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Central European Weekly

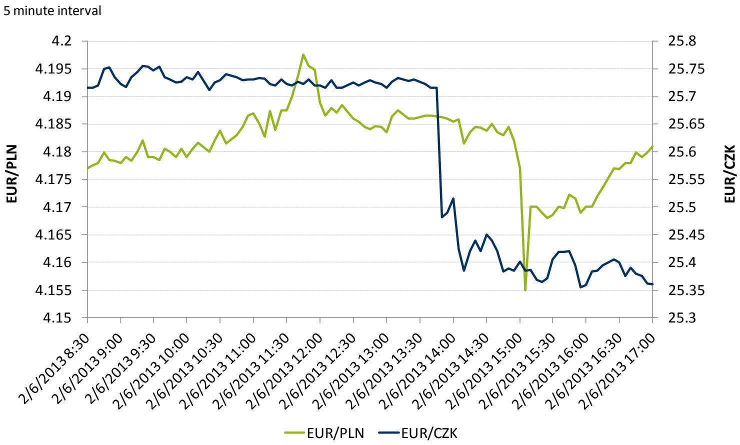
Monday, 11 February 2013

Table of contents

Weekly Highlights:

- Less dovish regional banks reversed the bearish in the region's forex markets.
- The CNB: No signal about interventions against the koruna
- The NBP cuts again, but the MPC sounds more hawkish
- A wave of poor figures from the Czech economy
- The Polish inflation still heading downwards

Chart of the Week



Regional central banks' meetings brought heavy price actions on the koruna and the zloty forex markets last Wednesday.

Market's editorial

Less dovish regional banks reversed the bearish in the region's forex markets.

Developments in Central European forex markets are rarely at the mercy of regional events; however, this was the case last week, when the Czech National Bank and National Bank of Poland stirred the koruna market and the zloty market respectively.

The CNB: interventions against the koruna not on its agenda

Let us begin with the CNB, where the market reaction was more dramatic. Although the CNB Board met expectations and left its base interest rate unchanged at the record low of 0.05%, the Czech National Bank did not even suggest that it was time to proceed to forex interventions. Various speculations about forex interventions that would be aimed at easing the monetary conditions, and even deliberations on a possible exchange rate 'targeting', had occurred prior to the February meeting of the CNB Board. Nevertheless, the reality is much simpler – no exchange rate 'revolution' is underway. The CNB views the current risks as balanced, and does not seem to intend to intervene in the situation soon. Statements from the CNB Governor even imply that the need to ease monetary conditions is less urgent now. The koruna, of which the CNB had been evidently afraid, necessarily had to react to such conclusions from the meeting – the currency strengthened by more than 2% against the euro.

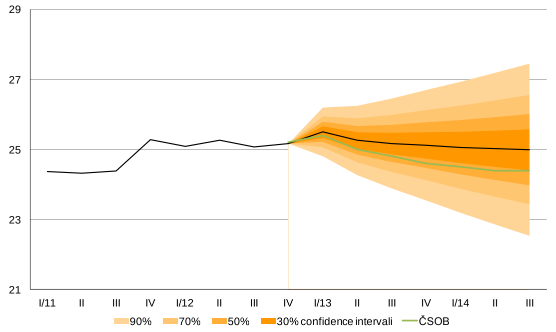
The NBP cuts again, but the MPC sounds more hawkish

In line with our expectations, the National Bank of Poland adopted a wait-and-see attitude, and its March decisions will be based on GDP data for the fourth quarter and a new forecast. Nevertheless, its official statement was slightly less dovish, and this pushed the zloty to stronger levels. NBP Head Belka did not rule out another rate cut in March, and made it clearly conditional upon incoming data and the new forecast. We still believe that the monetary easing cycle may end at 3.75%.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.3	-1.65%	→	→
EUR/HUF	291	-1.30%	↗	↗
EUR/PLN	4.15	-0.67%	↗	→

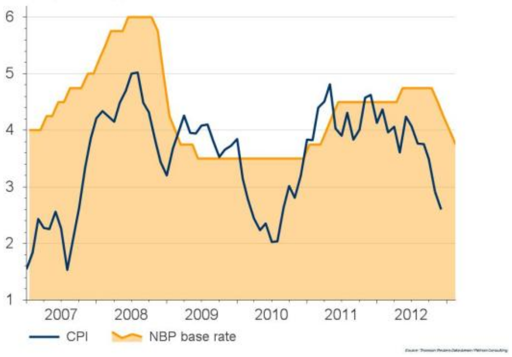
	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.52	1.33	→	↗
10Y HUF	5.63	3.59	→	↗
10Y PLN	3.87	2.66	→	↗

EUR/CZK: CNB forecast versus CSOB estimate



Polish inflation and NBP base rate

in %, inflation y/y



Review of Economic Figures

A wave of poor figures from the Czech economy

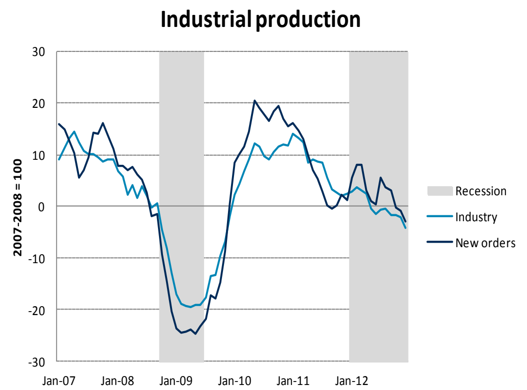
The data from the Czech economy for the end of last year, presented by the Statistical Office last week, did nothing to boost optimism. The drops in industrial output, exports, construction as well as retail sales signalled that GDP growth for the last quarter would be very low. Combined with poor industrial and construction orders, a change for the better is not yet on the way.

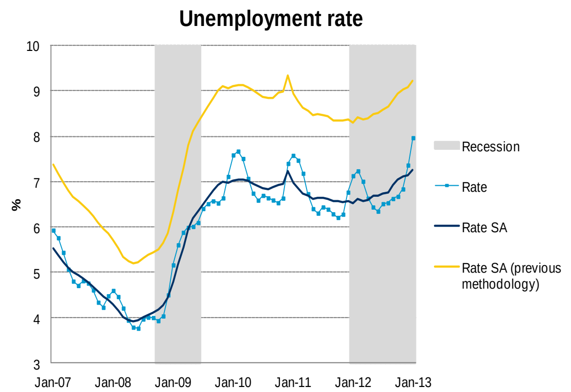
December's dramatic drop in industrial output is not that surprising if we take account of three fewer business days in the month and low orders in the previous months. However, adjusted for the different number of business days, industry fell by nearly 6%, the worst figure for the last three years. This time, the huge fall was attributable to carmakers, machinery, and plastics manufacturers, i.e., the strongest sectors of Czech industry. The promising figures from industry in early 2012 were completely offset by poor domestic as well as foreign demand in the second half of the year. Thus, after rising for two years, industry closed 2012 as a whole with a drop of 1.2%. Moreover, positive data from industry will not occur anytime soon, because new orders, which declined by 11.5%, hold no great hopes at the moment. As usual, domestic orders saw a significant downturn, but foreign ones followed suit this time.

Construction, which has been in a recession for four years, also fell dramatically in late 2012. December's construction output was down by 17.3% and, just as in industry, this was partly attributable to a lower number of business days in the month. However, even if adjusted for this factor, construction is in a deep recession, stemming from poor demand from both the public and private sectors. Thus construction has not yet hit bottom, and neither has housing construction. The number of dwellings now under construction is only about half the number that were being built in the strong years of 2007-8. In addition, new data from the construction sector, including orders, does not signal that the situation is starting to change for the better. While building construction shows a certain stabilisation, the negative trend in civil engineering orders is strong enough to keep construction in the red this year.

More and more bad news from the economy, including the data on rising unemployment, worsens the consumer mood as well as expectations. Hence it is no wonder that retail sales have been falling (most recently by 0.4%), particularly if real household income also went down last year. Thus retail sales fell by 1.1% in real terms for the whole of 2012.

The last signal of the weak demand in the Czech economy came from inflation as it rose less than expected in January - by 1.3% month-on-month and 1.9% year-on-year. Prices were pushed up mainly by higher VAT that affected almost all consumer goods and services. Next in line were price adjustments related to housing - rents deregulation, energy and water. Weak consumer demand has remained a strong brake for a faster price growth in the Czech Republic. We do not expect any visible improvement of the financial situation of households in the months ahead. Hence the January inflation has set a bar for the rest of this year. It is evident that inflation should move close to the CNB forecast, which sees inflation at 2% at the beginning of the year.





In Focus

The CNB Board met expectations and left its base interest rate unchanged at a record low of 0.05%. However in addition, the Czech National Bank has not signalled that it was time to proceed to forex interventions. Basically, the central bank maintains a wait-and-see attitude, having changed its forecast only slightly. Perhaps just the disappointment of EURCZK bulls that nothing dramatic had happened pushed the koruna to much stronger levels.

Various speculations about forex interventions that would be aimed at easing the monetary conditions, and even deliberations on a possible exchange rate 'targeting', had occurred prior to the February meeting of the CNB Board. Nevertheless, the reality is much simpler – no exchange rate 'revolution' is underway. Statements from the CNB Governor even imply that the need to ease monetary conditions is less urgent now.

An important outcome from yesterday's meeting was the forecast, which only negligibly differs from the previous one. The central bank worsened the GDP outlook for this year (see the table), and only very slightly adjusted the inflation and exchange rate outlooks. In the short-term horizon, we should note the increase in the forecast of 3-month Pribor, which the CNB has raised by 30bps for the second quarter of the year. Making the economic outlook more realistic, along with the facts that the koruna is above the forecast and the Pribor almost meets the CNB's expectations, has reduced the likelihood of a central bank intervention in the forex market.

While the CNB is not very optimistic about this year, the bank views 2014 positively, when it expects 2.1% economic growth. In conclusion, the forecast states that consistent with the forecast is a slight decline in market interest rates, followed by a rise in rates as from mid-2014. By and large, the upshot of the first CNB Board meeting is that nothing dramatic is happening and the central bank's view has not substantially changed.

No signal about interventions against the koruna

The koruna soared after an eagerly awaited meeting of the CNB. Let us recall that a significant part of the market had been betting against the koruna ahead of the meeting (earlier in the session, the EUR/CZK pair was seen even at 25.75 level). Along with the koruna's exchange rate currently in line with the central path of the CNB forecast, the revision explains both Governor Singer's comments and supports our view that there is no significant reason for interventions against the CZK, at least in the short run. At this moment, the koruna is trading close to the 200 days average (25.25). Although additional strengthening cannot be ruled out (to the EUR/CZK 25.0 level) we do not believe it would be sustainable now. If the koruna gained further, the CNB would probably launch a fresh round of verbal interventions as it foresees the average exchange rate in the current quarter at EUR/CZK 25.50.

CNB's prognosis		Feb. 2013	Nov. 2012	change
GDP (y/y, %)	2013	-0.3	0.2	↓
	2014	2.1	1.9	↑
Inflation (y/y, %)	2013Q4	2.3	2.3	
	2014Q2	1.7	1.6	↑
Monetary relevant inflation (y/y, %)	2013Q4	1.5	1.5	
	2014Q2	1.6	1.5	↑
PRIBOR 3M (average, %)	2013Q4	0.3	0.2	↑
	2014Q2	0.4	0.4	
CZK/EUR (average)	2013Q4	25.1	25.2	↓
	2014Q2	25.0	25.1	↓
External assumptions		**Feb. 2013**	**Nov. 2012**	**change**
GDP - euro area (y/y, %)	2013	0.6	0.8	↓
Inflation - euro area (y/y, %)	2013	2.1	1.7	↑
EURIBOR 3M (average, %)	2013	0.3	0.2	↑
Brent (average, USD)	2013	108.8	107.0	↑
USD/EUR (average)	2013	1.26	1.25	↑

Weekly preview

FRI 14:00	PL Inflation (change in %)		
	I.13	XII.12	I.12
CPI y/y	**2.2**	2.4	4.1
Food (ex Alc.) y/y	**3.4**	3.9	4.2
Transport (including fuel)	**0.3**	1.1	8.7

PL: Inflation still heading downwards

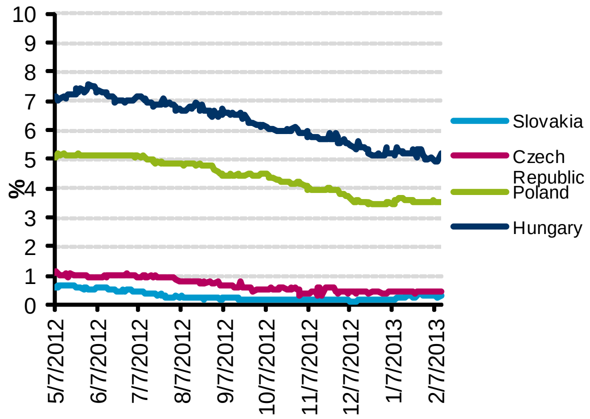
Poland's inflation likely continued to decelerate in January, when prices were up by 2.2% y/y and 0.5% m/m, according to our forecast. The month-on-month price rise was likely due mostly to food and soft drinks, the prices of which went up by 1.1% in our opinion. By contrast, we anticipate the transport sub-index to more or less stagnate; petrol and diesel prices at fuel stations have likely not yet been fully affected by the fairly rapid increase of fuel prices in Rotterdam in the second half of the month. Year-on-year inflation should continue to decelerate, and might even fall below 2% in March.

Calendar

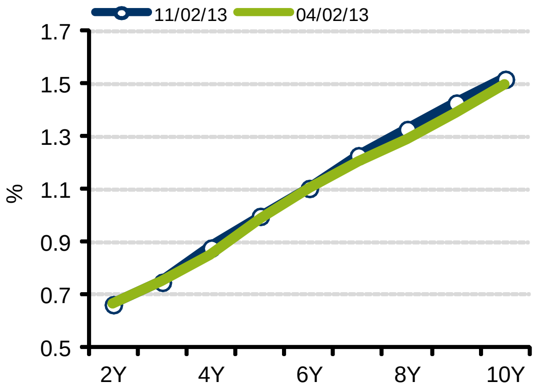
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	02/11/2013	9:00	CPI	%	01/2013	1.5	2.1	1.5	2.1	0.1	2.4
CZ	02/12/2013	10:00	Current account	CZK B	12/2012	-8.5		-12.7		-2.01	
PL	02/12/2013	14:00	Current account	EUR M	12/2012			-928		-1490	
PL	02/12/2013	14:00	Trade balance	EUR M	12/2012			-619		-394	
CZ	02/14/2013	9:00	GDP	%	4Q/2012 *P	-0.4	-1.7	-0.3	-1.7	-0.3	-1.3
HU	02/14/2013	9:00	CPI	%	01/2013			1	3.9	0	5
HU	02/14/2013	9:00	Industrial output	%	12/2012 *F					-2.5	-3.4
HU	02/14/2013	9:00	GDP	%	4Q/2012 *P			-0.3	-1.9	-0.2	-1.5
PL	02/14/2013	14:00	Money supply M3	%	01/2013			-1.1		2.2	
PL	02/15/2013	14:00	CPI	%	01/2013	0.5	2.2	0.3	2	0.1	2.4
PL	02/15/2013	15:00	Budget balance	PLN M	01/2013						

Fixed-income in Charts

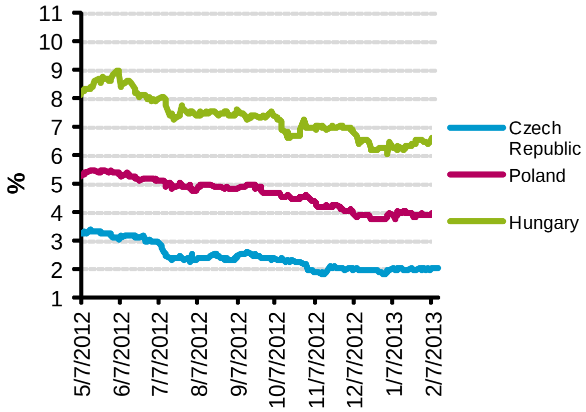
FRA 3x6



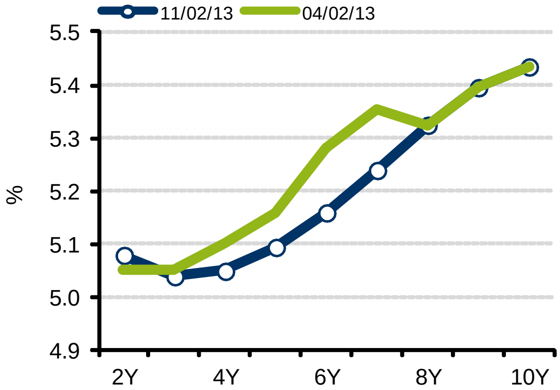
CZ IRS



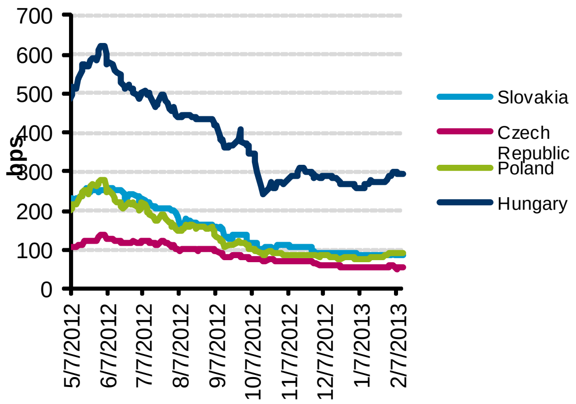
10Y GB Yields



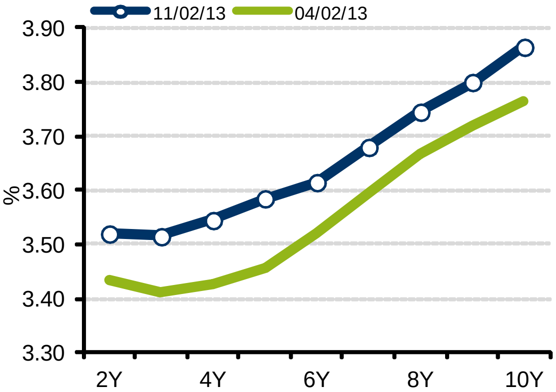
HU IRS



CDS 5Y



PL IRS



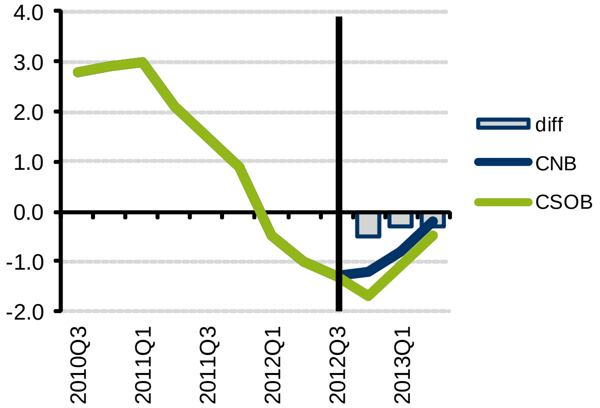
Source: Reuters

Medium-term Views & Issues

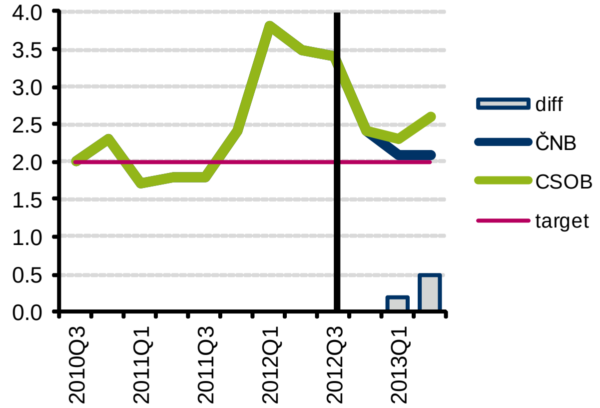
	The Czech Republic	Hungary	Poland
Growth & key issues	The Czech economy remains in a recession, which is shallower but longer than the previous one. The latest data from industry – production as well as orders – still tend to be negative. The drop in domestic demand was followed by a decline in foreign demand. Domestic growth stimuli are still absent. Another VAT increase will again curb household consumption, while concern about the negative outlook for the European economy curbs the investment activity of domestic firms. Nevertheless, taxes should remain unchanged in the next two years.	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	The CNB met expectations and left its rates unchanged, while it downgraded its economic outlook for this year. The CNB expects that the economy will continue to fall this year (as opposed to its original expectation of 0.2% growth). In addition, the central bank raised its three-month PRIBOR forecast for the next quarter to 0.5% (+30bps). The central bank also mitigated concern about forex interventions as an instrument to ease monetary conditions in the economy. Only much worse than expected economic developments could make the central bank 'diverge' from its wait-and-see attitude.	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 February. If leading indicators confirm bottoming out process, we believe the NBP should stay on hold in March with new forecast on the table.
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 uncertainty about the fragile bottoming process may weigh on the currency. Nevertheless end of easing cycle can be surprising for several market players and can play supportive role to the Polish currency at the end of first quarter. .

CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

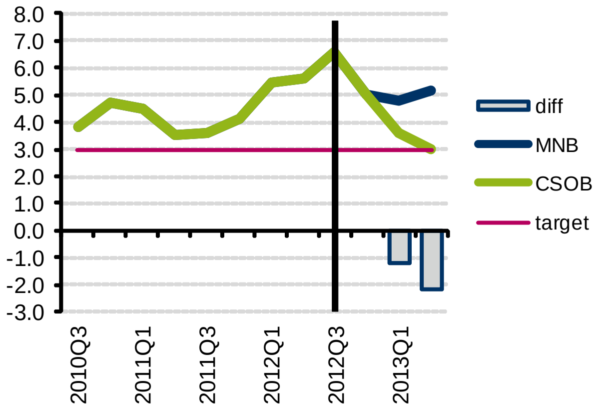


CZ: Inflation outlook (Y/Y, %)

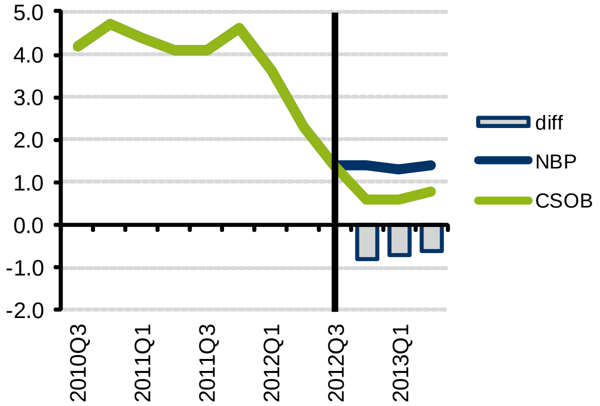


HU: GDP outlook (Y/Y, %)

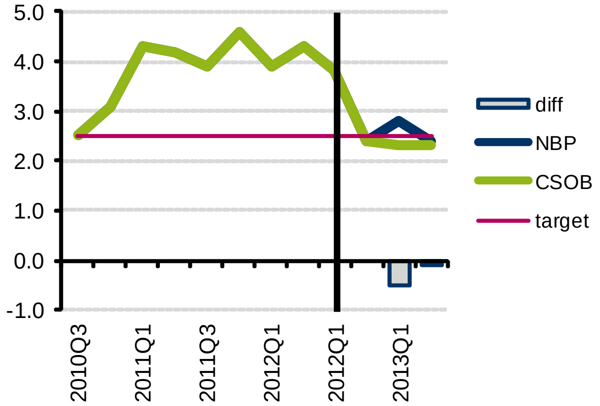
HU: Inflation outlook (Y/Y, %)



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	*3.75*	4.75	4.75	4.25	3.75	3.75	-25 bps	2/6/2013

*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	*5.49*	7.20	6.61	5.75	5.20	4.70
Poland	WIBOR	*3.82*	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	*1.52*	2.02	1.61	1.37	1.45	1.50
Hungary	HU10Y	*5.63*	6.71	6.56	5.49	7.25	7.00
Poland	PL10Y	*3.87*	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	*25.3*	25.5	25.1	25.1	25.1	24.7
Hungary	EUR/HUF	*291*	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	-1.7	-1.1	-0.5
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	2.6
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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