



# Central European Weekly

Monday, 23 April 2012

**Dear clients, due to public holidays there will be no CEWeekly on Monday 30th of April.**

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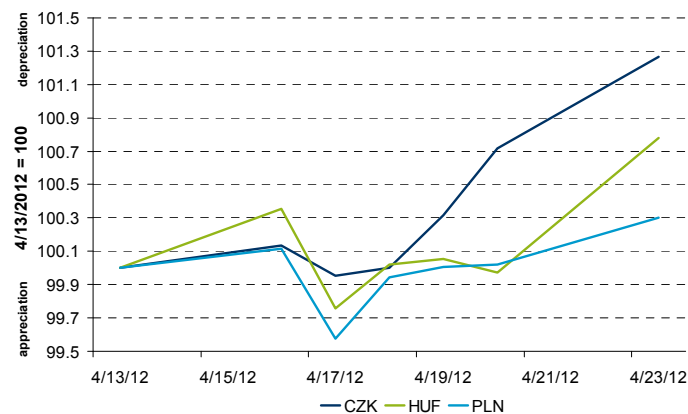
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## Weekly Highlights:

- The Czech ruling coalition ends. Should markets prepare for a scenario of early elections?
- Hungarian PM and EU Commission Chief meet
- Mixed fiscal readings for Central Europe in 2011
- While the NBH will stay on hold, an outcome of the Polish central is a close call

## Chart of the Week: CE Forex Markets

**CE currencies against the euro**



*The Czech koruna has been decoupling from its PEER's in recent days.*

# Market's editorial

Politics is affecting the Central European region for the first time in a long while, when the destiny of the Czech government coalition is 'again' at stake, and Hungary is again busy quieting its tense relationships with the IMF and the EU.

## A threat of early elections brinks the CZK under pressure

As concerns the Czech Republic, i.e., the Czech political scene – the situation inside the government coalition remains unclear, changing hour by hour, and thus it is too soon to draw any sweeping conclusions about the possible impact of domestic politics on Czech markets. Nevertheless, we still believe that the early election scenario, if any, (on which we do not bet) would certainly not be a positive factor for the Czech koruna (which we can already observe) or Czech government bonds.

## Meeting Barroso – Orban closely watched

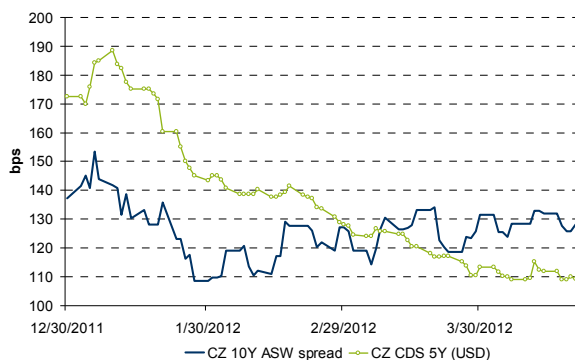
Regarding Hungary, it has already attempted to comply with the requirements of its official creditors - the IMF and the EU. The Hungarian government modified the Constitution and cancelled the paragraph that enabled the merger of the central bank and the Financial Supervisor. The EU commissioner's spokesman said that the five party talks between experts from the EU/IMF/ECB/Govt/MNB had a

good spirit, but did not detail further what this could mean for the future.). It is important to see that that there remained several open questions about the central bank law including the oath on the new Constitution, the salary cap, the appointment of two new Council members and a new Vice President. It will also be important how the EU sees the upcoming Convergence Program. In order to minimise the risk of failure, PM Mr Orban will meet Mr. Barroso this week and the program will be submitted only afterwards.

## A NBP rate hike – a close call

The only country in the region where markets will pay close attention to the macroeconomic data to be released this week is Poland. After the last meeting of the National Bank of Poland, its Monetary Policy Council seemed determined to raise official rates at its next meeting; however, slightly lower inflation and notably poor industrial output for March might have reduced the relevance of its intention; that said, the retail sales figures for March will be of very high importance now. In spite of the mixed data, we still bet on a rate hike by the NBP, albeit the retail sales data may, in the end, make us review our short-term outlook for Poland's official rates.

CZ: CDS & ASW



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.1	1.21%	↗	↗
EUR/HUF	299	0.89%	↗	↗
EUR/PLN	4.21	0.78%	↗	↗

The EUR/CZK breaks above 200-day moving ave.



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.18	-1.13	→	→
10Y PLN	7.56	1.48	↗	↗
10Y HUF	5.05	-1.17	↗	↗

# Review of Economic Figures

The Eurostat has just released final fiscal figures for all EU countries for the year 2011. Generally speaking, the fiscal readings (according to the EU ESA95 standards) were rather mixed in a case Central Europe last year.

## The Czech Republic:

As recently as in 2009, the Czech budget deficit fell by 1% of GDP and improved to nearly the Maastricht fiscal threshold. To be more specific the general budget deficit was down by CZK 64 billion, thus hitting -3.1% of GDP according to EU methodology (ESA95). The 2011 result was however extraordinary and influenced by investment cuts/delays. Although the general government budget deficit dropped significantly last year, gross government debt continued to grow and already exceeded the limit of 40% of GDP. Currently the debt level reaches 41.2% of GDP.

## Hungary:

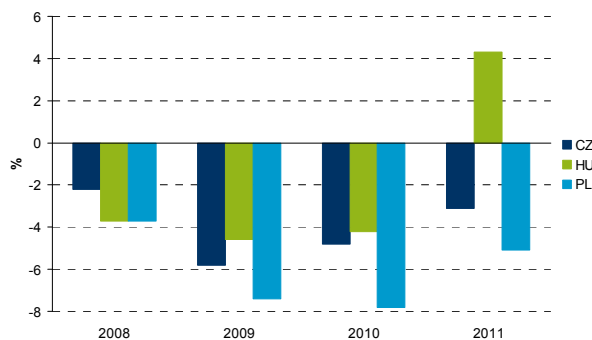
Regarding Hungary, its large surplus (4.3% of GDP) is attributable to the 9% of GDP asset takeover from mandatory pension funds and thus the underlying deficit was about %of GDP. The surplus helped the keep the debt at 80% of GDP and away from the 90% of GDP level, which could be a create risk of a debt crisis, but the high (50%) share of foreign currency debt is still affecting the public

debt indebtedness. Lets us add that the government is targeting 2.5% of GDP deficit for this year.

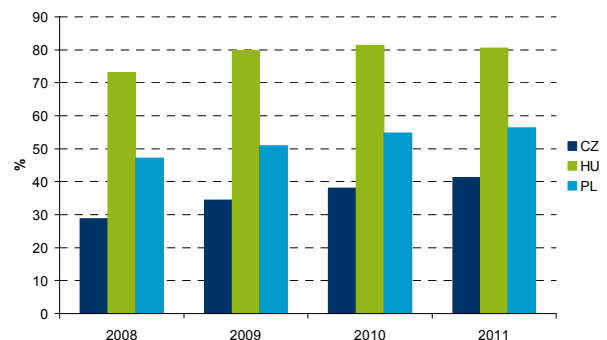
## Poland:

And last but not least in our brief survey, the Polish government deficit narrowed to 5.1% of GDP in 2011 from 7.8% in 2010 according to the official EU statistics. Meanwhile the debt has broken above 55% of GDP (reaching 56.3%). Nevertheless according to the domestic evidence (different from ESA) the Polish debt remains at 53.5% of GDP, below the crucial 55% threshold that automatically triggers austerity measures.

CE countries: budget balance as of GDP



CE countries: debt-to-GDP ratio



# Weekly preview

TUE 14:00

MNB base rate

	This meeting	Last change
rate level (in %)	7.00	11/2011
change in bps	0	50

## HU: NBH keeps at base rate at 7%

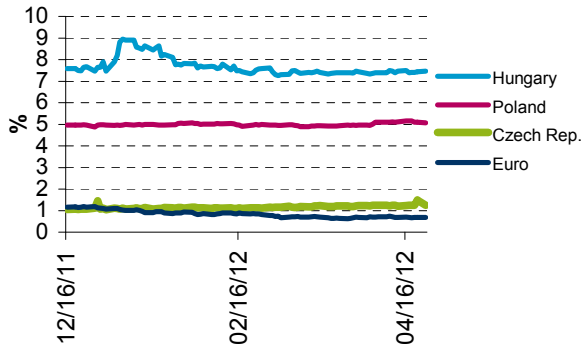
The headline inflation rate in Hungary has fallen, yet it remains well above the target of the NBH. This, along with the fairly weak forint, is also why the NBH will not change its base interest rate.

# Calendar

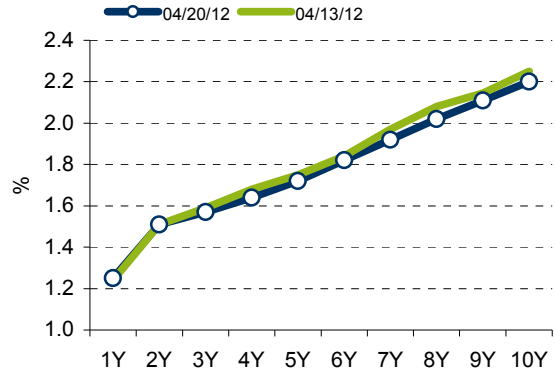
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	04/24/2012	9:00	Retail sales	%	02/2012				0.1		0.6
HU	04/24/2012	14:00	NBH meeting	%	04/2012	7		7		7	
PL	04/25/2012	10:00	Retail sales	%	03/2012			15.1	10.5	1.2	13.7
PL	04/25/2012	10:00	Unemployment rate	%	03/2012			13.4		13.5	
HU	04/27/2012	9:00	Unemployment rate	%	03/2012			11.7		11.6	

# Fixed-income in Charts

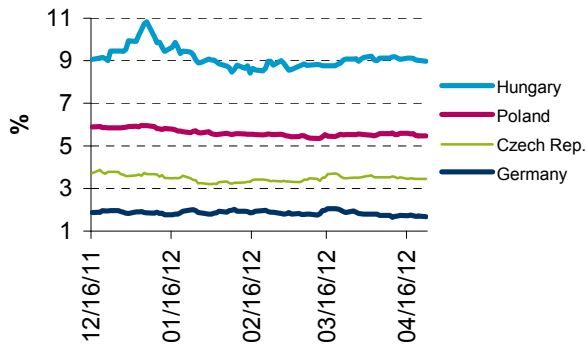
**FRA 3x6**



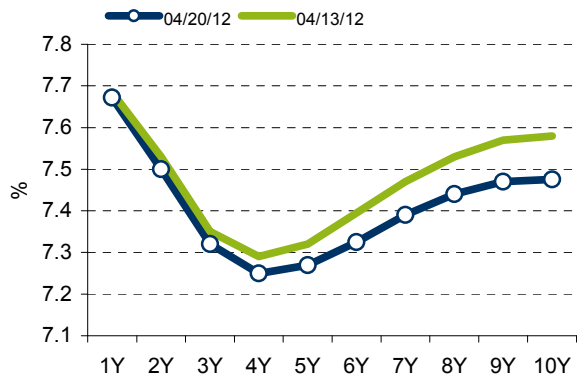
**CZ IRS**



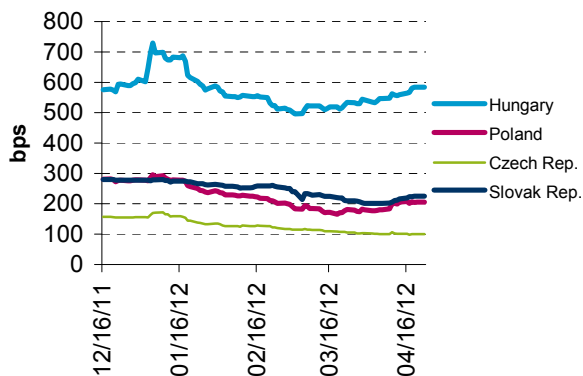
**10Y GB Yields**



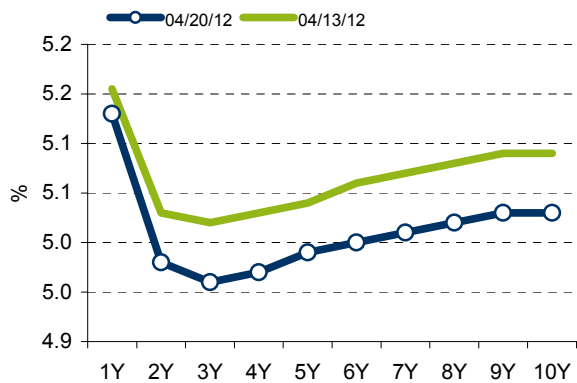
**HU IRS**



**CDS 5Y**



**PL IRS**



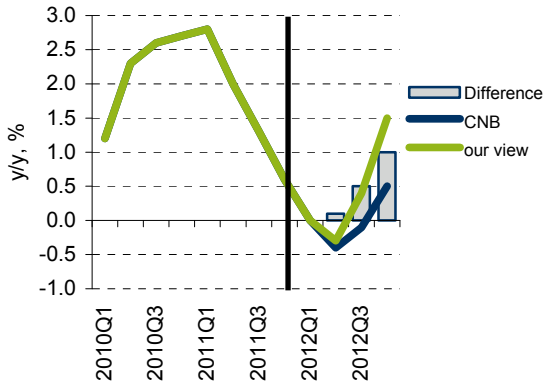
Source: Reuters

# Medium-term Views & Issues

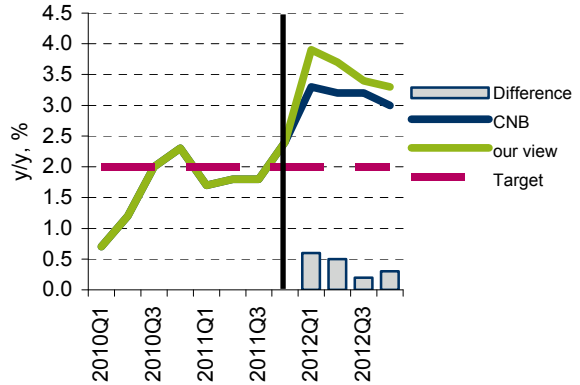
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The state budget for 2012 is based on the unrealistic assumption of economic growth by 2.5%. Achieving the deficit target of 105 billion remains very uncertain. It will require further austerity measures. In addition to saving, a further discussion 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 in the Euro-zone.</p>	<p>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.</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 prevent the board from hiking cycle. We bet on one off hike in May to cool persisting inflation expectations and on the stability for the rest of the year.</p>
Forex Outlook	<p>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, the koruna may be more vulnerable to potentially negative news from eurozone as well as to the domestic political tensions. We see the koruna in 12- month horizon near current levels at 24.50 EUR/CZK.</p>	<p>EURHUF stays below the 300 level. 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 strengthened on Greek hope. Nevertheless the fundamentals should not permit gains below 4.00 EUR/PLN – the economy should slow down in second half and the rates should remain flat after the one off hike in May. 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...</p>

# Cent. Banks' Projections vs. Our Forecasts

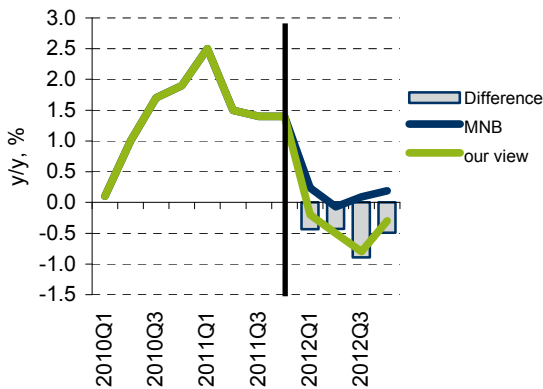
**CZ: GDP Outlook**



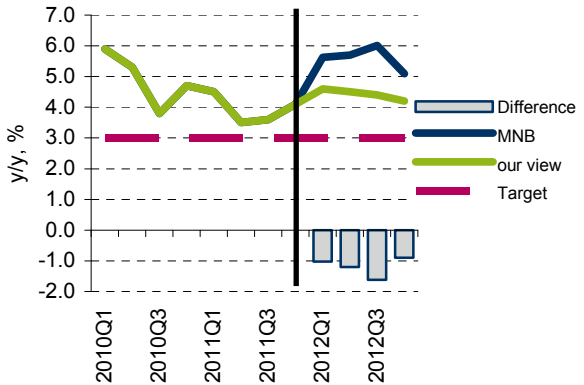
**CZ: Inflation outlook**



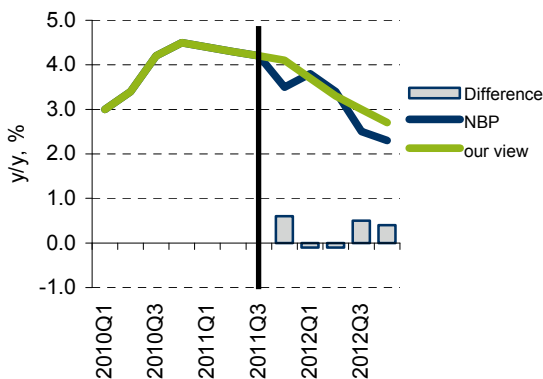
**HU: GDP Outlook**



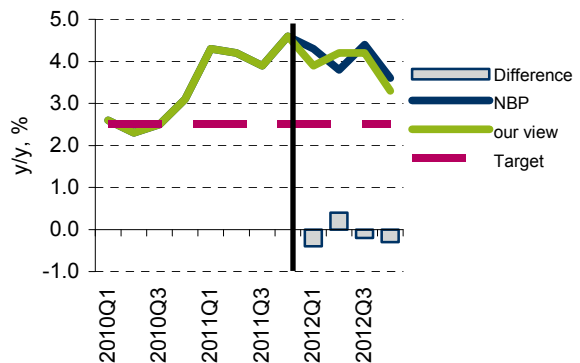
**HU: Inflation outlook**



**PL: GDP Outlook**



**PL: Inflation outlook**



Source: CNB, NBP, MNB, CSOB



# Summary of Our Forecasts

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

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	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	7.00	7.00	7.00	7.00	6.75	50 bps	12/20/2011
Poland	2W inter. rate	4.50	4.50	4.50	4.50	4.50	4.75	25 bps	6/9/2011

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

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	PRIBOR	1.25	1.24	1.18	1.20	1.22	1.28
Hungary	BUBOR	7.25	7.00	7.00	7.00	7.00	6.75
Poland	WIBOR	4.94	4.60	4.75	4.80	4.80	4.90

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

		Current	2012Q1	2011Q4	2012Q3	2012Q4	2013Q1
Czech Rep.	CZ10Y	2.18	2.23	2.24	2.60	2.85	3.15
Hungary	HU10Y	7.58	7.10	7.50	7.20	7.20	7.00
Poland	PL10Y	5.05	5.00	5.00	5.20	5.30	5.40

**Exchange rates (end of the period)**

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	EUR/CZK	25.1	24.8	24.5	25.0	25.0	24.5
Hungary	EUR/HUF	299	290	290	290	290	290
Poland	EUR/PLN	4.20	4.10	4.00	4.30	4.20	4.15

**GDP (y/y)**

	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	2.8	2.0	1.3	0.6	0.0	-0.3	0.4
Hungary	2.5	1.5	1.4	1.4	-0.2	-0.5	-0.8
Poland	4.4	4.3	4.2	4.1	3.7	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	3.9	3.7	3.4	3.3
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.	-3.9	-2.9
Hungary	0.5	2.9
Poland	-2.1	-5.0

**Public finance balance as % of GDP**

	2010	2011
Czech Rep.	-4.8	-3.1
Hungary	-4.2	4.3
Poland	-7.8	-5.1

Source: CSOB, Bloomberg

## Contacts

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	Brussels	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Didier Hanesse	+32 2 417 59 43	Commercial Desk	+32 2 417 53 23
Joke Mertens	+32 2 417 30 59	Institutional Desk	+32 2 417 46 25
Mathias Van der Jeugd	+32 2 417 51 94		
Dublin Research		London	+44 207 256 4848
Austin Hughes	+353 1 6646892	Frankfurt	+49 69 756 19372
Prague Research (CSOB)		Paris	+33 153 89 83 15
Jan Cermak	+420 2 6135 3578	New York	+1 212 541 06 97
Jan Bures	+420 2 6135 3574	Singapore	+65 533 34 10
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)		Prague	+420 2 6135 3535
Marec Gabris	+421 2 5966 8809	Bratislava	+421 2 5966 8436
Warsaw Research (CSOB)		Budapest	+36 1 328 99 63
		Warsaw	+48 22 634 5210
Budapest Research (CSOB)		Moscow	+7 495 7777 164
Gyorgy Barcza	+36 1 328 99 89		

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