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Central European Weekly

Monday, 22 April 2013

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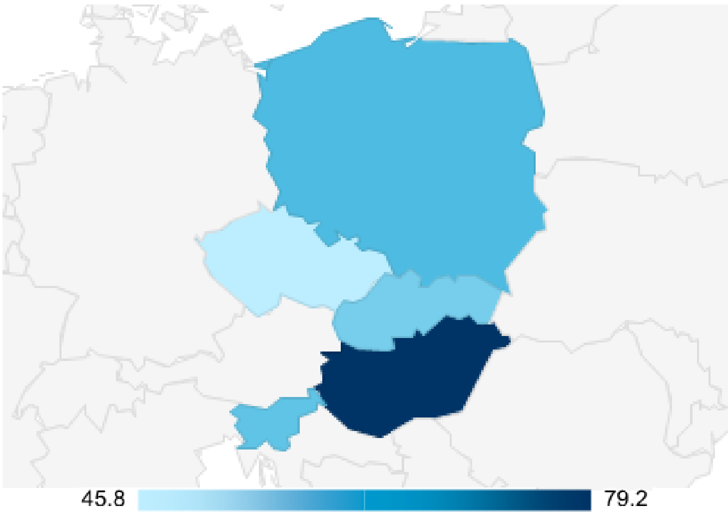
Chart of the Week: Public debt/GDP in CE



In 2012, Hungary remained by far the most indebted CE country. Its debt reached 79.2% of GDP. (Source: Eurostat, CSOB)

Market's editorial

The NBH brrings a new non-standard policy measure

The Hungarian central bank has again grabbed attention of local markets as NBH Governor Matolcsy said that he backed a proposal by the Hungarian Banking Association to constrain access of foreign credit institutions to central bank's short-term interest bearing instruments by abandoning emissions of 2-week bills.

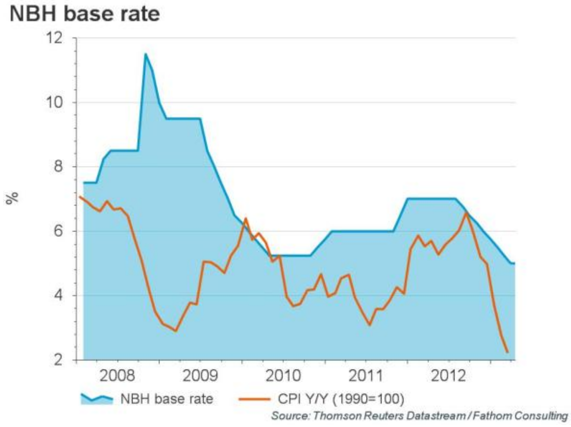
The idea is to revert to the previous practice of offering banks solely 2-week deposits available to those keeping reserves with the NBH. In Matolcsy words ' Those who are eligible to take part in the central bank's two-week bond programme, which offers very high returns, must undertake to extend credit in Hungary, play a role in the Hungarian economy and in preserving jobs'. We should add that the NHB mght also hope that the above mentioned meassure should help to improve its financial results. Reacall that previously NBH president Matolcsy stated the 2-week deposit has to be cut to HUF 3600bn from 4500bn.

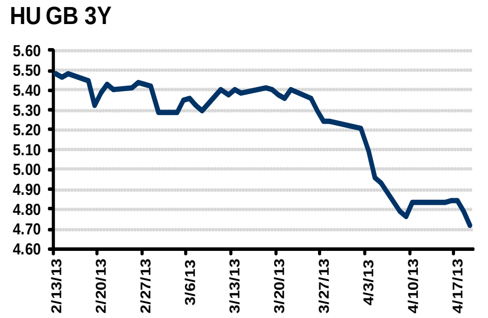
Following Matolcsy words, market demand for Hungarian bonds, T-bills or asset swap strengthened and yields declined primary on shorter maturities. Forint´s reaction was, on the contrary, slithtly negative, as investors unable to use the two-week facility have been attempting to find alternatives in different currencies.

However, the new NBH meassure is not without risk as it might fuel international backslash. according EU sources said the plan of György Matolcsy may infringe the EU's fundamental rule on the free movement of capital.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.9	0.23%	➔	➔
EUR/HUF	299	1.08%	➚	➔
EUR/PLN	4.10	-0.11%	➚	➔

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.31	-0.76	➔	➔
10Y HUF	4.73	-1.87	➔	➔
10Y PLN	3.27	-2.54	➔	➔





HU GB 3Y, last 45 days. Source: Reuters

In Focus: The Czech car industry

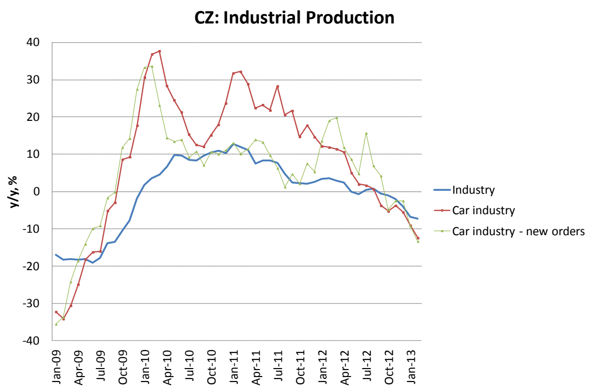
The current downturn of the automotive industry is having an impact on the performance of the sector as well as on the performance of the whole Czech economy.

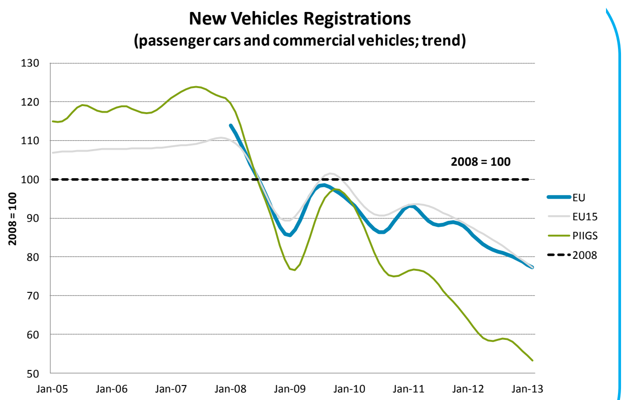
The Czech economy has been in a recession for a second year. In the first stage, the recession was primarily accompanied by subdued domestic demand, combined with a downturn of foreign demand in the second half of last year. The signs of a decline in exports, i.e., in industry, which had driven the economy until then, have become evident in the most important part of industry in particular – the automotive industry – in recent months. The last four months have seen a significant year-on-year fall in production as well as new orders, and this has affected exports, on which domestic car production is based.

The position of car production in the Czech economy is extremely strong, not only because the Czech Republic is nearly on top in the number of cars produced per capita, but mainly because car production makes up 30% of the entire domestic manufacturing industry in terms of revenues from the sales of own products. Exports of road vehicles currently make up approximately 17% of all exports. Hence the developments in this part of domestic industry, primary based on the development of the European automotive market, are automatically reflected in worsened data on the Czech economy.

The falling European market bites

The impression from the latest data on the registrations of passenger cars and light commercial vehicles in Europe can not be at all good. The EU automotive market has basically fallen for six years, with no signs of a turnaround in this adverse trend at the moment. The data for the EU15 shows a strong decline in registrations – up to 4 million vehicles per year, as the difference between the annual high after 2003 and the current data for February. No major national market in the EU except the United Kingdom shows increases in sales/registrations. Europe's largest market – Germany – is even falling at a double-digit rate this year (the passenger car category alone). Such a figure is more typical of the countries at the EU periphery that are affected by the debt crisis, rather than of a country that has avoided a recession quite successfully thus far. By contrast, the Q1 figures from France (-14.6%), Italy (-13%) and Spain (11.5%) are not that surprising. If we look at the consumer mood data for the EU, we find that the current purchases of durable goods continue to be highly conservative.





Weekly preview

TUE 14:00	NBH base rate	
	This meeting	Last change
rate level (in %)	**4.75**	3/2013
change in bps	**-25**	-25

HU: The NBH ready to cut its base rate to 4.75%

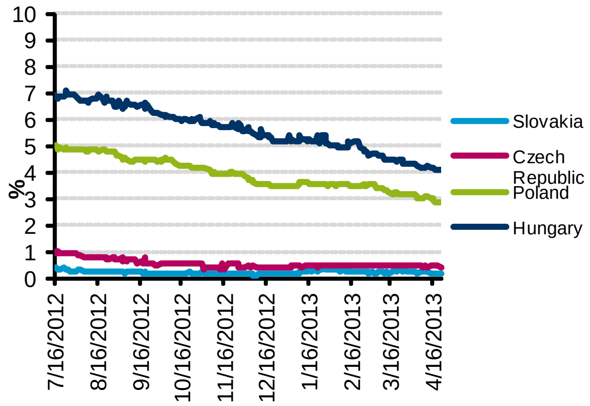
Several factors indicate that the National Bank of Hungary will continue to ease its monetary policy at its Tuesday meeting, through gradualist cuts in its base rate. Above all, inflation fell to 2.2% y/y in March and, given poor domestic demand and further plans for administrative cuts in energy prices, the NBH will not struggle with inflation in the foreseeable future either. In addition, the current members of the Monetary Council make no secret of their efforts to assist the Government in getting the economy underway. On the other hand, we believe that the NBH will not proceed to overly aggressive steps, because a depreciation of the Hungarian currency, if any, might unnecessarily increase the cost of covering Hungarian foreign-currency loans. This is why we anticipate a rate cut by 'only' 25 bps.

Calendar

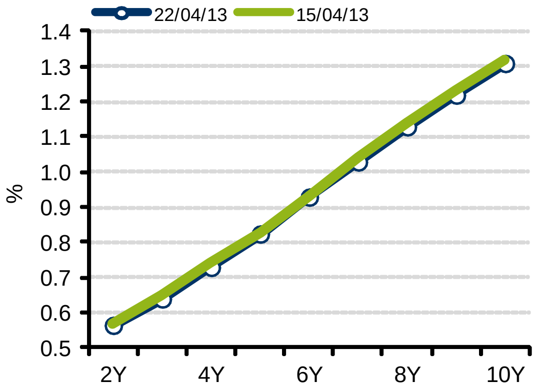
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	04/23/2013	10:00	Retail sales	%	03/2013			17	0.4	-2.6	-0.8
PL	04/23/2013	10:00	Unemployment rate	%	03/2013			14.4		14.4	
HU	04/23/2013	14:00	NBH meeting	%	04/2013	4.75		4.75		5	
CZ	04/24/2013	12:00	CZ bond auction floating rate/2023	CZK B	04/2013						
CZ	04/24/2013	12:00	CZ bond auction 2013-2016, 0.50 %	CZK B	04/2013						
HU	04/26/2013	9:00	Unemployment rate	%	03/2013			11.7		11.6	

Fixed-income in Charts

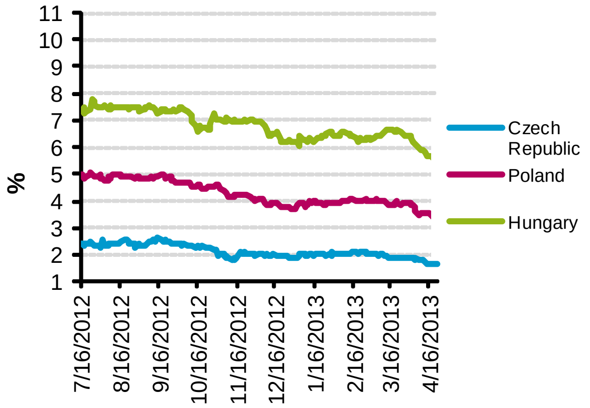
FRA 3x6



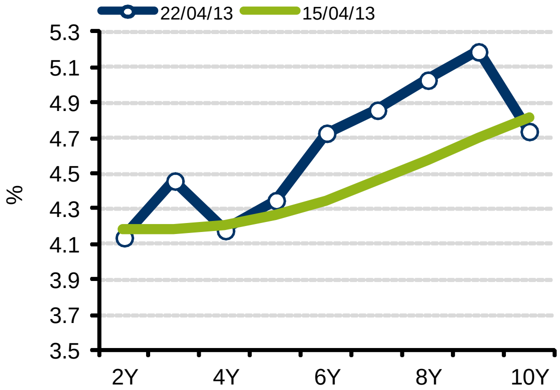
CZ IRS



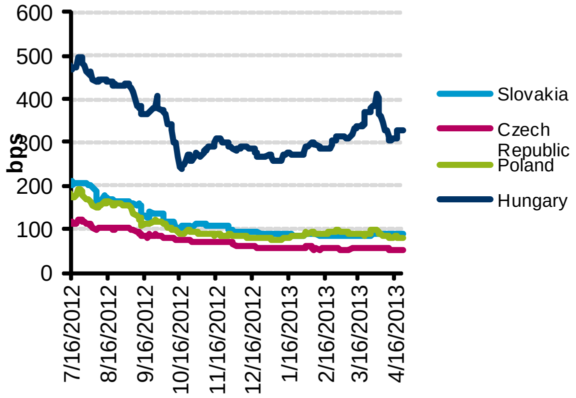
10Y GB Yields



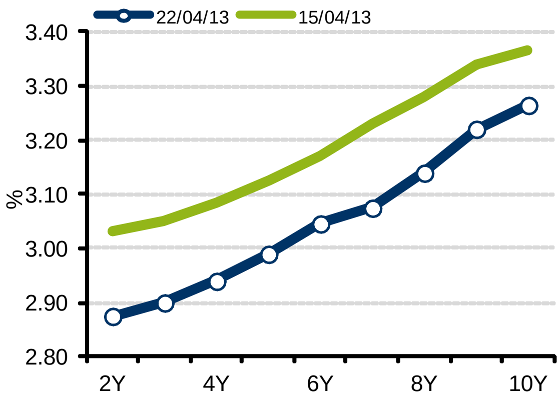
HU IRS



CDS 5Y



PL IRS



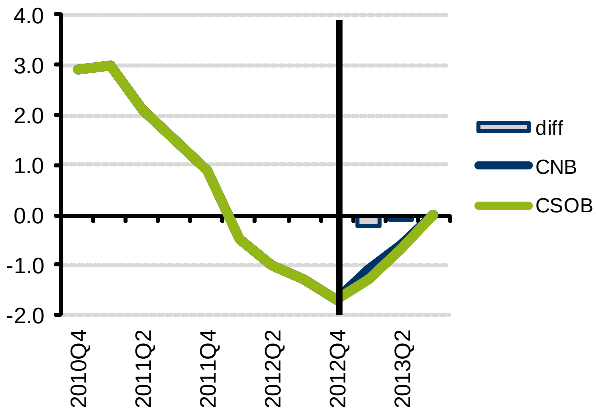
Source: Reuters

Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	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 again has curbed 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 rather visible in 2015.	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.	With newly appointed governor of the NBH György Matolcsy and his deputies, the doves have overwhelming majority in the central bank. The tendency for further monetary easing will be mainly supported by the inflation, which decelerated below the central bank target and the domestic demand which stays very low. On the other hand monetary easing is limited by the forint, which is very vulnerable and its weaker levels would hurt FX debtors. We thus believe that NBH will cut rates gradually further. We see the lowest levels of NBH rate at 4.5%, while the downside risk to our forecast is high due to current low transparency of the NBH.	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 does not have much space to weaken further above 26.00 EUR/CZK. We believe in near term stability and lower volatility in a range 25.20-26.00 EUR/CZK.	The forint has experienced some volatility, which has been attached to the recent appointment of a new NBH 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.

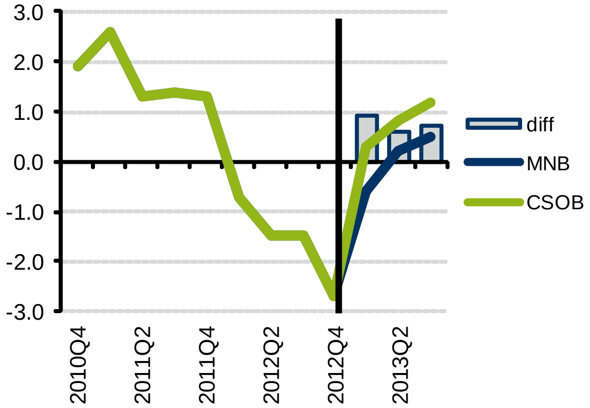
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

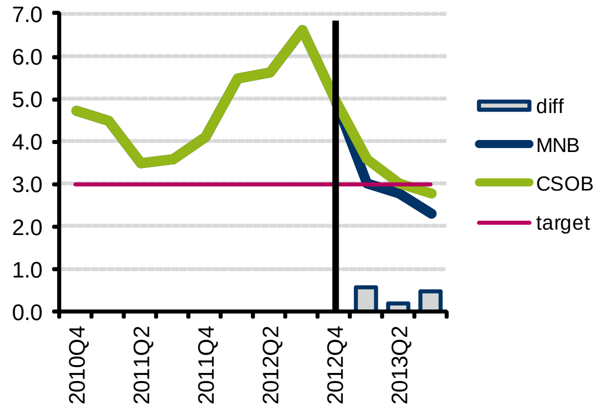


CZ: Inflation outlook (Y/Y, %)

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.	*5.00*	6.50	5.75	5.25	4.75	4.50	-25 bps	3/26/2013
Poland	2W inter. rate	*3.25*	4.75	4.25	3.25	3.25	3.25	-25 bps	4/22/2013

*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	*4.85*	6.61	5.75	5.20	4.70	4.50
Poland	WIBOR	*3.27*	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	*1.31*	1.61	1.37	1.43	1.40	1.55
Hungary	HU10Y	*4.73*	6.56	5.49	7.25	7.00	4.80
Poland	PL10Y	*3.27*	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	*25.9*	25.1	25.1	25.7	25.4	25.0
Hungary	EUR/HUF	*299*	285	291	280	280	#N/A
Poland	EUR/PLN	*4.10*	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	1.7	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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