



Central European Weekly

Monday, 03 December 2012

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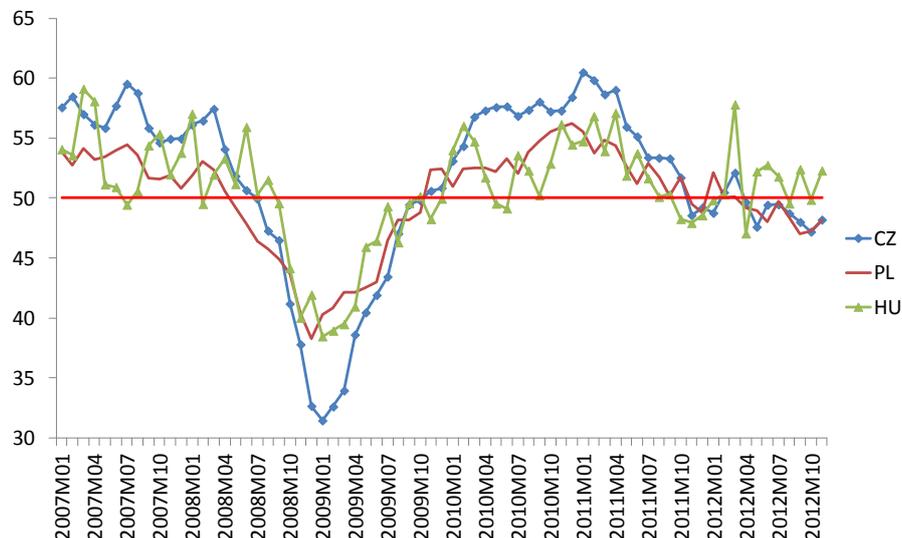
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Weekly Highlights:

- The Polish GDP weaker-than-expected
- In Focus: Updated outlook for the EUR/CZK
- The NBP is going to cut again. But how deep?

Chart of the Week

Central European PMI's



In November, sentiment among Central European manufacturers slightly improved. Still, Czech and Polish PMI remain below the key 50 points level.

Review of Economic Figures

The Polish PMI and GDP figures confirm slowdown

According to the Markit agency the Czech and Polish manufacturing sector remains in the recession zone or under the key 50 mark. However, the Polish PMI increased from 47.3 to 48.2 and was above the market consensus of 47.4 in November. The Czech PMI Manufacturing came out at the same level as in Poland i.e. 48.2 points. The Polish PMI index, which has been below the 50 mark, confirms the message sent by the GDP figures last week. On the other hand, Hungary was the only exception - the PMI indicator surprisingly rose above the 50-mark (from 49.9 to 52.3).

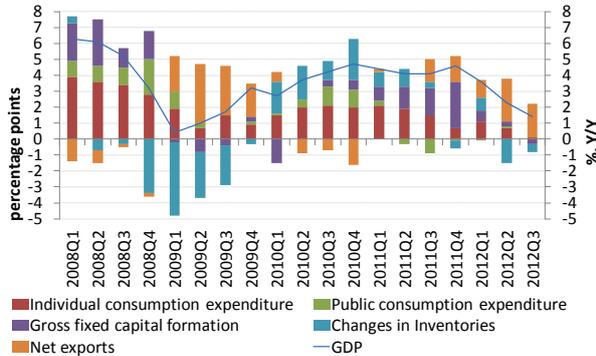
Looking back at the Polish GDP – figures – they showed a much stronger growth deceleration than both we and the market had expected. The GDP was up by 1.4% y/y (our forecast was 1.8%), and its structure sparked particular concern. While in the post-Lehman year of 2009, Poland could rely on the positive contributions from consumption (notably individual consumption) to growth, Friday's figures

are much more pessimistic in that regard, because the deceleration was primarily based on domestic consumption and investment.

Weak GDP figures open door for aggressive NBP's easing

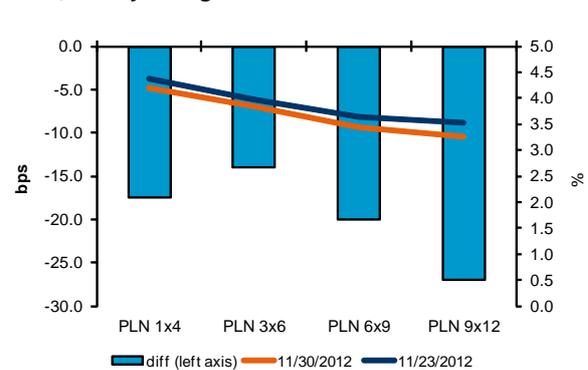
In our view, the weak GDP figures have strong implications for the upcoming two-day meeting of the National Bank of Poland. On Wednesday, The Polish MPC should cut rates by 25 basis points (bps), while we cannot completely rule out a more aggressive easing by 50 bps. The central bank's position on the latest GDP figures for the third quarter of the year will be even more interesting than the voting itself, as the deceleration of Poland's economic growth is greater than expected and primarily based on domestic consumption and investment. Therefore we believe that the market will eagerly await the press conference, where Governor Belka is likely to suggest further rate cuts.

PL: Contributions to GDP growth



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.3	-0.10%	→	↗
EUR/HUF	282	0.35%	→	↗
EUR/PLN	4.11	0.20%	↗	↗

FRA, weekly change



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.48	-0.40	→	→
10Y HUF	5.93	-1.00	→	↗
10Y PLN	3.85	-4.35	→	↘

In Focus: Update Outlook for EUR/CZK

The koruna will only strengthen slightly in 2013

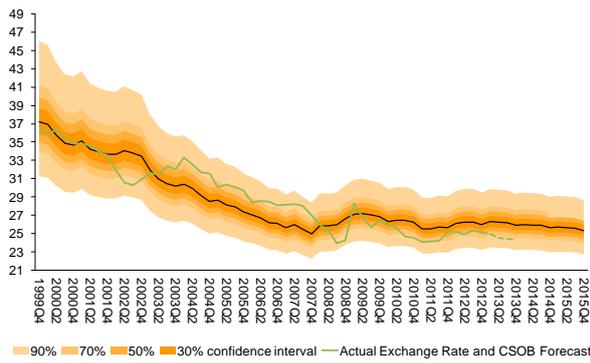
The Czech koruna has recovered slightly from its November depreciation, but nothing strongly positive for the Czech currency is going to happen in 2013. The bugbear of possible interventions by the Czech National Bank, in combination with the poor performance of the economy in the first half of the year, should prevent the Czech currency from strengthening to any great extent. We do not expect the koruna to appreciate greatly until the second half of 2013, when the bets on the start of real convergence may reoccur.

The long-term appreciation of the Czech koruna has been based on the Czech Republic catching up with the economies of its main trading partners in real terms, which has been accompanied, unlike in Poland and Hungary, by

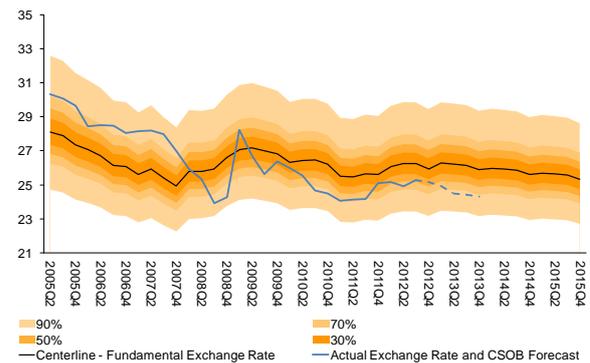
permanently low inflation. This combination is the breeding ground for the nominal appreciation of the Czech currency. However, the rate of real convergence significantly decelerated with the U.S. financial crisis (after the fall of Lehman Brothers – see the graph below).

In 2012, the Czech Republic is likely to fall at a faster rate than the eurozone, while next year we anticipate a positive zero. In addition, inflation in the Czech Republic will accelerate this year and next year (to more than the 3% target), and this is not a factor to encourage the koruna either (in fundamental terms). We now believe that the real convergence story can reoccur in 2014, but the pace is going to be significantly slower than before the crisis.

EUR/CZK, fundamental channel and CSOB forecasts



EUR/CZK, fundamental channel and CSOB forecasts



Weekly preview

WED 9:00 CZ Retail Sales (change in %)

	Oct-12	Sep-12	Oct-11
Sales	2.5	-3.3	1.1
cummulative (YTD)	-0.6	-0.9	2.0

CZ: Retail sales in the black, but only for a while

October's retail sales were likely in the black again, but this was due primarily to there having been three additional business days in the month, rather than to consumer appetite. New car sales also went up, and certainly influenced the retail sales figures. Nevertheless, consumers are still very reluctant and unable to spend money this year, and thus the trend of the record-breaking decline in household consumption persists. We believe that the last months of this year will be no exception to this trend.

WED 14:00 NBP rate (in %)

	This	Last change
rate level	4.25	11/2012
change in bps	-25	-25

PL: The NBP to cut rates by 25 bps

Our opinion is that the two-day meeting of the National Bank of Poland (NBP) will culminate with a decision on Wednesday to cut rates by 25 basis points (bps), and we cannot completely rule out a more aggressive easing by 50 bps either. The central bank's position on the latest GDP figures for the third quarter of the year will be even more interesting than the voting itself, as the deceleration of Poland's economic growth is greater than expected and primarily based on domestic consumption and investment. Therefore we believe that the market will eagerly await the press conference, where Governor Belka is likely to suggest further rate cuts.

FRI 9:00 CZ Foreign trade (CZK bn)

	Oct-12	Sep-12	Oct-11
Balance	40.0	31.6	32.2
cummulative (YTD)	278.0	237.8	165.6

CZ: Another huge trade surplus on the horizon

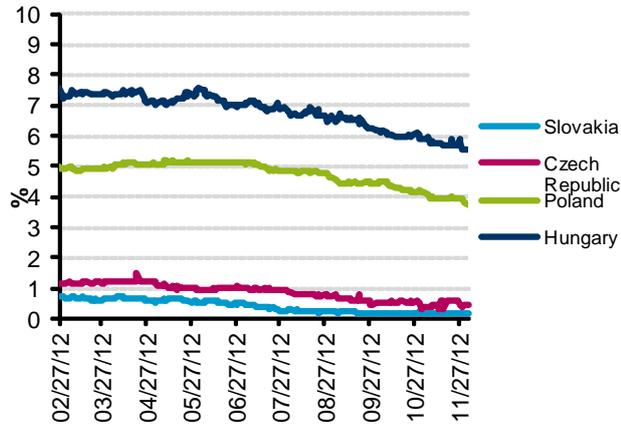
Although the downturn in industry and its orders has been quite evident in recent months, foreign trade stands a great chance of posting another very good figure. This should be primarily encouraged by the greater number of business days in the month and domestic demand, which is still subdued, thus reducing imports to the Czech Republic. In addition, carmakers probably continued to expand successfully into European and Asian markets, while electrical equipment manufacturers are also likely to show higher exports. The full-year foreign trade surplus will most likely set a new record of around CZK 300 bn this year.

Calendar

Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	12/03/2012	9:00	PMI manufacturing		11/2012					49.9	
PL	12/03/2012	9:00	PMI manufacturing		11/2012						
CZ	12/03/2012	9:30	PMI manufacturing		11/2012						
CZ	12/03/2012	14:00	Budget balance	CZK B	11/2012					-51.3	
CZ	12/04/2012	9:00	Wages	%	3Q/2012						-1.1
CZ	12/05/2012	9:00	Retail sales	%	10/2012		2.5				-3.3
PL	12/05/2012	14:00	NBP meeting	%	12/2012	4.25		4.25		4.5	
HU	12/06/2012	9:00	Trade balance	EUR M	10/2012 *P					751.1	
CZ	12/07/2012	9:00	GDP	%	3Q/2012 *F					-0.3	-1.5
CZ	12/07/2012	9:00	Trade balance	CZK B	10/2012	40				31.6	
HU	12/07/2012	9:00	GDP	%	3Q/2012 *F					-0.2	-1.5
HU	12/07/2012	9:00	Industrial output	%	10/2012 *P					0.7	0.6
CZ	12/07/2012	10:00	Current account	CZK B	3Q/2012					-260.2	
HU	12/07/2012	17:00	Budget balance	HUF B	11/2012					-658.1	

Fixed-income in Charts

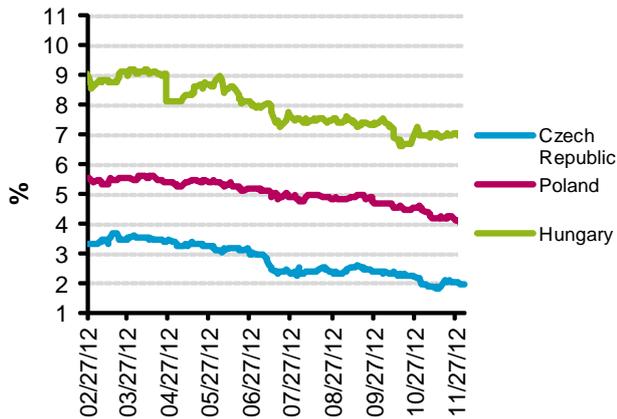
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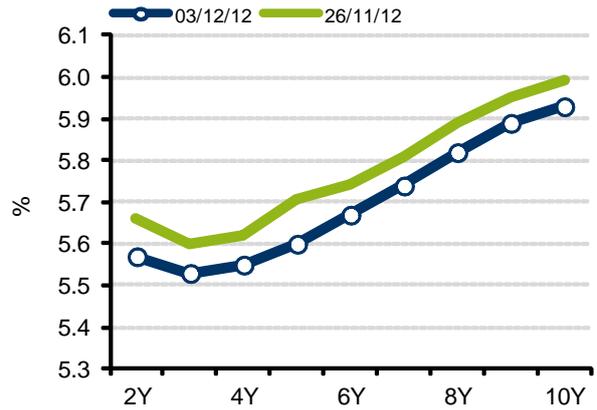
CZ IRS



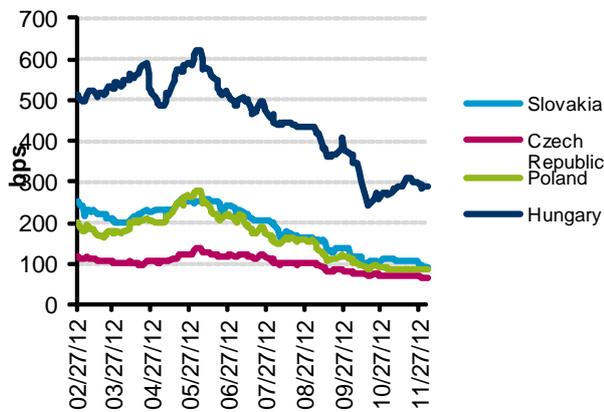
10Y GB Yields



HU IRS



CDS 5Y



PL IRS



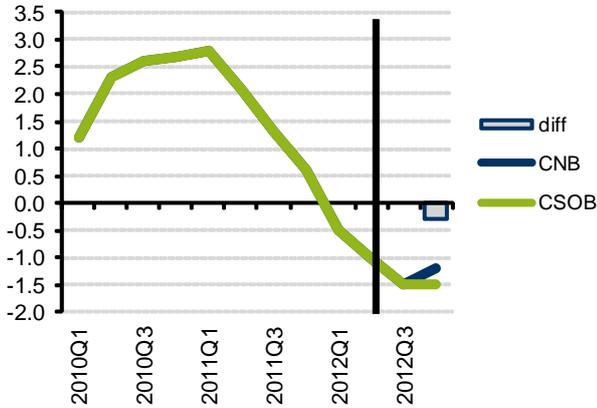
Source: Reuters

Medium-term Views & Issues

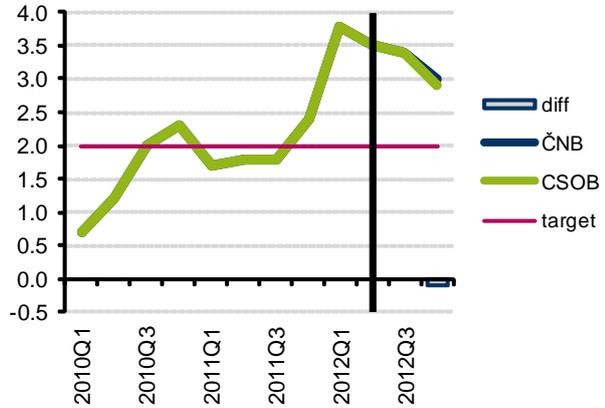
	The Czech Republic	Hungary	Poland
Growth & key issues	September's rapid drop in industrial output (-7.1% y/y) is primarily due to a lower number of business days and to weakening demand. This time, the greatest decline was generated by carmakers (-11.1%), which had been up until now the primary drivers 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 1.4% in the third quarter of 2012. Clearly, factors that kept the Polish economy growing during the World Financial Crisis have stepped 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 2.1% 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 decline back to the NBH's target (3.0%).	The data confirms 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 continue in monetary easing cycle.

CBs' Projections vs. Our Forecasts

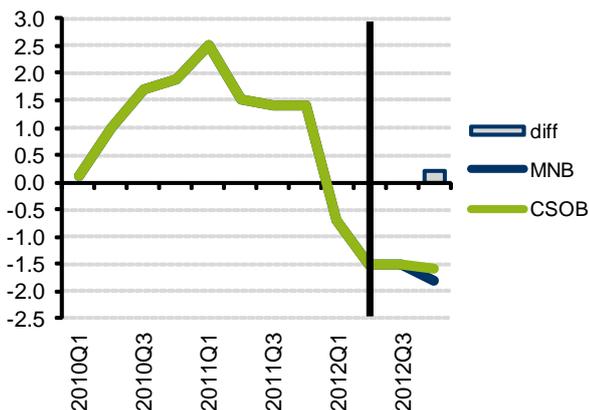
CZ: GDP outlook (Y/Y, %)



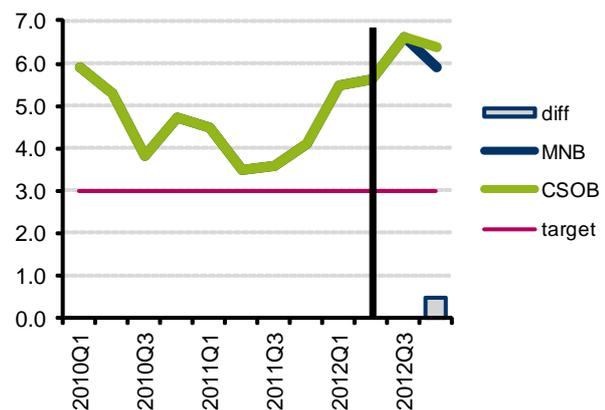
CZ: Inflation outlook (Y/Y, %)



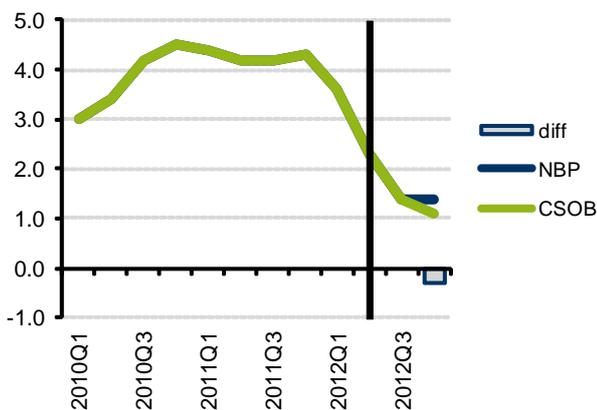
HU: GDP outlook (Y/Y, %)



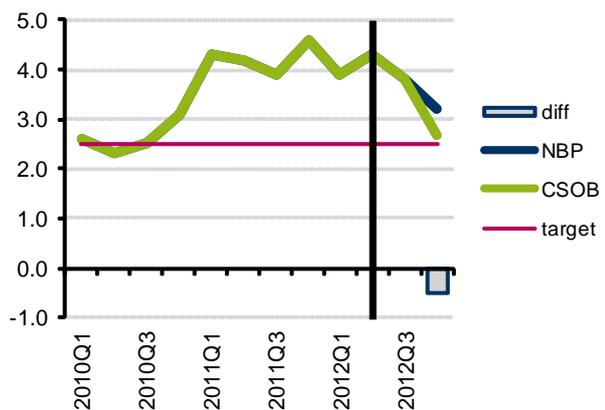
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outlook (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.	6.00	7.00	7.00	6.50	6.50	6.50	-25 bps	11/27/2012
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	0.51	1.28	1.03	0.80	0.50	0.50
Hungary	BUBOR	6.00	7.25	7.20	6.61	6.50	6.40
Poland	WIBOR	4.46	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	1.48	2.25	2.02	1.61	1.60	1.60
Hungary	HU10Y	5.93	7.36	6.71	6.56	7.50	7.25
Poland	PL10Y	3.85	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	24.7
Hungary	EUR/HUF	282	294	286	285	290	280
Poland	EUR/PLN	4.11	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	-1.5	-1.5
Hungary	1.5	1.4	1.4	-0.7	-1.5	-1.5	-1.6
Poland	4.2	4.2	4.3	3.6	2.3	1.4	1.1

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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