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Central European Weekly

Monday, 03 June 2013

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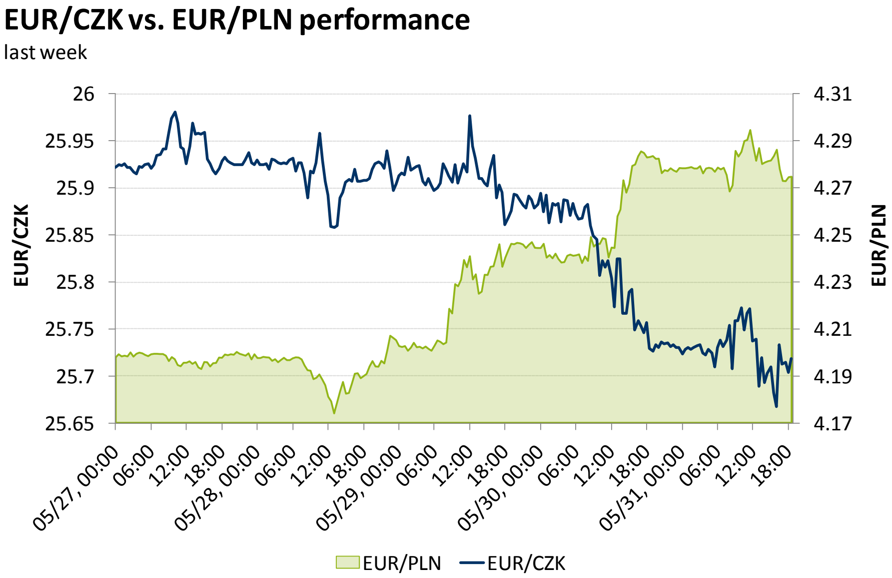
Chart of the Week



Mirror trading of the EUR/PLN and EUR/CZK pairs in recent hour and days sugests that carry trade could be in play.

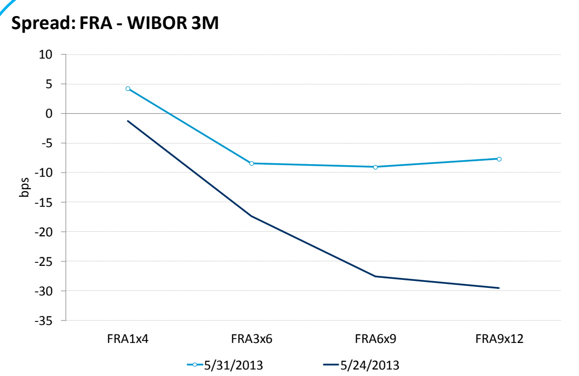
Market's editorial

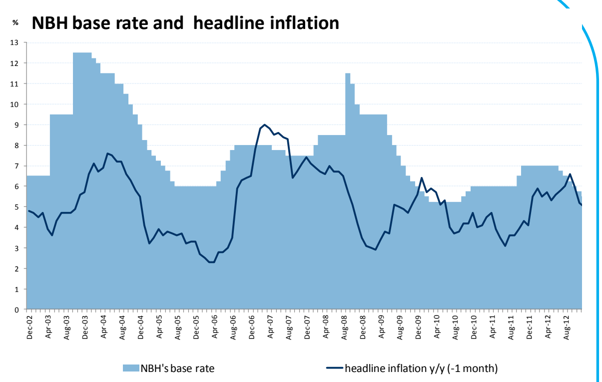
A weaker zloty – the recent dilemma for the NBP?

The European Commission's recommendation to allow Hungary to extract itself from the excessive deficit procedure, and a sale of the Polish zloty against the backdrop of the strengthening Czech koruna, were the two most interesting events of last week.

Let us first consider Hungary for a moment. In recent years, investors have been accustomed to Hungary being the sick and a somewhat problematic man of Central Europe; nevertheless, the fact that the National Bank of Hungary cut its interest rates to new lows on Tuesday without having to be afraid for the stability of its currency is further evidence that things in Hungary (at least from the macroeconomic point of view) are changing for the better. After all, there has been more evidence of that sort recently. A few days ago, it was the preliminary GDP forecast for the first quarter of the year, which, in spite of generally adverse figures in the region, sprang a pleasant surprise in Hungary (and was much better than, for example, the Czech GDP). In the end, the diplomatic and economic success of the revocation of the excessive budget deficit procedure is thus just a logical conclusion of the series of positive macroeconomic surprises, naturally reflected in favourable fiscal developments, which the Commission had to take into account.

As concerns the current appreciation of the zloty, this is interesting in two respects: firstly, the reasons that have led to it; and secondly, the implications that the weakened currency may have on the upcoming decisions by the Monetary Policy Council. Regarding the reasons for the depreciation of the zloty, these may include the outflow of speculative capital from Poland in relation to the global rise in yields and rates in developed countries, as well as purely domestic (Polish) reasons, in the form of poor macroeconomic data. The message from the weak zloty to the forthcoming NBP meeting should be slightly hawkish, to the extent that the central bank will cut its repo rate by 'only' 25 basis points this time (or again).





	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

The NBH cuts rates to a fresh all-time low

The National Bank of Hungary met expectations and cut rates for the tenth consecutive time by 25 basis points to a new all-time low. No surprise came from the press release either; just as was the case with April's rate cut, it highlights poor demand and its disinflation pressures, with more rate cuts to be considered by the central bank with a view to the medium-term inflation outlook and the mood in financial markets. We believe that the bank may continue to cut rates on an ongoing basis. Several factors favour a further monetary easing. According to the latest economic growth data, Hungary appears to be starting to fare well. It seems to be progressively leaving behind its status as the most problematic country in the region, in the eyes of the markets, and this is also encouraging the forint, which has strengthened (its losses due to the nervousness stemming from the appointment of the new NBH Governor have been completely eliminated. This means that Hungary no longer needs such a high interest rate differential, which has been helping the forint and consequently those repaying foreign currency loans. Not even inflation, influenced by more of the planned administrative price reductions, will be an obstacle to rate cuts.

Moreover, the NBH is seeking more ways to encourage the economy and concurrently to reduce the quantity of loans denominated in foreign currencies, and thus the susceptibility to the fluctuations of the exchange rate of the forint. The programme, launched in April, to provide commercial banks with interest-free loans to boost cheap credit for small and medium-sized enterprises has been expanded by a half. According to Adam Balog, a member of the NBH Monetary Council, the programme should encourage this year's economic growth by 0.2-0.5%. The latest data indicates that the NBH will supply HUF 425 bn under the first pillar, which should provide SMEs with cheap credit, and an additional HUF 325 bn (as opposed to the originally planned HUF 250 bn) under the second pillar, focused on the refinancing of foreign currency loans, i.e., about 30% of the current quantity of foreign currency loans held by small and medium-sized enterprises in Hungary. Thus a change in the susceptibility to fluctuations of the forint might become evident among enterprises; nevertheless, not only enterprises but also households are indebted in foreign currencies, with the total foreign currency debt of the latter being four times higher than that of SMEs.

The EC recommends to lift the EDP against Hungary

The change in the perception of the Hungarian economy is also signalled by the European Commission's decision. The Commission has recommended that Hungary should be allowed to extract itself from the excessive deficit procedure to which the country has been subject since 2004. According to the European Commission's forecasts, the fiscal actions planned by the Hungarian Government should lead to the deficits of 2.7% of GDP this year and 2.9% of GDP next year. The Hungarian Government sees the European Commission's decision as its great success, after its lingering disputes with the EU, which criticised certain moves by the current Orban Government, such as the imposition of a temporary tax on banks and other large enterprises or the nationalisation of private pension funds. The European Commission's decision is clearly good news for Hungary, as the country need no longer be afraid of the Commission's penalties; however, the lack of fiscal policy supervision may spark concern ahead of the approaching election.

Polish GDP revised slightly upwards

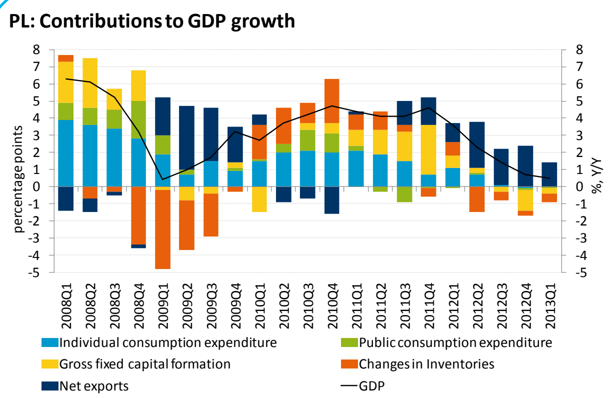
The first ever flash forecast of Poland's economic growth proved to be very accurate, as the Central Statistical Office adjusted the forecast only slightly on Wednesday – by 0.1% upwards to 0.5% y/y. On a quarter-on-quarter basis, the GDP grew slightly, by 0.1%. In other words, no miracle happened and the data again confirmed that the Polish economy is in its worst condition since 2009. The growth structure sprang no great surprises either. On the year-on-year basis, the economy was again driven by net exports (due in particular to falling imports). By contrast, domestic demand again contributed to a decline, albeit to a slightly lesser extent than in late 2012. Nonetheless, household consumption has actually stagnated for three consecutive quarters on the year-on-year basis, and this is something we are not used to seeing in Poland very much – even in 2009, household consumption was up by 2% and did not decelerate to less than 1.2% y/y (in the second quarter). Investment also saw its greatest year-on-year drop for the last three quarters (-5.8%), though primarily due to the adverse impact of the elimination of inventories.

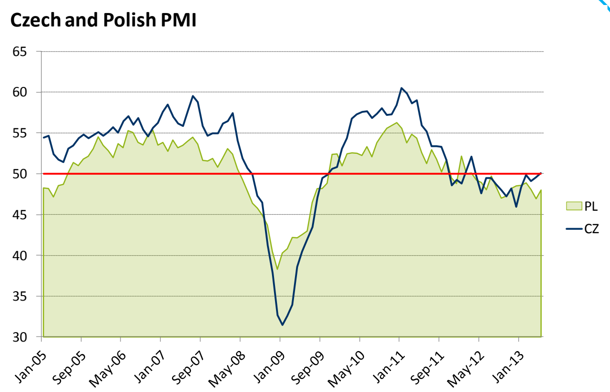
NBP will again cut rates in June, likely 'just' by 25 bps

We believe that the adverse growth structure is one of the impetuses that could make members of the Monetary Policy Council (MPC) again cut interest rates at its June meeting (June 5). On the other hand, although very slow growth must have surprised the central bankers, we bet on a rate cut by 'only' 25 basis points (bps) rather than 50 bps. We are made to believe so by statements from the doves on the MPC (Chojna-Duch), as well as by the fairly surprising reaction of the zloty following the release of revised growth forecasts. While the exchange rate of the Polish zloty practically failed to react to the flash forecast, it weakened by 2% to ten-month lows in the second half of last week. In addition, the depreciation of the Polish currency has recently gone hand in hand with the rising yields from government bonds, of which some MPC members are also afraid. Despite the NBP's high degree of uncertainty and inscrutability, we believe that the bank will prefer a cautious approach to more rate cuts and wait for the release of a new forecast in early July, before possibly taking any more aggressive additional steps.

Just ahead fresh floods Czech PMI moves back above 50

Just when fresh floods are hitting the Czech economy, the business confidence shows improvements. In June, the Czech PMI even slightly surpassed the critical level of 50 points (by 0.1 percentage point) for the first time in last fourteen months, indicating thereby improvement in overall manufacturing conditions. This finding is in line with our view of the Czech economy having bottomed out in the first quarter (in the second quarter, we expect quarter-on-quarter stagnation of the GDP).





Weekly preview

CZ: Recession not yet over

TUE 9:00 — CZ GDP (change in %)

	Q1-13	Q4-12	Q1-12
GDP (y/y)	**-1.8**	-1.7	-0.4
GDP (q/q)	**-0.6**	-0.2	-0.5

The preliminary GDP forecast for the first quarter of the year should now be followed by the updated and detailed data on the development of the Czech economy in that quarter. We expect that all components of demand drove the economy downwards, although the adverse effect of consumption was not as aggressive as in the previous year. The former driver of the economy – industry, i.e., exports, was also curbed for a while. Nevertheless, the first signs of stabilisation and a slow end of the recession might be increasingly evident from the second quarter on.

CZ: Poor demand keeps the sector in the red

WED 9:00 — CZ Retail sales (y/y change in %)

	Apr-13	Mar-13	Apr-12
Monhtly	**-1.0**	-3.3	-4.1
cummulative (YTD)	**-2.4**	-2.9	-0.4

The apparently improved figure in the retail sector, compared to what we saw in previous months, does not yet implies a turnaround of the existing adverse trend. It is rather an effect of a higher number of business days in the month, which helped the retail sector at least partly offset the falling sales of new passenger cars. However, household consumption remains subdued and thus, except for e-commerce, we will need to wait for about half a year to see any increase in sales.

PL: Central bank likely to cut rates again

WED, app. 12:00 — NBP rate (in %)

	This meeting	Last change
rate level	**2.75**	05/2013
change in bps	**-25**	-25

We believe that the adverse GDP growth structure for the first quarter of the year is one of the impetuses that could make members of the Monetary Policy Council (MPC) again cut interest rates at their June meeting. Even though such slow growth surprised the central bankers, we bet on a rate cut by 25 basis points (bps) rather than 50 bps. We are made to believe so by statements from the doves on the MPC (Chojna-Duch), as well as by the surprising reaction of the zloty following the release of revised growth forecasts. In addition, the depreciation of the Polish currency has recently gone hand in hand with the rising yields from government bonds, of which some MPC members are also afraid. Despite the NBP's high degree of uncertainty and inscrutability, we believe that the bank will choose a cautious approach to more rate cuts and wait for the release of a new forecast in early July, before possibly taking any more aggressive additional steps. Nevertheless, given the latest development of the exchange rate of the zloty, we cannot even rule out that the MPC will decide to leave rates unchanged.

CZ: Industry starts to stabilise

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

	Apr-13	Mar-13	Apr-12
Monhtly	**0.0**	-6.0	2.2
cummulative (YTD)	**-4.1**	-5.4	2.6

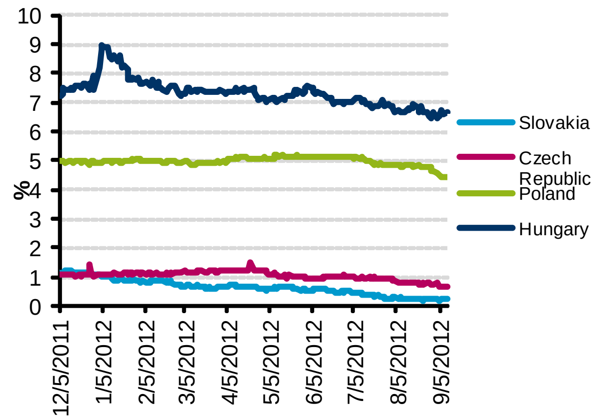
The latest data on new orders suggested that the situation in industry was no longer significantly deteriorating. Owing to a larger number business days in the month, year-on-year industrial output might even be around zero. Positive figures for April can be anticipated, in particular, in the food industry and electrical equipment production. The largest domestic industry, passenger car production, likely continued to be in the red that month.

Calendar

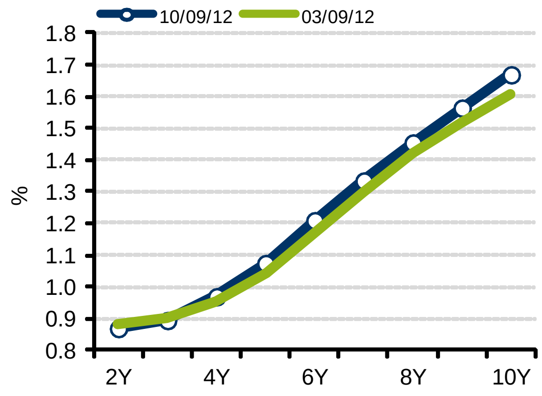
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	09/10/2012	9:00	CPI	%	08/2012	-0.1	3.3	0	3.3	-0.1	3.1
CZ	09/10/2012	9:00	Unemployment rate	%	08/2012	8.3		8.3		8.3	
HU	09/11/2012	9:00	CPI	CZK B	08/2012				6	-0.1	5.8
CZ	09/11/2012	10:00	Current account	EUR M	07/2012	-2.5		-12		-9.13	
PL	09/11/2012	14:00	Current account	USD B	07/2012			-1306		-1240	
PL	09/11/2012	14:00	Trade balance	USD B	07/2012					-412	
PL	09/13/2012	14:00	CPI	USD B	08/2012			-0.25	3.8	-0.5	4
HU	09/14/2012	9:00	Industrial output	%	07/2012 *F						0
PL	09/14/2012	14:00	Money supply M3	%	08/2012				9.65		11.1

Fixed-income in Charts

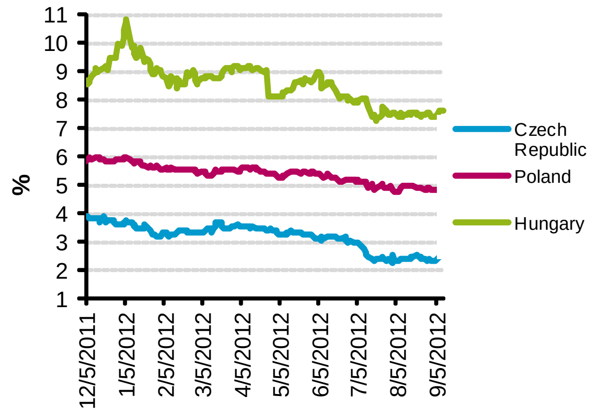
FRA 3x6



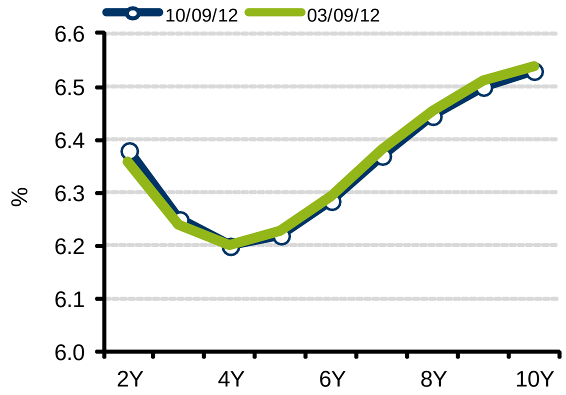
CZ IRS



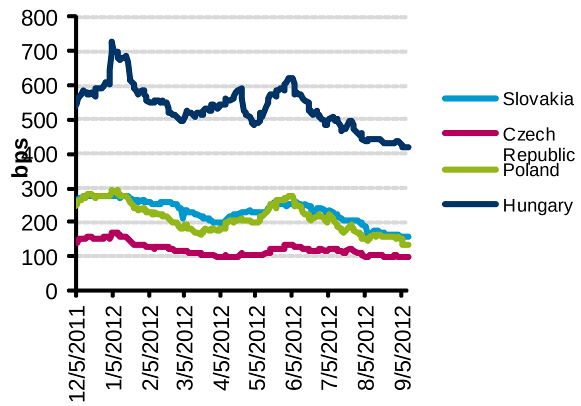
10Y GB Yields



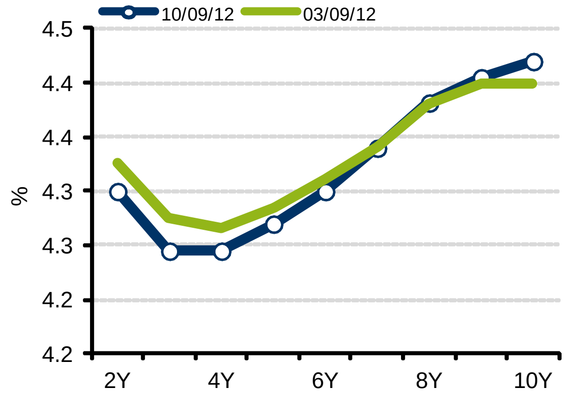
HU IRS



CDS 5Y



PL IRS



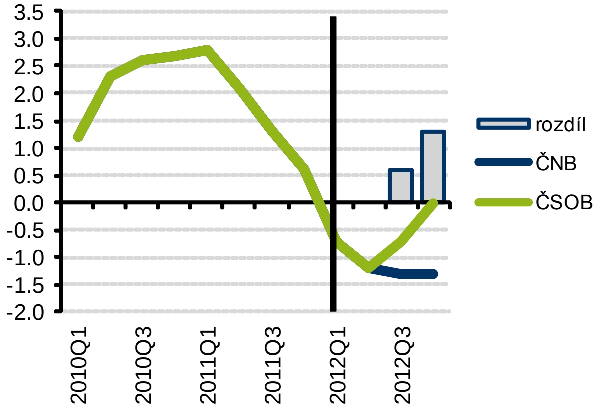
Source: Reuters

Medium-term Views & Issues

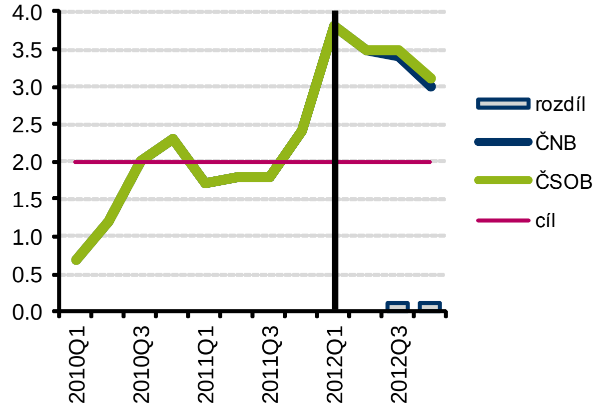
	The Czech Republic	Hungary	Poland
Growth & key issues	The Czech economy remains in a recession, which is shallower but longer than the previous one. The latest data from industry – production as well as orders – still tend to be negative. The drop in domestic demand was followed by a decline in foreign 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 2013Q1 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 be lowered by additional 25 bps in June.
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, %)

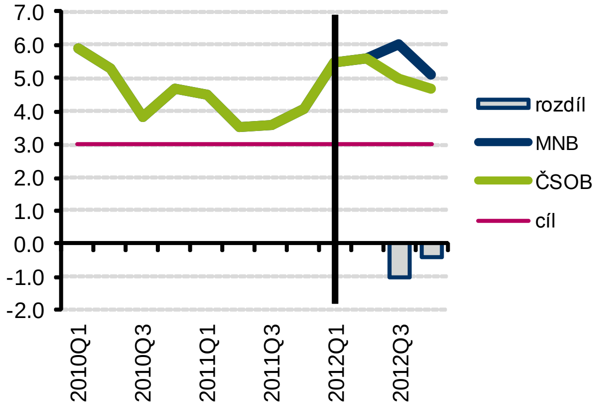


CZ: Inflation outlook (Y/Y, %)

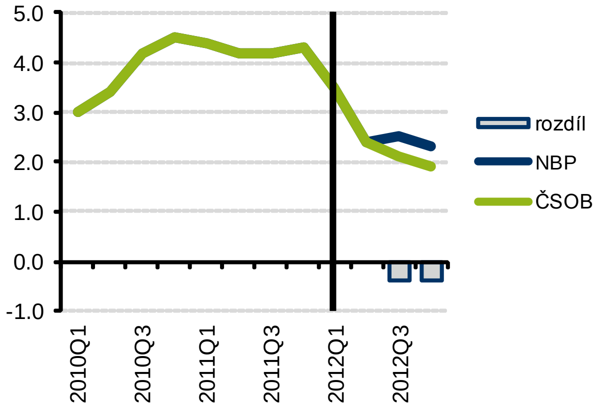


HU: GDP outlook (Y/Y, %)

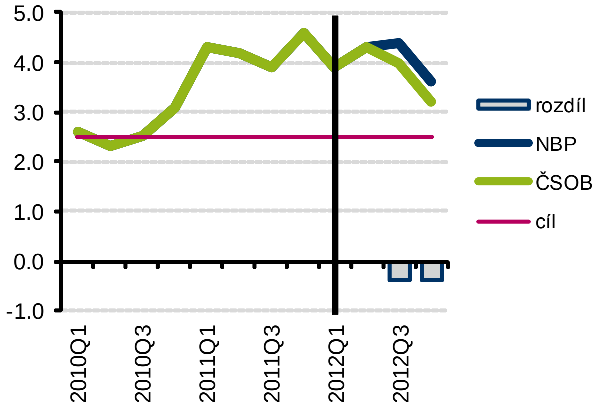
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outllok (Y/Y, %)



Zdroj: ČNB, NBP, MNB, ČSOB

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	Last change	
Czech Rep.	2W repo rate	*0.50*	0.75	0.50	0.25	0.25	0.25	-25 bps	6/29/2012
Hungary	2W deposit r.	*6.75*	7.00	7.00	6.75	6.50	6.50	50 bps	8/28/2012
Poland	2W inter. rate	*4.75*	4.50	4.75	4.75	4.50	4.50	25 bps	6/5/2012

*Short-term interest rates 3M *IBOR (end of the period)*

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	PRIBOR	*0.88*	1.28	1.03	0.70	0.70	0.70
Hungary	BUBOR	*6.90*	7.25	7.20	6.70	6.50	6.40
Poland	WIBOR	*4.96*	4.94	5.13	4.80	4.80	4.90

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

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	CZ10Y	*1.67*	2.25	2.02	1.60	1.70	1.80
Hungary	HU10Y	*6.53*	7.36	6.71	6.75	7.50	7.25
Poland	PL10Y	*4.42*	4.95	4.74	5.20	5.30	5.40

Exchange rates (end of the period)

		Current	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	EUR/CZK	*24.5*	24.8	25.5	25.2	25.0	24.5
Hungary	EUR/HUF	*285*	294	286	290	290	280
Poland	EUR/PLN	*4.11*	4.14	4.22	4.25	4.20	4.15

GDP (y/y)

	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Czech Rep.	2.1	1.3	0.6	-0.7	-1.2	-0.7	0.0
Hungary	1.5	1.4	1.4	-0.7	-1.2	-0.7	-0.4
Poland	4.2	4.2	4.3	3.5	2.4	2.1	1.9

Inflation (CPI y/y, end of the period)

	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1
Czech Rep.	1.8	2.4	3.8	3.5	3.5	3.1	2.9
Hungary	3.6	4.1	5.5	5.6	5.0	4.7	3.7
Poland	3.9	4.6	3.9	4.3	4.0	3.2	2.7

Current Account

	2012	2013
Czech Rep.	-2.2	-1.9
Hungary	1.5	1.0
Poland	-4.0	-3.8

Public finance balance as % of GDP

	2012	2013
Czech Rep.	-3.0	-3.8
Hungary	-2.5	-2.2
Poland	-3.5	-4.0

Source: CSOB, Bloomberg

Contacts

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