



# Central European Weekly

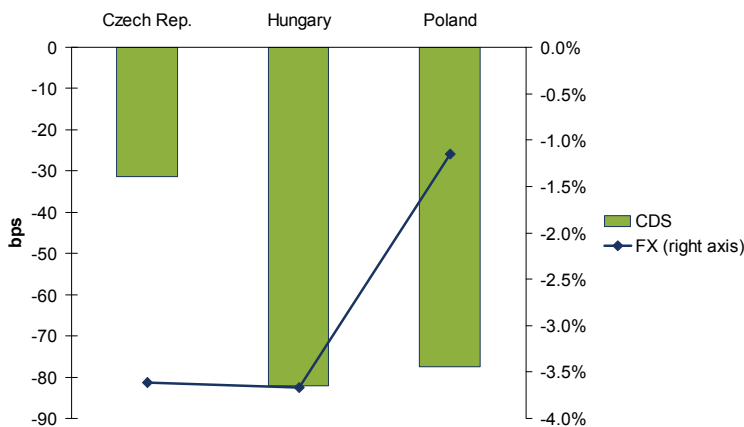
Written by CSOB Prague and K&H Budapest

## Weekly Highlights:

- Polish economy continues to grow by more than 4%
- MNB hikes by 50 bps and indicates more to come
- Solid demand in Czech bond auction triggers rally
- NBP stays on hold again

## Chart of the Week:

**CE: CDS and FX change over a week**



Relief rally has been apparent in both CE CDS and CE FX markets (negative values in case of FX show appreciation against the euro).

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# Market's editorial

## Finally few market-calming signals for CE markets

Central European markets fetched a sign of relief last week, although the relief was not based on a positive reversal in eurozone's bond markets, as purely regional factors also contributed to that relief.

### MNB hikes by 50 bps and indicates more to come

One of them was clearly a rate hike by the National Bank of Hungary. The bank not only raised its base rate by 50 basis points, it also indicated that it was prepared to do more. We believe that the NBH will repeat its November's move in December and, unless the situation in the eurozone escalates dramatically and if the talks on the IMF's loan are on a good way, this may be the last stabilisation rate hike.

### Polish growth still strong, despite weaker PMI

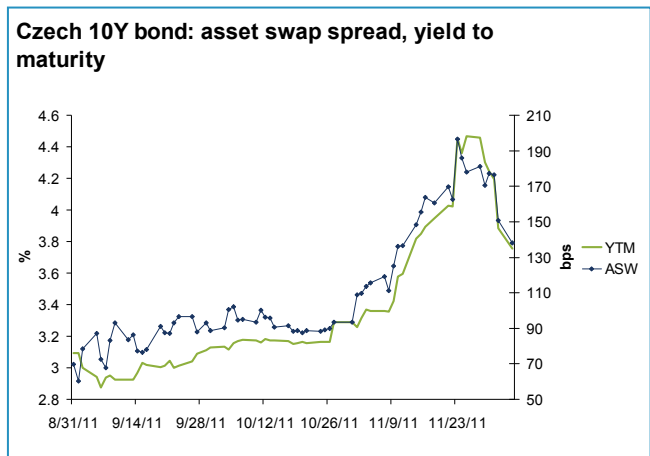
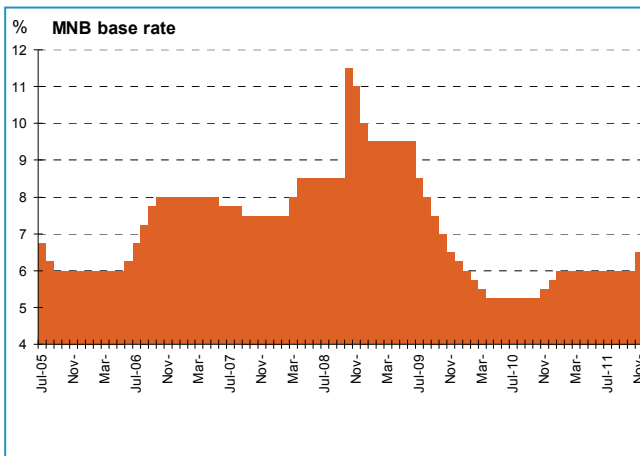
Poland's GDP figure for the third quarter of the year may be regarded as being another positive signal from the region (see the next page). The economy still grew by a robust 4.2% y/y, indicating that growth for the whole of 2011 might also exceed 4%. In other words, reasonable growth of the Polish economy remains a stabilisation factor in the Central European

region; after all, this was most evident in 2009, when Poland was the only EU country to avoid the recession.

On the other hand, the latest PMI readings which showed a drop below 50 points level (for the first time since October 2009) suggest that steps taken by the NBP in the first half of this year have started to weigh on a domestic demand. Moreover, even though that Poland is a relatively closed economy (in comparison with its regional peers), the EMU debt crisis and an overall slowdown in European growth also undermines the Polish economy.

### Solid demand in Czech bond auction

Finally, the third positive signal was the outcome of the Czech government bond auction. Naturally, this cannot be viewed separately from the developments in the eurozone's bond markets. Nonetheless, the facts that the Czech government bonds were well in demand and the State was able to subscribe 10-year instruments under very reasonable conditions in the auction are very pleasant surprises; all the more so because Slovakia failed to sell its 3-year bond just a few days before the Czech auction..



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.2	-1.60%	↗	↗
EUR/HUF	301	-2.63%	↗	↘
EUR/PLN	4.48	-1.54%	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.30	-5.74	↗	↗
10Y PLN	7.39	-3.27	↗	↗
10Y HUF	5.07	-3.61	↗	↗

## Review of Economic Figures

### The economy continued to grow by more than 4% in the third quarter, ...

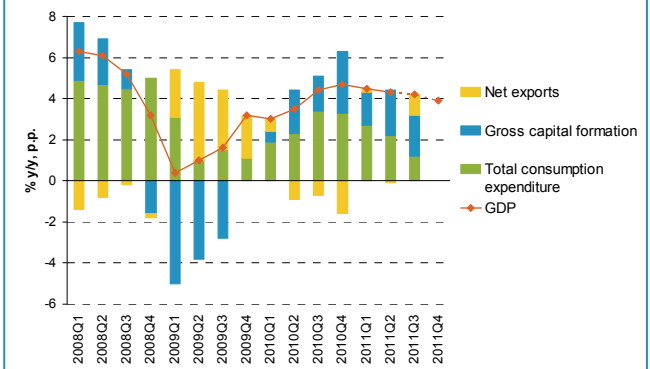
According to the preliminary estimate by Poland's Statistical Office, the Polish economy grew by 4.2% y/y in the third quarter of this year, and thus sprang another slightly pleasant surprise.

As concerns demand, growth was primarily driven by domestic consumption and investment, which collectively contributed 3.2% to that growth (2% of which being investment and 1.2% being consumption). The contribution of investment to growth, after excluding the effect of inventory replenishments, was even 1.6%, thus exceeding the previous quarter's figure (+1.2%), and hitting the highest value since the last quarter of 2008. The highest contribution of net exports to growth since the end of 2009, by 1%, was a modest surprise. Construction continued to be the fastest growing sector in terms of gross value added generation in the third quarter, rising by 12% y/y. This basically bore out the monthly sub-statistics, which indicated some of the fastest month-on-month increases in construction for the third quarter in the last decade.

### ... meaning that 2011 GDP growth may be around 4.1%.

Nevertheless, the outlook for next year remains less favourable. The factors that encouraged the Polish economy during the recent financial crisis should slowly wane. Poland's fairly high public debt, which will be boosted by this year's deficit in excess of 5% of

Contribution to GDP volume growth rate



GDP and the weakened zloty (approximately 30% of the debt is denominated in foreign currencies), along with the commitment to cut the deficit to less than 3% of GDP next year, should curb government expenditure in the years to come. In addition, high commodity prices have made the central bank tighten the monetary conditions in this country quite aggressively. Thus the combined effect of the increased interest rates and the increased austerity of the budget policy should curb economic growth. The figures should also reflect the base effect – which should already make itself felt in the last quarter of this year. However, given the very favourable figures for the first half of this year, we believe that Poland's economic growth for 2011 may be 4.1%.

## Weekly Preview

### WED 9:00 CZ Industry (y/y change in %) CZ: Industry driven by carmakers

	Oct-11	Sep-11	Oct-10
Monthly	2.4	2.8	11.2
cummulative (YTD)	7.5	8.1	9.5

The increase in industrial output, which was again very modest, however, was primarily driven by carmakers. The year-on-year increase in their output was at a double-digit rate again. We also anticipate a reasonable figure in the engineering and plastics industries as well as in the manufacture of electric equipment. However, the other industries are again likely to show poorer figures. New orders, which have not been very favourable in recent months, will grab the spotlight again. Domestic new orders have been falling for five consecutive months, and thus the increase in industrial output is currently at the mercy of anticipated foreign demand.

### WED 9:00 CZ Foreign trade (CZK bn) CZ: Exports again driven by cars

	Oct-11	Sep-11	Oct-10
Balance	16.0	21.0	13.7
cummulative (YTD)	151.7	135.7	111.3
Exports (y/y in %)	6.8	7.8	18.6
Imports (y/y in %)	6.2	3.5	21.8

We expect that exports were based on the favourable developments in Czech foreign trade. Exports again went up faster than imports this time albeit the gap between exports and imports shrank compared to previous months. The main contributors to exports include carmakers, which are successfully expanding into eastern markets while imports are still being driven upwards by costly raw materials. The year-on-year surplus in trade should again be higher, due also to poor domestic consumer and investment demand.

### WED 14:00 NBP rate (in %)

	This	Last change
rate level	4.50	5/2011
change in bps	0	25

### PL: Poland's central bank again leaves rates unchanged

Although the Polish economy grew at a reasonable rate in the third quarter, the development of the leading indicators (most recently the PMI) is disconcerting. Likewise, the labour market, with its decelerating creation of new jobs, is not developing very well either. If the Polish economy were currently not way above its inflation target and were not troubled by the weak zloty, it would nearly be high time to consider a monetary easing. However, given the above developments, Poles can do nothing but leave rates unchanged.

### FRI 9:00 CZ Inflation (change in %)

	Nov-11	Oct-11	Nov-10
CPI m/m	0.3	0.3	0.2
Food m/m	0.8	0.9	1.6
Housing, energy	0.4	0.1	0.0
Transportation	0.1	0.3	-0.1

### CZ: Gas and food drive inflation up

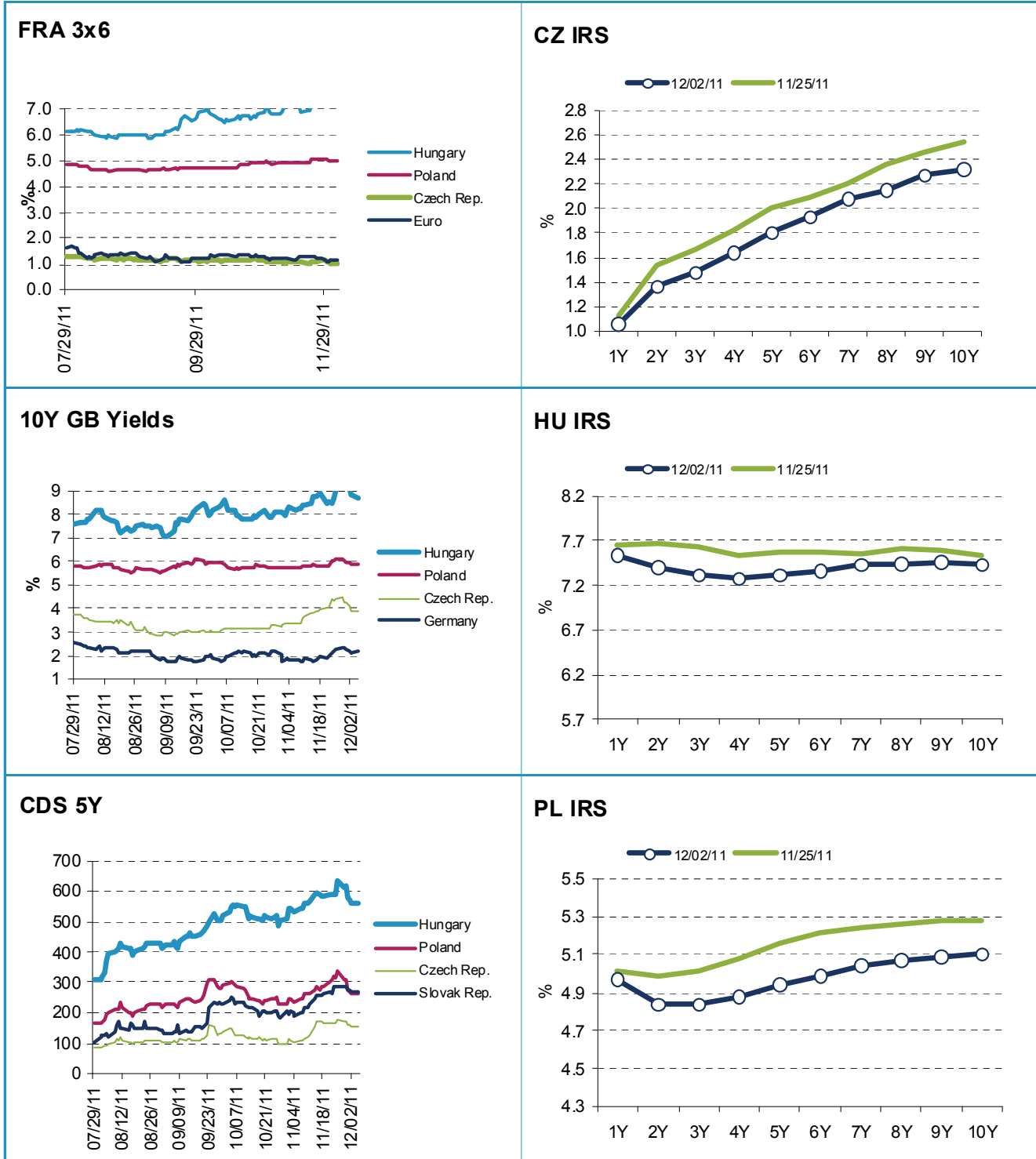
November's anticipated inflation acceleration was again due to the increased prices of food and natural gas for households. Prices of seasonal goods also went up while package tour prices went down. We can also speculate whether or not the VAT increase, with effect from January, is already affecting inflation. By and large, inflation is no longer in line with the Czech National Bank's target and its latest forecast, which envisaged November's inflation at 2%. However, neither the currently increased inflation rate nor the rapid inflation rise, effective from January, will make the CNB change rates in any way soon. That said, we will be in for a prolonged period of stable rates, encouraged by the declining performance of the economy.



## Calendar

Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	12/05/2011	9:00	Wages	%	3Q/2011		2.2		1.2		0.7
CZ	12/06/2011	9:00	Retail sales	%	10/2011		1.8		1.8		-0.5
CZ	12/2011	9:00	Trade balance		CZK B 10/2011	16			18.5		21
CZ	12/07/2011	9:00	Construction output	%	10/2011						-6.7
CZ	12/07/2011	9:00	Industrial output	%	10/2011		2.4		2.4		2.5
HU	12/07/2011	9:00	Industrial output	%	10/2011 *P						3.9 3
ČR	12/07/2011	12:00	CZ bond auction floating rate/2023		CZK B 12/2011				7		
PL	12/07/2011	14:00	NBP meeting	%	12/2011				4.5		4.5
HU	12/07/2011	17:00	Budget balance		HUF B 11/2011						-1327.8
CZ	12/08/2011	9:00	Unemployment rate	%	11/2011	8.1			8		7.9
CZ	12/08/2011	10:00	Current account		CZK B 3Q/2011						-2
HU	12/08/2011	12:00	GB bond auction/floating rate		HUF B 12/2011						
HU	12/09/2011	9:00	Trade balance		EUR M 10/2011 *P						740.6
HU	12/09/2011	9:00	GDP	%	3Q/2011 *F						0.5 1.4
CZ	12/09/2011	9:00	CPI	%	11/2011	0.3	2.4	0.3	2.3	0.3	2.3
CZ	12/09/2011	9:00	GDP	%	3Q/2011 *F						0 1.5

# Fixed-income in Charts

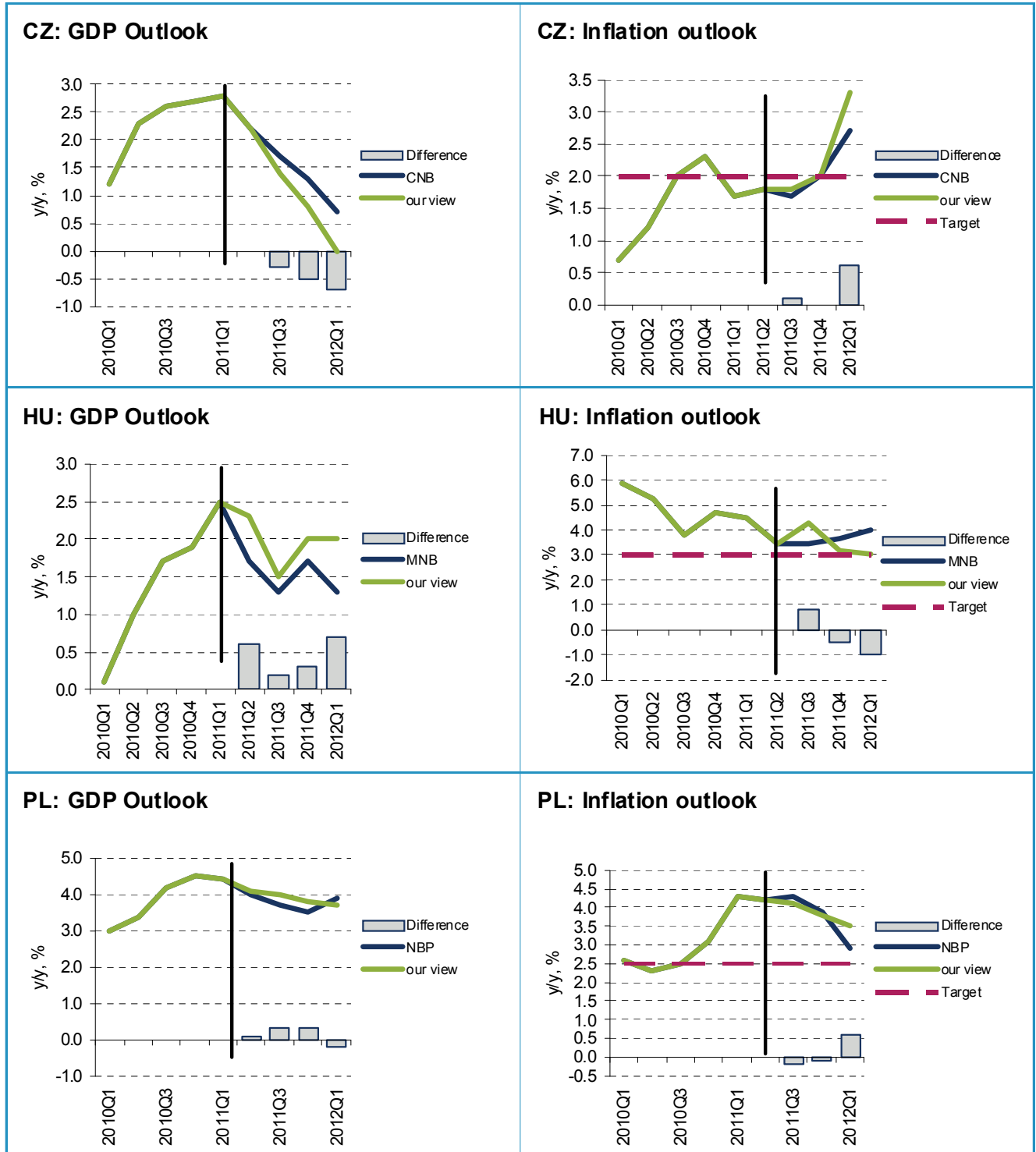


Source: Reuters

## Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	<p>Although the situation in the governing coalition after some turmoil has stabilized again, tensions in the government coalition might return during discussions of the 2012 budget. The government intends to change the system of direct taxes radically and to unify gradually the VAT rate in order to push the deficit below 3 percent of GDP by 2013. Despite the positive outlook of the public budgets, the government does not intend to set a target date for the euro adoption in the Czech Republic.</p>	<p>Most of the economists now expect a recession for Hungary in 2012 partly because some foreign banks will have to drastically improve their loan/deposit ratios. The growth forecast could be a key point in the upcoming IMF talks and probably this is the reason why the government has been talking to the central bank about it. A weaker growth outlook may also require additional fiscal measures, especially if the IMF opens only the stand-by loan facility instead of the precautionary credit line.</p>	<p>We believe that Poland's economic growth for may be 4.1% in 2011 (due to the very favourable figures for the first three quarters). Nevertheless, we expect that factors that kept the Polish economy growing during the World Financial Crisis will gradually step aside and we estimate that the economy will grow at a slower pace next year. More specifically, a room for relatively loose fiscal policy seems to have diminished and higher interest rates should, in our view, contribute to a slowdown in both households' consumption as well as private and public investment.</p>
Outlook for official & market rates	<p>Inflation increased above the central bank's target in October driven by food and fuel prices. Fuel prices as well as prices of agricultural commodities continue to pose a risk for future inflation. In January the inflation will jump above the 3% as a result of V.A.T. increase. On the other hand, weak domestic demand should counter a rise in inflation. We expect the CNB to maintain its wait-and-see policy at least until the end of the next year. The first rate hike delivered by the Czech central bank is probable in 2013H1.</p>	<p>The Hungarian central bank matched analysts' expectations and hiked the base rate by 50bps to 6.50%. As expected the MNB highlighted inflation concerns due to the weaker currency in the statement. It added that it may continue to tighten if financial risks remain elevated, implying another 50bps move on the next meeting in December.</p>	<p>Fears of inflation remaining above the target in medium term led to the further round of monetary tightening in Poland. The National Bank of Poland increased the reference rate already for the third time this year by 25 bps to 4.50%. Although the rate of inflation should stay above the target in the rest of 2011, the inflation expectations have stabilized and employment growth remains sluggish. Furthermore global risk has somewhat intensified recently. Hence we believe the NBP should stay on hold for some time, at least through 1-quarter 2012.</p>
Forex Outlook	<p>The Czech koruna should remain under pressure because of the escalating tension surrounding euro-crisis management. Nevertheless, if the worst case scenario of eurozone meltdown is avoided, the koruna has potential to appreciate. Slow continuation of real convergence, should remain a positive long-term factor for the Czech currency. Hence after current correction with short term target around 26.10 EUR/CZK, we continue to see the koruna stronger in 12-month horizon at 24.50 EUR/CZK.</p>	<p>Upcoming weeks will show whether the recent MNB policy change (into more hawkish stance) will be sufficient to stabilize the currency. We believe that yesterday's rate hike goes into a right direction, but naturally a lot will depend on the euro-zone crisis and outcome of the IMF talks.</p>	<p>The Polish zloty remains under pressure. The coordinated action of Polish state owned bank BGK and Polish central bank (NBP) provided certain relief to the Polish currency. Nevertheless it is questionable whether the weakness of the Polish zloty is over. It is not very clear whether the NBP or the Ministry of Finance have any strategy how to defend the currency. The markets were used to the fact that Polish authorities were comfortable with the range 3.8-4.25 EUR/PLN, where the pair stayed for nearly two years. Nevertheless this time the authorities did not mind much weaker zloty before stepping in.</p>

# CB's Projections vs. Our Forecasts



Source: CNB, NBP, MNB, CSOB



## Summary of Our Forecast

### Official interest rates (end of the period)

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	Last change	
Czech Rep.	2W repo rate	0.75	0.75	0.75	0.75	0.75	0.75	-25 bps	5/7/2010
Hungary	2W deposit r.	6.50	6.00	7.00	7.00	7.00	7.00	25 bps	11/29/2011
Poland	2W inter. rate	4.50	4.50	4.50	4.50	4.75	4.75	25 bps	6/9/2011

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

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	PRIBOR	1.15	1.17	1.17	1.18	1.20	1.21
Hungary	BUBOR	7.00	6.00	6.50	7.00	7.00	7.00
Poland	WIBOR	4.97	4.60	4.60	4.60	4.75	4.80

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

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	CZ10Y	2.34	2.05	2.20	2.30	2.50	2.85
Hungary	HU10Y	7.30	7.50	7.50	7.50	7.50	7.50
Poland	PL10Y	5.07	4.80	5.00	5.00	5.10	5.20

### Exchange rates (end of the period)

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	EUR/CZK	25.2	25.0	26.0	25.3	25.0	24.7
Hungary	EUR/HUF	300	295	280	270	270	268
Poland	EUR/PLN	4.47	4.35	4.10	3.95	3.90	3.90

### GDP (y/y)

	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	2.8	2.2	1.4	0.8	0.0	0.4	1.4
Hungary	2.5	1.5	1.5	2.0	2.0	1.8	1.8
Poland	4.4	4.3	4.0	3.8	3.7	3.5	3.3

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

	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Czech Rep.	1.8	1.8	2.0	3.3	3.3	3.0	3.0
Hungary	3.5	4.3	3.2	3.0	2.8	2.8	2.8
Poland	4.2	4.1	3.8	3.5	3.0	2.8	2.5

### Current Account

	2010	2011
Czech Rep.	-3.8	-3.6
Hungary	0.5	2.9
Poland	-2.1	-5.0

### Public finance balance as % of GDP

	2010	2011
Czech Rep.	-4.7	-4.3
Hungary	-3.8	-2.9
Poland	-7.1	-6.9

Source: CSOB, Bloomberg



## Central European Weekly

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