



# Central European Weekly

Monday, 21 November 2016

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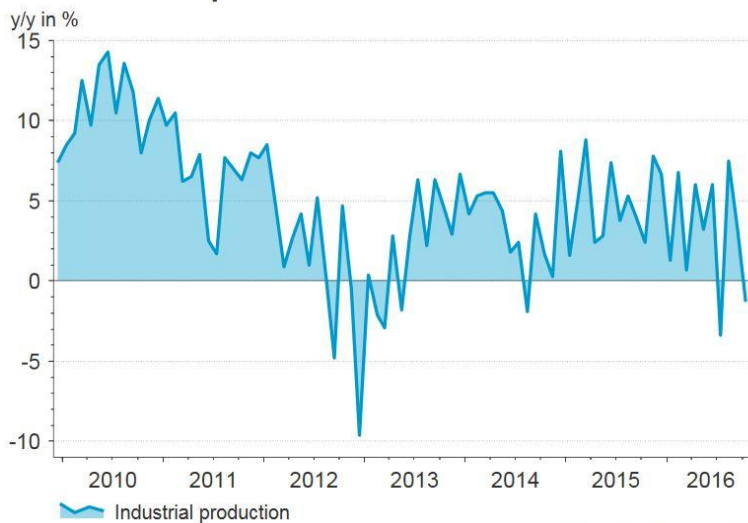
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## Weekly Highlights:

- A weak start for the Polish economy in the 4<sup>th</sup> quarter
- The Czech economy decelerates in the 3<sup>rd</sup> quarter
- Weekly preview: NBH's policy on hold

## Chart of the Week: Polish industry

### PL: Industrial production



Zdroj: Thomson Reuters Datastream / Fathom Consulting

The Polish industrial production surprisingly dropped in October.

# Review of Economic Figures

## The Czech economy decelerates in the 3rd quarter

In line with expectations, the growth of the **Czech economy continued to slow slightly in the third quarter of the year**. While GDP was still growing by 3% early this year, the rate according to a preliminary forecast by the Statistical Office was now just under 2% (1.9%). Nevertheless, the economy accelerated by 0.3% compared to the second quarter. Unlike last year, when GDP grew by 4.6% – primarily fuelled by investment – the economy is now being driven upwards primarily by household consumption and foreign demand. Investment activity remains feeble, due in particular to a fall in public sector investment. The boom triggered by the absorption of remaining EU funds is over, and thus investment is now returning to its original level. At the same time, we believe that private sector investment finds itself in a period of stabilisation, which had already begun at the turn of the year. By contrast, consumption is maintaining a very solid rate – hand in hand with steadily falling unemployment and the improving financial position of Czech households. After all, wage growth has been increasingly even, with almost everybody benefiting from economic growth, with retail sales data essentially bearing out this trend every month.

On the supply side, industry – the main driving force of the Czech economy – decelerated. Industrial output almost stagnated in the third quarter of the year despite very decent foreign demand. This is probably evidence that the period of domestic investment austerity is also taking its toll here – especially in the industries directly or indirectly linked to construction, which are still suffering from the lack

of new orders. At the same time, it is becoming evident that the economy has no adequate substitute for industry. When industry decelerates significantly, nothing seems to be able to substitute for the ‘drop’ in this sector in terms of GDP growth. After all, it is no coincidence that the Czech economy is actually the EU’s most industrial, with economic growth largely based on industry.

We expect figures for the fourth quarter of this year to be very similar to those for the third quarter – in terms of growth itself as well as the trends responsible for it. Industry will again play the primary role on the supply side, and household consumption on the demand side. **For this year as a whole, we believe that the Czech economy will grow by approximately 2.5%.** The same figure can be expected for 2017.

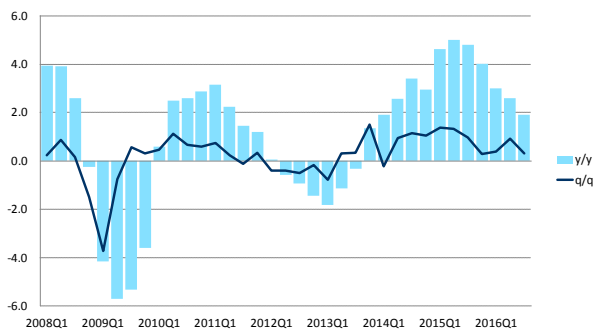
## Performance of the Polish economy deteriorates

GDP growth of the Polish economy surprised negatively as it came out just at 2.5% in the third quarter, which is the worst result in three years. Similarly to the case of Czech Republic, decline in investment has probably weighed on growth.

Moreover, weaker GDP figures were followed by surprisingly poor figures from the fourth quarter. **The (negative) eye catcher was outcome of the Polish industrial production, which dropped by 2.5% month-on-month and 1.3 year-on-year.** Moreover, retail sales and construction figures also disappointed, which implies that the Polish economy has begun the last quarter of the year on weak footing.

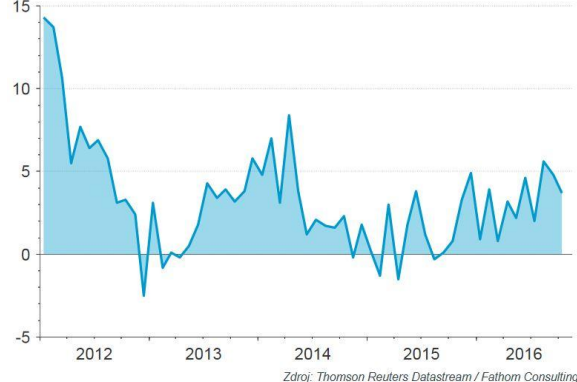
**CZ: GDP Growth**

(Source: CSO)



**PL: Retail sales**

y/y in %



Zdroj: Thomson Reuters Datastream / Fathom Consulting

# 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 to keep as policy unchanged

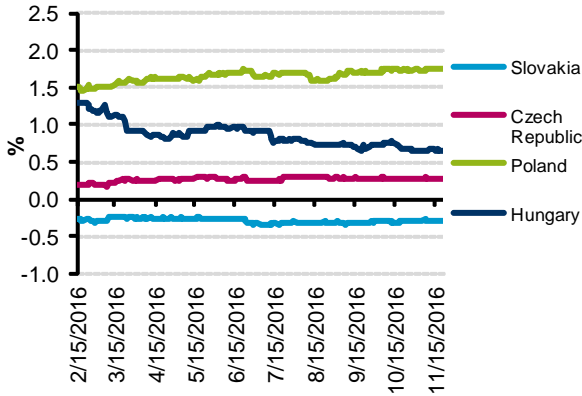
There is no reason for the National Bank of Hungary (NBH) to change its policy, since it can be satisfied that money market interest rates remain low on the one hand, and inflation is starting to rise at last on the other (year-on-year inflation jumped to 1% in October).

# Calendar

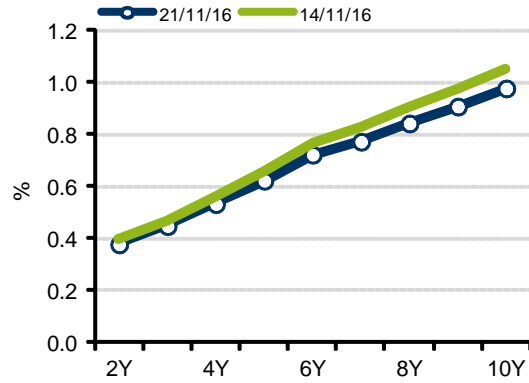
Country	Date	Time	Indicator	Period	Forecast		Consensus		Previous		
					m/m	y/y	m/m	y/y	m/m	y/y	
PL	11/21/2016	14:00	Retail sales	%	10/2016			4.2	4.2	-1.2	4.8
PL	11/21/2016	14:00	Industrial output	%	10/2016			-0.3	1	10.4	3.2
PL	11/21/2016	14:00	PPI	%	10/2016			0.3	0.4	0.3	0.2
CZ	11/22/2016	0:00	Earnings VIG	CZK	3Q/2016						
HU	11/22/2016	9:00	Wages	%, ytd.	09/2016				6.3		6.9
HU	11/22/2016	14:00	NBH meeting	%	11/2016	0.9		0.9		0.9	
CZ	11/23/2016	12:00	CZ bond auction 2016-19, 0.00%	CZK B	11/2016			5			
CZ	11/23/2016	12:00	CZ bond auction 2014-2027, floating rate	CZK B	11/2016			3			
CZ	11/23/2016	12:00	CZ bond auction 2013-2028, 2.50%	CZK B	11/2016			3			
CZ	11/24/2016	0:00	Earnings Pegas NW	CZK	3Q/2016						
PL	11/25/2016	10:00	Unemployment rate	%	10/2016			8.2		8.3	

# Fixed-income in Charts

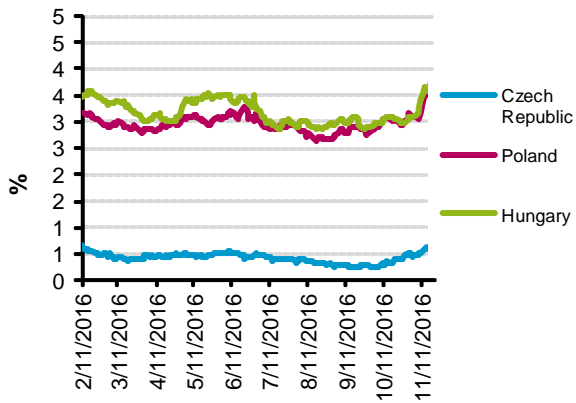
**FRA 3x6**



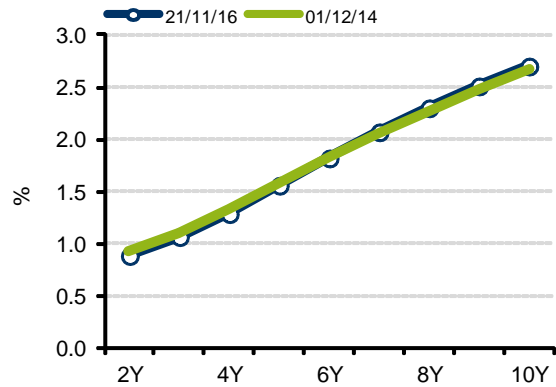
**CZ IRS**



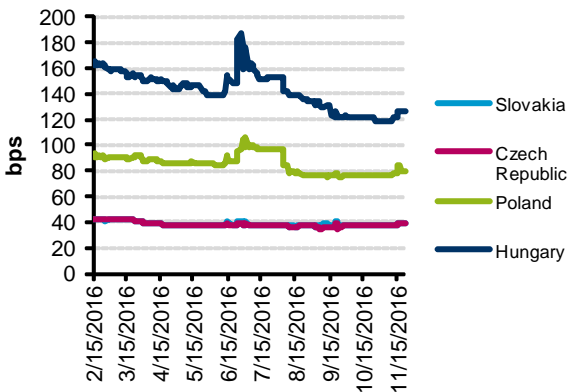
**10Y GB Yields**



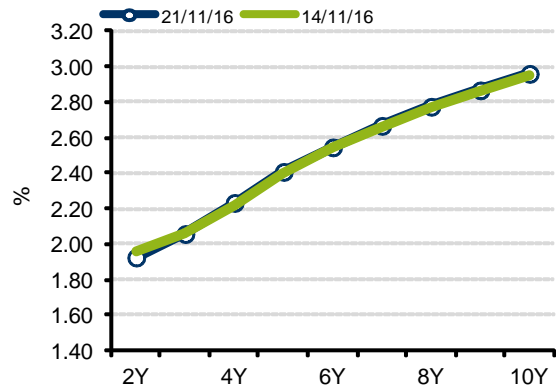
**HU IRS**



**CDS 5Y**



**PL IRS**



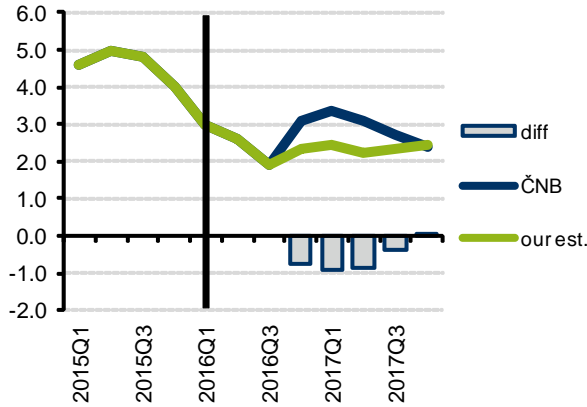
Source: Reuters

# Medium-term Views & Issues

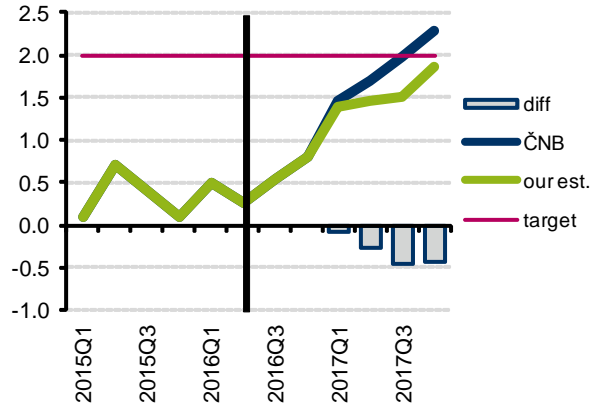
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>After last year's exceptionally strong GDP growth, the growth rate is gradually decelerating this year. The demand side is being primarily driven upwards by household consumption and exports. By contrast, investment activity has decelerated significantly. 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.</p>	<p>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 an 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.</p>	<p>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.</p>
Outlook for official & market rates	<p>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.</p>	<p>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.</p>	<p>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.</p>
Forex Outlook	<p>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 2016Q1 – 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.</p>	<p>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 strengthening around that levels. In medium term we expect trading range between 305 and 313.</p>	<p>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.</p>

# CBs' Projections vs. Our Forecasts

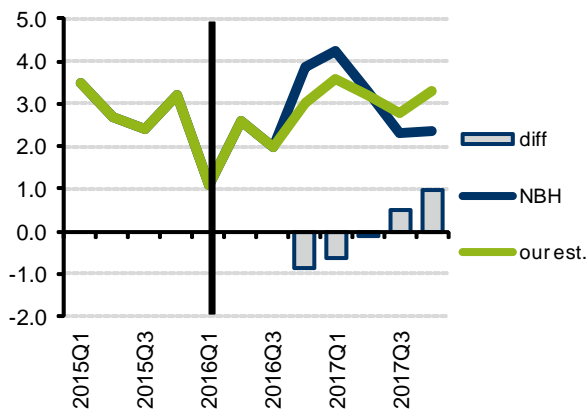
**CZ: GDP outlook (Y/Y, %)**



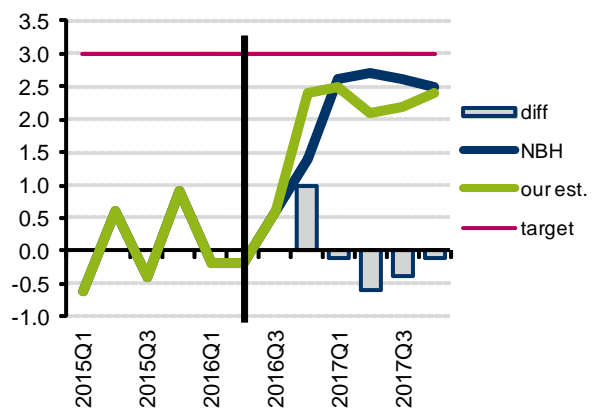
**CZ: Inflation outlook (Y/Y, %)**



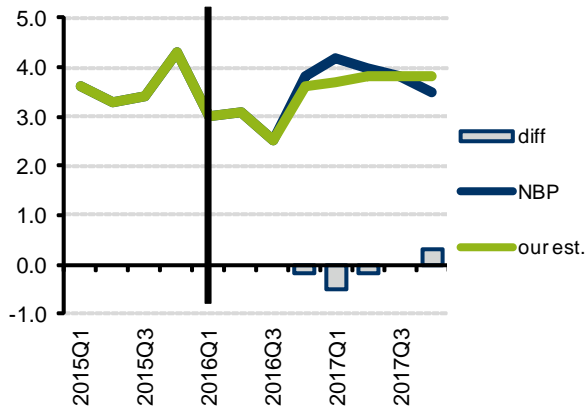
**HU: GDP outlook (Y/Y, %)**



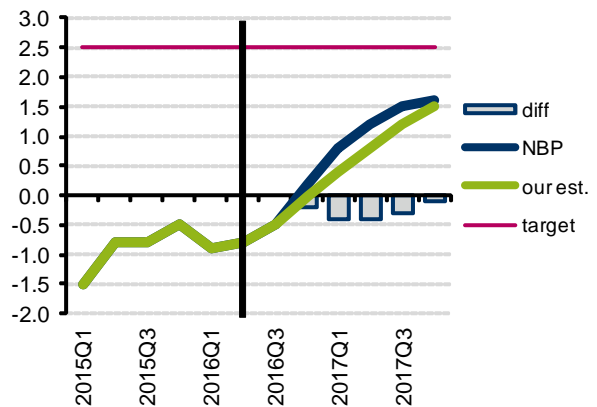
**HU: Inflation outlook (Y/Y, %)**



**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	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	0.66	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	2.70	2.18	2.00	2.80	2.80	2.90
Poland	PL10Y	2.96	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	27.06	27.06	27.02	27.02	27.02	26.20
Hungary	EUR/HUF	309	315	309	315	310	313
Poland	EUR/PLN	4.43	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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