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Central European Weekly

Tuesday, 15 May 2012

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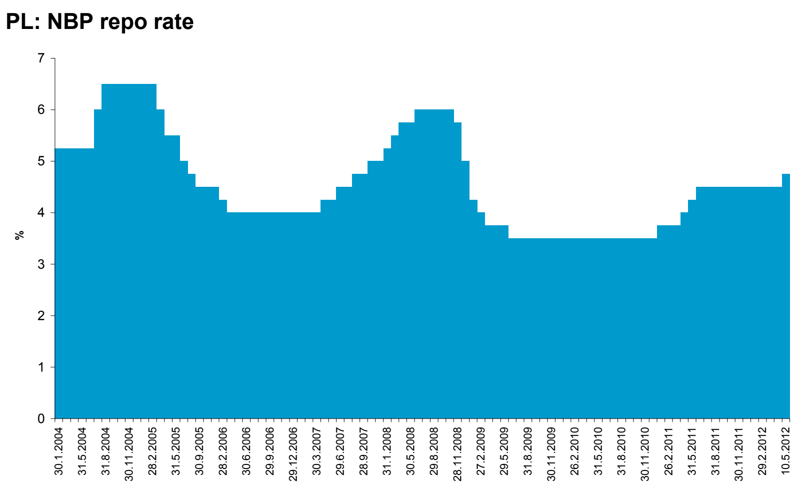
- NBP hike its repo rate to 4.75%
- CNB shifts to easing mode
- Czech leading indicator at crossroads
- Czech and Hungarian GDP still in growth mode

Chart of the Week



The NBP delivered on its hawkish statements and raised rates by 25 basis points.

Market's editorial

Regional divergence of central banks' policies

Although both from the same economic area NBP's and CNB's policies have been decoupling. While the former raised its repo rate, the latter may quite well be poised to cut its official rates. As recently as two months ago, we would have seen such moves by the two central banks as extreme – however, in view of the last few weeks, this is not such a great surprise.

While the NBP hikes to 4.75%...

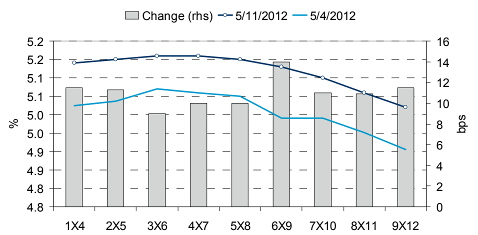
As concerns Poland – the central bank delivered on its hawkish statements and raised rates by 25 basis points. While the rate hike did not surprise us, owing to the well-managed communication by the NBP, we believe that it was not quite appropriate and we expect rate stability for the rest of this year (while the market has started to bet on another rate hike). What primarily makes us believe so is the more modest rhetoric by the NBP and the expectations of the future development of the Polish economy. Its growth should decelerate significantly in the second half of the year, and this should also lead to a gradual inflation fall towards the target. Inflation expectations have likely peaked and, in spite of higher inflation, wage growth is fairly slow, stagnating on the year-on-year basis. The increase in external risks in relation to re-heightened tension in the eurozone also weighs against another rate hike.

...the CNB might ease soon

At the CNB, just like in Poland, it was the Governor who sent the clear signal on the future development of rates – albeit in the opposite direction. Governor Singer and his CNB Board colleague Tomšík seem to increasingly incline to an alternative macroeconomic scenario, which envisages stronger domestic restriction and lower interest rates (Euribors) in the eurozone. In other words, they bet on a slower improvement of domestic and foreign demand, which should lead to lower inflation.

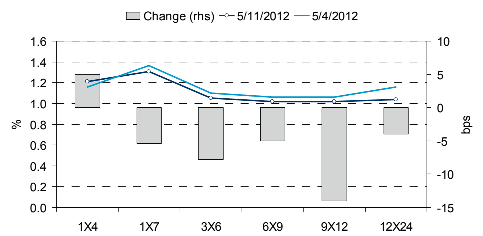
That said, if we take into account that two very influential members of the seven-member CNB Board favour monetary easing by the CNB, turning this into a majority opinion may not be very difficult. Given the worsening figures from the domestic economy as well as abroad, such a step might be taken at June's, or more likely, August's meeting, when a new CNB forecast will be on the agenda.

PL FRA



Source: Reuters

CZ FRA



Source: Reuters

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*25.4*	*0.60%*	↗	↗
EUR/HUF	*292*	*1.44%*	↗	↗
EUR/PLN	*4.30*	*2.34%*	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*2.02*	*-3.35*	→	→
10Y PLN	*7.09*	*0.00*	↗	↗
10Y HUF	*5.05*	*2.43*	↗	↗

Review of Economic Figures

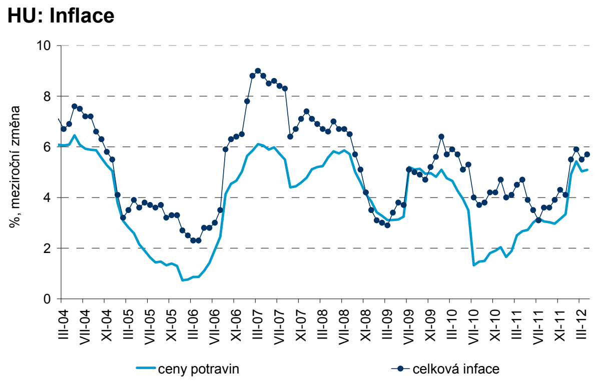
Hungary's inflation remains high

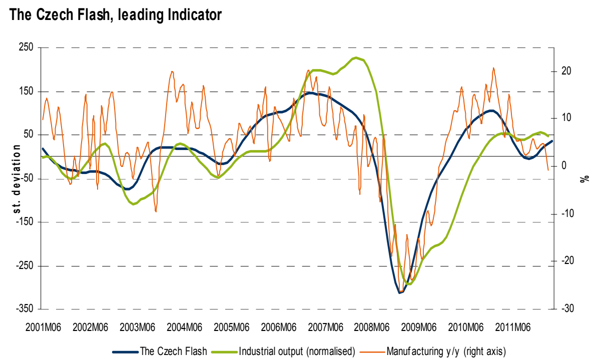
The April inflation in Hungary came in above expectations at 5.7% Y/Y on higher tobacco and fuel prices. This may reverse in May, when the fuel prices dropped about 5% on cheaper oil and stronger currency, but generally the trend looks to be quite negative as inflation could remain high around 5.5% and may not fall to the central bank's 3% target by the end of next year.

The leading indicator for the Czech industry at crossroads

For the moment, the first forecast of April's CSOB Flash confirms the good condition of Czech industry, but the slower rate of improvement may signal a negative reversal. The Flash rose for the sixth consecutive time (hitting 34.9) but February's data was revised downwards (from 34.6 to 29.7), with the accrual rate falling for the third consecutive month. This may signal that the peak is drawing near. While it is good that all components of the Flash, except for the sub-index of foreign orders of the Czech PMI, are currently continuing to improve, the rate of improvement has been falling for several consecutive months.

At the moment, the Flash (as a leading indicator) thus shows good prospects for Czech industry within the next three months; however, the prospects for a longer period (half a year) are much more uncertain.





In Focus

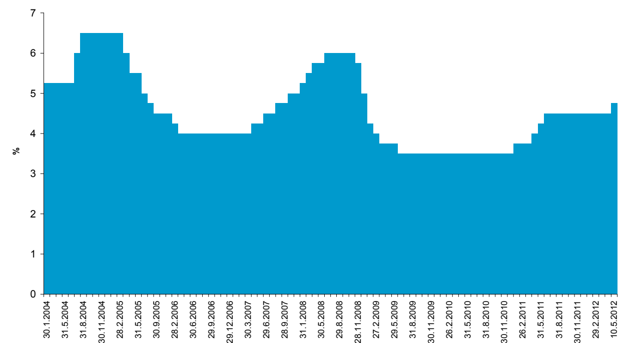
The NBP continues to fight with inflation

Last week's regional event number one was the meeting of the National Bank of Poland (NBP). Although analysts' opinions were largely divided as to how rates would continue to develop, the NBP honoured its 'promise' of last month and, in line with our outlook, raised repo rate by 25 basis points to 4.75%. The bank's official statement included fairly anticipated arguments, notably concern about persisting high inflation expectations, to the development of which the NBP tends to be sensitive.

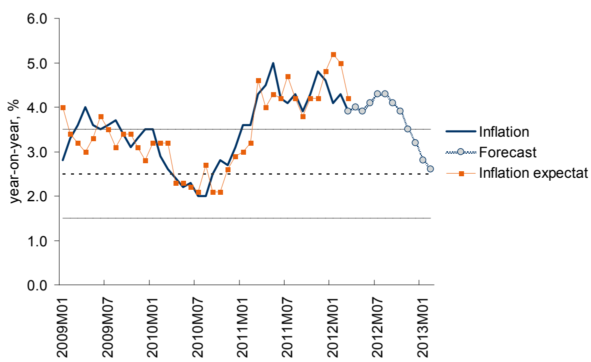
The unusually open comments by the Head of the NBP, Belka, at the subsequent press conference were also highly interesting. Belka said that the Monetary Policy Council had clearly said at its April meeting that it would consider a monetary tightening at its next meeting, and this was, according to Belka, interpreted as the augury of a rate hike. While the NBP recognised that the main reasons for inflation tended to lie outside its influence and were associated with costly commodities and the weak zloty, it left the door open for further similar decisions; however, Belka somewhat reduced the relevance of that fact. Although he basically confirmed that the NBP remained in the hawkish mode, he added that the message arising from May's meeting for June's meeting should not be interpreted as strictly as in the previous case.

While the rate hike did not surprise us, owing to the well-managed communication by the NBP, we believe that it was not quite appropriate and we expect rate stability for the rest of this year (while the market has started to bet on another rate hike). What primarily makes us believe so is the more modest rhetoric by the NBP and the expectations of the future development of the Polish economy. Its growth should decelerate significantly in the second half of the year, and this should also lead to a gradual inflation fall towards the target. Inflation expectations have likely peaked and, in spite of higher inflation, wage growth is fairly slow, stagnating on the year-on-year basis. The increase in external risks in relation to re-heightened tension in the Eurozone also weighs against another rate hike.

PL: NBP repo rate



PL: Inflation



Weekly preview

TUE 9:00 **CZ GDP (change in %)**

	Q1-12	Q4-11	Q1-11
GDP (y/y)	**0.1**	0.6	2.7
GDP (q/q)	**0.0**	-0.1	0.5

CZ: GDP still driven by industry

We believe that the Czech economy still finds itself on the verge of recession. Export-oriented industry keeps the economy in the black, while construction and services continue to be subdued. The Czech economy still cannot rely on domestic demand, with household demand being curbed by the real drop in income and by concern about the future. Investment activity has not at all been high either, with the public sector having reduced its investment projects and businesses preferring to postpone their investments. The upcoming release will include just the first GDP forecast, with details not to be unveiled until June.

TUE 14:00 **PL Inflation (change in %)**

	Apr-12	Mar-12	Apr-11
CPI y/y	**3.9**	3.9	4.5
Food (ex Alc.) y/y	**3.6**	3.7	6.4
Transport (including fuel)	**8.3**	9.3	7.6

PL: The April inflation flat year-on-year

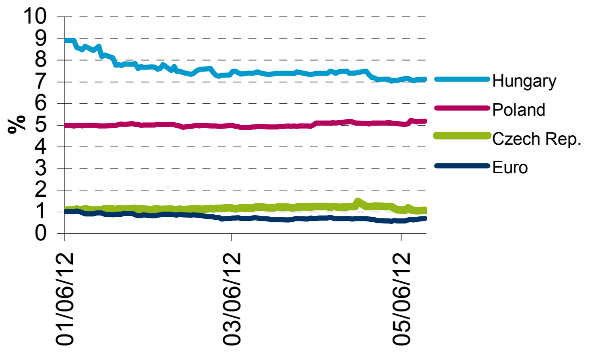
Our forecasts indicate that April's inflation in Poland stagnated at 3.9% y/y, while the month-on-month price rise was 0.5%. We believe that April's rise in food prices was lower than the seasonal rise, yet the prices were up by almost 1%. Fuel prices may have a similar effect on inflation, due in particular to lower oil prices; nevertheless, the price rise is still much faster than the NBP would like. We expect that inflation will not go down significantly until late 2012, when it might fall below the upper threshold of the tolerance band of the NBP (3.5%).

Calendar

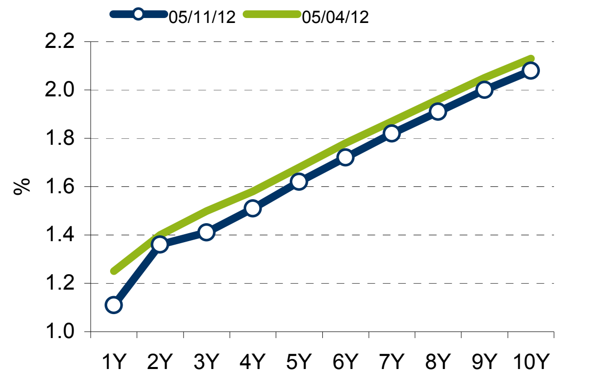
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	05/14/2012	14:00	Money supply M3	%	04/2012			0		0.2	
HU	05/15/2012	9:00	Industrial output	%	03/2012 *F					0.6	0.6
HU	05/15/2012	9:00	GDP	%	1Q/2012 *P		-0.2	-0.6	-0.3	0.3	1.4
CZ	05/15/2012	9:00	GDP	%	1Q/2012 *P	0	0.1	0	0.2	-0.1	0.6
PL	05/15/2012	14:00	CPI	%	04/2012		3.9	0.5	3.9	0.5	3.9
PL	05/15/2012	15:00	Budget balance	PLN M	04/2012					-22957	
CZ	05/16/2012	10:00	Current account	CZK B	03/2012	9		12.1		18.33	
PL	05/16/2012	14:00	Trade balance	EUR M	03/2012			-872		-838	
PL	05/16/2012	14:00	Current account	EUR M	03/2012			-1237		-1585	
CZ	05/17/2012	9:00	PPI	%	04/2012	0.3	2.5	0.2	2.4	0.3	3
HU	05/18/2012	9:00	Wages	%, ytd.	03/2012				6.1		6.9
PL	05/18/2012	14:00	Wages	%	04/2012			-0.5	4.2	5.7	3.8

Fixed-income in Charts

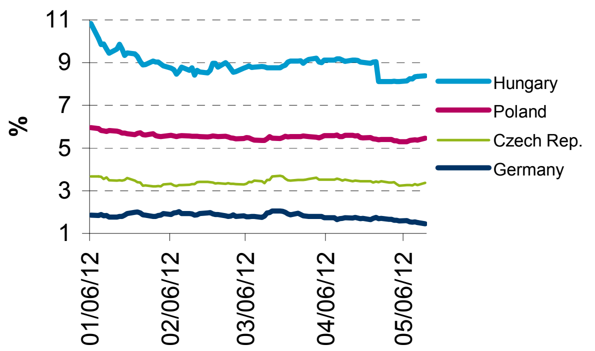
FRA 3x6



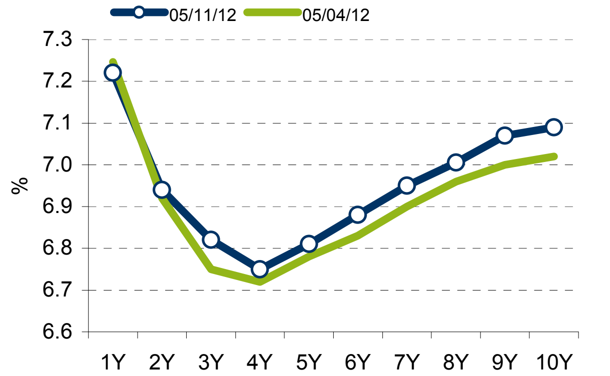
CZ IRS



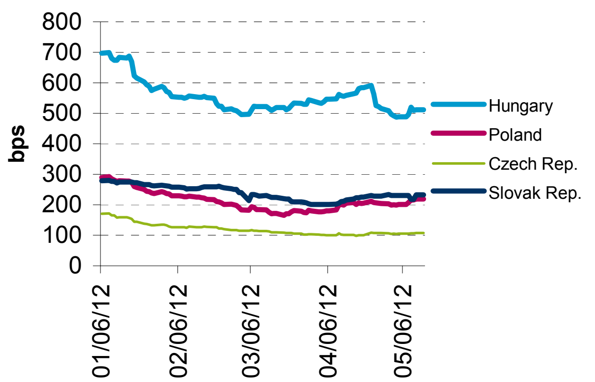
10Y GB Yields



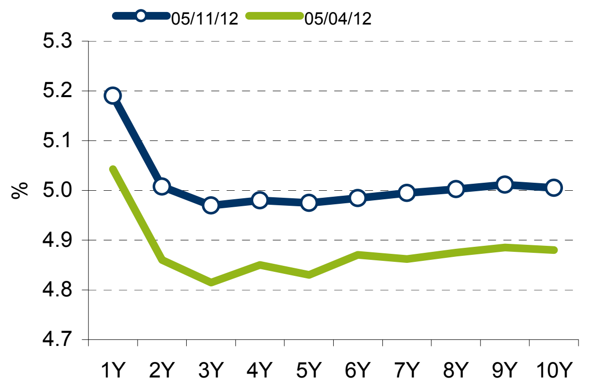
HU IRS



CDS 5Y



PL IRS



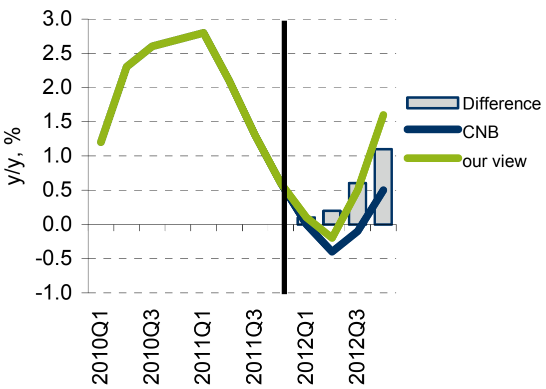
Source: Reuters

Medium-term Views & Issues

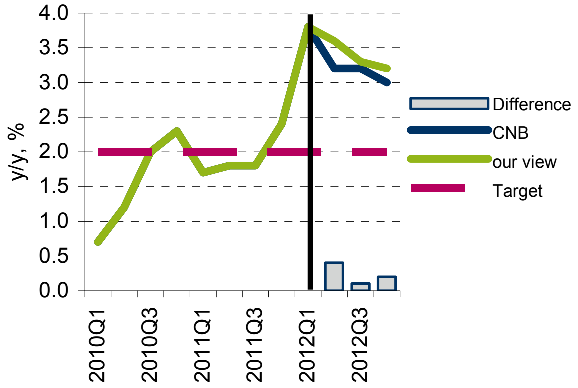
	The Czech Republic	Hungary	Poland
Growth & key issues	The state budget for 2012 is based on the unrealistic assumption of economic growth by 2.5%. Achieving the deficit target of 105 billion remains very uncertain. It will require further austerity measures. In addition to saving, a further discussion 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 in the Euro-zone.	The EU gave green light to the talks, but the IMF stated that it has also prerequisites, namely definite steps regarding the central bank's independence. They gave no further details, so the government withdrew some proposal from the central bank law's, while kept others. Currently the ball is in the IMF's court, we do not rule out that they will not accept the steps taken so far and will ask for additional changes. Of course, this will not be beneficial for the forint, but the government can take further steps before the summer break, therefore the beginning of the talks by June is not out of the question. The risk of autumn talks is that the implementation of market financing slips to the last months of the year with the risk of the market situation at that time.	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 caused by high fuel and food prices and also by V.A.T. increase. On the other hand, weak domestic demand should counter a rise in demand-pull inflation. In spite of higher inflation the CNB still maintains its wait-and-see policy. In fact there are some voices for another rate cut as two board members (incl. governor) voted for cut. So the probability of another monetary policy easening has been increasing. The first rate hike delivered by the Czech central bank is probable in 2013H2.	The April inflation in Hungary came in above expectations at 5.7% Y/Y on higher tobacco and fuel prices. This may reverse in May, when the fuel prices dropped about 5% on cheaper oil and stronger currency, but generally the trend looks to be quite negative as inflation could remain high around 5.5% and may not fall to the central bank's 3% target by the end of next year. Thus, we still believe that the next move of the MNB base rate will be down.	While the rate hike did not surprise us, owing to the well-managed communication by the NBP, we believe that it was not quite appropriate and we expect rate stability for the rest of this year (while the market has started to bet on another rate hike). What primarily makes us believe so is the more modest rhetoric by the NBP and the expectations of the future development of the Polish economy. Its growth should decelerate significantly in the second half of the year, and this should also lead to a gradual inflation fall towards the target.
Forex Outlook	Stronger USD dollar may keep further gains limited for the koruna. Also the Czech domestic factors do not look very supportive - slow continuation of real convergence and dovish CNB do 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.	Leaving aside the Greek crisis, the Improved relationship with the IMF/EU should be beneficial for the forint, but the government can take further steps before the summer break, therefore the beginning of the talks by June is not out of the question. The risk of autumn talks is that the implementation of market financing slips to the last months of the year with the risk of the market situation at that time.	Zloty's fundamentals should not permit the currency perform extremely well in the short-run as 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...

Cent. Banks' Projections vs. Our Forecasts

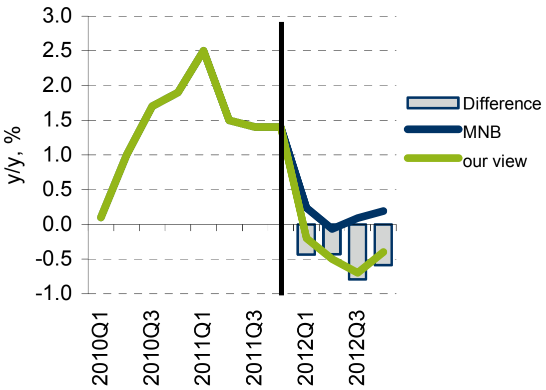
CZ: GDP Outlook



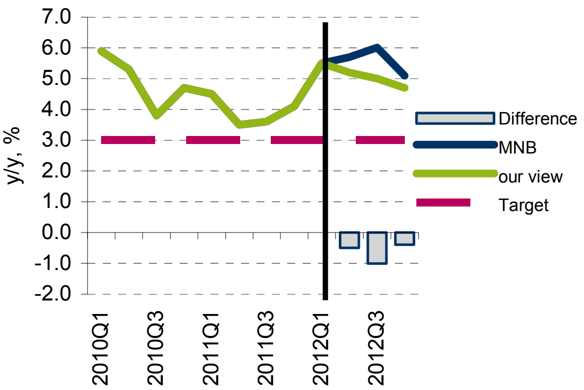
CZ: Inflation outlook



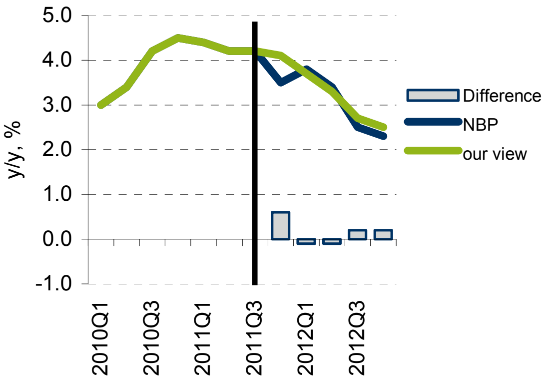
HU: GDP Outlook



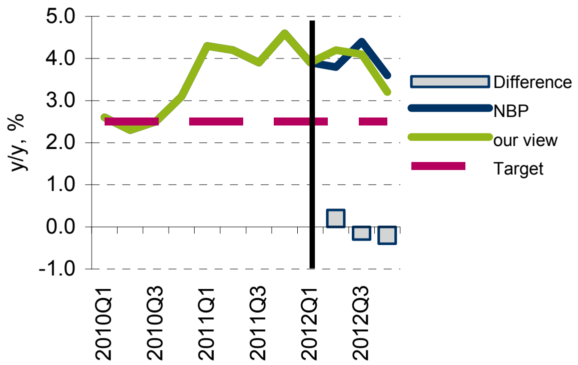
HU: Inflation outlook



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	6.50	6.25	50 bps	12/20/2011
Poland	2W inter. rate	*4.75*	4.50	4.50	4.50	4.50	4.75	25 bps	5/9/2012

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

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	PRIBOR	*1.25*	1.24	1.22	1.20	1.25	1.30
Hungary	BUBOR	*7.21*	7.00	7.00	7.00	6.50	6.25
Poland	WIBOR	*5.06*	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	*2.02*	2.28	2.24	2.60	2.85	3.15
Hungary	HU10Y	*7.09*	7.10	7.50	7.75	7.50	7.25
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	*25.4*	24.8	26.0	25.2	25.0	24.5
Hungary	EUR/HUF	*292*	290	292	290	290	280
Poland	EUR/PLN	*4.31*	4.10	4.50	4.25	4.20	4.15

GDP (y/y)

	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Czech Rep.	2.1	1.3	0.6	0.1	-0.2	0.5	1.6
Hungary	1.5	1.4	1.4	-0.2	-0.5	-0.7	-0.4
Poland	4.2	4.2	4.4	3.7	3.3	2.7	2.5

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

	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	1.8	2.4	3.8	3.6	3.3	3.2	2.0
Hungary	3.6	4.1	5.5	5.2	5.0	4.7	3.7
Poland	3.9	4.6	3.9	4.2	4.1	3.2	2.8

Current Account

	2012	2013
Czech Rep.	-2.3	-2.6
Hungary	1.5	1.0
Poland	-3.5	-3.1

Public finance balance as % of GDP

	2012	2013
Czech Rep.	-3.3	-2.8
Hungary	-2.5	-2.2
Poland	-3.0	

Source: CSOB, Bloomberg

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