



# Central European Weekly

Monday, 25 March 2013

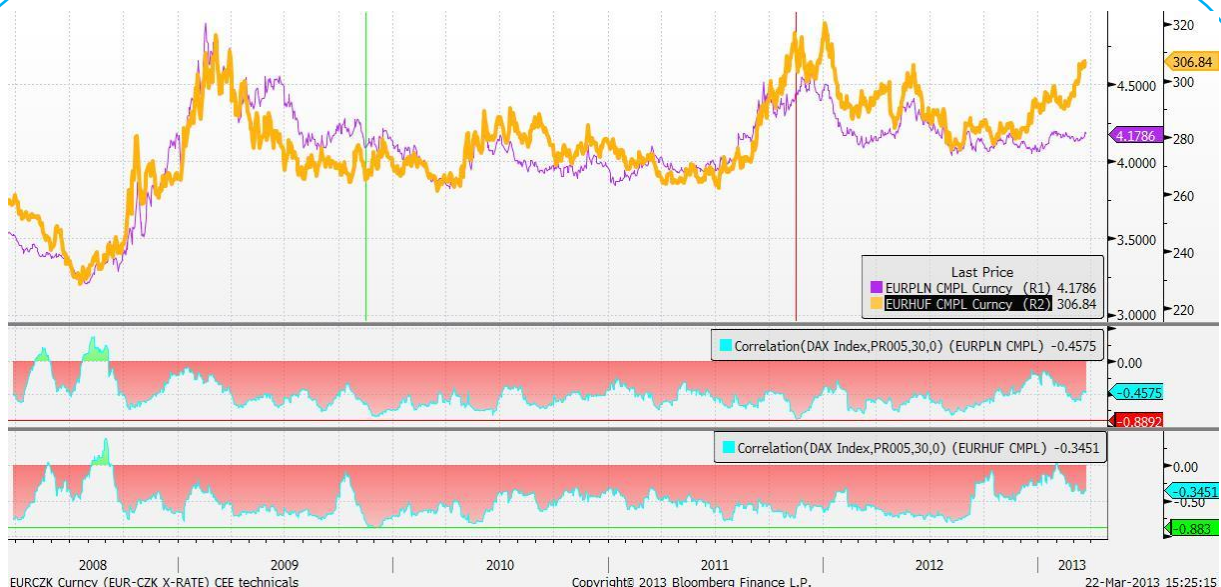
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## Weekly Highlights:

- CE currencies weakened last week. What was really behind? Cyprus or weak eco figures from the EMU?
- The Hungarian central bank will cut its base rate to 5%
- Discussions about forex interventions will continue in the CNB

## Chart of the Week



While negative correlation of EUR/HUF and DAX reaches maximum during the periods of sell-offs (such as in 2009), the EUR/PLN increases ses Its correlation with equities more during the periods of optimism (such as in mid 2011).

# Market's editorial

## All CE currencies weakened last week. What was behind?

All CE currencies weakened last week. Although there were definitely some negative spill-over effects from Cyprus felt in CE forex markets last week, we believe that even more severe damage was delivered to the region by very weak business confidence figures (Ifo, PMI) released in the euro zone. CE economies have had since decades well established and intensive trade connections with their western neighbours and that is why their currencies have been very sensitive to German or euro economic performance.

## A closer look at CE currencies' link to the German DAX

Since it is hard to distinguish between negative effects caused by contagion from Cyprus and those, which could be related to worse euro-zone leading indicators, we have decided to look closer at the recent correlations of CE currencies with German stocks.

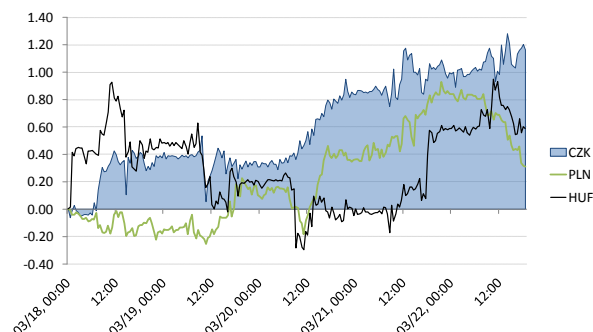
Generally, all CE currency pairs have had historically negative links to the German DAX stock index – i.e., when the DAX falls, the EUR/CZK, EUR/HUF and EUR/PLN currency pairs rise, and thus all Central European currencies depreciate. In recent years, the Hungarian forint (as shown at the front page in the comparison of the developments in the correlations of the EUR/HUF and EUR/PLN pairs with the DAX index) has more significantly tightened its link to the external environment (DAX) in times of global tension and

pessimism, such as in 2009, when the DAX index fell the most. Tension in global markets has nearly always augmented negative domestic factors, and this may also happen now. In this respect the forint has become a sort of a regional hot potato as from time to time the currency is exclusively driven by domestic political events or/and dovish comments from newly appointed central bankers.

As concerns the Polish zloty, it played the opposite role in past years. The Polish currency tightened its link to the DAX in times of optimism, mainly because the local economy was seen as resistant and its real interest rates could remain higher than in other countries. In addition, the zloty is not exposed to any hidden threat from the NBP, as theoretically is the Czech koruna from the CNB. In recent days, the Czech currency has weakened not only because of Cyprus, but also because of a series of poor data from the euro zone. Speculations about interventions against the koruna are reoccurring among some investors a few days before a CNB meeting. Nevertheless, we believe that such interventions are unlikely at these levels. Even if the CNB were after some time to worsen its outlook for the Czech economy, because of the euro zone, the implied trajectory of the exchange rate would not deteriorate significantly from the current average EUR/CZK 25.30 for 2013. By and large, we currently see the latitude for a depreciation of the zloty and the koruna as limited.

CE currencies' performance against euro, last week

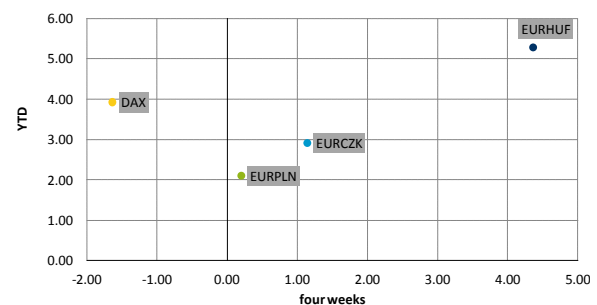
30 min intervals



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.8	0.66%	↗	→
EUR/HUF	306	0.19%	↗	↗
EUR/PLN	4.16	-0.14%	↗	→

FX performance vs DAX

(%)



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.40	-1.06	→	→
10Y HUF	5.58	-1.41	↗	↗
10Y PLN	3.61	-0.55	→	→

# Weekly preview

**TUE 14:00 MNB base rate**

	This meeting	Last change
rate level (in %)	5.00	2/2013
change in bps	-25	-25

**HU: The MNB will cut the base rate to 5%**

With new President at its helm, the National Bank of Hungary (MNB) will again cut its base rate by an additional 25 basis points. The speculations that the upcoming rate cut might be greater were cooled by the depreciation of the forint and the related statement by new Deputy Governor Balog, who said that a gradualist approach (to rate cuts) was needed. On the other hand, the inflation fall, and likely also the downgrade of the central bank's new macroeconomic forecast, rule out that this meeting will end up with no rate cut at all.

**THU 13:00 CNB base rate**

	This meeting	Last change
rate level (in %)	0.05	11/2012
change in bps	0	-20

**CZ: Discussion over forex interventions back again**

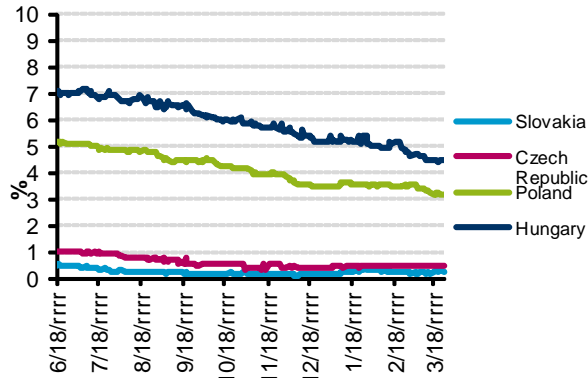
The CNB Bank Board will again leave interest rates unchanged at its second meeting of the year. The rates have hit bottom. Inflationary pressures have waned and even the VAT increase has not stirred inflation very much. Yet demand in the economy continues to be curbed. Real household income has fallen thus far, unemployment is on the rise, and consumer confidence remains very low. Reflections on possible forex interventions, which might 'ensure' that the 2% inflation target will be met, continue to be put onto the agenda. However, such a forced inflation increase may again reduce the real financial position of consumers without helping exports significantly. Hence the CNB maintaining its wait-and-see attitude appears to be a likely conclusion.

# Calendar

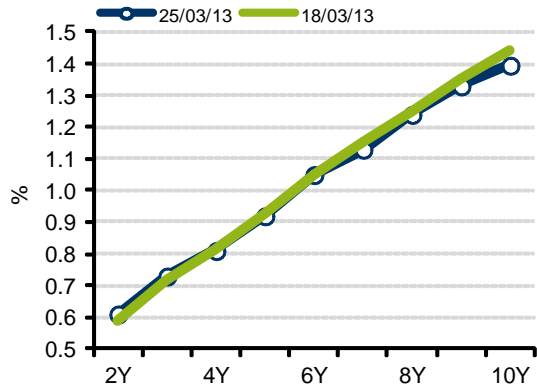
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	03/26/2013	14:00	NBH meeting	%	03/2013	5		5		5.25	
HU	03/28/2013	8:30	Current account		HUF B 4Q/2012			293		780	
HU	03/28/2013	9:00	Unemployment rate	%	02/2013			11.6		11.2	
CZ	03/28/2013	12:30	CNB meeting	%	03/2013	0.05		0.05		0.05	
PL	03/28/2013	14:00	Current account		EUR M 4Q/2012			-3436		-3367	
HU	03/29/2013	9:00	Trade balance		EUR M 01/2013 *F					317.9	
HU	03/29/2013	9:00	PPI	%	02/2013			0.8	1.4	-0.9	
CZ	03/29/2013	11:00	Money supply M2	%	02/2013					4.6	

# Fixed-income in Charts

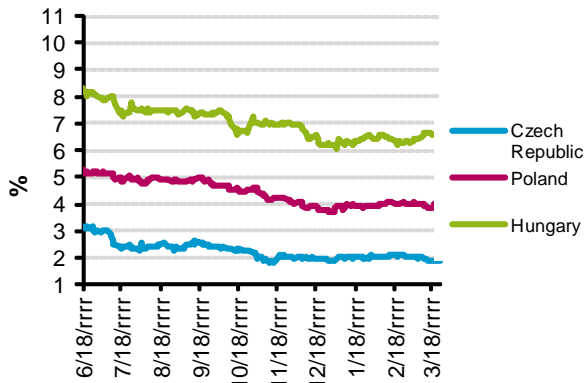
**FRA 3x6**



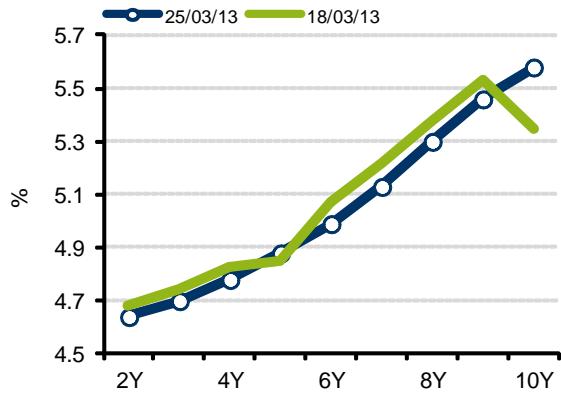
**CZ IRS**



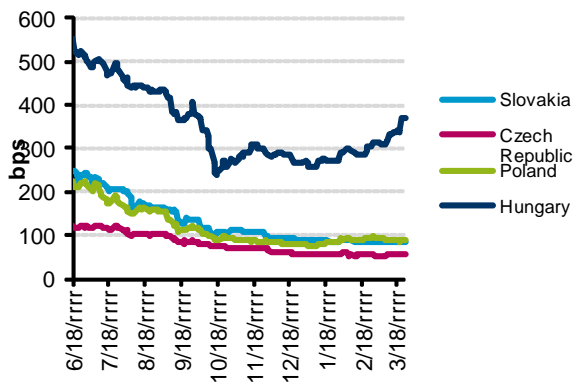
**10Y GB Yields**



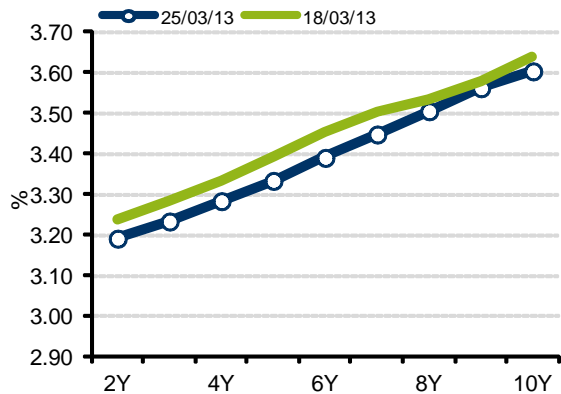
**HU IRS**



**CDS 5Y**



**PL IRS**



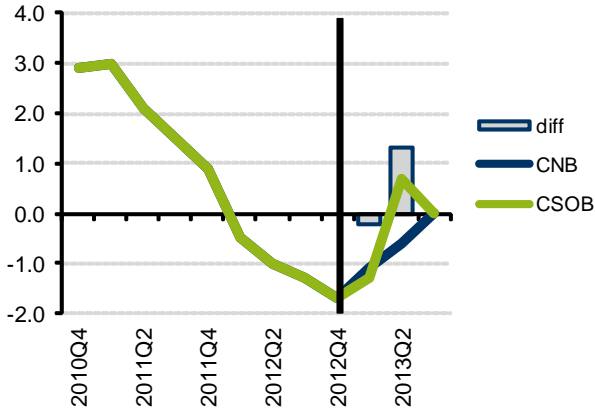
Source: Reuters

# Medium-term Views & Issues

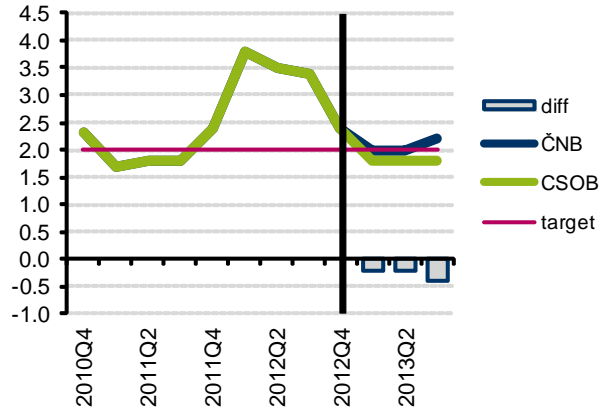
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The Czech economy remains in a recession, which is shallower but longer than the previous one. The latest data from industry – production as well as orders – still tend to be negative. The drop in domestic demand was followed by a decline in foreign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

# CBs' Projections vs. Our Forecasts

**CZ: GDP outlook (Y/Y, %)**



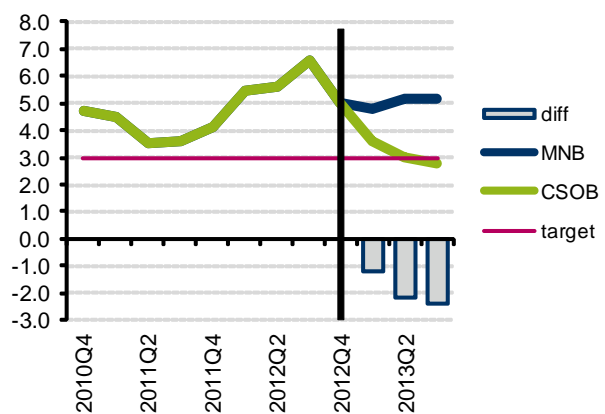
**CZ: Inflation outlook (Y/Y, %)**



**HU: GDP outlook (Y/Y, %)**



**HU: Inflation outlook (Y/Y, %)**



**PL: GDP outlook (Y/Y, %)**



**PL: Inflation outlook (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	0.47	0.80	0.50	0.47	0.46	0.45
Hungary	BUBOR	5.11	6.61	5.75	5.20	4.70	4.50
Poland	WIBOR	3.39	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	1.395	1.61	1.37	1.43	1.58	1.78
Hungary	HU10Y	5.58	6.56	5.49	7.25	7.00	4.80
Poland	PL10Y	3.61	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	25.8	25.1	25.1	25.7	25.4	25.0
Hungary	EUR/HUF	306	285	291	280	280	#N/A
Poland	EUR/PLN	4.16	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	-1.3	0.7	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	1.8	1.8	1.8
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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