Central European Weekly

Monday, 25 February 2013

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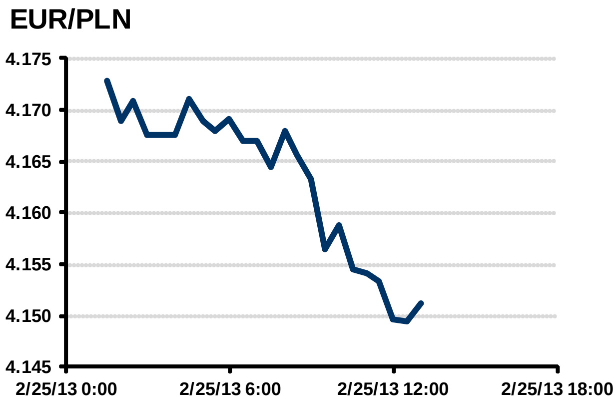
- The Czech koruna seeks its lost link to the dollar
- Polish industry and retail sales surprise positively
- Polish GDP growth in 2012Q4 the slowest since 2009

Chart of the Week



EUR/PLN, last 12 hours. Source: Reuters

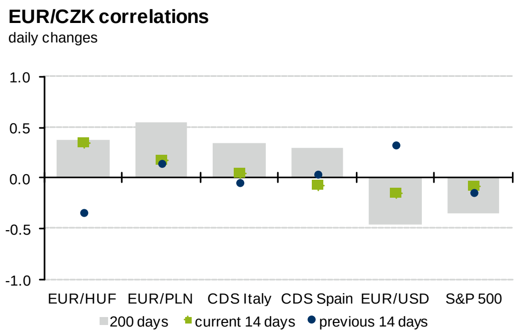
A reaction of the zloty on better than expected January retail sales data.

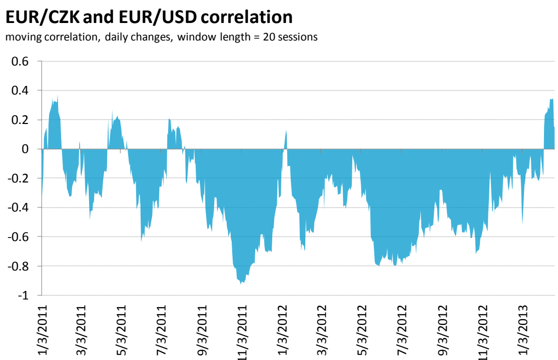
Market's editorial

The Czech koruna seeks its lost link to the dollar

In the first half of February, the negative linkage of the EUR/CZK currency pair to the EUR/USD was at its weakest level over the last two years. This was primarily due to the unwinding of speculative positions against the Czech koruna, which were created in January ahead of the February meeting of the Czech National Bank. At that time, markets were under fire from central bankers' statements against the koruna; however, it came to light in the end that (in line with our expectations as well as those of numerous domestic players) with the koruna at around CZK 25.75 per EUR, the CNB would certainly not feel like switching from verbal interventions to real ones.

The creation and the subsequent unwinding of the speculative positions against the koruna have significantly weakened the typical negative linkage of the EUR/CZK to the EUR/USD. Nevertheless, we believe that this has only been temporary. Last week, the monthly moving correlation coefficient between the EUR/USD and the EUR/CZK started to return towards negative values. The appreciation of the dollar in the wake of the Fed's hawkish statements triggered a typical negative reaction from the koruna. This negative linkage is likely to grow over the course of time, and the EUR/CZK volatility, which also increased in the sessions held on the days close to the CNB meeting, might decrease again, because it seems that markets will respect the CNB's preferred range for the EUR/CZK, which, with a view to the current forecast, should be between EUR/CZK 25.00 (25.10) and EUR/CZK 25.75.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*25.5*	*0.69%*	↗	→
EUR/HUF	*294*	*0.99%*	↗	→
EUR/PLN	*4.17*	*-0.22%*	↗	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*1.55*	*0.65*	→	↗
10Y HUF	*5.42*	*0.09*	→	↗
10Y PLN	*3.91*	*1.43*	→	↗

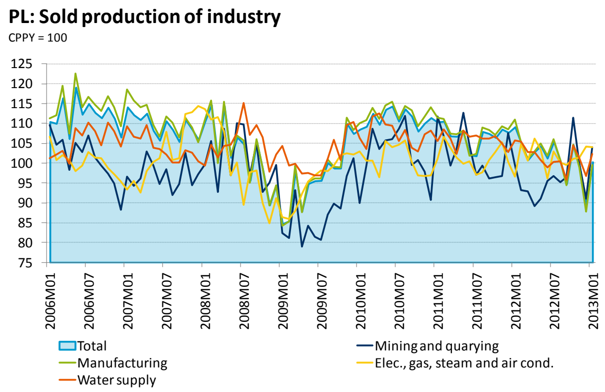
Review of Economic Figures

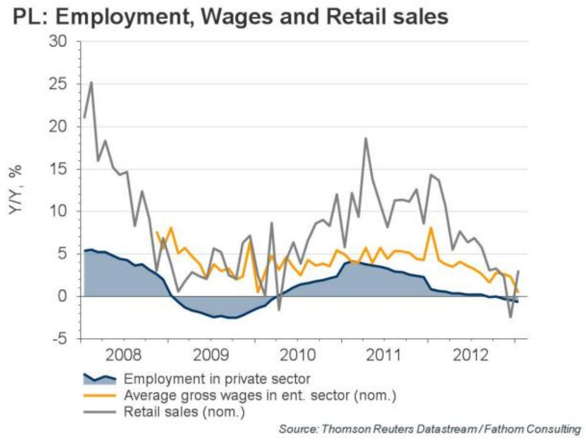
Polish figures will determine whether to cut rates again; January's industrial output surpassed expectations.

The most interesting developments in Central Europe last week occurred in Poland, with domestic events having contributed significantly to this. The primary factor was January's industrial output data, which was a pleasant surprise for the market, thus showing promise that our bets on the improvement of conditions within the next three months might be borne out. According to information from the Statistical Office, industrial output was up by 0.3% y/y (the market expected a 3% decline), with positive accruals registered in 20 of 34 sectors, according to the domestic classification. The figures from industry triggered a wave of comments from members of the Monetary Policy Council (MPC). Probably the most interesting ones were those from dove Elzbieta Chojna-Duch and from median voter Hausner. Chojna-Duch admitted that the support for a rate cut at the March meeting might not be strong enough, while Jerzy Hausner said that the MPC should consider terminating its rate cut cycle (however, he declined to answer the question as to how he would vote in March).

Retail stabilisation may stop the doves on the MPC.

Our model likelihood of a rate cut, based on changes in employment and in the inflation expectations, is on the rise (see the Graph), due in particular to the falling inflation expectations. In addition, these expectations may continue to fall until the middle of this year. By contrast, employment is improving, while numerous leading indicators show a rising industrial output after January's favourable figure. This might encourage the recruitment of new staff and stop further rate cuts. Another argument for the stability of rates is their low level and narrowed latitude for further monetary easing. In 2010, rates stood at 3.5% (as opposed to 3.75% now), the model likelihood of a rate cut was below 20%, just like today, and rates were not cut again. Moreover, the fresh figure on January's retail sales surprised on the upside of market expectations as it showed year-on-year growth of 3.1 % and indicated that the Polish economy might recover sooner than expected. We thus believe that February's rate cut to 3.75% was the last one, albeit the release of (likely unflattering) data on GDP growth for the last quarter of 2012 may still stir things up.





Weekly preview

FRI 10:00 PL GDP (y/y change in %)

	2012Q4	2012Q3	2011Q4
GDP	**0.6**	1.4	4.6

PL: Slowest GDP growth since 2009

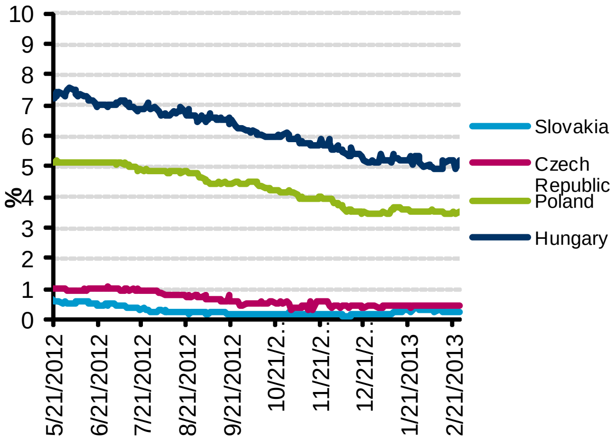
We predict that Poland's economic growth dropped to 0.6% in the last quarter of 2012, the worst figure since the first quarter of the crisis year of 2009. The contributors to the further growth deceleration in late 2012 likely included external as well as internal conditions – retail sales fell in real terms in the last quarter, as did industrial output. The Polish economy might, however, bottom out as early as in the first quarter of this year.

Calendar

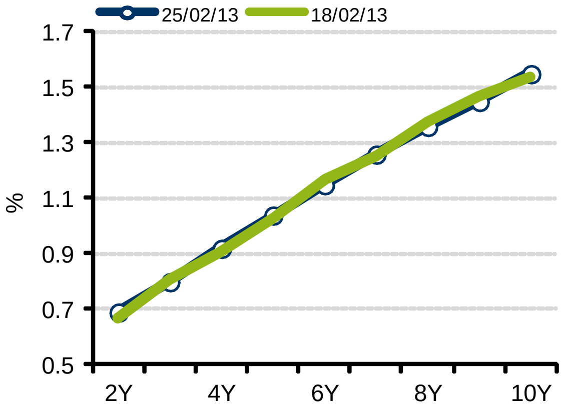
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	02/25/2013	9:00	Retail sales	%	12/2012				-3.7		-4.1
PL	02/25/2013	10:00	Retail sales	%	01/2013			-22.4	-0.2	15.1	-2.5
PL	02/25/2013	10:00	Unemployment rate	%	01/2013			14.2		13.4	
HU	02/26/2013	9:00	Unemployment rate	%	01/2013			11.1		10.7	
HU	02/26/2013	14:00	NBH meeting	%	02/2013	5.25		5.25		5.5	
HU	02/28/2013	9:00	PPI	%	01/2013				-0.7	0.5	-1.8
CZ	02/28/2013	11:00	Money supply M2	%	01/2013						4.5
HU	03/01/2013	9:00	PMI manufacturing		02/2013					55.9	
PL	03/01/2013	9:00	PMI manufacturing		02/2013						
CZ	03/01/2013	9:30	PMI manufacturing		02/2013						
PL	03/01/2013	10:00	GDP	%	4Q/2012			-0.1	1	0.4	1.4
CZ	03/01/2013	14:00	Budget balance	CZK B	02/2013					42.4	

Fixed-income in Charts

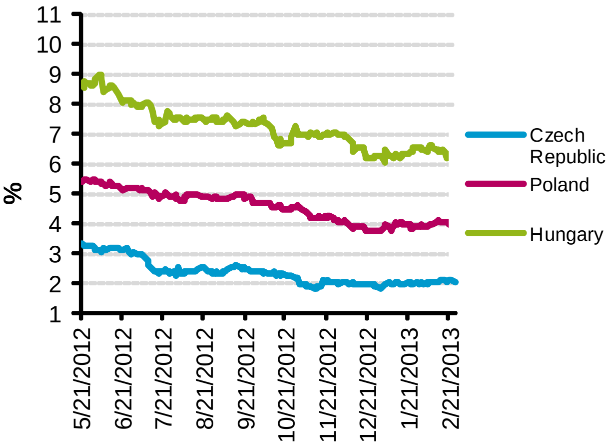
FRA 3x6



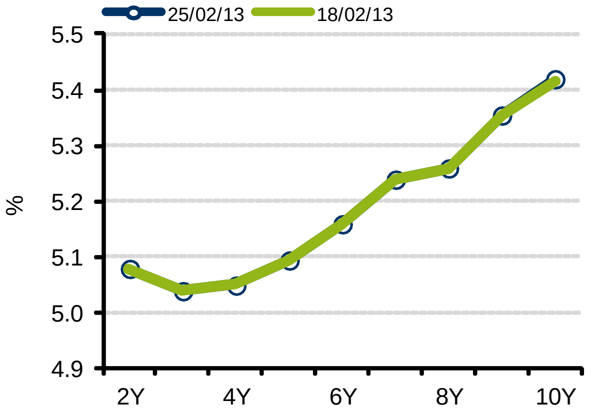
CZ IRS



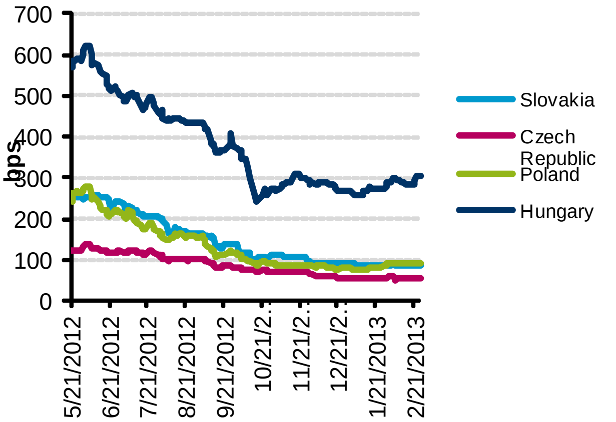
10Y GB Yields



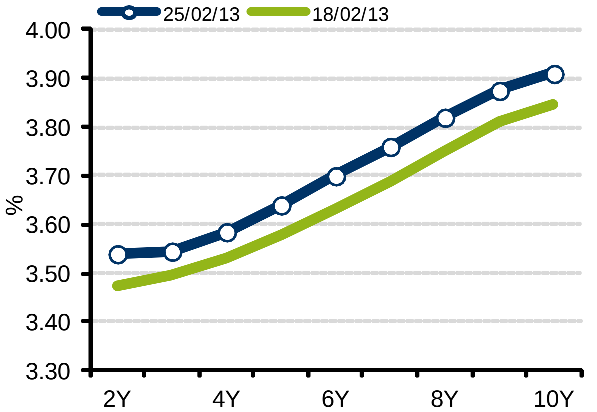
HU IRS



CDS 5Y



PL IRS



Source: Reuters

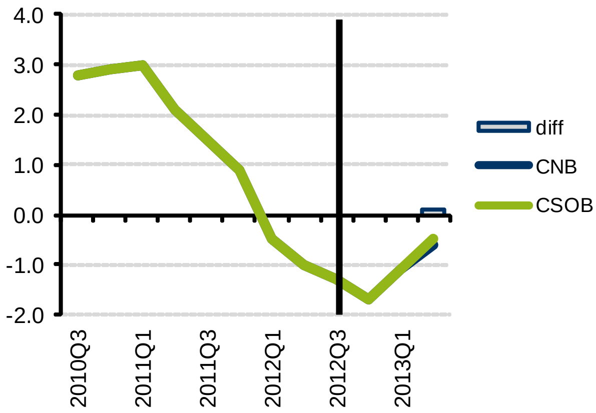
Monday, 25 February 2013

Medium-term Views & Issues

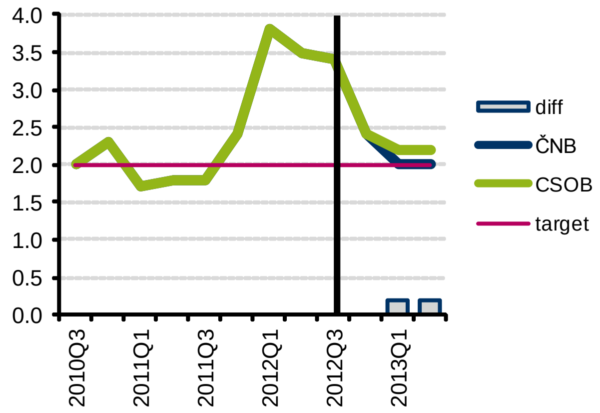
	The Czech Republic	Hungary	Poland
Growth & key issues	The Czech economy remains in a recession, which is shallower but longer than the previous one. The latest data from industry – production as well as orders – still tend to be negative. The drop in domestic demand was followed by a decline in foreign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

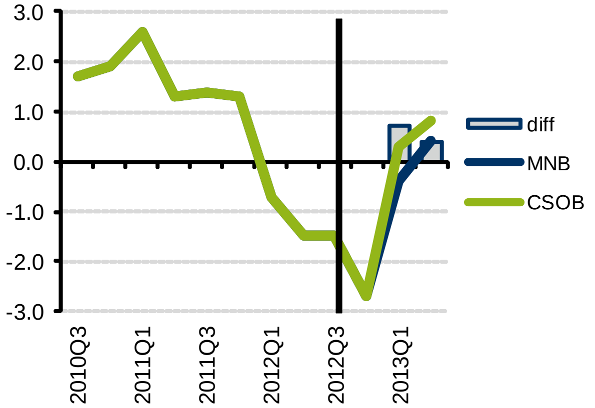
CZ: GDP outlook (Y/Y, %)



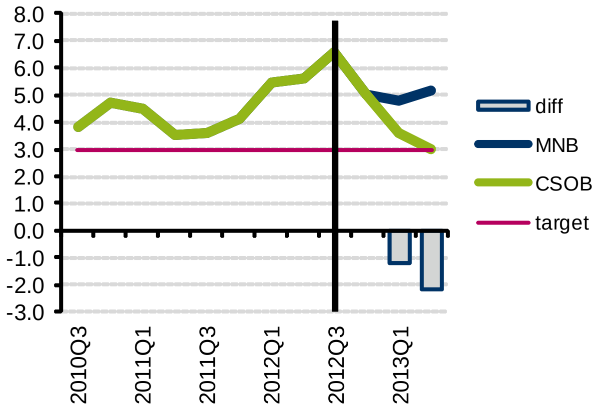
CZ: Inflation outlook (Y/Y, %)



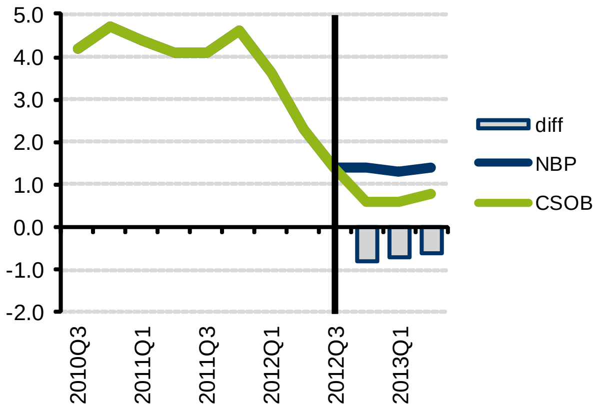
HU: GDP outlook (Y/Y, %)



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	*5.44*	7.20	6.61	5.75	5.20	4.70
Poland	WIBOR	*3.75*	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	*1.55*	2.02	1.61	1.37	1.45	1.50
Hungary	HU10Y	*5.42*	6.71	6.56	5.49	7.25	7.00
Poland	PL10Y	*3.91*	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	*25.5*	25.5	25.1	25.1	25.1	24.7
Hungary	EUR/HUF	*294*	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	-1.7	-1.1	-0.5
Hungary	1.3	-0.7	-1.5	-1.5	-2.7	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

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