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Central European Weekly

Tuesday, 15 January 2013

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- Leading indicators in Central Europe continue to improve.
- Uncertainty around the new MNB governor scares markets
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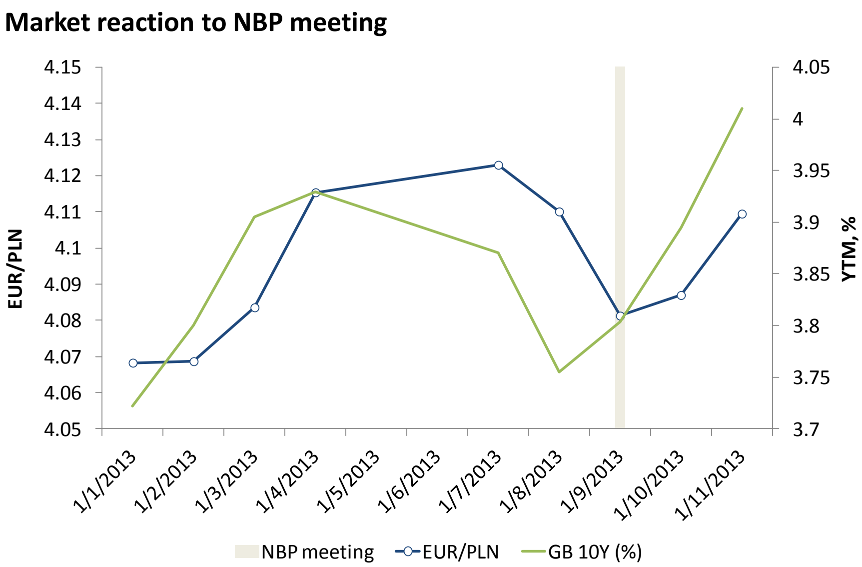
Chart of the Week



The zloty temporarily strengthened and government bond yields rose after NBP's President Belka said that only one more rate cut remains in play. (Source: CSOB, Thomson Reuters).

Market's editorial

The National Bank of Poland springs a surprise

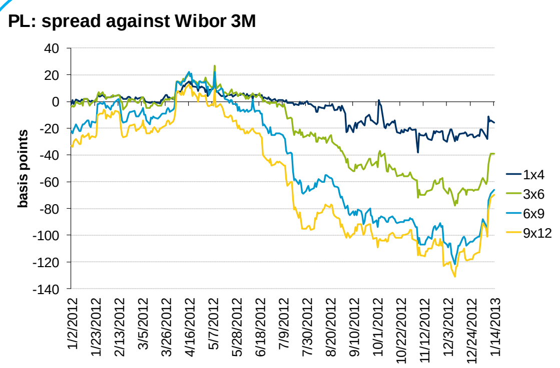
While the Czech National Bank has surprised markets with its dovish attitude in recent months, its Polish counterpart (NBP) did just the contrary on Wednesday. Although it met general expectations and cut its base interest rate by 25 basis points, its President, Marek Belka, suggested that the current monetary easing cycle was drawing to a close. There is every indication that rates will be cut just once more, at the February meeting (February 6).

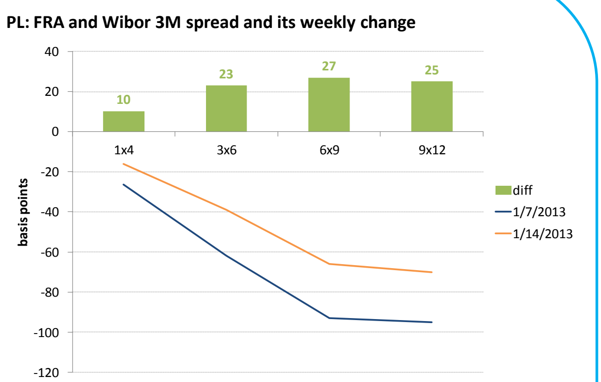
We need to point out that we foresaw such a scenario as being fairly likely. If we disregard the economic reasons this time, which we analysed in greater detail in our last weekly issue, another argument is the composition of the Monetary Policy Council (MPC). For example, at the November meeting, which took place against the backdrop of the newly released GDP growth data for the third quarter of the year, three of the ten members voted against any rate cut. A proposal to cut rates by 50 basis points was even raised at the meeting, with six members opposing it. Bear in mind that GDP growth lagged well behind expectations in the third quarter.

Naturally, we are no prophets, but, in view of the information available at the moment, we believe that the NBP will take a breather after its February cut and analyse the impacts on the economy. This should in no way be altered by the Polish Finance Minister's comments, which seem to be unusual from the "mainstream" point of view, with the Minister having said on Thursday that a rate cut breather would be a 'serious mistake' that would affect the economy.

Uncertainty around the new MNB governor scares markets

EUR/HUF currency pair edged lower on comments of Economy Minister Maltocsy, who wrote in a column that the country was wrong when aiming at low inflation at the cost of a strong forint. Let us recall that Mr. Maltocsy is, according to the local press, among possible successors of the current central bank Governor Simor whose term expires early in March. As a result, the forint hit a seven-month low on Friday and technically opened a room for further depreciation to EUR/HUF 300. Meanwhile, yield of 10Y government bond rose by 17 basis points.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25,7	0,51%	↗	→
EUR/HUF	298	2,14%	↗	→
EUR/PLN	4,12	0,37%	↗	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1,48	6,47	→	↗
10Y HUF	5,78	6,35	→	↗
10Y PLN	3,84	4,07	→	↗

Review of Economic Figures

Leading indicators in Central Europe continue to improve. The Czech Republic indicates a possible turnaround within the next three months, but the positive signals need to be confirmed.

Leading indicators for the Czech and Polish economies (Flash) improved for the second consecutive month in December. This may set the limits for central banks that are attempting to continue to ease their respective monetary policies.

The Czech Flash shows that Czech industry might bottom out within the next 3 months. Although industry performed poorly in November, the Flash leading indicator rose in December for the second consecutive time and stands at five-month highs (-59.2). Nonetheless, the December signals may be challenged in the months to come. A similar event occurred in late 2011, when the Flash correctly confirmed a recovery in industry, but the recovery only persisted for a single quarter. Ambiguous developments in the individual components of the Flash are another reason to be prudent. While the expectations in industry according to the OECD are rapidly improving, and the German business mood index Ifo as well as new orders in the automotive industry are also developing well, the Czech PMI index (foreign orders) is continuing to fall. By contrast, the PMI is very low from the historical point of view, and it would be surprising if it did not bottom out soon, thus following the example of the other components of the Flash. In any event, the bets on the recovery of Czech industry will be more certain after January's Flash figure is available.

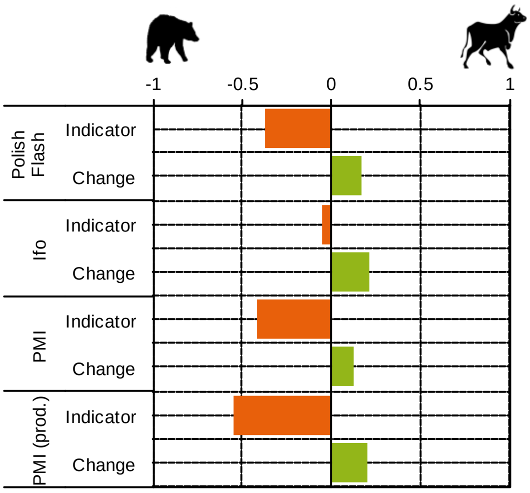
The situation in Poland, where the signs of bottoming out are more convincing, is similar.

Just like in the Czech Republic, the first forecast of the Polish Flash indicates that, in spite of the poor performance of industry as well as GDP, things may change for the better within the next three months. After falling for more than two years, the Polish Flash rose for a second consecutive month in December. Admittedly, the gains of the Flash are still modest – at -159 points, it is not far off of its lowest October levels. Just like in the Czech Republic, we will need to see at least the January data in order to be sure.

On the other hand, the Polish Flash, unlike that of the Czech Republic, shows signs of stabilisation across all of its components. The Ifo, the PMI, as well as the PMI's production sub-index, are all improving. Particularly the PMI's production sub-index indicates significant latitude for further improvements – historically, it stands at relatively low levels.

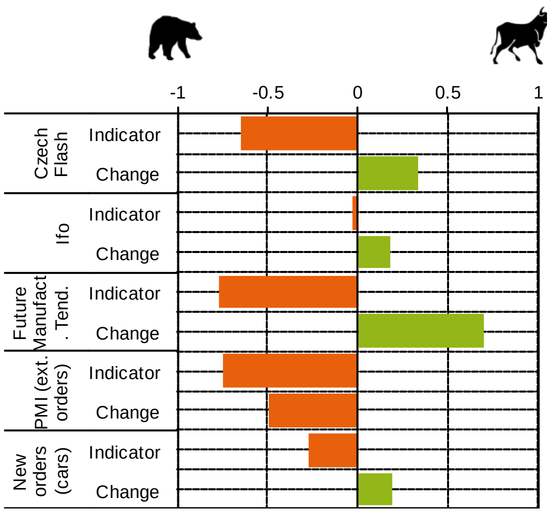
The bets on a turnaround in industry are also consistent with our reticent attitude to the possibilities of the National Bank of Poland continuing to ease its monetary policy. We believe that rates will not be cut more than once, to 3.75%.

The Polish Flash- leading indicator



**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)

The Czech Flash- leading indicator



Weekly preview

TUE 14:00	PL Inflation (change in %)		
	XII.12	XI.12	XII.11
CPI y/y	**2.5**	2.9	4.6
Food (ex Alc.) y/y	**3.6**	4.6	4.7
Transport (including fuel)	**1.4**	6.0	9.0

Poland: Inflation hits the target for the first time in more than two years

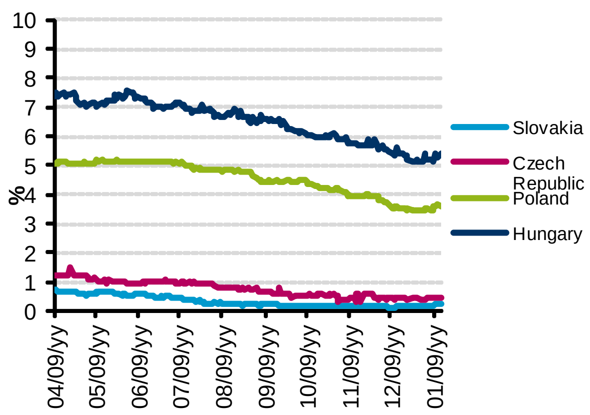
According to our forecasts, Poland's inflation returned to the central bank target (2.5% y/y) in December, after two years and two months. Month-on-month prices likely rose by 0.1%, i.e., slightly faster than usual for a seasonal rise, with food as well as fuel prices likely having increased. Inflation may continue to fall in the months to come, to reach a level slightly below the central bank target. Nevertheless, we do not expect the NBP to take any substantial steps; the bank is likely to cut rates just once more, by 25 bps.

Calendar

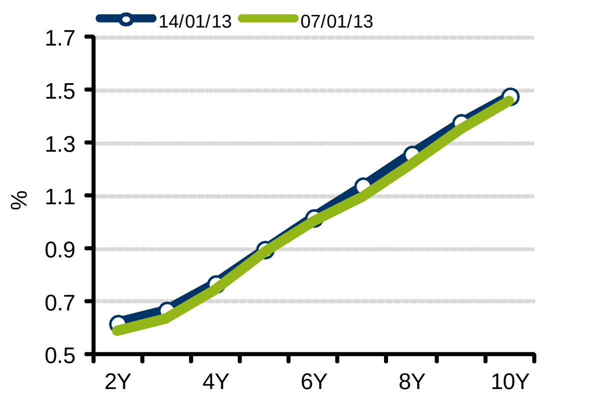
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	01/14/2013	14:00	Money supply M3	%	12/2012			2		0,1	
CZ	01/15/2013	9:00	PPI	%	12/2012	0	1,5	0,1	1,6	0,1	1,6
HU	01/15/2013	9:00	CPI	%	12/2012			0,2	5,2	-0,1	5,2
PL	01/15/2013	14:00	CPI	%	12/2012	0,1	2,5	0,1	2,5	0,1	2,8
PL	01/15/2013	15:00	Budget balance	PLN M	12/2012					-30426	
HU	01/16/2013	9:00	Industrial output	%	11/2012 *F					-0,1	-6,9
PL	01/16/2013	14:00	Core CPI	%	12/2012			0	1,5	0,1	1,7
HU	01/18/2013	9:00	Wages	%, ytd.	11/2012				4,1		4,6
CZ	01/18/2013	10:00	Current account	CZK B	11/2012	2,5		-8,4		-16,12	
PL	01/18/2013	14:00	Wages	%	12/2012			8,5	2,1	1,7	2,7
PL	01/18/2013	14:00	Industrial output	%	12/2012			-10,5	-6,8	-4,8	-0,8
PL	01/18/2013	14:00	PPI	%	12/2012			-0,2	-0,7	-0,2	-0,1
PL	01/18/2013	14:00	Current account	EUR M	11/2012			-770		-650	
PL	01/18/2013	14:00	Trade balance	EUR M	11/2012			110		225	

Fixed-income in Charts

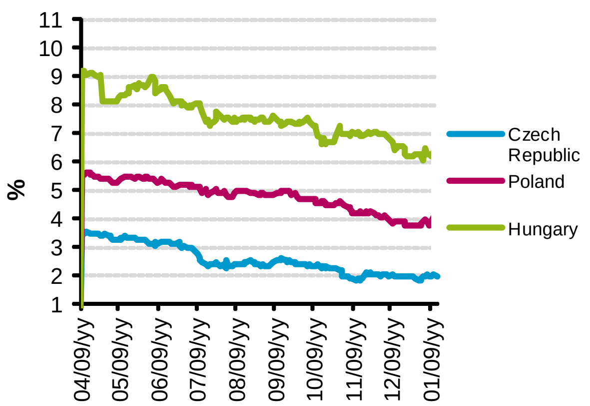
FRA 3x6



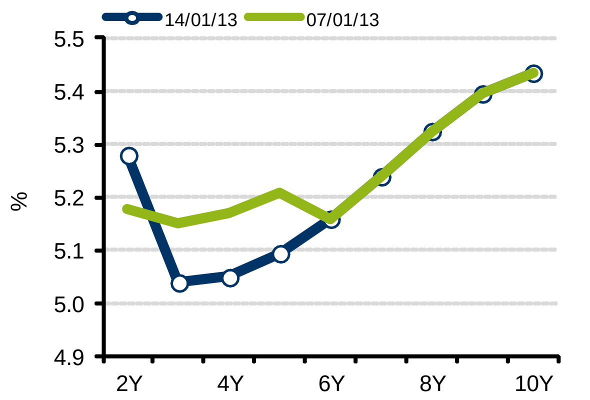
CZ IRS



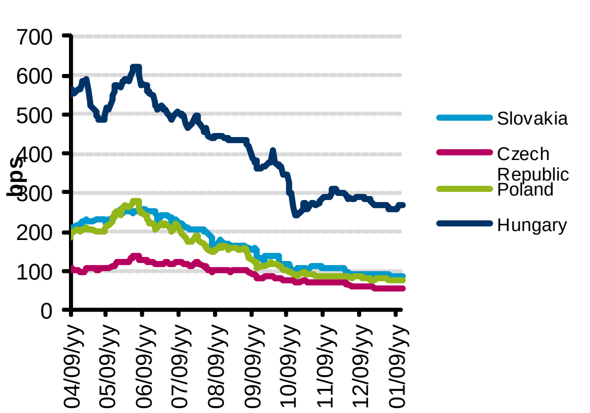
10Y GB Yields



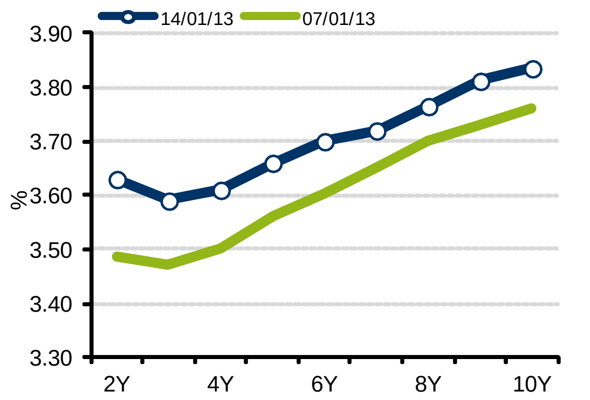
HU IRS



CDS 5Y



PL IRS



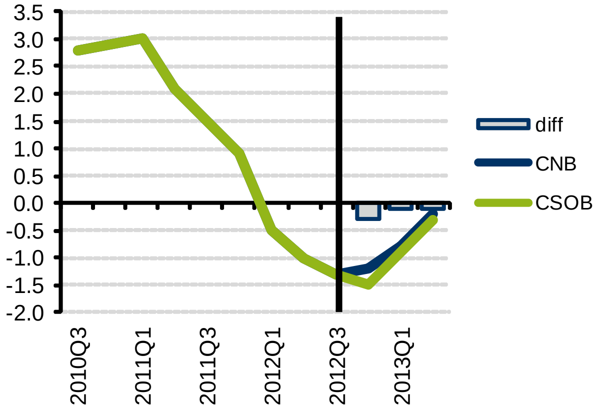
Source: Reuters

Medium-term Views & Issues

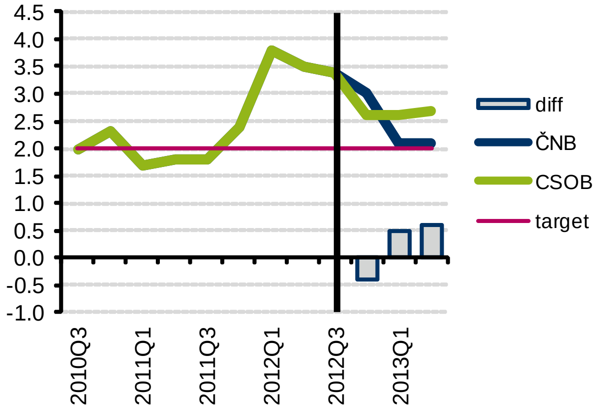
	The Czech Republic	Hungary	Poland
Growth & key issues	September's rapid drop in industrial output (-7.1% y/y) is primarily due to a lower number of business days and to weakening demand. This time, the greatest decline was generated by carmakers (-11.1%), which had been up until now the primary drivers 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. Year-on-year inflation already fell to 5.2 percent and is expected to ease further due to a substantial government subsidies of energy prices. Moreover, the term of central bank governor and his two deputies, who were the only members of the monetary policy council who consistently opposed recent cuts, is coming to an end.	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 another 25 or 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, or if the naming of the new governor undermines market confidence.	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

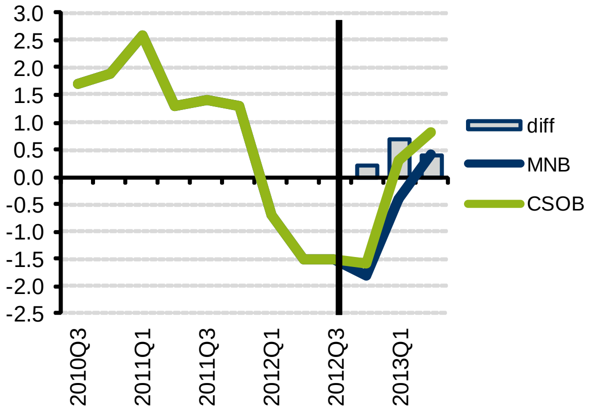
CZ: GDP outlook (Y/Y, %)



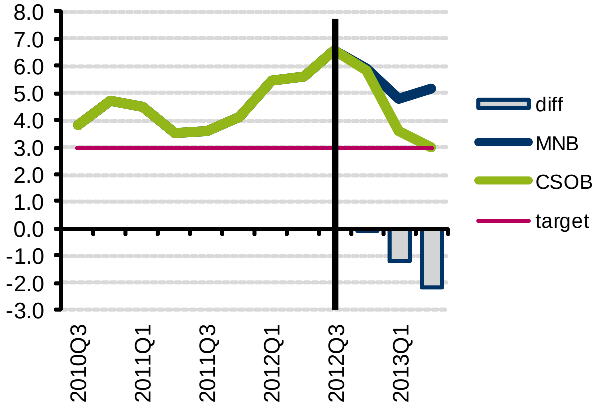
CZ: Inflation outlook (Y/Y, %)



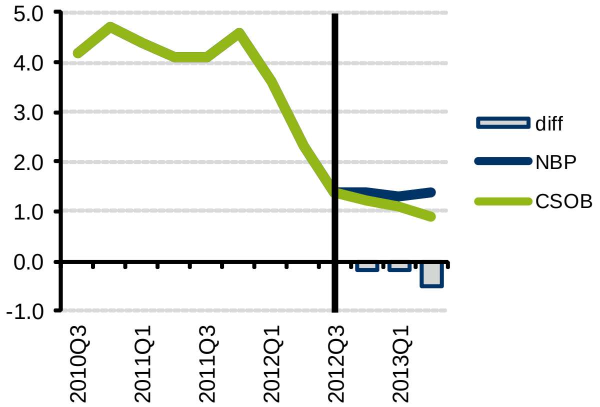
HU: GDP outlook (Y/Y, %)



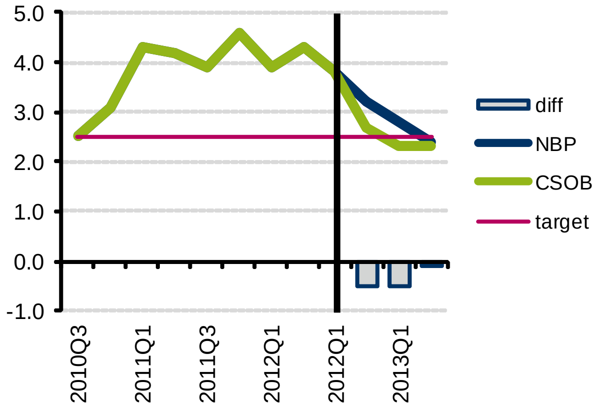
HU: Inflation outlook (Y/Y, %)



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.	*5,75*	7,00	6,50	5,75	6,50	6,25	-25 bps	12/18/2012
Poland	2W inter. rate	*4,00*	4,75	4,75	4,25	4,00	4,00	-25 bps	1/9/2013

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

		Current	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Czech Rep.	PRIBOR	*0,50*	1,03	0,80	0,50	0,50	0,45
Hungary	BUBOR	*5,70*	7,20	6,61	5,75	6,40	6,20
Poland	WIBOR	*4,03*	5,13	4,92	4,11	4,90	4,90

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

		Current	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Czech Rep.	CZ10Y	*1,48*	2,02	1,61	1,37	1,40	1,50
Hungary	HU10Y	*5,78*	6,71	6,56	5,49	7,25	7,00
Poland	PL10Y	*3,84*	4,74	4,39	3,60	5,40	5,40

Exchange rates (end of the period)

		Current	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Czech Rep.	EUR/CZK	*25,7*	25,5	25,1	25,1	25,0	24,7
Hungary	EUR/HUF	*298*	286	285	291	280	280
Poland	EUR/PLN	*4,12*	4,22	4,11	4,08	4,15	4,00

GDP (y/y)

	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2
Czech Rep.	0,9	-0,5	-1,0	-1,3	-1,5	-0,9	-0,3
Hungary	1,3	-0,7	-1,5	-1,5	-1,6	0,3	0,8
Poland	4,6	3,6	2,3	1,4	1,2	1,1	0,9

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	2,6	2,6	2,7
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.	-5,0	-3,0
Hungary	-2,5	-2,2
Poland	-3,5	-4,0

Source: CSOB, Bloomberg

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