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Central European Weekly

Monday, 11 March 2013

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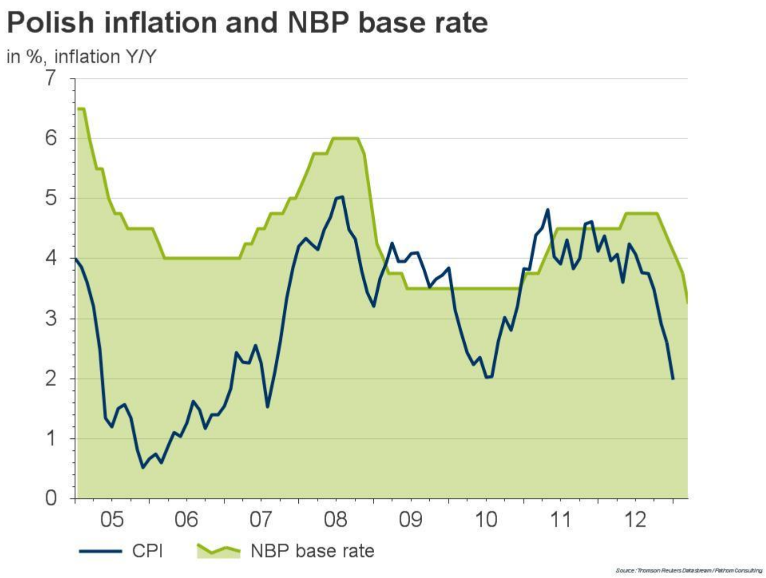
Chart of the Week



Polish central bank cut interest rates unexpectedly last Wednesday. According to the NBP President Belka, Wednesday's cut should mark the end of the monetary easing cycle that had begun in November 2012.

Market's editorial

The NBP surpises wit a 50 bps rate cut

It seems as if the National Bank of Poland is trying to jump on the bandwagon of (global or regional) currency wars at the last moment, as the NBP quite unexpectedly cut its repo rate by 50 basis points.

The NBP surprised us as well as the market by its 50 bps rate cut, which, according to the bank's statement, put an end to its rate cut cycle, commenced last November. According to the press release, the latest data indicates that Poland is heading for a longer period of modest growth, which requires another rate cut. Remarkably, the latest data includes no breakthrough information and springs positive rather than negative surprises, whether as concerns retail sales, January's industry, or the GDP for the last quarter of 2012 (however, we should add that the structure was not very favourable). Inflation was inconsistent with this set of data, with January inflation falling more than expected (the inflation data is yet to be revised). Neither the official minutes of the February meeting, nor the communication of MPC members signalled that the bank was about to take such an aggressive step. It did not decide to do so even after the surprising drop in GDP in the third quarter of 2012. By and large, the latest decision is consistent with the series of surprises that the NBP also sprang in the past (such as its rate hike in May last year), and indicates relatively poorly managed communication by the NBP.

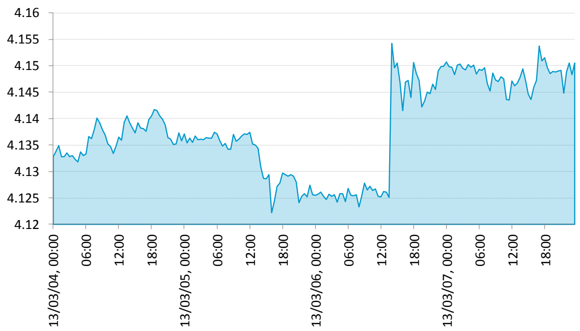
Is the zloty entering the slowly culminating currency wars?

While the surprise by Poland's Monetary Policy Council triggered an immediate negative reaction from the zloty, the question is whether the Polish currency's defensive stance will really persist for long. The money market currently anticipates one more rate cut, which, we believe, will not occur; moreover, the market opinion on the NBP may completely turn about. Naturally, this might be grist to the mill of the zloty, which may benefit from fairly high interest rates even today.

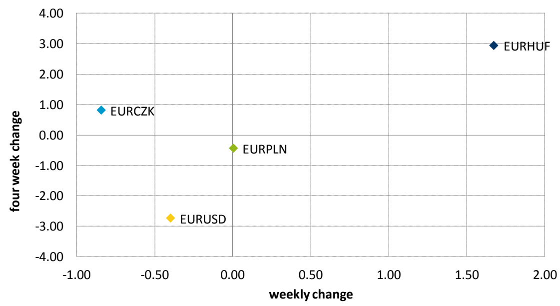
By and large, however, the question is whether future currency wars will take place in the form that we have seen in the last two years, because, for cyclical reasons, the dollar is starting to strengthen in reaction to very good macroeconomic figures. In other words, the previously known equation, which implied that falling aversion to risk = weak dollar = strengthening Central European currencies, may no longer necessarily apply in the upcoming period. Aversion to risk may really fall, implying the appreciation of regional currencies, but only against the euro, not against the dollar, next time.

EUR/PLN

30 minute intervals



FX performance (%)



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.5	-0.44%	↘	↘
EUR/HUF	300	0.74%	↘	↘
EUR/PLN	4.13	0.17%	↘	↘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.49	-0.60	↗	↗
10Y HUF	5.47	2.24	↗	↗
10Y PLN	3.88	-1.15	↗	↗

Review of Economic Figures

Hard data confirm the poor state of the Czech economy

The latest figures from the Czech economy indicate that the recession is not yet over. Rising unemployment on the one hand and falling imports on the other indicate that the economic performance will continue to be poor in the first quarter of this year. After the unemployment increase to 8% in January, the number of the unemployed again rose to a new all-time high in February. There are currently 594,000 jobless people, almost 52,000 more than last year, with 17 job seekers per vacancy now, as opposed to slightly below 15 in February last year.

February's unemployment, which usually falls, was up by 0.1% to 8.1% this time. The labour market is affected by the recession, which is raising the number of the unemployed, without generating new jobs (there are 2,000 fewer jobs than a year ago). According to the old methodology, unemployment has exceeded the 10% mark. This is worse than during the previous recession, from which the economy did not fully recover before it slipped into another recession.

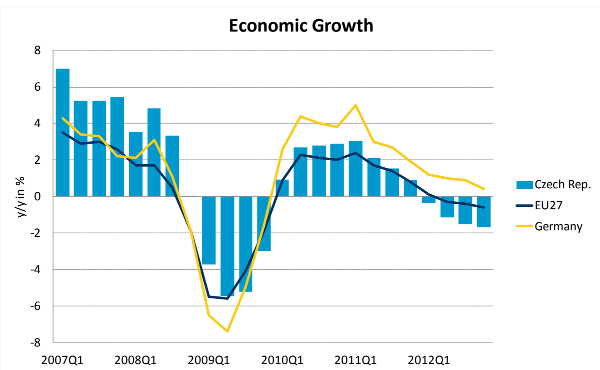
The labour market situation will start to improve slightly as early as in March, when seasonal jobs in agriculture and construction are resumed; yet we do not expect the overall unemployment trend to begin to change for the better this year. Given also the rise in unemployment, consumer purchasing power is unlikely to recover this year. The number of the unemployed is breaking records, real income will stagnate in the best case scenario, and thus the willingness to spend money will continue to be low.

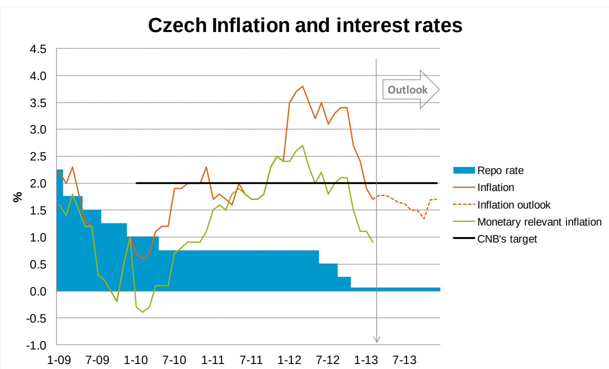
Recession enviroment and weak demand is also visible in inflation figures.

The data showed further deceleration of price growth to 1.7% Y/Y and 0.1% M/M. As for the structure of the monthly figure, the prices were supported mainly by higher fuel prices while the main drag on inflation was that from food prices. The most interesting piece of information, however, is that this year's VAT hike had almost no impact on inflation (unlike the previous year) which indicates that retailers probably are afraid to further undermine already weak consumers' demand.

Foreign trade is also affected by the recession. Czech exports are affected by curbed European demand, which is probably culminating now, having a negative impact on the Czech Republic's main export goods – i.e., machinery and means of transport. Nevertheless, the situation is not that critical, because, on the other hand, the year-on-year decline in exports is also based on the high comparative baseline of January of last year. In addition, the unsurprising drop in imports only confirms that domestic consumer as well as investment demand continues to be subdued in early 2013. Thus imports continue to indicate that people's willingness to spend money on consumer goods is decreasing, while the eagerness of businesses to invest remains poor. As signalled by previous statistics, the decline is also strongly affecting car imports, as demand for those articles noticeably declined in the first two months of this year.

The Czech Republic is likely to show a new all-time high trade-balance surplus this year. The existing all-time high was set last year, when the foreign trade surplus exceeded the CZK 310 bn mark. Thus foreign trade is likely to remain the only driver to keep the Czech economy 'afloat'. However, a significant precondition of this anticipation is the existence of demand by European and Asian consumers for Czech cars, i.e., the success of Czech carmakers in the falling European and rising Asian markets.





Weekly preview

THU 9:00 — CZ Retail Sales (change in %)

	Jan-13	Dec-12	Jan-12
Sales	**-4.0**	-5.1	2.4
cummulative (YTD)	**-4.0**	-1.1	2.4

CZ: Consumers feel still squeezed

Consumer demand is unlikely to start to recover in early 2013 either. Given the rise in unemployment and the fall in real income, the eagerness to spend money remains very weak. The data on new car sales for both January and February was also unfavourable. This is why the retail sector is likely to see a very poor first half of the year, which may be followed by stabilisation and a slow recovery in late 2013.

THU 14:00 — PL Inflation (change in %)

	Feb-13	Jan-13	Feb-12
CPI y/y	**1.5**	1.7	4.3
Food (ex Alc.) y/y	**3.2**	3.5	4.5
Transport (including fuel)	**-0.8**	-0.7	10.3

PL: Inflation continued to fall in February

We predict that Poland's inflation fell to 1.5% y/y in February, albeit it was up by 0.2% m/m. We believe that the month-on-month price rise was due in particular to the increases in food and soft drink prices. By contrast, clothing prices should seasonally fall for a second consecutive month, this time by 2.1%. Let us add that the complete structure of the January index, recalculated with newly weighted items in the consumer basket, will be released this month.

FRI 9:00 — CZ Industry (y/y change in %)

	Jan-13	Dec-12	Jan-12
Monhtly	**-5.0**	-12.5	3.4
cummulative (YTD)	**-5.0**	-1.2	3.4

CZ: Poor beginning of the year in industry

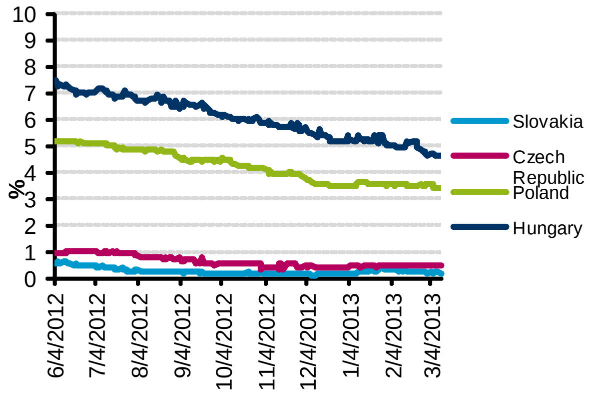
The decline that industry saw in December is unlikely to end soon. Poor orders in late 2012 did not signal a turnaround yet. January was most likely poor for the production of cars, metals, plastics, electronics, food – i.e., the most important industries in the Czech Republic. Yet the latest soft indicators – the mood in industry and the PMI – suggest that the fall in industry will not persist for as long as during the previous recession. Hence the situation might stabilise during the first half of the year.

Calendar

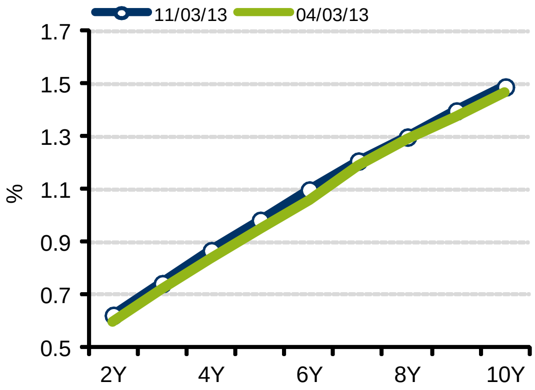
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	03/11/2013	9:00	Trade balance	EUR M	01/2013 *P			387		143.1	
CZ	03/11/2013	9:00	CPI	%	02/2013	0.3	2	0.2	1.8	1.3	1.9
CZ	03/11/2013	9:00	Wages	%	4Q/2012				0.1		-1.8
CZ	03/11/2013	9:00	GDP	%	4Q/2012 *F					-0.2	-1.7
HU	03/12/2013	9:00	CPI	%	02/2013			0.2	3.2	0.8	3.7
HU	03/14/2013	9:00	Industrial output	%	01/2013 *F					2.9	-1.4
CZ	03/14/2013	9:00	Retail sales	%	01/2013		-4		-1.9		-5.1
CZ	03/14/2013	10:00	Current account	CZK B	01/2013	7		10		-24.3	
PL	03/14/2013	14:00	Current account	EUR M	01/2013			-1421		-1204	
PL	03/14/2013	14:00	Trade balance	EUR M	01/2013			-450		-1212	
PL	03/14/2013	14:00	Money supply M3	%	02/2013			0.5		-0.8	
PL	03/14/2013	14:00	CPI	%	02/2013			0.2	1.5	0.1	1.7
CZ	03/15/2013	9:00	PPI	%	02/2013	0.2	1.5	0.2	1.5	1.1	1.4
CZ	03/15/2013	9:00	Construction output	%	01/2013						-17.3
CZ	03/15/2013	9:00	Industrial output	%	01/2013				-4		-12.5
PL	03/15/2013	15:00	Budget balance	PLN M	02/2013					-8437	

Fixed-income in Charts

FRA 3x6

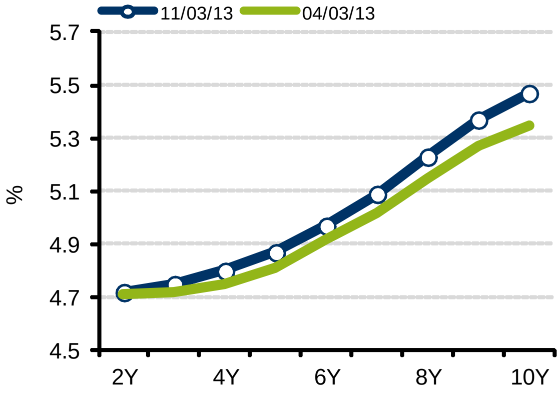


CZ IRS

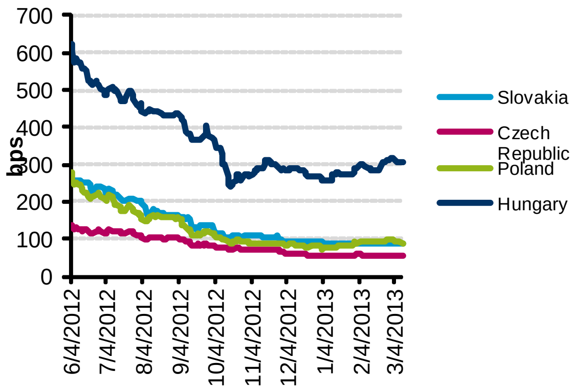


10Y GB Yields

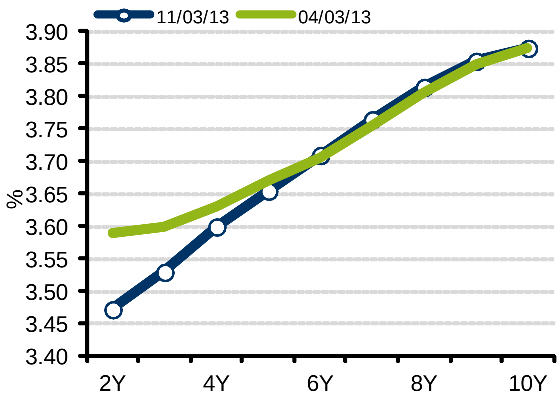
HU IRS



CDS 5Y



PL IRS



Source: Reuters

Medium-term Views & Issues

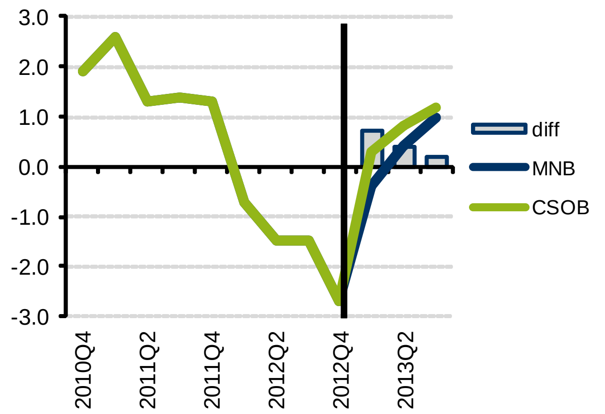
	The Czech Republic	Hungary	Poland
Growth & key issues	The Czech economy remains in a recession, which is shallower but longer than the previous one. The latest data from industry – production as well as orders – still tend to be negative. The drop in domestic demand was followed by a decline in foreign 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.	Like the Czech economy, the Hungarian has been facing a double dip. The persistent weakness of the domestic demand cannot be compensated by improvement in (net) exports. Real recovery of the economy could be visible in 2014.	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 MNB will very likely continue to ease its policy under the new Presidency of György Matolcsy. Although the former member of the government and the Minister of the Economy toned down his dovish previous statements by labeling himself an enemy of inflation, we think the monetary easing cycle seems to be far from over.	After surprising 50 bps cut in march, the NBP cutting cycle is over. We believe in longer term stability of interest rates. Although economic recovery could argue in favor of interest rate hikes later in the 2013, we believe that further decline in inflation should prevent the bank from doing so. The inflation should stay below the target till the beginning of 2013.
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 experienced some volatility, which has been attached to the recent appointment of a new MNB President (see the text above). However, given the improvement in Hungary's balance of payments and global market sentiment, we believe that forint's weakness will be rather temporary than persistent..	While the surprise by Poland's Monetary Policy Council triggered an immediate negative reaction from the zloty, we believe this should not last for long time. The money market currently anticipates one more rate cut, which, we believe, will not occur; moreover, the market opinion on the NBP may completely turn about. Naturally, this might be grist to the mill of the zloty, which may benefit from fairly high interest rates even today.

CBs' Projections vs. Our Forecasts

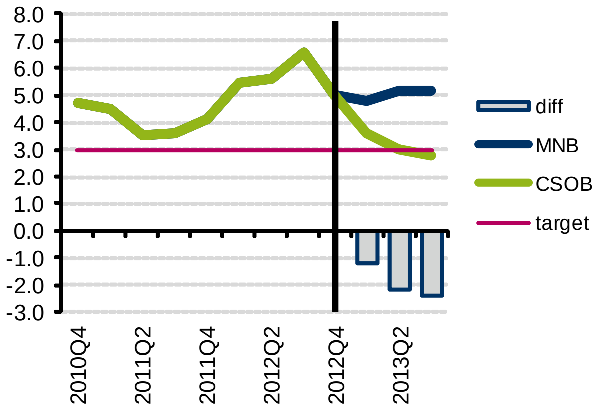
CZ: GDP outlook (Y/Y, %)

CZ: Inflation outlook (Y/Y, %)

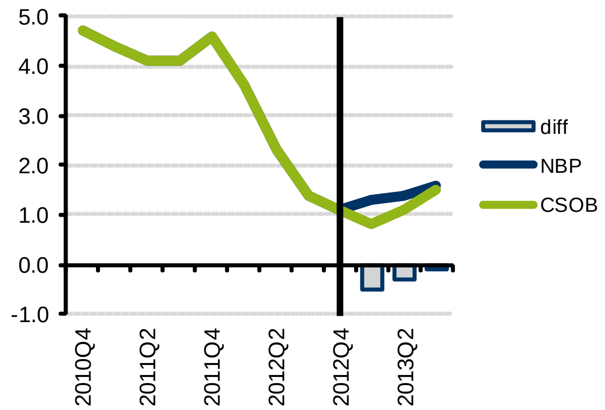
HU: GDP outlook (Y/Y, %)



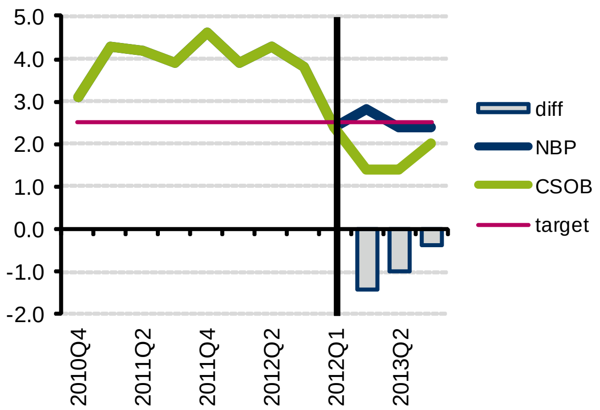
HU: Inflation outlook (Y/Y, %)



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	*3.25*	4.75	4.25	3.25	3.25	3.25	-25 bps	3/6/2013

*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	*5.17*	6.61	5.75	5.20	4.70	4.50
Poland	WIBOR	*3.46*	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	*1.491*	1.61	1.37	1.45	1.50	1.75
Hungary	HU10Y	*5.47*	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	*25.5*	25.1	25.1	25.7	25.4	25.0
Hungary	EUR/HUF	*300*	285	291	280	280	#N/A
Poland	EUR/PLN	*4.13*	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	2.1	2.1	2.1
Hungary	5.5	5.6	6.6	5.0	3.6	3.0	2.8
Poland	3.9	4.3	3.8	2.4	1.4	1.4	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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