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Central European Weekly

Monday, 29 April 2013

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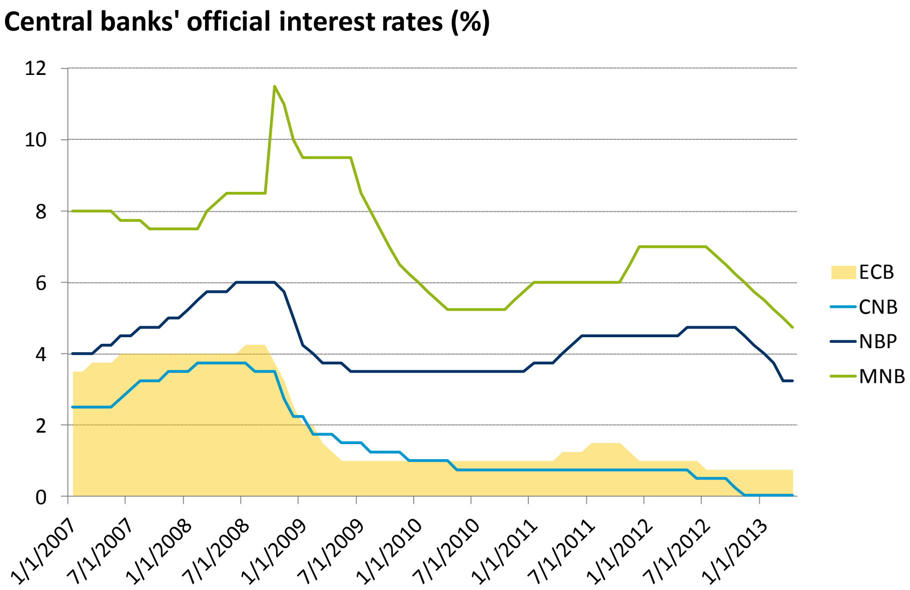


Base interest rates are falling across the whole Europe, whileits centre is not excluded . Will an expected ECB rate cut bring a new roundof portfolio inflows to Central Europe?

Market's editorial

The NBH continue to gradually ease, more to come

The meeting of the National Bank of Hungary sprang no major surprises, if we disregard the incorrect news by Bloomberg on a rate cut to 1%, which temporarily nudged the EUR/HUF towards 303. The final decision subsequently met market expectations, when the bank announced a rate cut by 25 basis points to a new all-time low of 4.75%. The tenor of its accompanying comment was also fairly cautious. Just as during its previous rate cut, the NBH stressed the downside inflation pressures of poor domestic demand, and did not rule out another rate cut if the inflation outlook were to remain below the target (3%) and the sentiment in financial markets were to be favourable. Hungary's inflation fell to 2.2% in March and we believe that inflation pressures are unlikely to arise soon, not only because of poor domestic demand but also because of another possible administrative reduction in prices. After having intervened in electricity prices, the Government is about to intervene in water rates and waste disposal prices. In addition, the entireMonetary Council is already fully appointed by the current Government, and thus it is likely to assist in getting the economy underway. In this respect, we believe that the NBH will continue to cut rates gradually at its next meeting. The vulnerable forint is still preventing a more aggressive monetary easing.

The ECB cut and its spill overs in Central Europe

While domestic macro situation is definititely important for both regional central banks and markets, external factors – namely key policy changes in core markets play even a stronger role. In this respect, we looking forward for the ECB meeting schedulled for this Thursday. ECB President Draghi opened the door for an easing of policy last month when he said the ECB was ready to act if needed. Since the eco data have not improved, probably even weakened further, including in the core. Prices have cooled and the recent drop in commodity prices together with ongoing negative growth will drag inflation further away from the target. Monetary data and the bank lending survey also point towards room to ease policy. Thus, although some uncertainties remain we think that the ECB refi-rate will be cut by 25 basis points to 0.50%, while also some other measures aimed at repairing the transmission mechanism might be announced.

How might Central Europe react to Thursday's rate cut by the ECB? With markets already fully anticipating it, the immediate reaction may be fairly moderate, i.e., almost none. By contrast, if another expansive move by the ECB were to mean that euro rates would be pegged even closer to zero for even a longer time, the impacts on the markets and economies of the Central European region may be even more enduring. Above all, with euro rates close to zero for a long time, Central European higher-interest assets may become objects of sustained attraction. This may lead to a further inflow of portfolio investment to the regional bond markets. As a result, the interest rate spread between the rates in Central Europe and those in the eurozone may continue to shrink. Another side effect may be a reduced tendency of Central European currencies to depreciate, which may lead to even stronger disinflation tendencies in the regional economies.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.7	-1.06%	↗	→
EUR/HUF	301	0.45%	↗	→
EUR/PLN	4.15	0.18%	↗	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.28	-0.47	→	→
10Y HUF	4.68	-0.43	→	→
10Y PLN	3.20	0.00	→	→

Weekly preview

THU 13:00	CNB base rate	
	This meeting	Last change
rate level (in %)	**0.05**	11/2012
change in bps	**0**	-20

CZ: The CNB no rate change and no intervention

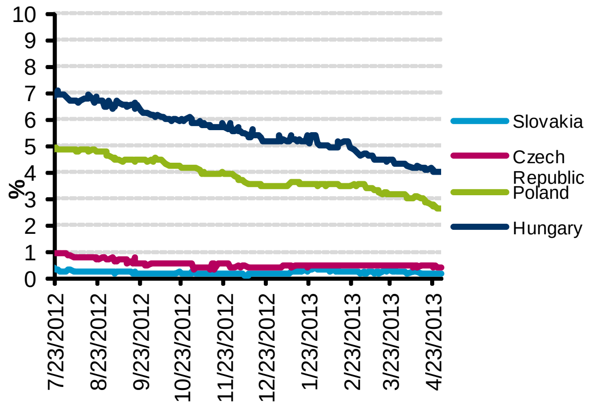
The Czech National Bank will have a new forecast available at its meeting to be held in May. However, no significant changes will be made. The growth forecast for 2013 will be worsened only slightly while the inflation outlook within the horizon of the forecast will remain similar to that of February. The latest risks of the inflation forecast were slightly on the downside, and the new forecast may indicate a slightly weaker exchange rate and lower rates (PRIBOR). However, these effects are unlikely to be strong enough to make the CNB intervene against the Czech currency at its current levels.

Calendar

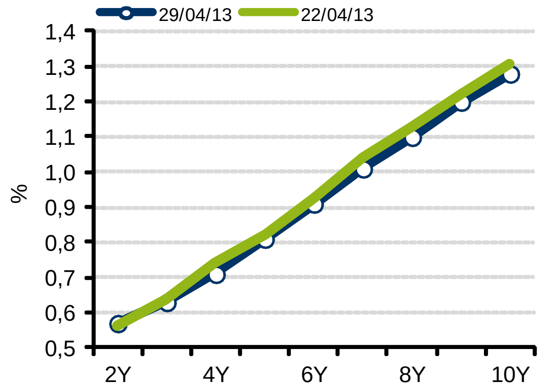
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	04/30/2013	9:00	PPI	%	03/2013				2.1	0.4	0.8
CZ	04/30/2013	11:00	Money supply M2	%	03/2013						4
HU	05/02/2013	9:00	PMI manufacturing		04/2013					55.7	
PL	05/02/2013	9:00	PMI manufacturing		04/2013						
CZ	05/02/2013	9:30	PMI manufacturing		04/2013						
CZ	05/02/2013	12:30	CNB meeting	%	05/2013	0.05		0.05		0.05	
CZ	05/02/2013	14:00	Budget balance	CZK B	04/2013					14	
HU	05/03/2013	9:00	Trade balance	EUR M	02/2013 *F					672.6	
CZ	05/03/2013	9:00	CNB minutes		05/2013						

Fixed-income in Charts

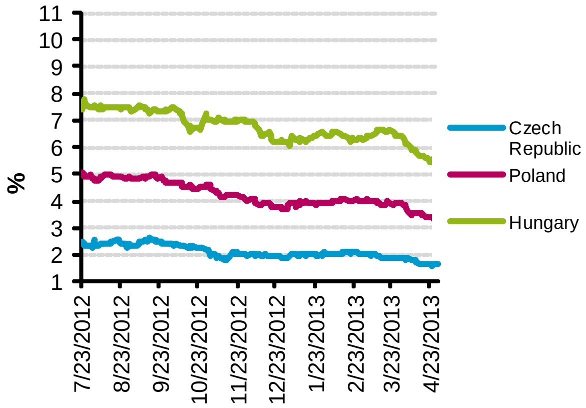
FRA 3x6



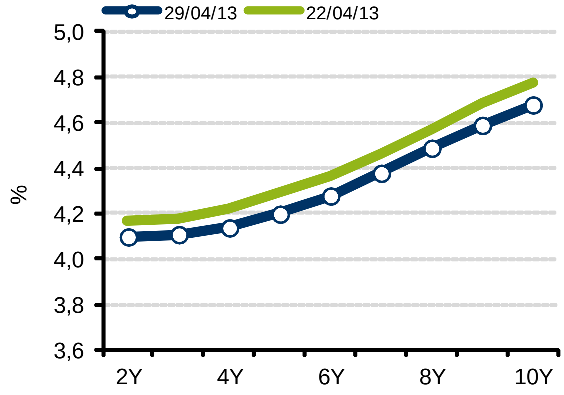
CZ IRS



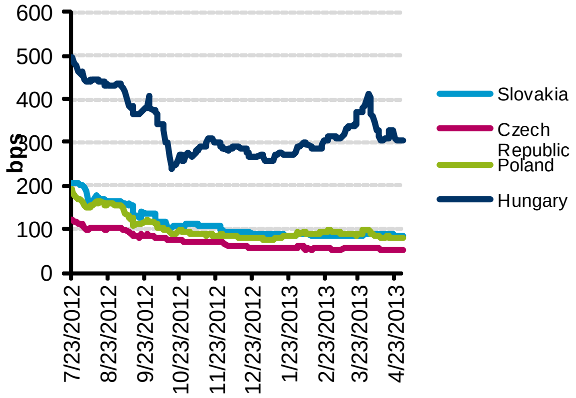
10Y GB Yields



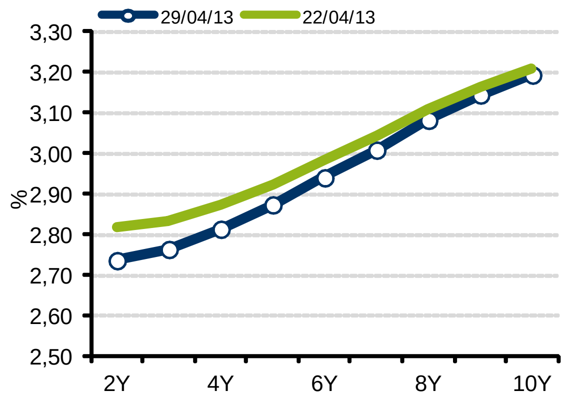
HU IRS



CDS 5Y



PL IRS



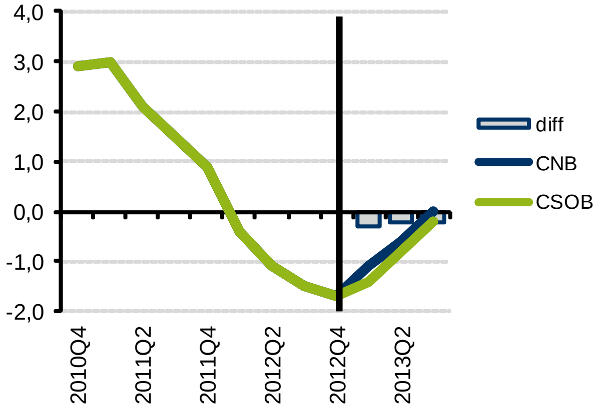
Source: Reuters

Medium-term Views & Issues

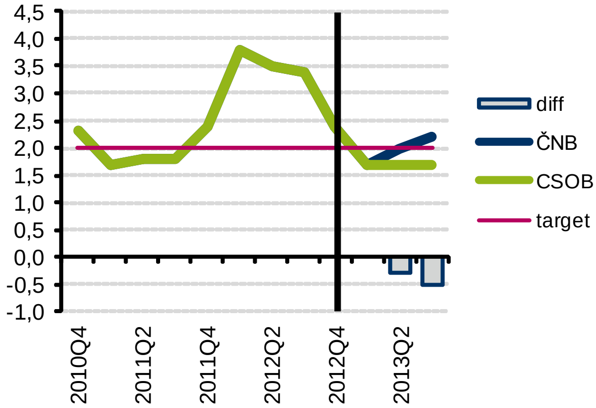
	The Czech Republic	Hungary	Poland
Growth & key issues	The Czech economy remains in a recession, which is shallower but longer than the previous one. The latest data from industry – production as well as orders – still tend to be negative. The drop in domestic demand was followed by a decline in foreign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

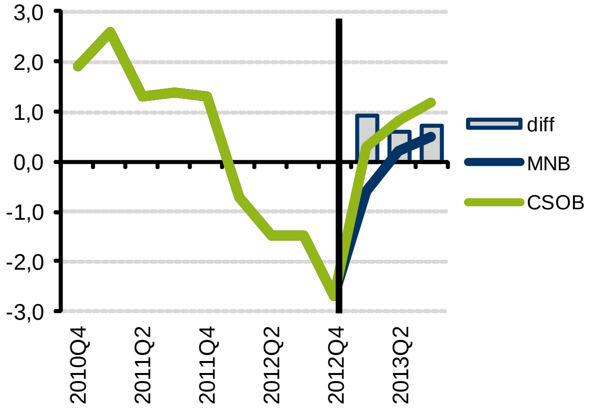
CZ: GDP outlook (Y/Y, %)



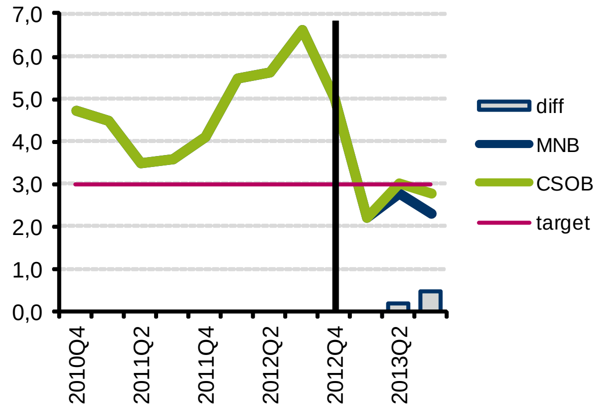
CZ: Inflation outlook (Y/Y, %)



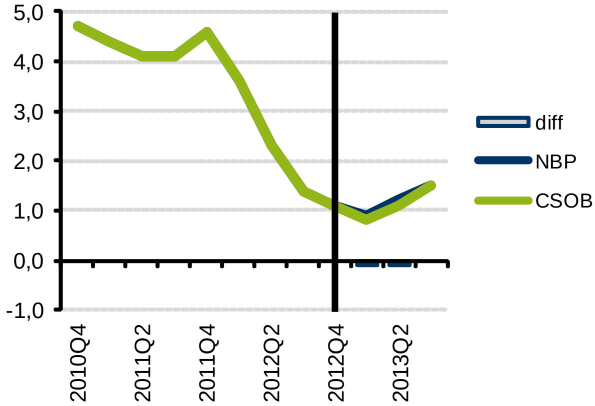
HU: GDP outlook (Y/Y, %)



HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation 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.	*4.75*	6.50	5.75	5.00	4.75	4.50	-25 bps	4/23/2013
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	0.45	0.45
Hungary	BUBOR	*4.61*	6.61	5.75	4.90	4.70	4.50
Poland	WIBOR	*3.1*	4.92	4.11	3.39	4.90	4.90

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

		Current	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3
Czech Rep.	CZ10Y	*1.28*	1.61	1.37	1.31	1.40	1.55
Hungary	HU10Y	*4.68*	6.56	5.49	5.41	7.00	4.80
Poland	PL10Y	*3.20*	4.39	3.60	3.61	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	*301*	285	291	304	280	#N/A
Poland	EUR/PLN	*4.15*	4.11	4.08	4.18	4.00	4.00

GDP (y/y)

	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3
Czech Rep.	-0.4	-1.1	-1.5	-1.7	-1.4	-0.8	-0.2
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	1.7	1.7
Hungary	5.5	5.6	6.6	5.0	2.2	3.0	2.8
Poland	3.9	4.3	3.8	2.4	1.0	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	-3.9	-4.0

Source: CSOB, Bloomberg

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