



Central European Weekly

Monday, 02 June 2014

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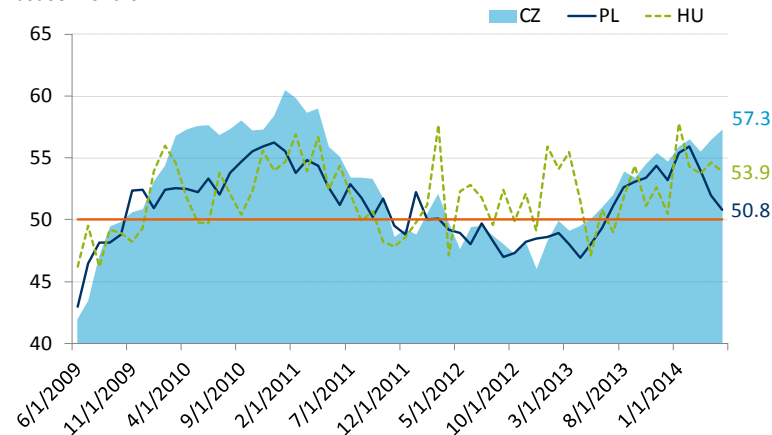
Weekly Highlights:

- Regional markets are awaiting ECB action, after mixed PMI figures
- GDP details for Q1 showed that Poland's domestic demand continued to improve
- The NBP again on hold, but some dovish comments could be heard

Chart of the Week: Regional PMI's

CE: Manufacturing PMI

last 60 months



Polish PMI slipped to an 11-month high while the Czech index hit a 37-month high in May.
(Source: Bloomberg, CSOB).

Market's editorial

Regional markets eye ECB action on Thursday

Just like the asset markets in the Eurozone, traders and investors in the Central European region are gearing up for the upcoming meetings. As concerns bond markets, last week saw no significant changes, with yields falling, but only slightly. Nevertheless, the expectations of a more aggressive monetary expansion were evident in forex markets, especially with the Polish zloty. The Polish currency significantly strengthened against the euro, but this time neither the Czech koruna nor the Hungarian forint followed suit, with the latter being exposed to another move by the National Bank of Hungary (NBH), which cut its base interest rate by an additional 10 basis points last week.

Apart from the ECB, the NBP meeting should be watch too

Apart from external events, such as the upcoming ECB meeting or major US data (labour market and ISM statistics), it will be interesting to digests the details of Czech and Hungarian GDP growth, which will be released along with the interesting monthly data (e.g. industrial production).

Moreover, the Polish central bank will conclude its meeting on Tuesday. The MPC meeting could be an eye catcher as

May's PMI index in Poland will that the Ukrainian-Russian conflict is starting to have a slightly adverse impact on the recovery, while the zloty becomes former. We think that the NBP will reiterate its commitment to keep interest rates unchanged until at least the end of the third quarter and NBP President Belka will support the overall dovish tenor of the meeting by his comments at the subsequent press conference. However, any serious considerations of another possible rate cut should be prevented by new GDP data for the first quarter, which confirmed a robust growth structure as well as decent quarter-on-quarter rate of GDP. The 'commitment' to keep rates unchanged until at least the end of the year, which is a very likely scenario, will not be extended before the July meeting, when a new forecast is available to the NBP.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.5	0.23%	↘	↗
EUR/HUF	303	-0.08%	↘	↗
EUR/PLN	4.14	-0.66%	↘	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.52	-2.56	↘	↗
10Y HUF	4.37	0.23	↘	↗
10Y PLN	3.63	0.42	↘	↗

Review of Economic Figures

Czech and Polish PMIs divergence continues

Fresh PMI figures for May unveiled deepening divergence between Czech and Polish index. While the Czech index reached a 37-month high, the Polish index slipped further in May and hit an 11-month low. The different results were driven mainly by a new orders component - while it kept its growth in the case of the Czech Republic (due to increase in both domestic and foreign demand), the Polish index fell most notably due to decline in new export orders (ongoing political crisis in Ukraine remains the main suspect).

Polish GDP growth reached 3.4% Y/Y in 2014Q1

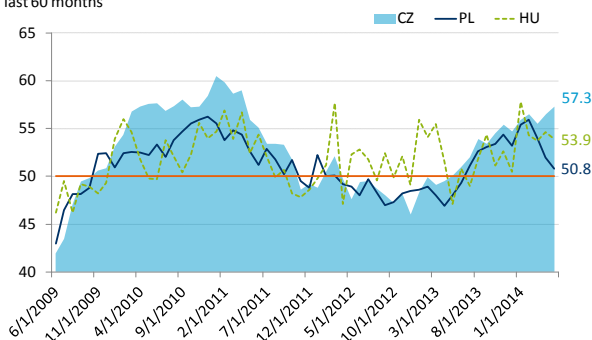
The Polish Statistical Office released more details of economic growth for the first quarter of 2014. In addition to having revised its first forecast slightly upwards (from 3.3% to 3.4%), it confirmed the increasing role of domestic demand. As long ago as in late 2013, growth was mostly attributable to domestic demand, and in early 2014 this trend continued to grow (in accordance with our expectations). Strong contributors to economic growth primarily included household consumption (1.7 percentage points and up by 2.6% Y/Y) and investment (a total of 1.2 percentage points), with the latter, in particular, being a pleasant surprise (up by a huge 10.7% Y/Y). Net exports as a contributor to growth (0.5%) continued to be overshadowed, despite having been the primary driver of the Polish economy only recently. As concerns the creation

of value added, we should certainly mention its strong increase in construction (by 8% Y/Y, the highest value since the third quarter of 2011) but this was partly attributable to a very moderate winter.

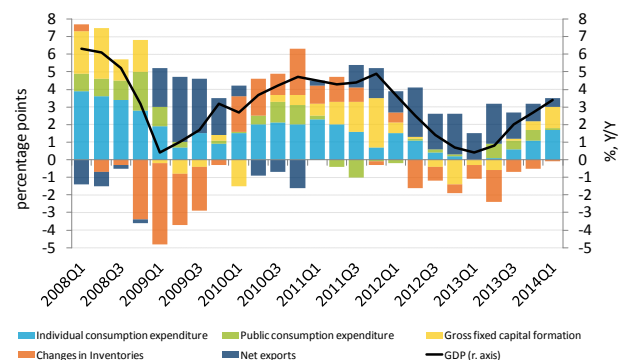
The robust structure of economic recovery, fuelled by domestic demand, only underlined the high quarter-on-quarter growth rate, which, with its seasonally adjusted value of 1.1%, has been the highest since the middle of 2011 (investment rose by 3.8% Q/Q). Both of the above-mentioned factors, along with the lack of inflationary pressures, are another argument for the stability of official interest rates this year. Bear in mind that the market has even begun to bet on a rate cut recently, but very reasonable economic growth, based on strong foundations, should calm the central bank down. Probably the main risk in this regard stems from the ECB meeting, which may easily surprise markets this week by easing its monetary policy more aggressively than expected. In that event, the zloty may continue to strengthen and, with inflation below the target for a long time, this would not be welcome news for the NBP.

CE: Manufacturing PMI

last 60 months



PL: Contributions to GDP growth



Weekly preview

WED 14:00
NBP rate (in %)

	This	Last change
rate level	2.50	7/2013
change in bps	0	-25

PL: The NBP again with no change

The meeting of the National Bank of Poland (NBP) will yield no substantial news. The NBP will reiterate its 'commitment' to keep interest rates unchanged until at least the end of the third quarter and NBP President Belka will support the overall dovish tenor of the meeting by his comments at the subsequent press conference. Any serious considerations of another possible rate cut should be prevented by new GDP data for the first quarter, which confirmed a robust growth structure as well as decent quarter-on-quarter rate of GDP. The 'commitment' to keep rates unchanged until at least the end of the year, which is a very likely scenario, will not be extended before the July meeting, when a new forecast is available to the NBP.

THU 9:00
CZ Retail Sales (change in %)

	Apr-14	Mar-14	Apr-13
Sales	5.5	5.2	2.1
cummulative (YTD)	6.2	6.5	-1.7

CZ: Retail sales still driven by car sales

Car sales, which have been breaking new records this year, continued to be the primary contributor to retail sales in April. Moreover, the retail sector is still coping with the fairly low comparative baseline of last year. This is why we believe that the rise in retail sales will continue to be strong this time. Even so, with the automotive segment excluded, retail sales will continue to be more modest – below 2%. In addition to cars, we also expect strong performance from e-commerce and electronics. The total rise in retail sales (including cars) should gradually lose momentum in the months to come and settle between 2% and 3%.

FRI 9:00
CZ Industry (y/y change in %)

	Apr-14	Mar-14	Apr-13
Monthly	7.0	8.7	0.0
cummulative (YTD)	7.1	7.1	-4.1

CZ: Automotive manufacturing as growth leader

The expansion of industry, which started last year, likely persisted in April. After all, new orders from industrial firms as well as purchasing manager indices still indicate a very reasonable rise in this sector. Carmakers were probably responsible for April's industrial growth again, but we also anticipate positive figures from other strong sectors, such as the production of electric equipment, plastics, and electronics. Orders, whose rise might be maintained at a double-digit level, will again be more interesting than the production figures.

FRI 9:00
CZ Foreign trade (CZK bn)

	Apr-14	Mar-14	Apr-13
Balance	42.0	49.1	34.5
cummulative (YTD)	167.7	125.7	129.8
Balance (national)	16.2	23.8	15.0
cummulative (YTD)	66.3	50.1	49.0

CZ: Exports supported by European demand

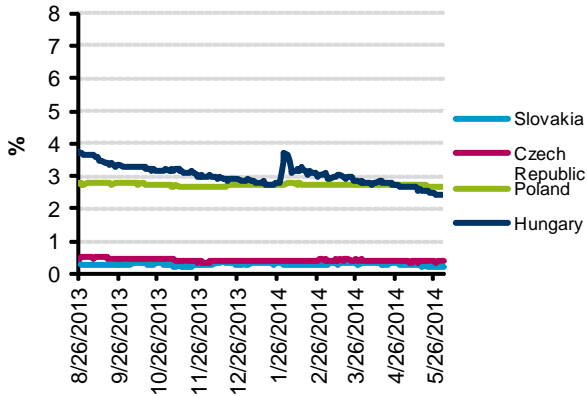
With the very decent performance of export-oriented industry, we can also expect very good foreign trade figures. Successful export articles include, in particular, cars and their parts, electric equipment, and electronics. By contrast, engineering has been losing momentum thus far, which we believe to be only temporary. As commodity prices have stabilised at relatively low dollar levels and domestic demand is not expanding dramatically, we expect no dramatic developments in imports. Hence the foreign trade surplus may continue to increase in both cross-border and national statistics.

Calendar

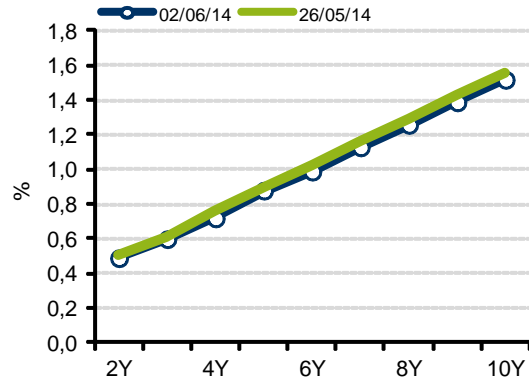
Country	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	06/02/2014	9:00	PMI manufacturing	05/2014					54.6	
HU	06/02/2014	9:00	Trade balance	EUR M 03/2014 *F					675	
PL	06/02/2014	9:00	PMI manufacturing	05/2014			52.2		52	
CZ	06/02/2014	9:30	PMI manufacturing	05/2014					56.5	
CZ	06/02/2014	14:00	Budget balance	CZK B 05/2014					26.6	
PL	06/03/2014	14:00	NBP meeting	% 06/2014	2.5		2.5		2.5	
CZ	06/04/2014	9:00	GDP	% 1Q/2014 *P					0	2
HU	06/04/2014	9:00	Retail sales	% 04/2014				7.5		8.3
HU	06/04/2014	9:00	GDP	% 1Q/2014 *F					1.1	3.5
CZ	06/04/2014	12:00	CZ bond auction 2014-2020, floating rate	CZK B 06/2014						
CZ	06/04/2014	12:00	CZ bond auction 2014-2027, floating rate	CZK B 06/2014						
CZ	06/05/2014	9:00	Retail sales	% 04/2014		5.5				5.2
CZ	06/05/2014	9:00	Real wages	% 1Q/2014						-2.9
HU	06/05/2014	9:00	Industrial output	% 04/2014 *P				7.2	0.4	8.1
HU	06/06/2014	9:00	Trade balance	EUR M 04/2014 *P				675		
CZ	06/06/2014	9:00	Trade balance (national)	CZK B 04/2014	16.2				23.8	
CZ	06/06/2014	9:00	Industrial output	% 04/2014		7				8.7
CZ	06/06/2014	9:00	Construction output	% 04/2014						12.8
CZ	06/06/2014	10:00	Current account	CZK B 1Q/2014						-370.9

Fixed-income in Charts

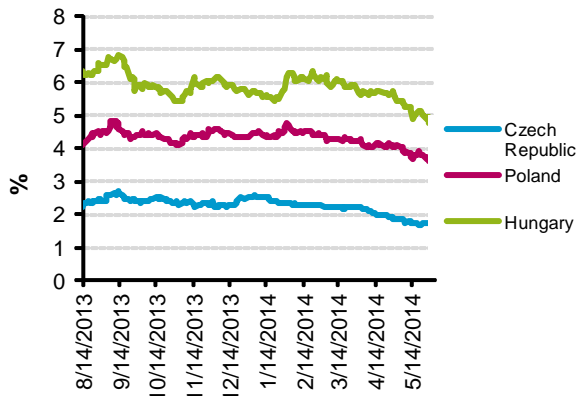
FRA 3x6



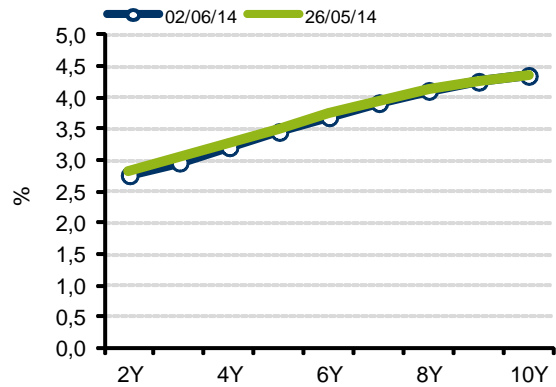
CZ IRS



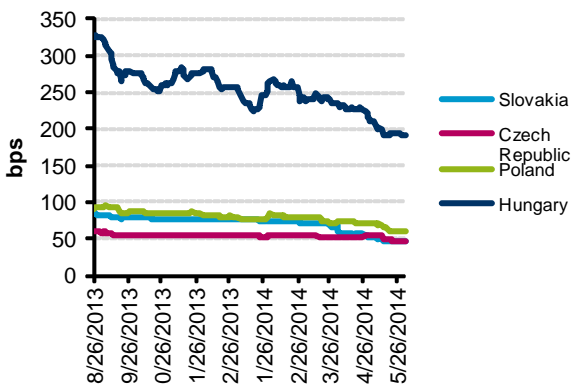
10Y GB Yields



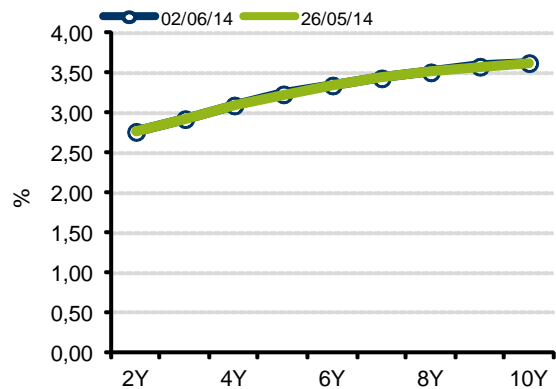
HU IRS



CDS 5Y



PL IRS



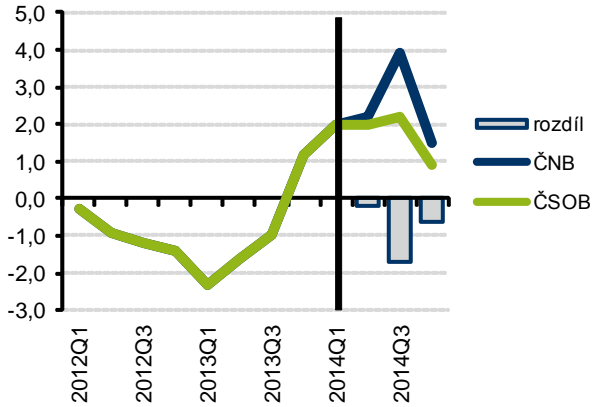
Source: Reuters

Medium-term Views & Issues

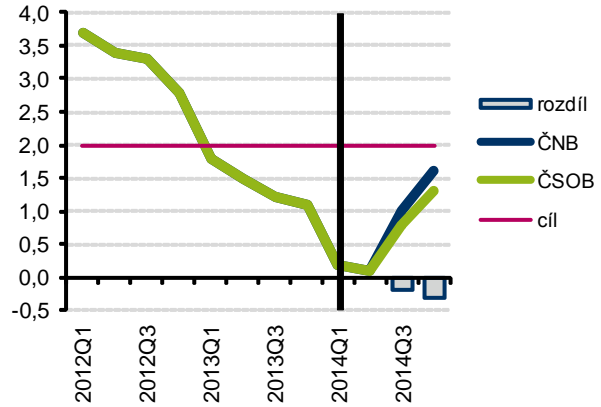
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The president appointed a new coalition government a few months after the election. The programme of the future government is likely to be consistent with the concluded coalition agreement, which envisages keeping the government deficit below 3% of GDP throughout the government's electoral term. Statistics for the last six months confirm that the worst is over for the economy. The economy is being driven by the manufacturing industry, notably passenger car production, while construction, as well as many of services, are struggling to bottom out.</p>	<p>Based on the first quarter figure and the recent trends in the economy, Hungary's GDP may grow above 2.5% Y/Y in 2014 and it cannot be excluded that the growth might be close to 3% Y/Y level. The low base supports this economic growth level in short term, but without a substantial rise of investments in the private sector this year, economy may slow down to around 2% Y/Y level in 2015.</p>	<p>According to the GUS estimates the Polish economy grew by 3.4% in 2014Q1. For this year, the growth should significantly exceed 3%. Household consumption should support growth, owing to the improving labor market situation as well as to low inflation. Investment should also develop favorably, owing to the replenishment of inventories as well as to gross capital formation. In addition, lower government debt could also give a greater lift to the economy. By contrast, net exports are likely to curb rather than boost growth, especially in view of recent crisis in Ukraine.</p>
Outlook for official & market rates	<p>The CNB has exhausted the possibility of easing its monetary policy through interest rates, and therefore it has decided to weaken the koruna and keep it close to CZK 27 per EUR. Statements from the CNB representatives indicate that the CNB would like to maintain that level for a prolonged period, until strong inflation pressures become evident in the economy. The CNB believes that the depreciation of the koruna should enable the economy to avoid deflationary pressures and boost its growth up to 2.6% this year. The CNB is very unlikely to change rates, and just as likely to maintain its intervention regime throughout this year.</p>	<p>As the minutes of last MPC meeting highlighted that the council didn't want to give clear message of the stop of rate cut cycle, and Minister of National Economy (Mr. Varga) said in an interview yesterday that there is still room for loosen the monetary policy, it is now very likely that NBH may cut base rate again in May and the tone of the statement might remain also quite loose.</p>	<p>Inflation pressures in Poland remain subdued and year-on-year prices growth is seen well below the lower tolerance band of the inflation target. Although the recent development has supported our bets on faster economic recovery in Poland, outlook for persistently low inflation should play in favor of stable official interest rates in the rest of this year. The main risk in this regard stems from the ECB meeting and its possible impact on the zloty exchange rate. If the zloty continued to strengthen, it would not be welcome news for the NBP, especially in line with inflation hovering well-below the target.</p>
Forex Outlook	<p>The CNB has started FX interventions and we expect the koruna to stay within the regime at least till the mid 2015. Hence the currency should stay above 27.00 EUR/CZK at least in 12-month horizon. When the FX targeting regime is set to be abandoned, the CNB will have to intervene on the market much more aggressively to stop the spot koruna from appreciation. As a side effect, the forward koruna can appreciate significantly before the regime is abandoned.</p>	<p>The NBH ongoing easing cycle might be also a reason, why HUF was hit more aggressive in this sell-off than its regional peers. It has also a message that Hungary is still more sensitive on international sentiment than its regional PEERS. So we don't expect substantial HUF strengthening from the levels of EUR/HU 305.</p>	<p>Low inflation pressures and improving prospects of the economy may support the zloty in months ahead. Albeit we expect only gradual strengthening against the euro, the Polish currency might perform well against the koruna as the room for koruna's appreciation remains virtually closed and the economic recovery in Poland is likely to continue at faster pace. The main risk as regards the zloty is upcoming meeting of the ECB which could further support the currency (which has already strengthened significantly due to ECB's "commitment" to ease MP).</p>

CBs' Projections vs. Our Forecasts

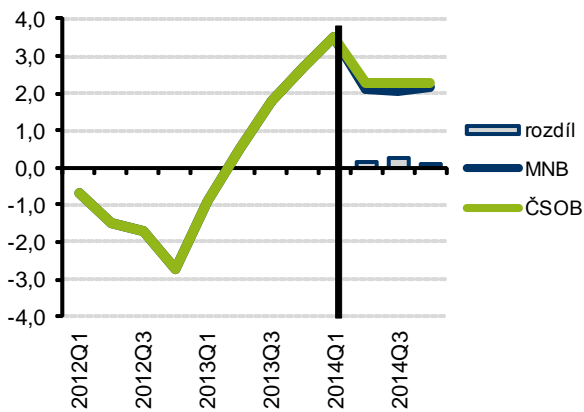
CZ: GDP outlook (Y/Y, %)



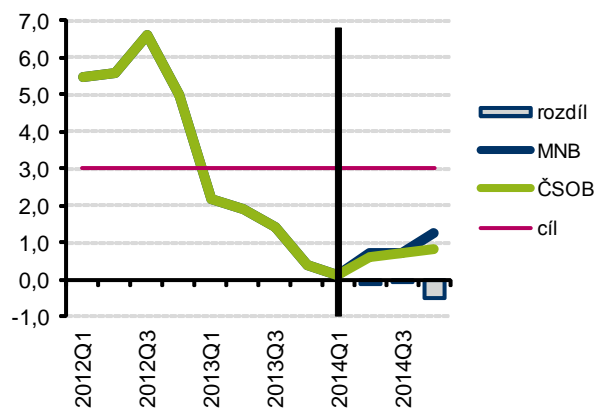
CZ: Inflation outlook (Y/Y, %)



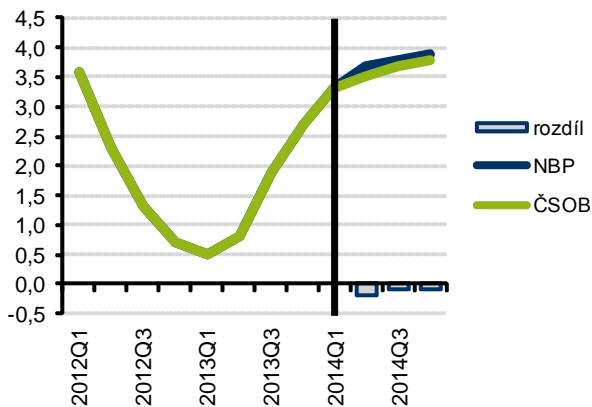
HU: GDP outlook (Y/Y, %)



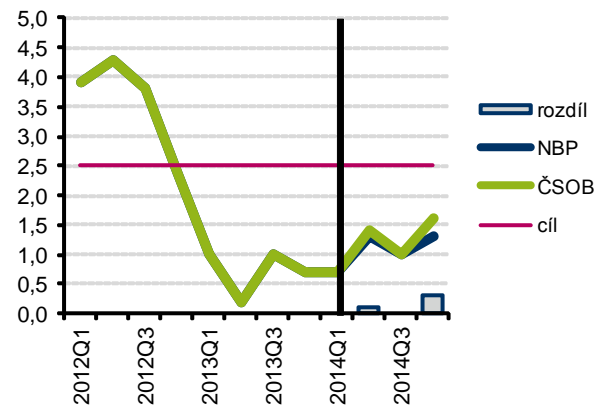
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outlook (Y/Y, %)



Source: CNB, NBP, MNB, CSOB

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4	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.	2.40	3.00	2.60	2.50	2.50	2.50	-15 bps	5/27/2014
Poland	2W inter. rate	2.50	2.50	2.50	2.50	2.50	2.75	-25 bps	7/3/2013

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

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	PRIBOR	0.36	0.38	0.37	0.36	0.36	0.40
Hungary	BUBOR	2.45	2.99	2.67	2.50	2.50	2.50
Poland	WIBOR	2.72	2.71	2.71	2.75	2.75	3.00

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

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	CZ10Y	1.52	2.09	1.84	1.75	1.90	2.00
Hungary	HU10Y	4.37	5.25	4.95	5.00	5.30	5.70
Poland	PL10Y	3.63	4.25	4.03	4.10	4.45	4.70

Exchange rates (end of the period)

		Current	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	EUR/CZK	27.5	27.3	27.4	27.2	27.2	27.2
Hungary	EUR/HUF	303	297	307	305	298	295
Poland	EUR/PLN	4.14	4.16	4.17	4.16	4.15	4.09

GDP (y/y)

	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	-1.6	-1.0	1.2	2.0	2.0	2.2	0.9
Hungary	0.5	1.8	2.7	3.5	2.3	2.3	2.3
Poland	0.8	1.9	2.7	3.3	3.5	3.7	3.8

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

	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Czech Rep.	1.6	1.0	1.4	0.2	0.3	1.1	1.5
Hungary	1.9	1.4	0.4	0.1	0.6	0.7	0.8
Poland	0.2	1.0	0.7	0.7	1.4	1.0	1.6

Current Account

	2013	2014
Czech Rep.	-1.4	-1.4
Hungary	2.0	2.2
Poland	-1.2	-2.5

Public finance balance as % of GDP

	2013	2014
Czech Rep.	-1.5	-2.5
Hungary	-2.7	-3.0
Poland	-4.4	-3.5

Source: CSOB, Bloomberg

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