Written by ČSOB Prague and K&H Budapest

Central European Weekly

Monday, 02 September 2013

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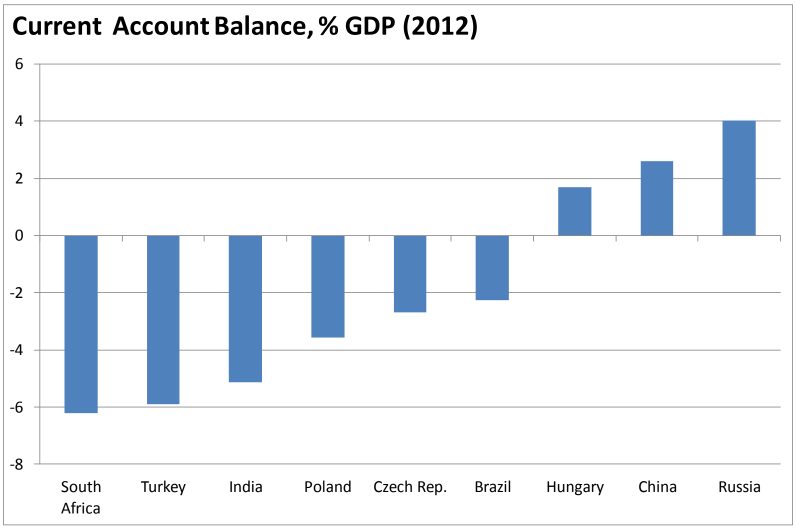
- Sell-off in emerging markets has brought only moderate contagion to central Europe
- Regional PMI show that recovery is on track
- The NBH slightly surprises with a 20 bps rate cut
- The NBP bring no changes to its monetary policy

Chart of the Week: C/A balance comparison



Central European Economies have reasonable CA balances in compare with other emerging markets
CE countries have much lower C/A imbalances than BRICS.

Market's editorial

Sell-off in emerging markets has brought only moderate contagion to central Europe. Better fundamentals help.

Syria generates a GDP that is approximately one-third of that of the Czech Republic or Hungary, and in the last two years it has been struggling with a civil war. Thus it seems as if the threat of a military attack could not do much damage to anyone. Wrong. The Turkish lira and the Indian rupee hit all-time lows last week. After all, the nervousness also affected Central Europe – both the Polish zloty and the Hungarian forint lost nearly 1% in the end.

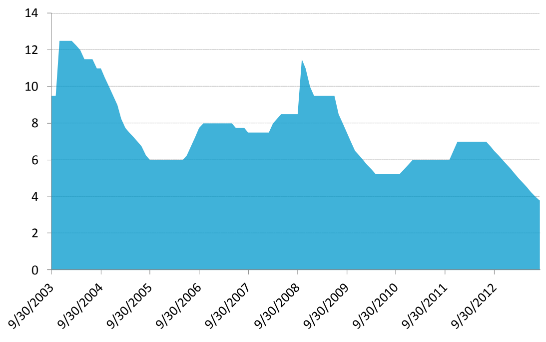
It is true that the Syrian conflict alone poses no primary danger to most emerging markets. However, the related uncertainty has come at a bad time, when numerous emerging economies, from Asia to South America, are facing capital outflows. The main reason is the fear of a turnaround in the U.S. Fed's policy. This has the most adverse impact on those economies that have built up their dependence on the super-cheap dollar in recent years, while the balances of payments of their current accounts have deteriorated significantly – India, Turkey, the Republic of South Africa. Unlike these emerging economies, no Central European country has problems with its current account deficit and did not develop a habit for the super-cheap dollar in the past. On the contrary, the current account in each of the three economies have improved in the last three years: from - 5.1% of GDP (in 2010) to -3.5% of GDP (a 2013 forecast) in Poland, from -3.8% of GDP to -2% of GDP in the Czech Republic, and Hungary's balance of current account is even in the black and has continued to improve in the last two years. Moreover, in the upcoming quarters, Central European economies, more than any others, can benefit from the ongoing recovery in Germany, which should be grist to the mill of their exports.

The NBH slightly suprises with a 20 bps rate cut

The National Bank of Hungary cut its base rate by 20bp from 4% to 3.8% in line with our expectation, but more than the market consensus of 10bp cut. The statement highlighted that fundamentally there is more room for monetary easing as inflation is well anchored and GDP growth is still below its potential level, but the uncertain market sentiment calls for more cautious monetary policy. The statement suggests that the NBH may cut base rate further, but the speed may slow down if the market environment doesn't improve in the coming month. We expect 10bp rate cut for the September meeting.

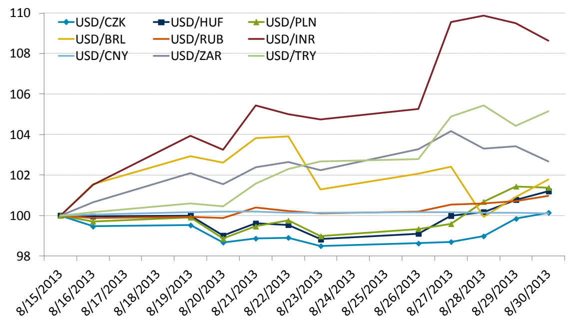
The HUF reacted on the news and the negative market sentiment with substantial weakening and EURHUF broke 300 levels. There is a resistance level at 302.5 and if the HUF breaks this level than the next technical level is at around 305-306. We still see more chance for further weakening in the coming months, so we maintain our forecast that EUR/HUF may test the above mentioned levels.

HU: Official MNB interest rate



Performance against US dollar

8/15/2013 = 100



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.7	0.07%	→	→
EUR/HUF	300	0.45%	→	↘
EUR/PLN	4.25	0.34%	→	↘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.27	-0.44	→	↗
10Y HUF	5.92	-3.27	→	↗
10Y PLN	4.41	-0.68	→	↗

Review of Economic Figures

Regional PMI show that recovery is on track

The August regional PMI figures confirm our view that cyclical recovery both in Poland, the Czech Republic and Hungary is on track. In Poland, the HSBC PMI reached the highest level in 25 months and, maybe the most importantly, the sentiment improved even in case of employment. Let us recall that the economic growth in the second quarter was almost exclusively driven by net exports while domestic demand (again) fell behind. Improvement in employment is therefore good news for more balanced structure of economic growth in quarters ahead. In the Czech Republic, the overall index even reached 53.9 points which is the strongest reading since June 2011. And last but not least, the Hungarain PMI jumped well above the 50 treshold and the August headline figure (51.7) has been the best in four months.

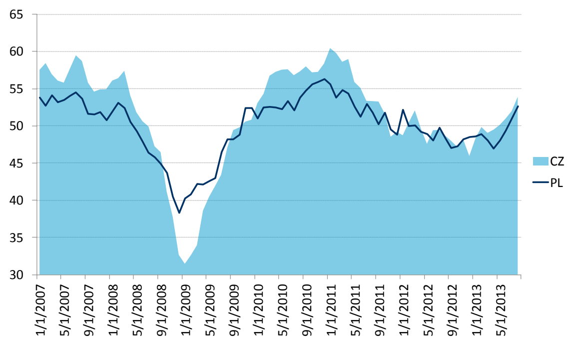
Final Polish GDP figures -the bottom has been reached

Poland's Statistical Office confirmed its flash forecast and stated that the economy grew by 0.8% y/y in the second quarter. In other words, the Polish economy has hit bottom on the year-on-year basis, because its growth accelerated by 0.3 percentage point vis-à-vis the first quarter. Concurrently with the revision, the Office also unveiled the GDP structure. Unfortunately, this sprang no significantly positive surprise – government consumption was the only domestic component with a positive contribution (the greatest in two and a half years) to growth, with growth as a whole again primarily driven by foreign trade. By contrast, a highly negative contribution of the change in inventories sprang an unpleasant surprise.

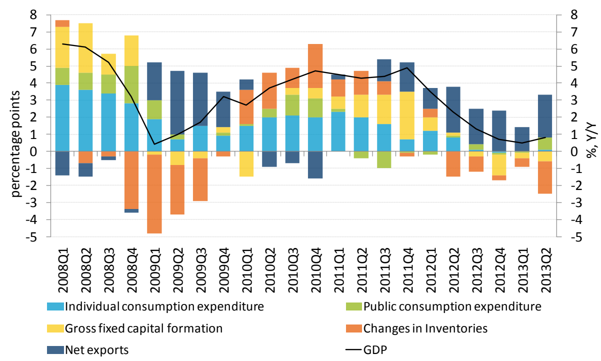
Two scenarios to solve FX loans in Hungary on the table

Recall that the Bank Association created two alternative scenarios how to solve the foreign currency denominated mortgage loans problem in Hungary. Although the details were not published we can conclude from previous days statements what may be the possible program. The size of the FC denominated mortgage loans at the household sector is around HUF1800bn. The government would like to abolish the exchange rate risk. The first version would be an immediate conversion to HUF provided by National Bank of Hungary from its FC reserves. As it won't decrease the monthly installments, the interest rate of the new HUF loans would be moderated substantially, which would create a loss for the banking sector. The second version is the expansion of the already existing FC currency fixation tool, which means that households can pay the monthly installment calculated with a fix exchange rate, which is in case of CHFHUF 180 and incase of EURHUF is 250. Both solution will cause more hundreds of billions HUF loss for the banking sector. The Bank Association would like to achieve that the program divide the loss for several years instead of one-off loss.

Purchasing Managers Index (PMI)



PL: Contributions to GDP growth



Weekly preview

TUE 9:00 **CZ GDP (change in %)**

	Q2-13	Q1-13	Q2-12
GDP (q/q)	**0.7**	-1.3	-0.5
GDP (y/y)	**-1.2**	-2.4	-1.1

CZ: Will the end of the recession be confirmed?

The very first GDP forecast, released by the Statistical Office as long ago as in the middle of August, signalled reasonable economic growth for the second quarter, marking the end of the longest Czech recession. Now the data will be updated and in particular elaborated, to indicate precisely how the supply and demand sides are developing. As concerns the second quarter, we believe that the economy was primarily driven into the black by foreign trade and likely also by inventories, while domestic demand remained subdued. We do not expect the updated forecast to differ significantly from the flash forecast (0.7% q/q), and do not at all expect that such a figure might reoccur in the second half of this year. Thus the economy remains at the onset of a fragile recovery, which lacks adequate domestic support.

WED 9:00 **CZ Retail Sales (change in %)**

	Jul-13	Jun-13	Jul-12
Sales	**2.5**	-2.7	0.1
cummulative (YTD)	**-0.9**	-1.4	-0.6

CZ: Higher sales fuelled by cars

July's rise in retail sales does not automatically mean any rapid recovery of consumer demand. We believe that the figure was significantly boosted by there having been two more business days in the month and, in particular, by the strong year-on-year increase in new car sales; however, not even this marks the beginning of a new sales boom; a more likely reason would be the impact of last year's low comparative baseline. Consumer demand remains muted and its lethargy may, perhaps, only be stirred up by improved consumer mood, along with falling inflation.

WED 14:00 **NBP rate (in %)**

	This	Last change
rate level	**2.50**	7/2013
change in bps	**0**	-25

PL: The NBP to keep rates unchanged

The National Bank of Poland (NBP) will probably leave interest rates unchanged at its two-day meeting to be held this week (and concluded on Wednesday). According to forecasts, the economy grew by 0.8% in the second quarter, while forward-looking indicators suggest that the worst is likely over for the economy. The recovery and a more rapid inflation rise should also be encouraged by significant rate cuts made over the previous months (the NBP cut rates by a total of 225 bps in this cycle). In addition, July's inflation sprang an upside surprise, and this should potentially provide hawks at the NBP (with most of its members being hawks in the long term) with sufficient arguments for negotiations; moreover, it should help the Monetary Policy Council resist any political pressures for further rate cuts (the Minister of Finance stated in Parliament that there was still latitude for another rate cut).

THU 9:00 **CZ Foreign trade (CZK bn)**

	Jul-13	Jun-13	Jul-12
Balance	**26.7**	33.0	23.8
cummulative (YTD)	**219.0**	192.2	188.8

CZ: Another fall in exports as well as imports?

A greater number of business days in the month on the one hand and a high comparative baseline on the other are the technical factors that influenced the Czech foreign trade figures in July. Given poor domestic demand, the rate of imports likely lagged behind exports again, and this led to another rise in the trade balance surplus. A reasonable figure should be posted by the balance of the trade in means of transport, which, in foreign markets, may benefit from the current renewal of the lines of models and innovations. The rise might be technically, though temporarily, curbed by the summer leaves of the entire workforce at industrial businesses over that period.

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

	Jul-13	Jun-13	Jul-12
Monhtly	**0.3**	-5.3	5.3
cummulative (YTD)	**-3.3**	-3.9	1.4

CZ: A positive calendar effect helped in July

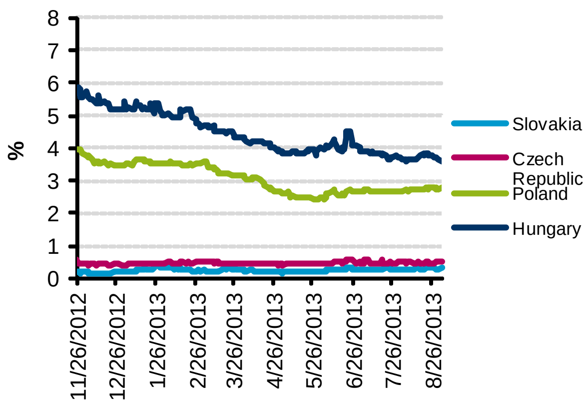
This time, the anticipated surplus in industrial output was due to there having been a greater number of business days in the month. Adjusted figures likely remained in the red. The production of computers, basic metals and likely also the food industry are likely to show particularly strong declines. Most industries probably stand a good chance of falling; however, we may, slowly but surely, see an improvement in the performance of the dominating domestic industry, i.e., car production. This time, however, new orders, which most likely went up in July, owing to carmakers in particular, will again be more interesting than output alone.

Calendar

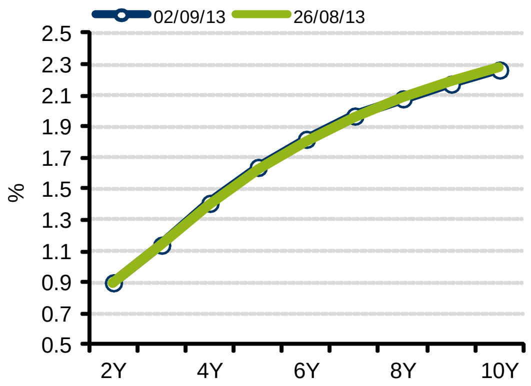
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	09/02/2013	9:00	Trade balance	EUR M	06/2013 *F					582.8	
HU	09/02/2013	9:00	PMI manufacturing		08/2013					49	
PL	09/02/2013	9:00	PMI manufacturing		08/2013			51.6		51.1	
CZ	09/02/2013	9:30	PMI manufacturing		08/2013					52	
CZ	09/02/2013	14:00	Budget balance	CZK B	08/2013					-27.6	
CZ	09/03/2013	9:00	GDP	%	2Q/2013 *F	0.7	-1.2			0.7	-1.2
HU	09/04/2013	9:00	GDP	%	2Q/2013 *F					0.1	0.5
CZ	09/04/2013	9:00	Retail sales	%	07/2013		2.5				-2.7
HU	09/04/2013	9:00	Retail sales	%	07/2013						-0.4
CZ	09/04/2013	10:00	Current account	CZK B	2Q/2013	3				16.8	
CZ	09/04/2013	12:00	CZ bond auction 2005-2020, 2.75%	CZK B	09/2013						
CZ	09/04/2013	12:00	CZ bond auction 2013-2028, 2.50%	CZK B	09/2013						
PL	09/04/2013	14:00	NBP meeting	%	09/2013			2.5		2.5	
CZ	09/05/2013	9:00	Trade balance	CZK B	07/2013	26.7		29.5		33	
HU	09/06/2013	9:00	Trade balance	EUR M	07/2013 *P						
HU	09/06/2013	9:00	Industrial output	%	07/2013 *P					1.2	1.7
CZ	09/06/2013	9:00	Construction output	%	07/2013		-8				-11.1
CZ	09/06/2013	9:00	Industrial output	%	07/2013		0.3		1.4		-5.3
CZ	09/06/2013	9:00	Real wages	%	2Q/2013		-1				-2.2

Fixed-income in Charts

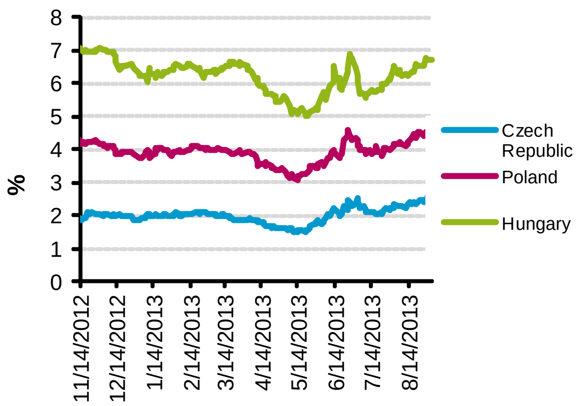
FRA 3x6



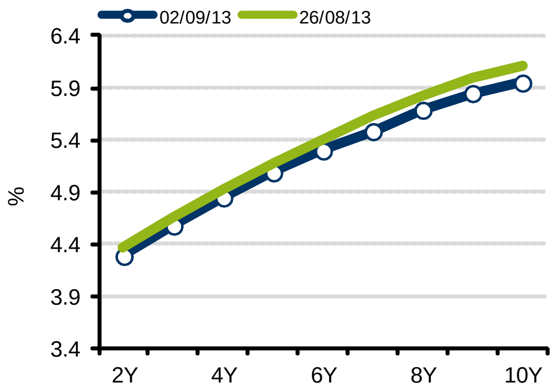
CZ IRS



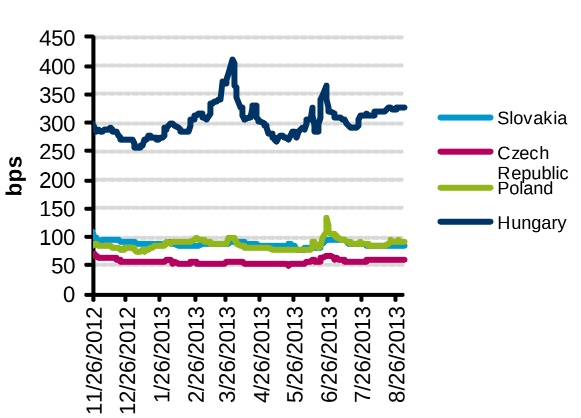
10Y GB Yields



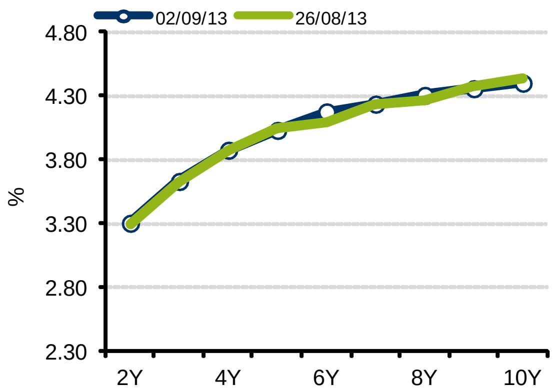
HU IRS



CDS 5Y



PL IRS



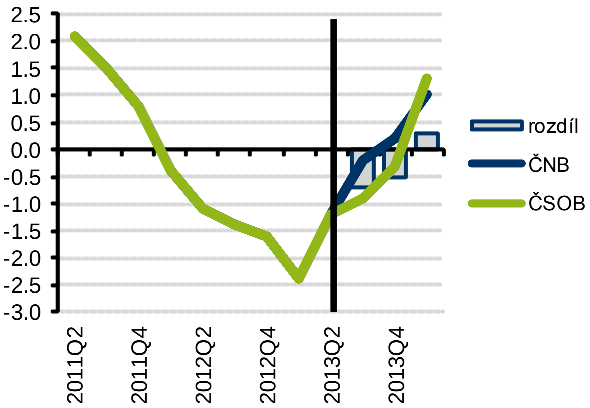
Source: Reuters

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. The Czech Economy seems to get from the worst. After six consecutive quarters of falls the cyclical leading indicators (our Czech Flash, PMI) improve strongly and point to bottoming.	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 bottomed out in the second quarter of 2013 and reached 0.8%. On the quarter-to-quarter basis, the economy grew by 0.4%. Figures from the Statistical Office confirmed that the economy was almost exclusively driven by net exports, which improved owing to falling imports as well as rising exports. On the contrary, domestic demand (except of government consumption) remained weak. However, fresh PMI figures support our view that the economy could accelerate further in the second half of the year.
Outlook for official & market rates	The CNB met expectations kept the rates at record lows and has not started FX interventions. On the other hand it downgraded its economic (and inflation) outlook for this year and openly communicated that the risk of interventions have risen. The CNB expects that the economy will continue to fall this year (-1.5%) and grow a bit faster next one (2.1 %). The rates should stay at technical zero for extended period. The interventions are probable from our point of view, if the koruna strengthens below 25.60 (see the FX outlook).	The National Bank of Hungary cut its base rate by 20bp from 4% to 3.8% in August. The statement highlighted that fundamentally there is more room for monetary easing as inflation is well anchored and GDP growth is still below its potential level, but the uncertain market sentiment calls for more cautious monetary policy. The statement suggests that the NBH may cut base rate further, but the speed may slow down if the market environment doesn’t improve in the coming month. We expect 10bp rate cut for the September meeting.	Clearly, the NBP is concerned with a sharp decline in inflation rate and unfavorable structure of GDP growth, which has lately been almost exclusively driven by net exports; traditionally strong domestic demand contributed negatively to both 2013Q1 and 2013Q2 growth. However, prospects of the Polish economy have been improving and inflation rate surged unexpectedly in July 2013. We therefore stick to our base scenario which bets on stability of official interest rates in the remainder of this year and we anticipate the NBP could start discussing possibility of interest rate hikes in the second quarter of 2014.
Forex Outlook	The new CNB forecast implies the weaker koruna and the lower rates. The implied exchange rate (adjusted for the difference between actual and foreacted PRIBOR) is currently around 26.20 EUR/CZK. Hence there is nearly no potential for gains for the koruna for now. We believe the interventions could be triggered if the koruna settles below 25.60 EUR/CZK at the time of next meeting (Sept 26th).	The HUF did not like and EURHUF broke 300 levels. There is a resistance level at 302.5 and if the HUF breaks this level than the next technical level is at around 305-306. We still see more chance for further weakening in the coming months, so we maintain our forecast that EUR/HUF may test the above mentioned levels. All in all the Forint could affected no just by rate decision, but it will face some headwinds, if situation in emerging markets deteriorates further.	The zloty has been hit by an outflow of funds related to the rise in US government bond yields after Fed announced the possibility of tapering the QE policies. Nevertheless the situation has calmed down and NBP similarly to Fed decided to end an easing cycle. Hence EUR/PLN has not much potential for further losses now. Furthermore th NBP is probably ready to intervene above 4.35 level (the last intervention occurred at EUR/PLN 4.32).

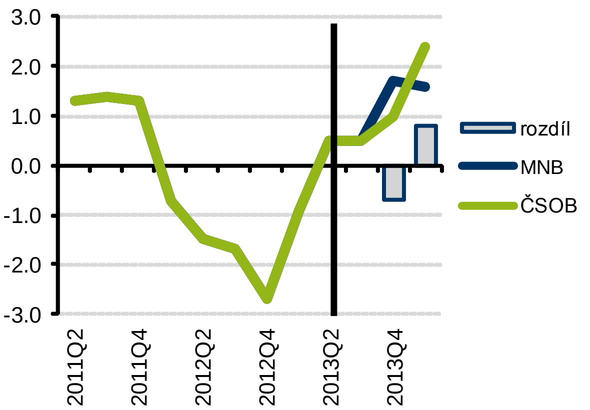
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

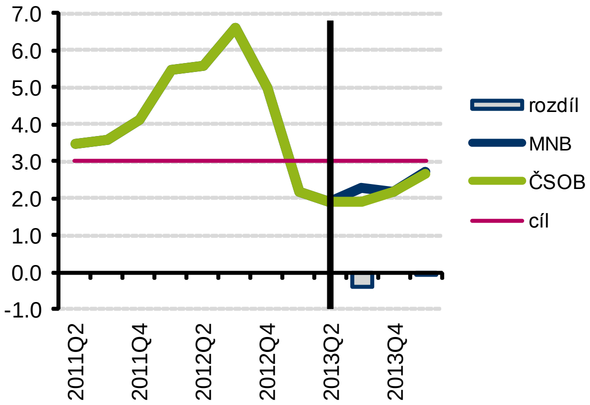


CZ: Inflation outlook (Y/Y, %)

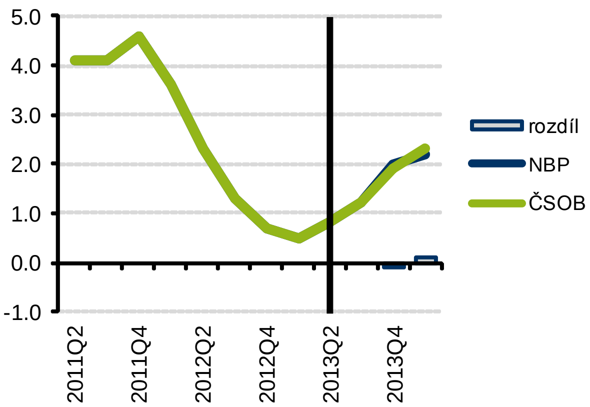
HU: GDP outlook (Y/Y, %)



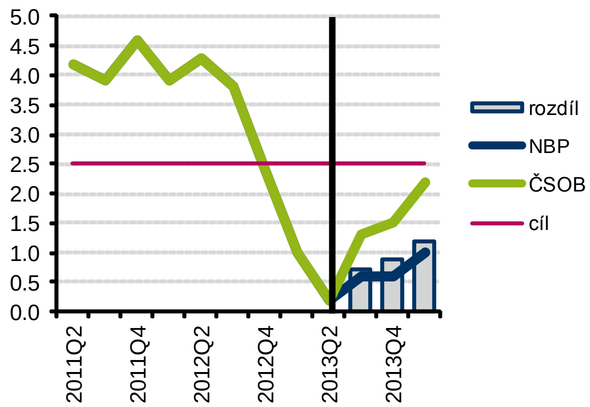
HU: Inflation outlook (Y/Y, %)



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.	*3.80*	5.75	5.00	4.25	3.75	3.75	-20 bps	8/27/2013
Poland	2W inter. rate	*2.50*	4.25	3.25	2.75	2.50	2.50	-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	*3.76*	5.75	4.90	4.20	3.80	3.90
Poland	WIBOR	*2.7*	4.11	3.39	2.73	2.70	2.75

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

		Current	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	CZ10Y	*2.266*	1.37	1.31	1.97	2.05	2.15
Hungary	HU10Y	*5.92*	5.49	5.41	5.84	5.50	5.90
Poland	PL10Y	*4.41*	3.60	3.61	4.14	3.90	3.95

Exchange rates (end of the period)

		Current	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	EUR/CZK	*25.7*	25.1	25.7	26.0	26.0	25.5
Hungary	EUR/HUF	*300*	291	304	295	300	300
Poland	EUR/PLN	*4.25*	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	-2.4	-1.2	-0.9	-0.3
Hungary	-1.5	-1.7	-2.7	-0.9	0.5	0.5	1.0
Poland	2.3	1.3	0.7	0.5	0.8	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	1.6
Hungary	5.6	6.6	5.0	2.2	1.9	1.9	2.2
Poland	4.3	3.8	2.4	1.0	0.2	1.3	1.5

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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