Central European Weekly

Monday, 04 March 2013

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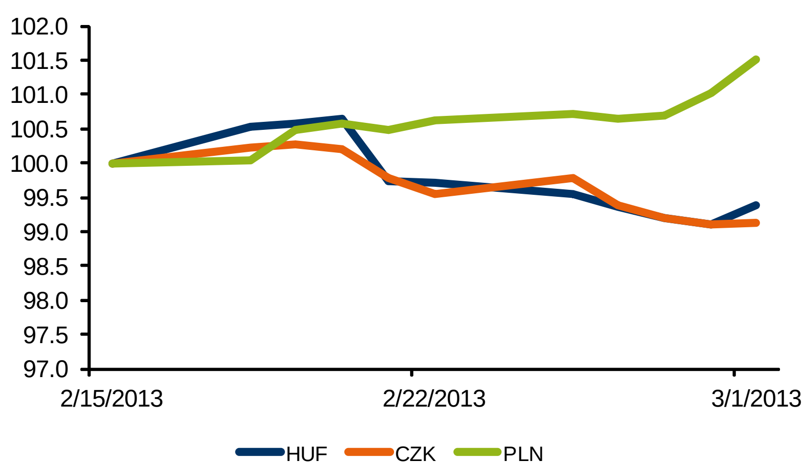
Chart of the Week

CE currencies agains the euro



The Polish zloty has outperformed its peers as the latest data have been consistently surprising on the upside of expectations.

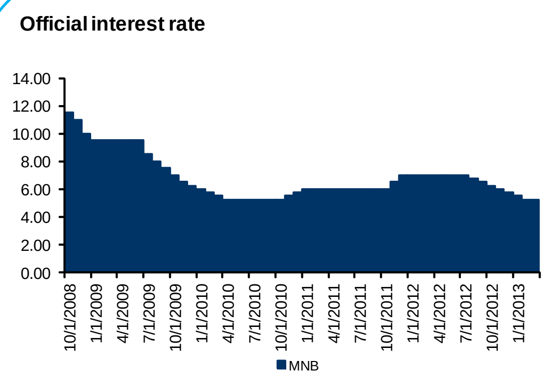
Market's editorial

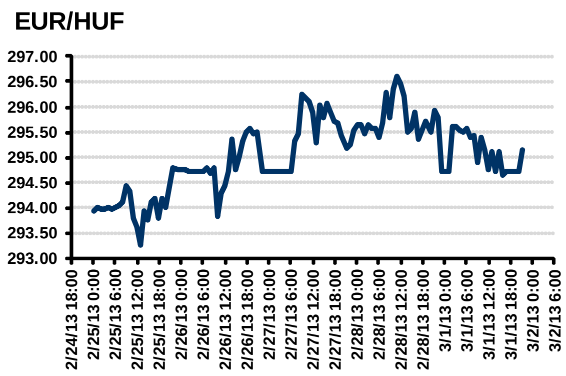
Matolcsy – new MNB President as expected,...

Hungary, and in particular its economic policy, again grabbed the spotlight, when Prime Minister Orban met expectations and appointed György Matolcsy – a member of the government and the Minister of the Economy – to be the new President of the MNB. Although Matolcsy had advocated certain unconventional expansive interventions into monetary policy in the past, the market reaction to his appointment was very moderate in the end. The reason is that, once being appointed, Matolcsy toned down his previous statements by labeling himself an enemy of inflation. On the other hand, it is also true that his first appearance as MNB President (in Parliament) was not clearly conservative, as would be appropriate for a new central bank governor. One of Matolcsy's messages to markets was that the MNB policy also has to foster growth and, without providing a detailed specification, he cited the experience of the Bank of England and, somewhat surprisingly, that of the National Bank of Poland.

....so its easing cycle might continue

Bear in mind that on Tuesday the MNB (still led by MNB President Simor) met expectations and cut its rate by 25 basis points. Thus its base rate fell to 5.25%, the lowest level ever, which the bank had already set once before, in April 2010, when Viktor Orban became Prime Minister. Nonetheless, even though the rate is at all-time lows, the monetary easing cycle seems to be far from over. The statement released after the decision on rates clearly indicates that the MNB does not currently see inflation as a risk; the bank is more concerned about very low domestic demand and its downside effect on inflation, and therefore believes that its inflation target may even be achieved with a more eased monetary policy than there is at the moment. In other words, it is evident that the Monetary Council, which has been completely at the mercy of doves after its last hawk (outgoing Governor Simor) left the bank, will continue to cut rates.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*25.7*	*0.34%*	→	→
EUR/HUF	*297*	*0.53%*	→	→
EUR/PLN	*4.14*	*0.00%*	→	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*1.44*	*-6.49*	→	↗
10Y HUF	*5.33*	*-0.37*	→	↗
10Y PLN	*3.88*	*-0.26*	→	↗

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Review of Economic Figures

Poland's GDP grew due only to net exports

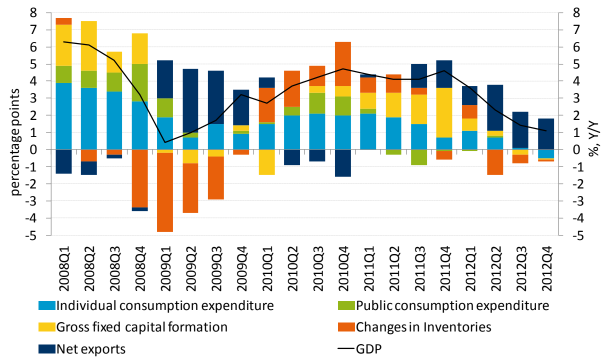
Poland's economic growth for the fourth quarter of last year significantly surpassed our expectations and reached 1.1% y/y. By contrast, figures from the Statistical Office confirmed that the economy was only driven by net exports, which improved owing to falling imports as well as rising exports. Household consumption was down by 1% y/y, while investment also dropped on a year-on-year basis (though much less than in the third quarter).

Domestic absorption of the Polish economy bore out the mediocre performances of retail sales, industry, as well as construction. Gross value added fell by 1.2% y/y in industry and 2.1% in construction. While industry already rose slightly on a quarter-on-quarter basis in the last two quarters of 2012 (after seasonal adjustment, in constant prices of 2005), construction fell for the fourth consecutive quarter (and this was also reflected in poor investment).

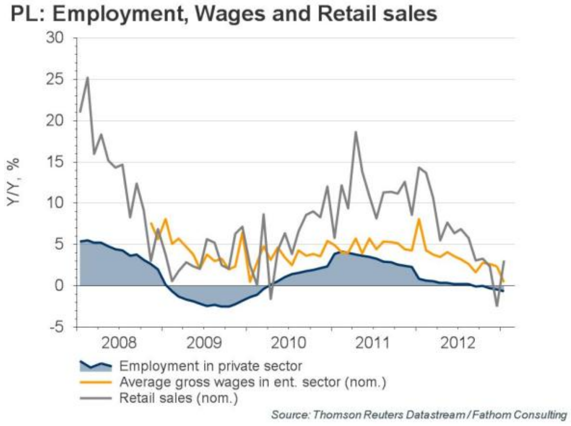
Yet the NBP may be discouraged from continuing to cut rates.

The GDP figures, along with the business mood data for February, were the last important information ahead of the meeting of the National Bank of Poland (NBP), which will culminate in a decision on rates this Wednesday. Given the latest figures, along with January's favourable data on industry (also encouraged by the positive developments in leading indicators), and the retail sales, we believe that the central bank might decide to leave its base interest rate unchanged at 3.75%. Nevertheless, such an outcome is not at all certain. At least two factors may affect our scenario. The first is the significant decrease in the inflation expectations, which are slightly below the target of the NBP now. The second is the above-mentioned GDP growth structure, which indicated further declines in consumption and investment (albeit the rate of the falls decelerated).

PL: Contributions to GDP growth



PL: Employment, Wages and Retail sales



In Focus: CZK outlook after Italy's election

The Italian election deadlock has increased the risks related to Europe's growth and reduced the already-low ambition of the Czech koruna for this year.

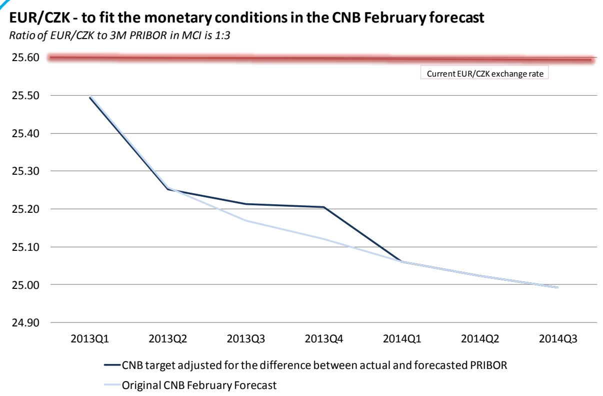
Italy's post-election deadlock has increased the risks to which the fragile recovery in the eurozone is exposed. The outcome of the election implies an increased aversion to risk, and this will not benefit Central European assets, including the koruna, at least until a viable government is set up in Italy.

In addition, the increased risk margins on the government debt of Italy and likely also Spain will tighten the monetary conditions of the entire monetary union, and have an adverse effect on its growth in the first half of 2013. Worse-than-expected growth in the eurozone may also curb the recovery in the Czech Republic, and this may indirectly affect the exchange rate of the koruna, as there will not be many reasons for the Czech National Bank to improve its macroeconomic forecast for this year in May, as we originally expected. Thus we need to reduce our outlook for this year's appreciation of the koruna, arising from a more tolerant CNB approach to a stronger Czech currency.

The look into 2014 is affected by the general election and the slow rate of real convergence.

Moreover, in the first half of the year, we should prepare for the fact that the outlook for the koruna may also be affected by two domestic factors – the approaching general election in the Czech Republic and the changes in the composition of the CNB Board, made by the new Czech President Zeman.

As far as the medium-term fundamentals of the Czech economy are concerned, these do not currently provide many reasons for optimism about the Czech koruna. Practically no real convergence is occurring now, and bets on its resumption may not occur before the second half of 2013, after the Czech domestic demand starts to recover, following the example of the export sector, and after the CNB stops its intervention 'warmongering'. Nevertheless, in the medium and long-term horizons, the koruna may benefit from the necessity of balancing the external disequilibria within the eurozone. As a result, the Czech Republic's largest trading partner – the German economy – may be made (or forced) to grow faster (in nominal terms) than the rest of the eurozone. The inevitable overheating of the German economy might benefit the koruna.



February CNB Forecast of CNB, versus CSOB Estimate				
	2013		2014	
	CNB	CSOB	CNB	CSOB
Inflation	2.1	2.20	1.70	2.00
GDP	-0.3	0.00	2.10	2.00

Weekly preview

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

	This	Last change
rate level	**3.75**	2/2013
change in bps	**0**	-25

PL: The NBP to leave rates unchanged this time

We believe that the National Bank of Poland will decide to put an end to its monetary easing cycle at its Wednesday meeting. January's data from the Polish economy mostly sprang pleasant surprises, as did GDP growth for the fourth quarter. At least two factors may affect our scenario. The first is the significant decrease in the inflation expectations, which are slightly below the target of the NBP now. The second is the above-mentioned GDP growth structure, which indicated further declines in consumption and investment (albeit the rate of the falls decelerated).

THU 9:00 **CZ Unemployment Rate (in %)**

	Feb-13	Jan-13	Feb-12
Rate	**8.1**	8.0	7.2

CZ: Unemployment on the rise again

Given the persisting recession in February, when the number of job seekers otherwise falls, we believe that unemployment rose slightly. Thus it climbed slightly beyond 8% according to the new methodology, as opposed to more than 10% according to the original methodology. In March, however, the number of those who are jobless should start to go down, due to the commencement of seasonal works. Nonetheless, the overall unemployment trend will continue to be negative this year. It might be alleviated in the second half of the year, when the economy starts to stabilize and subsequently grow.

THU 9:00 **CZ Foreign trade (CZK bn)**

	Jan-13	Dec-12	Jan-12
Balance	**27.8**	6.4	30.6
cummulative (YTD)	**27.8**	310.8	30.6

CZ: Exports decelerate in early 2013

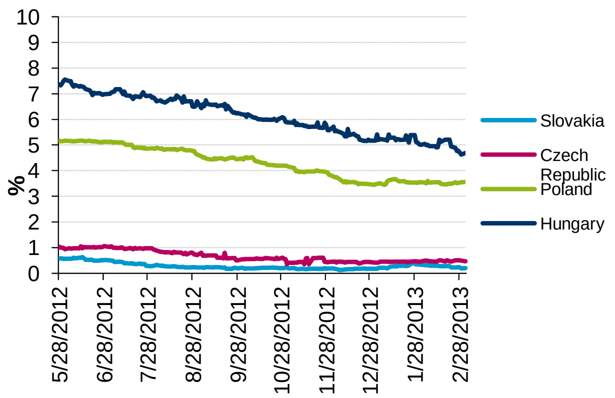
As signaled by the data on new orders for the preceding months, the beginning of the year likely saw mediocre figures on production and consequently exports. The exports of cars and electronics were likely lower this time, while poor domestic demand continued to reduce the need for imports to the Czech market. Production is likely to recover in the months to come, and thus exports by industrial firms should gradually increase. This should be encouraged by the improving demand in the German and Asian markets in particular.

Calendar

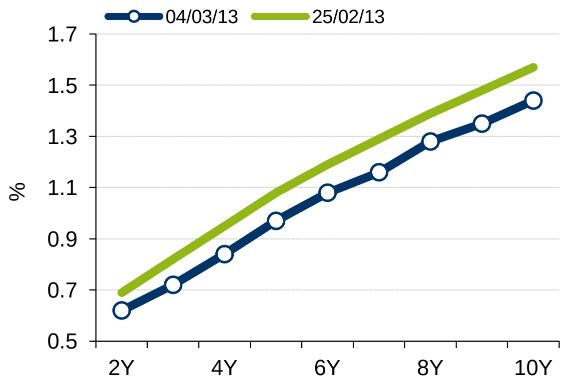
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	03/04/2013	9:00	Trade balance	EUR M	12/2012 *F					192.3	
CZ	03/06/2013	12:00	CZ bond auction floating rate/2023	CZK B	03/2013			5			
CZ	03/06/2013	12:00	CZ bond auction 2013-19, 1.50%	CZK B	03/2013			5			
PL	03/06/2013	14:00	NBP meeting	%	03/2013	3.75		3.5		3.75	
HU	03/07/2013	9:00	Industrial output	%	01/2013 *P				0.2	-2.5	-3.4
HU	03/07/2013	17:00	Budget balance	HUF B	02/2013					-2.5	
HU	03/08/2013	9:00	GDP	%	4Q/2012 *F					-0.9	-2.7
CZ	03/08/2013	9:00	Trade balance	CZK B	01/2013	27.8		31.5		6.4	
CZ	03/08/2013	9:00	Unemployment rate 15-64	%	02/2013	8.1		8.1		8	
CZ	03/08/2013	10:00	Current account	CZK B	4Q/2012					-2024.7	

Fixed-income in Charts

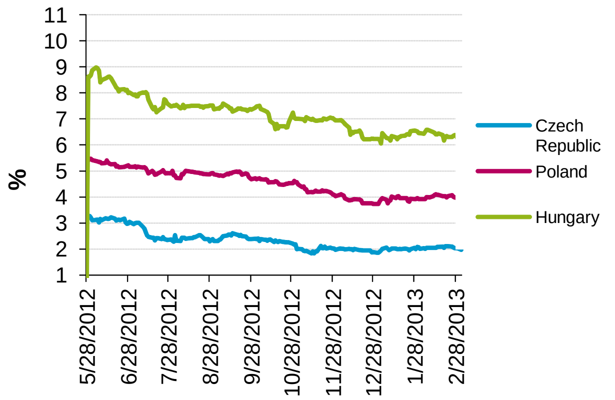
FRA 3x6



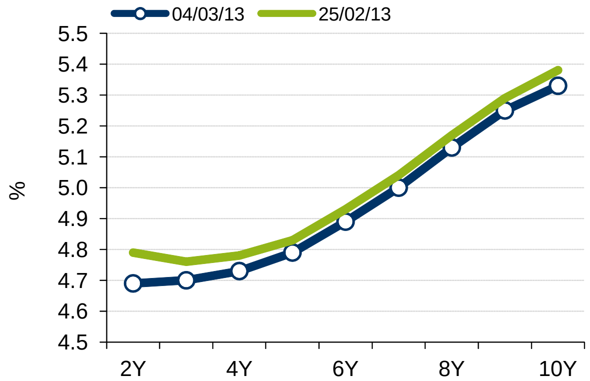
CZ IRS



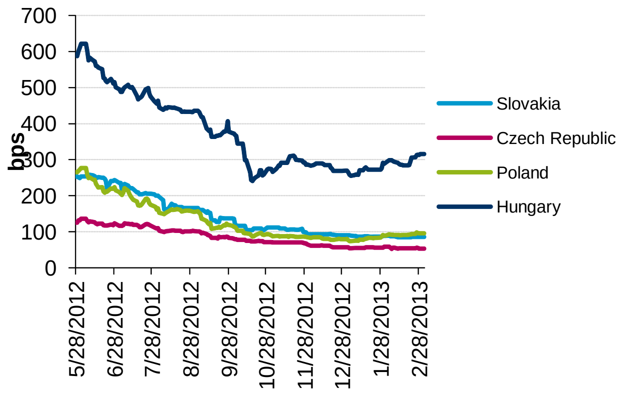
10Y GB Yields



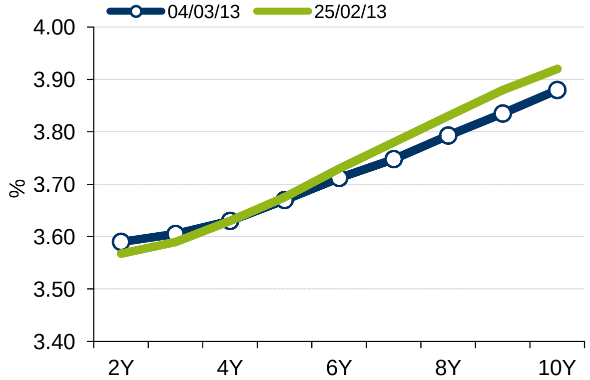
HU IRS



CDS 5Y



PL IRS



Source: Reuters

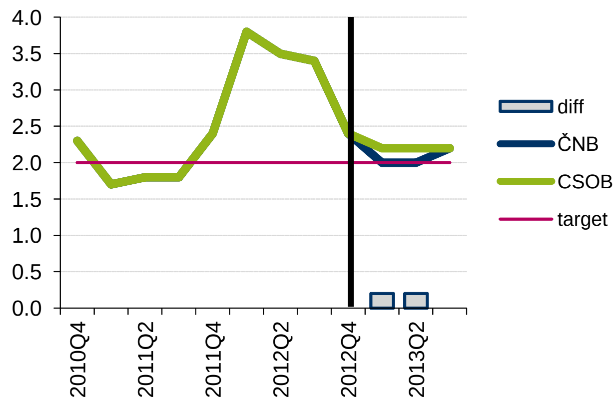
Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	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 to 1.1% in the fourth quarter of 2012. Figures from the Statistical Office confirmed that the economy was only driven by net exports, which improved owing to falling imports as well as rising exports. Household consumption was down by 1% y/y, while investment also dropped on a year-on-year basis (though much less than in the third quarter). However, we expect that the recent rate cuts should help the economy to bottom out as early as in the first quarter 2013.
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	The koruna should be more prone to losses after Italian elections than we initially expected. First of all because of higher uncertainty and risk aversion on the global markets. Secondly because of lower GDP growth in the eurozone. We downgraded the koruna over the whole one year horizon with 1-month target at 25.70 and 12 month at 24.80 EUR/CZK.	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.

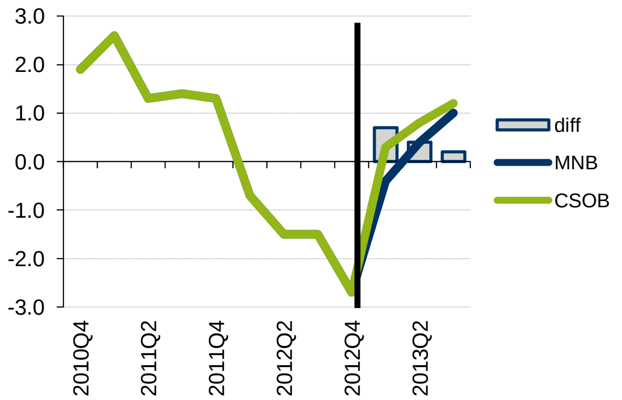
CBs’ Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

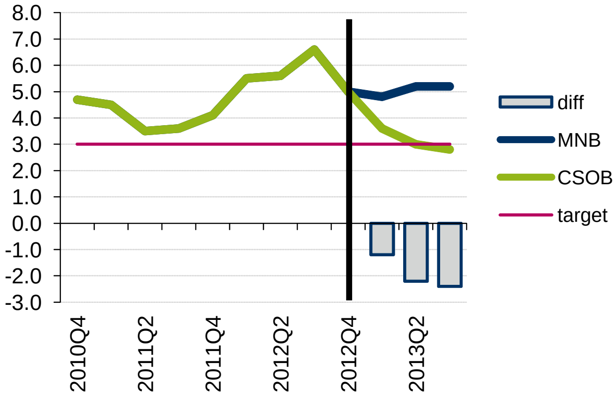
CZ: Inflation outlook (Y/Y, %)



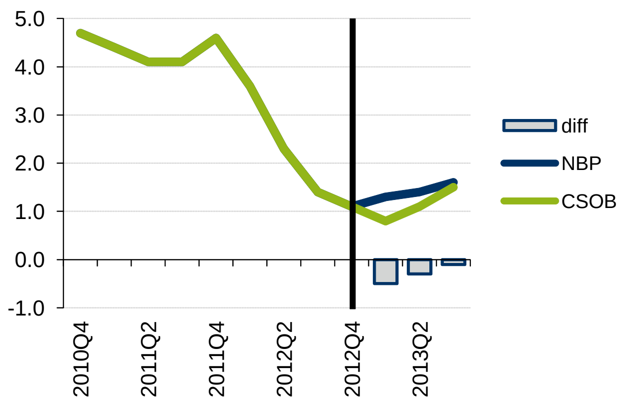
HU: GDP outlook (Y/Y, %)



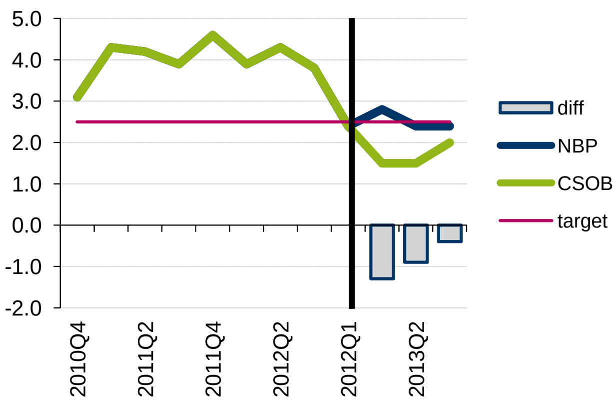
HU: Inflation outlook (Y/Y, %)



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	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	Last change	
Czech Rep.	2W repo rate	*0.05*	0.50	0.05	0.05	0.05	0.05	-20 bps	9/27/2012
Hungary	2W deposit r.	*5.25*	6.50	5.75	5.25	4.75	4.50	-25 bps	2/26/2013
Poland	2W inter. rate	*3.75*	4.75	4.25	3.75	3.75	3.75	-25 bps	2/6/2013

*Short-term interest rates 3M *IBOR (end of the period)*

		Current	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3
Czech Rep.	PRIBOR	*0.50*	0.80	0.50	0.50	0.45	0.45
Hungary	BUBOR	*5.19*	6.61	5.75	5.20	4.70	4.50
Poland	WIBOR	*3.73*	4.92	4.11	4.90	4.90	4.90

Long-term interest rates 10Y IRS (end of the period)

		Current	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3
Czech Rep.	CZ10Y	*1.44*	1.61	1.37	1.45	1.50	1.75
Hungary	HU10Y	*5.33*	6.56	5.49	7.25	7.00	4.80
Poland	PL10Y	*3.88*	4.39	3.60	5.40	5.40	5.40

Exchange rates (end of the period)

		Current	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3
Czech Rep.	EUR/CZK	*25.7*	25.1	25.1	25.7	25.4	25.0
Hungary	EUR/HUF	*297*	285	291	280	280	280
Poland	EUR/PLN	*4.14*	4.11	4.08	4.15	4.00	4.00

GDP (y/y)

	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3
Czech Rep.	-0.5	-1.0	-1.3	-1.7	-1.1	-0.5	0.0
Hungary	-0.7	-1.5	-1.5	-2.7	0.3	0.8	1.2
Poland	3.6	2.3	1.4	1.1	0.8	1.1	1.5

Inflation (CPI y/y, end of the period)

	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3
Czech Rep.	3.8	3.5	3.4	2.4	2.2	2.2	2.2
Hungary	5.5	5.6	6.6	5.0	3.6	3.0	2.8
Poland	3.9	4.3	3.8	2.4	1.5	1.5	2.0

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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