Central European Weekly

Tuesday, 06 November 2012

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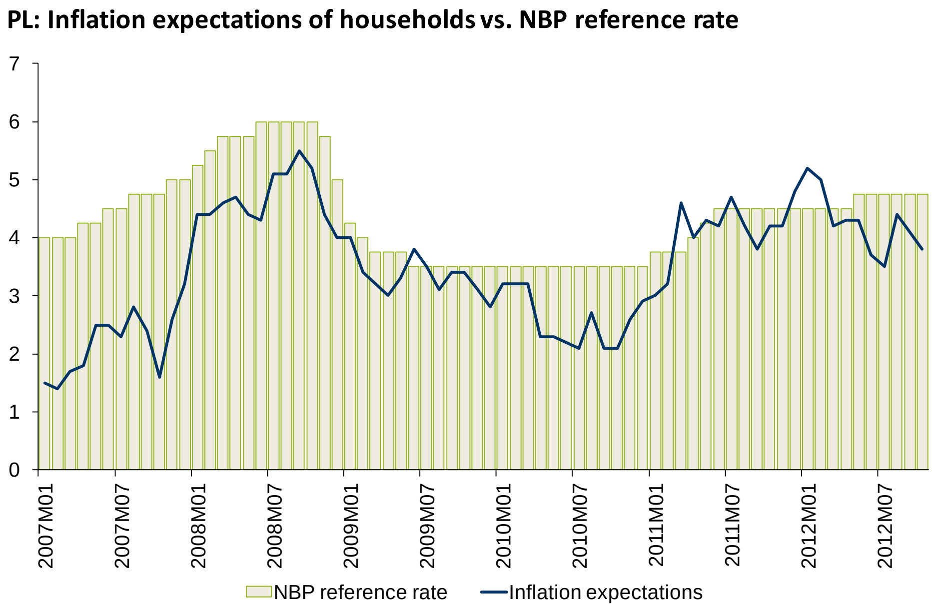
Weekly Highlights:

- CNB cuts rates to technical zero
- The Czech koruna moves sharply above 25.00 EUR/CZK
- NBH cut has no major impact on Hungarian forint
- NBP set to start monetary easing cycle

Chart of the Week



Polish real interest rates se to remain in a positive territory even after the expected interest rate cut. (Source: NBP, Bloomberg).

Central European Daily

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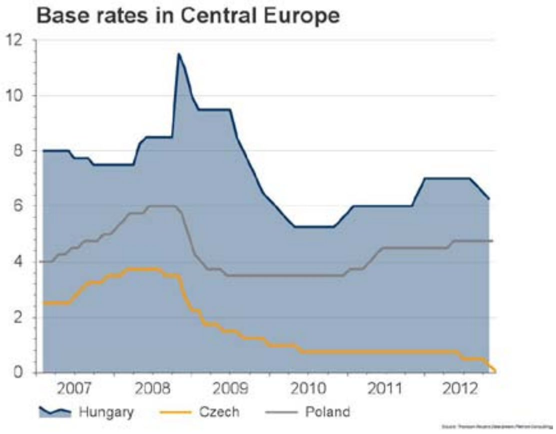
Market's editorial

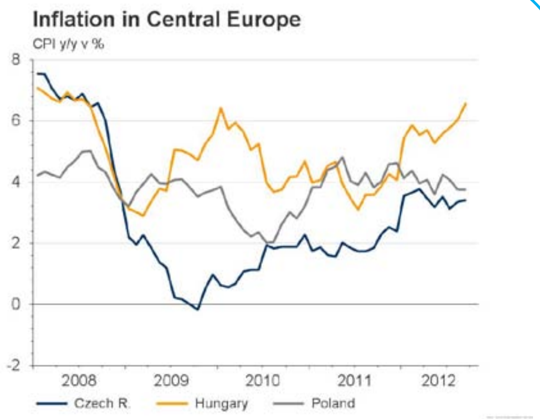
Central Europe eases its monetary policies

Central Europe has started to ease its monetary policies in a big way. The Czech National Bank cut its rates to the technical zero, verbally guaranteed a prolonged period of super-low rates, and decided to put an end to its conversions of yields from forex reserves into korunas. Thus the CNB has set the stage for its forex interventions, when appropriate, and made the koruna rapidly weaken significantly above25.00 EUR/CZK.

The National Bank of Hungary cut its base rate for the third consecutive time by 25 basis points, to 6.25%. Hence the real base rate of the NBH slipped into negative territory for the first time in a long while, because the inflation rate is currently 6.6%. Thus the doves on the NBH Board narrowly outvoted the moderate members, 4-3, which is yet more evidence that the Board's opinion continues to be divided quite significantly. Nevertheless, the forint has absorbed the dovish policy of the NBH without major troubles thus far, unlike the koruna.

A meeting of the last of the three Central European central banks, the National Bank of Poland, is going to be held this week. The latest series of macroeconomic data, including a fairly rapid decline of inflation expectations and poorer retail figures, should encourage the doves on the Monetary Policy Council. While the Polish headline PMI has improved slightly, the key production sub-index remains far below 50 points. This is why we expect that the NBP to cut rates by 25 bps, and thus trigger relatively short monetary easing cycle.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*25.3*	*1.11%*	↗	↗
EUR/HUF	*282*	*-0.93%*	↗	↗
EUR/PLN	*4.12*	*-0.34%*	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*1.53*	*-2.30*	→	→
10Y HUF	*6.36*	*-0.39*	→	→
10Y PLN	*4.29*	*-2.72*	→	→

In Focus: Czech interest rates hit rock bottom

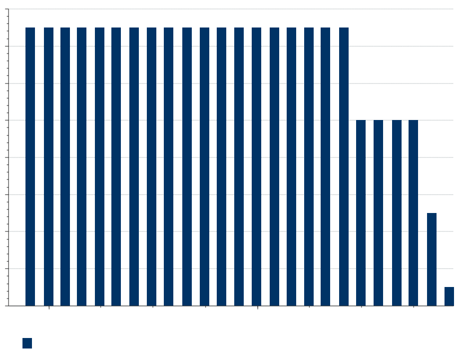
The CNB policy rate reaches a “technical zero” and will stay there for some time…

At its last meeting, the Czech National Bank (CNB) Board again decided to cut its interest rates. Thus the central bank’s base rate hit a new all-time low of 0.05% and the CNB made a commitment to keep it there until it sees a significant inflationary pressure. In our view, these will not be visible until the second half of 2014.

Statements from the CNB made prior to the meeting had already signalled that the rates would be cut again. A new forecast, available to the CNB Board, also contributed to its decision as it is more pessimistic about the economic outlook - the CNB forecasts 0.2% GDP growth for the next year which is more or less in line with our scenario which foresees zero growth for the Czech economy. Domestic demand is completely muted, with negligible hopes of improvement. Moreover, another increase in consumption taxation (VAT), which would curb household expenditure next year, may affect that situation.

The CNB Board also decided on Thursday that it would no longer sell yields from its forex reserves, in an evident effort to avoid pouring oil on the flames by stimulating demand for the koruna and thus contributing to its appreciation. Nevertheless, the question is whether this will actually have any impact. The Czech National Bank currently keeps €31.5bn in forex reserves while the annual yield from those reserves will not exceed €600m. This sum (the average for one business day is ‘just’ €3m) will hardly move the Czech forex market.

Thus, a more important fact for the koruna is that interest rates have fallen to the ‘technical zero’; moreover, the CNB is threatening to intervene against the Czech currency (which is number one policy tool at the moment). Therefore, when the global economic situation improves, the koruna may become a ‘victim’ of carry trades, when speculators will borrow at the ‘zero’ rate in Czech korunas and deposit those funds in high-yielding currencies (the zloty or the forint could be appropriate candidates).



2013	CPI inflation	GDP	Pribor 3M	EUR/CZK
CNB forecast 08/12	2.3	0.8	0.30	25.10
CNB forecast 11/12	2.3	0.2	0.20	25.10
CSOB forecast	3.0	0.0	0.55	24.38

Weekly preview

WED 14:00	NBP rate (in %)	
	This	Last change
rate level	4.50	5/2012
change in bps	-25	25

PL: NBP to cut rates to 4.50%

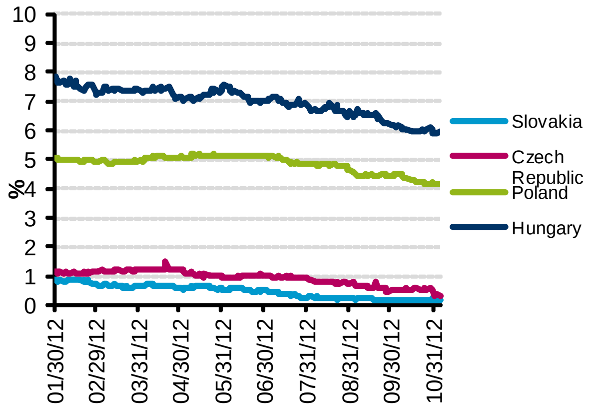
The data released in October confirmed the declining performance of the Polish economy, while pointing out a slightly faster inflation fall towards the target than expected. According to our forecasts, this means that the year-on-year inflation rate might fall to close to 3% by the end of this year. We believe that the newly released inflation forecast of the NBP will bear out the above trends and make the National Bank of Poland (NBP) start to cut interest rates; our opinion is that the rates are likely to be cut twice (with the second cut to be made in January).

Calendar

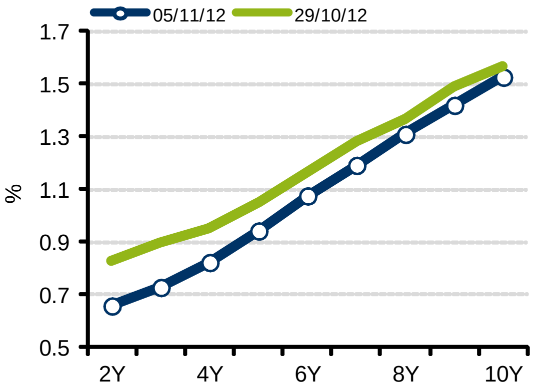
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	11/05/2012	9:00	PMI manufacturing		10/2012					52.5	
CZ	11/05/2012	9:00	Retail sales	%	09/2012		-2.8		-3.1		-0.8
CZ	11/06/2012	9:00	Construction output	%	09/2012						-4.7
CZ	11/06/2012	9:00	Industrial output	%	09/2012		-3.5		-2.5		-3.1
CZ	11/06/2012	9:00	Trade balance	CZK B	09/2012	30		31		16.9	
PL	11/07/2012	14:00	NBP meeting	%	11/2012	4.5		4.5		4.75	
HU	11/07/2012	17:00	Budget balance	HUF B	10/2012					-545.8	
CZ	11/08/2012	9:00	Unemployment rate	%	10/2012	8.4		8.3		8.4	
HU	11/08/2012	9:00	Trade balance	EUR M	09/2012 *P					587.6	
CZ	11/09/2012	9:00	CPI	%	10/2012	0.1	3.3		3.4	-0.1	3.4
HU	11/09/2012	9:00	Industrial output	%	09/2012 *P				-0.4	2.6	1.4

Fixed-income in Charts

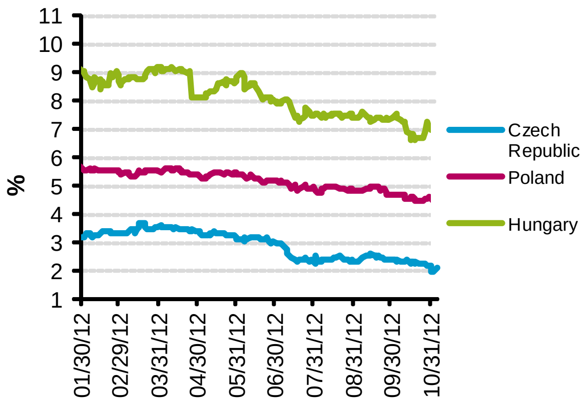
FRA 3x6



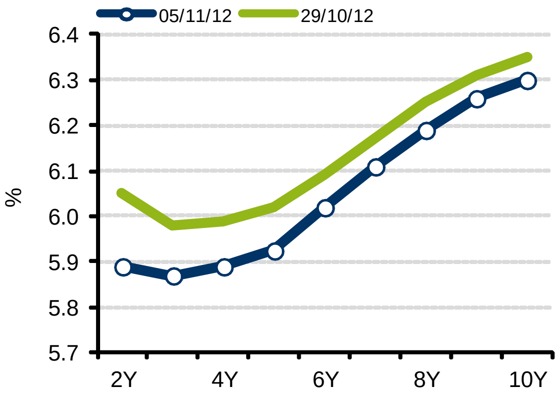
CZ IRS



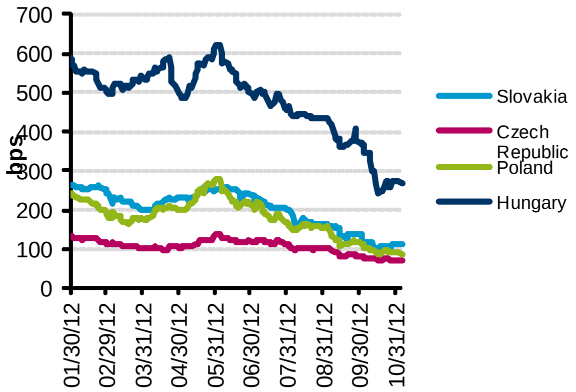
10Y GB Yields



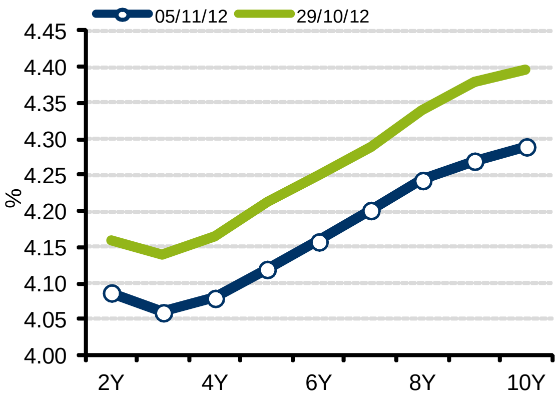
HU IRS



CDS 5Y



PL IRS



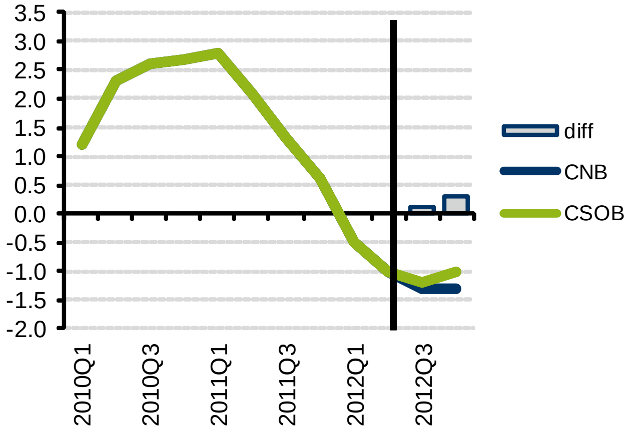
Source: Reuters

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 & key issues 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 government announced HUF 764 billion (2.5% of GDP) of fiscal measures. On one side the government's commitment to keep the budget deficit under 3% seems to be firm. On the other hand, it is fairly evident that the government is likely to be able to keep its deficit below the Maastricht level only at the cost of sharply reduced economic growth.	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 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. We expect CNB to stay at technical zero (0.05%) at least till early 2014..	The NBH will probably continue to gradually ease its policy despite unfavorable inflation readings. Recall that the year-on-year inflation has already reached 6.6%, while it is far from certain whether it will be decline back to the NBH's target (3.0%).	The data released in October confirmed the declining performance of the Polish economy, while pointing out a slightly faster inflation fall towards the target than expected. We believe that the newly released inflation forecast of the NBP will bear out the above trends and make the National Bank of Poland (NBP) start to cut interest rates; our opinion is that the rates are likely to be cut twice (with the second cut to be made in January).
Forex Outlook	CNB willingness to intervene against the koruna should play against the currency in the near term. Also the Forex Outlook 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 as high as 25.50 EUR/CZK.	The forint has been able to withstand both NBH's rate cuts and worsened relationship with the IMF. The exchange rate might not be stable forever, especially if the NBH continue to ease its policy.	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 Greek package US fiscal cliff may weigh on CE currencies.

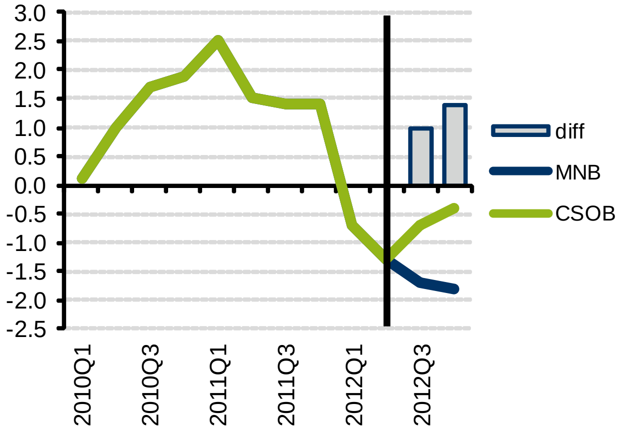
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

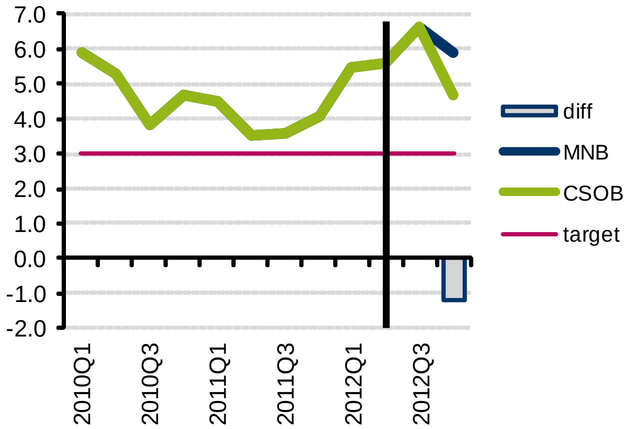


CZ: Inflation outlook (Y/Y, %)

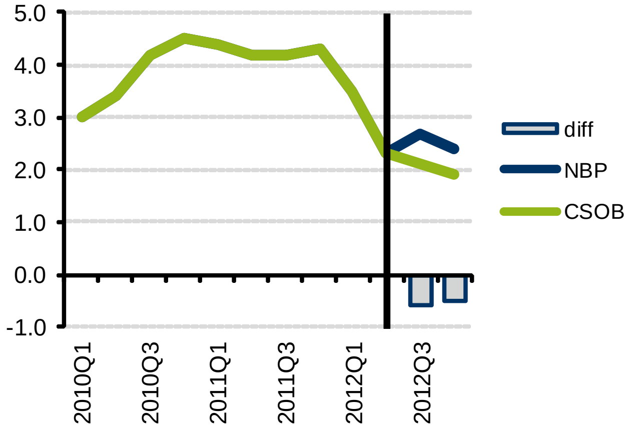
HU: GDP outlook (Y/Y, %)



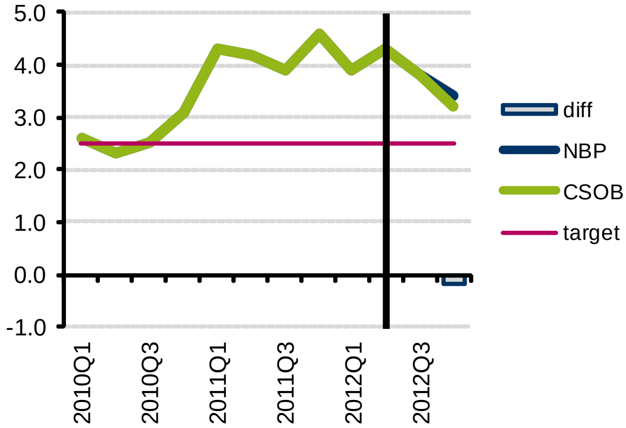
HU: Inflation outlook (Y/Y, %)



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	*0.05*	0.75	0.50	0.50	0.25	0.25	-25 bps	9/27/2012
Hungary	2W deposit r.	*6.25*	7.00	7.00	6.50	6.50	6.50	-25 bps	10/30/2012
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	*0.58*	1.28	1.03	0.80	0.70	0.70
Hungary	BUBOR	*6.28*	7.25	7.20	6.61	6.50	6.40
Poland	WIBOR	*4.72*	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	*1.529*	2.25	2.02	1.61	1.70	1.80
Hungary	HU10Y	*6.36*	7.36	6.71	6.56	7.50	7.25
Poland	PL10Y	*4.29*	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	*25.3*	24.8	25.5	25.1	24.9	24.5
Hungary	EUR/HUF	*282*	294	286	285	290	280
Poland	EUR/PLN	*4.12*	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	2.3	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	3.4	2.9	2.9
Hungary	3.6	4.1	5.5	5.6	6.6	4.7	3.7
Poland	3.9	4.6	3.9	4.3	3.8	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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