% Y/Y) due to base effect, and headline inflation may move back to around 3% YoY only in autumn, hence the NBH won't be in a hurry to reverse its monetary policy. Moreover, we see increasing chance for another cut of the cap of the 3-month deposit. This action should rather come in June, but definitely not this week.

Calendar

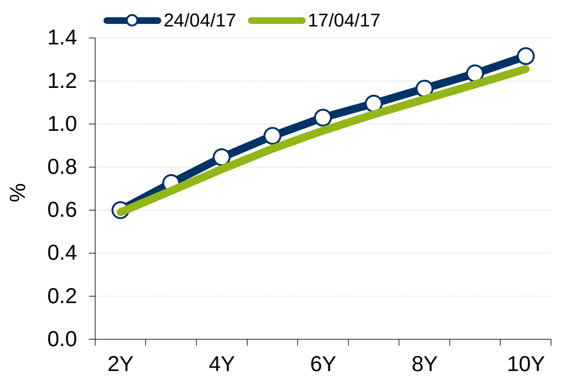
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	04/25/2017	14:00	NBH meeting	%	04/2017	0.9		0.9		0.9	
PL	04/26/2017	10:00	Unemployment rate	%	03/2017			8.2		8.5	
CZ	04/26/2017	12:00	CZ bond auction 2017-20, 0.00%	CZK B	04/2017			5			
CZ	04/26/2017	12:00	CZ bond auction 2014-25, 2.40%	CZK B	04/2017			4			
CZ	04/26/2017	12:00	CZ bond auction 2015-30, 0.95%	CZK B	04/2017			4			
HU	04/28/2017	9:00	PPI	%	03/2017					0.3	4
HU	04/28/2017	9:00	Unemployment rate	%	03/2017			4.5		4.4	
CZ	04/28/2017	10:00	Money supply M2	%	03/2017						9
PL	04/28/2017	14:00	CPI	%	04/2017 *P				2.1	-0.1	2
PL	04/28/2017	15:00	Budget balance	PLN M	03/2017					855	

Fixed-income in Charts

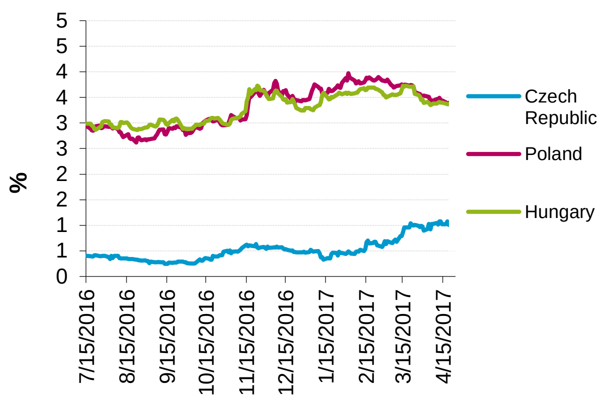
FRA 3x6



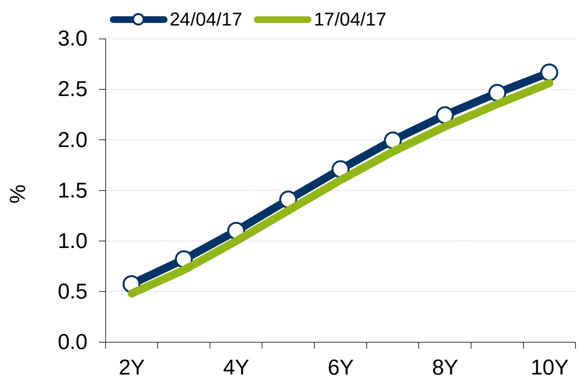
CZ IRS



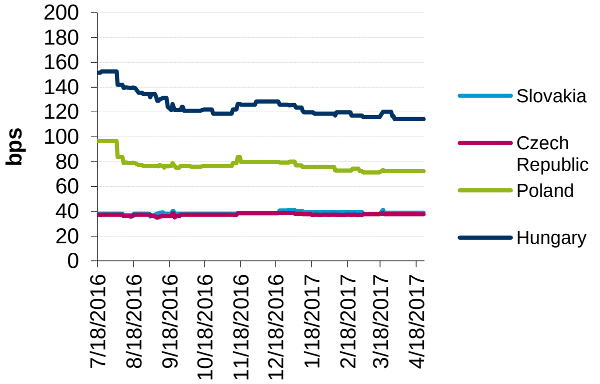
10Y GB Yields



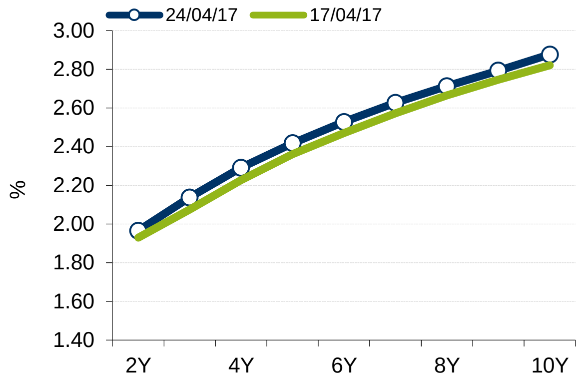
HU IRS



CDS 5Y



PL IRS



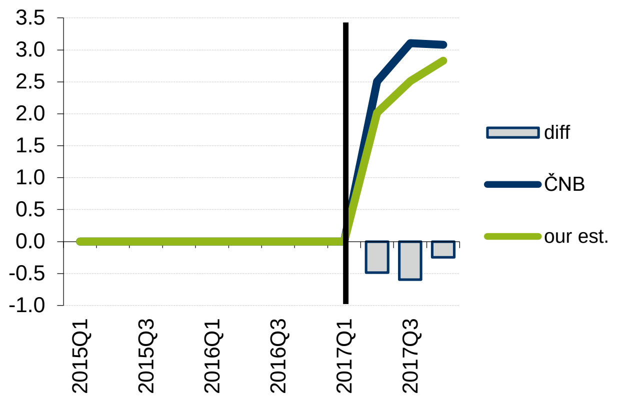
Source: Reuters

Medium-term Views & Issues

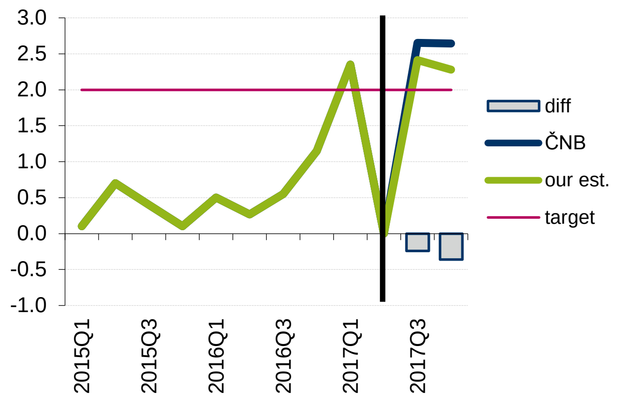
	The Czech Republic	Hungary	Poland
Growth & key issues	GDP growth remains primarily driven by the manufacturing industry, albeit most sectors of the economy are showing a positive trend. On the demand side, we can see boom of consumption supported by the accelerating wages and positive consumers' expectations. 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.	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.	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.
Outlook for official & market rates	As the CNB abandoned the exchange rate intervention regime the monetary conditions in the Czech Republic tightened. So there is no reason to hike CNB's interest rates soon as the central bank can be afraid of fast appreciation of the koruna due to the interest rate differential widening. We therefore assume the first interest rate hike to come in the 2nd half of 2018.	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.	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.
Forex Outlook	We believe the Czech koruna should post gains in the mid to long-term after the end of the interventions seeing it in 1Y horizon about 5% stronger (slightly below 26.00 EUR/CZK). Nevertheless in the short-run, which can last up till several months, we believe the koruna might be volatile in both directions as we might see speculative part of the market closing its long positions at certain levels.	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.	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.

CBs' Projections vs. Our Forecasts

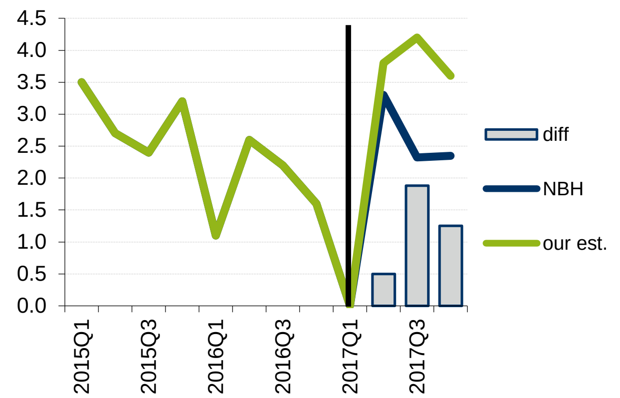
CZ: GDP outlook (Y/Y, %)



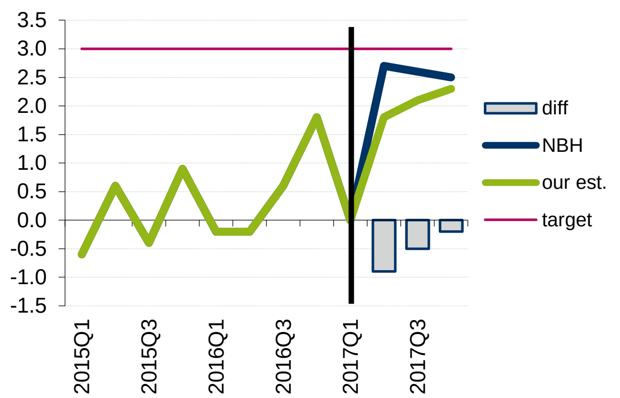
CZ: Inflation outlook (Y/Y, %)



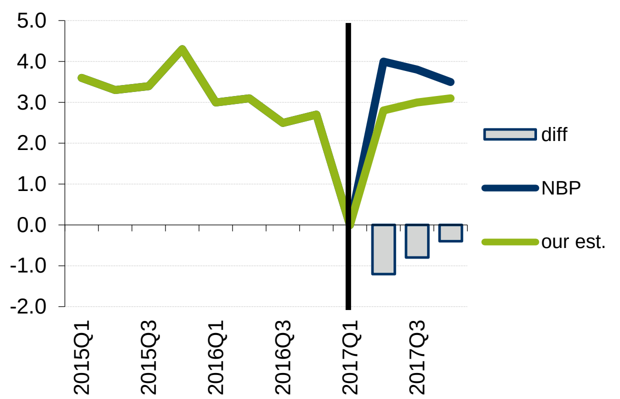
HU: GDP outlook (Y/Y, %)



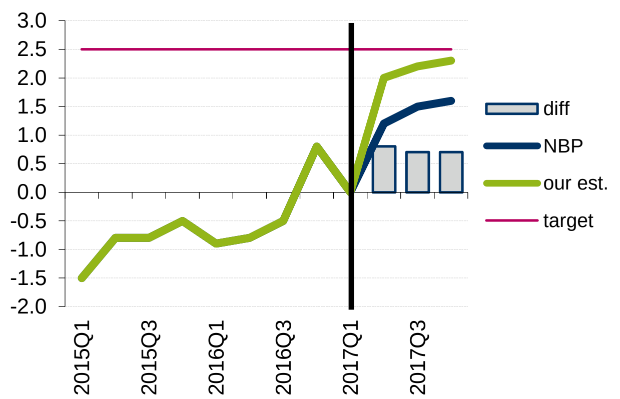
HU: Inflation outlook (Y/Y, %)



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	0.00	0.05	0.05	0.05	-20 bps	9/27/2012
Hungary	2W deposit r.	*0.90*	0.90	0.00	0.90	0.90	0.90	-10 bps	5/24/2016
Poland	2W inter. rate	*1.50*	1.50	0.00	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	*0.29*	0.25	0.00	0.28	0.28	0.28
Hungary	BUBOR	*0.16*	0.37	0.00	0.40	0.50	0.70
Poland	WIBOR	*1.73*	1.73	0.00	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	*1.32*	0.88	0.00	1.33	1.37	1.40
Hungary	HU10Y	*2.67*	2.39	0.00	2.60	2.80	3.00
Poland	PL10Y	*2.88*	3.00	0.00	3.20	3.30	3.50

Exchange rates (end of the period)

		Current	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4
Czech Rep.	EUR/CZK	*26.85*	27.02	0.00	26.90	26.60	26.20
Hungary	EUR/HUF	*312*	309	0	310	303	308
Poland	EUR/PLN	*4.25*	4.40	0.00	4.28	4.27	4.25

GDP (y/y)

	2016Q4	2017Q1	2017Q2	2017Q3	2017Q4	2018Q1	2018Q2
Czech Rep.	0.0	0.0	2.0	2.5	2.8	#N/A	#N/A
Hungary	1.6	0.0	3.8	4.2	3.6	#N/A	#N/A
Poland	2.7	0.0	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	0.0	2.5	2.5	2.1	#N/A	#N/A
Hungary	1.8	0.0	1.8	2.1	2.3	#N/A	#N/A
Poland	0.8	0.0	2.0	2.2	2.3	#N/A	#N/A

Current Account

	2016	2017
Czech Rep.	1.1	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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