Written by ČSOB Prague and K&H Budapest

Central European Weekly

Monday, 29 July 2013

Dear clients, due to a summer break, the next CEWeekly will be issued on September 2nd.

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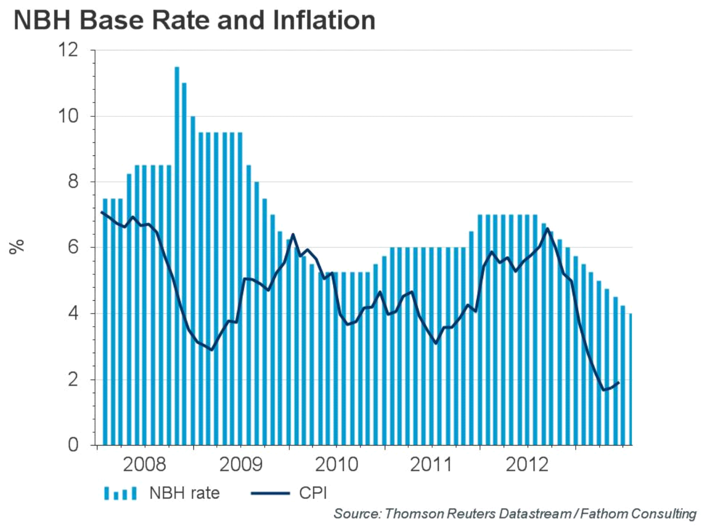
Weekly Highlights:

- The NBH cut rates to 4% and signal slow down in monetary easing
- The CNB issue a new projection. An exchange rate forecast will be in focus.

Chart of the Week: Hungary's easing cycle



The NBH Monetary Council cut its base rate by 25bp from 4.25% to 4%. It was the twelfth consecutive months in rate cut cycle.

Market's editorial

A calm week followed by a hot one

Last week was really calm in the Central European forex and bond markets. While the Hungarian central bank cut rates to a new all-time low and the flash forecasts of business sentiment indices in Western Europe slightly moved the prices of the region's government bonds, the expectations tend to be focused on the coming days, when the volatility may again change significantly.

The NBH cuts to fresh all-time lows at 4.0%

Regarding the the NBH meeting, the Monetary Council cut its base rate by 25bp from 4.25% to 4% in line with market expectations. It was the twelfth consecutive months in rate cut cycle. The statement of the Monetary Council highlighted that the domestic demand is still poor and may remain weak in the coming months, which keeps inflation pressure low, additionally in the wage growth dynamic slowed down, which suggest that companies are adjusting to higher production cost mainly through labor costs, so they see inflation target of 3% YoY achievable in 2014 as well. Hungary's economic growth may remain below it potential level, which leaves room for further monetary easing as well. The statement had slightly more hawkish end. "The significant reductions in interest rates so far and the volatile conditions in financial markets may justify changing the pace or extent of policy easing over the coming months."

The governor of NBH, Gyorgy Matolcsy said on the press conference that MPC will focus on the most important real economic figure during their decision, which means a clear shift from the simple inflation targeting system towards and FED type of monetary decision making process. He added also that the Council made the decision that rate cut cycle will be continued as inflation, real economic and stability outlook allows lower interest rate environment in Hungary. He named as the bottom of the rate cut cycle between 3% and 3.5%. The third announcement was that the Council may slow down the speed of the rate cut cycle, but not keep a pause and then cut again but rather reduced magnitude of the steps to 10 bps, but there is not a predefined action plan.

The announcement doesn't show really new element (except of the smaller steps of rate movement), it rather confirms the NBH policy followed in the previous months. It was quite clear that NBH may continue rate cut cycle until the market allows it as the economic growth outlook is quite weak and there is only moderated inflationary pressure. The slowdown of rate cut cycle may be a preemptive decision by the NBH before today government announcement about the new measure to help households indebted in foreign currency denominated loans.

The CNB and its new projection in focus

As concern this week – regional events are unlikely to wake-up Central European markets in upcomming months. The only possible exception to this might be the CNB Board meeting, which may be relevant for the Czech koruna in particular. The currency is permanently exposed to verbal interventions from certain CNB Board Members, with the likelihood of the launch of the interventions being increased when the koruna is stronger than the implicit prediction of its exchange rate available in a CNB forecast.

Nevertheless, it will be the core markets, i.e., events such as the U.S. GDP figure, July's statistics from the U.S. labour market, or the meetings of central banks (Fed, ECB, Bank of England) that will, in the end, determine how Central European currencies and markets will look at the end of a fairly hot mid-summer week.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.9	-0.10%	↗	↗
EUR/HUF	298	1.17%	↗	↗
EUR/PLN	4.24	0.57%	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.01	8.06	↗	↗
10Y HUF	5.54	2.59	↗	↗
10Y PLN	3.85	5.63	↗	↗

Weekly preview

THU 14:00	CNB base rate	
	This meeting	Last change
rate level (in %)	**0.05**	11/2012
change in bps	**0**	-20

CZ: Anything new about FX interventions?

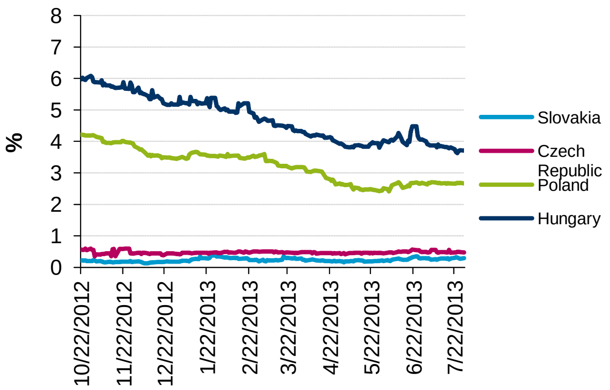
We do not expect the CNB Board to do anything about rates at its next meeting; however, it will make its decision with a new forecast at hand, and the forecast may encourage occasional calls from the central bank for easing the monetary conditions. The only way of achieving this is through the weakening of the Czech koruna, which has been close to the EURCZK 26.0 for some time now. Therefore it will be interesting to monitor a new exchange rate forecast, which might envisage a weaker koruna. To date, the CNB has anticipated that the koruna will hover around the average levels of EUR/CZK 25.60 and 25.50, in the third quarter and fourth quarter respectively. If the new outlook were to push the exchange rate forecasts higher, this would certainly open up room for an intervention, although we probably cannot expect anything more than imported inflation from such a move. In addition, the current return of inflation to a level above the forecast last month, when the huge reduction of mobile phone price plans was counterbalanced by costlier food, is working against any urgent interventions. In any event, the new forecast is likely to revise the outlook for the Czech economy downwards.

Calendar

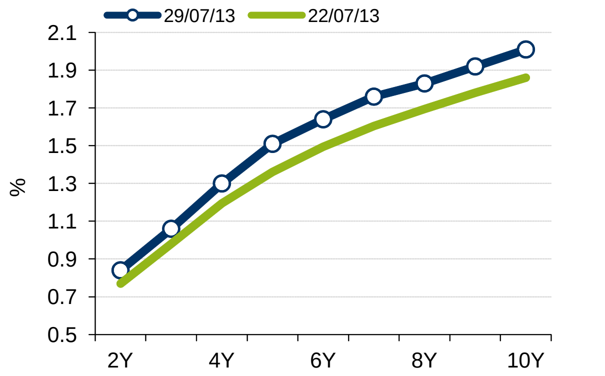
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	07/30/2013	9:00	Unemployment rate	%	06/2013			10.3		10.5	
HU	07/31/2013	9:00	PPI	%	06/2013				0.8	-1.2	-1.3
CZ	07/31/2013	11:00	Money supply M2	%	06/2013						3.8
HU	08/01/2013	9:00	PMI manufacturing		07/2013					50.8	
PL	08/01/2013	9:00	PMI manufacturing		07/2013					49.3	
CZ	08/01/2013	9:30	PMI manufacturing		07/2013					51	
CZ	08/01/2013	14:00	CNB meeting	%	08/2013	0.05		0.05		0.05	
CZ	08/01/2013	14:00	Budget balance	CZK B	07/2013					-31.5	
HU	08/02/2013	9:00	Trade balance	EUR M	05/2013 *F					653.2	

Fixed-income in Charts

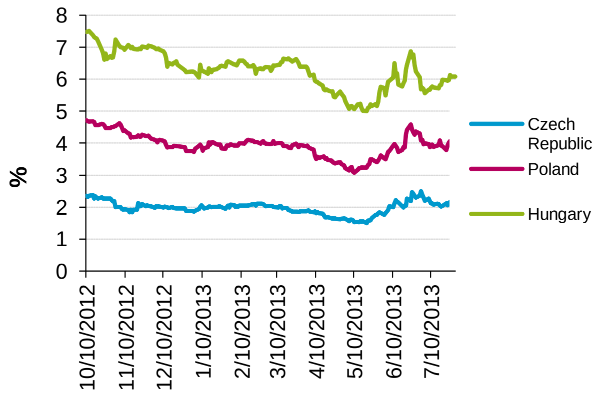
FRA 3x6



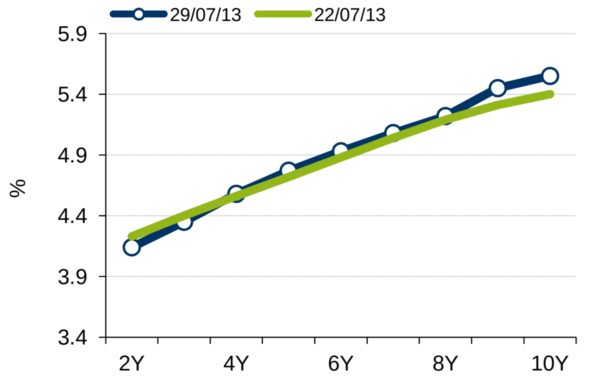
CZ IRS



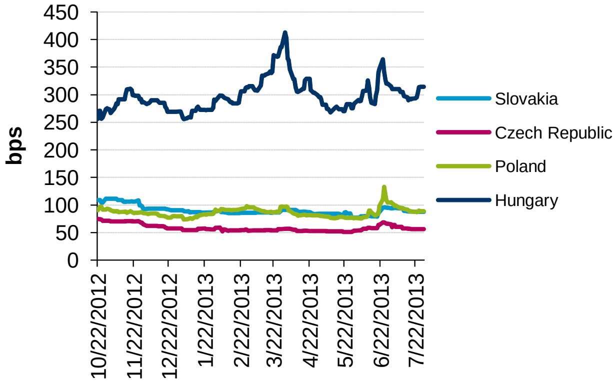
10Y GB Yields



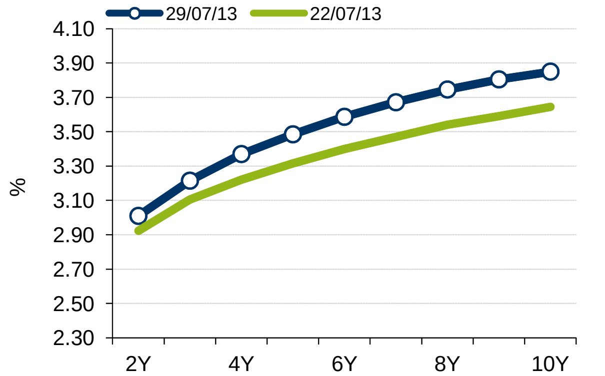
HU IRS



CDS 5Y



PL IRS



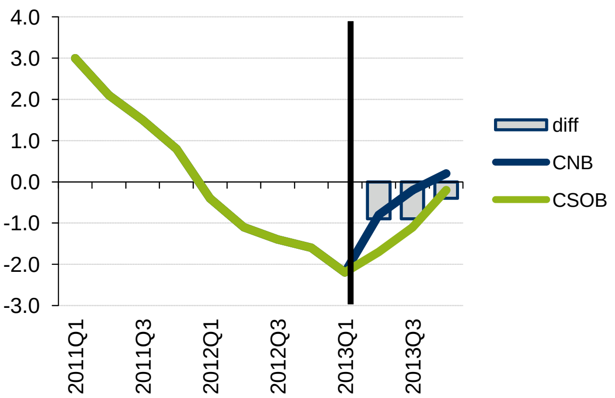
Source: Reuters

Medium-term Views & Issues

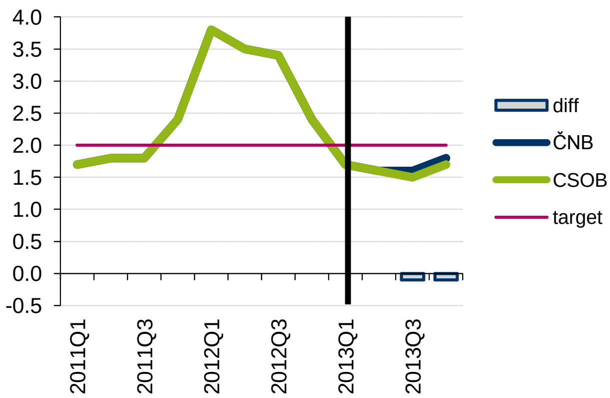
	The Czech Republic	Hungary	Poland
Growth & key issues	Three years after last elections the Prime Minister resigned and his cabined fell. With minor exceptions, the bulk of political scene in the CR refuses to call premature elections a less than year before regular parliamentary elections. Newly formed "independent" caretaker government has to ask the Parliament for confidence and start to prepare the 2014 state budget. Prior to that, the Parliament will vote on its dissolution that is on premature elections.	Negative signs of growth in May about second quarter economic performance. Industrial production decreased by 2.1% YoY. The ongoing fall of electronic devices were standing behind the bad May figure, while car manufacturing companies are still helping industrial production. It looks that in 2Q13 Hungary's GDP may slow down on QoQ basis from the very impressive 0.7% QoQ growth in 1Q13, but may remain in the positive territory. We expect 0.3% YoY growth from 2013.	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.	The NBH feels comfortable itself with the latest consumer price index development and sees inflation target of 3% achievable on relevant time horizon. In the mean time economic performance is still subdued so they see further room for rate cut. The possible slowdown of FED's QE policy calls for more cautious monetary policy in the future, so NBH will monitor market development very closely. Until the international sentiment remains favorable monetary council may continue rate cut cycle. Recently, the governor of NBH, Gyorgy Matolcsy named as the bottom of the rate cut cycle a range between 3% and 3.5%.	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, the central bank decided recently to cut interest rates to a new all-time low at 2.5%. Although inflation is seen markedly below the target (and is expected to stay there in the rest of this year), we expect the NBP to keep rates unchanged.
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 EURHUF remained relatively sensitive on international developments but it was traded mainly in a range of 290 and 300. As a narrower range we can name 292 and 297 which is between the 100 and 200 days moving average. The recent wide range if acceptable for the NBH, and we see that NBH may tolerate around 305 and 310 levels for a couple of weeks as well without any active intervention. We expect that in the positive market sentiment the above mentioned trading range may remain in the following weeks.	The zloty has been hit by an outflow of funds related to the rise in US government bond yields. Sharp depreciation of the zloty spurred the NBP to intervene in favor of the Polish currency. We believe that the central bank might decide to step in again if the zloty remained persistently above EUR/PLN 4.30 level (the last intervention occurred at EUR/PLN 4.32).

CBs' Projections vs. Our Forecasts

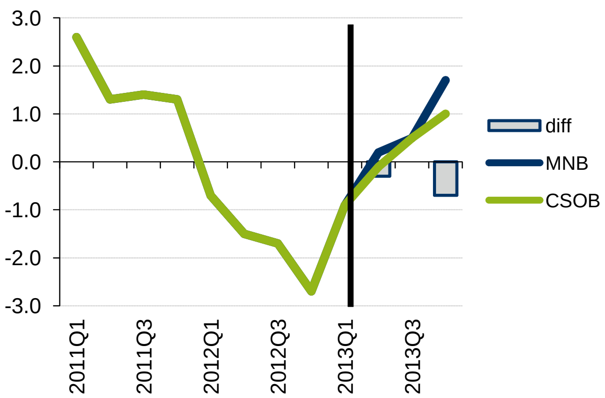
CZ: GDP outlook (Y/Y, %)



CZ: Inflation outlook (Y/Y, %)



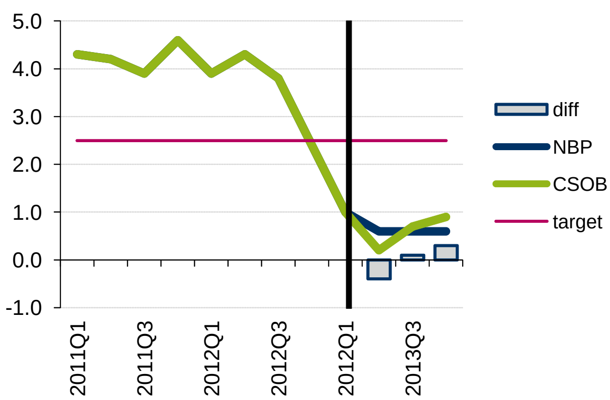
HU: GDP outlook (Y/Y, %)



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	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	Last change	
Czech Rep.	2W repo rate	*0.05*	0.05	0.05	0.05	0.05	0.05	-20 bps	9/27/2012
Hungary	2W deposit r.	*4.00*	5.75	5.00	4.25	3.75	3.75	-25 bps	7/23/2013
Poland	2W inter. rate	*2.50*	4.25	3.25	2.75	2.75	2.75	-25 bps	7/3/2013

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

		Current	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	PRIBOR	*0.46*	0.50	0.47	0.44	0.43	0.43
Hungary	BUBOR	*3.96*	5.75	4.90	4.20	3.80	3.90
Poland	WIBOR	*2.7*	4.11	3.39	2.73	2.60	2.65

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

		Current	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	CZ10Y	*2.01*	1.37	1.31	1.97	2.00	2.20
Hungary	HU10Y	*5.54*	5.49	5.41	5.84	5.80	6.20
Poland	PL10Y	*3.85*	3.60	3.61	4.14	3.55	3.65

Exchange rates (end of the period)

		Current	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	EUR/CZK	*25.9*	25.1	25.7	26.0	25.9	25.5
Hungary	EUR/HUF	*298*	291	304	295	300	300
Poland	EUR/PLN	*4.24*	4.08	4.18	4.33	4.25	4.20

GDP (y/y)

	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	-1.1	-1.4	-1.6	-2.2	-1.7	-1.1	-0.2
Hungary	-1.5	-1.7	-2.7	-0.9	-0.1	0.5	1.0
Poland	2.3	1.3	0.7	0.5	0.6	1.2	1.9

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

	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	3.5	3.4	2.4	1.7	1.6	1.5	1.7
Hungary	5.6	6.6	5.0	2.2	2.0	1.9	2.2
Poland	4.3	3.8	2.4	1.0	0.2	0.7	0.9

Current Account

	2012	2013
Czech Rep.	-1.9	-2.5
Hungary	1.5	2.0
Poland	-4.0	-3.8

Public finance balance as % of GDP

	2012	2013
Czech Rep.	-4.4	-3.0
Hungary	-2.5	-2.7
Poland	-3.9	-4.0

Source: CSOB, Bloomberg

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