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Central European Weekly

Monday, 06 May 2013

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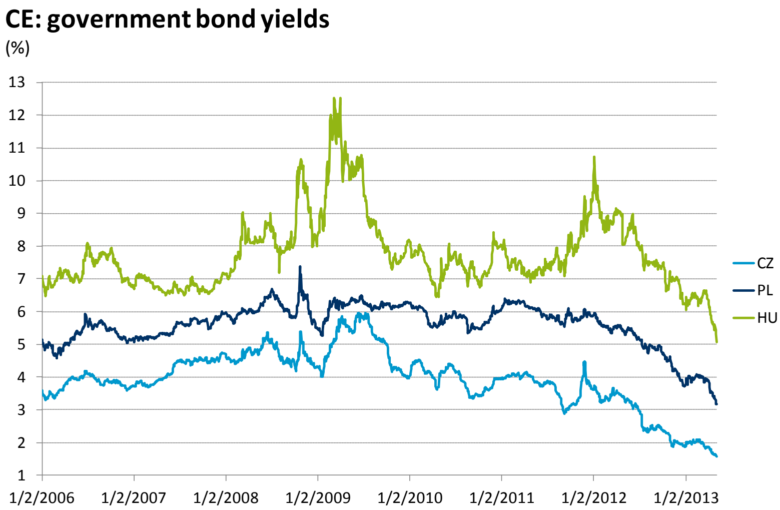
Chart of the Week



CE government bond yields hit new all-time lows on Friday.

Market's editorial

Negative interest rates? Maybe in the EMU, but not in the Czech Republic

The ECB cut its repo rate in-line with market expectations; what surprised was the ECB's technical readiness to introduce a negative deposit rate. Remarkably, the ECB meeting was held on the same day as that of the Czech National Bank, whose Deputy Governor, just like the ECB President, was asked whether Czech central bankers were also considering such a move. The reply by Deputy Governor Tomšík indicated that they were not. Not that the CNB Board did not consider ways to continue to ease its monetary policy, but, if anything like that should really happen, the instrument to be used will not be the CNB interest rates. Firstly, the CNB's introduction of negative interest rates would likely require a prior amendment to Czech legislation. Secondly, the CNB Board (rightly, in our opinion) believes that it has a more powerful instrument at hand to ease its monetary policy – the exchange rate of the koruna, which can be weakened through forex interventions, if necessary.

Despite weak PMIs the NBP stay on hold

The series of Central European business confidence indicators released early last week was mixed, and thus it is all the more interesting to observe whether these 'soft' leading indicators will be in any way reflected in the hard data to be released in markets within the next two weeks. Probably the most important market message came from another deterioration of the business sentiment in the Polish industry, where the hard data (actual output) signals nothing good too. Nonetheless, despite this poor cyclical data, we do not believe that the NBP will be ready to resort to another rate cut this week. MPC members will rather wait for at least for a new macroeconomic forecast (to be released in July), which should provide them with a more accurate picture of how the economy will develop in the second half of this year (and on).

Meanwhile, regional bonds remained well bid and their yields hit new all-time lows (see the chart on the cover page). Polish and Hungarian bonds have been supported by both bets on additional rate cuts countries as well as foreign portfolio investments. Foreign investors, for example, boosted their holdings of Hungarian sovereign bonds by 43% Y/Y in the course of the first two months of this year.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.6	-0.20%	➔	➔
EUR/HUF	296	-1.30%	➔	➔
EUR/PLN	4.15	0.16%	➔	➔

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.18	-4.84	➚	➚
10Y HUF	4.39	-4.57	➔	➔
10Y PLN	3.06	-1.13	➚	➚

In Focus: The New CNB's Forecast

The new forecast stresses downside inflation risks

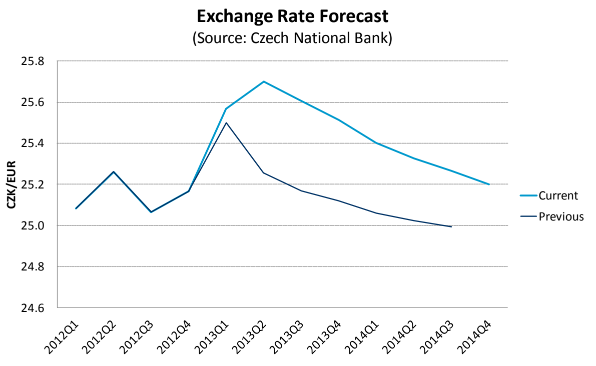
The CNB Board met expectations and left its interest rates unchanged. While taking its decision, the CNB Board had a new forecast available, which unsurprisingly envisages temporarily worsened economic performance, a weaker koruna, and lower inflation. The risks to the new forecast are on the downside. Last but not least, the Czech National Bank reiterated after its Thursday meeting that it is ready to use foreign exchange interventions, "if further monetary policy easing becomes necessary".

In its new forecast, the CNB slightly worsened the overall outlook for the Czech economy for both this year and the next. In addition, it significantly reduced its inflation forecast for this year and very slightly increased the inflation forecast for 2014. Moreover, the CNB anticipates a decline in market interest rates to as low as 0.3% in late 2013, but this is actually the same value as we saw in February's forecast. We should stress that, according to the CNB, official interest rates will remain at technical zero over a longer horizon, as the central bank currently sees no inflation pressures for this year and the next. The tenor of the forecast is as follows: "Consistent with the forecast is a slight decline in market interest rates, followed by a rise in rates in 2014". Of the outcomes of the press conference, we should mention that such a rise would be possible if a recovery (in the euro area) should occur at that time.

The CNB model sees the EUR/CZK average at 25.6 in 2013

The central bank's view on the exchange rate of the Czech koruna has changed a bit. The CNB currently sees the EUR/CZK 25.50 level at the end of the year (the previous forecast implied the 25.20 level in December). Moreover, the CNB model suggests that the currency should be at the EUR/CZK 25.70 for this quarter.

The latest forecast does not signal any aggressive move by the central bank, although it emphases downside inflation risks and also includes temporarily lower inflation expectations. This is why we do not believe that, at its current levels, the koruna might be a reason for the possible interventions that have been so greatly discussed in the media. For the coming week, we therefore expect a steady wait-and-see attitude from the CNB, with forex interventions rather at the verbal level. After all, as indirectly stated at the press conference, the current exchange rate of the koruna does not compel the central bank to continue to ease monetary conditions.



CNB's forecast		May-13	Feb-13	change
GDP (y/y, %)	2013	**-0.5**	-0.3	↓
	2014	**1.8**	2.1	↓
Inflation (y/y, %)	2013Q4	**1.8**	2.3	↓
	2014Q3	**1.9**	1.8	↑
Monetary relevant inflation	2013Q4	**1.0**	1.5	↓
(y/y, %)	2014Q3	**1.8**	1.6	↑
PRIBOR 3M (average, %)	2013Q4	**0.3**	0.3	
	2014Q3	**0.6**	0.5	↑
CZK/EUR (average)	2013Q4	**25.5**	25.1	↑
	2014Q3	**25.3**	25.0	↑

Weekly preview

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

	Mar-13	Feb-13	Mar-12
Monhtly	**-3.5**	-5.7	0.1
cummulative (YTD)	**-4.5**	-5.1	0.1

CZ: Industry remains subdued

Industrial output likely continued to fall in March. However, the overall decline might be slower, even though it was affected by one less business day in the month. In recent months, industry has continued to be affected by the lack of orders from domestic as well as foreign markets, with this also having an impact on the key sector of Czech industry – car production. Highly adverse year-on-year figures for last month were likely posted, in particular, by the energy sector, electronics production, metals, and the automotive industry. Data on new orders will be awaited very tensely. At the moment, however, we do not expect them to return to the positive region. Such a turnaround is more likely in the second half of the year.

WED 14:00 — NBP rate (in %)

	This	Last change
rate level	**3.25**	3/2013
change in bps	**0**	-50

PL: The NBP on hold this time

The National Bank of Poland (NBP) is likely to leave interest rates unchanged at its Wednesday meeting, albeit the recently released macroeconomic statistics (such as April's PMI) have been negative. Nevertheless, with its surprising rate cut by 50 basis points at its March meeting, which was passed by the narrowest of margins, owing to the vote by NBP President Belka having greater weight, the bank, according to its own statement, has put an end to the rate cut cycle it commenced in November last year, and its current forecast still relies on an economic recovery in the second half of the year (another forecast, which is likely to be more pessimistic, will be released in July). Statements from Adam Glapinski, who is one of median voters on the Monetary Policy Council, also suggest that rates will be kept at their current levels at the May meeting.

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

	Mar-13	Feb-13	Mar-12
Sales	**-3.0**	-4.7	-0.6
cummulative (YTD)	**-2.8**	-2.7	1.0

CZ: Retail driven down by cars

The lower number of business days in the month also affected the retail sector, which is still curbed by consumer demand. March did not visibly change this trend. Especially new car sales were very poor. Figures, except for e-commerce, are likely to be more or less in the red. After all, not even consumer confidence surveys have signalled any turnaround in consumption thus far. Strong concern about unemployment persists, and the anticipated seasonal fall in April (to 7.7%) cannot change this at all.

FRI 9:00 — CZ Inflation (change in %)

	Apr-13	Mar-13	Apr-12
CPI m/m	**0.0**	0.1	0.0
CPI y/y	**1.7**	1.7	3.5

CZ: Inflation stagnates below the target

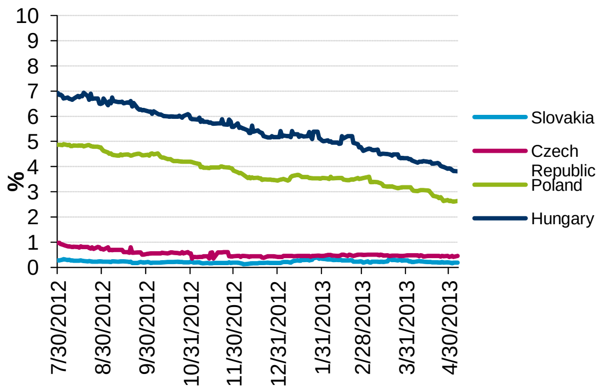
Poor consumer demand still significantly curbs inflation pressures in the economy. Thus, with a few exceptions, retail prices did not visibly change in April. Seasonal clothing and shoe prices went up, while food and fuel prices likely went down this time. Hence year-on-year headline inflation remained at the same level as in the previous month – i.e., 1.7%. Lower-than-targeted inflation, along with a positive inflation outlook, enables the central bank to maintain record-low interest rates longer than originally expected. Moreover, inflation in the Czech Republic is unlikely to recover in any way this year.

Calendar

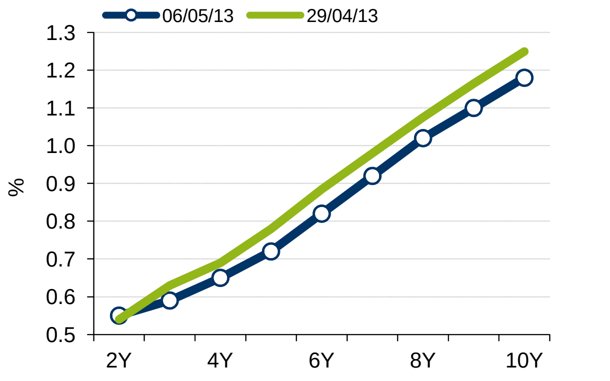
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	05/06/2013	9:00	Retail sales	%	03/2013						-1.4
CZ	05/06/2013	10:00	Current account	CZK B	1Q/2013	50		1635		-1444.3	
HU	05/07/2013	9:00	Industrial output	%	03/2013 *P					0.3	-1.1
CZ	05/07/2013	9:00	Construction output	%	03/2013						2.3
CZ	05/07/2013	9:00	Industrial output	%	03/2013		-3.5		-4.5		-5.7
CZ	05/07/2013	9:00	Trade balance	CZK B	03/2013	38		36.5		28.7	
HU	05/07/2013	17:00	Budget balance	HUF B	04/2013					-493.6	
PL	05/08/2013	14:00	NBP meeting	%	05/2013	3.25		3.25		3.25	
CZ	05/09/2013	9:00	Retail sales	%	03/2013		-3		-3		-4.7
CZ	05/10/2013	9:00	CNB minutes		05/2013						
HU	05/10/2013	9:00	Trade balance	EUR M	03/2013 *P						
CZ	05/10/2013	9:00	CPI	%	04/2013	0	1.7	0	1.7	0.1	1.7
CZ	05/10/2013	9:00	Unemployment rate 15-64	%	04/2013	7.7		7.6		8	

Fixed-income in Charts

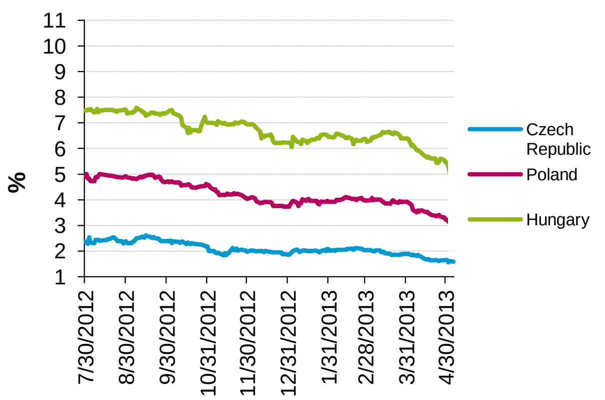
FRA 3x6



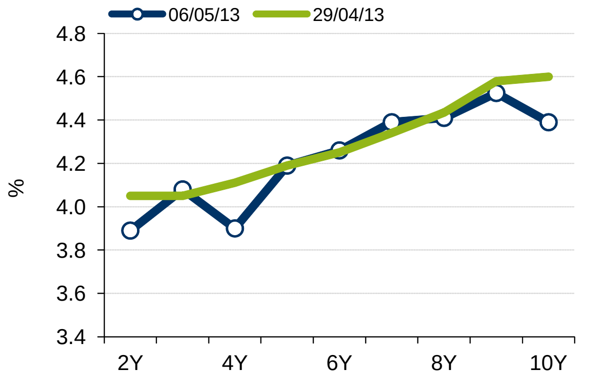
CZ IRS



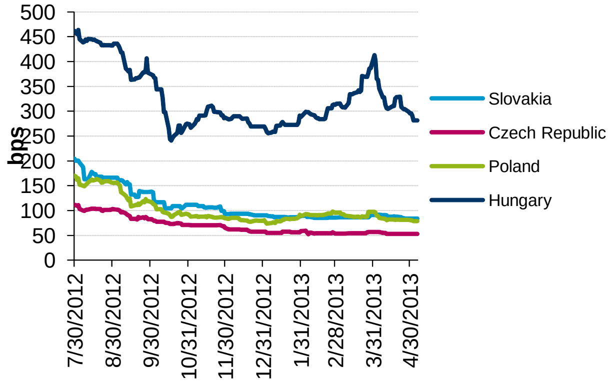
10Y GB Yields



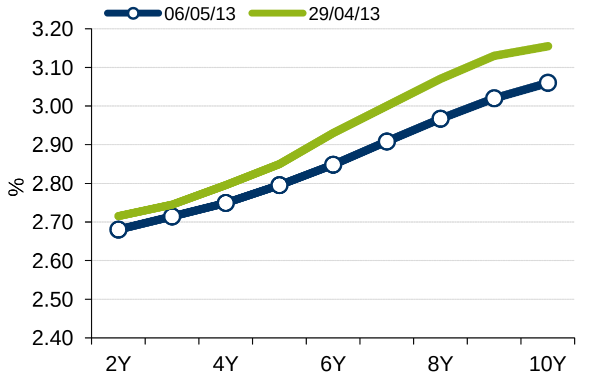
HU IRS



CDS 5Y



PL IRS



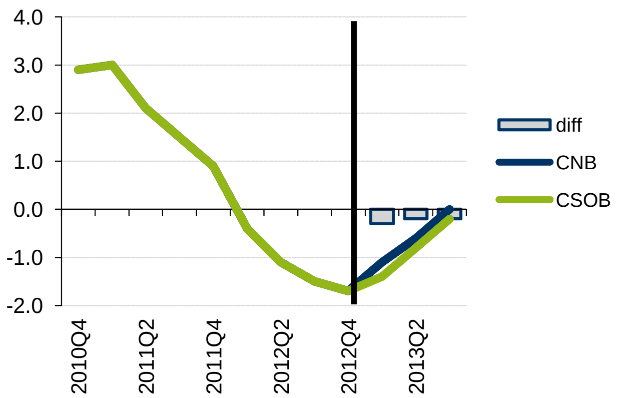
Source: Reuters

Medium-term Views & Issues

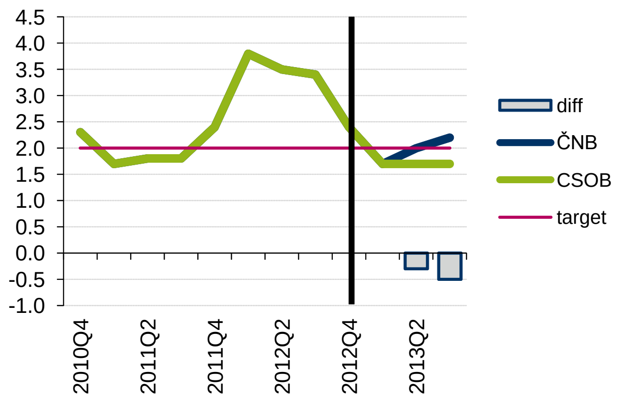
	The Czech Republic	Hungary	Poland
Growth & key issues	The Czech economy remains in a recession, which is shallower but longer than the previous one. The latest data from industry – production as well as orders – still tend to be negative. The drop in domestic demand was followed by a decline in foreign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

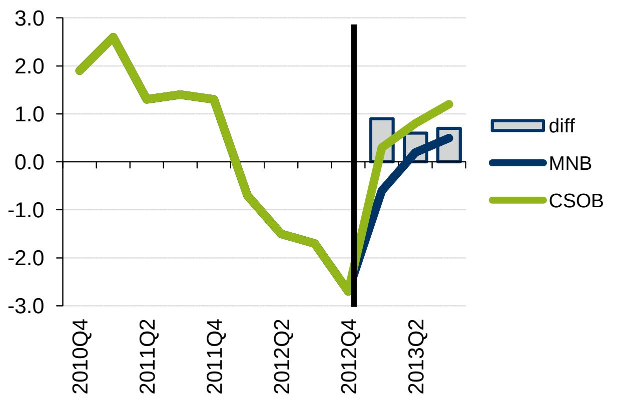
CZ: GDP outlook (Y/Y, %)



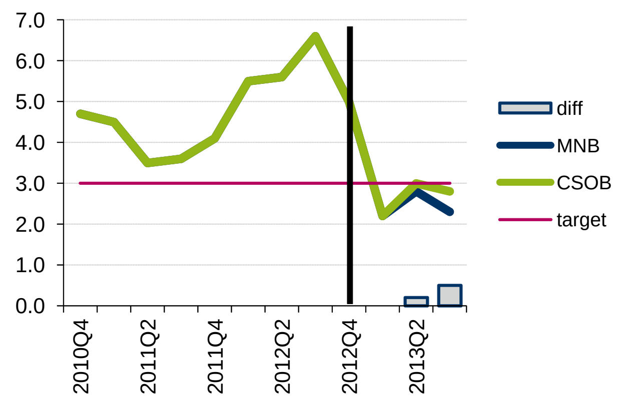
CZ: Inflation outlook (Y/Y, %)



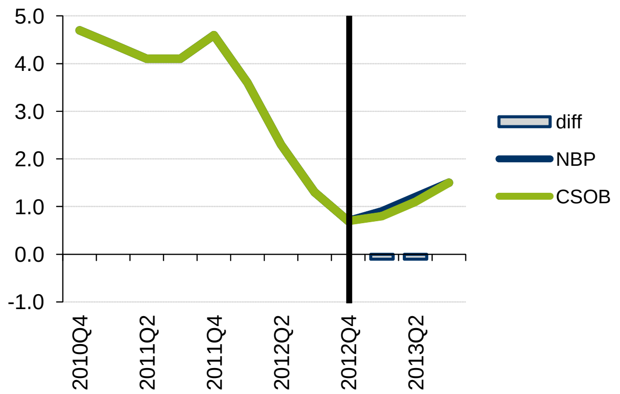
HU: GDP outlook (Y/Y, %)



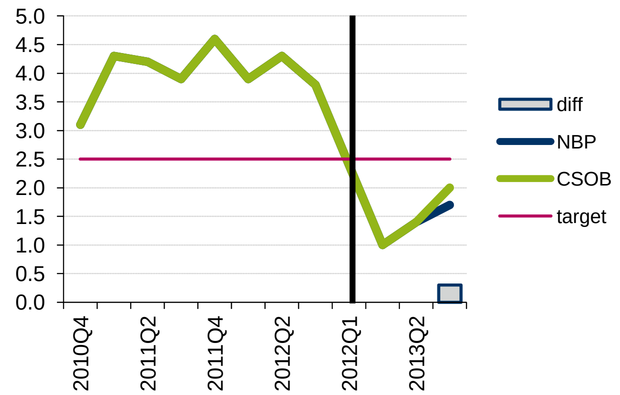
HU: Inflation outlook (Y/Y, %)



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.	*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	*0.46*	0.80	0.50	0.47	0.45	0.45
Hungary	BUBOR	*4.58*	6.61	5.75	4.90	4.70	4.50
Poland	WIBOR	*3.07*	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	*1.18*	1.61	1.37	1.31	1.40	1.55
Hungary	HU10Y	*4.39*	6.56	5.49	5.41	7.00	4.80
Poland	PL10Y	*3.06*	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	*25.6*	25.1	25.1	25.7	25.4	25.0
Hungary	EUR/HUF	*296*	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	-1.7	-2.7	0.3	0.8	1.2
Poland	3.6	2.3	1.3	0.7	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.	-1.9	-1.9
Hungary	1.5	1.0
Poland	-4.0	-3.8

Public finance balance as % of GDP

	2012	2013
Czech Rep.	-4.4	-3.0
Hungary	-2.5	-2.2
Poland	-3.9	-4.0

Source: CSOB, Bloomberg

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