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KBC

Central European Weekly

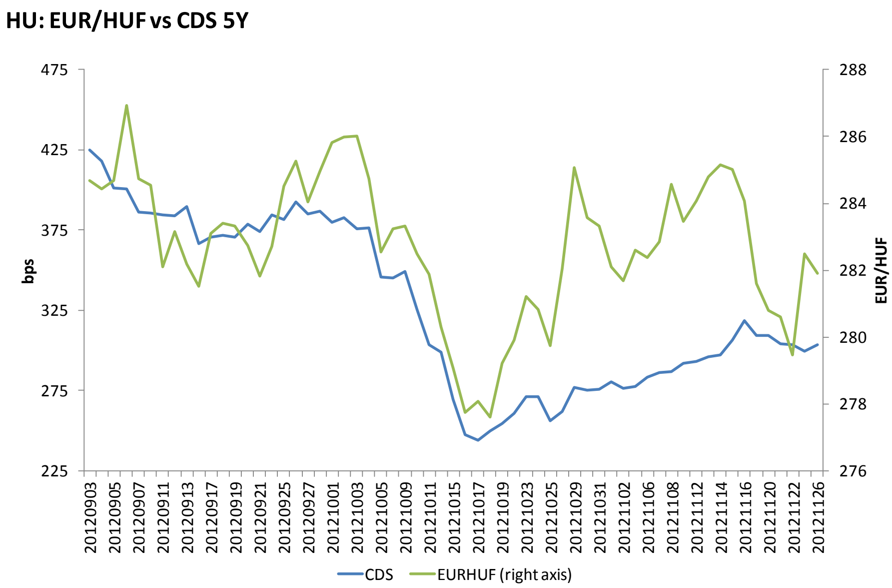
Monday, 26 November 2012

Table of contents

Weekly Highlights:

- The NBH ready to cut again, despite S&P's rating cut
- Dovish voices become stronger inside the Polish MPC – so, the December rate cut is more likely
- Weekly preview: The Polish GDP growth below 2% for the first time in 3 years

Chart of the Week



S&P agency lowered Hungary's rating deeper in to the speculative territory. The negative rating action, however, only follows markets as there already had been some deterioration in Hungary's sovereign risk premium. See the CDS in the chart above...

Market's editorial

After a fairly uneventful week, last week, in the Central European region, when only Poland's macroeconomic data was worthy of attention, this week may be more attractive. It might be pepped up by the meeting of the National Bank of Hungary and the release of Poland's GDP figure for the third quarter of this year.

The NBH ready to cut again, despite S&P's rating cut

As concerns the NBH meeting – it is evident that the base rate is going to be cut again by 25 basis points. The stable forint, the inflation fall, and particularly the clear predominance of doves on the NBH Monetary Council, should make another monetary easing possible. The policy will be eased, even though Hungary's sovereign risk premium went up slightly (by approximately 50 bps for Hungary's CDS). This move had happened even before Standard & Poor's downgraded Hungary's credit rating to 'BB' from 'BB+'. Since we believe that S&P downgrade rationale (unorthodox policies and uncertainty about medium-term growth potential) has been already priced we think that the S&P rating action will not change either market sentiment or NBH's readiness for a rate cut.

Weaker economy makes dovish voices within the Polish MPC stronger, so a 25 rate cut in December is likely

Another interesting event in the region will be Poland's GDP figure for the third quarter of the year. Even Poland, which always reports its economic growth data slightly later than the other countries in the region, will show a poorer GDP figure. While Poland's GDP growth, unlike that of the Czech Republic and Hungary, remains in the black, the data for the third quarter signals that the year-on-year growth of the Polish economy dropped to as low as 1.8% for that period. This would be the worst figure in the last 3 years.

Thu it is not surprising that members of the Monetary Policy Council (MPC) are also aware of the less than ideal prospects for the Polish economy (which are, however, still outstanding in the European context). Although opinions within the ten-member Council are diverse, most MPC members agree on the need for additional monetary easing, according to the minutes of the last meeting. In spite of households' inflation expectations, which are still fairly high (3.8% for the next twelve months, as at October), inflation is expected to fall below the central bank target in the medium term, due to declining pressures for wage growth, and this requires another rate cut, according to the MPC's majority opinion. The tenor of recent comments by individual MPC members has been similar. Even the sworn hawks, Winiecki and Kazmierczak, see latitude for cutting rates to lower levels, albeit both are warning of a rapid pace of monetary easing and arguing that real interest rates should remain positive. Anna Zielinska-Glebocka, who we see as a median voter within the MPC, said that she could imagine rate cuts by an additional 50-75 bps.

As the opinions within the MPC are not at all uniform, we still do not expect any dramatic pace of monetary easing in the months to come. Bear in mind that at the December meeting, when rates are most likely to be cut by 25 basis points, the GDP growth data for the third quarter (we predict 1.8% y/y) will be available to the MPC, and this data will probably hint at many of the further steps to be taken by the National Bank of Poland.

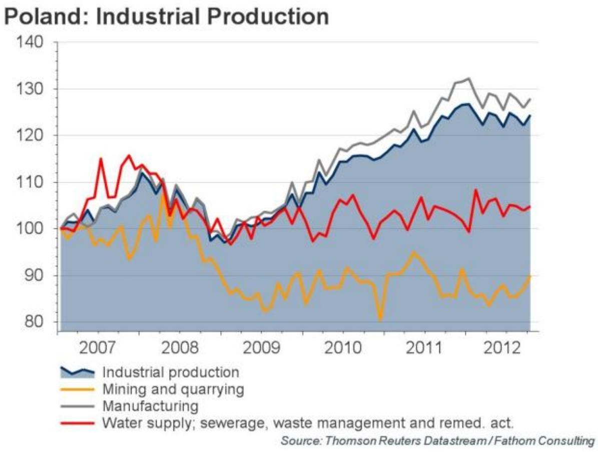
	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.3	-0.07%	↘	↗
EUR/HUF	282	0.03%	↘	↗
EUR/PLN	4.12	-0.11%	↘	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.50	4.47	→	→
10Y HUF	6.02	1.52	↘	↗
10Y PLN	4.04	0.88	↘	↘

Review of Economic Figures

The Polish industry took a breather

The data on Poland's industrial output for October sprang a pleasant surprise, which was, however, rather apparent, when we look at the data more closely. While the output was up by 4.6% y/y, which was more than the market had foreseen (2.9%), the rise shrinks to only 0.6% when adjusted for the different number of working days in the month. In other words, the downturn in Polish industry is likely to persist, and this, along with a decelerating increase in consumption and declining investment, means that Poland's economic growth within the rest of the year is likely to be at the levels last seen in 2009.



Weekly preview

TUE 14:00 **MNB base rate**

	This meeting	Last change
rate level (in %)	**6.00**	10/2012
change in bps	**-25**	-25

THU 10:00 **PL GDP (y/y change in %)**

	2012Q3	2012Q2	2011Q3
GDP	**1.8**	2.4	4.1

HU: The NBH to cut rates again

The National Bank of Hungary is again about to cut its base rate by 25 basis points at its meeting. The stable forint, the inflation fall, and particularly the clear predominance of doves on the NBH Monetary council, should make another monetary easing possible. The policy will be probably eased, even though Hungary's sovereign risk premium went up slightly (by approximately 50 bps for 5Y Hungary's CDS).

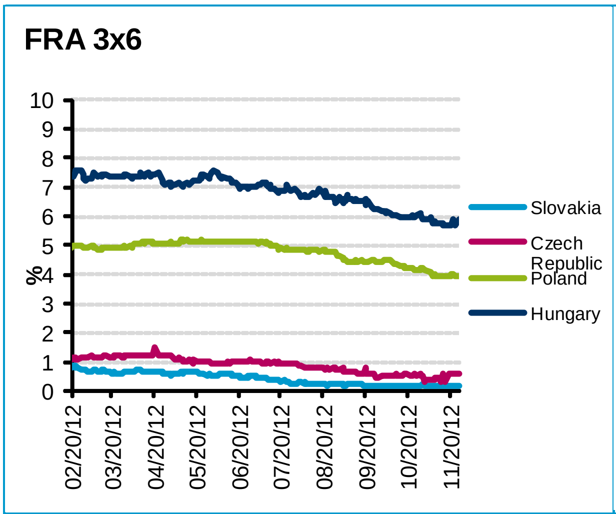
PL: Growth below 2% for the first time in 3 years

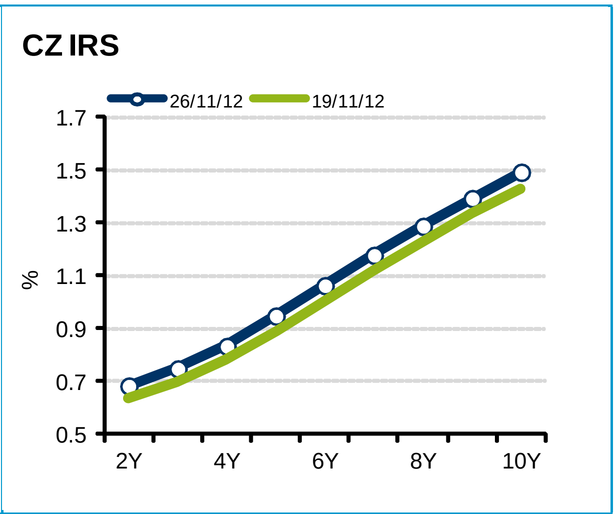
The Q3 data indicates that the year-on-year growth of the Polish economy dropped to 1.8% for that period, the lowest figure in the last three years. The moderate employment increase that occurred in the first half of the year is gone and, through the declining real income, this affected retail sales, which were up by less than 1.5% y/y in real terms, and consequently consumption. The construction downturn certainly had an adverse effect on investment. Thus notably net exports should continue to be the primary positive factor in the third quarter.

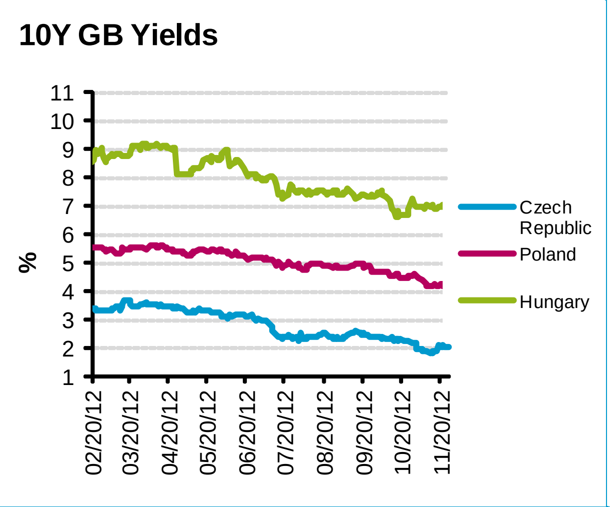
Calendar

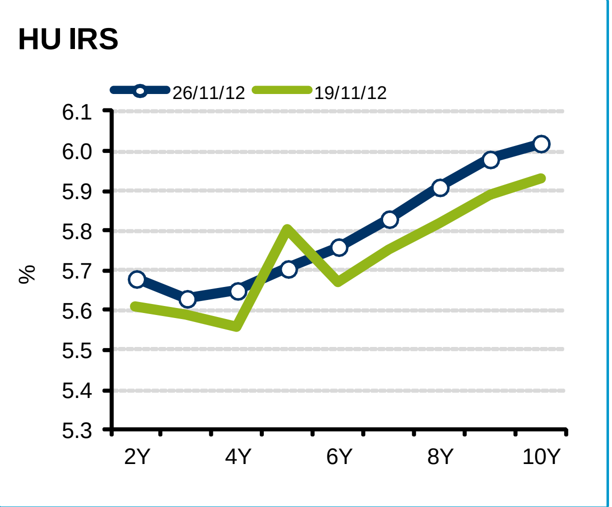
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	11/26/2012	9:00	Retail sales	%	09/2012				-2.3		-2.4
HU	11/27/2012	14:00	NBH meeting	%	11/2012			6		6.25	
HU	11/28/2012	9:00	Unemployment rate	%	10/2012			10.5		10.4	
PL	11/28/2012	10:00	Retail sales	%	10/2012			4.6	3.6	-1.3	3.1
PL	11/28/2012	10:00	Unemployment rate	%	10/2012			12.5		12.4	
HU	11/30/2012	9:00	PPI	%	10/2012				0.5	0.8	2.5
HU	11/30/2012	9:00	Trade balance	EUR M	09/2012 *F					739.1	
PL	11/30/2012	10:00	GDP	%	3Q/2012		1.8	0.1	1.8	0.4	2.4
CZ	11/30/2012	11:00	Money supply M2	%	10/2012						5.4

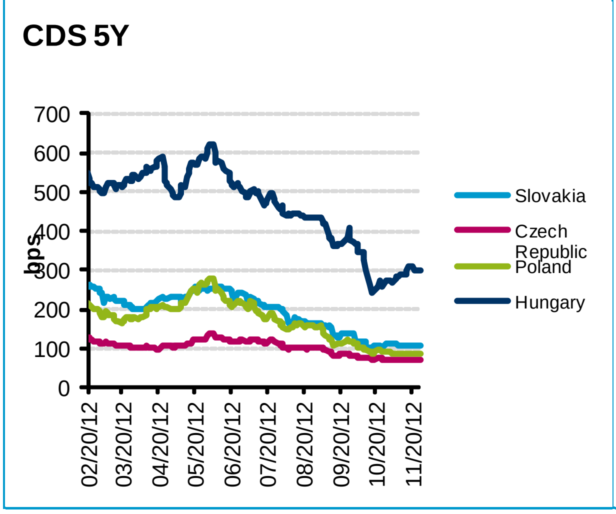
Fixed-income in Charts

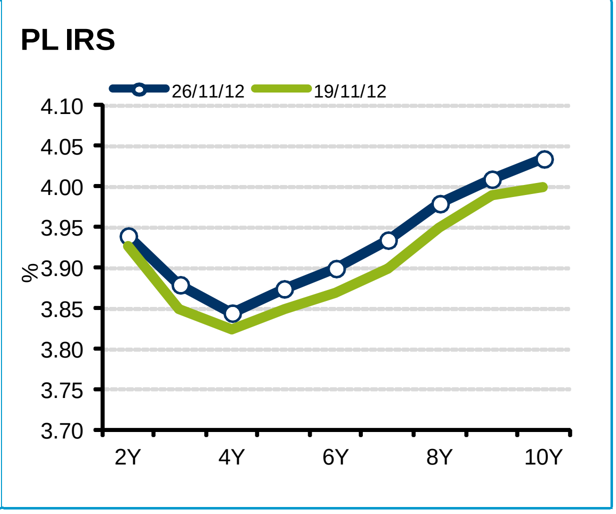












Source: Reuters

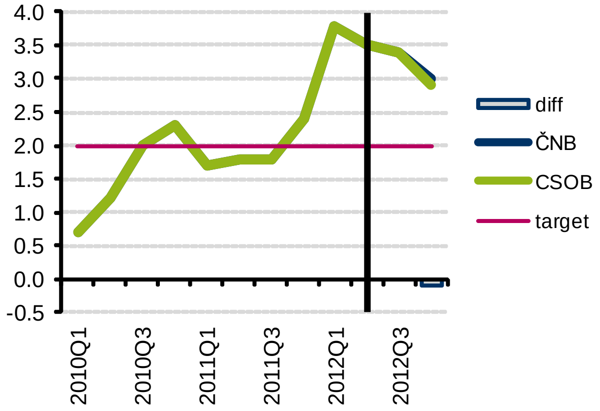
Medium-term Views & Issues

	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.

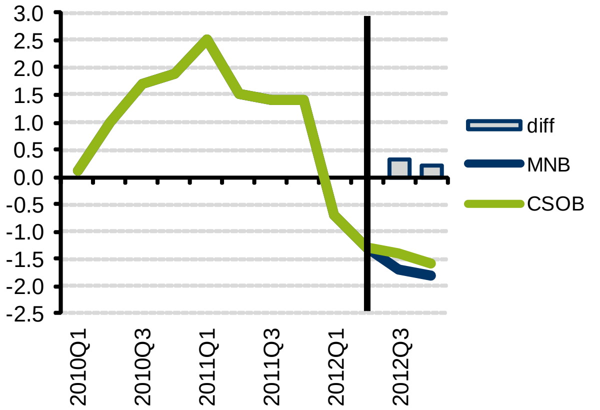
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

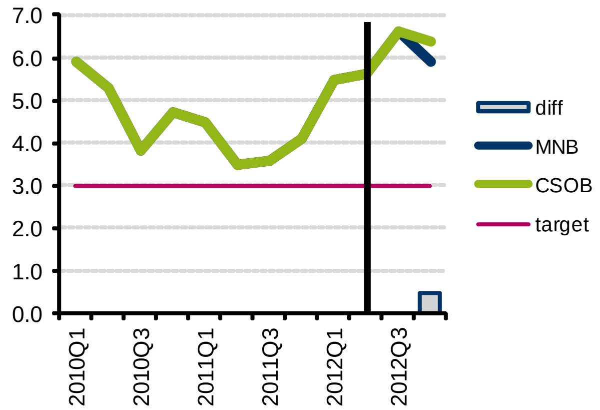
CZ: Inflation outlook (Y/Y, %)



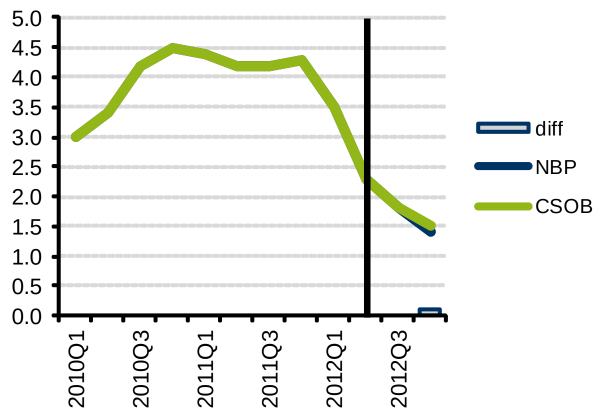
HU: GDP outlook (Y/Y, %)



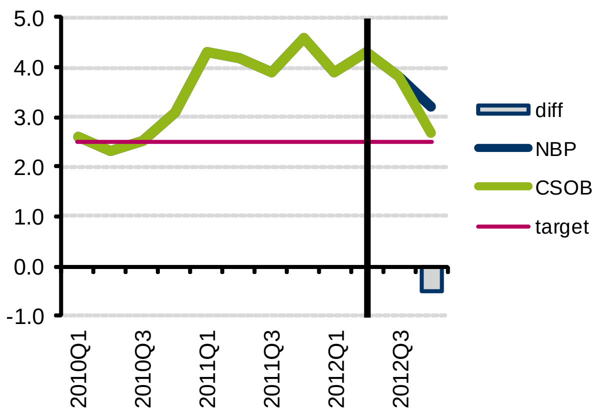
HU: Inflation outlook (Y/Y, %)



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	*6.26*	7.25	7.20	6.61	6.50	6.40
Poland	WIBOR	*4.6*	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	*1.495*	2.25	2.02	1.61	1.60	1.60
Hungary	HU10Y	*6.02*	7.36	6.71	6.56	7.50	7.25
Poland	PL10Y	*4.04*	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	25.0	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	-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	1.8	1.5

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	2.7	2.3

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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