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Central European Weekly

Monday, 10 December 2012

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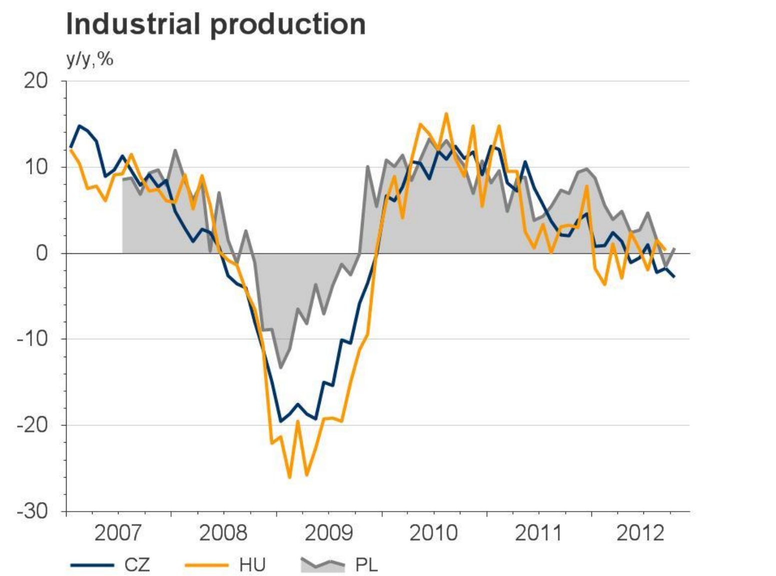
Weekly Highlights:

- Although the Czech and Hungarian industrial output are loosening momentum…
- …our leading indicators for the Czech and Polish industries are actually bottoming out
- Preview: the Polish inflation will slip below 3% for the first time in two years

Chart of the Week



Industrial production slows down across the region. On the other hand our leading indicators for the Czech and Polish industries show some signs of stabilization (see page 3).

Dear clients, please note that the next CE Weekly will be released on January 6th, 2013.

Market's editorial

Pessimisms is spreading....

With the end of the year drawing near, this is an opportunity not only for reviewing the past developments but also for thinking about what the next year in Central Europe might be like as concerns the development of the economy.

Until recently, our growth outlooks for Central European economies had definitely and mostly been among the most pessimistic ones. If we look at GDP figures for the third quarter of the year, we can say with satisfaction that our bet on pessimism has proved true thus far. Even the market consensus about the economic outlook seems to have shifted, and the market no longer looks into the future with such hope, i.e., truly negativist voices are increasingly starting to be heard. One of them is certainly that of the ECB, whose new forecast for 2013 anticipates a fairly clear recession in the eurozone.

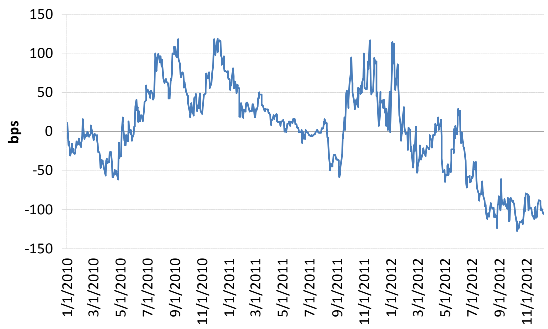
...., but the situation may not be that bad in the end

While our growth forecasts for Central Europe still rank us among the cautious realists, we in no way wish to share the ultra-negativist positions. We believe that two growth-oriented arguments favour the adoption of a more neutral position. Firstly, financial conditions have been eased really markedly in recent weeks and months, not only in the eurozone but also in Central Europe. Secondly, our leading indicators for both Czech and Polish industries have modestly signalled that the bottom may have been hit, and we may consequently be able to bottom out.

PL: FRA 9x12 - Wibor 3M spread

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*25.3*	*0.11%*	↘	→
EUR/HUF	*283*	*-0.05%*	↘	→
EUR/PLN	*4.11*	*-0.51%*	↘	→

HU: FRA 9x12 - Bubor 3M spread



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*1.39*	*-4.47*	↘	→
10Y HUF	*5.81*	*-1.86*	↘	→
10Y PLN	*3.65*	*-4.83*	↘	↘

Review of Economic Figures

Our leading indicators for the Czech and Polish industries show some signs of stabilization

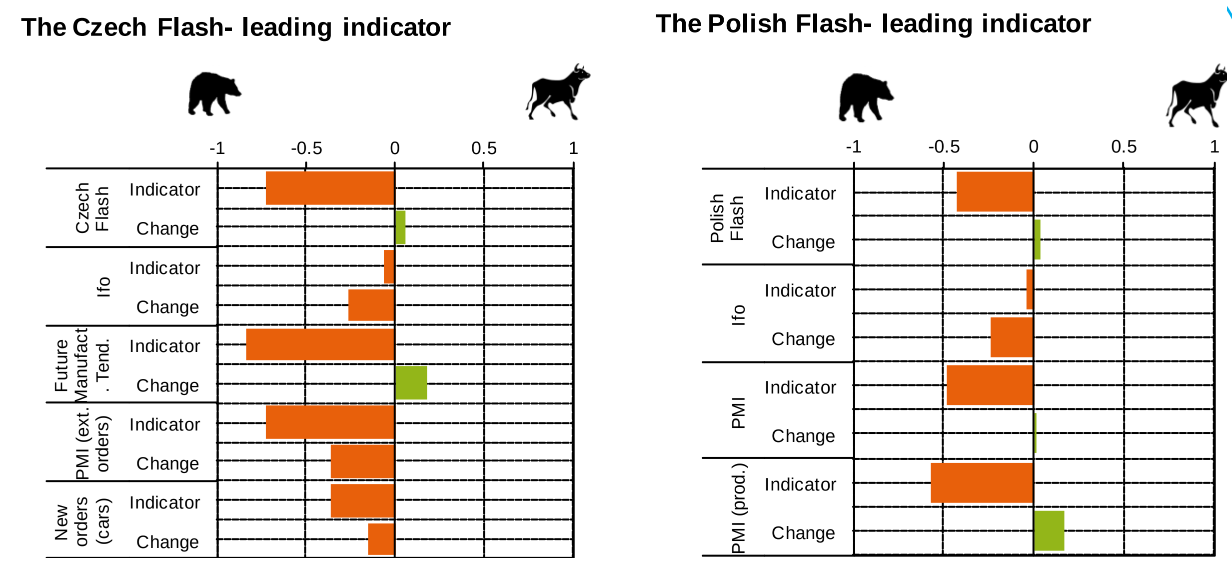
The regional Flash reports (our leading indicators) show the deterioration of the economic conditions has somewhat eased.

The first estimate of the Polish Flash indicates that, despite the poor performance of industry and slowing GDP growth, things may change for the better within the next 3-4 months. The Polish Flash rose after falling for more than two years. However, the situation is still very far from optimistic. The Flash rose only slightly, and revisions in the months to come may still turn the full picture upside down. In addition, the Flash is not rising across all of its components – only the production sub-index within the PMI is improving to a greater extent. If December's Flash confirms the positive reversal of November's data, we will be pleased, of course. For now, we still bet on rate cuts just by an additional 50 bps, while the market anticipates rate cuts by more than 100 bps within nine months.

In the Czech Republic, at -70.5 points, the Flash stays near lows from September 2009. Notably foreign orders within the PMI, which are at their lowest level since July 2009, are particularly low. On the other hand, good news is that the Czech Flash has marginally improved for the first time in eight months. Some of its components has gained. Manufacturing Future Tendency (according to the OECD) increased after having fallen for seven months, while the Ifo index and new orders in the automotive industry have also been gradually stabilising. Hence December's figures may confirm a change for the better in the end. This would be in line with our bet on a positive reversal of the Czech economy during the first half of 2013

The Czech inflation cools strongly

The Czech CPI fell down by 0.2% M/M due to lower telecom and fuel prices in November. Annual inflation decreased to 2.7% (from 3.3%). Czech inflation has remained above the inflation target of the Czech National Bank (CNB) over the last twelve months, due in particular to the January increase in the reduced VAT rate from 10% to 14% and the rise in regulated and controlled prices primarily related to housing. Moreover, inflation was also affected by the increased prices of agricultural and energy commodities (oil and fuel).



*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)

Weekly preview

THU 14:00 PL Inflation (change in %)

	XI.12	X.12	XI.12
CPI y/y	**2.9**	3.4	4.8
Food (ex Alc.) y/y	**4.6**	4.7	4.6
Transport (including fuel)	**6.0**	6.0	11.0

Pl: Inflation below 3% for the first time in two years

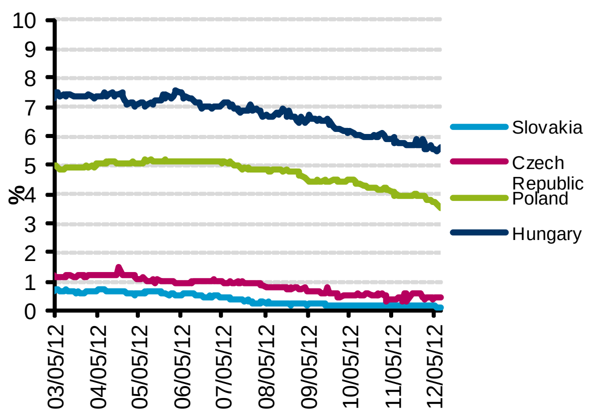
After its surprisingly large decline in October, Poland's inflation continued to fall in November, according to our forecasts, and returned to less than 3% y/y for the first time in two years. As concerns month-on-month developments, we believe that, basically, food prices saw a seasonal rise (+0.5%) while transport prices also went up slightly (+0.3%). By contrast, we anticipate a seasonal decline in package tour prices (-0.4%). By and large, we predict that November's prices were up by 0.2% m/m. Year-on-year inflation should continue to fall, thus opening the door to the central bank continuing to ease its monetary policy.

Calendar

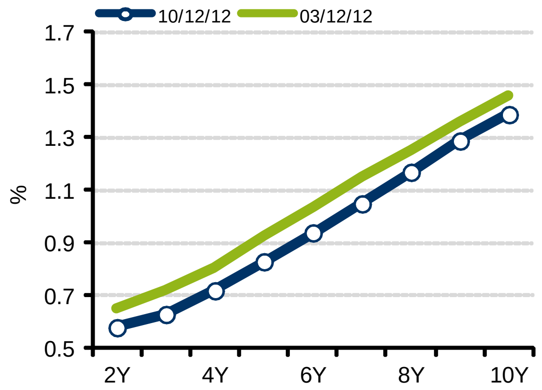
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	12/10/2012	9:00	CPI	%	11/2012	0	3	0	3	0.2	3.4
CZ	12/10/2012	9:00	Unemployment rate	%	11/2012	8.6		8.6		8.5	
CZ	12/10/2012	9:00	Industrial output	%	10/2012		1.8		3.5		-7.1
CZ	12/10/2012	9:00	Construction output	%	10/2012						-10.6
HU	12/11/2012	9:00	CPI	%	11/2012			0.2	5.4	0.1	6
CZ	12/13/2012	10:00	Current account	CZK B	10/2012	15		1		-7.14	
PL	12/13/2012	14:00	Current account	EUR M	10/2012			-1030		-1137	
PL	12/13/2012	14:00	CPI	%	11/2012		2.9	0.2	3	0.4	3.4
PL	12/13/2012	14:00	Trade balance	EUR M	10/2012			-87		84	
HU	12/14/2012	9:00	Industrial output	%	10/2012 *F						
PL	12/14/2012	14:00	Money supply M3	%	11/2012			0.8		1.1	

Fixed-income in Charts

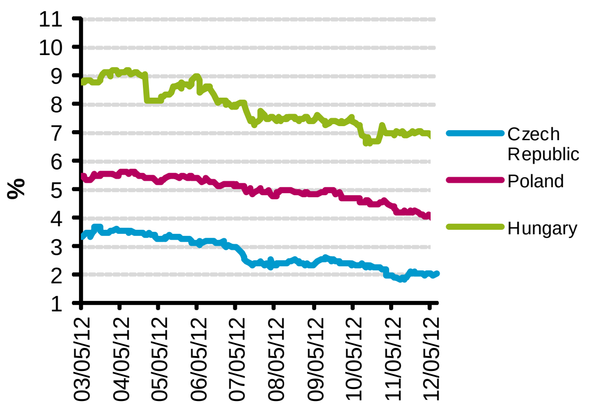
FRA 3x6



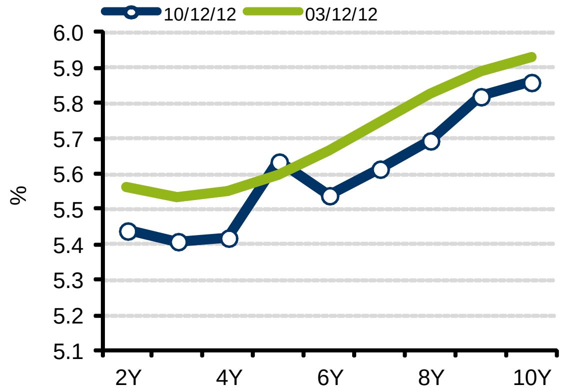
CZ IRS



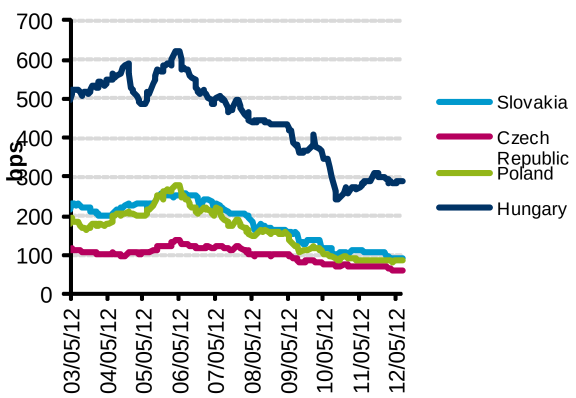
10Y GB Yields



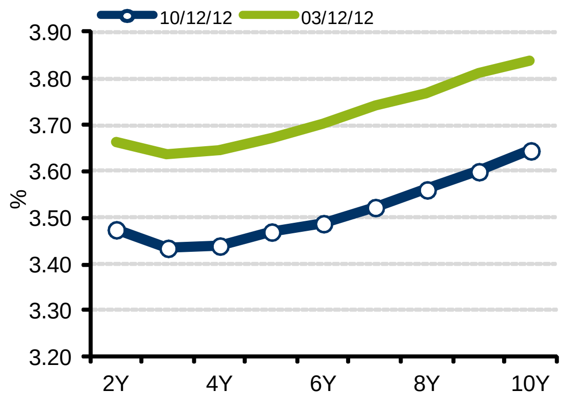
HU IRS



CDS 5Y



PL IRS



Source: Reuters

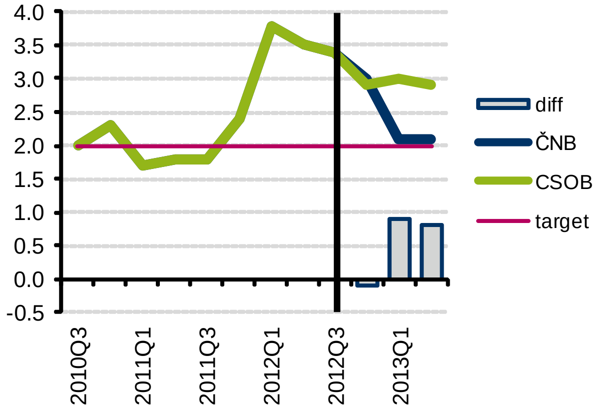
Medium-term Views & Issues

	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 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 be 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 another 25 basis points in December . We believe that further weakness in the Economy warrants further monetary easing by at least 50 bps at the beginning of 2013.
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 new year. Bottoming out of the recession should help the koruna in the second quarter of 2013.	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. Nevertheless bottoming out in the first quarter should help the zloty to regain the positive momentum in 2013.

CBs' Projections vs. Our Forecasts

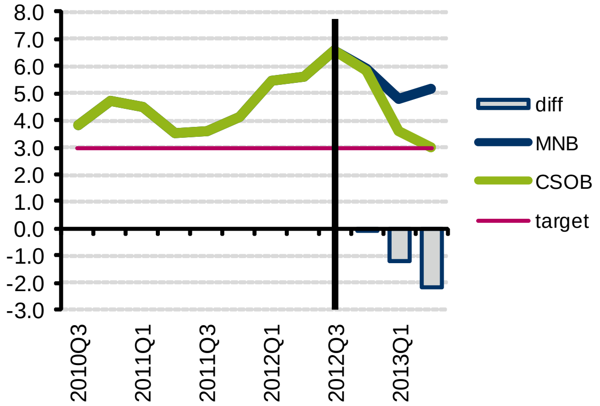
CZ: GDP outlook (Y/Y, %)

CZ: Inflation outlook (Y/Y, %)

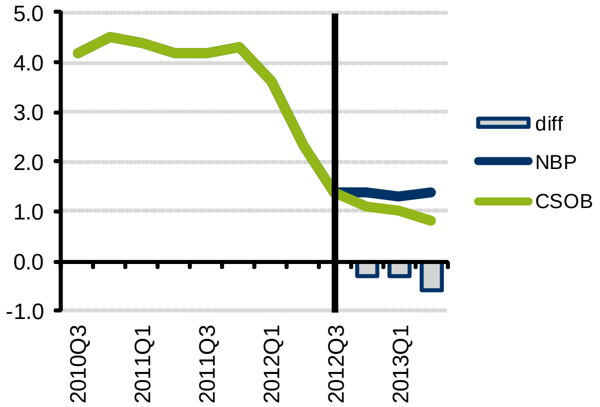


HU: GDP outlook (Y/Y, %)

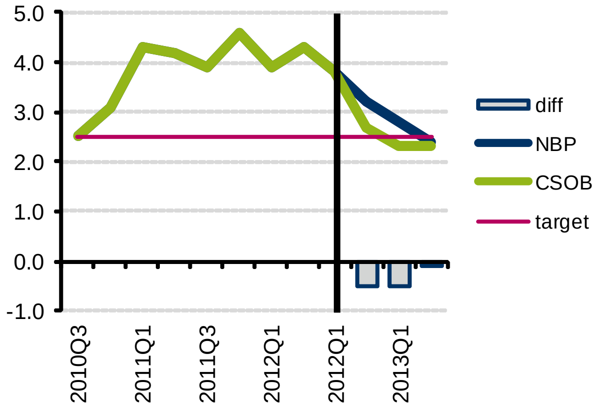
HU: Inflation outlook (Y/Y, %)



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	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	Last change	
Czech Rep.	2W repo rate	*0.05*	0.50	0.50	0.05	0.05	0.05	-20 bps	9/27/2012
Hungary	2W deposit r.	*6.00*	7.00	6.50	6.50	6.50	6.25	-25 bps	11/27/2012
Poland	2W inter. rate	*4.25*	4.75	4.75	4.50	4.50	4.50	-25 bps	12/5/2012

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

		Current	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Czech Rep.	PRIBOR	*0.51*	1.03	0.80	0.50	0.50	0.45
Hungary	BUBOR	*6.00*	7.20	6.61	6.50	6.40	6.20
Poland	WIBOR	*4.33*	5.13	4.92	4.80	4.90	4.90

Long-term interest rates 10Y IRS (end of the period)

		Current	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Czech Rep.	CZ10Y	*1.39*	2.02	1.61	1.60	1.60	1.90
Hungary	HU10Y	*5.81*	6.71	6.56	7.50	7.25	7.00
Poland	PL10Y	*3.65*	4.74	4.39	5.30	5.40	5.40

Exchange rates (end of the period)

		Current	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Czech Rep.	EUR/CZK	*25.3*	25.5	25.1	25.0	24.7	24.6
Hungary	EUR/HUF	*283*	286	285	290	280	280
Poland	EUR/PLN	*4.11*	4.22	4.11	4.30	4.15	4.00

GDP (y/y)

	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Czech Rep.	0.6	-0.5	-1.0	-1.5	-1.5	-0.9	-0.3
Hungary	1.4	-0.7	-1.5	-1.5	-1.6	0.3	0.8
Poland	4.3	3.6	2.3	1.4	1.1	1.0	0.8

Inflation (CPI y/y, end of the period)

	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Czech Rep.	2.4	3.8	3.5	3.4	2.9	3.0	2.9
Hungary	4.1	5.5	5.6	6.6	5.8	3.6	3.0
Poland	4.6	3.9	4.3	3.8	2.7	2.3	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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