Written by ČSOB Prague and K&H Budapest

Central European Weekly

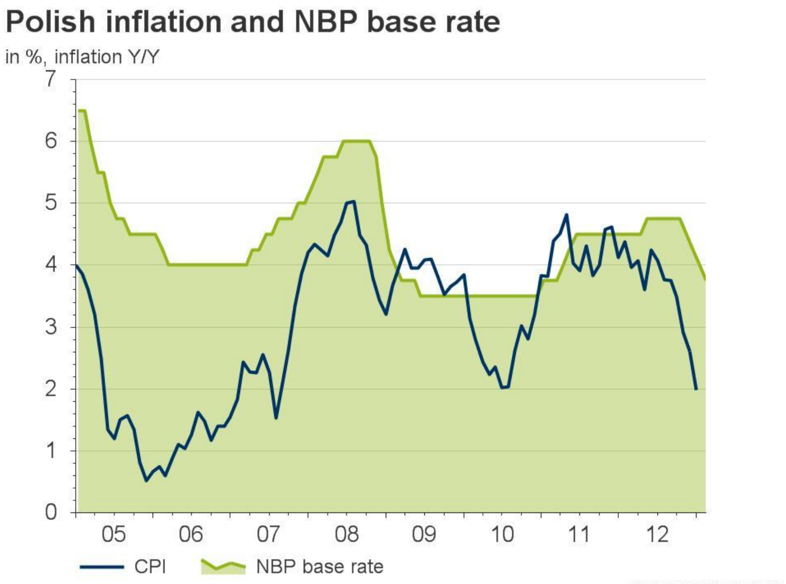
Monday, 18 February 2013

Table of contents

Weekly Highlights:

- End-of-year hard data shows the depth of the recession, …
- … but January leading indicators confirm our recovery hopes
- Polish inflation falls to 5-1/2 year low

Chart of the Week



Polish inflation fell to 5-1/2 year low in January and strengthened a case for a rate cut in March.

Central European Daily

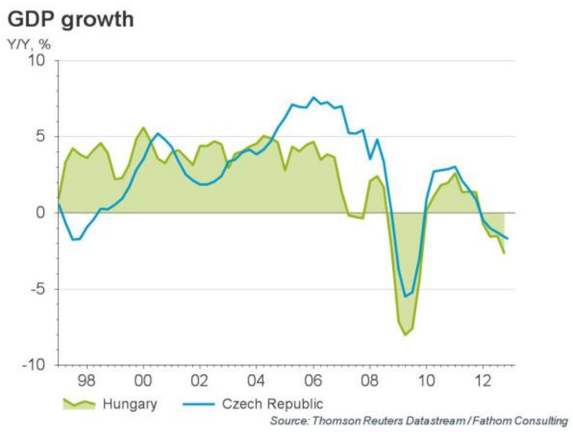
Market's editorial

End-of-year hard data shows the depth of the recession

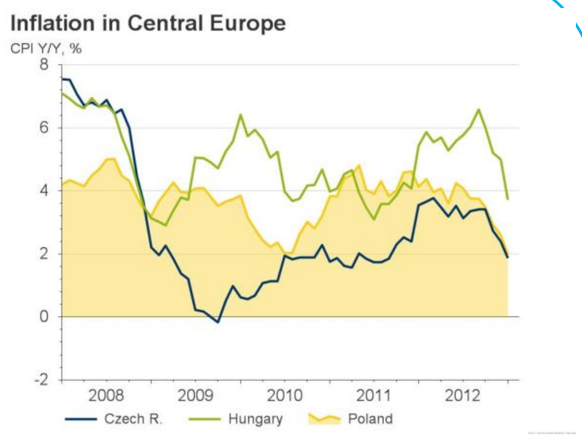
While we report (see page 2) that our leading indicators for Czech and Polish industries are signaling an approaching upswing, the latest release of hard GDP data outlined the real depth of the recessions in the Czech Republic and Hungary. Let us add that the actual message from Poland's inflation data is similar: it is evident that the decelerating economy is curbing inflation.

As concerns growth in Hungary and the Czech Republic, or actually declines in GDP, the stories of both countries are much the same. Clearly, the economies are falling because of the curbed domestic demand, not because of the supply side – i.e., low competitiveness of exports or structural problems. The persisting budgetary restriction and the stagnating (or falling) wages have led to a permanent drop in household consumption in both the Czech Republic and Hungary. In addition, the falls in those economies accelerated because businesses, being afraid of economic developments in Western Europe, probably cut their investments. Moreover, reduced foreign demand also had an impact.

It is hard to predict a reversal of the above trends at the moment – nevertheless, foreign demand might improve somewhat as early as in the second half of the year. As far as domestic demand is concerned – it might recover next year at least, when general elections are scheduled to take place in the Czech Republic and Hungary, and the ruling parties will certainly not wish to curb the economy.



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.4	0.25%	↗	→
EUR/HUF	292	0.48%	↗	→
EUR/PLN	4.19	0.20%	↗	→



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.57	1.23	→	↗
10Y HUF	5.38	-1.01	→	↗
10Y PLN	3.89	-1.15	→	↗

Review of Economic Figures

January Leading indicators confirm our recovery hopes

Leading indicators in Central Europe continue to improve. Although initial signals still need to be confirmed, the recovery-story has gained credibility.

In January **the Czech Flash** (leading indicator for the Czech industry) rose for a third consecutive month and hit its highest level since July 2012. It has been improving at a decent rate in all of its components, except for new orders in the automotive industry. However, the rate of decline of these orders has started to decelerate.

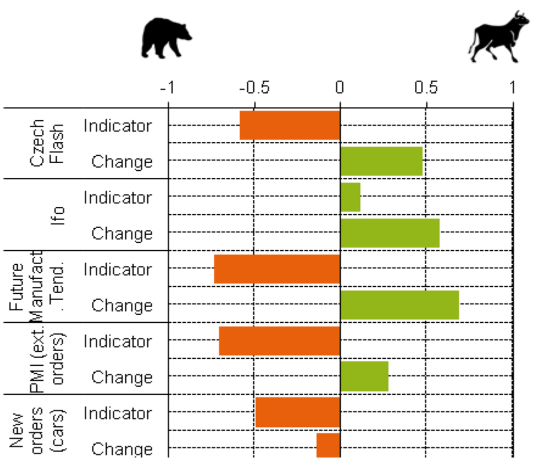
The figures from January's Flash are consistent with our call on the export-led recovery of industry in the first half of 2013. However, domestic demand will certainly remain a drag on the overall growth forecast. As a result, 2013 won't be a bumper year for the Czech economy. A slight positive growth figure is the best one (including the Czech National Bank) can expect. The National Bank still forecasts a 0.3% decline of growth in 2013.

The Polish Flash has improved in all of its components for a fourth consecutive month. Standing at -38 points, it is at its highest level since June 2012.

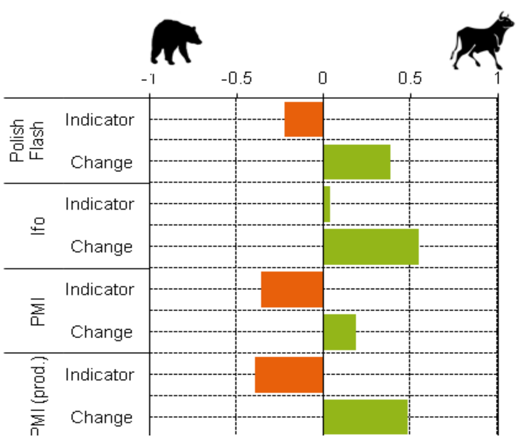
Especially the Ifo, the German business sentiment index, improved significantly, as did the evaluation of production under the PMI index, which is at its best level since April 2012.

The Polish Flash figure confirms our call of a recovery of industry in the first quarter of 2013. To be sure, we would like to see improvement in January industrial output. However, even if the industry and retail sales stabilise in January, our call for unchanged interest rates at March the NBP meeting is at risk. The inflation has surprisingly declined in to 1.7% in January and is set to decline further below NBP target till mid-2013. If the inflation expectations decline correspondingly, the NBP has the space to ease the monetary conditions further no matter how cyclical indices such as the Polish Flash improve.

The Czech Flash- leading indicator



The Polish Flash- leading indicator

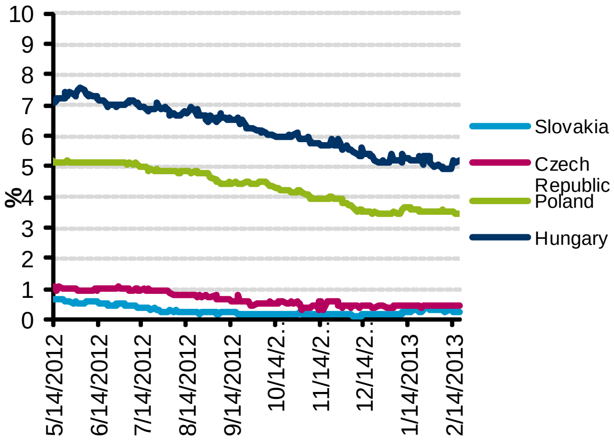


Calendar

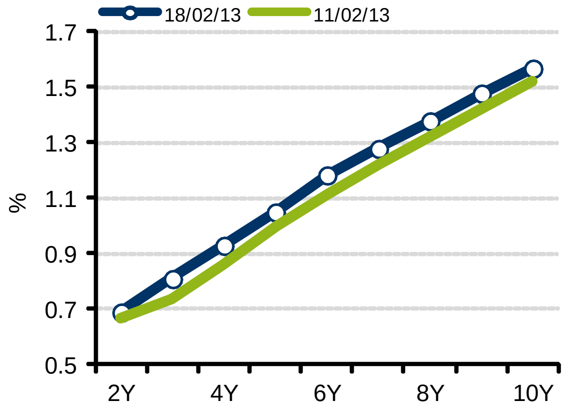
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	02/18/2013	11:00	Czech Central Bank Governor Singer to Spe		02/2013						
PL	02/18/2013	14:00	Wages	%	01/2013			-10.2	1	8.8	2.4
PL	02/19/2013	14:00	Industrial output	%	01/2013			2.7	-2.8	-14.2	-10.6
PL	02/19/2013	14:00	PPI	%	01/2013			0.2	-1.1	-0.6	-1.1
CZ	02/20/2013	12:00	CZ bond auction 2013-2028, x,xx %	CZK B	02/2012			5			
CZ	02/20/2013	12:00	CZ bond auction 2013-2016, 0.50 %	CZK B	02/2013			5			
HU	02/21/2013	9:00	Wages	%, ytd.	12/2012				3.9		5.4
CZ	02/22/2013	9:00	PPI	%	01/2013	0.7	0.9	0.7	1	-0.3	1.2

Fixed-income in Charts

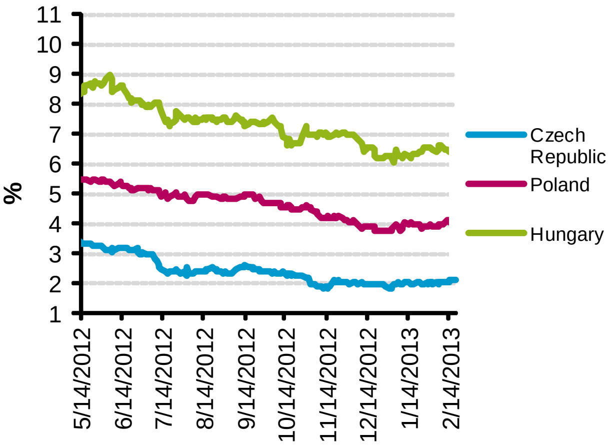
FRA 3x6



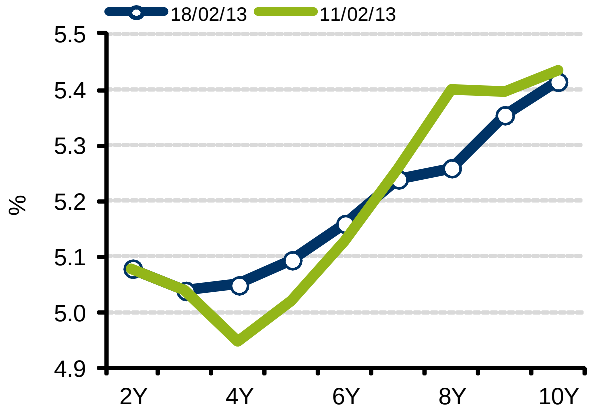
CZ IRS



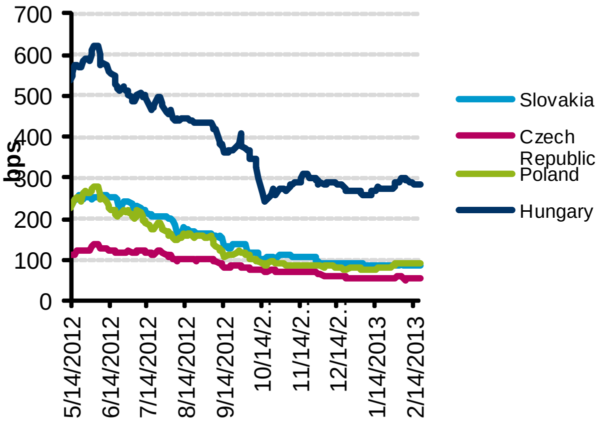
10Y GB Yields



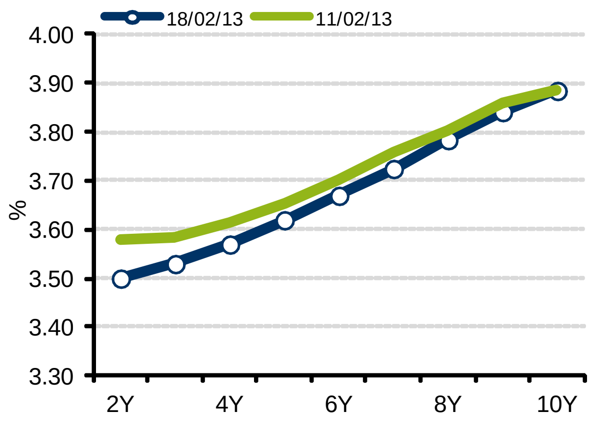
HU IRS



CDS 5Y



PL IRS



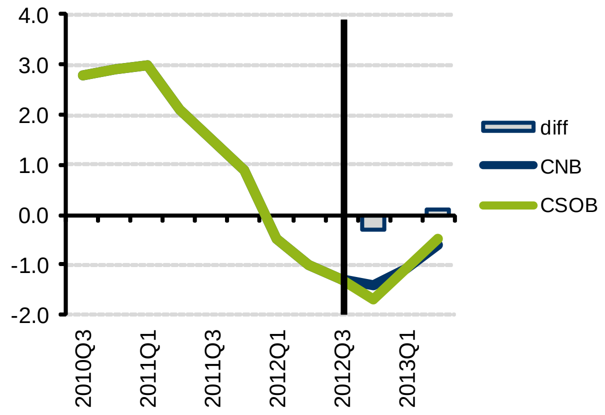
Source: Reuters

Medium-term Views & Issues

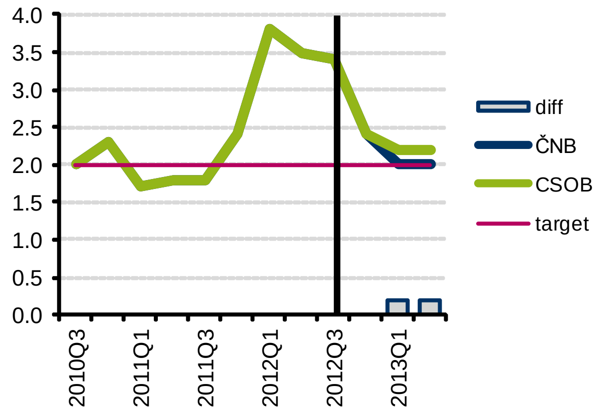
	The Czech Republic	Hungary	Poland
Growth & key issues	The Czech economy remains in a recession, which is shallower but longer than the previous one. The latest data from industry – production as well as orders – still tend to be negative. The drop in domestic demand was followed by a decline in foreign 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

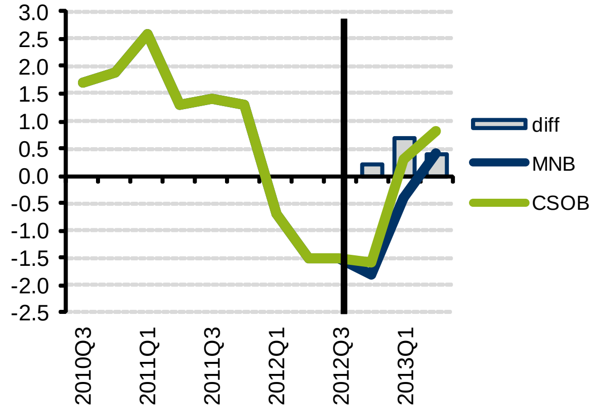
CZ: GDP outlook (Y/Y, %)



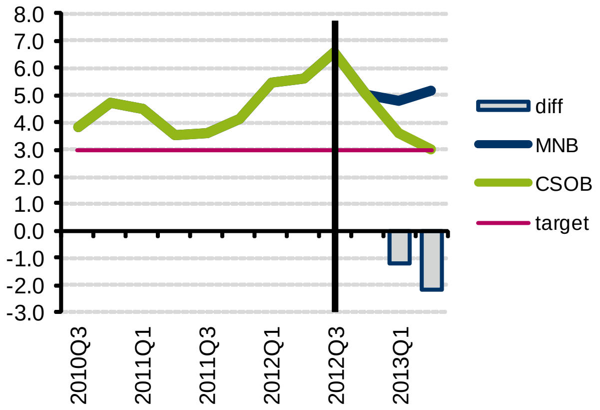
CZ: Inflation outlook (Y/Y, %)



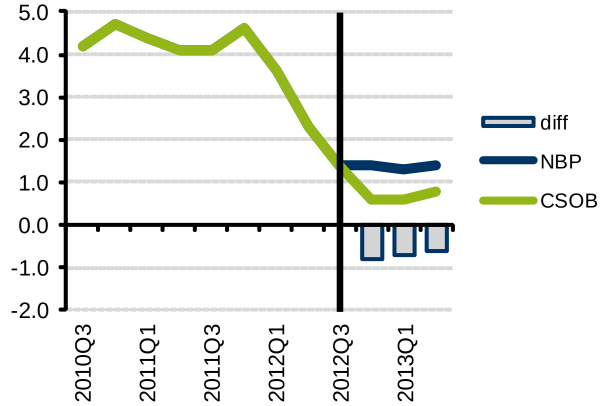
HU: GDP outlook (Y/Y, %)



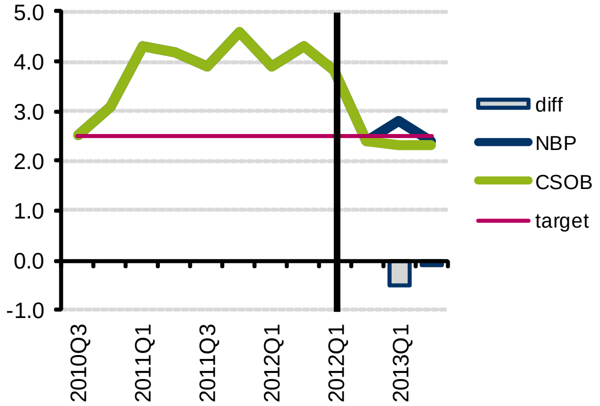
HU: Inflation outlook (Y/Y, %)



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	*5.45*	7.20	6.61	5.75	5.20	4.70
Poland	WIBOR	*3.79*	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	*1.57*	2.02	1.61	1.37	1.45	1.50
Hungary	HU10Y	*5.38*	6.71	6.56	5.49	7.25	7.00
Poland	PL10Y	*3.89*	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	*25.4*	25.5	25.1	25.1	25.1	24.7
Hungary	EUR/HUF	*292*	286	285	291	280	280
Poland	EUR/PLN	*4.19*	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	2.2	2.2
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
Budapest Research			

ALL OUR REPORTS ARE AVAILABLE ON WWW.KBC.BE/DEALINGROOM