Central European Weekly

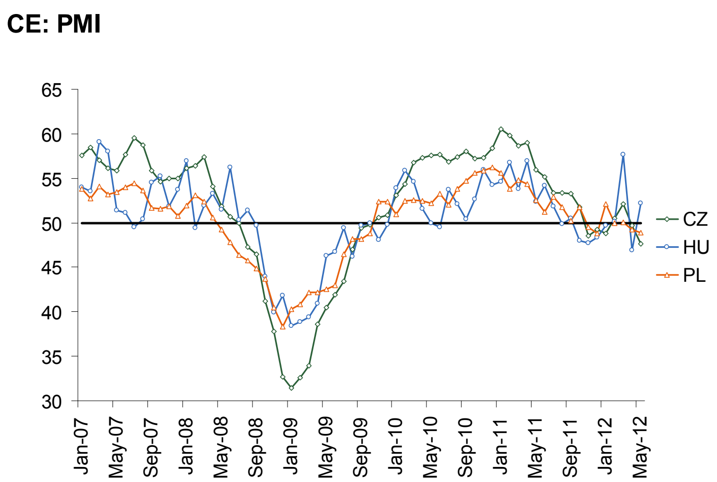
Tuesday, 05 June 2012

Table of contents

Weekly Highlights:

- Polish growth cools down to 3.5% in Q1/2012
- Czech PMI hit 33-month lows
- BGK intervenes in favor of the zloty
- NBP will keep rates unchanged

Chart of the Week



The Czech PMI fell to the lowest level in 33 months in May.

Market's editorial

Slowdown already visible in Central Europe

Viewed purely in terms of macroeconomic data, the impacts of the economic deceleration in the eurozone have not been limited thus far; however, this has started to change in recent weeks. The surprisingly poor GDP growth figures for the first quarter of the year in the Czech Republic and Hungary were followed by another cold shower, the closely followed business mood indices in industry, with the PMI indices in the Czech Republic and Poland having dropped to the crisis levels of 2009. Hence it has been increasingly evident that even very close links with the performing German economy is no panacea.

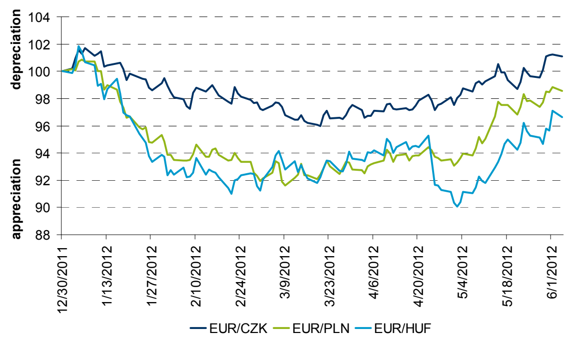
Unlike the economies on the periphery of the eurozone, which have slipped into recession, Central European economies enjoy the advantage of having their own currencies. Those can depreciate when their economies are getting in trouble, thus encouraging the economic performance through easing of the overall monetary conditions. This is already occurring as Central European currencies have hit their five-month lows.

However, not all economic policymakers in the region welcome significant currency depreciation. While the Czech National Bank can be satisfied that the weak koruna, along with an anticipated rate cut, will encourage the local economy, Poland and Hungary may view the depreciation of their respective currencies with some unease. In Hungary, the reason is that the depreciation of the forint goes hand in hand with the rise in risk premiums on Hungarian assets (see Hungary's CDS), while the reason in Poland is that the weak zloty is not in line with the policy of the National Bank of Poland. It currently prefers combating inflation, and consequently would likely wish to see a stronger local currency. This is why more forex interventions in favour of the zloty may occur – albeit they may be initiated by Poland's state-owned bank BGK, which manages the euros from EU funds (rather than by the NBP itself).

EUR/PLN

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*25.8*	*1.06%*	↗	↗
EUR/HUF	*305*	*2.33%*	↗	↗
EUR/PLN	*4.40*	*0.99%*	↗	↗

CE currencies in 2012



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*1.71*	*-6.81*	→	→
10Y PLN	*7.34*	*3.89*	→	↗
10Y HUF	*4.86*	*-0.10*	↗	↗

Review of Economic Figures

Poland's growth below 4% for the first time in two years

In the first quarter of this year, the Polish economy grew by 3.5%, thus falling slightly short of our expectations. As concerns the structure, a notable surprise was a lower contribution of investment to growth (+0.8% excluding inventories); however, this was partly offset by the fairly high contribution of net exports (+0.7%). This indicates that growth was primarily driven by domestic absorption (+2.8%), which was broadly based on household consumption (+1.4%).

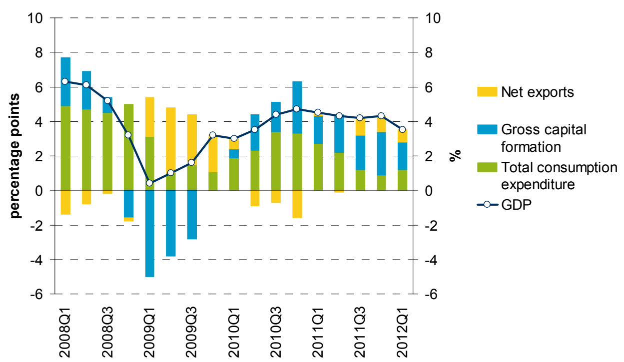
In terms of value added, industry decelerated significantly (+3.4%), but this, given the industrial output data released in February and March, was not such a great surprise; that said, of the major sectors of the Polish manufacturing, only the food industry and the manufacture of non-metallic products grew on average in the first three months of the year, and the growth rates were not particularly amazing from the historical point of view. We should certainly mention a high increase of the gross value added in construction (+9.6%), although its rate was also slower than in 2011.

Even though Poland's GDP grew at a slower than 4% rate for the first time in two years, the data is still outstanding compared to the other countries. This should also hold true for the whole of 2012, notwithstanding our anticipation of a further deceleration of economic growth in the rest of this year. We predict that the combination of higher interest rates, government austerity measures, and lower infrastructure investment, along with weakened foreign demand, should shrink economic growth to the vicinity of 3% in 2012.

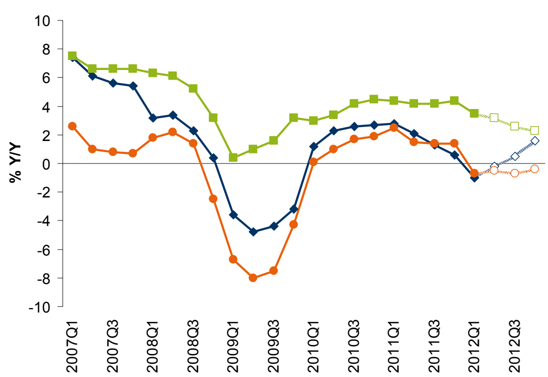
The Czech PMI among 33-lows

The biggest surprise among regional PMI's came from the Czech Republic as the overall index fell to the lowest level since August 2009. Moreover, especially worrying is the development in new orders (both from abroad and domestic) which fell significantly. Hence, the latest set of data is more or less in line with the weaker than expected result of the Czech economy in the first quarter (recall that the Czech economy contracted by 1 percent Q/Q; market expected 0.1 percent growth) and thus further supports our bet on an interest rate cut at the next CNB meeting (June 28th)

PL: Contributions to growth



CE: Growth outlook



Weekly preview

WED 14:00	NBP rate (in %)	
	This	Last change
rate level	**4.75**	5/2012
change in bps	**0**	25

PL: Official rates will remain unchanged

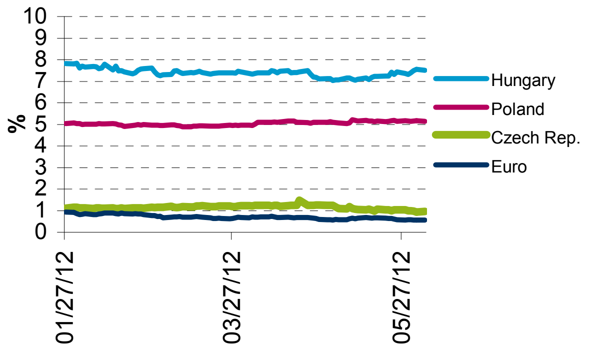
The National Bank of Poland is unlikely to change rates at its Wednesday meeting. Bear in mind that, due to persisting high inflation, high inflation expectations, and the reasonable condition of the economy, the central bank decided to raise rates by 25 basis points in May. Its move surprised some market participants, although the bank had declared its intentions at its April meeting in a fairly clear manner. Equally transparently, the bank signalled in May that another rate change at its upcoming meeting was unlikely. This is also consistent with the latest release of macroeconomic data. In addition to the GDP growth figures for the first quarter (which lagged behind the expectations of the NBP), we also mean new business expectation figures (PMI), which continued to decline to less than the key 50-point level in May. April's industrial output and retail sales also fell short of expectations. Our baseline scenario envisages that rates will remain unchanged for the rest of 2012, even though July's inflation report may include new information in that regard.

Calendar

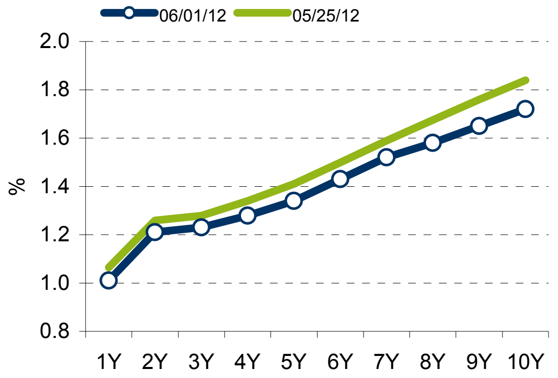
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	06/05/2012	9:00	Retail sales	%	04/2012		1		1		-0.3
CZ	06/06/2012	9:00	Construction output	%	04/2012						-8.9
CZ	06/06/2012	9:00	Industrial output	%	04/2012		2.5		1.3		-0.7
CZ	06/06/2012	9:00	Trade balance	CZK B	04/2012	25		26		37.5	
PL	06/06/2012	14:00	NBP meeting	%	06/2012			0.75		4.75	
HU	06/07/2012	9:00	Industrial output	%	04/2012 *P				0.2	0.6	0.6
CZ	06/07/2012	9:00	Wages	%	1Q/2012						-0.4
CZ	06/07/2012	10:00	Current account	CZK B	1Q/2012					-688.2	
HU	06/07/2012	17:00	Budget balance	HUF B	05/2012					-228.2	
HU	06/08/2012	9:00	Trade balance	EUR M	04/2012 *P					635.9	
CZ	06/08/2012	9:00	GDP	%	1Q/2012 *F					-1	-1
CZ	06/08/2012	9:00	Unemployment rate	%	05/2012	8.1		8.1		8.4	
HU	06/08/2012	9:00	GDP	%	1Q/2012 *F					-0.7	-1.3

Fixed-income in Charts

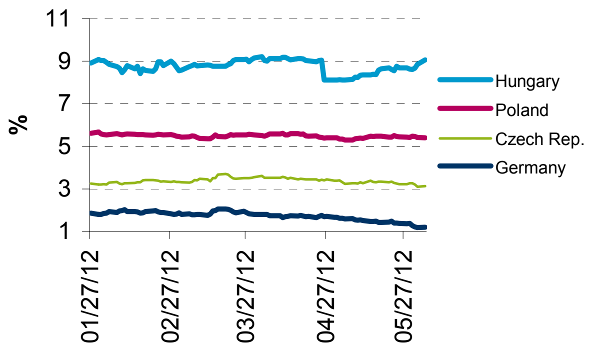
FRA 3x6



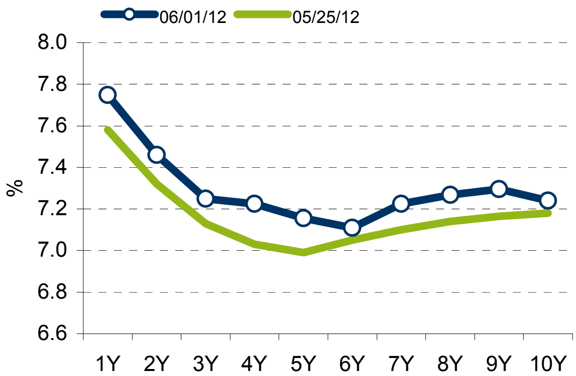
CZ IRS



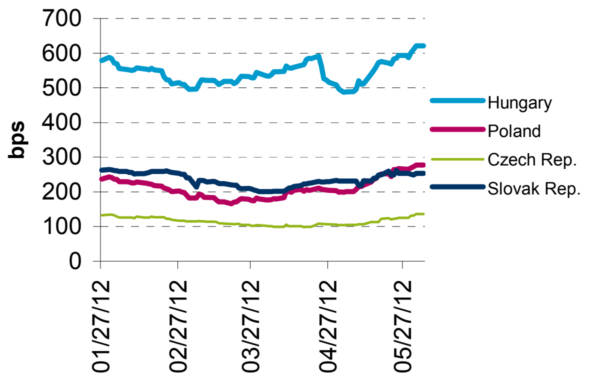
10Y GB Yields



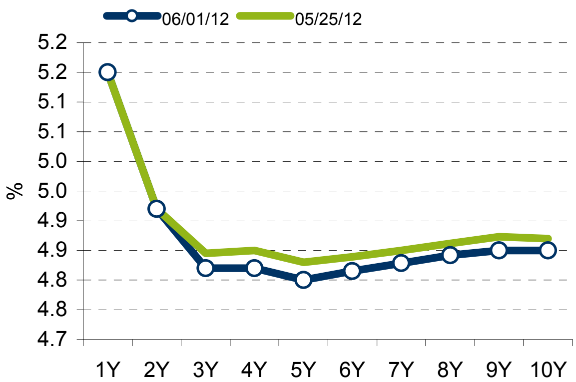
HU IRS



CDS 5Y



PL IRS



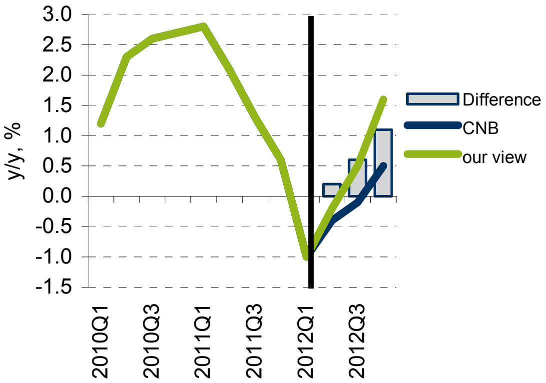
Source: Reuters

Medium-term Views & Issues

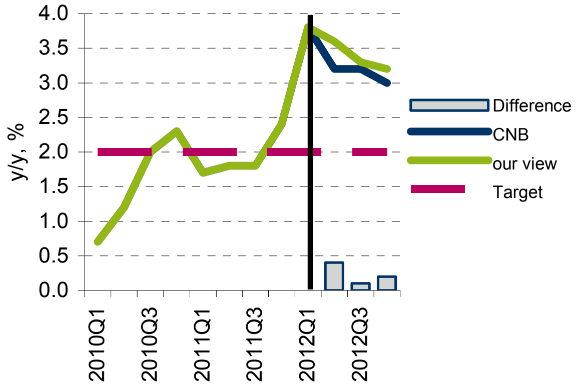
	The Czech Republic	Hungary	Poland
Growth & key issues	The state budget for 2012 is based on the unrealistic assumption of economic growth by 2.5%. Achieving the deficit target of 105 billion remains very uncertain. It will require further austerity measures. In addition to saving, a further discussion 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 the Polish Statistical Office, the pace of growth of the Polish economy fell to less than 4% in the first quarter of 2012. 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 continue to slow down in following quarters. 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 waitandsee 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

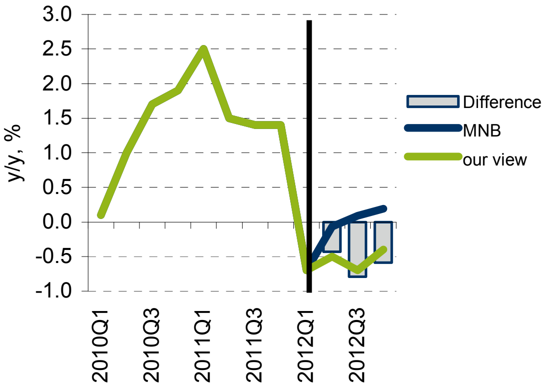
CZ: GDP Outlook



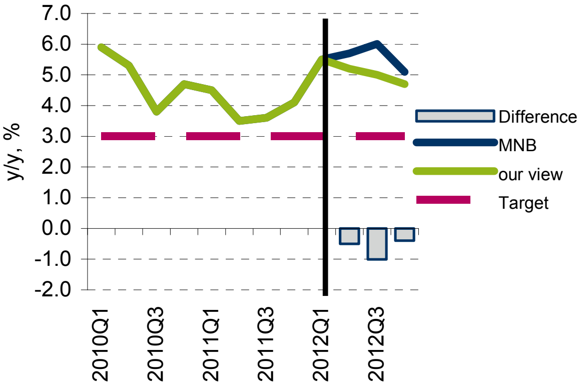
CZ: Inflation outlook



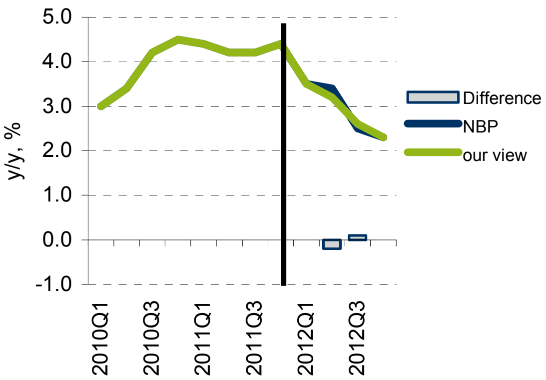
HU: GDP Outlook



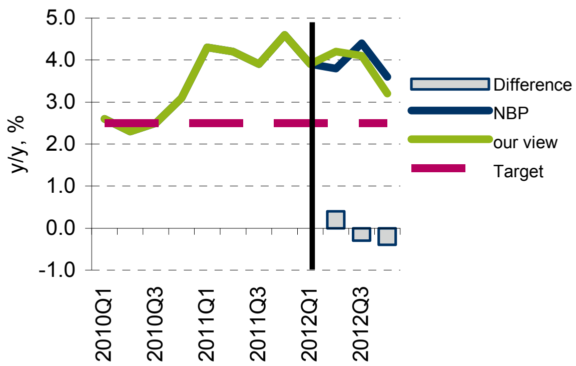
HU: Inflation outlook



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	0.50	0.50	0.50	0.50	-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	*1.23*	1.24	1.22	1.10	1.10	1.10
Hungary	BUBOR	*7.19*	7.00	7.00	7.00	6.50	6.25
Poland	WIBOR	*5.11*	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	*1.71*	2.28	2.24	2.60	2.85	3.15
Hungary	HU10Y	*7.34*	7.10	7.50	7.75	7.50	7.25
Poland	PL10Y	*4.86*	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	*25.8*	24.8	26.0	25.2	25.0	24.5
Hungary	EUR/HUF	*305*	290	292	290	290	280
Poland	EUR/PLN	*4.40*	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	-1.0	-0.2	0.5	1.6
Hungary	1.5	1.4	1.4	-0.7	-0.5	-0.7	-0.4
Poland	4.2	4.2	4.4	3.5	3.2	2.6	2.3

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

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
Joke Mertens	+32 2 417 30 59	Commercial Desk	+32 2 417 53 23
Mathias Van der Jeugt	+32 2 417 51 94	Institutional Desk	+32 2 417 46 25
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		

ALL OUR REPORTS ARE AVAILABLE ON WWW.KBC.BE/DEALINGROOM