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Central European Weekly

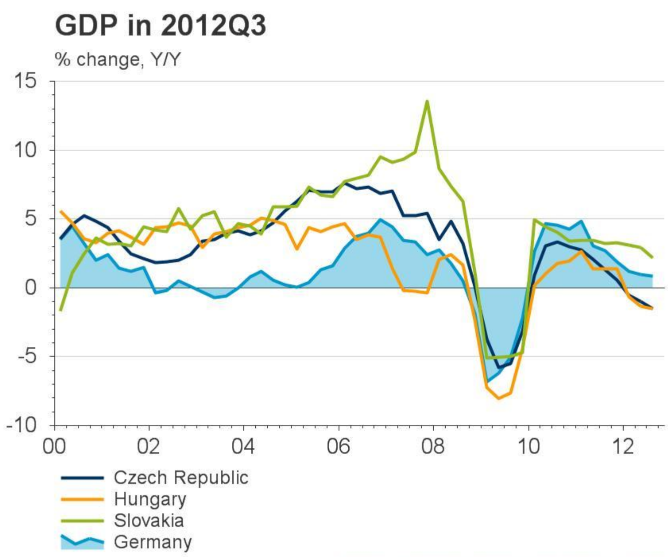
Monday, 19 November 2012

Table of contents

Weekly Highlights:

- The koruna fears interventions
- The longest recession of the Czech economy
- Not only the Czech Republic but also Hungary experiences a double bottom scenario
- The Slovak economy decelerates. Employment falls

Chart of the Week



Source: Thomson Reuters Datastream/Fathom Consulting

Economic growth in Central Europe slowed down in the third quarter...

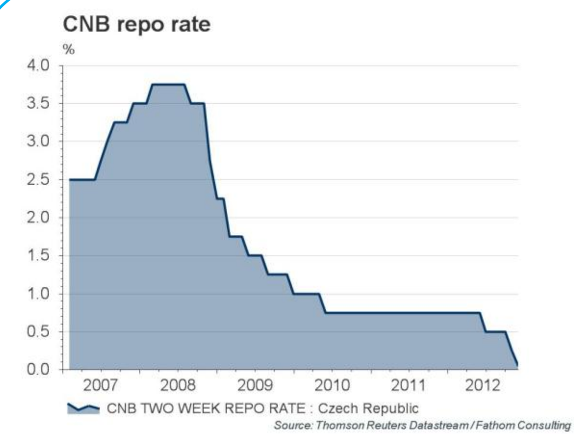
Market's editorial

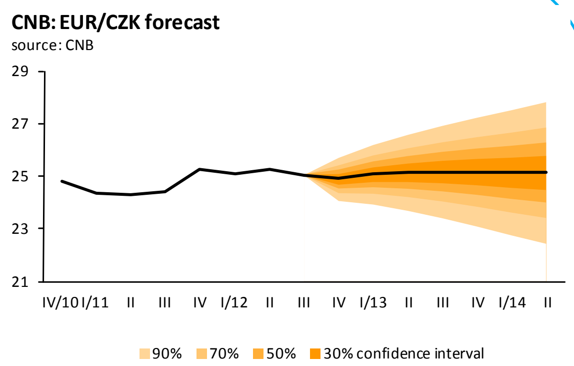
The koruna fears interventions

Markets believe that the poor GDP figure for the third quarter of the year and the latest comments by Governor Singer have increased the risk of potential interventions against the koruna. This clearly nudged the Czech currency to weaker levels, and the koruna settled at around CZK 25.00 per EUR.

Nevertheless, we believe that interventions are still likely at much stronger levels. Even though the fear of interventions, notably by foreign traders, significantly changed London's attitude to the koruna, we believe that interventions against the koruna are not really in the cards for the next while. Above all, Governor Singer spoke of needing to ease the monetary policy again, no sooner than the middle of 2013. In that event, the Czech National Bank envisages a decline in PRIBOR from today's approximately 0.5% to 0.2%. With base rates at technical zero (0.05%), it is not really all that easy for the CNB to continue to push market rates further downwards, and the weakened koruna supports that argument. However, we can hardly bet on interventions now that the koruna is 1% weaker than the forecast and market rates will not start to diverge from the forecast until the second quarter of 2013.

Moreover, a switch from verbal to actual interventions may not at all be easy in practice either. Verbal statements do not cost the CNB much; however, defining, at least for its internal needs, a reasonable strategy of forex interventions, which would not smell of switching to a fixed exchange rate, will not be easy. This is why we believe that actual interventions would not be considered until the koruna starts to leave the 70-90% reliability ranges of the CNB forecast – i.e., close to CZK 24.50 per EUR.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.5	0.57%	→	→
EUR/HUF	284	-0.12%	→	→
EUR/PLN	4.15	-0.50%	→	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.43	-1.99	→	→
10Y HUF	5.98	-2.29	→	↘
10Y PLN	4.00	0.25	→	↘

Review of Economic Figures

The longest recession of the Czech economy - the downturn of the Czech economy persists and even accelerates.

Not even the third quarter saw an improvement of the situation in the Czech economy. The GDP fell by 0.3% q/q and a huge 1.5% y/y. Poor domestic demand was again responsible for another decline in the economy. Although we do not know the details, it is evident that the trends of the first half of the year persist, i.e., households continue to cut their expenses, while businesses are not eager to invest. Compared to the Czech Republic's main trading partner – Germany – the Czech economy finds itself in a much worse position. Germany remains in the black, whereas the Czech economy has been in a recession for a year; this time, due to a drop in domestic rather than foreign demand. While the current recession is less severe than the previous one (2009), it has already been longer, and no signs of a change for the better are anywhere to be seen. In addition, industry – the main driver of the Czech economy – is running out of steam, while new orders in industry and construction do not indicate an improvement for the end of this year either, particularly now that the situation in almost the entire European economy is starting to deteriorate significantly.

Even a worse figure than expected by the CNB

The latest data from the Czech economy looks much worse than expected by the CNB's latest forecast. The central bank predicted a GDP fall of only 0.8% in the third quarter, but the actual fall was almost double that figure (-1.5%). The strongly curbed lower domestic demand is boosting the downside inflation risks to the forecast and just confirms the expectations that the period of record-low interest rates is likely to persist beyond 2013. The CNB has basically exhausted its interest rate potential, and thus it can only react to the increasing downside risks to inflation through the exchange rate. It is no coincidence that the CNB is starting to focus its statements on that. Yet we believe that it is too early to consider forex interventions, given the current exchange rate of the koruna. The koruna remains close to CZK 25.50 per EUR, i.e., CZK 0.60 above the central bank forecast for the last quarter of this year. This is why we expect that the CNB will not pay more attention to the koruna until the Czech currency 'diverges' from the forecast and rapidly heads towards less than CZK 24.50 per EUR.

Not only the Czech Republic but also Hungary experiences a double bottom scenario

The Hungarian economy, just like the Czech one, performed very poorly, when its GDP growth in the third quarter dropped by 0.2% q/q and 1.6% y/y. Although this growth was strongly affected by the summer crop failure, the fall continues to be primarily driven by the persisting fall in domestic demand, which is due to the fairly strict budgetary policy and still fairly strict credit policy of the domestic banking sector. Not even the good foreign trade figures are evidently able to counterbalance the drop in domestic demand. September's poorer data on industrial production, which is mostly exported (a drop by 3.8% y/y), signals that the contribution of foreign trade to growth may even be lower within the rest of the year.

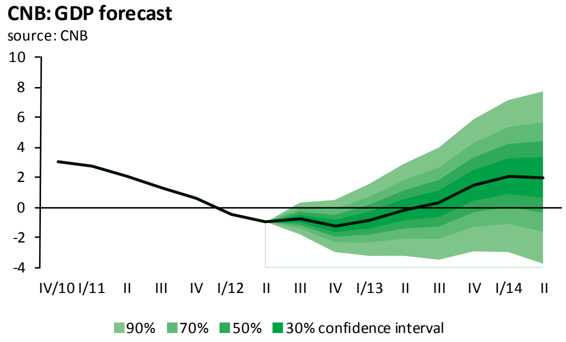
The Slovak economy decelerates. Employment falls

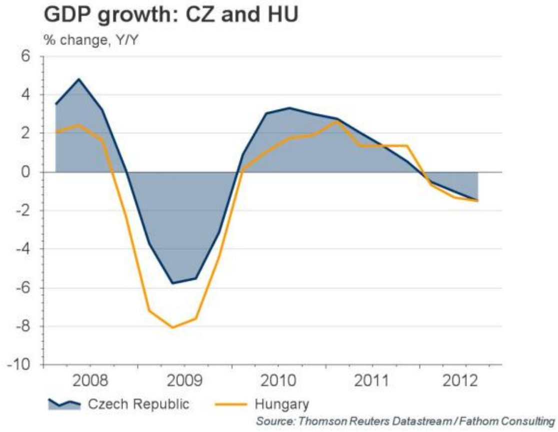
In accordance with expectations, Slovakia's economic growth is gradually decelerating. According to preliminary figures, the economy grew by 2.2% y/y in Q3, as opposed to its growth rate of 2.6% in Q2, and 2.9% in Q1. The deceleration is likely due to the cooling of the economies of Slovakia's trading partners; the German economy decelerated from 1.0% to 0.9% in the third quarter, while the Czech economy remained in a recession.

The economic deceleration is now clearly having a greater impact on employment. While the increase in the number of jobs had been tending to decelerate, now the labour market is starting to stagnate or even decline. Seasonally unadjusted employment has fallen by 0.1% y/y.

The economic growth structure will not be published until early December, and thus we can only speculate as to what was responsible for the released data; nevertheless, growth is still likely driven by foreign trade and, as concerns industry, notably by carmakers. Given the employment and inflation developments, we can expect that consumption was again under pressure. The economy is likely to continue to decelerate. For 2013, we anticipate growth of around 2.0%, primarily based on external demand; however, if it continues to decelerate dramatically, such a forecast may be too optimistic. Basically, everything currently depends on the performance of Slovakia's trading partners, notably Germany, and domestic carmakers, which have been surprisingly resistant to the deterioration of external conditions thus far.

Slovak Prime Minister Fico estimated the 2013 economic growth at 1.0-2.0%. This is less than the official forecast by the Ministry of Finance (2.0%), which was, however, made in mid-September. Fico also confirmed the intention to cut the government deficit to 2.9% of GDP. However, the recently published autumn forecast by the European Commission only envisages a reduction to 3.2% of GDP.


CNB: GDP forecast
source: CNB
10
8
6
4
2
0
-2
-4
IV/10 I/11 II III IV I/12 II III IV I/13 II III IV I/14 II
90% 70% 50% 30% confidence interval

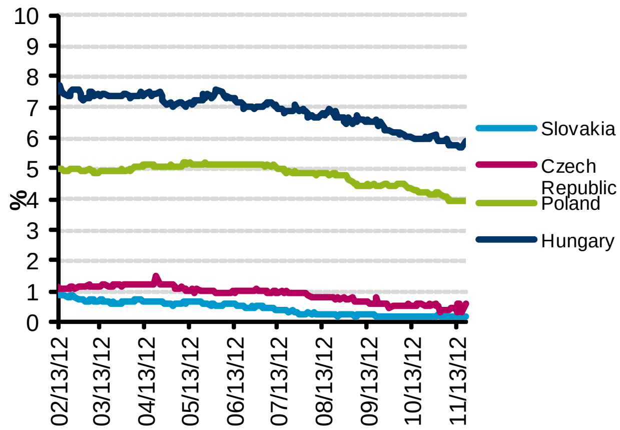

GDP growth: CZ and HU
% change, Y/Y
6
4
2
0
-2
-4
-6
-8
-10
2008 2009 2010 2011 2012
Czech Republic
Hungary
Source: Thomson Reuters Datastream / Fathom Consulting

Calendar

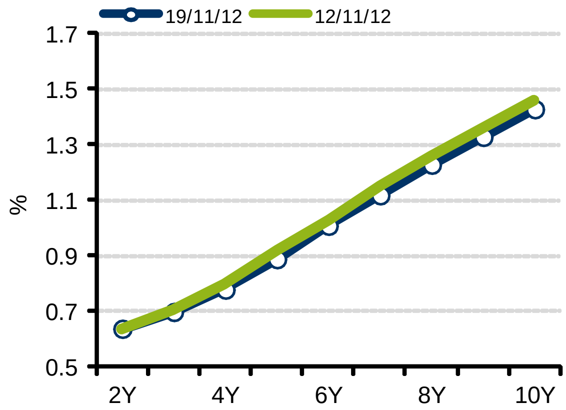
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	11/19/2012	14:00	Wages	%	10/2012			1.7	2.4	-1.2	1.6
HU	11/20/2012	9:00	Wages	%, ytd.	09/2012				4.6		3.8
PL	11/20/2012	14:00	Industrial output	%	10/2012			4.1	2.9	6.1	-5.2
PL	11/20/2012	14:00	PPI	%	10/2012			0	1.5	0.5	1.8
PL	11/21/2012	14:00	Core CPI	%	10/2012			0.2	1.8	0	1.9

Fixed-income in Charts

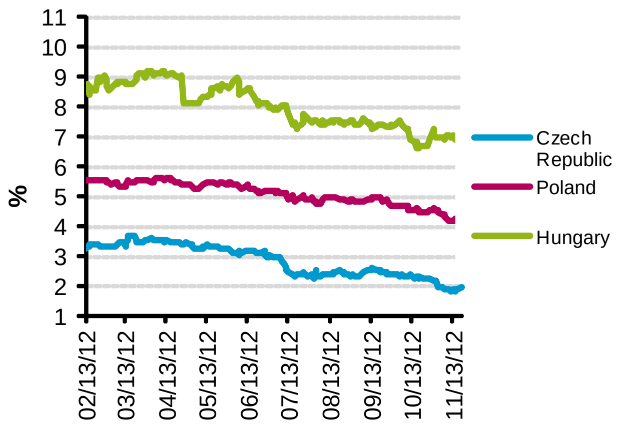
FRA 3x6



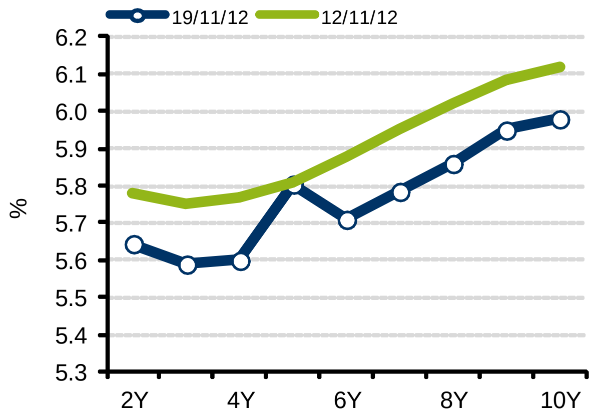
CZ IRS



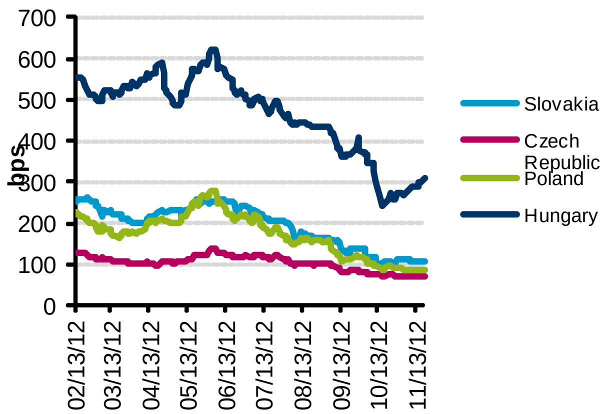
10Y GB Yields



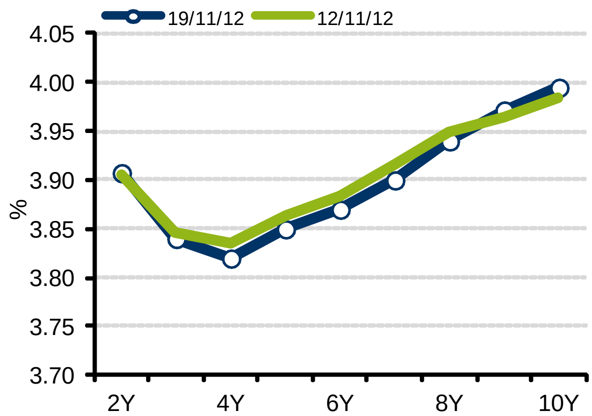
HU IRS



CDS 5Y



PL IRS



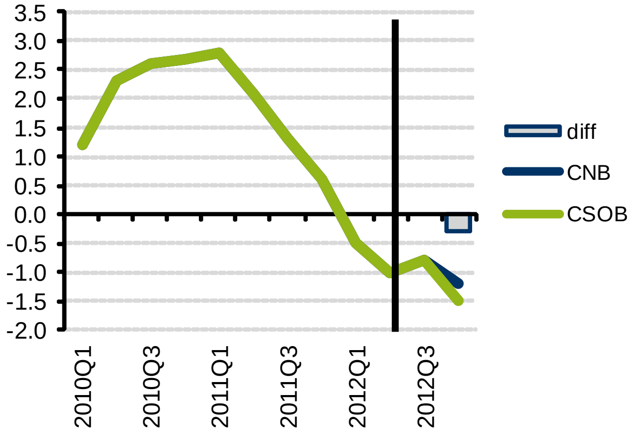
Source: Reuters

Medium-term Views & Issues

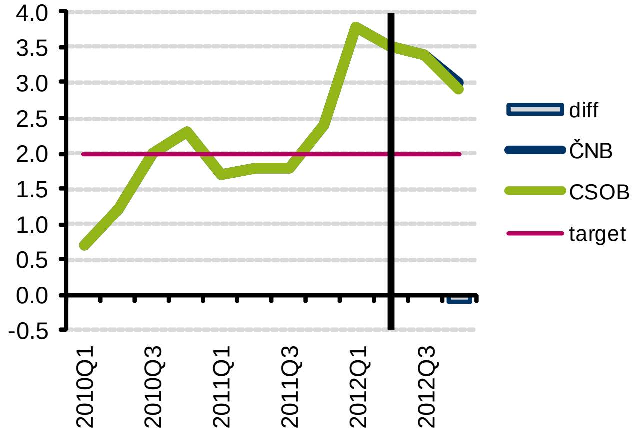
	The Czech Republic	Hungary	Poland
Growth & key issues	September's rapid drop in industrial output (-7.1% y/y) is primarily due to a lower number of business days and to weakening demand. This time, the greatest decline was generated by carmakers (-11.1%), which had been up until now the primary drivers 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

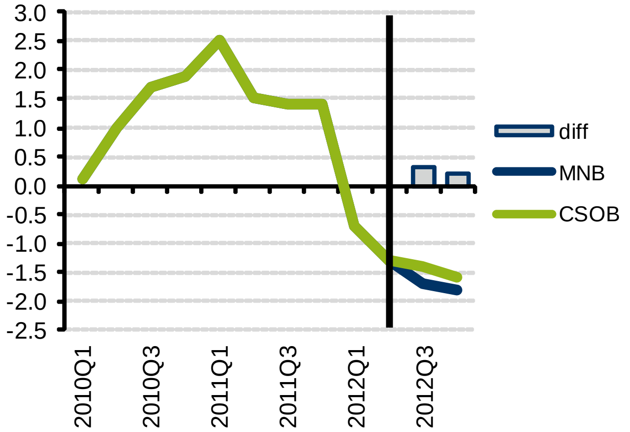
CZ: GDP outlook (Y/Y, %)



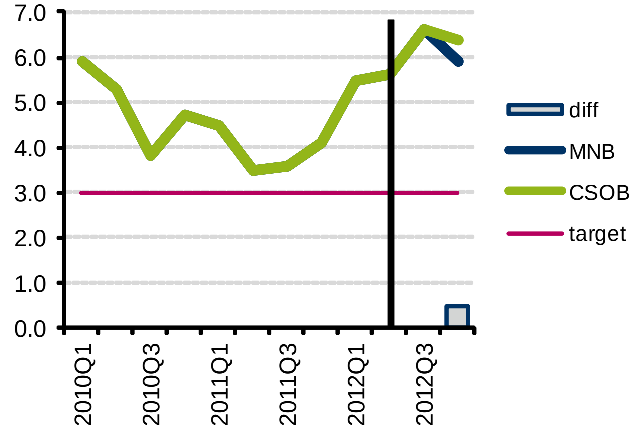
CZ: Inflation outlook (Y/Y, %)



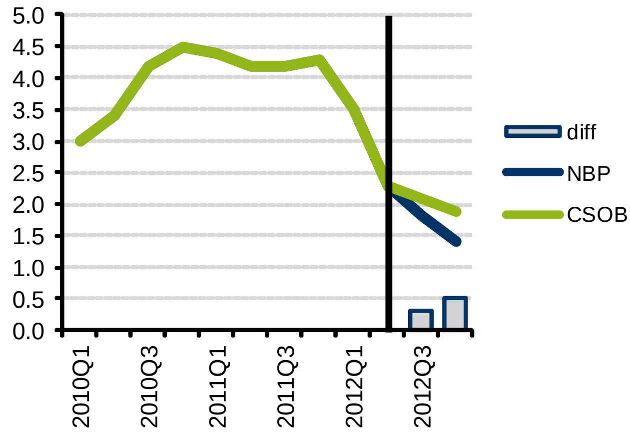
HU: GDP outlook (Y/Y, %)



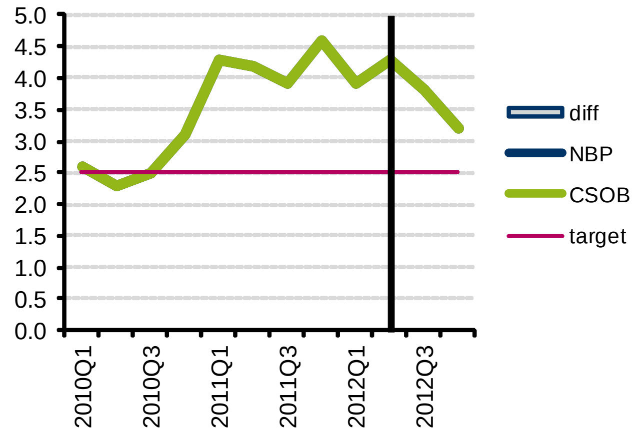
HU: Inflation outlook (Y/Y, %)



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	0.05	0.05	-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	*0.52*	1.28	1.03	0.80	0.50	0.50
Hungary	BUBOR	*6.28*	7.25	7.20	6.61	6.50	6.40
Poland	WIBOR	*4.64*	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	*1.431*	2.25	2.02	1.61	1.50	1.60
Hungary	HU10Y	*5.98*	7.36	6.71	6.56	7.50	7.25
Poland	PL10Y	*4.00*	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	*25.5*	24.8	25.5	25.1	25.0	24.5
Hungary	EUR/HUF	*284*	294	286	285	290	280
Poland	EUR/PLN	*4.15*	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	-0.8	-1.5
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	3.0
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.	-1.7	-1.9
Hungary	1.5	1.0
Poland	-4.0	-3.8

Public finance balance as % of GDP

	2012	2013
Czech Rep.	-3.3	-3.0
Hungary	-2.5	-2.2
Poland	-3.5	-4.0

Source: CSOB, Bloomberg

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