Central European Weekly

Monday, 13 May 2013

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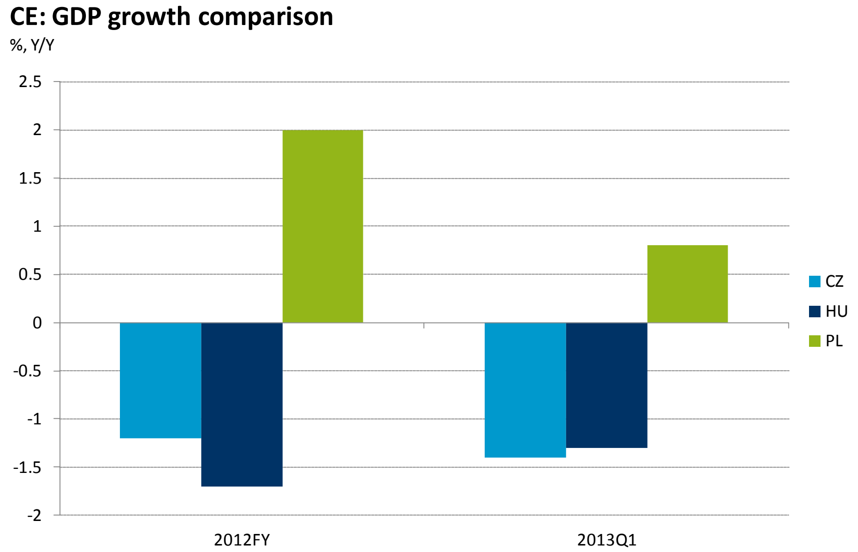
Weekly Highlights:

- The NBP: another meeting, another surprising rate cut
- The CNB has confirmed our again that it does not bank plan an unconventional measures (negative rates)
- Week ahead: weak Czech and Hungary's GDP together with Polish inflation below 1%

Chart of the Week



Both Czech Czech and Polish GDP is expected to have fallen in the first quarter of this year. (Source: CSOB, CZSO, MNB, CSO).

Market's editorial

The NBP: another meeting, another surprising rate cut

Unfortunately, the National Bank of Poland surprised us for the second consecutive time by cutting its base interest rate – this time by 25 basis points. Although the rate cut by the NBP is certainly based on fundamentals, i.e., the development of the national economy, this move was evidently not isolated. Polish central bankers obviously jumped on the bandwagon of developments commenced by the ECB in May, surprisingly continued by the Reserve Bank of Australia, and, just a few hours after the NBP, completed with a rate cut by the Bank of Korea.

The CNB still keeps watching the koruna

Following a release of the Minutes from the latest CNB Bank Board meeting, the central bank has met analyst community to explain them its new macro forecast. The meeting confirmed our feeling that the bank plans no unconventional measures (such as negative repo rates) to further ease monetary conditions. In other words, the only discussed policy tool (let us recall that the main repo rate already hit its 'technical zero') remains the exchange rate. CNB board members who were present at the meeting (vice-governor Tomsik and board member Janacek) confirmed their strong focus on the exchange rate by remembering its precise value which had prevailed during the last policy meeting. Besides that, the board has been clearly concerned with falling inflation expectations and negative core inflation. According to the CNB board, a weaker koruna should be able to tackle both; moreover, as a side-effect of rising inflation expectations, it should even support household consumption (Board members believe that a weaker koruna would pass-through into import prices and the households would speed-up their consumption spending due to the fear from additional increase in prices).

As we already pointed out, we believe that rather than risks of outright interventions, the CNB policy sets a threshold for eventual (fast) strengthening of the koruna. Therefore, we think that the koruna is heading for the period of lower volatility and relative decoupling from global and regional markets.

Watch weak Czech and Hungary's GDP and Polish inflation

The coming week will be interesting through the lens of central banks as well as markets in practically all of the countries in the region that have their own currencies, because the Czech Republic and Hungary will release preliminary GDP forecasts, while Poland will unveil May's inflation data. All of those figures should confirm that the current highly eased monetary policies of all of the central banks are justified, because the Czech and Hungarian economies are still likely to perform clearly in the red (on the year-on-year basis) while Polish inflation should even fall below 1%, which is not only a seven-year low but also another disinflation divergence from the NBP target.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.5	-1.47%	↘	↘
EUR/HUF	285	0.19%	↘	↘
EUR/PLN	4.11	-1.98%	↘	↘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.67	3.73	↗	↗
10Y PLN	6.53	-0.31	↘	↘
10Y HUF	4.42	0.68	↘	↘

Review of Economic Figures

While monthly figures confirm the Czech recession,..

The latest data from the Czech economy clearly suggests that the recession, which has lasted for more than a year, is not about to end. Thus the decline, which began in the wake of domestic restriction in the second half of last year and accelerated due to waning European demand, is still not over. This is probably most evident in industry, which was down by 5.4% in the first quarter of this year. Its most important component, which kept the Czech economy from falling to an even greater extent for the most of last year – i.e., car production – even dropped by almost 12%. In addition, as we can see from the soft indicators of confidence and mood or from the statistics on orders, industry has yet to hit its bottom. Nevertheless, the situation is by far not as dramatic as in late 2008 and early 2009, when the volume of orders shrank by 25% almost all at once. Compared to that period, Czech industry is still 13% in the black, while car production is even 35% higher.

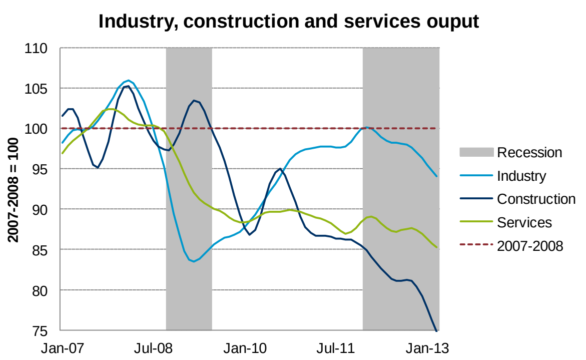
By contrast, the performance of construction is much worse than that of industry; given its lack of orders, construction is in its sixth year of recession. Construction output is currently 35% below that of early 2009, with new orders signalling no turnaround on the horizon. The construction of new dwellings, the numbers of which shrank to a half vis-à-vis the strong years 2007 and 2008, is also in a record-breaking downturn.

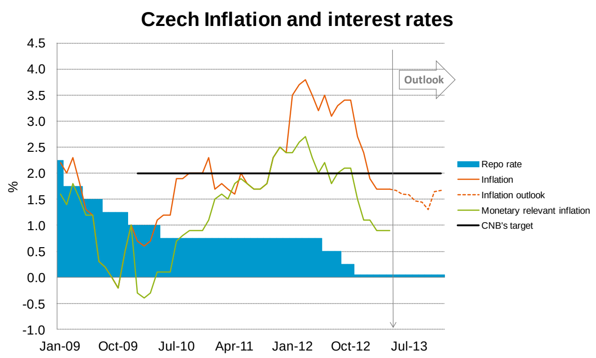
... Poor demand curbs inflation

Goods news has not even come from certain services thus far. While the latest data from the retail sector was not that bad (0.1%) owing to Easter, the key trend of curbed demand remains unchanged. Poor confidence in the economy is encouraging restriction in shopping, notably in respect of durable goods such as cars, the domestic registrations of which dropped by nearly 15% for the first four months. Not even the other services performed well in the first quarter, perhaps with the great exception of information technology. And the Q1 GDP forecast, which will be released this week and which remained primarily at the mercy of poor domestic demand, is unlikely to be favourable either.

Declining consumer demand for shopping continues to act as a strong downside inflation factor, and thus inflation, despite the increased VAT, remains below the Czech National Bank's target level (currently 1.7%, just like in February and March), while monetary relevant inflation is even below the lower threshold of the tolerance band (0.9%).

The actual figures are continuing to approach the latest central bank forecast, thus still confirming the anticipation that interest rates in the Czech economy will continue to be low for a fairly long period.





In Focus

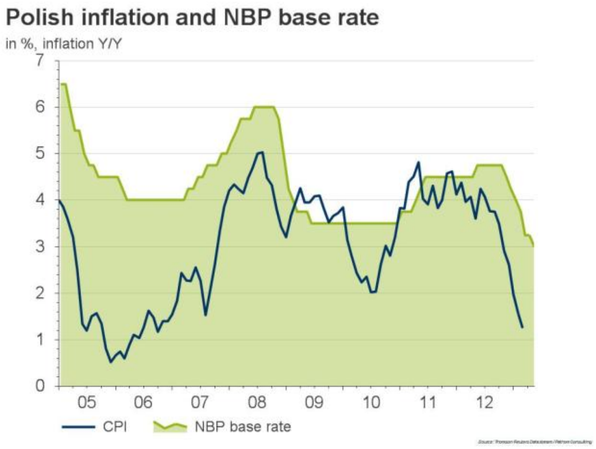
The NBP surprisingly lowered interest rates by 25 bps

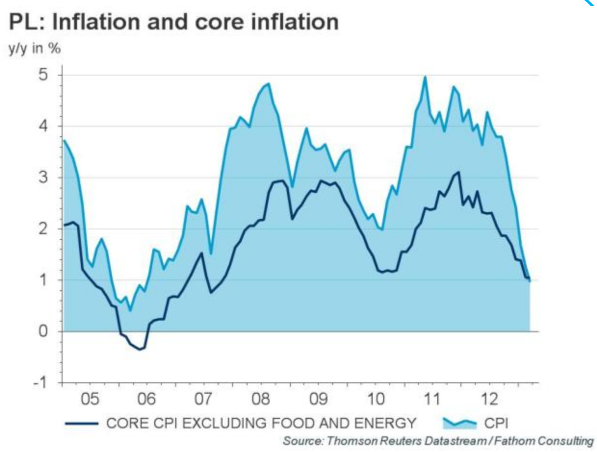
The National Bank of Poland's (NBP) decision to cut interest rates by additional 25 basis points took markets by surprise last week. According to the official statement, the NBP based its decision on the fact that "[...] the incoming data indicate that economic growth in Poland remains weak, while inflation decline is stronger than forecasted in the March projection. At the same time, uncertainty about the pace and timing of the expected recovery in the euro area has increased". At the subsequent press conference, NBP President Belka indicated the rate cut was not the beginning of a new monetary easing cycle but rather fine-tuning of the previous one which had ended in March. Nevertheless, Belka added, the Monetary Policy Council (MPC) was still leaning towards an easing stance and further rate cuts could not be ruled out.

… and another rate cut may come in July

Clearly, the NBP is concerned with a sharp decline in inflation rate and unfavourable structure of GDP growth, which has lately been almost exclusively driven by net exports; traditionally strong domestic consumption and investment even contributed negatively to the 2012Q4 growth. Although signs of relative underperformance of the Polish economy (in comparison with the previous decade) have been present for some time, we thought the MPC would be reluctant to undertake more aggressive easing policies. Recent decisions of the Council, however, have undermined this view. Therefore, we have revised our outlook and newly expect the reference rate to stay unchanged in June and to be lowered by additional 25 bps in July along with the release of a new Inflation report.

Regarding market reactions, yield of the 10Y government bond fell by 15 basis points, mainly owing to strong foreign demand. Moreover, additional 48 bps decline in the 3M WIBOR is priced in the six months horizon now.





Weekly preview

CZ: Still in a recession

WED 9:00	CZ GDP (change in %)		
	Q1-13	Q4-12	Q1-12
GDP (y/y)	**-1,4**	-1,7	-0,4
GDP (q/q)	**-0,2**	-0,2	-0,5

The economy did not emerge from the recession in the first quarter of the year either. Production statistics are not even signalling stabilisation at the moment. Household consumption remains subdued because of increased uncertainties and a worsened financial position. We do not even believe that investment might already see a positive turnaround.

HU: GDP will continue to fall

WED 9:00	HU GDP (change in %)		
	2013Q1	**2012Q4**	**2012Q1**
GDP (y/y)	**-1,3**	-2,7	-0,7

We expect the GDP to fall for the fifth consecutive time in the first quarter of this year. Nonetheless, the decline should already be slower. We predict that the decline of 2.7% in the last quarter of 2012 might decelerate to around 1.3% y/y in the first quarter of 2013. The data, which was released piecemeal, indicates that during that quarter domestic demand, which makes up more than 60% of GDP, remained highly muted (retail sales dropped by 2.8% y/y in March). Thus growth may be driven by exports. The latest data from industry shows that, even if year-on-year industrial output is continuing to fall, the month-on-month data indicates a possible onset of better times (industry has grown since the beginning of the year on the month-on-month basis). The central bank would also like to contribute to the growth with its new programme to support small and medium-sized businesses; however, the start of the programme is not scheduled before June this year.

PL: Year-on-year inflation drops below 1%

WED 14:00	PL Inflation (change in %)		
	Apr-13	Mar-13	Apr-12
CPI y/y	**0.7**	1.0	4.0
Food (ex Alc.) y/y	**1.9**	1.5	3.2
Transport (including fuel)	**-2.5**	-0.5	8.7

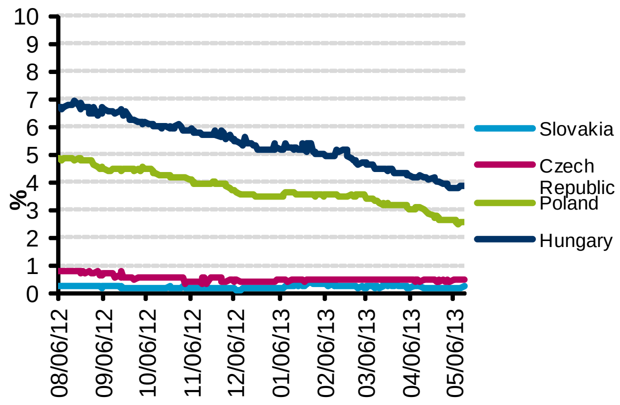
The year-on-year inflation rate in Poland likely continued to fall and hit 0.7% in April. Month-on-month prices were up by 0.3%, according to our forecast. This time, the main reasons for another inflation deceleration likely included fuel prices, which probably fell not only on the month-on-month basis (as opposed to their usual seasonal rise) but also on the year-on-year basis. On the contrary, food prices rose more slowly than is usual in April (+0.5% m/m).

Calendar

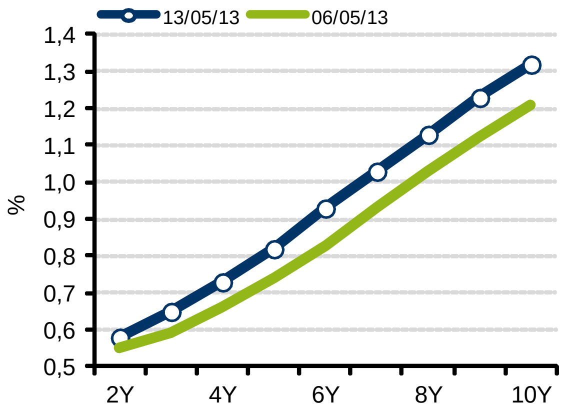
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	05/14/2013	9:00	CPI	%	04/2013			0,3	1,7	0,3	2,2
PL	05/14/2013	14:00	Money supply M3	%	04/2013			-0,1		1,3	
HU	05/15/2013	9:00	Industrial output	%	03/2013 *F					0,4	-0,7
HU	05/15/2013	9:00	GDP	%	1Q/2013 *P		-1,3	0,1	-1,5	-0,9	-2,7
CZ	05/15/2013	9:00	GDP	%	1Q/2013 *P	-0,2	-1,4	-0,1	-1,3	-0,2	-1,7
CZ	05/15/2013	10:00	Current account	CZK B	03/2013	16,5		11		27,7	
CZ	05/15/2013	12:00	CZ bond auction 2012-17, floating rate	CZK B	05/2013						
CZ	05/15/2013	12:00	CZ Bond auction 4,20 %/2036	CZK B	05/2013						
PL	05/15/2013	14:00	Current account	EUR M	03/2013			-175		-854	
PL	05/15/2013	14:00	Trade balance	EUR M	03/2013			160		602	
PL	05/15/2013	14:00	CPI	%	04/2013	0,3	0,7	0,3	0,7	0,2	1
PL	05/15/2013	15:00	Budget balance	PLN M	04/2013					-24406	
CZ	05/16/2013	9:00	PPI	%	04/2013	-0,1	0,9	-0,1	0,9	0	1
PL	05/16/2013	14:00	Core CPI	%	04/2013			0,3	0,8	0,3	1

Fixed-income in Charts

FRA 3x6

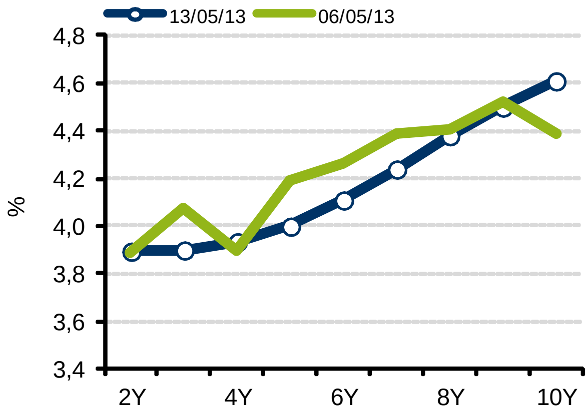


CZ IRS

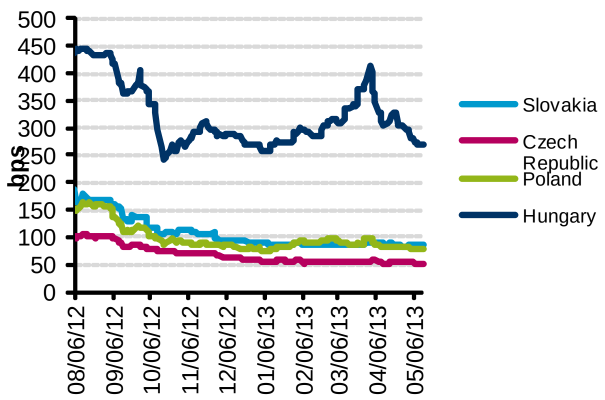


10Y GB Yields

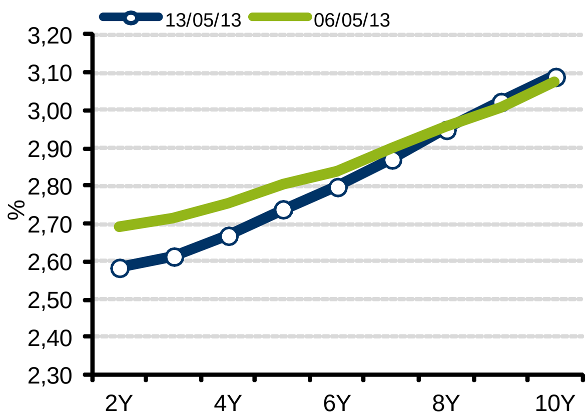
HU IRS



CDS 5Y



PL IRS



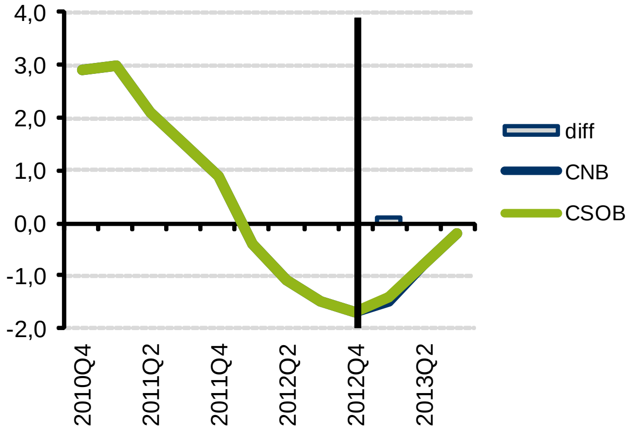
Source: Reuters

Medium-term Views & Issues

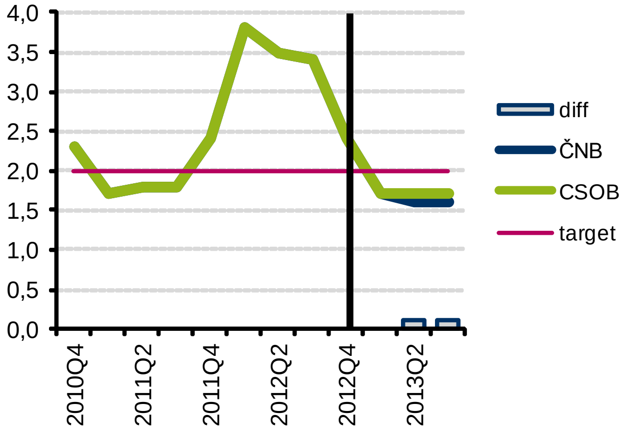
	The Czech Republic	Hungary	Poland
Growth & key issues	The Czech economy remains in a recession, which is shallower but longer than the previous one. The latest data from industry – production as well as orders – still tend to be negative. The drop in domestic demand was followed by a decline in foreign 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 0.7% in the fourth quarter of 2012 (after revision). 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 in the second half of 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 (-0.5%). 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 development or rapidly firming koruna 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.	Clearly, the NBP is concerned with a sharp decline in inflation rate and unfavourable structure of GDP growth, which has lately been almost exclusively driven by net exports; traditionally strong domestic consumption and investment even contributed negatively to the 2012Q4 growth. Although signs of relative underperformance of the Polish economy (in comparison with the previous decade) have been present for some time, we thought the MPC would be reluctant to undertake more aggressive easing policies. Recent decisions of the Council, however, have undermined this view. Therefore, we have revised our outlook and newly expect the reference rate to stay unchanged in June and to be lowered by additional 25 bps in July along with the release of a new Inflation report.
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 25.40-26.00 EUR/CZK. We believe that rather than risks of outright interventions (against CZK), the CNB policy sets a threshold for eventual (fast) strengthening of the koruna. Therefore, we think that the koruna is heading for the period of lower volatility and relative decoupling from global and regional markets.	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

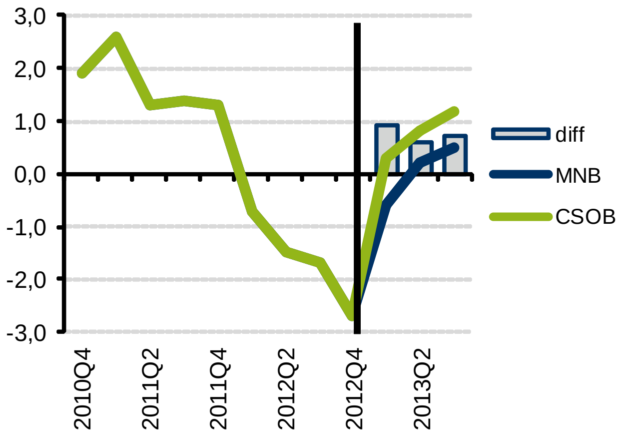
CZ: GDP outlook (Y/Y, %)



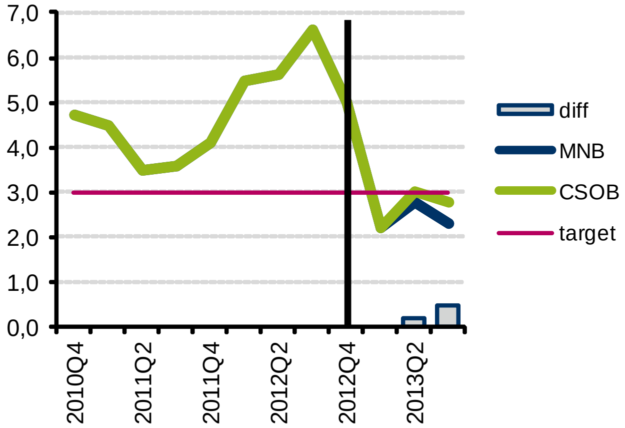
CZ: Inflation outlook (Y/Y, %)



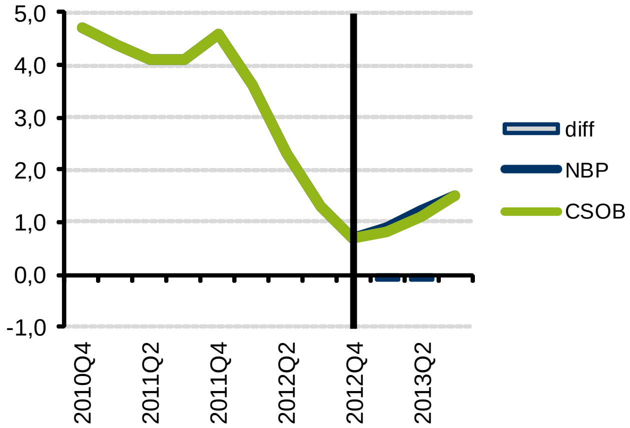
HU: GDP outlook (Y/Y, %)



HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outllok (Y/Y, %)

Source: CNB, NBP, MNB, CSOB

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	*3,00*	4,75	4,25	3,25	3,25	3,25	-25 bps	5/8/2013

*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	0,43
Hungary	BUBOR	*4,58*	6,61	5,75	4,90	4,70	4,50
Poland	WIBOR	*2,9*	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	*1,32*	1,61	1,37	1,31	1,40	1,50
Hungary	HU10Y	*4,61*	6,56	5,49	5,41	7,00	4,80
Poland	PL10Y	*3,09*	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	*25,8*	25,1	25,1	25,7	25,6	25,5
Hungary	EUR/HUF	*294*	285	291	304	280	280
Poland	EUR/PLN	*4,16*	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	-1,3	-1,0	-0,6
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

Contacts

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	Brussels	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Joke Mertens	+32 2 417 30 59	Commercial Desk	+32 2 417 53 23
Mathias van der Jeugt	+32 2 417 51 94	Institutional Desk	+32 2 417 46 25
Dublin Research		London	+44 207 256 4848
Austin Hughes	+353 1 6646892	Frankfurt	+49 69 756 19372
Prague Research (CSOB)		Paris	+33 153 89 83 15
Jan Cermak	+420 2 6135 3578	New York	+1 212 541 06 97
Jan Bures	+420 2 6135 3574	Singapore	+65 533 34 10
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)		Prague	+420 2 6135 3535
Marek Gabris	+421 2 5966 8809	Bratislava	+421 2 5966 8436
Warsaw Research		Budapest	+36 1 328 99 63
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