Monday, January 30,

Central European Weekly

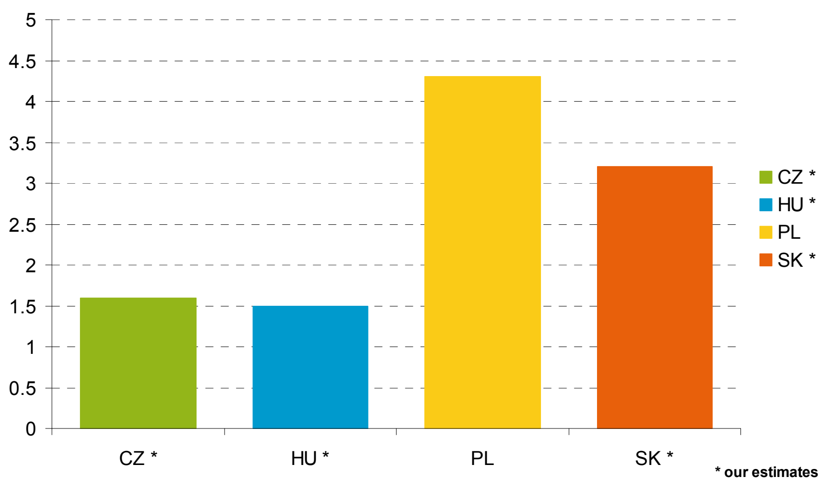
Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- Not even a dovish move by the NBH could make the forint plummet
- Poland’s strong GDP growth and high inflation are signalling rate stability
- CNB will sticks to its wait-and-see interest-rate

Chart of the Week:

CE: GDP growth in 2011



Polish economy outperformed its regional peers last year.

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Market's editorial

NBH surprisingly on hold, forint does not care…

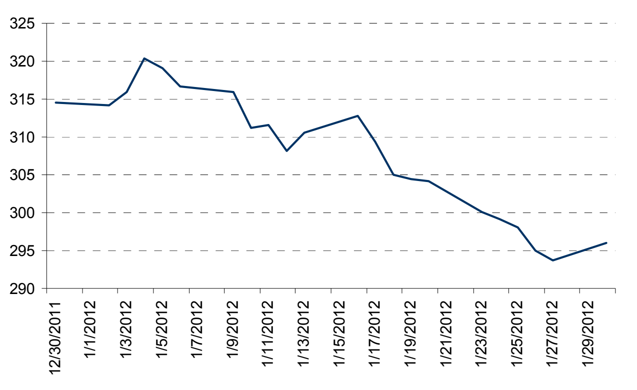
Central European markets continued to be in an up-beat mood for another week, when currencies strengthened and bond prices went up in all countries in the region, and this was also true of stock markets.

Gains by a few percent were above all seen in Hungary, which is still awaiting an agreement on a new stand-by loan from the IMF. Owing to the generally positive global sentiment, which is favourable for risky assets, the forint very easily withstood the surprisingly dovish decision by the Board of the National Bank of Hungary. Notwithstanding the market expectations, betting on a hike in the base rate, the Board decided to leave its official rate unchanged. The decision by the NBH not only failed to trigger a sale of the forint, it even boosted demand for Hungarian bonds, and this consequently encouraged the Hungarian currency. As a result, the forint hit its strongest levels since the middle of October 2011. We will see how sustainable this appreciation of the Hungarian currency is. We believe, however, that the forint is exposed to the risk of a negative correction, which is likely to lead to a change in moods on global markets again.

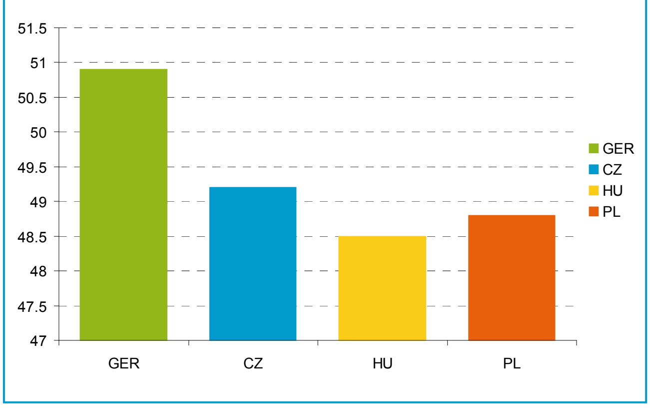
Regional PMI's could point to some improvement

This week may be interesting for Central European economies, because the leading indicators of business moods in industry will show us just how serious the recession risk is, in the export-oriented economies of this region. Bearing in mind the strong links of the Czech, Hungarian and even the Polish industrial sectors to the performance of large German companies, another good result concerning German business sentiment (the Ifo and PMI indices) may mark another moderate improvement of the situation in Central Europe's industry and consequently the suppression of the risk of recession in some of the regional economies.

EUR/HUF in 2012



PMI: CE vs Germany



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*25.2*	*-0.67%*	↗	↗
EUR/HUF	*295*	*-1.42%*	↗	↗
EUR/PLN	*4.24*	*-0.75%*	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*2.21*	*-2.47*	→	↗
10Y PLN	*7.64*	*1.60*	→	↗
10Y HUF	*4.95*	*0.20*	↗	↗

Review of Economic Figures

Poland post solid GDP growth in 2011

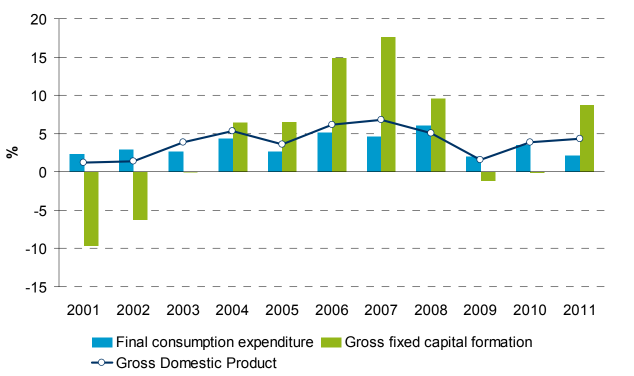
According to preliminary estimates by Poland's Statistical Office (GUS), the Polish economy grew by 4.3% last year, i.e., 0.1% faster than expected. As concerns demand, the growth was primarily fuelled by investment, which, after eliminating the effect of inventories, went up by 8.7% y/y. Compared to the previous year, however, household consumption lagged behind slightly, having improved by 3.1% (as opposed to 3.2% in 2010). The primary supply factor was construction, as also indicated by monthly data; the gross value added in this sector even went up at the fastest rate since 2006.

The reasonable condition of the Polish economy was also discussed by the central bankers at their January meeting. While central bankers recognise that a deceleration of the economy is expectable, they agree on the fact that growth remains fairly strong, in spite of noticeable rate hikes in the first half of last year. In recent weeks, members of the Monetary Policy Council (MPC) have therefore curbed the market optimism associated with an anticipated rate cut within a nine-month horizon. The series of their comments was consistent with this – most MPC members preferred rate stability, and, should the rates change, they unanimously stated that a rate hike is more likely than a cut. In addition to the good condition of the domestic economy, the central bankers are also concerned about the inflation rate, which has persisted at a high level. Even though the market was resisting central bankers' comments for quite a long time, it largely erased its bets on a rate cut after the release of the minutes of January's meeting.

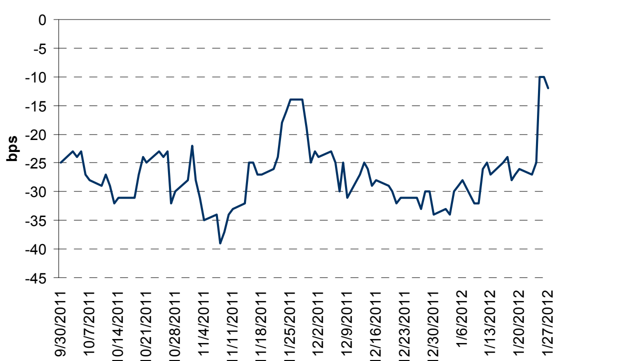
Macro-environment speaks for flat NBP rates

Thus the market currently indicates the likelihood of rate stability for most of 2012, and this is close to our baseline scenario. We predict that inflation will continue to remain well above the target of the National Bank of Poland this year (possibly at 3.8% on average), with economic growth to remain close to 3%, in spite of government austerity measures and reduced consumption and investment.

PL: GDP



Spread between FRA 9x12 and WIBOR 3M



Weekly Preview

THU 13:00 **CNB base rate**

	This meeting	Last change
rate level (in %)	**0.75**	5/2010
change in bps	**0**	-25

CZ: CNB's rates unchanged again

The CNB Board will most likely leave its base interest rate unchanged. The risks of further developments are balanced at the moment: lower economic growth on the one hand, and the weak koruna along with higher inflation on the other. The wait-and-see strategy continues to be appropriate at the moment, particularly if the figures from the European economy are mixed and the situation as to the overly indebted countries remains unclear. At this year's first meeting where rates will be discussed, the CNB Board will have a new inflation forecast at hand; compared to the existing forecast, the new one is likely to be based on much lower GDP growth (+1.2% thus far) and indicate higher inflation (in excess of 3%). The CNB may also adjust its exchange rate outlook, because it still expects the koruna to strengthen to as far as EUR/CZK 22.70 by the end of this year.

FRI 9:00 **CZ Retail Sales (change in %)**

	Dec-11	Nov-11	Dec-10
Sales	**0.5**	0.5	0.4
cummulative (YTD)	**1.7**	1.9	1.3

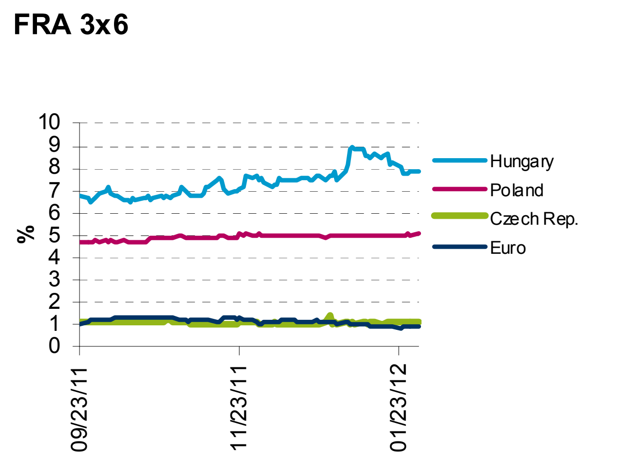
CZ: Retail growth driven cars

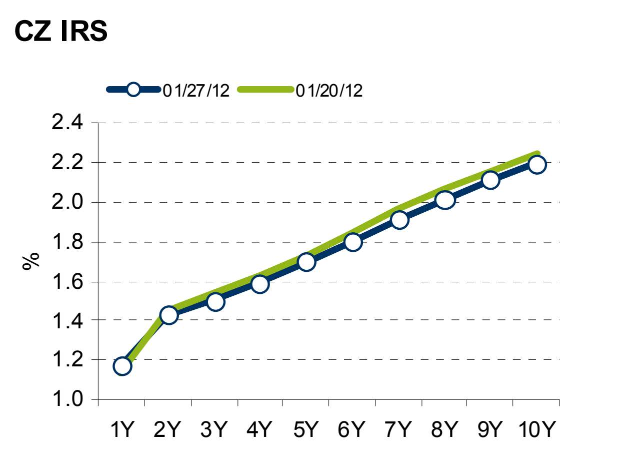
Just like in previous months, retail sales continued to be primarily fuelled by the positively developing sales of new cars. Retail sales excluding the automotive segment were likely close to zero in late 2011. For 2011 as a whole, the real rise in retail sales was closely below 2%, and below 1% with cars excluded. The retail sales data will only bear out the expectations that domestic demand remains subdued, with basically no latitude for demand-pull inflation. And this year will not change anything about this, because 2012 is likely to see retail sales fall in real terms.

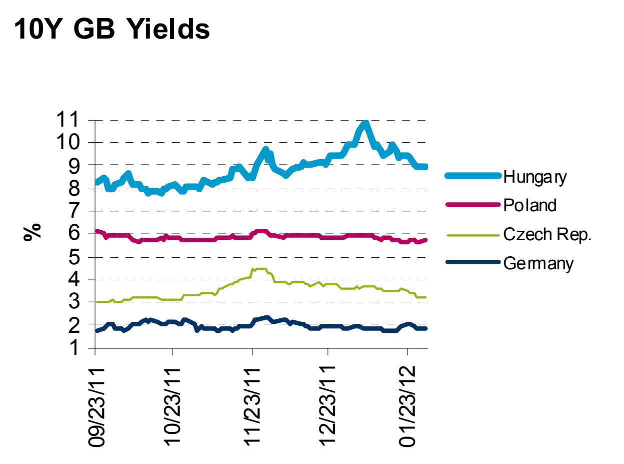
Calendar

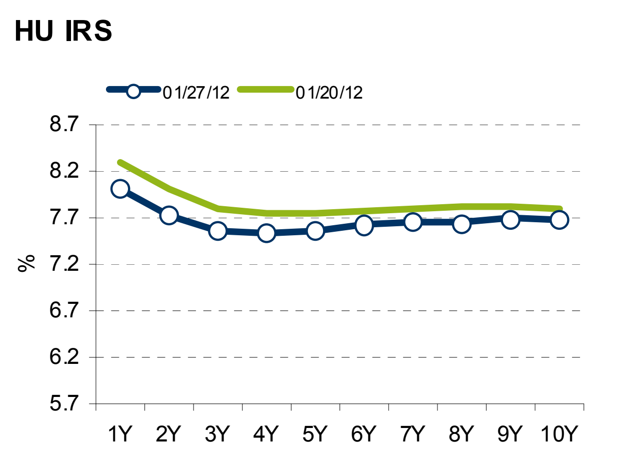
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	01/30/2012	15:00	Budget balance	PLN M	12/2011			-21.5		-21.5	
HU	01/31/2012	9:00	Unemployment rate	%	12/2011			10.8		10.6	
HU	01/31/2012	9:00	PPI	%	12/2011				7.4	2.5	8
CZ	01/31/2012	11:00	Money supply M2	%	12/2011						5.1
PL	01/31/2012	14:00	CPI	%	01/2012 *P						4.8
HU	02/01/2012	9:00	Trade balance	EUR M	11/2011 *F					666	
PL	02/01/2012	9:00	PMI manufacturing		01/2012						
HU	02/01/2012	9:00	PMI manufacturing		01/2012					48.5	
CZ	02/01/2012	9:30	PMI manufacturing		01/2012					49.2	
CZ	02/01/2012	14:00	Budget balance	CZK B	01/2012					-142.8	
CZ	02/02/2012	12:30	CNB meeting	%	02/2012	1		0.75		0.75	
CZ	02/03/2012	9:00	Retail sales	%	12/2011		0.5		0.5		0.5

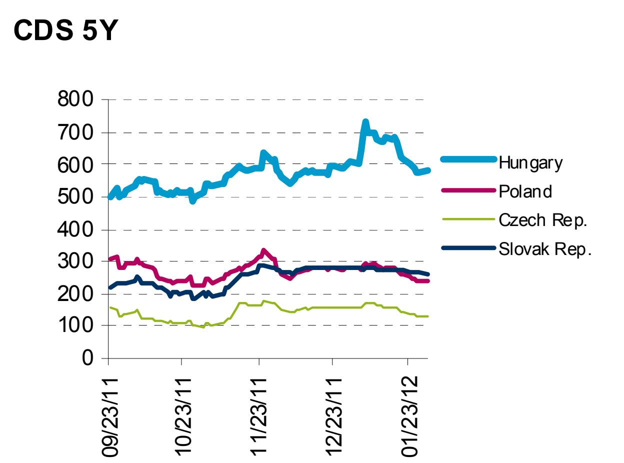
Fixed-income in Charts

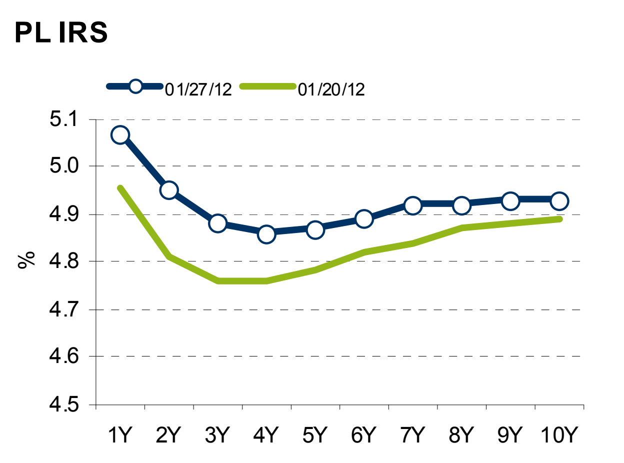












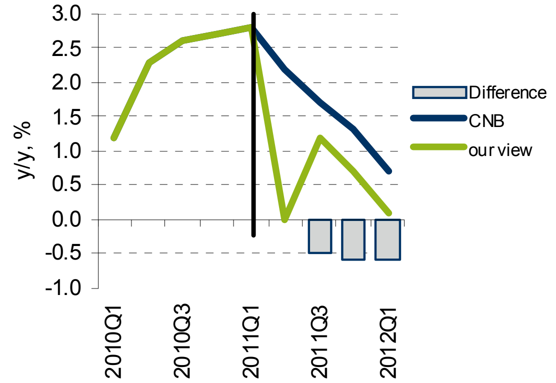
Source: Reuters

Medium-term Views & Issues

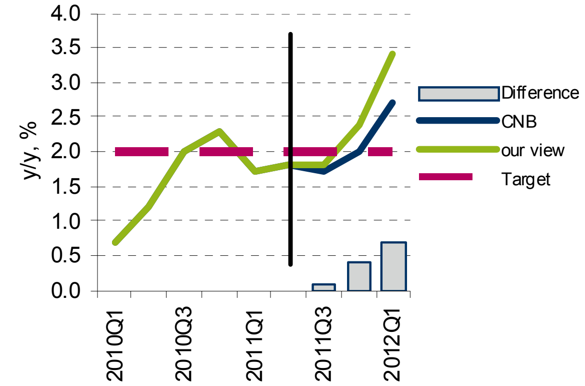
	The Czech Republic	Hungary	Poland
Growth & key issues	Although the situation in the governing coalition after some turmoil has stabilized again, tensions in the government coalition might return during discussions of the 2012 budget. The government intends to change the system of direct taxes radically 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.	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 point in the IMF talks. A weaker growth outlook may also require additional fiscal measures. The IMF would like to see 'tangible' steps from the government, but did not specify what tangible means here. The next step could be that the EU also replies to the government message and that we may see how negotiations could continue. As a base case, we think a deal could be reached till the end of February.	According to preliminary estimates, the Polish economy grew by 4.3% last year. 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.
Outlook for official & market rates	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.	The Hungarian central bank matched analysts' expectations and hiked the base rate by 100bps in aggregate by the end of 2011. We expect two more 50bps rate hikes, so the base rate should hit 8.00% in 2012.	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.
Forex Outlook	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. However, after re-pricing of systemic risks, slow continuation of real convergence does not argue for dramatic gains of the Czech currency over 2012. Putting it together, after current correction with short term target around 26.6 EUR/CZK, we continue to see the koruna stronger in 12- month horizon at 24.50 EUR/CZK.	Talks between Hungary and the IMF/EU has been ongoing slowly, which means that on the positive side there is some advance, while negotiations will take time because both side are giving in concessions only marginally.. The FX market may react to incoming news over the short-term, which is probably a range between 308 and 315/€, while we expect the forint to appreciate after negotiations reach a key point and the main fundamentals of the agreement are formulated. We expect the currency to appreciate to 290/€ by the year-end.	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 the motivation to intervene in 2012 may be weaker due to changed methodology of debt/GDP calculation and lower sensitivity to FX volatility. Hence we are afraid escalating tensions on the eurozone markets can weigh heavily on the Polish markets and the zloty can easily move above 4.80 EUR/PLN in 3month horizon.

CB's Projections vs. Our Forecasts

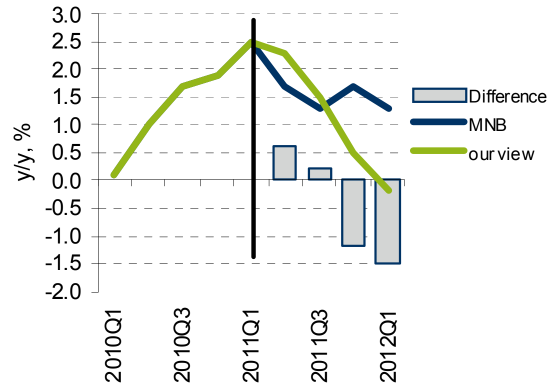
CZ: GDP Outlook



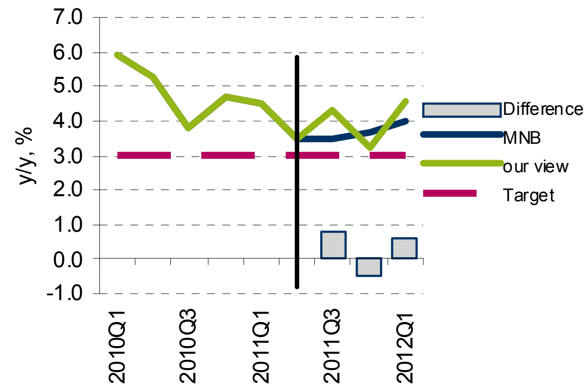
CZ: Inflation outlook



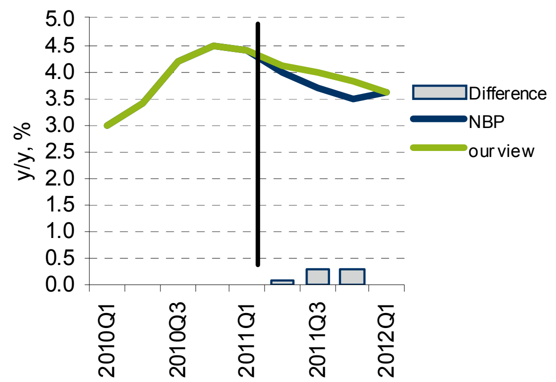
HU: GDP Outlook



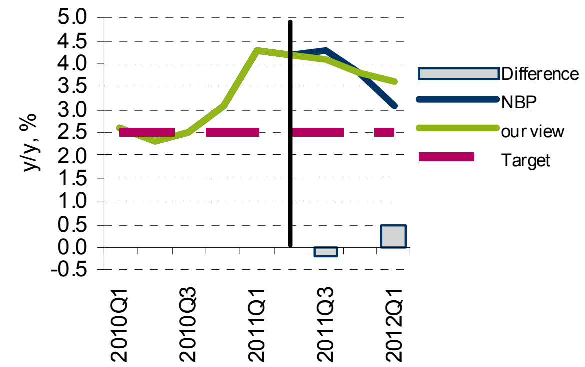
HU: Inflation outlook



PL: GDP Outlook



PL: Inflation outlook



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.	*7.00*	6.00	7.00	8.00	8.00	8.00	50 bps	12/20/2011
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	*1.18*	1.17	1.17	1.12	1.10	1.12
Hungary	BUBOR	*7.50*	6.00	6.50	8.00	8.00	8.00
Poland	WIBOR	*4.98*	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	*2.21*	2.05	2.24	2.25	2.40	2.60
Hungary	HU10Y	*7.64*	7.50	7.50	9.25	9.25	9.00
Poland	PL10Y	*4.95*	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	26.2	25.0	24.7
Hungary	EUR/HUF	*295*	295	280	310	300	290
Poland	EUR/PLN	*4.24*	4.35	4.10	4.60	4.40	4.20

GDP (y/y)

	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	2.8	2.0	1.2	0.7	0.1	-0.1	0.6
Hungary	2.5	1.5	1.4	0.5	-0.2	-0.5	-0.8
Poland	4.4	4.3	4.2	3.8	3.6	3.3	3.0

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

	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Czech Rep.	1.8	1.8	2.4	3.4	3.3	3.2	3.1
Hungary	3.5	3.6	4.1	4.6	4.5	4.4	4.2
Poland	4.2	3.9	4.6	3.6	4.1	4.1	3.1

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

Brussels Research (KBC)		Global Sales Force	
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