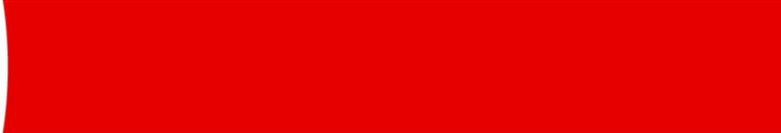




FX Focus: Outlook for HUF & PLN

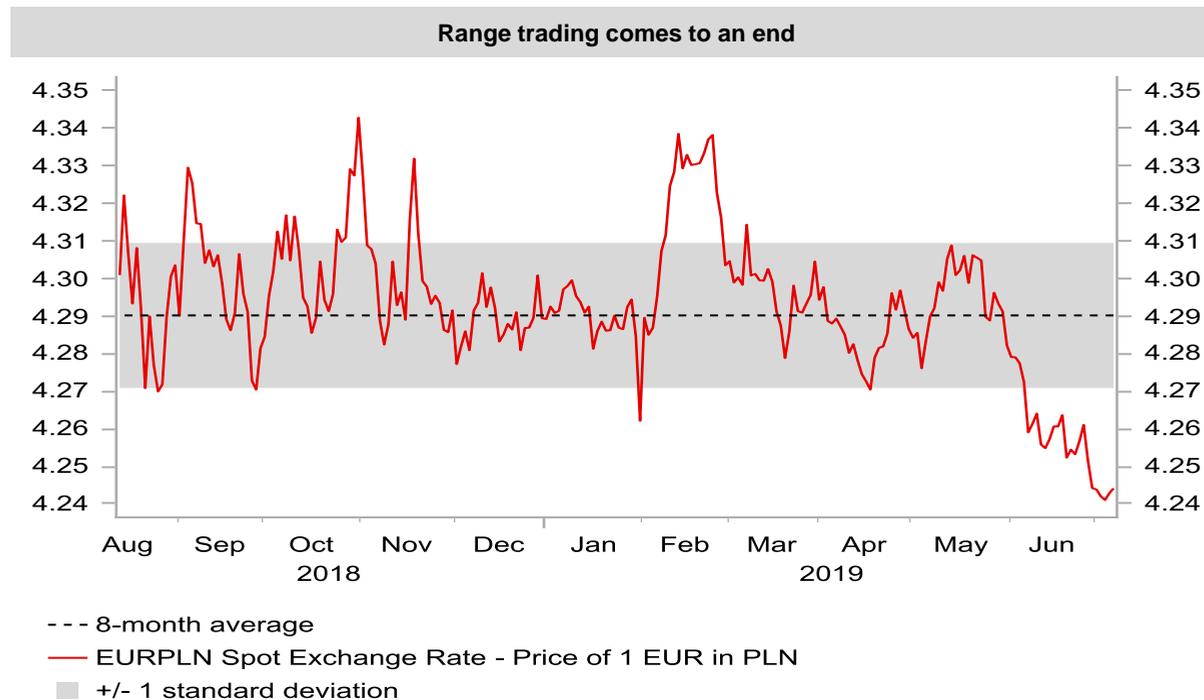


July 2019

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PLN: Zloty outperforming as Poland's economy is proving resilient

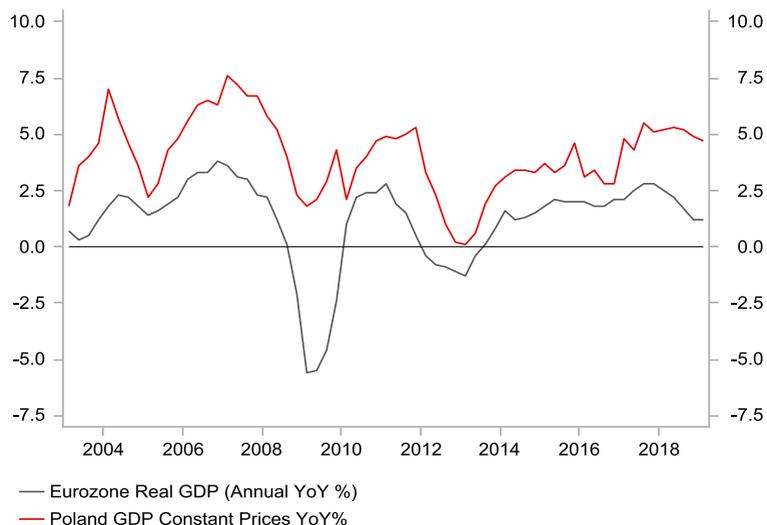
EUR/PLN has broken lower recently



- The zloty has strengthened over the past month. It has resulted in EUR/PLN breaking below the bottom of the narrow range between 4.2600 and 4.3100 which has held most of the time since the summer of last year.
- It hit a recent low of 4.2374 which was the lowest level since May of last year. The adjustment lower in EUR/PLN has been driven mainly by building expectations of looser ECB policy over the past month. We expect the ECB to cut rates by 20bps in Q3 and potentially restart QE later this year if euro-zone slowdown proves more persistent.

Looser fiscal policy helps to maintain solid growth in Poland

Polish economy has not felt chill yet from slowdown in euro-zone



Leading indicators signal risk of sharper slowdown



- Poland's economy continued expand strongly at the start of this year by an annual rate of 4.7% in Q1. Private consumption remains the leading driver of growth supported by the tight labour market and looser fiscal policy. Public investment has recovered from the deep lull in 2016 driven by a pick-up in public projects backed by EU funding.
- Growth is expected to moderate this year towards 4%. Negative spill-overs from slowing growth in Europe are expected to provide more of dampener on growth alongside tightening supply side constraints. However, it will be offset by looser fiscal policy ahead of the parliamentary election in October. The government's budget for this year included higher pensions, child benefit payments, and the abolition of income taxes for employees under the age of 26%. Estimated full year cost PLN40 billion.

PLN would be hit by higher US auto tariffs but not as much as CZK

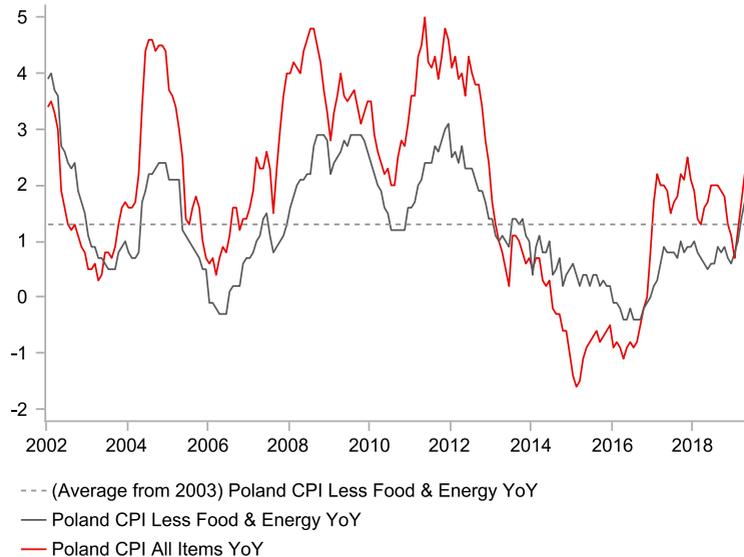
Top Passenger Car Producers in the EU		
	2017	% of EU
Germany	5,645,581	33%
Spain	2,291,492	14%
France	1,674,717	10%
UK	1,671,166	10%
Czech Republic	1,413,881	8%
Slovakia	949,365	6%
Italy	742,107	4%
Poland	514,700	3%
Hungary	472,107	3%

Source: European Automobile Manufacturers Association

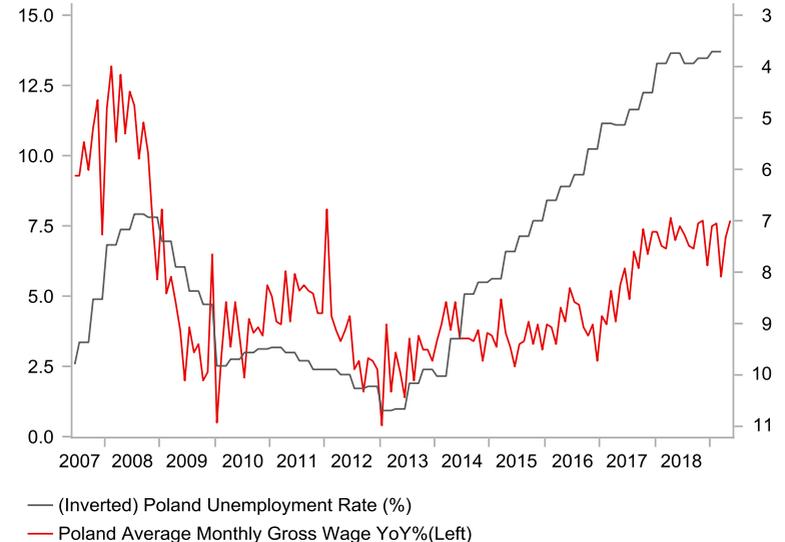
- One of the main downside risks for Europe's economy which could reinforce the current slowdown is President Trump's threat to impose a 20% tariff on imports of autos. EU-US auto related trade currently accounts for some 10% of total trade between the two regions. Poland is the eighth largest car producer in the EU. President Trump will make a decision on whether to impose higher tariffs on imports on autos by November. A decision to raise the tariff rate could lift EUR/PLN higher above the 4.3000-level.

NBP has downplayed recent pick up in inflation pressures

Core inflation pressures are finally picking up

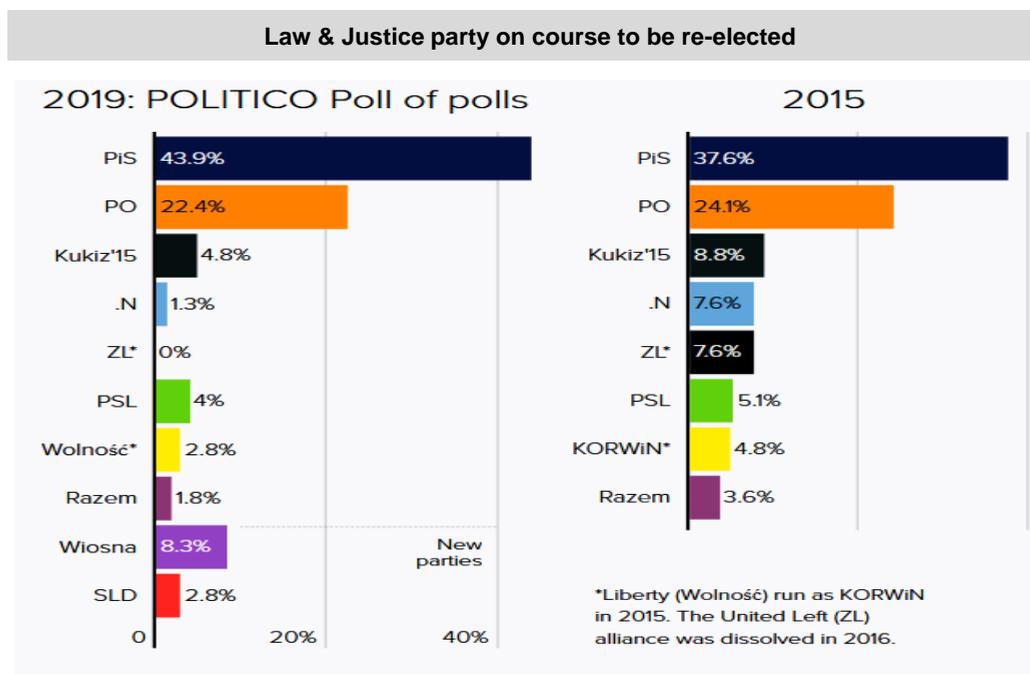


Tight labour market & strong wage growth



- Inflation pressures have picked up at the start of this year. The annual rate of headline inflation accelerated to 2.6% in June. The highest levels since November 2012. It has been even more notable that core inflation has accelerated to 1.7% in May compare to an average of just 0.9% in recent years.
- Nevertheless, the NBP is still downplaying the recent pick-up in inflation pressures. Governor Glapinski has reiterated that he does not expect to raise rates in the coming years. A more persistent pick up in inflation pressures will be needed to change the NBP's outlook for policy. The still dovish NBP is putting a dampener on upside potential for the zloty from stronger growth and inflation in Poland. We do not expect a rate hike in the year ahead.

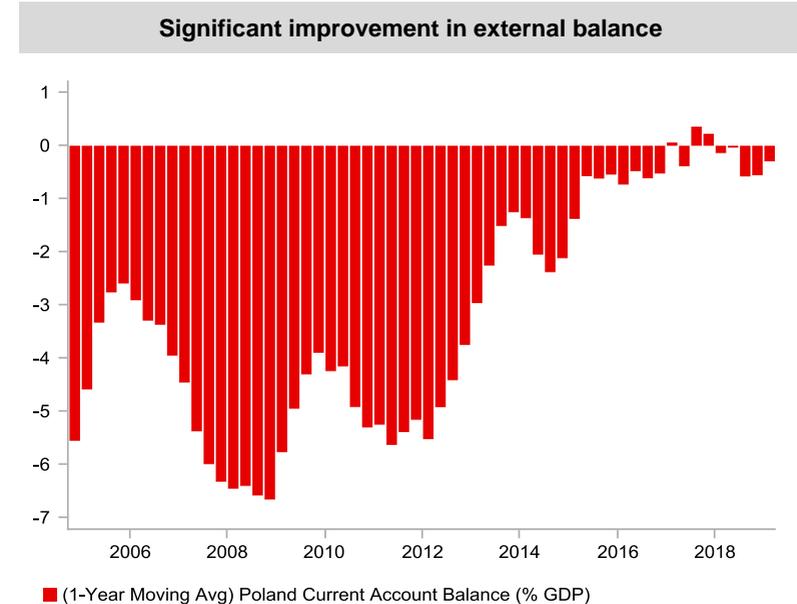
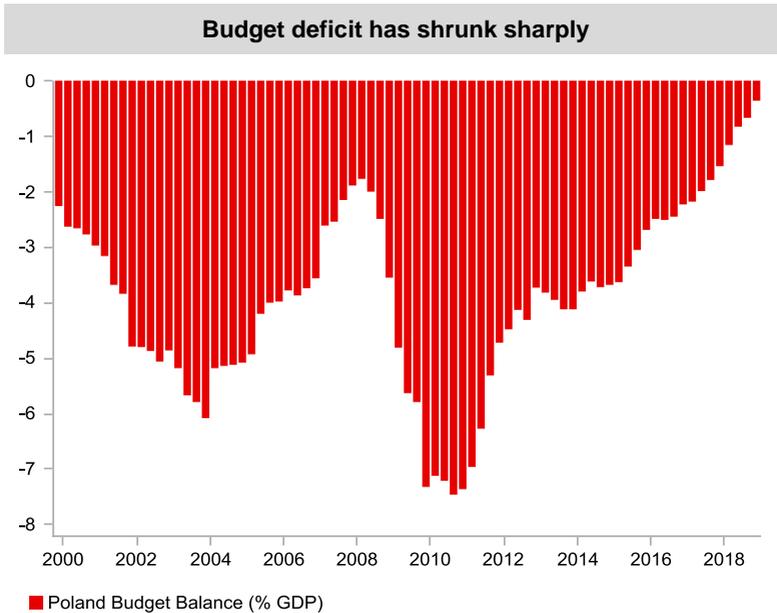
Domestic politics remain in focus but downside risks for zloty have eased



Source:
www.politico.eu

- The political situation in Poland is broadly stable. Nationwide local elections held in October 2018 produced mixed results. The ruling right-wing Law & Justice party's hopes to expand its support base in urban areas failed to materialise. They still won the highest share of the vote in elections to Poland's 16 regional authorities, but performed poorly in medium to large sized towns.
- In opinion polls, the Law & Justice has regained support following the EU elections, and remains on course to emerge as the largest party after the parliamentary elections this autumn.
- Downside risks for the zloty from domestic politics have eased as the government has attempted to dampen tensions with the EU by withdrawing some of the most contested elements of judicial reform, although EU has triggered Article 7 disciplinary procedures. The EU is currently seeking to resolve judiciary concerns.

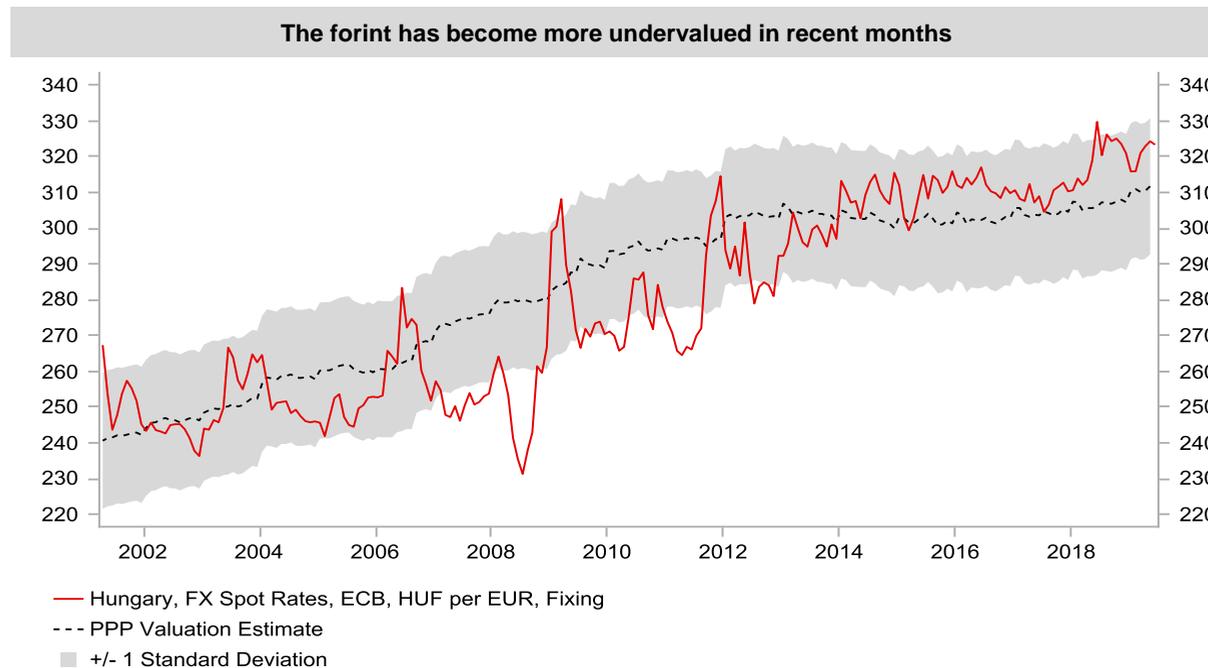
Structural factors offer more support for the zloty



- There has been a significant improvement in Poland's twin deficits. Robust growth has helped to narrow Poland's budget deficit to just 0.5% of GDP. It creates room to loosen fiscal policy ahead of the general election in the autumn.
- The current account has recently moved back into deficit although it remains well below levels recorded prior to the global financial crisis. Robust domestic demand growth has encouraged some renewed deterioration in the current account balance. The smaller deficit should help to dampen the sensitivity of the zloty to external conditions.

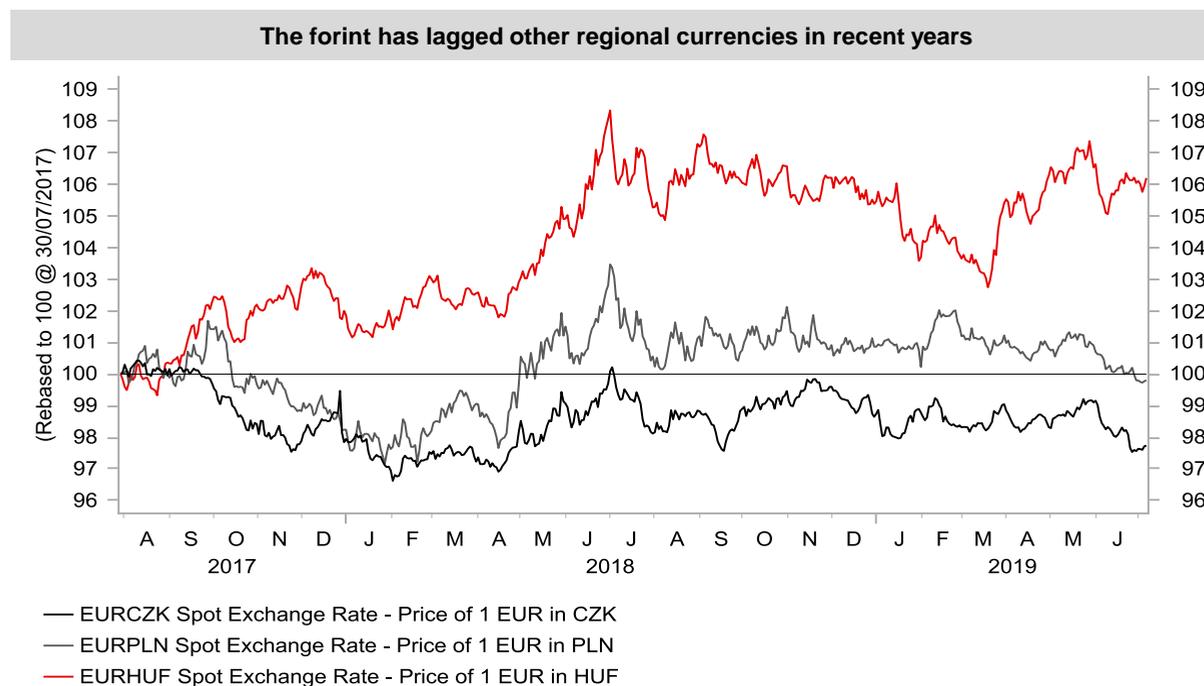
HUF: weaker forint reflects concerns over upside inflation risks

The forint has weakened over the past year



- The forint has started this year on a stronger footing with EUR/HUF hitting an intra-day low of 312.62 in March. However, it has since given back all of those gains and hit an intra-day high of 327.58 in May.
- EUR/HUF has been trending higher since early last year and has become more undervalued. Recent weakness in the forint has reflected in part disappointment that the NBH has not tightened policy more in response to rising inflation

The forint has been an underperformer within the region



- In recent years the forint has been the weakest performing regional currency. The NBH's aggressive easing of monetary policy including unconventional measures such as negative rates contributed towards forint weakness. In contrast, the best performing currency has been the koruna as it has benefitted from the CNB tightening policy ahead of other regional central banks.
- The forint attempted to stage a rebound earlier this year as market participants expected the NBH to become more active in tightening policy but those hopes have since diminished. Even building expectations for ECB easing have failed to drag EUR/HUF much lower over the past month.

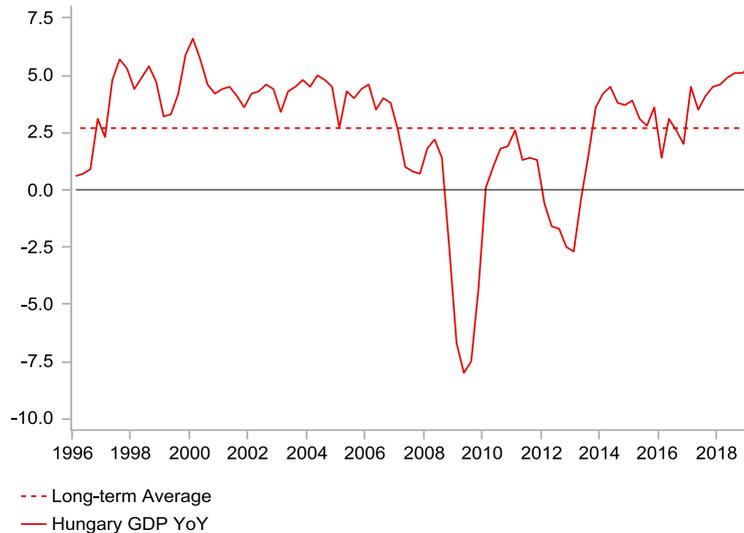
Lack of NBH response to building inflation pressures prompts concern



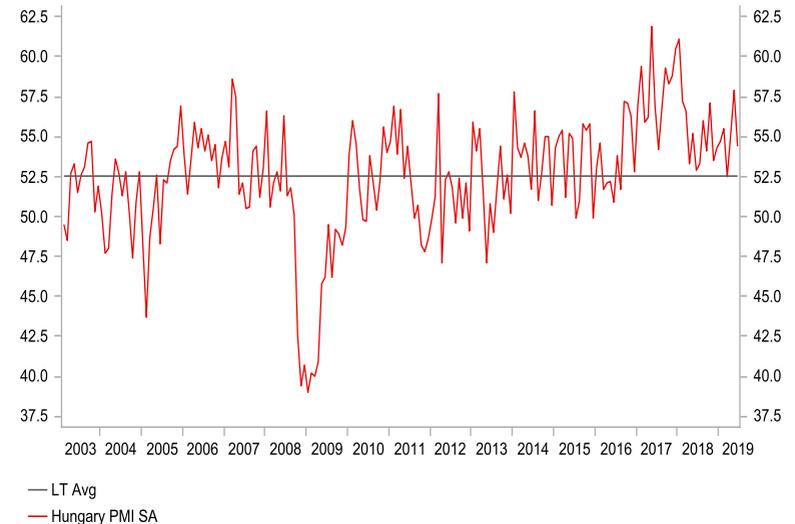
- The annual rate of core inflation excluding indirect taxes has accelerated sharply to an annual rate of 3.7% in May. It is the highest rate since December 2008. It compares to an average of 2.6% in recent years. Upside risks to the NBH's inflation target have clearly increased which is increasing pressure on the NBH to tighten policy.
- However, the NBH still appears somewhat reluctant to tighten policy as continues to focus more on supporting growth than combating inflation. The NBH raised rate sin April but it was surprisingly described as a “one-off”. Downside risks for the forint would increase if the NBH does not raise rates furtherin the year ahead.

Is Hungary's economy in danger of overheating?

Hungary's economy has been expanding robustly

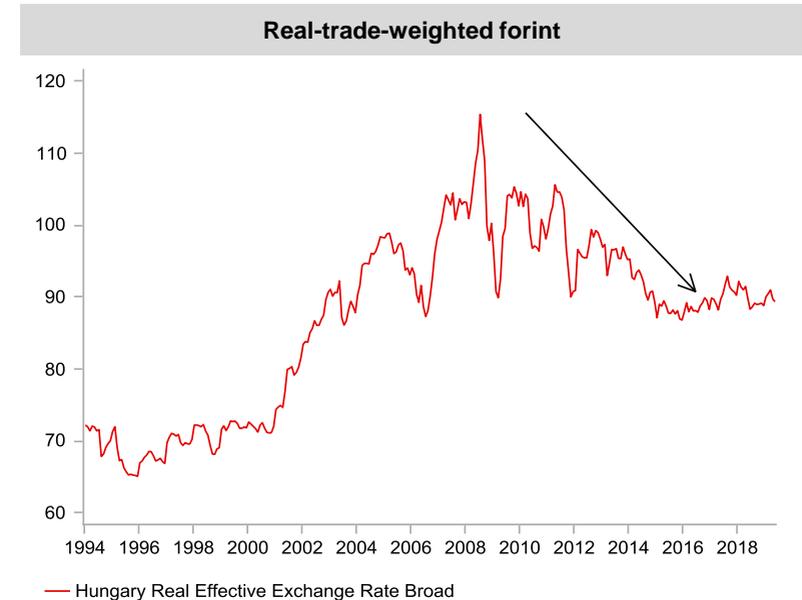
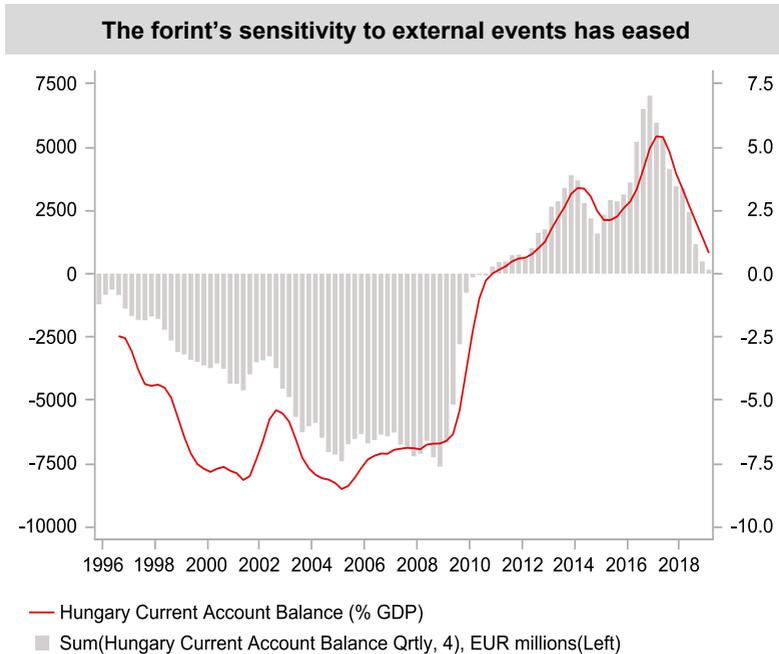


Leading indicators signal a modest slowdown so far



- Hungary's economy has continued to expand robustly at the start of this year by an annual rate of 5.3% in Q1. Growth has been boosted by the faster absorption of EU investment funds while household consumption remained robust supported by strong wage growth. The tightening labour market and a minimum wage hike helped to keep wage growth into double digits.
- We believe that the recent robust pace of growth is unsustainable amidst building supply constraints. Growth is likely to moderate back towards the NBH's estimate of potential growth at around 3% in the coming years.
- However, Prime Minister Orban has stated that "we will do anything in our power to maintain growth at 4%" which could include further subsidies for families. Robust growth and better tax collection has helped to prevent a larger deterioration in the budget deficit which stands at just over 2% of GDP. Loose fiscal policy is increasing the risk that Hungary's economy could overheat

Hungary's external position improved markedly... but is deteriorating again



- Hungary's economy has become less reliant on external financing. There has been a marked improvement in Hungary's current account balance since the global financial crisis. The current account is now just in surplus. In recent years, the Hungary's external balance has started to deteriorate again driven by robust domestic demand growth.
- At the current juncture, we see no clear need for the forint to adjust sharply lower on a sustained basis. Hungary does not have unsustainable imbalances which require a weaker currency like prior to the GFC. Following the GFC, the real trade-weighted forint lost around a quarter of its value in the following seven years, and has since stabilized.

MUFG FX Forecasts

	Q2 2019	Q3 2019	Q4 2019	Q1 2020
EUR/HUF	324	324	323	322
USD/HUF	284.2	279.3	273.7	268.3
HUF/JPY	0.376	0.380	0.380	0.384
EUR/PLN	4.25	4.26	4.24	4.22
USD/PLN	3.728	3.672	3.593	3.517
PLN/JPY	28.70	28.86	28.74	29.29

Source : July 2019 MUFG Foreign Exchange Outlook

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Source : All Charts Macrobond unless otherwise stated

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