Central European Weekly

Monday, 23 November 2015

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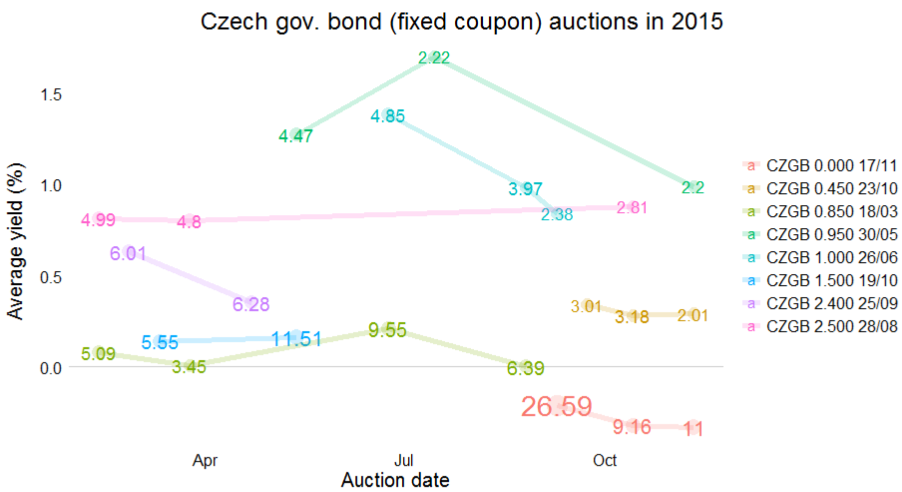
Weekly Highlights:

- The Czech Ministry of finance ready to make use of negative rates
- Is Poland's new government preparing (T)LTRO despite stable growth?
- The NBH to keep its base rate unchanged as long as possible

Chart of the Week



Czech government bond auctions (fixed coupon only) in 2015, average yields in primary auctions. Numbers show total amount sold (CZK billion). Colour varies by particular bonds. (Source: CNB, CSOB)

Market's editorial

New Polsih PM: NBP might try to run LTROs

The third week of a month usually sees monthly macroeconomic data releases in Poland, and October was no exception. However, this time the data on retail sales and industrial output were somewhat overshadowed by the speech delivered by Poland's new Prime Minister Szydlo. In her inauguration speech she outlined some of the points from the government's economic programme. Not only the oncoming fiscal expansion but, in particular, a slightly more specific outline of the direction of the possible thoughts by Poland's new government about its monetary policy drew market attention. Specifically, Prime Minister Szydlo suggested that the Polish government was considering the introduction of a longer-term refinancing operations programme with the aim of encouraging credit activity, i.e., a measure similar to that used by the ECB (TLTRO).

Czech MinFin to hike bond supply as negative rates loom

The Czech Ministry of Finance also drew attention by its expansive steps. Minister Babiš said that, notwithstanding the improving fiscal position and a lower state budget deficit, he was going to take advantage of the favourable conditions (negative interest rates) on the government bond market next year once again. In 2016 the Ministry is going to issue at least CZK 150 billion in new debt. Let us add that, until at least the end of this year, the Ministry is unlikely to have even the least problems finding investors willing to finance the Czech government debt, given the liquidity conditions on the market as well as other circumstances. The government bond auction scheduled for this Wednesday will probably bear this out.

the National Bank of Hungary (NBH) left base rate unchanged at 1.35% in line with the market expectation. The stance of the statement also didn't change compared to the previous month. The Monetary Council sees still inflation gradually increasing, which might achieve the inflation target of 3% Y/Y only at the end of the forecasted horizon (second half of 2017). Although the domestic demand pushes up the core inflation, the low cost environment holds back the increase of consumer price index. The Council highlighted that there are many uncertainties in foreign sentiment, which still calls for cautious monetary policy.

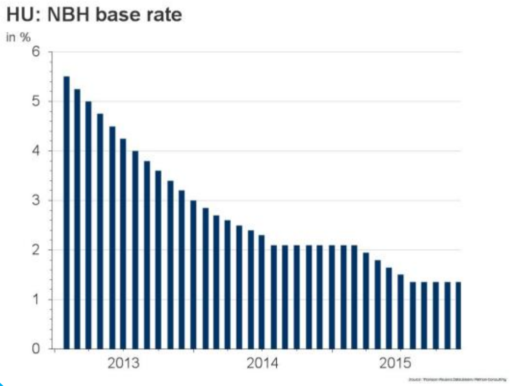
The NBH to keep its base rate unchanged as long as possible

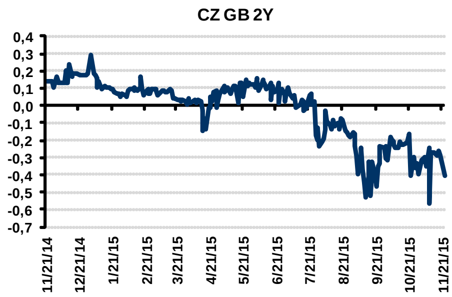
The statement was finished with the following sentence: "If the assumptions underlying the Bank's projections hold, the current level of the base rate and maintaining loose monetary conditions for an extended period, over the entire forecast horizon, are consistent with the medium-term achievement of the inflation target and a corresponding degree of support to the economy."

It is clear that the NBH would like to keep its base rate unchanged as long as possible, and looking ahead no base rate hike is expected for 2016. On the down side there are two main risks: 1) Poland restarts a substantial rate cut cycle 2) The EUR/HUF moves below 305 permanently. These cases may force NBH to cut the base rate in 1Q16, but this is not our base case scenario.

	Last	Change 1W
EUR/CZK	27.1	-0.14%
EUR/HUF	311	-0.47%
EUR/PLN	4.24	-0.13%

	Last	Change 1W
10Y CZK	0.86	-3.37
10Y HUF	2.68	-0.74
10Y PLN	2.33	0.04





CZ GB 2Y, last 250 days. Source: Reuters

Review of Economic Figures

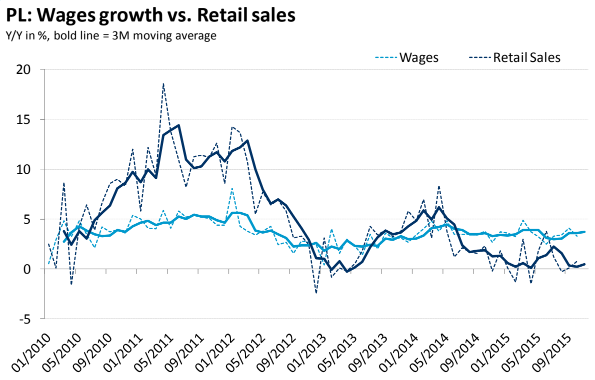
The rise in Polish retail sales accelerated in October

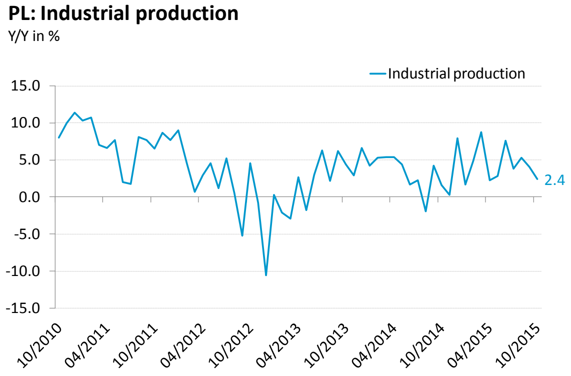
The macroeconomic data released last week in Poland have not changed our expectations of Polish economic growth for this year either (we still expect 3.5%) and not even our expectations regarding the main growth drivers. The strongest and also positive deviation from market expectations was attributable to retail sales, which accelerated to 3.6% y/y (in real terms) in October. As far as the other data are concerned, we should mention good performance from industry and positive data from the labour market (although wage growth fell short of expectations this time).

The new government outlined its economic programme. Are we going to see the Polish version of the ECB's policy?

The inauguration speech delivered by Poland's new Prime Minister Szydlo drew more attention than macroeconomic statistics last week. In the economic section of her speech she confirmed the oncoming expansive measures on the fiscal side (such as greater support for families with children), earlier retirement as well as increased taxation of retail chains and banks. Overall, Poland is likely to post a budget deficit on the brink of the 3% Maastricht criterion.

However, more interesting and more controversial mentions are those about the possible introduction of a longer-term refinancing operations (LTRO) programme similar to that carried out by the European Central Bank (ECB). Through this programme the government would like to encourage the creation of new loans and subsequently to speed up economic growth. Bear in mind that the new government (moreover, backed by President Duda coming from the same party) has a great opportunity to influence the central bank's future policy, as the government and the Polish President will appoint an overwhelming majority of the Monetary Policy Council (MPC) members next year, including the NBP President (whose term of office expires in June). Details of the plan by the new government are not yet available. Nevertheless, while it is probable that its economic impacts would not be clearly positive or negative, it would be bad news for the zloty. Therefore, in the context of the anticipated changes in the NBP leadership and the related nervousness, we expect the Polish currency to weaken in the first quarter of the year. This is why we believe that the exchange rate of the zloty against the euro may hover around PLN 4.30 per EUR.



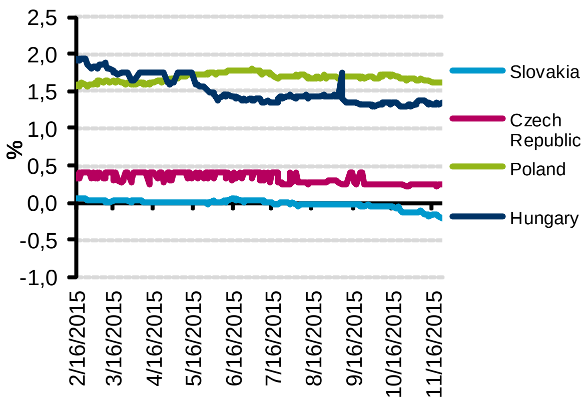


Calendar

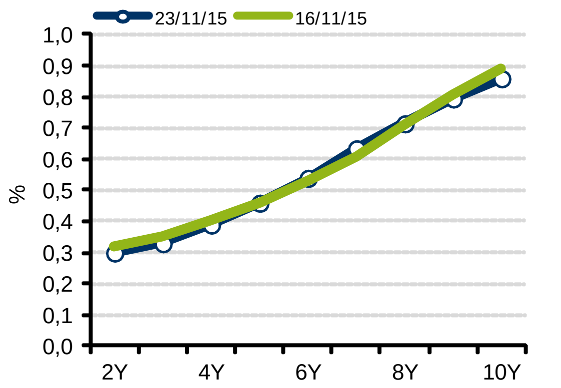
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	11/25/2015	10:00	Unemployment rate	%	10/2015			9.6		9.7	
CZ	11/25/2015	12:00	CZ bond auction 2014-2027, floating rate	CZK B	11/2015						
CZ	11/25/2015	12:00	CZ bond auction 2015-2026, 1.00%	CZK B	11/2015						
CZ	11/27/2015	9:00	GDP	%	3Q/2015 *P					0.5	4.3
HU	11/27/2015	9:00	Unemployment rate	%	10/2015			6.2		6.4	

Fixed-income in Charts

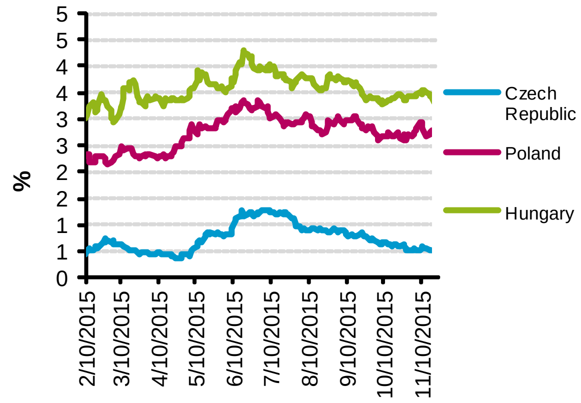
FRA 3x6



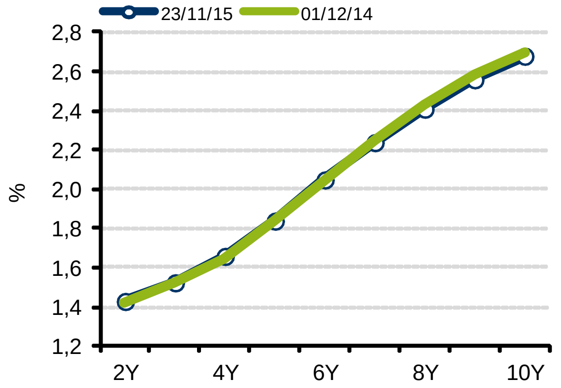
CZ IRS



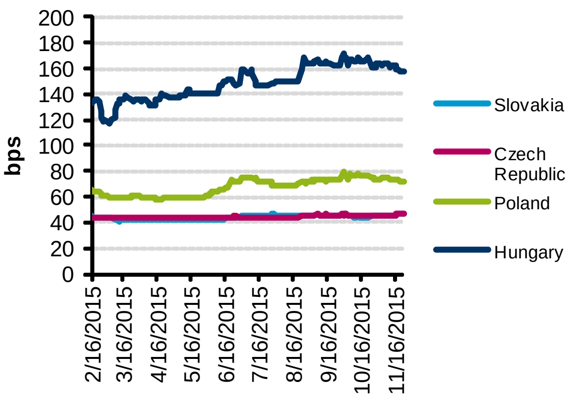
10Y GB Yields



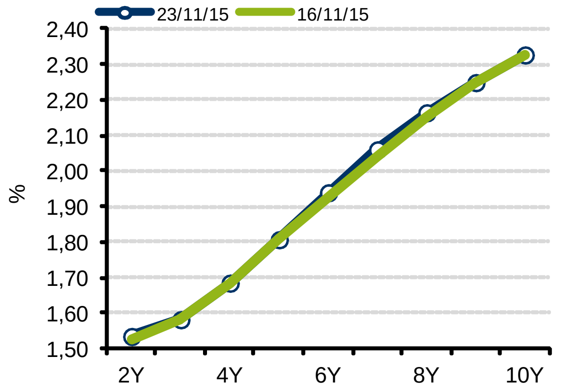
HU IRS



CDS 5Y



PL IRS



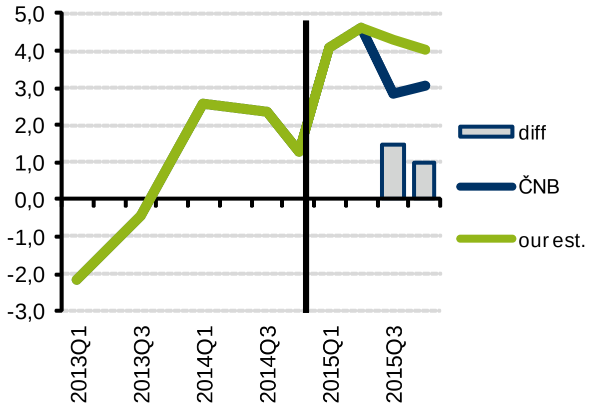
Source: Reuters

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 may bounce back closer to 3% Y/Y, as EU funds money use is accelerated and the industrial production and domestic consumption may be stronger this year as a year before, so the growth might be around 2.7% Y/Y in 2015. The bigger question what may happen next year, as the Q/Q figures reflects only 2% annualized economic growth for this year and the falling out EU funds money may push GDP growth below 2% Y/Y in some quarters. We expect 2.3% Y/Y grwoth for 2016, but risks are rather on the downs side.	Although the overall positive economic developments in Europe and the long-term eased monetary policy should translate into growth of the Polish economy within the range of 3.5-4% this year as well as the next, we put our outlook on hold unless there is a clear view on the economic policy of the new government. This should be based on an economic program of the opposition party - Law and Justice.
Outlook for official & market rates	The CNB has implicitly postponed the deadline for discontinuing its intervention policy until late 2016 but, unlike its previous practice, it does not want to commit itself to any clearer deadline this time. With regard to the uncertainty surrounding the ECB's moves, we can only anticipate an exit sometime probably at the turn of 2016 to 2017. A scenario of negative rates is not on the agenda. Given the market developments, the CNB itself is even considering it to a lesser extent than it has done recently.	The NBH surprised the market as it shifted the interest rate corridor of overnight (O/N) instrument by 25bp downward, so the new interest rate is 0.1% (base rate minus 125bp) for deposit and 2.1% (base rate plus 75bp) for loans. This move means practically a 25bp rate cut and is clear the NBH is fully committed to force out money from NBH so it cannot be excluded that further steps may come in the future. We think the NBH will cut further its base rate, if the ECB loosen further its monetary policy and the EUR/HUF moves closer to 300. In that case the base rate might be cut below 1%, while we think that with the previous speed, namely by 15bp per meetings.	We expect the NBP to keep rates at new lows (1.50%) this year, but we cannot completely rule out the likelihood of further rate cuts. The main reason is the combination of the "inflow of cheap euros from the ECB" to markets and the unusually open commitment by the NBP not to continue to cut rates. This promise will probably be hold, while we should wait how the MPC will be changed in 2016 as new President and Sejm will appoint almost all Board members.
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. We believe the Czech National Bank will meet its "pledge" and won't terminate its intervention regime before the second half of 2016 and can extend the pledge even further. The above mentioned factors should however keep the koruna close to EURCZK 27.0 in the months ahead. Possible start of tightening of US monetary policy poses negative risks for the koruna. We however think the fallout should only be limited.	We think that any strengthening of the HUF is rather temporary and the NBH's commitment to the long time low interest rate (just like the gradual push out of foreign holding from Hungarian government bonds) may lead to a HUF weakening in the coming weeks and months. It is also clear that the NBH has no problem with the HUF weakening, so rate hike driven by a temporary HUF devaluation is out of picture.	Although the new government may eventually turn out to be more market-friendly than had been expected, we think that pressures on zloty´s depreciation may intensify again at the beginning of 2016 when most members of the Monetary Policy Council (MPC) will be replaced. Also probability of further interest rate cuts by the Polish central bank rises under the new government. Nonetheless, we still keep our base-line scenario unchanged and bet on stable rates in Poland by the end of 2016. Fed hikes and weaker zloty should prevent the altered MPC from cutting rates again.

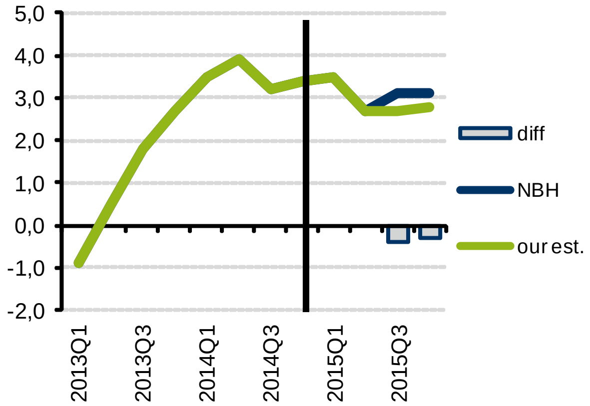
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

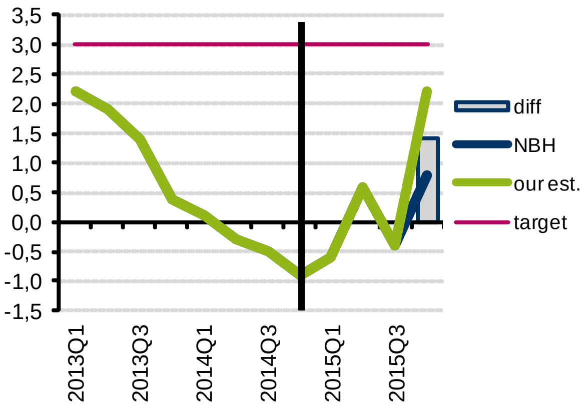


CZ: Inflation outlook (Y/Y, %)

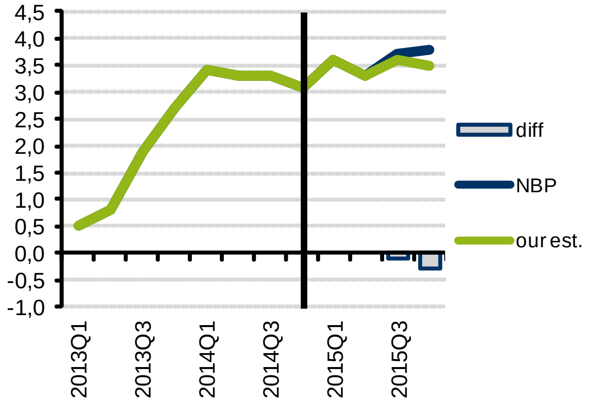
HU: GDP outlook (Y/Y, %)



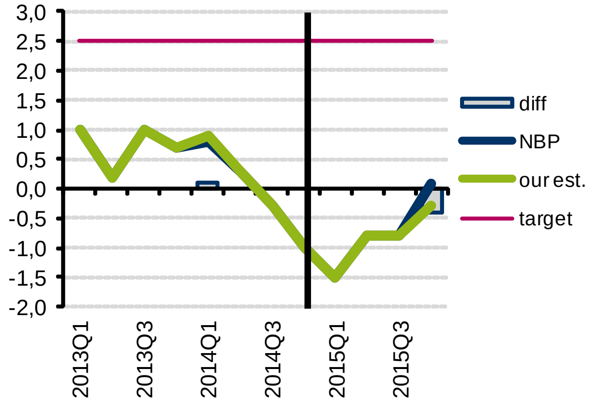
HU: Inflation outlook (Y/Y, %)



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	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	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*	1.95	1.50	1.35	2.00	2.25	-10 bps	7/21/2015
Poland	2W inter. rate	*1.50*	1.50	1.50	1.50	1.50	1.50	-50 bps	3/4/2015

*Short-term interest rates 3M *IBOR (end of the period)*

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	PRIBOR	*0.00*	0.30	0.29	0.26	0.28	0.28
Hungary	BUBOR	*1.35*	1.89	1.41	1.35	2.10	2.40
Poland	WIBOR	*1.73*	1.65	1.72	1.73	1.65	1.67

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

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	CZ10Y	*0.86*	0.64	1.30	0.98	1.10	1.20
Hungary	HU10Y	*2.68*	2.71	3.45	2.93	3.60	3.80
Poland	PL10Y	*2.33*	2.12	3.01	2.50	2.40	2.80

Exchange rates (end of the period)

		Current	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	EUR/CZK	*27.05*	27.57	27.35	27.19	27.05	27.00
Hungary	EUR/HUF	*311*	300	315	314	315	310
Poland	EUR/PLN	*4.24*	4.07	4.19	4.25	4.15	4.10

GDP (y/y)

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	2.4	1.3	4.1	4.6	4.3	4.1	2.3
Hungary	3.2	3.4	3.5	2.7	2.7	2.8	2.2
Poland	3.3	3.1	3.6	3.3	3.6	3.5	3.5

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

	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
Czech Rep.	0.7	0.1	0.2	0.8	0.4	0.8	1.5
Hungary	-0.5	-0.9	-0.6	0.6	-0.4	2.2	2.7
Poland	-0.3	-1.0	-1.5	-0.8	-0.8	-0.3	0.2

Current Account

	2015	2016
Czech Rep.	1.5	1.5
Hungary	6.0	4.5
Poland	-1.2	-2.0

Public finance balance as % of GDP

	2015	2016
Czech Rep.	-1.6	-1.3
Hungary	-2.3	-2.1
Poland	-3.0	-2.5

Source: KBC, Bloomberg

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