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Central European Weekly

Monday, 21 January 2013

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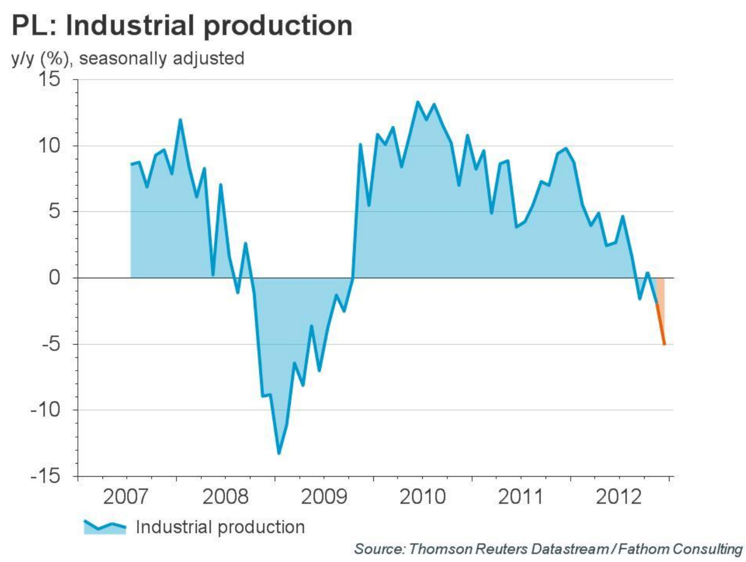
Weekly Highlights:

- CE currencies under pressure despite risk-on mode in global markets
- Inflation in the Central Europe wanes
- Polish industrial production shrunk deeply in December

Chart of the Week



In December, the Polish industrial production shrunk by 5.1% Y/Y which was the largest drop since June 2009.

Central European Daily

Market's editorial

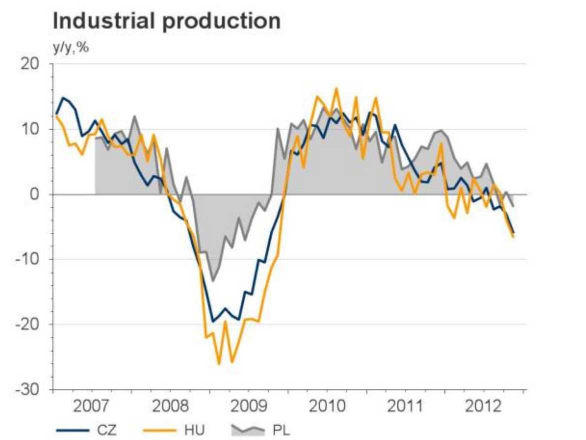
The beginning of the year in Central Europe catches the eye

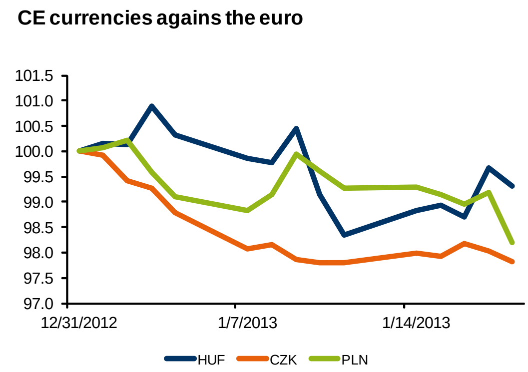
The new year of 2013 in Central European economies started in a very interesting way in several respects.

Firstly, while November's hard data on industrial output does not look good at all, other upswing indicators show that the downturn might hit bottom soon. At least, this is evident from our leading indicators for Czech and Polish industry, because, owing to certain cyclical sub-indicators, the leading indicators continued to improve, moderately signalling an improvement within the next three months.

Other information worth noting is the inflation decline across the region, which was even stronger than expected. Naturally, the inflation fall provided arguments for further monetary easing. Some market participants are speculating that this may even lead to unconventional interventions in Hungary and the Czech Republic, through the buying of Hungarian government bonds (by the National Bank of Hungary) and the selling of the Czech koruna (by the Czech National Bank) respectively. Under these circumstances, it is no surprise that both the forint and the koruna are weakening, albeit the overall aversion to risk is continuing to wane globally and asset prices in the Central European region mostly tend to fare well.

Just recently, regional forex bears have hit the Polish market too as the industrial output plunged in December, posting the sharpest decline since April 2009. Obviously, such a horrible output decline triggered bets on additional monetary policy easing. Let us recall that the central bank (NBP) indicated that after possible 25bps rate cut in February it would put further cuts on hold and analyze impacts of lower interest rates on the economy. In light of the recent (IP) figures, February's rate cut seems to be a certain thing, but we still doubt that more aggressive easing might be on agenda.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.6	0.02%	→	→
EUR/HUF	293	-0.65%	→	→
EUR/PLN	4.17	0.02%	→	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahea
10Y CZK	1.47	0.34	↗	↗
10Y HUF	5.68	4.51	→	↗
10Y PLN	3.77	-2.08	↗	↗

Review of Economic Figures

Inflation in Central Europe recedes

Hungary's inflation is continuing to fall even more rapidly than expected by the market. Year-on-year inflation even fell to 5.0% and is likely to continue to fall rapidly in the months to come, although prices have not yet fully reflected the increase in the excise duty on tobacco products, which also took place in December. Two important factors will contribute to a further decline in Hungarian inflation in the first quarter of the year: 1) A favourable effect of the comparative baseline, because since January, year-on-year data will no longer be affected by the VAT rate increase that took place in January 2012; and 2) The inflation rate will also be reduced by the 10% cut in regulated prices of electricity and natural gas for households. Given the above two factors, the year-on-year inflation figure may begin with "3" at the start of the second quarter.

Poland's inflation very close to the NBP target now, after more than two years

December's inflation figures confirm that prices also decelerated fairly dramatically in Poland in the last quarter of the year. The year-on-year inflation of late 2012 hit 2.4%, as opposed to a 3.8% year-on-year price rise in September. The main contributor to the inflation fall was a positive base effect; the index is no longer affected by last year's dramatic increases in food and petrol prices, which took place in the last quarter. As concerns December's figure, the greatest surprise in terms of structure was a slightly greater month-on-month increase in food prices.

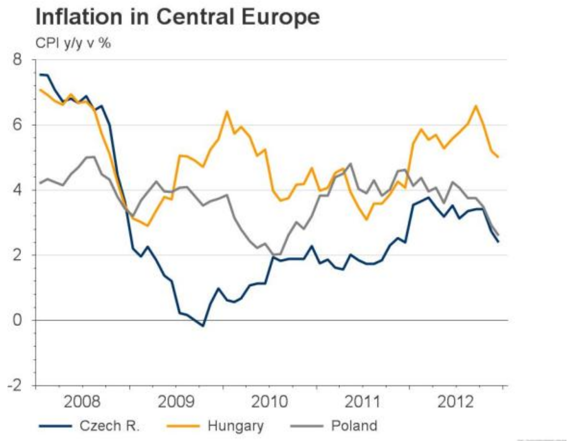
In the months to come, we expect inflation to continue to fall (we do not rule out levels around 2% y/y during the first and second quarters). Nevertheless, given the anticipated gradual recovery of economic growth and the composition of the Monetary Policy Council, we expect no dramatic response by the central bank.

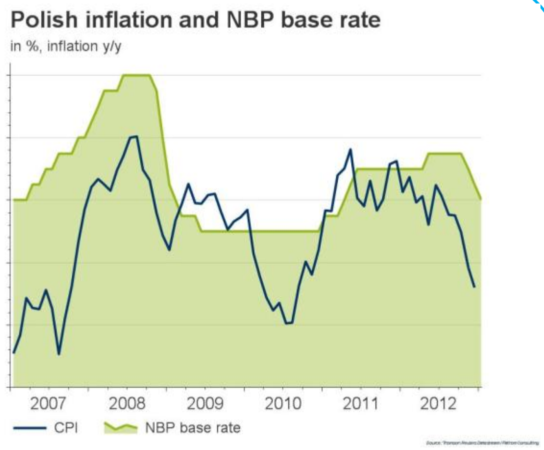
Polish industry shrunk deeply in December

The Polish zloty hit a two-month low after the release of industrial production and construction figures for December. Industrial production fell by 10.6% Y/Y while construction and assembly production shrunk by 24.8% Y/Y. Athough both numbers were biased due to the different number of working days, even after the adjustment, industrial production fell by 5.1% Y/Y, i.e. the most since June 2009.

Both figures surprised on the downside of expectations and thus triggered bets on additional monetary policy easing. Let us recall that the central bank (NBP) indicated that after possible 25bps rate cut in February it would put further cuts on hold and analyze impacts of lower interest rates on the economy.

In light of the recent figures, February's rate cut seems to be a certain thing. Even Adam Glapinski, a hawkish member of the Monetary Policy Council (MPC), said today he would support the cut. Further steps of the MPC remain, however less certain. At its March meeting, the MPC will have the new inflation report at its disposal. In our view, it might point to a modest recovery around in the Q2/2013 and Q3/2013. On the other hand, the MPC will have also the fresh estimates of GDP growth for the fourth quarter of 2012 which may fall even below 1% Y/Y.



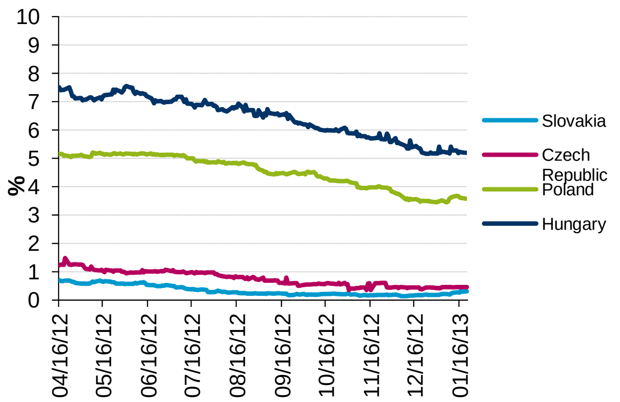


Calendar

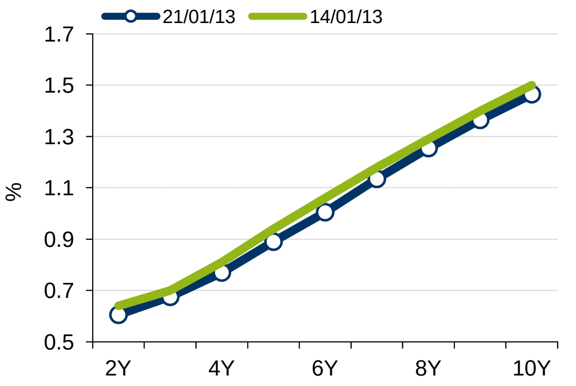
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	01/23/2013	12:00	CZ bond auction 2007-22, 4.70%	CZK B	01/2013						
CZ	01/23/2013	12:00	CZ bond auction 2013-16, x.xx%	CZK B	01/2013						
HU	01/25/2013	9:00	Retail sales	%	11/2012				-3		-3.7

Fixed-income in Charts

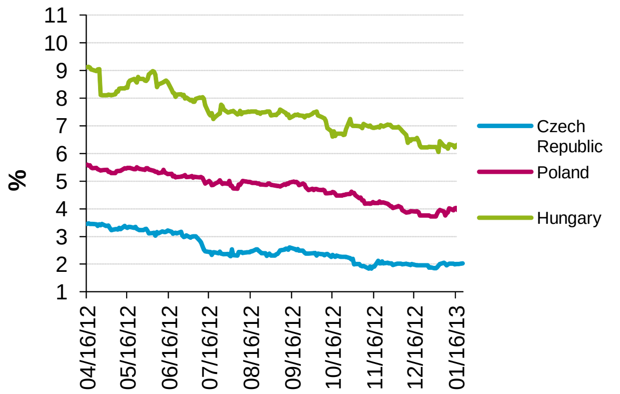
FRA 3x6



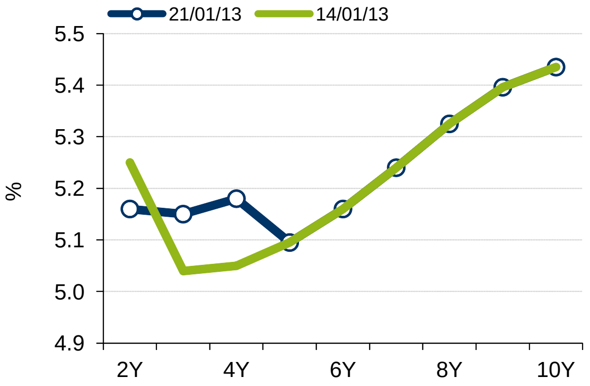
CZ IRS



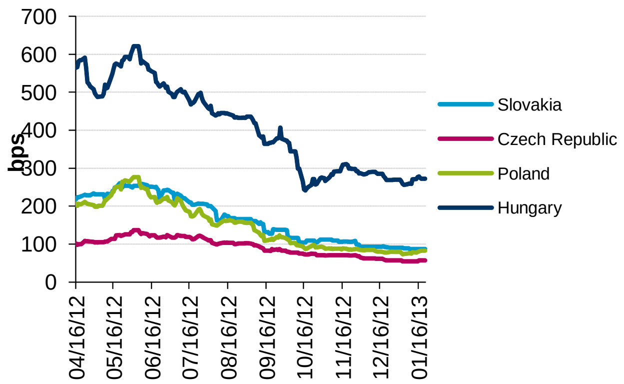
10Y GB Yields



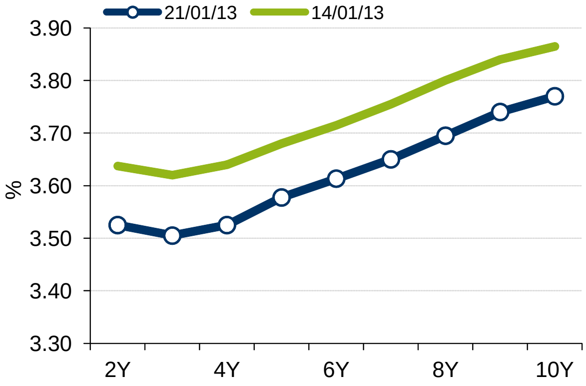
HU IRS



CDS 5Y



PL IRS



Source: Reuters

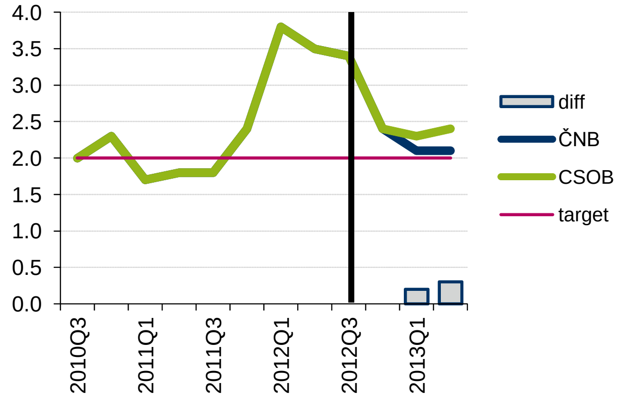
Medium-term Views & Issues

	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 5.0 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.

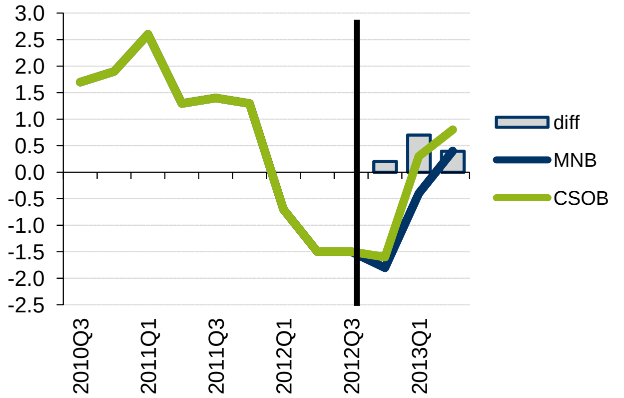
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

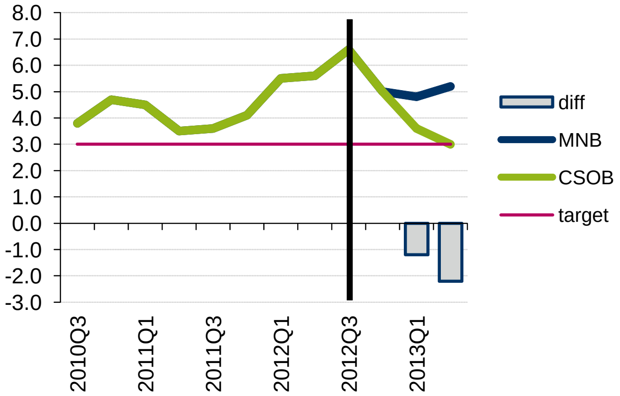
CZ: Inflation outlook (Y/Y, %)



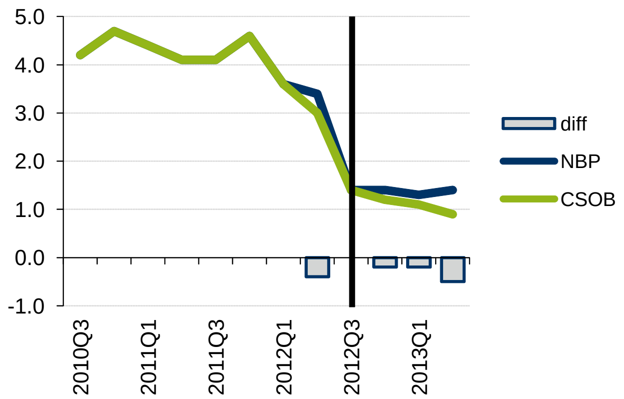
HU: GDP outlook (Y/Y, %)



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	5.25	4.75	-25 bps	12/18/2012
Poland	2W inter. rate	*4.00*	4.75	4.75	4.25	3.75	3.75	-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	5.20	4.70
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	*1.465*	2.02	1.61	1.37	1.45	1.50
Hungary	HU10Y	*5.68*	6.71	6.56	5.49	7.25	7.00
Poland	PL10Y	*3.77*	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	*25.6*	25.5	25.1	25.1	25.0	24.7
Hungary	EUR/HUF	*293*	286	285	291	280	280
Poland	EUR/PLN	*4.17*	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	3.0	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	2.4	2.3	2.4
Hungary	4.1	5.5	5.6	6.6	5.0	3.6	3.0
Poland	4.6	3.9	4.3	3.8	2.4	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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