



# Central European Weekly

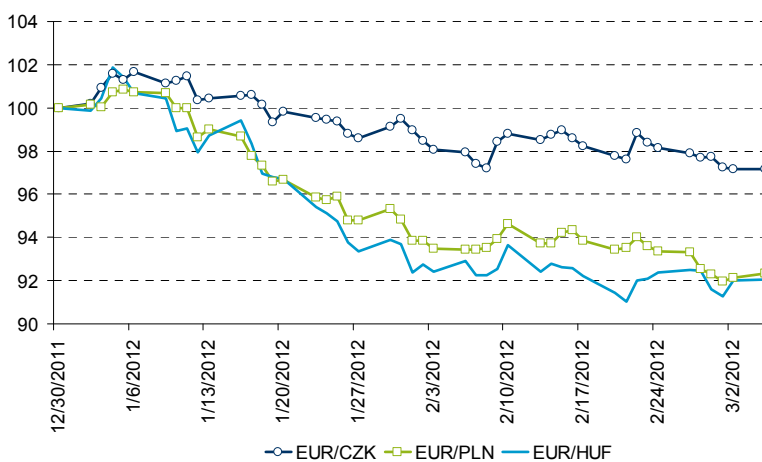
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## Weekly Highlights:

- CE currencies enjoy liquidity driven rally
- Polish economy proved remarkable resilience in 2011
- NBP stays on hold, while Czech inflation accelerates

## Chart of the Week: CE currencies and their gains against Euro

**CE currencies in 2012**



ECB's liquidity measures (LTRO) have supported Central European forex markets so far this year.

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## Market's editorial

### Cheap money from ECB helps regional markets

The hundreds of billions of euros that the ECB has released into the European banking system have been increasingly evident on financial markets. In addition to the dramatic drop in the sovereign credit spreads of key (vulnerable) countries of the eurozone, such as Italy and Spain, the cheap money from the ECB has likely also reached Central Europe's forex markets too.

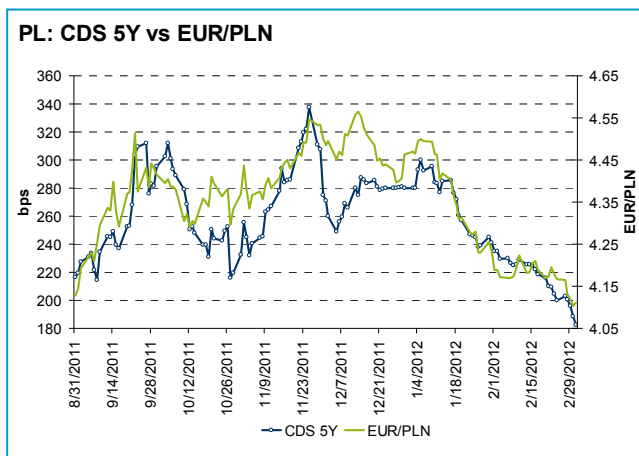
Thus, Central European currencies, including the koruna, have fared really well recently. This is particularly evident with the Polish zloty and the Hungarian forint, as both currencies have strengthened against the euro by approximately 9% since the beginning of the year.

Two arguments support the assumption that the Central European currencies' beautiful rally this year has been propelled by liquidity from the ECB. Firstly, the economic fundamentals of the countries in the region have not substantially changed recently, and thus the dramatic appreciation of the zloty or the forint cannot be based on domestic events, from the macroeconomic point of view (for Hungary and its disputes with the EU, the situation has theoretically even wors-

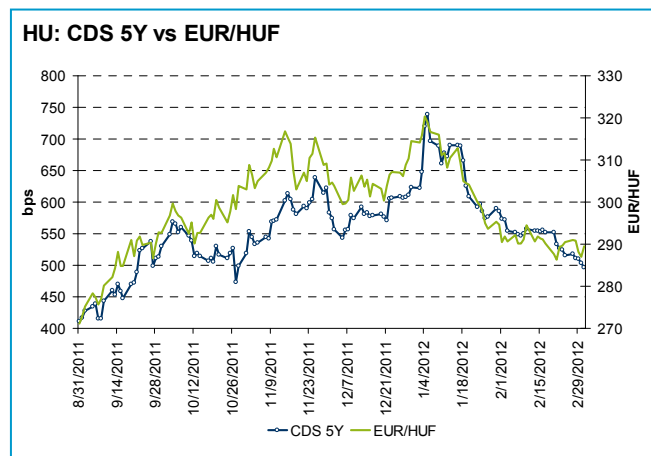
ened). Secondly, the hundreds of billions of euros provided by the ECB to banks have led to a dramatic fall in short-term euro rates, and thus, for example, the one-month Euribor has approached its all-time lows, seen during the 2009 financial crisis. This has made the currencies bearing fairly high interest, such as the zloty and the forint, even more attractive.

### How long will the rally last?

The question is how long the rally of Central European currencies, driven by available liquidity, may persist. It is quite possible that the upbeat sentiment on Central European markets may continue to last for a few days or weeks. On the other hand, a negative correction may occur very soon. Those who currently bet on carry trades (with Central European currencies) have to take into account that the leading central banks, such as the ECB and the Fed, have indicated to markets that another expansion (beyond the scope of the existing one) will not occur soon. And thus the risky positions (including forex carry trades) cannot rely on another prompt (monetary) intervention, which might neutralise a release of surprisingly unfavourable information, if any, from the periphery of the eurozone.



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.8	-0.58%	→	↗
EUR/HUF	291	-0.10%	→	↗
EUR/PLN	4.13	-1.06%	→	↗



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.18	3.12	→	↗
10Y PLN	7.14	-0.21	↘	↘
10Y HUF	4.84	-0.10	↘	↘

# Review of Economic Figures

## Polish GDP without surprises in Q4 of 2011

In the last quarter of 2011, Poland's economic growth was again slightly better than expected by markets. Compared to the last quarter of 2010, the GDP grew by 4.3%, and thus easily outpaced the other Central European economies, not only for that period but also for 2011 as a whole.

The structure sprang no great surprises. Although the contribution of domestic absorption to GDP growth (+3.4%) was lower than in the first half of the year, investment and domestic consumption continued to drive growth in the last quarter of 2011. Investment, adjusted for the effect of inventories, even went up at the fastest rate since the second quarter of 2008, having contributed 2.9% to growth.

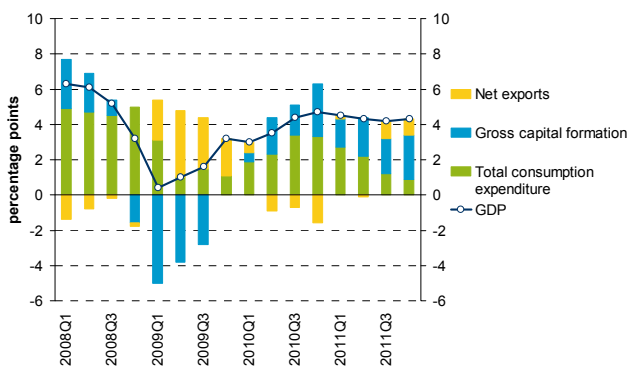
The positive effect of capital formation was signalled by the construction output index, notably in civil engi-

neering, where the trend was highly positive throughout last year. The gross value added in construction was up by 7.1% y/y in the last quarter. Industry lagged slightly behind (with its year-on-year increase in value added by 6.7%). These two sectors thus made up more than a third of the gross value added in the Polish economy.

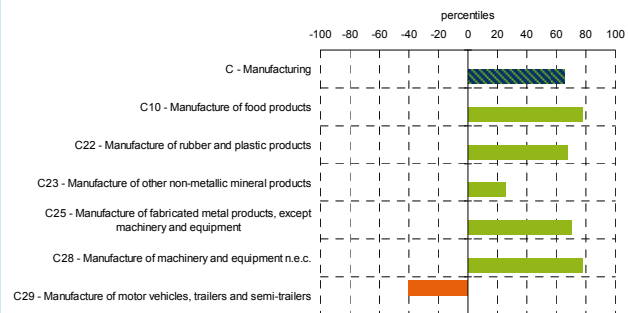
## Polish economic outlook less optimistic

The outlook for this year is somewhat less optimistic. We believe that the factors which prevented the Polish economy from falling during the financial crisis will slowly wane. We predict that the combination of higher interest rates, government austerity measures, and declining infrastructure investment in the second half of the year is likely to shrink 2012's economic growth to slightly above 3%.

PL: Contributions to growth



Industrial production breakdown and historical comparisons  
three month changes, SA



## Weekly Preview

WED 14:00

NBP rate (in %)

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

### PL: NBP on hold again

The National Bank of Poland (NBP) is unlikely to change rates at its Wednesday meeting. While the market still sees the chance of a rate cut within the next nine months as more likely, the latest development of economic indicators and central banker comments are fairly clear in signalling a possible rate hike rather than a rate cut. However, the exchange rate of the Polish zloty, which has strengthened by 8% against the euro since the beginning of the year, may calm the increasingly hawkish mood of the NBP. That said, the Monetary Policy Council may, perhaps, only be afraid of Polish households' inflation expectations, which still stand at 5%.

THU 9:00

CZ Foreign trade (CZK bn)

	Jan-12	Dec-11	Jan-11
Balance	19.0	10.5	17.8
cumulative (YTD)	19.0	191.4	17.8
Exports (y/y in %)	8.0	10.1	26.8
Imports (y/y in %)	8.0	5.1	29.1

### CZ: January's record-breaking trade surplus

The Czech Republic's foreign trade surplus is about to set a new January record. We predict that foreign trade showed a surplus of CZK 19 bn in the first month of this year, primarily fuelled by the increase in the exports of machinery and means of transport. Imports are still under the influence of two opposing tendencies, which are offsetting each other, costly raw materials on the one hand and declining domestic demand on the other.

FRI 9:00

CZ Inflation (change in %)

	Feb-12	Jan-12	Feb-10
CPI m/m	0.4	1.8	0.1
Food m/m	0.5	2.2	0.3
Housing, energy	0.4	3.2	-0.1
Transportation	0.4	1.8	0.0

### CZ: Inflation heading towards 4%

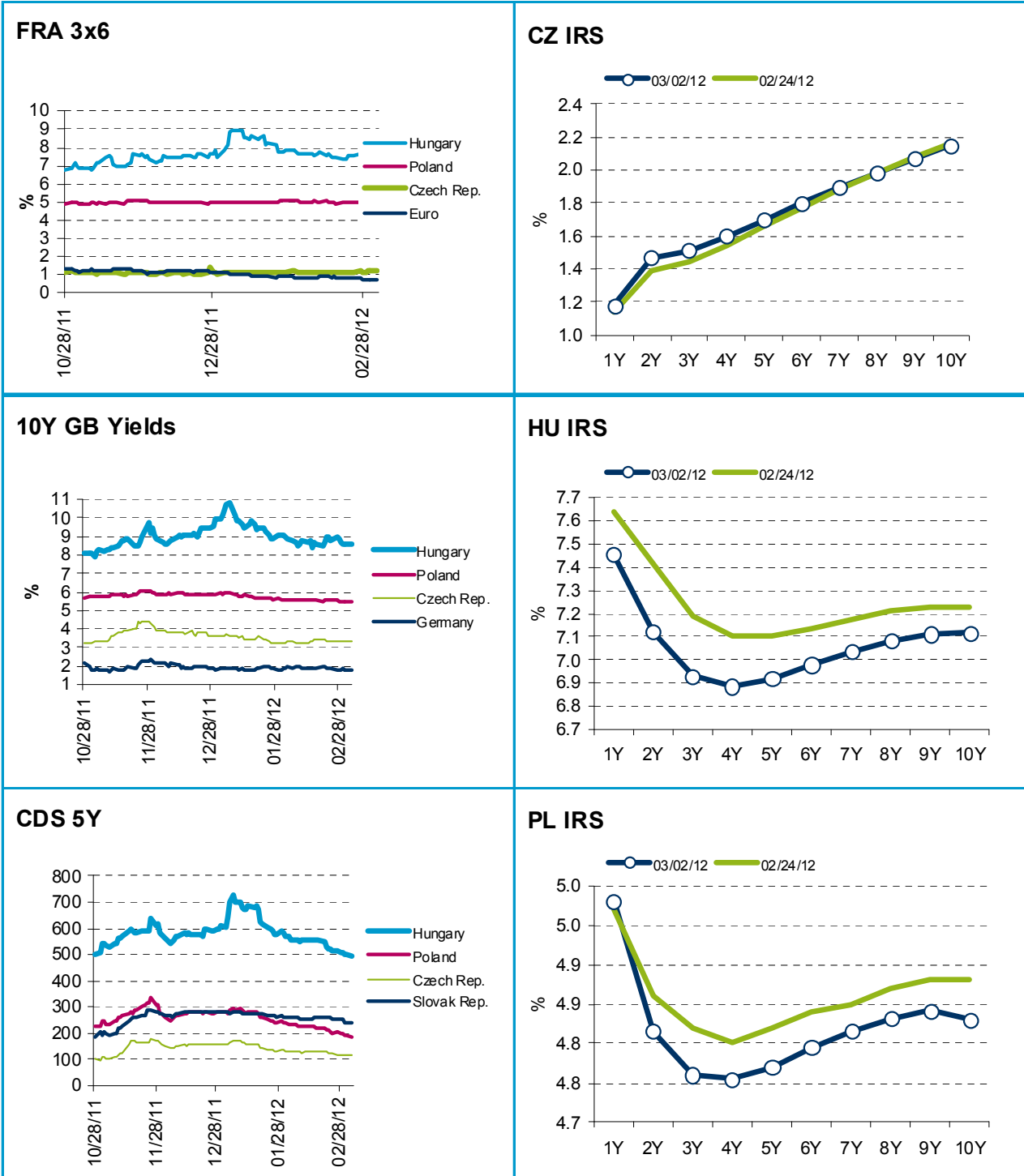
The price rise in the Czech economy will not ease in February either. We believe that the prices of food, fuel, package tours, and tobacco products again went up. By contrast, clothing and shoe prices went down again this time. Year-on-year inflation likely rose from January's 3.5% to 3.8%, thus again extending the gap between the actual inflation rate and the Czech National Bank's target. Yet we do not expect the CNB to respond to this inflation surge, because it is primarily based on administrative moves in the form of tax changes and regulated prices. Inflation will not fall until the second half of this year, when the year-on-year price rise might decelerate to the vicinity of 3%.



# Calendar

Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	03/07/2012	9:00	Industrial output	%	01/2012 *P					-7.4	6.7
CZ	03/07/2012	12:00	CZ Bond auction 4.20 %/2036		CZK B 03/2012			5-7			
CZ	03/07/2012	12:00	CZ bond auction 4.60%/2018		CZK B 03/2012			5-7			
PL	03/07/2012	14:00	NBP meeting	%	03/2012			4.5		4.5	
HU	03/07/2012	17:00	Budget balance		HUF B 02/2012					107.3	
CZ	03/08/2012	9:00	Unemployment rate	%	02/2012	9.1				9.1	
CZ	03/08/2012	9:00	Trade balance		CZK B 01/2012	19				10.5	
CZ	03/09/2012	9:00	Wages	%	4Q/2011						0.6
HU	03/09/2012	9:00	GDP	%	4Q/2011 *F					0.3	1.4
CZ	03/09/2012	9:00	CPI	%	02/2012	0.4	3.8			1.8	3.5
HU	03/09/2012	9:00	Trade balance		EUR M 01/2012 *P					325	
CZ	03/09/2012	9:00	GDP	%	4Q/2011 *F					-0.3	0.5
CZ	03/09/2012	10:00	Current account		CZK B 4Q/2011					-1729.3	

# Fixed-income in Charts

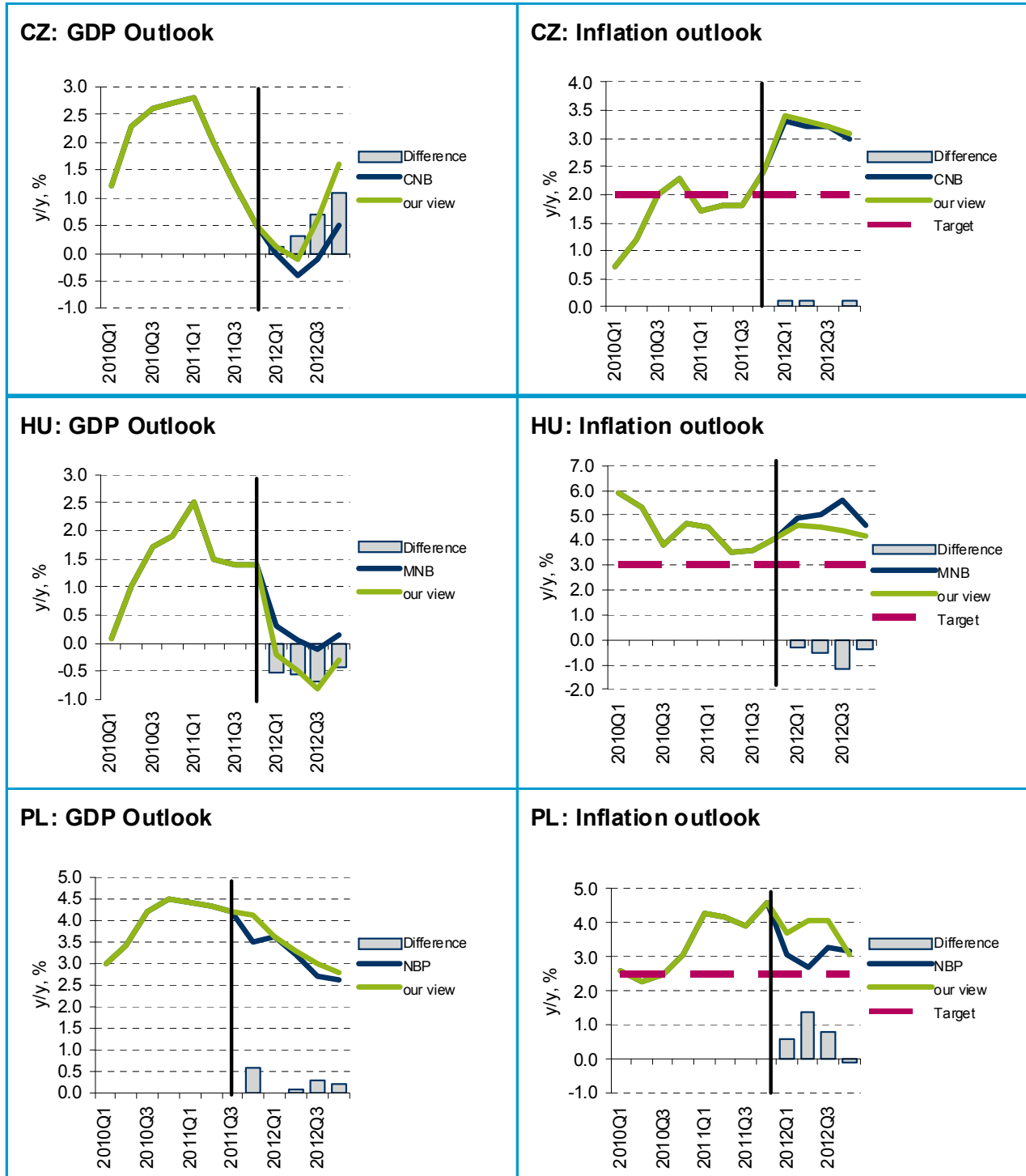


Source: Reuters

## Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The state budget for 2012 is based on the unrealistic assumption of economic growth by 2.5%. Achieving the deficit target of 105 billion remains very uncertain. It will require further austerity measures. In addition to saving, a further discussion of tax increases may be considered. It can not therefore exclude the growing tensions in the government coalition. The government does not intend to set a target date for the euro adoption in the Czech Republic. On the other hand, CR will lend more money to the IMF to address the debt crisis Eurozone.</p>	<p>In the Hungarian outlook the IMF agreement will evidently have a crucial role.</p> <p>The EU/IMF talks have been ongoing in the background and the government sent its reply to the Commission, where it stand up to its demand about the oath of the central bank leaders and the retirement age of judges. We think it would be unlikely if Hungary does not get the loan facility because of these issues and the loan agreement could come in May-June.</p>	<p>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.</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 MNB announced three new measures to boost forint credit in the banking system. Overall, I could help somewhat in the current deleveraging world, but the central bank also admits that current situation is more of the case of lack of willingness, where these may not help much. Meanwhile, the headline inflation accelerated to above 5% Y/Y on VAT hike. Further tightening does not look needed now, but definitely the VAT hike does not seem to pass on smoothly. Overall, cautious monetary policy is warranted, ie. the MNB may stay in a wait-and-see mode.</p>	<p>Although the inflation should somewhat decelerate and growth slow down in 2012, we do not believe in monetary easing. The inflation should still remain above the target for the whole year and the volatility of the zloty could have impact on inflationary expectations, if the NBP started with easing once again. On the other hand pretty low job creation should keep also the hawks on hold. Hence we bet on interest rate stability over the whole year 2012.</p>
Forex Outlook	<p>The Czech koruna should stabilize after the second Greek bailout deal and extend gains in reaction to the global optimism. On the other hand the eurozone issues could continue to weigh on the CEE later during the year. Also the Czech domestic factors do not look very supportive - slow continuation of real convergence does not argue for dramatic gains of the Czech currency over 2012. We continue to see the koruna only mildly stronger in 12-month horizon at 25.00 EUR/CZK.</p>	<p>EURHUF stays around 290 levels. As we have a look at the situation of EU countries in crisis, HUF strengthening in the past few weeks is remarkable. It is important to be aware of the international trends and investors' sentiment as the volatility of bond yields would not drop in the near future.</p>	<p>The Polish zloty has stabilized on Greek hope. Similarly to the koruna, the Greek deal may help to ensure further gains. Nevertheless the fundamentals should not permit gains below 4.00 EUR/PLN – the economy should slow down in second half and the rates remain flat. During the summer we may see some renewed selling pressure after the European championship in football takes place and the Greek issue potentially comes back to the table. The motivation by official authorities to defend the zloty may be weaker this time due to changed methodology of debt/GDP calculation and lower sensitivity to FX volatility...</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.	7.00	6.00	7.00	7.00	7.00	7.00	50 bps	12/20/2011
Poland	2W inter. rate	4.50	4.50	4.50	4.50	4.50	4.50	25 bps	6/9/2011

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

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	PRIBOR	1.23	1.17	1.17	1.12	1.10	1.12
Hungary	BUBOR	7.33	6.00	6.50	7.00	7.00	7.00
Poland	WIBOR	4.96	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	2.1809	2.05	2.24	2.25	2.40	2.60
Hungary	HU10Y	7.14	7.50	7.50	9.25	9.25	9.00
Poland	PL10Y	4.84	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	24.8	25.0	26.0	24.8	24.5	25.0
Hungary	EUR/HUF	291	295	280	290	290	290
Poland	EUR/PLN	4.13	4.35	4.10	4.10	4.00	4.30

### GDP (y/y)

	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	2.8	2.0	1.2	0.5	0.1	-0.1	0.6
Hungary	2.5	1.5	1.4	1.4	-0.2	-0.5	-0.8
Poland	4.4	4.3	4.2	4.1	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	3.7	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



## Central European Weekly

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