Poland and CEE

Macroeconomic picture

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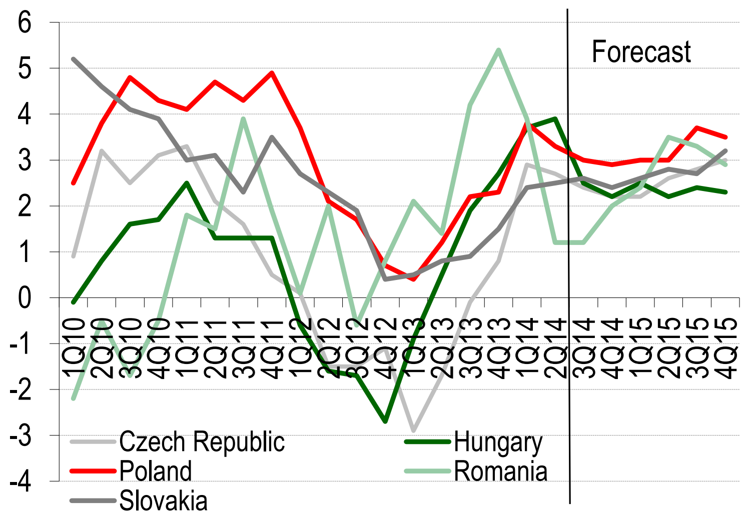
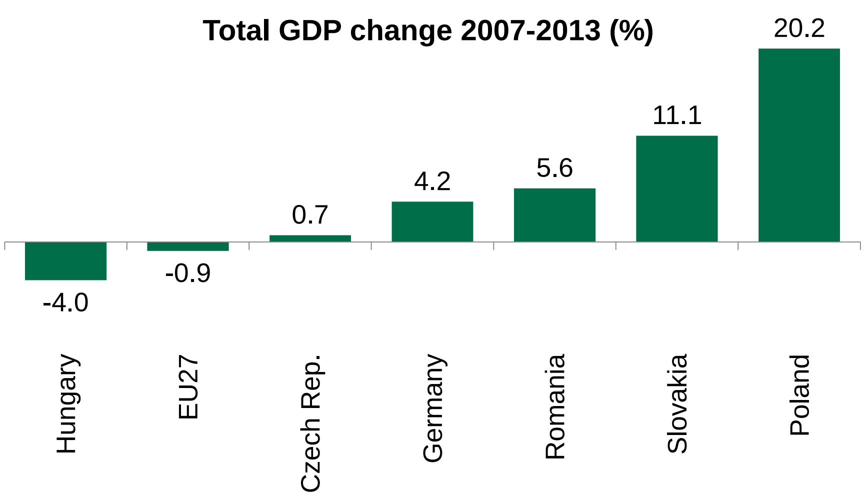
GDP in CEE – moderate growth expected…

Growth in CEE countries



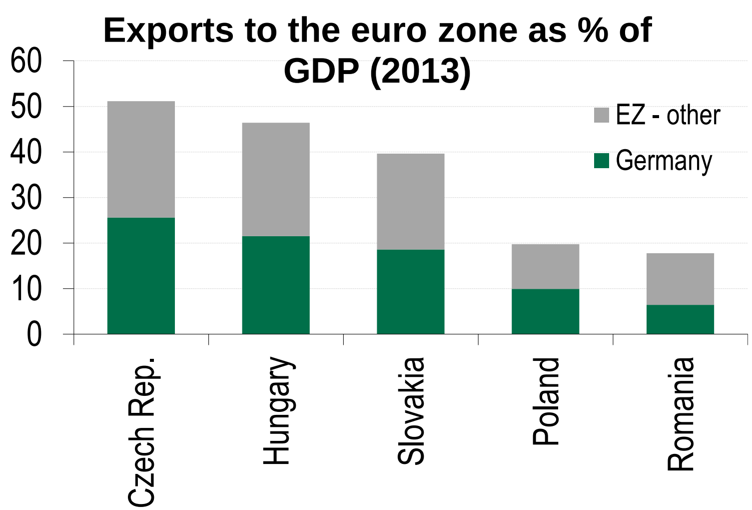
Total GDP change 2007-2013 (%)



- The Polish economic outlook deteriorated due to weaker prospects of growth in the euro zone and effects of conflict in Ukraine.
- The Polish economy is still mostly likely to outperform its peers in 2014-2015 period.
- The Czech economic growth decelerated only slightly and is driven mostly by domestic demand with weaker external demand. Most economic sentiment indices (including the PMI) point to a further growth.
- Growth in Hungary picked up recently, but weak domestic demand and Russia-related risk weigh on economic outlook. Moreover, high political risk and an unorthodox economic policy are viewed as long-term risk factors.
- The Romanian economy slowed down considerably on the back of weakening exports, but a recovery thanks to rebounding investment is expected.
- Slovakia is likely to continue growing at current pace.
- In general, all these countries are expected to grow by 2.0-3.5% in 2015, mainly thanks to domestic demand.

Sources: Eurostat, Focus Economics, BZ WBK.

… but Russia (and the euro zone!) poses risks



- Exports to Russia and Ukraine make up a few percent of CEE countries' GDP. Thus, slowdown in these countries will surely negatively affect GDP growth. Poland and Hungary are major exporters of food to Russia (0.3% and 0.2% of GDP, respectively, other countries below 0.05%), so are more vulnerable to counter-sanctions (so far).
- Still, the euro zone remains the main trading partner of CEE countries, so economic climate in the monetary union is crucial as regards CEE economic outlook. Czech Republic, Hungary and Slovakia are especially vulnerable to demand from the euro zone. Poland and Romania are more dependent on their internal markets.
- A risk-case scenario of Russian gas supply disruptions would see Poland with a shortfall already 3 months after supply disruption. Czech Republic, Slovakia and Hungary less vulnerable, only Romania is immune.

Sources: Eurostat, BZ WBK.

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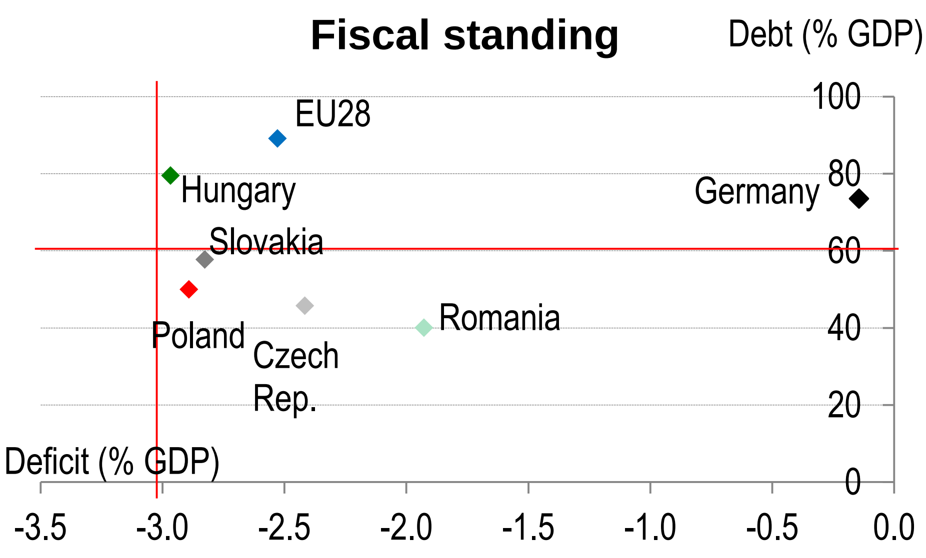
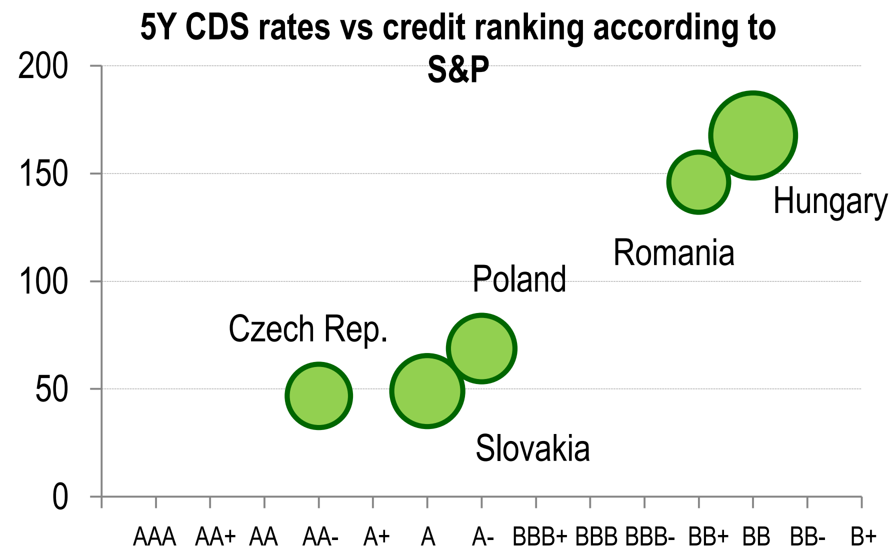
Some room for fiscal manoeuvre



Note: data show European Commission's forecasts for 2015

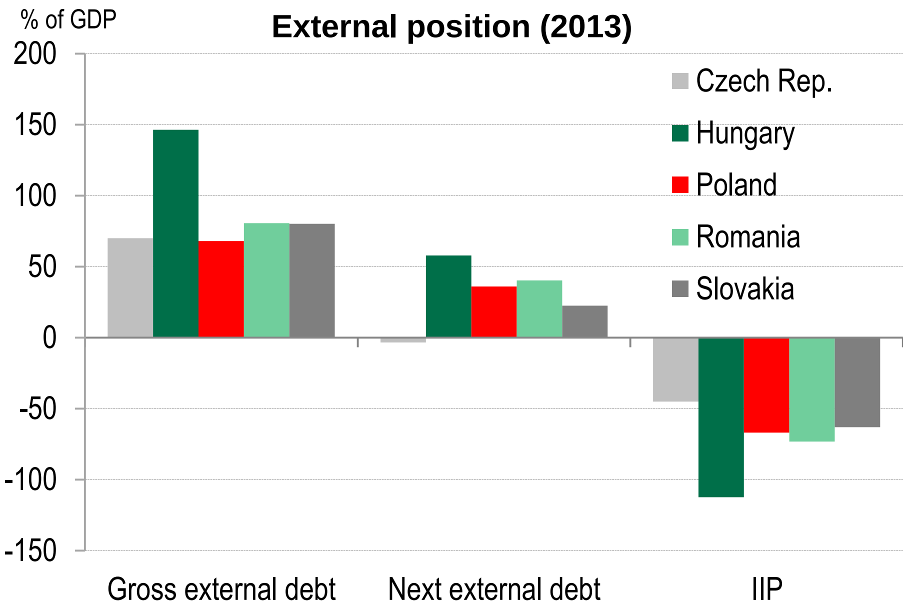


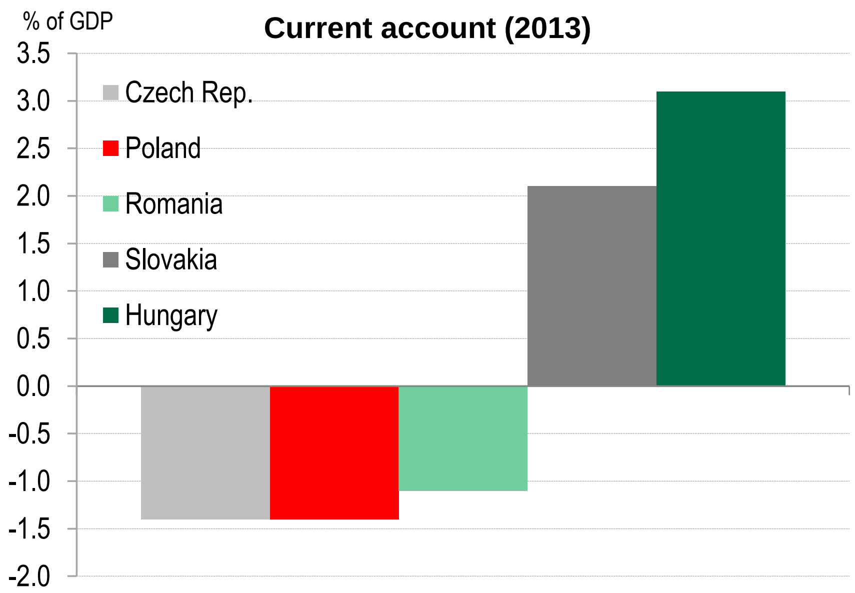
Note: Size of bubbles reflects the debt/GDP ratio

- CEE countries are expected to reach rather favourable fiscal positions in 2015, with deficits below 3% of GDP and public debts below 60% of GDP. (Hungary as an exception with debt above 80%) This leaves room for fiscal stimulus, if necessary.
- Poland is still under Excessive Deficit Procedure, expected to be abrogated in 2016 (based on 2015 data). Other countries managed to close the EDP recently.

Sources: European Commission, Reuters, Eurostat, S&P, BZ WBK.

Improving external position

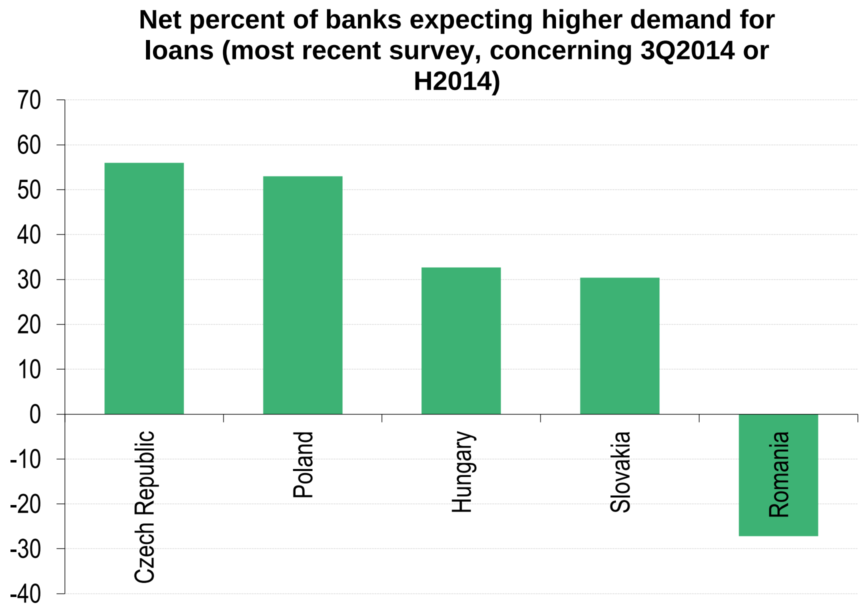




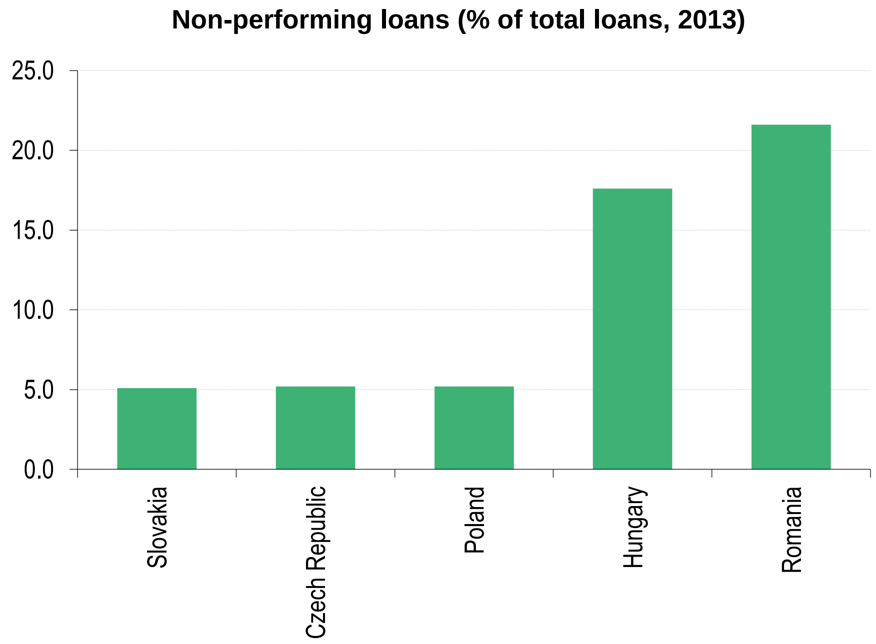
- External positions of CEE countries (as measured by gross external debt or international investment position) show a clear outperformance of Czech Republic and underperformance of Hungary.
- Current account deficits relatively low, suggesting a resistance to sudden stops in foreign financing. Slovakia and Hungary showing surpluses, meaning an ongoing improvement in external position.

Sources: Eurostat, BZ WBK.

Expectations for higher demand for corporate borrowing



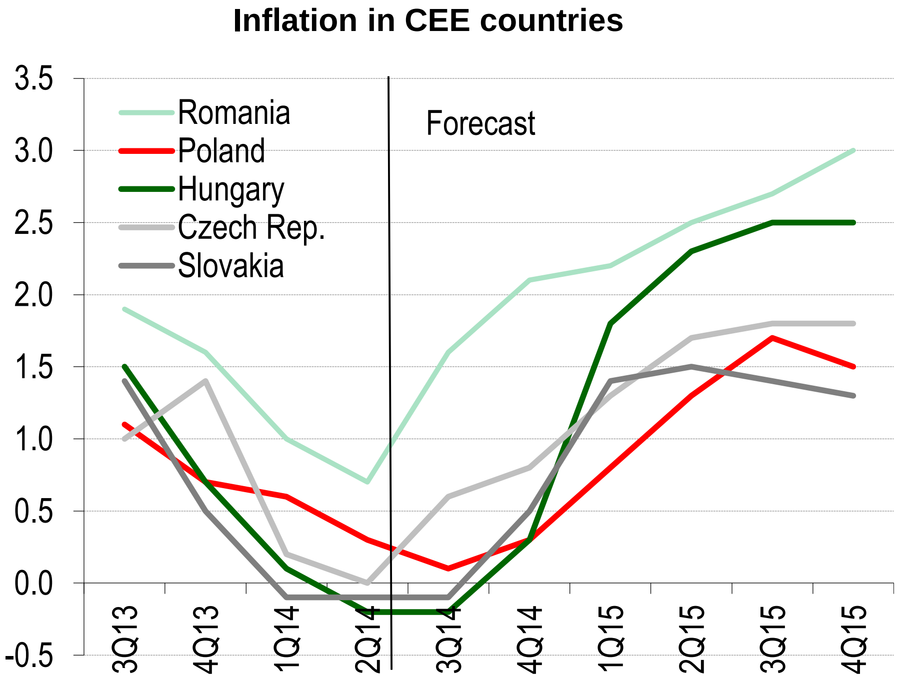
Note: number for Poland is an average of answers in four categories

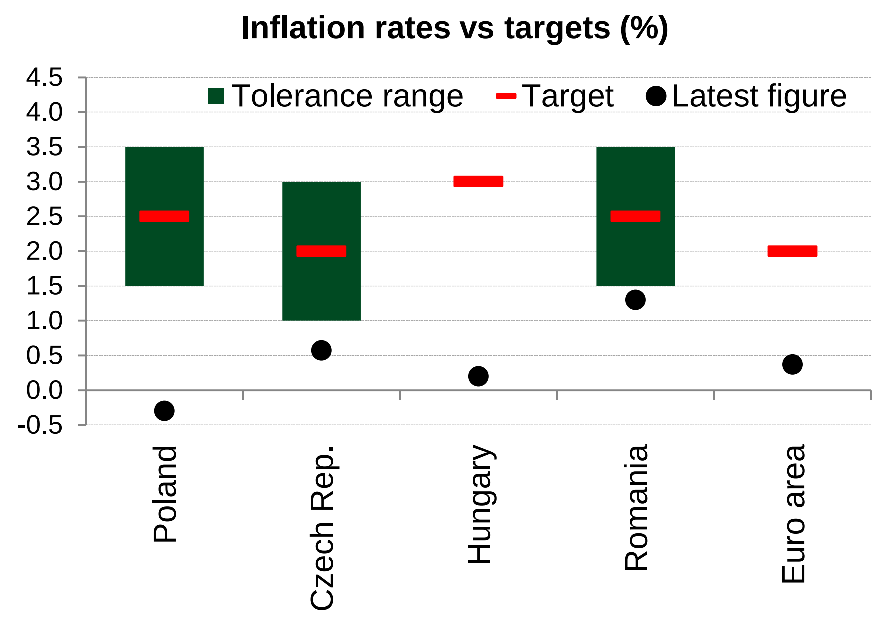


- Banks in most CEE countries expect higher demand for corporate loans in the upcoming period, with an exception of Romania. Hungary and Romania clearly lag behind with borrowers' quality.
- There are major differences among countries as regards sectors: Slovak banks expect an equal rise of demand across the sectors, Czech: strong rise of long-term loans for large companies, Polish: rise of short- and long-term loans for SMEs, Hungarian: rise of short-term loans, Romanian: decline of long-term loans for large companies.

Sources: central banks, World Bank, BZ WBK

Inflation – running low, only moderate rebound expected

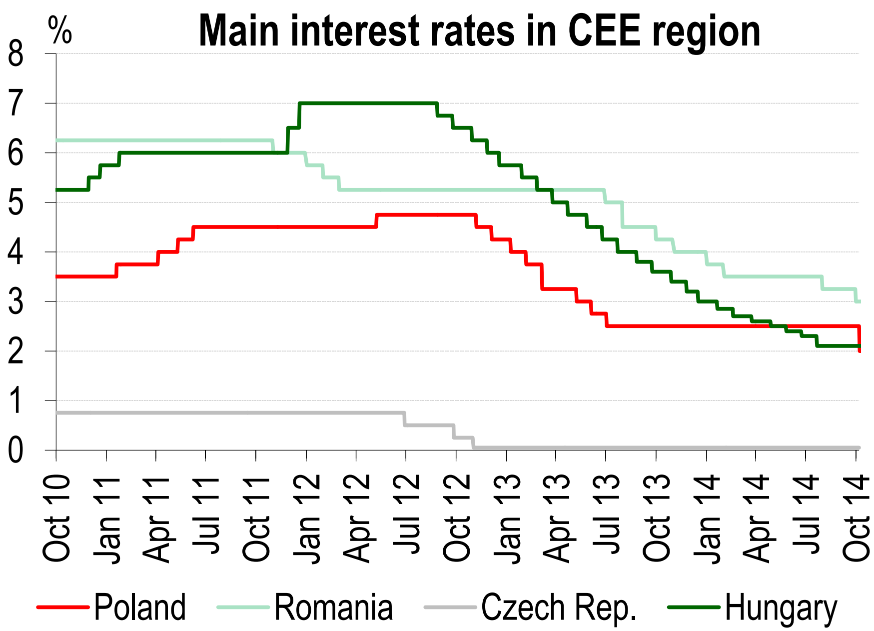




- Inflation is running close to zero in most CEE countries driven by positive supply-sde shocks, disinflation in the euro zone and some economic slowdown. It is expected to rebound in 2015, yet to still remain relatively low (relative to targets). Additionally, risk is skewed downwards, given a general disinflationary tendency in Europe and impact of sanctions in Russia on food prices.

Sources: Eurostat, Focus Economics, BZ WBK.

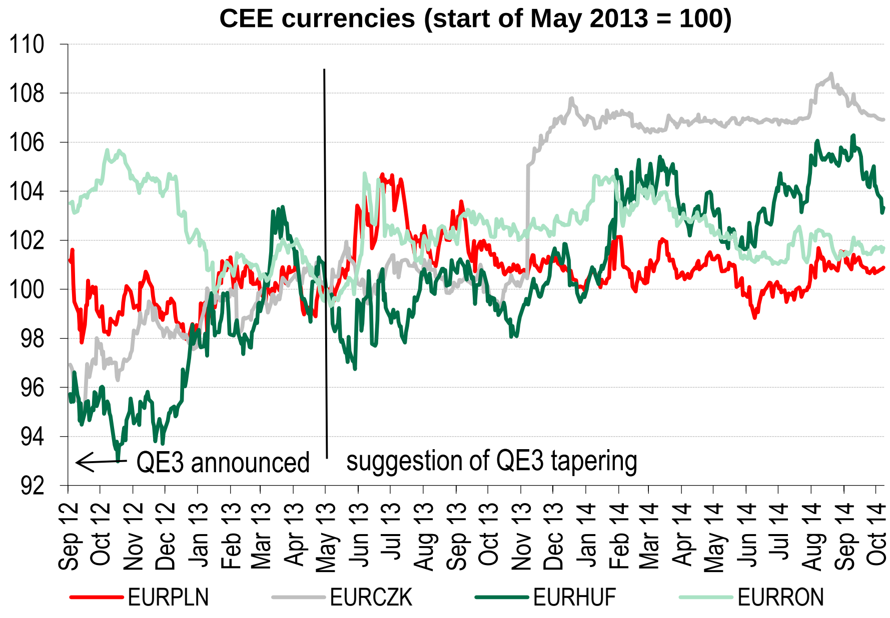
Monetary policy – still dovish bias

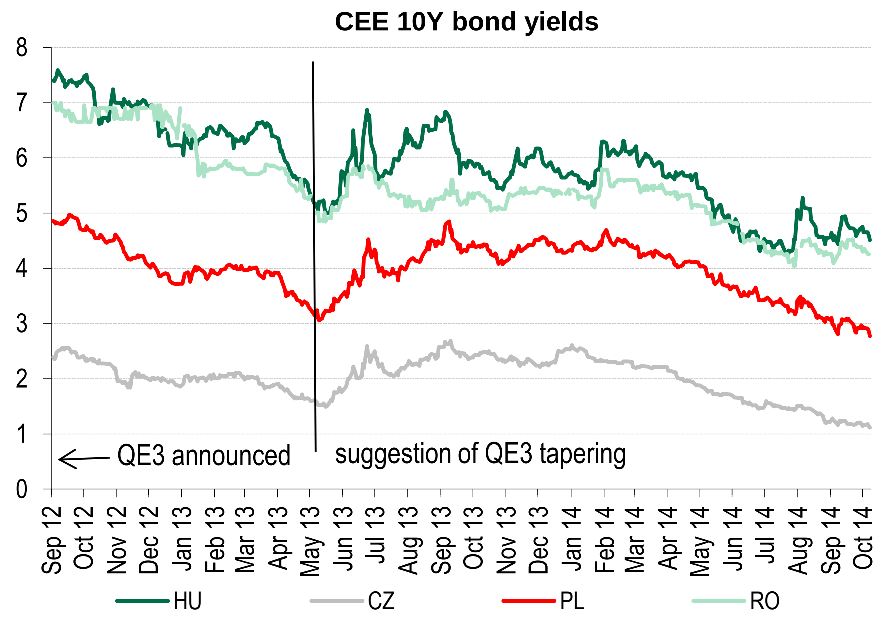


- The National Bank of Poland cut rates by 50bp in October, bringing the reference rate to all-time low 2.00%. One more cut is possible in November.
- The Czech National Bank keeps rates close to zero. The CNB reaffirmed its intention to continue using the exchange rate as a monetary policy instrument at least until 2016. Outlook for growth and inflation shifted slightly down, yet the CNB views domestic economic environment as inflationary with external environment acting anti-inflationary.
- The Hungarian National Bank (MNB) ended the two-year long easing cycle, bringing the main rate to 2.10% and declared it will remain stable for an extended period. The MNB views inflationary pressure as moderate.
- The National Bank of Romania (BNR) cut its reference rate to 3.00% and lowered the minimum requirement rate. Romanian economy is slowing down and inflation declining. The BNR is ready to use all its instruments to meet its objectives, so further cuts are likely

Sources: Bloomberg, BZ WBK.

Main central banks' policy affecting CEE assets



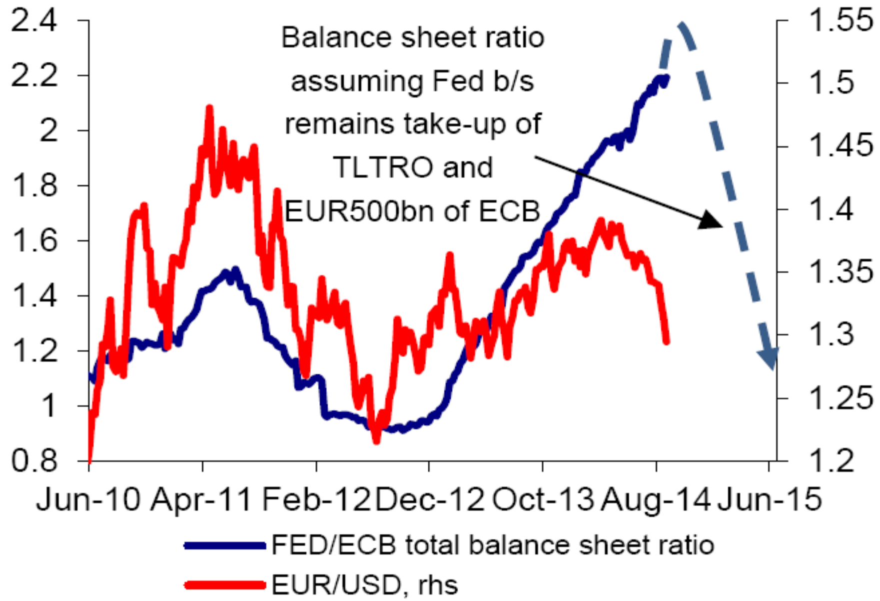


- Fed's QE3 provided an inflow of fresh cash into CEE market, supporting mostly bonds, which gained 100-250bp until May 2013. FX market was less affected.
- Suggestion of QE3 tapering by the Fed in early May 2013 undermined both the CEE bonds (yields climbed by 100-200bp) and currencies, with EURRON and EURPLN suffering by most (depreciation by c4%). EURCZK was mostly driven by the central bank policy (floor on the rate) and EURHUF was more vulnerable to domestic issues (FX-denominated loans).
- Fed's tapering talk had only temporary impact on CEE markets. Will it be the same with the beginning of Fed's rates normalisation? Is this time (because of the ECB) different?

Sources: Eurostat, Markit, Bloomberg, Santander, BZ WBK.

Stagnation in the euro zone encouraged the ECB to act

Relative change of central bank balance sheets vs EURUSD



- The euro zone unexpectedly slid into recession in 2Q2014 after growing by 0.2% QoQ in Q1.
- The growth breakdown showed that the economic slowdown was due to weakening of domestic demand, clearly showing that the underlying trend deteriorated. Inflation outlook remains subdued.
- The ECB effectively reached zero lower bound, introduced asset purchase programmes and is ready too apply more instruments given prolonged risk of low inflation. This should be the factor offsetting (at least to some extent) negative signals from Fed (at least for CEE countries with good credit).

Sources: Eurostat, Markit, Bloomberg, Santander, BZ WBK.

Summary

- Economic growth expected to remain moderate, driven mainly by domestic demand.
- Main risk factors are external: conflict in Ukraine, sanctions imposed by Russia and (last but not least!) slowdown in the euro zone.
- Room for fiscal policy gives some hope for a stimulus if necessary (depends on current fiscal position and investors' appetite for local debt).
- Negative balance of risks for growth and inflation support dovish stance of central banks.
- CEE financial markets driven (also?) by the policy of central banks

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