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Central European Weekly

Tuesday, 09 October 2012

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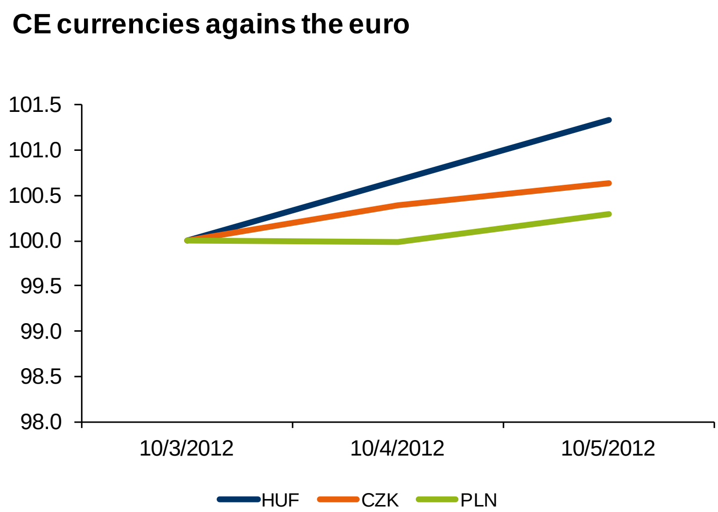
Chart of the Week



Despite the fact that the Polish central bank unexpectedly decided to keep interest rates unchanged, the zloty underperformed its CE peers last week. (Source: Reuters).

Market's editorial

The NBP surprisingly stay on hold but a rate cut might come as already as in November

The events that took place in Central European economies last week were very interesting, in and of themselves, but also because they may temporarily influence the behaviour of markets in the region.

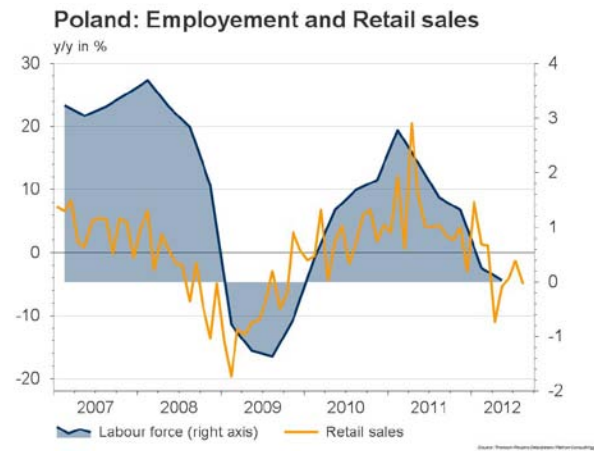
The first such event was the meeting of the National Bank of Poland, which decided not to cut rates at the moment, unlike the Czech National Bank and the National Bank of Hungary.

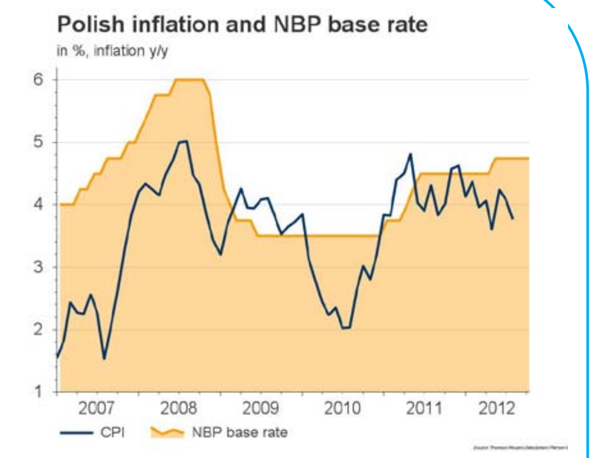
According to a press release, the main argument for the surprising decision was high inflation, which, notwithstanding its decline, remained well above the target of the NBP. Governor Belka stated that one of the criteria for setting the monetary policy is the effort to keep real interest rates above zero. Nevertheless, the NBP is aware of the uncertain outlook, and therefore further long-term talks are likely to take place immediately after the next meeting, to be held in November (November 7). A new inflation forecast will be released at that meeting and it will likely be crucial for further decisions of the NBP; if it highlights a longer period of slower growth and limited upside risks to inflation, the NBP will cut rates.

As the prospects for the Polish economy are not very good (a deceleration is evident in construction, industrial output, and the retail sector), we believe that the NBP (with the new forecast at hand) will proceed to a rate cut at its next meeting. Nonetheless, we stick to our opinion that the bets on the fall in rates by 90 basis points (bps) within the next nine months, as suggested by market rates (i.e., at least three rate cuts by the standard 25 bps), are exaggerated. Our scenario envisages two 25 bps rate cuts to 4.25%, which might take place within the next three months.

The Hungarian government scraps a transactional tax on the MNB

However, the forint and Hungary's government bonds may also fare well, because the Hungarian government has presented a new mix of budgetary austerity measures, which reflects a weaker growth forecast for next year. More importantly, the new budgetary strategy no longer includes the planned imposition of the transaction tax on the central bank. This tax was criticised by Hungary's official creditors, and this led to unnecessary pressure for the rise in risk premiums on Hungarian assets.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*24.9*	*-0.43%*	→	↘
EUR/HUF	*284*	*-0.89%*	↘	↘
EUR/PLN	*4.08*	*-0.93%*	→	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*1.65*	*-4.07*	→	↗
10Y HUF	*6.50*	*-0.69*	→	↗
10Y PLN	*4.41*	*-0.11*	→	→

In Focus

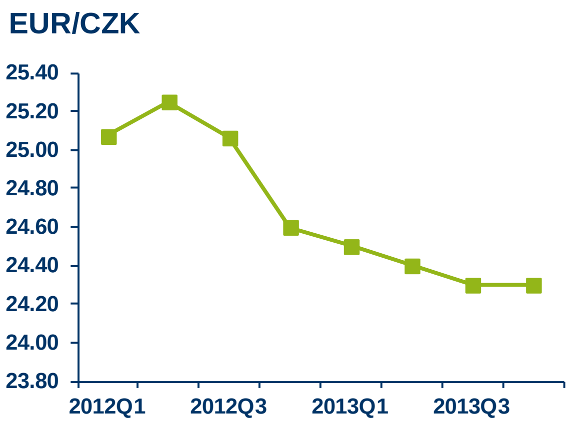
The Czech koruna should not weaken more despite CNB...

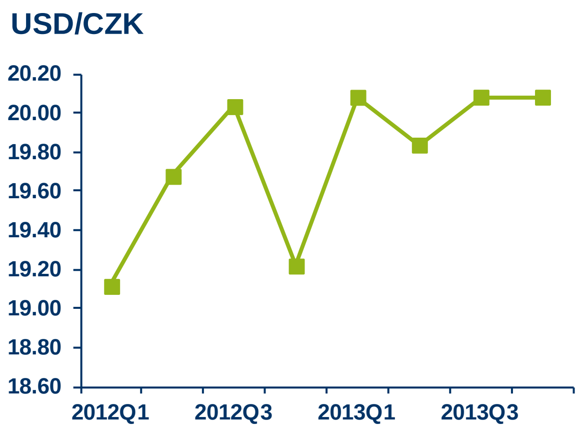
At its September meeting, the Czech National Bank cut its base rate to a new all-time low of 0.25%. It also cut its discount rate, at which banks may deposit funds with the CNB, to 0.1%. In addition, Governor Singer admitted that the central bank might intervene against the koruna in the future, if it decides to continue to ease its monetary policy.

While the bugbear of possible interventions may discourage the koruna from a greater appreciation, it should not completely prevent the Czech currency from strengthening. The main reason is that the interventions are likely to occur at much stronger levels. As Governor Singer has remarked, the question of interventions is not relevant at the moment; in addition, the CNB Board is not of one mind in respect of the interventions. Our opinion is that particularly the hawkish group (Janáček, Zamrazilová) and the opponents of alternative monetary policy instruments (Hampl, Řežábek) would have a problem with the triggering of any such interventions. This is why we believe that the interventions are unlikely to occur until the koruna hits approximately CZK 24.00 per EUR, where it will start to diverge from the fundamental range that we have predicted. In its forecast, the CNB itself anticipates that, in the extreme scenario, the koruna is unlikely to strengthen beyond CZK 24.10 per EUR by the end of this year, and CZK 23.70 per EUR in the first quarter of 2013.

This basically means that there is still latitude for the koruna to follow the return of optimism to global markets and to appreciate somewhat, due in particular to the anticipated agreement on the new plan for Greece and on the package for Spain. We also believe that numerous cyclical leading indicators should change for the better in late 2012. Although eurozone peripheries will remain in a recession, the German economy may start to show signs of stabilisation at the end of the year, as are currently evident in the United States and China.

Three factors may basically affect our bet on the positive end of the year. First: Greece, which will need a second restructuring of its debt sooner or later. Second: the fear of the expiration of tax exemptions in the U.S. And last but not least: the increasing tension in the domestic political scene also poses a risk to the koruna.



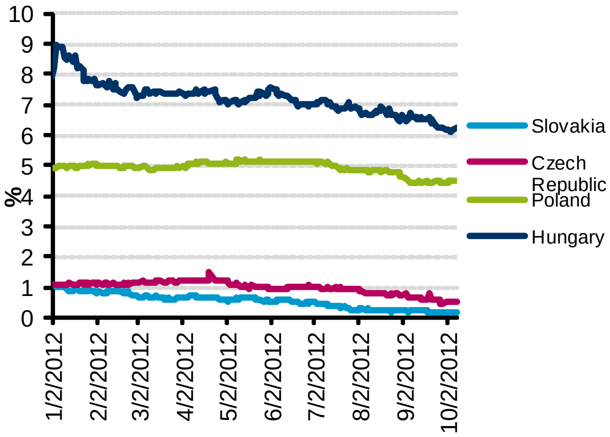


Calendar

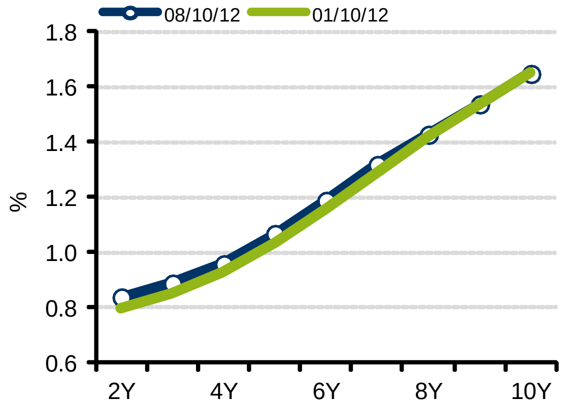
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	10/08/2012	9:00	Construction output	%	08/2012						-0.5
CZ	10/08/2012	9:00	Industrial output	%	08/2012		0.5		0		4.2
CZ	10/08/2012	9:00	Unemployment rate	%	09/2012	8.3		8.3		8.3	
CZ	10/08/2012	9:00	Trade balance	CZK B	08/2012	15		15.3		25.85	
HU	10/08/2012	17:00	Budget balance	HUF B	09/2012					-559.5	
CZ	10/09/2012	9:00	CPI	%	09/2012	-0.1	3.4	-0.1	3.4	-0.1	3.3
HU	10/09/2012	9:00	Trade balance	EUR M	08/2012 *P			524.5		431	
HU	10/11/2012	9:00	CPI	%	09/2012			0.2	6.3	0.1	6
HU	10/12/2012	9:00	Industrial output	%	08/2012 *F					2.6	1.4
PL	10/12/2012	14:00	Money supply M3	%	09/2012			0.4		0.7	

Fixed-income in Charts

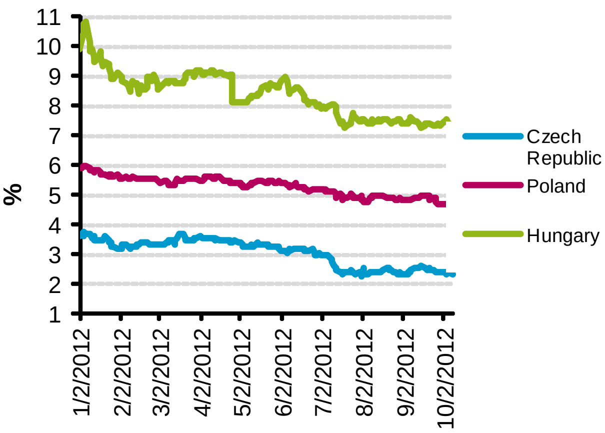
FRA 3x6



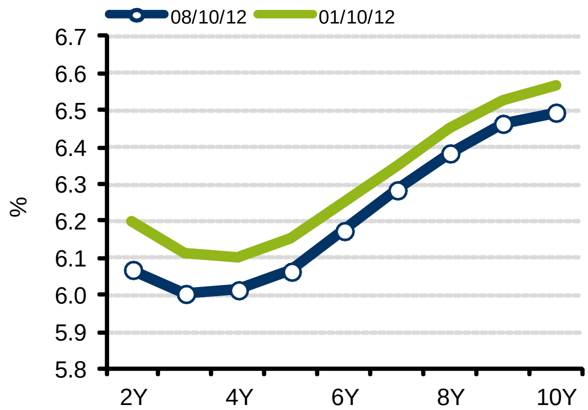
CZ IRS



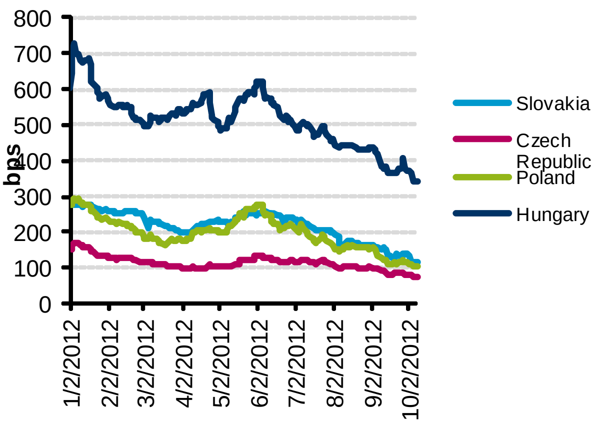
10Y GB Yields



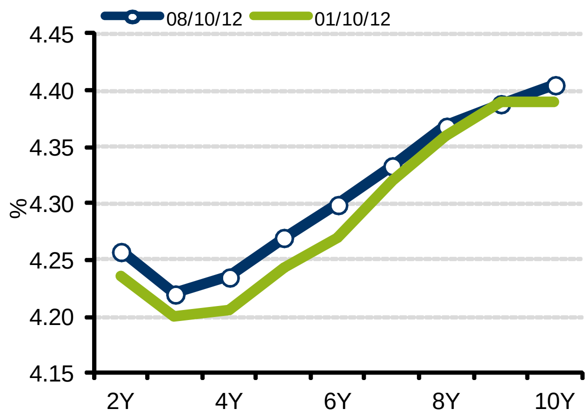
HU IRS



CDS 5Y



PL IRS



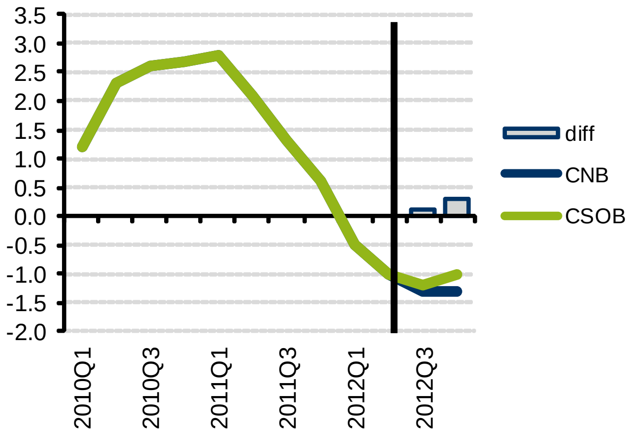
Source: Reuters

Medium-term Views & Issues

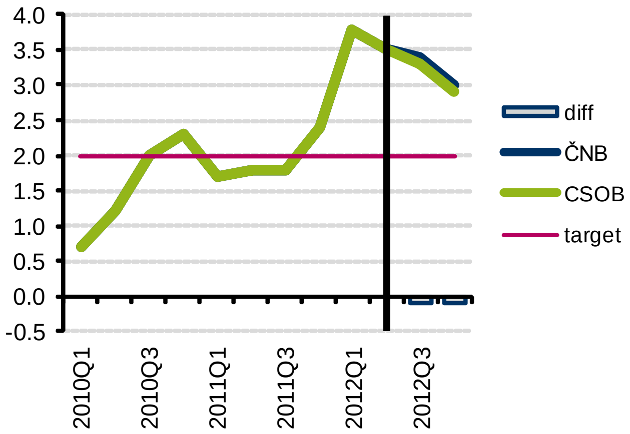
	The Czech Republic	Hungary	Poland
Growth & key issues	The state budget for 2012 is based on the unrealistic assumption of economic growth by 2.5%. Achieving the deficit target of 105 billion remains very uncertain. It will require further austerity measures. In addition to saving, a further discussion 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.	The IMF accepted the most recent modification to the central bank law. This means that negotiations may start soon, according to the government around mid-July. The government said that the end date could be between mid-September and end-October. The government announced new tax cuts worth Ft300bn funded 1/3rd from budgetary reserves and 2/3rd from extending the transaction tax onto the central bank and state treasury. In case of the latter, it is only a temporary funding because the state owns both institutions. Although it has not yet been communicated, it may mean that revenue side will be used in 2013 and expenditure side in 2014.	Growth of the Polish economy fell to 2.4% in the second 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, although at a more moderate pace. 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. Therefore, we expect that the Polish economy might grow by about 2.5% in 2012.
Outlook for official & market rates	Inflation increased above the central Outlook for official & market rates 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 cut its base rate to a new all-time low of 0.25% in September.	The MNB cut its base rate twice by 25 bps in two months so the base rate stands at 6.5%, although the headline inflation is back above 6%. We think the last decision was too risky and market expectation for a gradual rate easing of 25bps every second month would have been a better strategy. Further weakening of the currency however may trigger substantial increase of short-term rates and thus could act as a defence, especially if council members indicate that the easing cycle could stop.	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. For now the deteriorating macro-figures start to argue for a rate cut. However this might not come till November when inflation expectations cool down and new forecast is on the table.
Forex Outlook	CNB willingness to intervene against the koruna should play against the currency in the near term. Also the Czech domestic factors do not look very supportive - slow continuation of real convergence That said, the koruna may be more vulnerable to potentially negative news from euro zone at the beginning of the autumn and may go further above 25.00 EUR/CZK.	Leaving aside the Greek (euro) crisis, the improved relationship with the IMF/EU should be beneficial for the forint in the medium-term.	Zloty's fundamentals should not permit the currency perform well in the short-run as the economy should slow down and the Central bank is about to change its course. At the beginning of the autumn we may see some renewed selling pressure as uncertainties around ECB intervention on the secondary markets and Greek package may weigh on CE currencies.

CBs' Projections vs. Our Forecasts

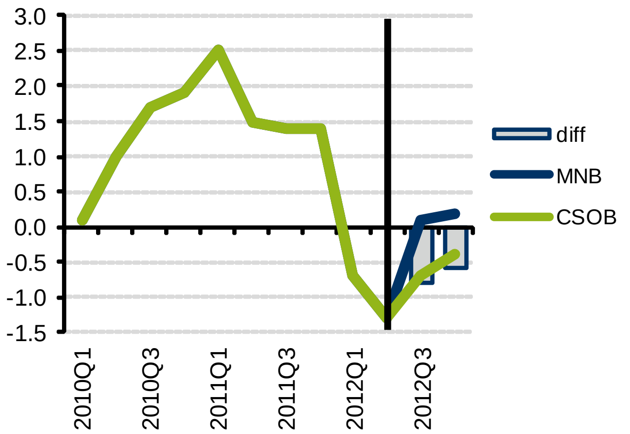
CZ: GDP outlook (Y/Y, %)



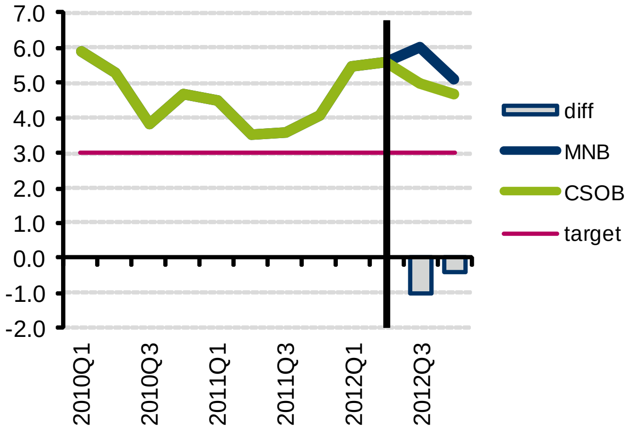
CZ: Inflation outlook (Y/Y, %)



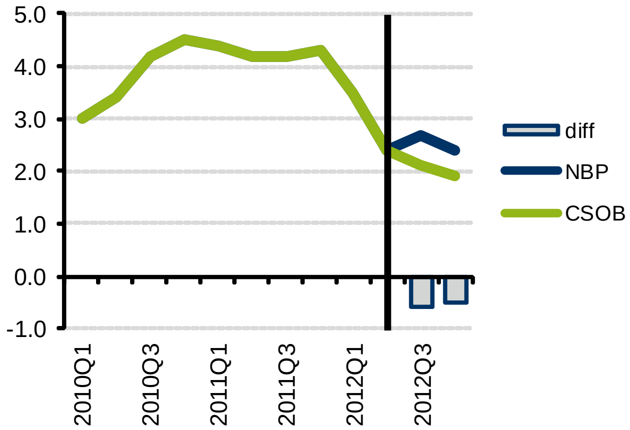
HU: GDP outlook (Y/Y, %)



HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outllok (Y/Y, %)

Zdroj: ČNB, NBP, MNB, ČSOB

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	Last change	
Czech Rep.	2W repo rate	*0.25*	0.75	0.50	0.50	0.25	0.25	-25 bps	9/27/2012
Hungary	2W deposit r.	*6.50*	7.00	7.00	6.50	6.50	6.50	-25 bps	9/25/2012
Poland	2W inter. rate	*4.75*	4.50	4.75	4.75	4.50	4.50	25 bps	6/5/2012

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

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	PRIBOR	*0.71*	1.28	1.03	0.80	0.70	0.70
Hungary	BUBOR	*6.60*	7.25	7.20	6.61	6.50	6.40
Poland	WIBOR	*4.91*	4.94	5.13	4.92	4.80	4.90

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

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	CZ10Y	*1.65*	2.25	2.02	1.61	1.70	1.80
Hungary	HU10Y	*6.50*	7.36	6.71	6.56	7.50	7.25
Poland	PL10Y	*4.41*	4.95	4.74	4.39	5.30	5.40

Exchange rates (end of the period)

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	EUR/CZK	*24.9*	24.8	25.5	25.1	24.9	24.5
Hungary	EUR/HUF	*284*	294	286	285	290	280
Poland	EUR/PLN	*4.08*	4.14	4.22	4.11	4.30	4.15

GDP (y/y)

	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Czech Rep.	2.1	1.3	0.6	-0.5	-1.0	-1.2	-1.0
Hungary	1.5	1.4	1.4	-0.7	-1.3	-0.7	-0.4
Poland	4.2	4.2	4.3	3.5	2.4	2.1	1.9

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

	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	1.8	2.4	3.8	3.5	3.3	2.9	2.9
Hungary	3.6	4.1	5.5	5.6	5.0	4.7	3.7
Poland	3.9	4.6	3.9	4.3	3.7	3.2	2.7

Current Account

	2012	2013
Czech Rep.	-2.2	-1.9
Hungary	1.5	1.0
Poland	-4.0	-3.8

Public finance balance as % of GDP

	2012	2013
Czech Rep.	-3.3	-2.8
Hungary	-2.5	-2.2
Poland	-3.5	-4.0

Source: CSOB, Bloomberg

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