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Central European Weekly

Monday, 12 November 2012

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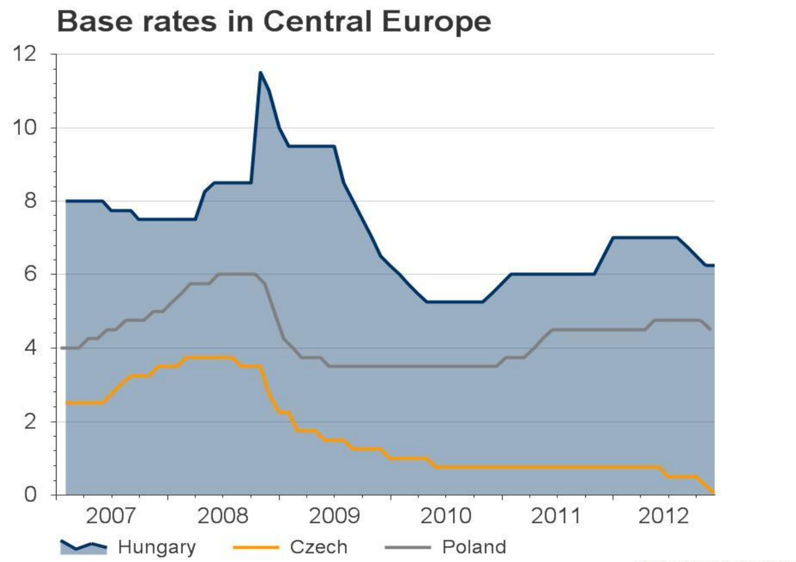
Chart of the Week



The Polish NBP is the last one that starts easing cycle.

Market's editorial

The German slowdown felt in Central Europe

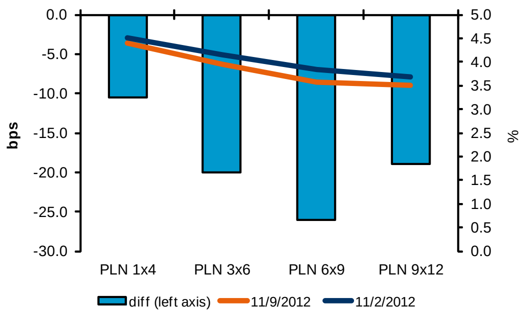
The German economy is decelerating, with Central Europe unavoidably beginning to be effected. Not only soft data, such as the Ifo business mood index, but also hard indicators of upswing, such as industrial output, confirm that even the driver of the European economy is starting to slow down. No wonder this is affecting Central Europe, whose industry is strongly tied to the Germany economy. This conclusion is also confirmed by our leading indicators (the Flash for the Czech Republic as well as Poland – see the next page), which suggest that the developments in this sector will be negative in the next three months.

Of course, the question now is how much this negative trend in export-oriented industry may be influenced by the eased monetary policy, which, after the start of the rate cut cycle in Poland, has been typical of the entire region. This policy has led to the depreciation of (real) exchange rates, which should theoretically encourage those economies; however, our empirical forecasts of the susceptibility of exports to exchange rate changes indicate that currency depreciation is certainly not a panacea for the performance of exports.

The NBP has started its easing cycle as expected

The National Bank of Poland met expectations and cut its base interest rate by 25 bps; however, what surprised markets was Governor Belka's dovish tenor at the press conference. He stated that, given the deceleration of the Polish economy, another rate cut was likely and might take place in December. The Governor's statement should not be underestimated, and if November's data indicates a further deterioration of the performance of the Polish economy, rates may be cut again at December's meeting. In that event, rates are likely to be cut one more time, in early 2013 (to the final 4%), vis-à-vis our baseline scenario. Yet the market currently bets on a much more aggressive easing of the monetary policy – by an additional more than 100 bps within the next 6-9 months.

FRA, weekly change



PL: government bond yields, 10Y

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.4	1.44%	↗	↗
EUR/HUF	284	-0.32%	↗	↗
EUR/PLN	4.17	0.92%	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.44	-4.00	→	→
10Y HUF	6.12	-4.15	↗	↗
10Y PLN	3.99	-9.64	→	→

In Focus:CE leading indicators deteriorate

Polish Flash confirms that the economy is likely to decelerate within next 3-4 months

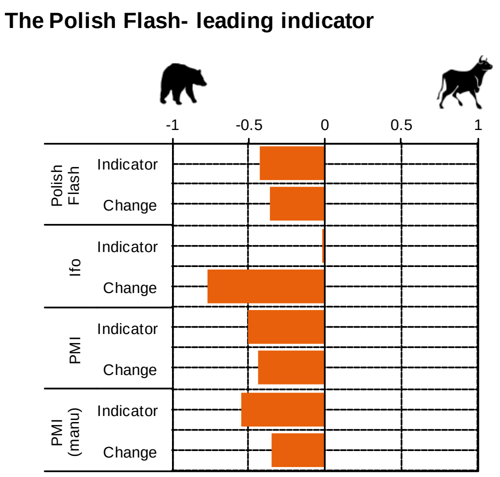
October's first estimate of the Polish Flash (leading indicator for the, Polish economy) fell to its lowest levels since August 2009, with all of its components having dropped again (for an eighth consecutive month). While the drop in certain components of the Flash is easing (the PMI and the PMI production sub-index), this is mainly because these components have already reached very low levels. By and large, the Flash confirms that the Polish economy is likely to continue to decelerate within the next three to four months, and thus monetary easing should stay on the table.

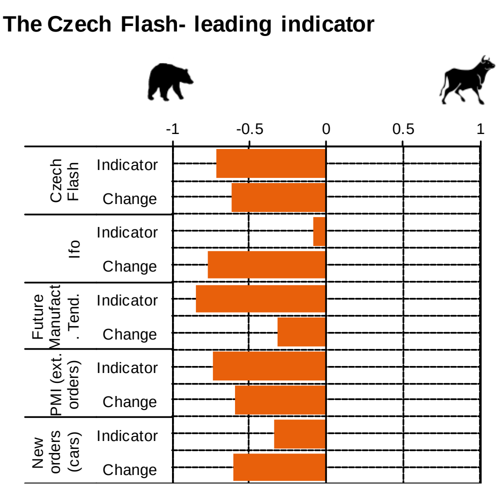
The Czech Flash points to ongoing recession

The first October estimate of a leading indicator for the Czech economy, the Czech Flash, is signalling nothing good for the end of the year. The Flash has fallen continuously since the beginning of the year, for ten consecutive months. Thus it has dropped to the lowest levels since 2009.

The Czech Flash is also falling across all of its components, and this boosts its negative signal for the next 3 months. The Future manufacturing tendency (according to OECD) and external orders (sub-index of PMI), are particularly low. New orders for cars and the German business sentiment index Ifo are not that low vis-à-vis their historical values.

The only positive aspect of the Czech Flash is a milder rate of decline, which has been decelerating for four consecutive months. This is also evident across all components of the Flash, except external orders; however, it reflects similarly to Poland already depressed levels of several components of the Flash. By and large, October's Czech Flash confirms that the Czech economy stands a poor chance of emerging from the recession before the beginning of next year





**Indicator: the level of the indicator vis-à-vis historical values*
***Change: the change in the indicator vis-à-vis historical values (1 = the current value is the maximum historical value; -1 = the current value is the minimum historical value)*

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Weekly preview

Headline inflation is heading south in Poland

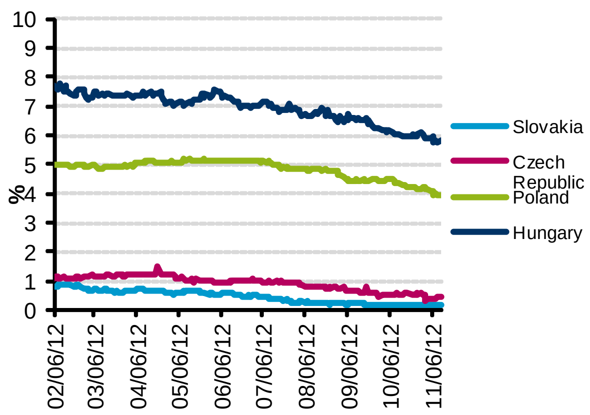
Year-on-year inflation in Poland fell significantly in October and hit its lowest level since December 2010, according to our forecasts; however, an increase in the comparative baseline had a crucial impact on that decline. Prices went up by 0.7% m/m in October last year, while we believe that this year’s rise was approximately half that value (+0.4% m/m). Food prices probably rose slightly less than usual for this season of the year, as did clothing and shoe prices, where, surprisingly, the rise already was very low in the previous month.

Calendar

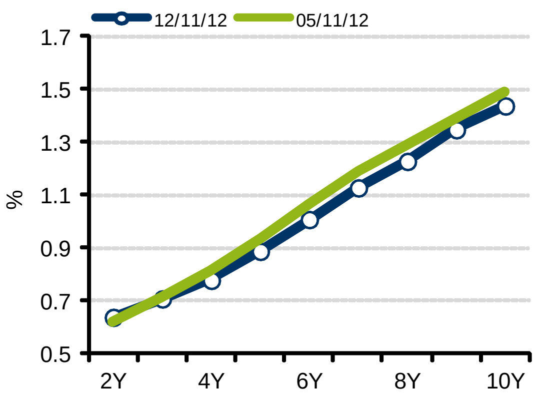
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	11/12/2012	10:00	Current account	CZK B	09/2012	-2		-7.6		-26.59	
PL	11/12/2012	14:00	Current account	EUR M	09/2012			-784		-633	
PL	11/12/2012	14:00	Trade balance	EUR M	09/2012			3		-48	
HU	11/13/2012	9:00	CPI	%	10/2012			0.4	6.3	0.4	6.6
PL	11/14/2012	14:00	CPI	%	10/2012	0.4	3.5	0.4	3.4	0.1	3.8
PL	11/14/2012	14:00	Money supply M3	%	10/2012			0.4		-0.3	
CZ	11/15/2012	9:00	GDP	%	3Q/2012 *P			-0.1	-1.2	-0.2	-1
CZ	11/15/2012	9:00	PPI	%	10/2012	-0.1	1.7	0	1.7	0	1.7
HU	11/15/2012	9:00	GDP	%	3Q/2012 *P			-0.3	-1.3	-0.2	-1.3
PL	11/15/2012	15:00	Budget balance	PLN M	10/2012					-21122	
HU	11/16/2012	9:00	Industrial output	%	09/2012 *F					0.6	0.7

Fixed-income in Charts

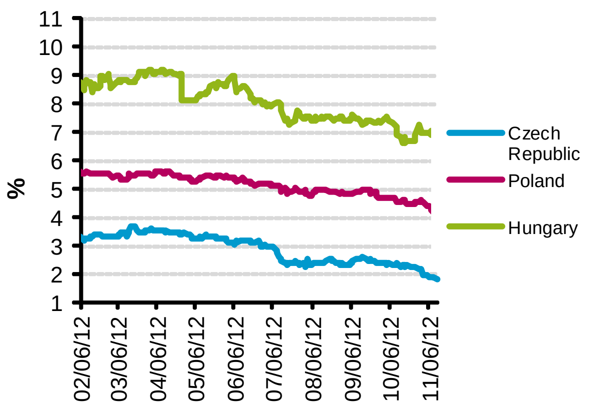
FRA 3x6



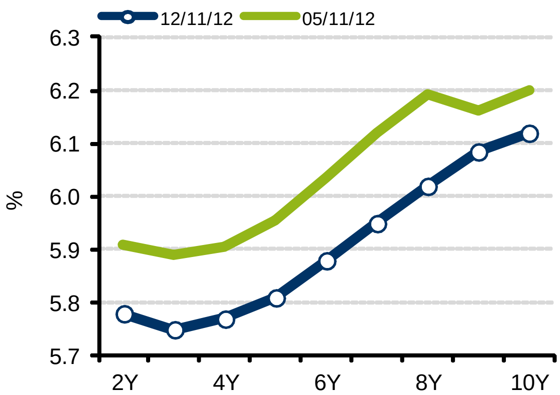
CZ IRS



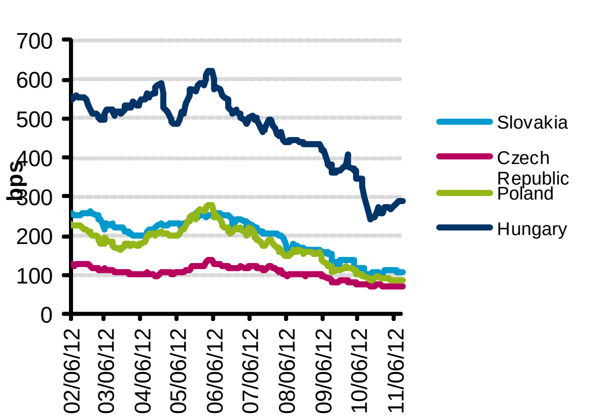
10Y GB Yields



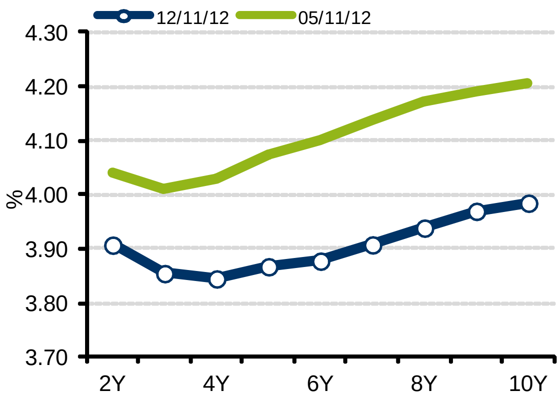
HU IRS



CDS 5Y



PL IRS



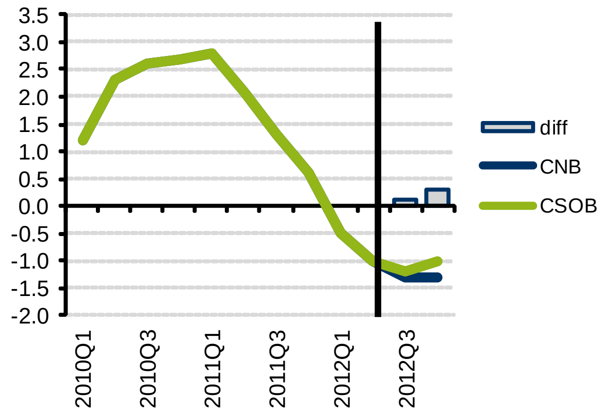
Source: Reuters

Medium-term Views & Issues

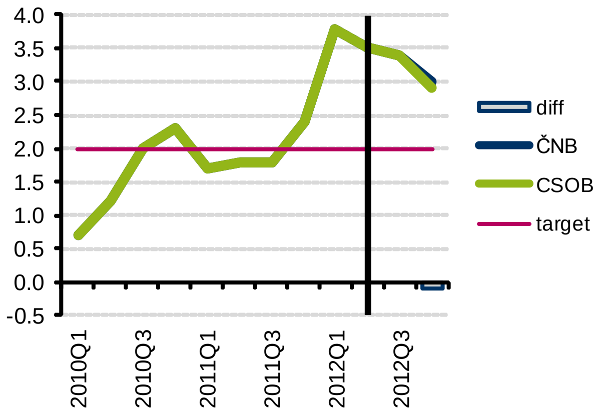
	The Czech Republic	Hungary	Poland
Growth & key issues	September's rapid drop in industrial output (-7.1% y/y) is primarily due to a lower number of business days and to weakening demand. This time, the greatest decline was generated by carmakers (-11.1%), which had been up until now the primary drivers of industry as a whole, exports and also GDP. The figures from industry are not pleasant, even if we look at the statistics of new orders, which fell by 5.2%.	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	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.	The NBH will probably continue to gradually ease its policy despite unfavourable 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. In a response, the National Bank of Poland decreased its interest rates by 25 basis points in November and significantly cut its estimates for GDP growth and inflation. We believe that this warrants further monetary easing which might take place as early as at December's meeting.
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

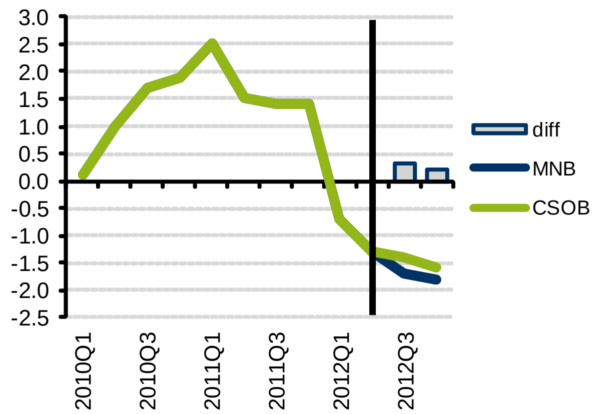
CZ: GDP outlook (Y/Y, %)



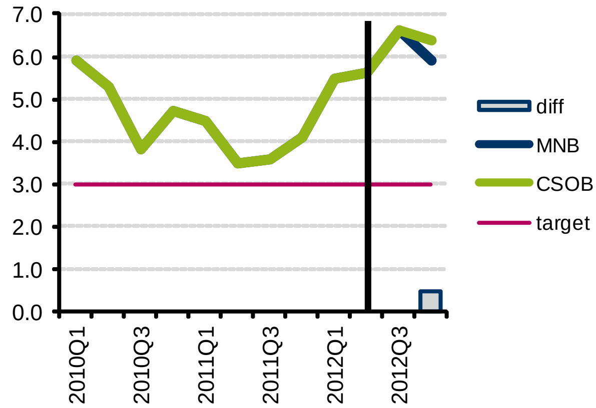
CZ: Inflation outlook (Y/Y, %)



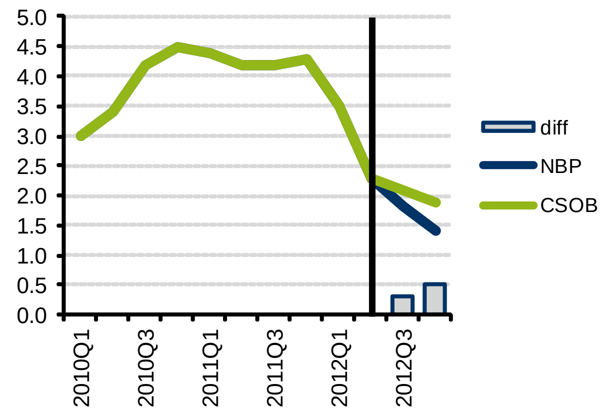
HU: GDP outlook (Y/Y, %)



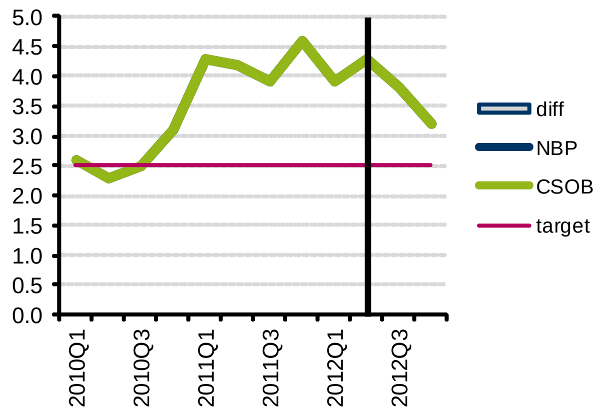
HU: Inflation outlook (Y/Y, %)



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	*4.50*	4.50	4.75	4.75	4.50	4.50	25 bps	11/7/2012

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

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	PRIBOR	*0.53*	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	*4.65*	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	*1.44*	2.25	2.02	1.61	1.70	1.80
Hungary	HU10Y	*6.12*	7.36	6.71	6.56	7.50	7.25
Poland	PL10Y	*3.99*	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	*25.4*	24.8	25.5	25.1	25.0	24.5
Hungary	EUR/HUF	*284*	294	286	285	290	280
Poland	EUR/PLN	*4.17*	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	-1.4	-1.6
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	6.4	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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