Written by ČSOB Prague and K&H Budapest

Central European Weekly

Monday, 04 February 2013

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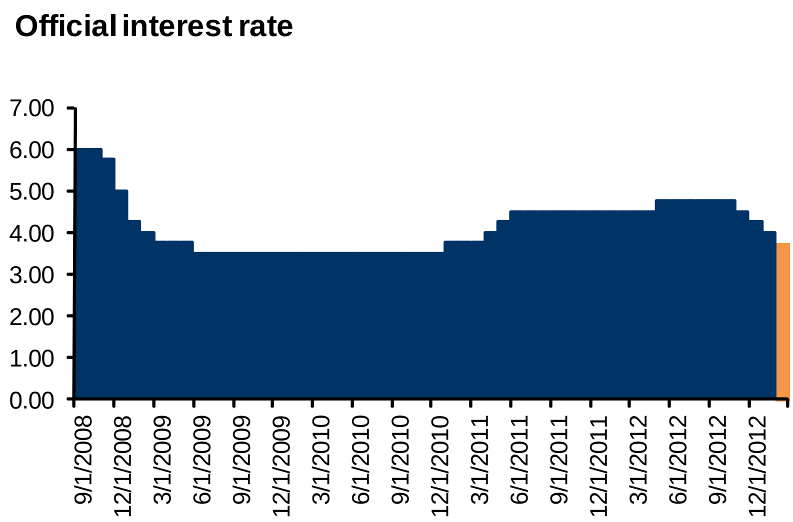
Weekly Highlights:

- Regional PMI's show visible improvement
- The Polish GDP grew 2%in 2013 – no surprise
- The NBP ready to cut again by 25 bps
- The CNB might disappoint part of the FX market as its attitude to forex intervention would remain vague

Chart of the Week



The NBP should bring another 25bps rate cut this Wednesday.

Market's editorial

Regional central banks grab the spotlight again

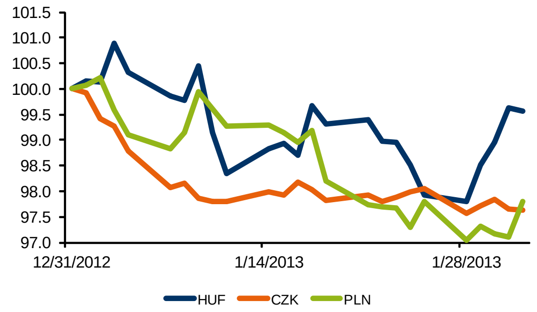
Although the aversion to risk is falling globally, it seems as if Central European currencies have wished to continue to ignore such developments. While the fact that the koruna, the zloty or the forint are trading near half-year lows is partly due to the global strength of the euro, the depreciation of Central European currencies is more likely based on regional factors, which are connected with the policies of central banks in any event.

Let us begin with the forint and the National Bank of Hungary, because it was speculation as to who would become the successor to the current NBH President, Simor, that drove the EUR/HUF currency pair to the vicinity of EUR/HUF 300. The market is evidently nervous, because Simor's successor will be every inch a dove and will prefer a really eased monetary policy. Although last week's news mitigated that concern, the fact that Prime Minister Orban suggested that he would announce the name of the new NBH President closely before the expiration of the current President's term of office (March 2) did not at all reduce the uncertainty as to the NBH leadership.

The Czech koruna is awaiting further steps by the Czech National Bank, as certain market participants are afraid of interventions, i.e., the central bank endorsing the exchange rate targeting policy. Nevertheless, we believe that these speculations will not be borne out. At its next meeting, the CNB Board is likely to be content to upgrade its inflation targeting with a 'more binding opinion' on the exchange rate. However, this will not be a fixed target for the exchange rate; it will be a sliding opinion on the exchange rate, which will change with every forecast. Thus the CNB will not even set, a priori, any bounds for the fluctuations around those forecasted exchange rate values.

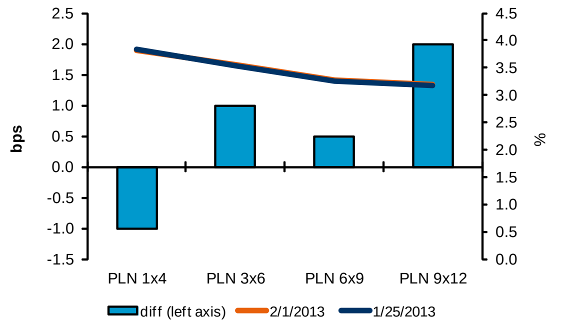
Finally, there is the National Bank of Poland and the zloty, which, by contrast, is being troubled by weaker (hard) data from the economy. As concerns the NBP, we, just like everyone else, believe that the central bank is likely to cut rates again on Wednesday, by 25 bps to 3.75%. Such a decision will certainly not surprise the market, and rather than the decision itself, the press release from the meeting and the subsequent conference will be awaited. Markets are still betting on fairly dramatic rate cuts in the months to come, although we do not see this as being realistic, and this might also be signalled by the press conference of NBP Governor Belka.

CE currencies agains the euro



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*25.6*	*-0.19%*	↘	↘
EUR/HUF	*292*	*-1.50%*	↗	↗
EUR/PLN	*4.15*	*-1.01%*	→	↘

FRA, weekly change



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*1.49*	*2.76*	↗	↗
10Y HUF	*5.65*	*3.96*	→	↗
10Y PLN	*3.73*	*0.54*	→	↗

Review of Economic Figures

Poland's GDP was not very good, but PMIs indicate an improvement

Polish economy grew by 2% in 2012

The first growth estimates for the Polish economy, released on Tuesday, confirmed our expectations and indicated 2% GDP growth. In other words, the figure implicitly bore out the bets on a significant deceleration of the Polish economy in the last quarter of 2012, to approximately 0.6% y/y (the worst figure since 2009). While the Statistical Office has not yet unveiled a more detailed growth structure, the released data about value added primarily indicates a significant deceleration in investment (both construction output and industrial output slowed down markedly). As concerns expenditure, household consumption decelerated significantly last year, affected by adverse trends in the labour market (slow wage growth, rising unemployment).

PMI in Central Europe improved

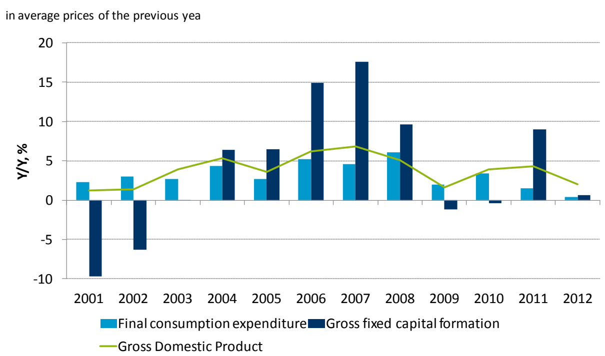
Meanwhile, business moods in Central Europe improved in January. Thus our baseline scenario, that the region is, slowly but surely, about to hit bottom after the very poor last quarter of 2012, has been confirmed so far.

While the PMI index in the already discussed Poland remains below 50, it rose for a fourth consecutive month (to 48.6), having climbed to its highest level since July 2012. The stagnation of the production sub-index, which has a strong position in our leading indicator for Poland, is rather disappointing. By and large, however, the result confirms our bets on the advent of a recovery, which, we believe, should not allow the National Bank of Poland to cut rates below 3.75%.

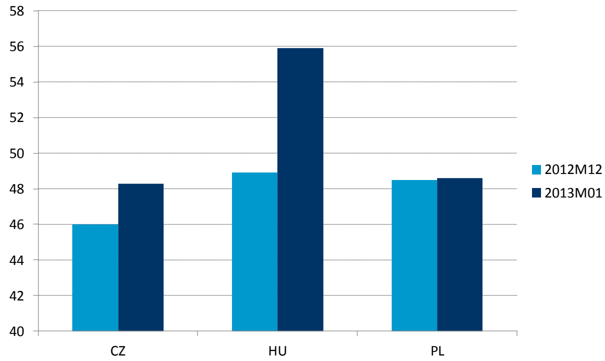
The PMI in the Czech Republic rose to 48.3 points, the highest level since August 2012. The rate of decline in new foreign orders, which are part of our leading indicator for Czech industry, is continuing to decelerate. On the other hand, businesses have definitely not yet started to recruit new staff, and this is not a good message for domestic demand.

Hungary sprang the greatest surprise of the Central European economies. Its PMI soared from 49.1 to 55.9, a level that indicates a decent recovery and has been concurrently the highest since March 2012.

PL: GDP and its selected components



Purchasing manager index



Weekly preview

TUE 9:00 **CZ Retail Sales (change in %)**

	Dec-12	Nov-12	Dec-11
Sales	**-5.7**	-1.8	1.0
cummulative (YTD)	**-1.1**	-0.6	1.8

CZ: Retail sales continue to fall

The decline in real purchasing power, along with a lower number of business days in the month, likely continued to affect retail sales in December. The overall fall in retail sales probably hit nearly all segments, and thus only web shops, the market share of which is increasing to the detriment of their brick-and-mortar counterparts, will show positive figures. The situation was not even counterbalanced by the sales of new cars, the registrations of which fell by more than 15% in that month. The effect of stockpiling ahead of January's increase in both VAT rates was likely not very evident this time.

WED 9:00 **CZ Industry (y/y change in %)**

	Dec-12	Nov-12	Dec-11
Monhtly	**-7.7**	-3.9	2.1
cummulative (YTD)	**-0.8**	-0.2	6.5

CZ: Industry facing poor demand

December's figures from Czech industry were primarily affected by poor orders and three fewer business days in the month. Hence significantly negative data should be no surprise. Perhaps the only major sector to remain in the black will be the chemical industry. Manufacturers of electronics, metals, and plastics saw a significant decline. Not even carmakers avoided a decline this time. As usual, attention will be paid to new orders, which probably fell again on the year-on-year basis. Nonetheless, as indicated by the PMI, January's figures from industry might provide a positive signal, though still very weak.

WED 13:00 **CNB base rate**

	This meeting	Last change
rate level (in %)	**0.05**	11/2012
change in bps	**0**	-20

CZ: The CNB brings no surprise this time either

As the Czech National Bank's base rate is technically at zero and the koruna is still above the EUR/CZK 25, we expect no specific action from the CNB Board's first meeting of the year. The new forecast, which will be available to the CNB Board, is likely to confirm a not very optimistic outlook for the economy, and thus the Board will probably just state that its interest rates are set properly, and will mention the possibility using forex interventions to continue to ease monetary conditions. Just like the market, the CNB will eagerly await January's inflation data, which will be affected by the increased VAT, but this data will not yet be available at the time of the meeting.

WED 14:00 **NBP rate (in %)**

	This	Last change
rate level	**3.75**	1/2013
change in bps	**-25**	-25

PL: The central bank to cut rates again by 25 bps

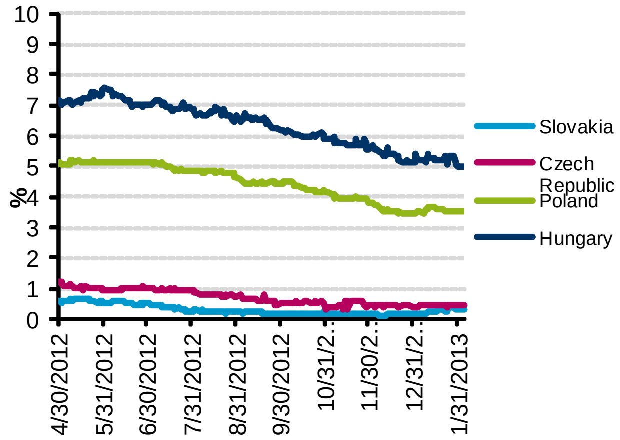
The National Bank of Poland is likely to cut rates again, by 25 bps to 3.75%, on Wednesday. Such a decision will certainly not surprise the market, and rather than the decision itself, the press release from the meeting and the subsequent conference will be awaited. The market is still betting on fairly dramatic rate cuts in the months to come (but these expectations are not quite well founded in our opinion). Nevertheless, we believe that there is not much to expect from the press conference, and bold commitments would be a surprise – the NBP is more likely to wait for the release of the GDP structural data for the last quarter of 2012 and for a new inflation forecast, to be discussed in March.

Calendar

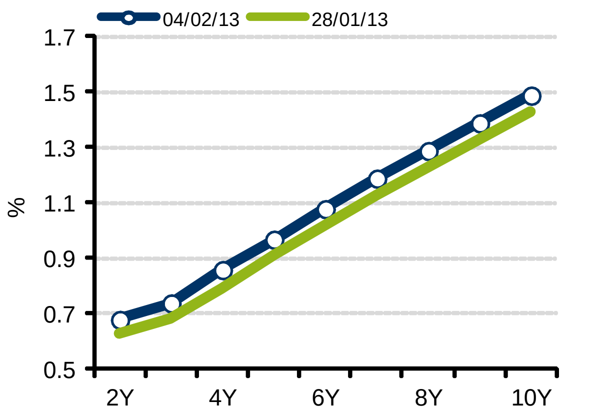
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	02/05/2013	9:00	Retail sales	%	12/2012		-5.7		-5.8		-1.8
CZ	02/06/2013	9:00	Construction output	%	12/2012						-2.7
CZ	02/06/2013	9:00	Industrial output	%	12/2012		-7.7		-10.8		-3.9
CZ	02/06/2013	9:00	Trade balance	CZK B	12/2012	13.8		17		35.5	
CZ	02/06/2013	12:30	CNB meeting	%	02/2013	0.05		0.05		0.05	
PL	02/06/2013	14:00	NBP meeting	%	02/2013	3.75		3.75		4	
HU	02/07/2013	9:00	Industrial output	%	12/2012 *P				-3	-0.1	-6.9
HU	02/07/2013	17:00	Budget balance	HUF B	01/2013					-607.5	
CZ	02/08/2013	9:00	Unemployment rate 15-64	%	01/2012	7.9				7.4	
HU	02/08/2013	9:00	Trade balance	EUR M	12/2012 *P					659.5	

Fixed-income in Charts

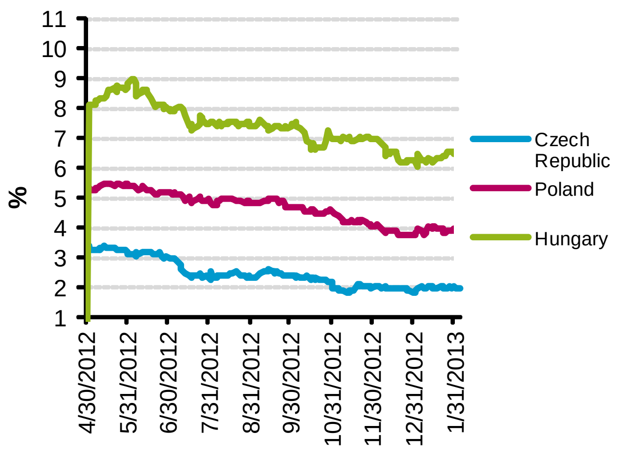
FRA 3x6



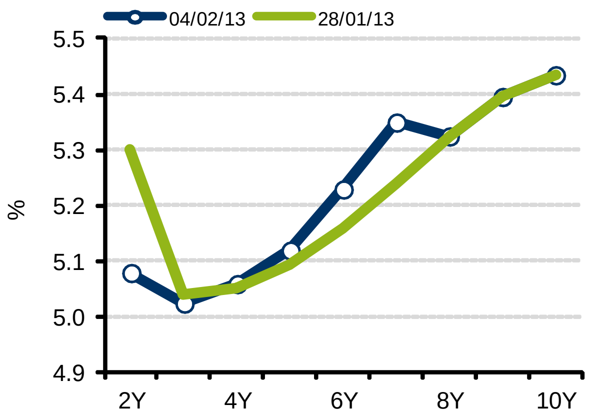
CZ IRS



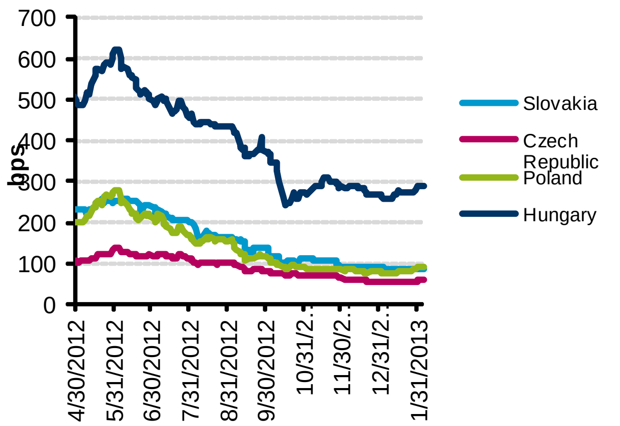
10Y GB Yields



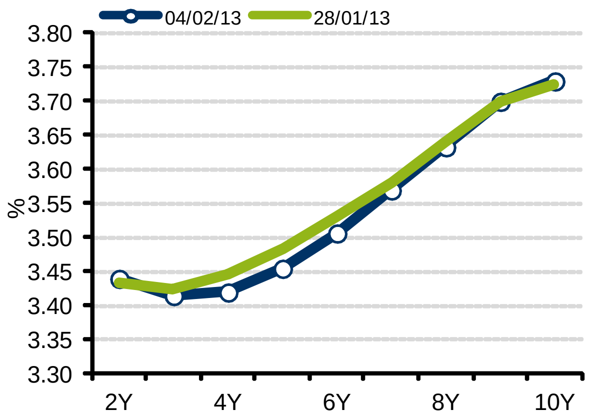
HU IRS



CDS 5Y



PL IRS



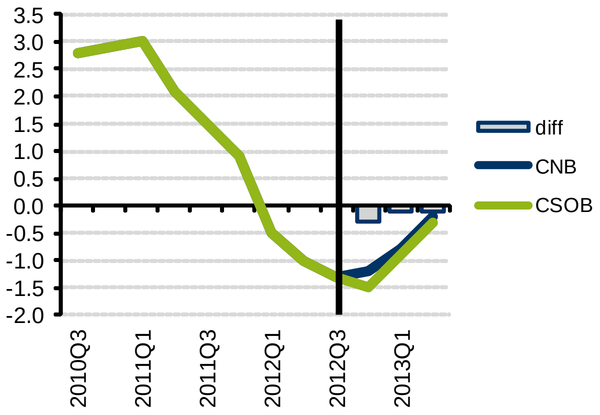
Source: Reuters

Medium-term Views & Issues

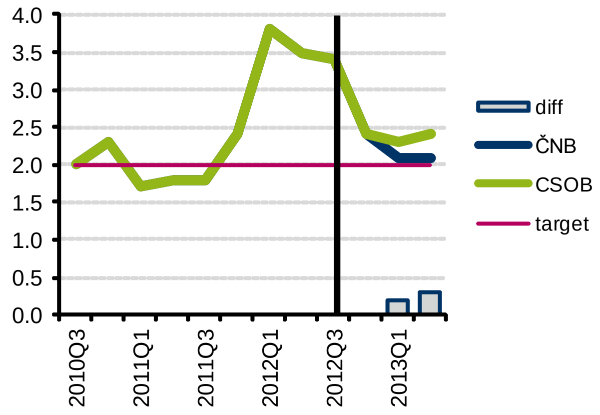
	The Czech Republic	Hungary	Poland
Growth & key issues	The Czech economy is in its second recession in four years. For the first three quarters of 2012, GDP dropped by 0.9%, and the first data for the last quarter signal no reversal of the downtrend. At the end of the year, the current driver of the economy - industry - got into the red and. First indications of economic stabilisation should become visible in the second half of 2013.	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 probably to 0.6% in the fourth 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 2.0% 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

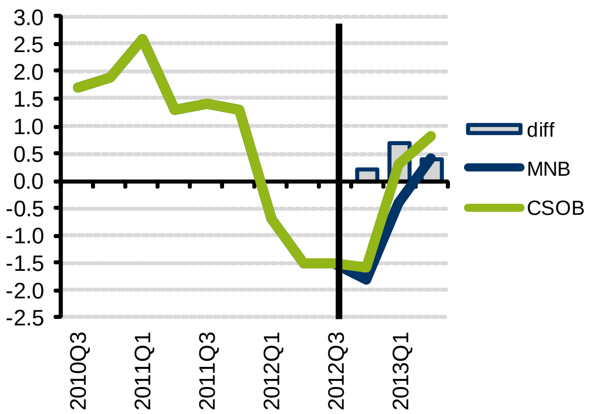
CZ: GDP outlook (Y/Y, %)



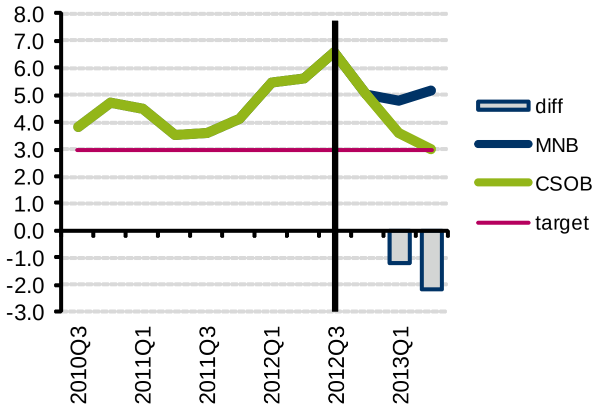
CZ: Inflation outlook (Y/Y, %)



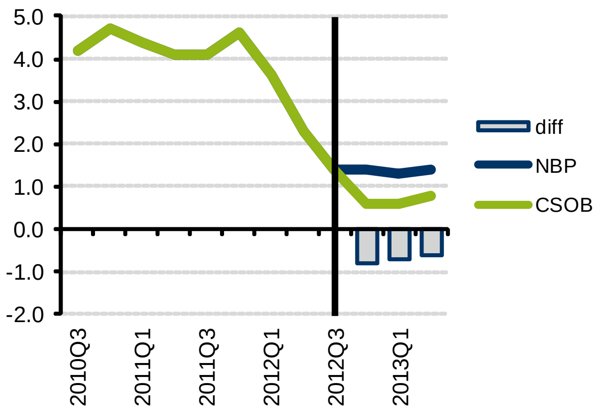
HU: GDP outlook (Y/Y, %)



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.	*5.50*	7.00	6.50	5.75	5.25	4.75	-25 bps	1/29/2013
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	*5.50*	7.20	6.61	5.75	5.20	4.70
Poland	WIBOR	*3.94*	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	*1.49*	2.02	1.61	1.37	1.45	1.50
Hungary	HU10Y	*5.65*	6.71	6.56	5.49	7.25	7.00
Poland	PL10Y	*3.73*	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	25.1	24.7
Hungary	EUR/HUF	*292*	286	285	291	280	280
Poland	EUR/PLN	*4.15*	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	0.6	0.6	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	2.4	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

Contacts

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	Brussels	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Joke Mertens	+32 2 417 30 59	Commercial Desk	+32 2 417 53 23
Mathias van der Jeugt	+32 2 417 51 94	Institutional Desk	+32 2 417 46 25
Dublin Research		London	+44 207 256 4848
Austin Hughes	+353 1 6646892	Frankfurt	+49 69 756 19372
Prague Research (CSOB)		Paris	+33 153 89 83 15
Jan Cermak	+420 2 6135 3578	New York	+1 212 541 06 97
Jan Bures	+420 2 6135 3574	Singapore	+65 533 34 10
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)		Prague	+420 2 6135 3535
Marek Gabris	+421 2 5966 8809	Bratislava	+421 2 5966 8436
Warsaw Research		Budapest	+36 1 328 99 63
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