Tuesday, March 20, 2012

Central European Weekly

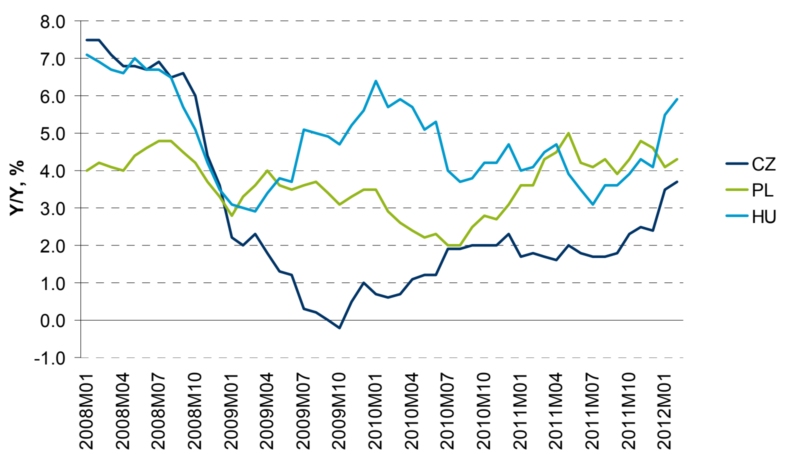
Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- Both Hungarian and Polish headline inflation turn higher…
- …but higher inflation readings will hardly bring a turn in monetary policies
- Our leading indicator for the Czech industry points to gradual improvement

Chart of the Week:

CE: CPI Inflation



Polish and Hungarian inflation followed the Czech lead and both increased in February.

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Market's editorial

Higher Inflation Hardly Turn in Monetary Policies

February's high inflation readings grabbed markets' attention in Central Europe in recent days. Although in the Czech Republic and Hungary high headline inflation is due in part to the increased indirect taxes, three very obvious items are generally responsible for the regionally high inflation – petrol, food, and energy prices.

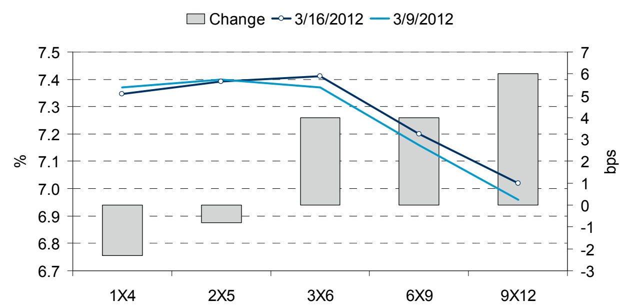
The acceleration of inflation (above targeted values) is thus based on factors that are beyond the control of Central European central banks, and this may calm those institutions to a great extent. In addition, increased inflation, which will hardly be offset by adequate wage growth, will actually lead to a decline in real purchasing power, and this should subsequently make itself felt in a slower improvement of demand and consequently slower economic growth.

…although it might bring a change in rhetoric

That said, central banks in the region will not react to the latest inflation developments by any dramatic reversal of their policies and rather accommodate them. More likely, the most dovish members of the central banks' boards may change the tenor of their statements or the most visible hawks will only repeat their inflation warnings. This was exactly the case of the CNB and MNB last week.

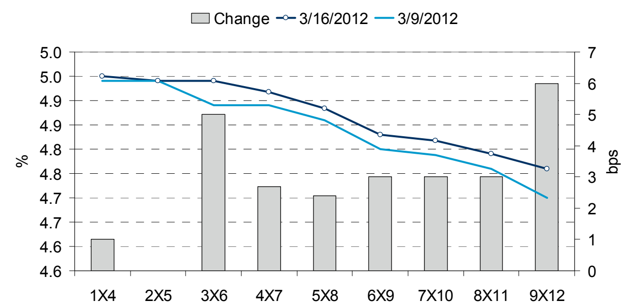
Nevertheless, markets – notably the fixed-income market– may not be necessarily calmed by the moderate reaction of central bankers. That said, yields and market interest rates may easily change, on the grounds of inflation being (just) above both the inflation target and the inflation forecast respectively.

HU FRA



Source: Reuters

PL FRA



Source: Reuters

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*24.5*	*-0.24%*	➔	➔
EUR/HUF	*290*	*-0.50%*	➔	➔
EUR/PLN	*4.13*	*0.22%*	➔	➔

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*2.35*	*7.55*	➚	➚
10Y PLN	*7.25*	*0.55*	➚	➚
10Y HUF	*4.97*	*3.54*	➚	➚

Review of Economic Figures

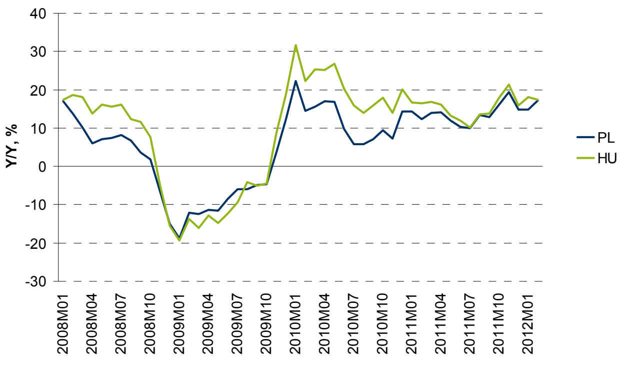
Hungary’s year-on-year inflation below 6% mark

Hungary’s inflation jumped to 5.9% Y/Y in February, core inflation rose to 5.4% and tax-adjusted inflation to 3.9%. Food prices were the main drivers behind, while durable goods experienced only 0.1% price increase during the month, implying that the weak currency has not been passing through. On this basis, we think that despite the central bank forecast has been far away from reality - the December report saw the first quarter average at 5.0% Y/Y - monetary policy may not change much, except probably that the latest proposal to cut rates by 25bps could come off the agenda.

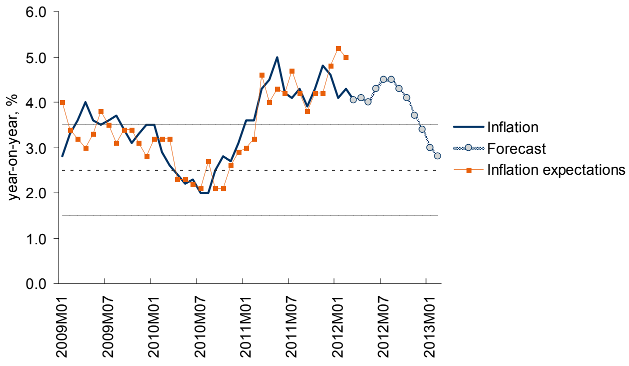
The Polish headline inflation up too

Just like its regional peers, Poland also saw rising prices in February. Nevertheless, this was no huge surprise, with year-on-year inflation having climbed to 4.3%. Compared to January, alcohol and tobacco prices went up the most (1.3% m/m), with these prices even seeing their greatest February increase in the last ten years. Housing prices went up basically in line with expectations, unlike their rapid rise in January.
In addition to the inflation figure itself, the change in the structure of the weights of the consumer basket is worth mentioning as they basically reflect the expenditure composition of an ‘average’ household. The weights of the ‘necessary’ housing and food expenditure, which together make up approximately 45% of the basket, increased slightly. This indicates that higher commodity prices (including both food and energy) are affecting Polish family budgets, notwithstanding last year’s moderate growth of real average wages and salaries.

Fuel prices: PL, HU



PL: Inflation



In focus: Carmakers drive the Czech industry

Czech industry accelerates

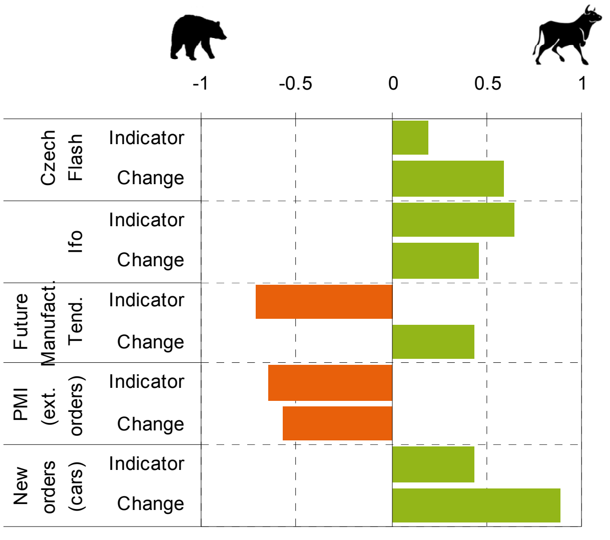
The first data of the year to do with industry looks very positive. January's industrial output was up by 3.2% y/y, due in part to the greater number of business days in the month; however, as usual, the increase was primarily fuelled by car production, followed by electrical equipment production and chemicals. After all, the success of the CR's largest carmaker is also borne out by the European registrations of new cars, which indicate that Škoda sales are ever increasing, even on the declining EU market (-8.3% y/y over the first two months), with Škoda consequently expanding its market share. The data on orders is also very favourable this time; orders went up by 14.9% y/y, with foreign orders rising and, for the first time in a long while, domestic ones too. Industrial orders confirm our expectations that it is too soon to draw up any super-pessimistic scenarios for the economy, such as have been presented so frequently of late.

Is the Czech industry facing gradual recovery?

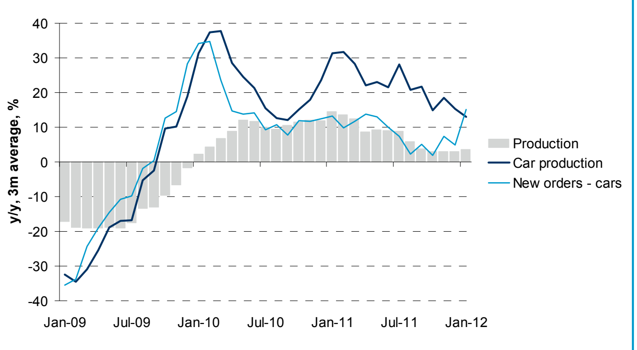
The first February estimate of 'the Czech Flash' (our leading indicator for the Czech economy) indicates a gradual improvement in the Czech industry. The Czech Flash rose for the fourth consecutive month (having hit 18.4) and its rate of growth also accelerated again, with the February's growth being the highest since June 2010.

This indicates good prospects for the Czech industry over the next 3 to 4 months. However, there are several risks connected with this optimistic outlook. Firstly, not all the Flash components are equally optimistic. While the Ifo index and new orders from Czech carmakers have significantly improved vis-à-vis their already high levels, the Czech PMI's sub-index of external orders continued to decline in February. This may partly reflect the outstanding success of the Czech automotive industry, something of a contrast to the rest of the economy. In addition, the Flash is growing from already fairly high levels, and this slightly curbs its growth potential in advance. Last but not least, Germany, the Czech Republic's neighbour, shows a discrepancy between soft indicators (mood indicators such as Ifo) and hard data from industry.

The Czech Flash- leading indicator



CZ: Industrial production and new orders

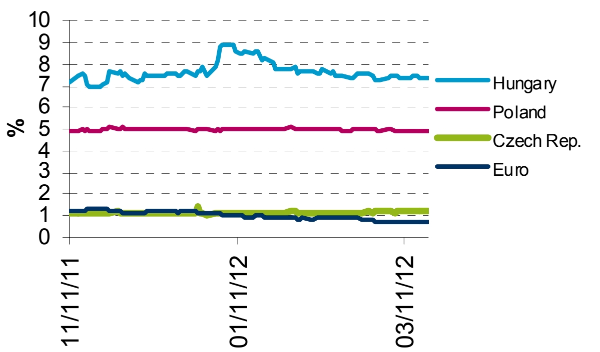


Calendar

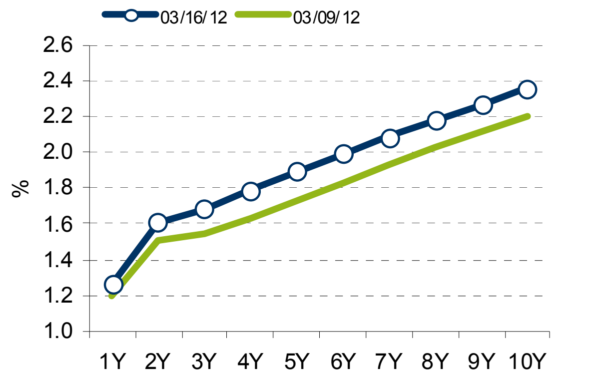
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	03/19/2012	14:00	Industrial output	%	02/2012			3	8.8	-5.1	9
PL	03/19/2012	14:00	PPI	%	02/2012			0	6.5	0.2	8
HU	03/20/2012	9:00	Wages	%, ytd.	01/2012				3.5		10.1
PL	03/20/2012	14:00	Core CPI	%	02/2012			0.1	2.8		
CZ	03/21/2012	12:00	CZ bond auction 3.40%/2015	CZK B	03/2012			5-7			
CZ	03/21/2012	12:00	CZ bond auction floating rate/2023	CZK B	03/2012			5-7			

Fixed-income in Charts

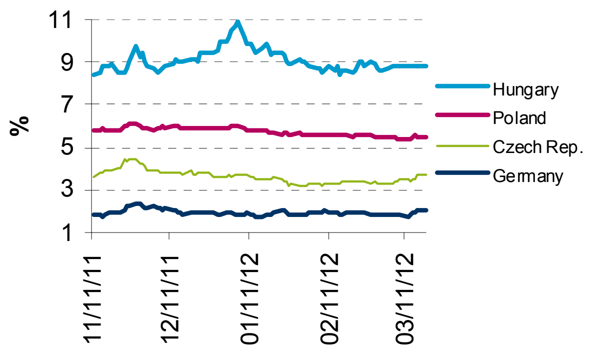
FRA 3x6



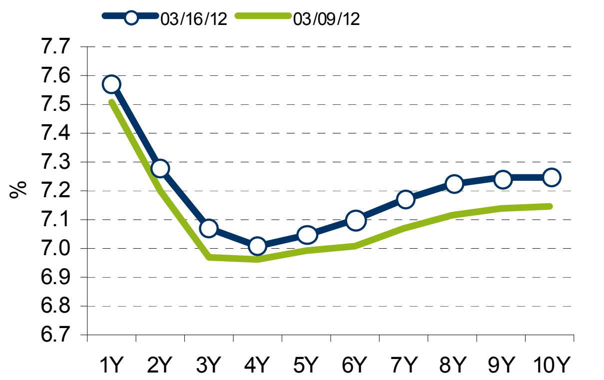
CZ IRS



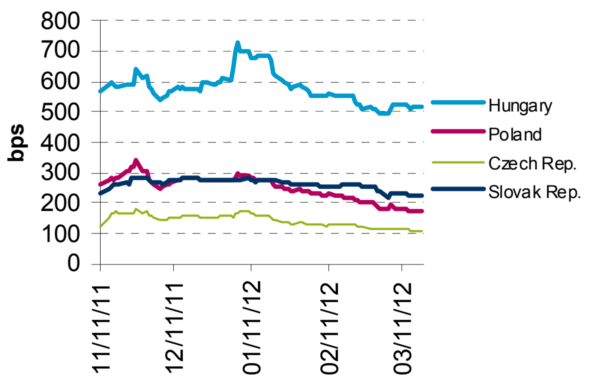
10Y GB Yields



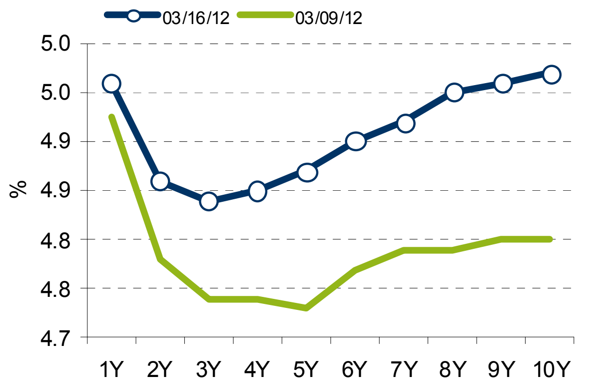
HU IRS



CDS 5Y



PL IRS



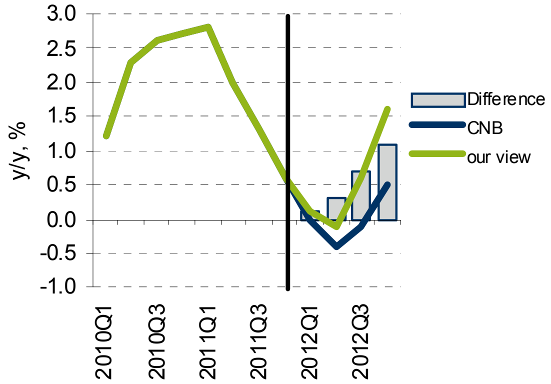
Source: Reuters

Medium-term Views & Issues

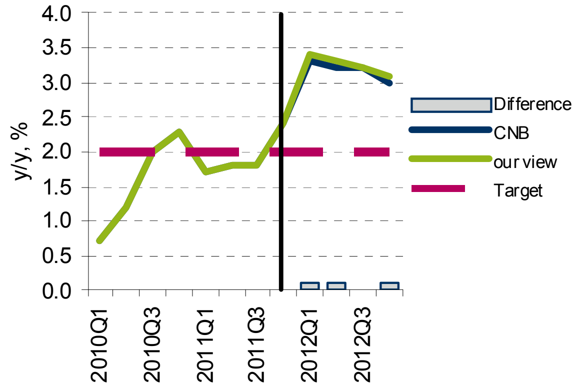
	The Czech Republic	Hungary	Poland
Growth & key issues	The state budget for 2012 is based on the unrealistic assumption of economic growth by 2.5%. Achieving the deficit target of 105 billion remains very uncertain. It will require further austerity measures. In addition to saving, a further discussion 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.	In the Hungarian outlook the IMF agreement will evidently have a crucial role. 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.	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 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.	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.
Forex Outlook	The Czech koruna has strengthened on the second Greek bailout deal and may extend gains in reaction to the global optimism On the other hand stronger US dollar may keep further gains limited. 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. That said, at levels near 24.00 EUR/CZK, the koruna may be more vulnerable to potentially negative news from eurozone We see the koruna in 12- month horizon near current levels at 24.50 EUR/CZK.	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.	The Polish zloty has strnghened 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/Portugal 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...

CB's Projections vs. Our Forecasts

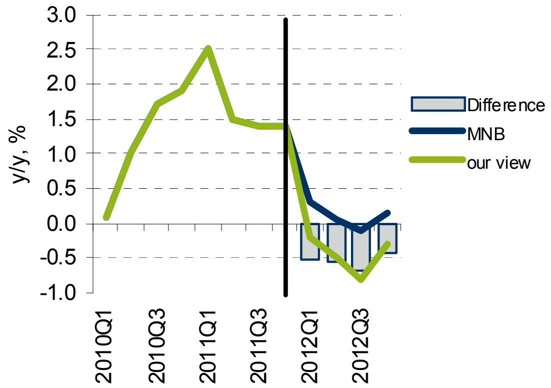
CZ: GDP Outlook



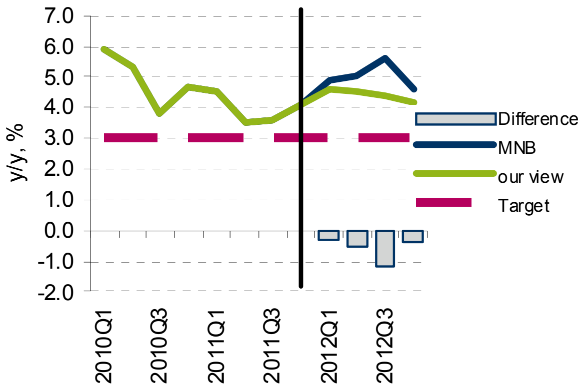
CZ: Inflation outlook



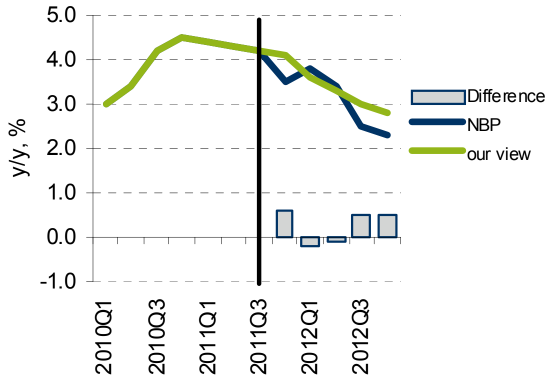
HU: GDP Outlook



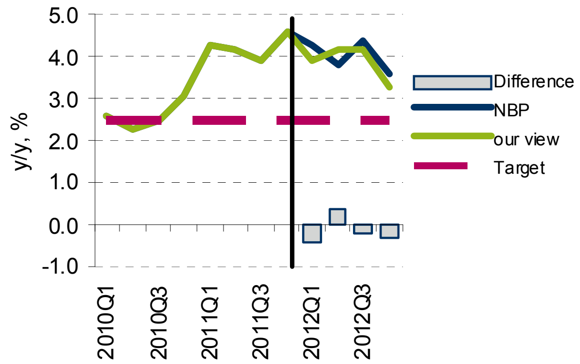
HU: Inflation outlook



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	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	*7.29*	6.00	6.50	7.00	7.00	7.00
Poland	WIBOR	*4.95*	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	*2.35*	2.05	2.24	2.25	2.40	2.60
Hungary	HU10Y	*7.25*	7.50	7.50	7.10	6.80	7.20
Poland	PL10Y	*4.97*	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	*24.5*	25.0	26.0	24.8	24.5	25.0
Hungary	EUR/HUF	*290*	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	1.3	0.6	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	3.9	4.2	4.2	3.3

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

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