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Central European Weekly

Monday, 09 September 2013

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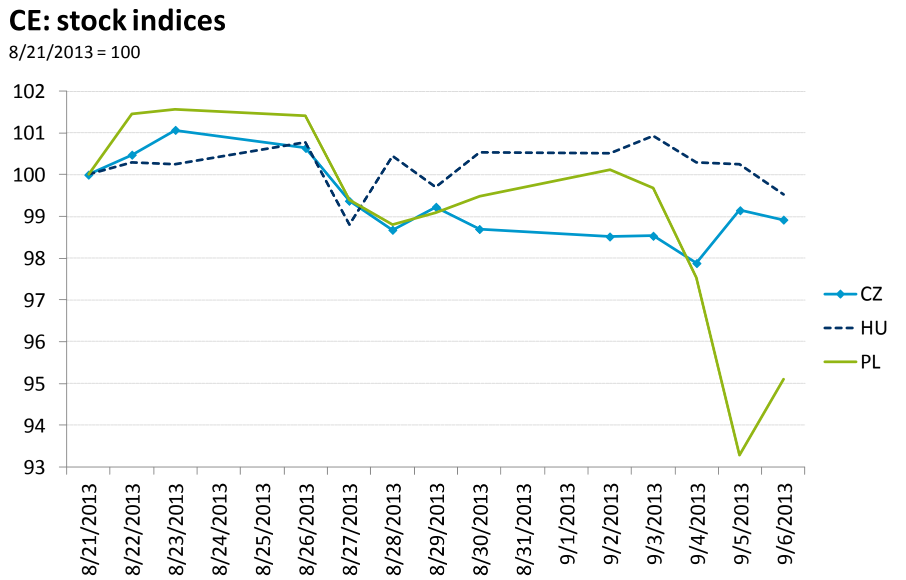
- An infamous end of a once famous reform in Poland
- The Czech GDP revision brings no major surprises
- Czech headline inflation fell to 1.3% Y/Y in August
- Poland's August inflation likely stagnated

Chart of the Week: Sell-off of Polish stocks



Polish stocks underperformed its peers last week as government plans to reform pension system. (Source: Bloomberg, CSOB).

Market's editorial

An infamous end of a once famous pension reform in Poland

Poland attracted the greatest attention in the region last week. One would imagine that it was because of the meeting of its central bank, which concluded on Wednesday with the decision to leave rates unchanged; however, this did not surprise markets to any great extent, nor were they surprised by the bank's 'forecast' that rates would likely remain at their all-time lows of 2.5% until the end of the year. The reason why Polish bonds and in particular shares have not fared very well in recent days is that the Government has probably conclusively decided to put an end to the pension reform launched at the end of the 20th century.

The Government had already made its intention to do so known in late June, and therefore the latest news came as no great surprise. What is surprising, however, is that the Government has chosen to implement probably the hardest combination out of the measures suggested at that time; moreover, it has probably done so without consulting the private funds. According to a statement by Prime Minister Tusk, the reform will be based on the Government 'draining' private funds of the money invested in government bonds, i.e., approximately half the assets of those funds. This will, according to the Government, reduce public debt by approximately 7% of GDP. In addition, participation in the 'second pillar', which was previously mandatory, will be made voluntary. In other words, at least some of the money previously invested in private funds is likely to be redirected into the state budget.

The above measures will temporarily help the Government address its high debt problems and enable it to boost the economy more significantly in the period of slow growth; in the longer term, however, there are potential problems of pension financing and the Government's credibility.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.8	0.51%	→	↗
EUR/HUF	301	0.20%	→	↗
EUR/PLN	4.28	0.48%	→	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.31	1.72	→	↗
10Y HUF	6.00	1.35	→	↗
10Y PLN	4.56	3.17	→	↗

Review of Economic Figures

Revisions did not change the original Czech 2013Q2 GDP

According to the latest figures from the Statistical Office, Czech GDP grew by 0.6% (q/q) in the second quarter of the year. On the year-on-year basis, GDP dropped by 1.3%, and by 1.9% for the first half of the year as a whole.

Compared to the beginning of the year, GDP was affected by household and government consumption as well as investment. By contrast, exports, owing to the recovered demand in Western Europe, still succeed in maintaining a reasonable lead over imports.

The year-on-year figure, which usually draws attention, is developing somewhat differently. Owing to a low comparative baseline vis-à-vis the second quarter of last year, household consumption went up again, for the first time in more than a year. This time, consumers focused their demand on durable goods. Nevertheless, we still cannot speak of any long-term improvement in consumer appetite.

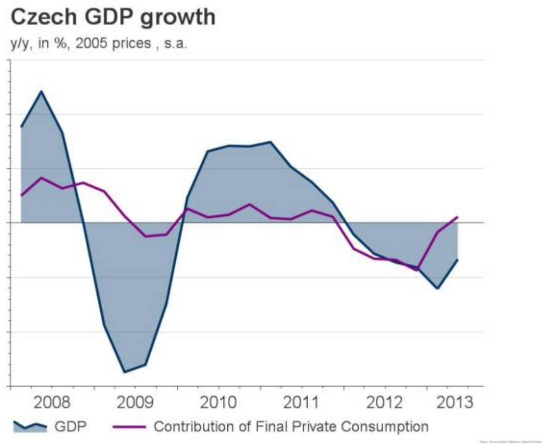
Investment gives no reason to rejoice at the moment. It fell by more than 6% y/y, with adverse developments in the investment in vehicles as well as machinery, buildings and dwellings.

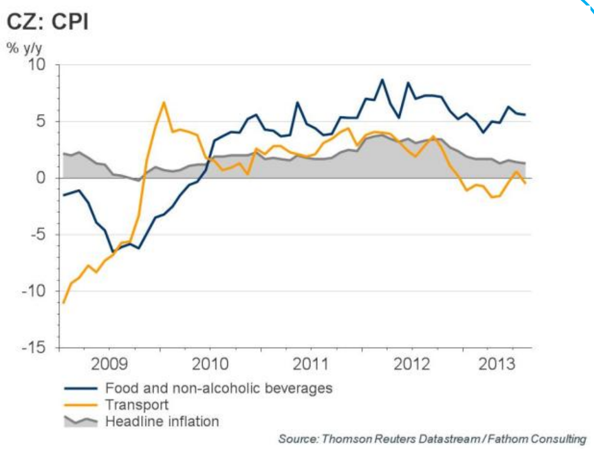
Investment activity continues to be muted in the Czech Republic, hand in hand with businesses continuing to be cautious because of the fragile improvement of demand, while the public sector is not encouraging an investment boom either, as indicated by orders as well as performance in construction.

The latest figures confirmed the end of the recession in the Czech economy, but the incipient economic growth has only been based on foreign demand thus far. Domestic consumption and particularly investment did not fare very well in the second quarter of the year. A particular disappointment was the latest investment data. Thus the further direction of the Czech economy will continue to be primarily based on foreign customers' appetite for buying Czech products.

The Czech inflation dips 0.2 % month-on-month in August

Regarding the fresh inflation figures, the August CPI has showed that consumer prices fell by 0.2 % m/m. This figure has put the annual inflation at 1.3%, which is lower figure than the CNB forecasted. Although behind the month-on-month decline in headline CPI were volatile food prices, low inflation still weighed on the koruna, so the EUR/CZK pair has moved above the 25.8 level.





Weekly preview

FRI 14:00 **PL Inflation (change in %)**

	Aug-13	Jul-13	Aug-12
CPI y/y	**1.1**	1.1	3.8
Food (ex Alc.) y/y	**2.4**	2.5	5.3
Transport (including fuel)	**-1.3**	-1.2	6.5

PL: The August inflation flat year-on-year

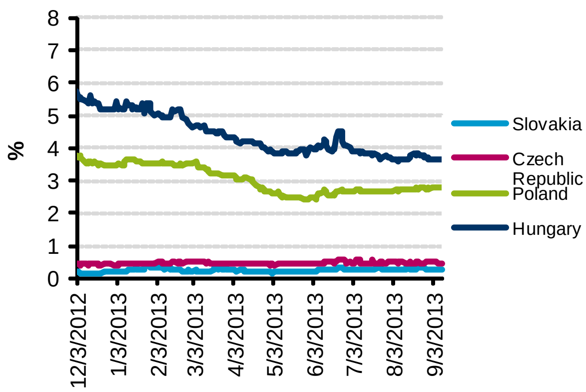
According to our forecasts, Poland's inflation stagnated at 1.1% y/y in August, after its surprising rise in July. Month-on-month prices likely fell by 0.3%. While the main reason for July's price rise was the increase in housing costs (which went up by 1.5%, in spite of a decline in electricity prices), what helped to keep inflation above 1% in August was likely above all food and soft drink prices (where we predict a fall by 1.1%, which is less than the seasonally usual 1.4%). Inflation was probably also influenced by another increase in oil prices, which exceeded the appreciation of the zloty against the dollar.

Calendar

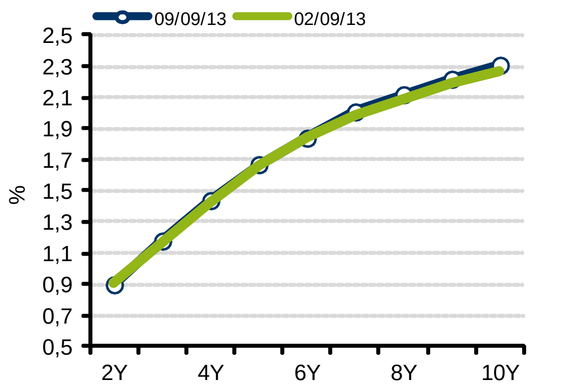
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	09/09/2013	9:00	CPI	%	08/2013	-0.2	1.3	-0.1	1.4	-0.2	1.4
CZ	09/09/2013	9:00	Unemployment rate 15-64	%	08/2013	7.5		7.5		7.5	
HU	09/09/2013	17:00	Budget balance	HUF B	08/2013					-851.2	
HU	09/11/2013	9:00	CPI	%	08/2013			0.1	1.6	-0.3	1.8
CZ	09/11/2013	10:00	Current account	CZK B	07/2013	-7		-7.3		-3.21	
PL	09/11/2013	14:00	Current account	EUR M	07/2013					574	
PL	09/11/2013	14:00	Trade balance	EUR M	07/2013					561	
HU	09/13/2013	9:00	Industrial output	%	07/2013 *F					0.3	2.5
PL	09/13/2013	14:00	Money supply M3	%	08/2013					-0.2	
PL	09/13/2013	14:00	CPI	%	08/2013		1.1			0.3	1.1

Fixed-income in Charts

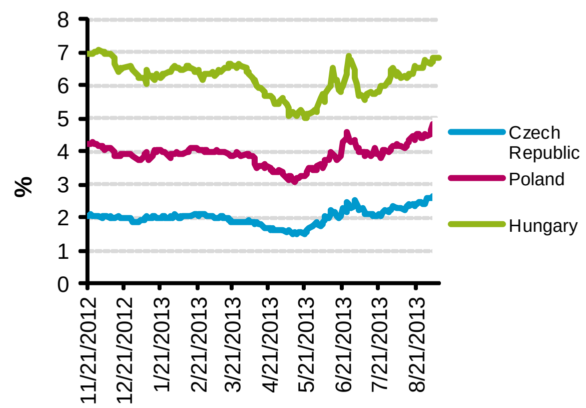
FRA 3x6



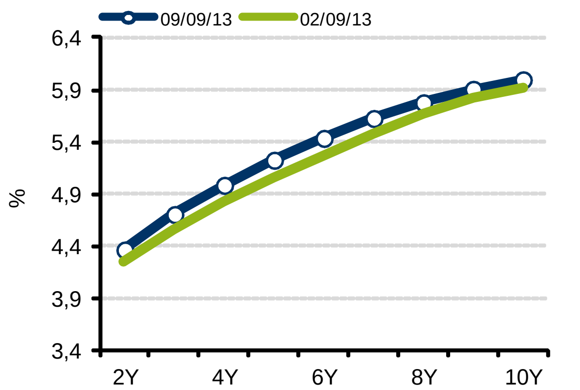
CZ IRS



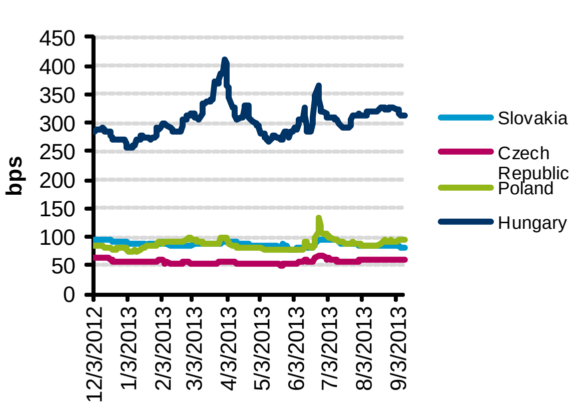
10Y GB Yields



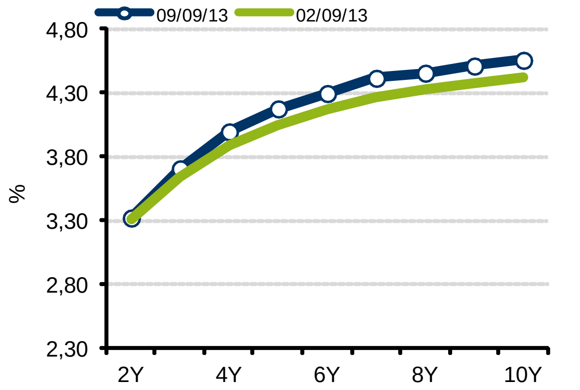
HU IRS



CDS 5Y



PL IRS



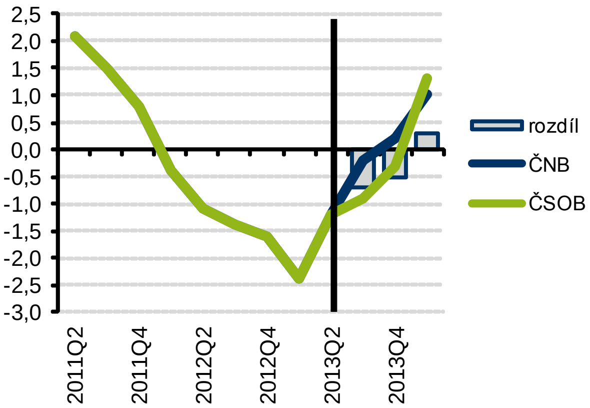
Source: Reuters

Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	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).

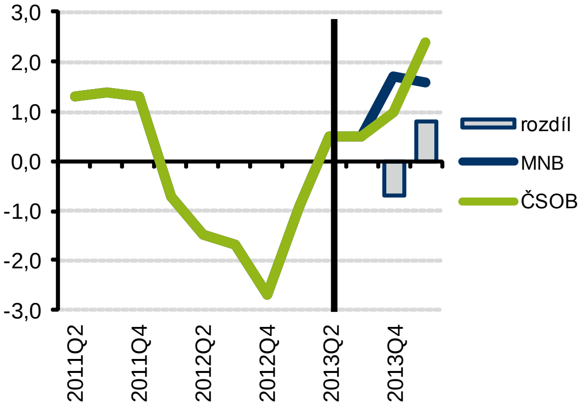
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

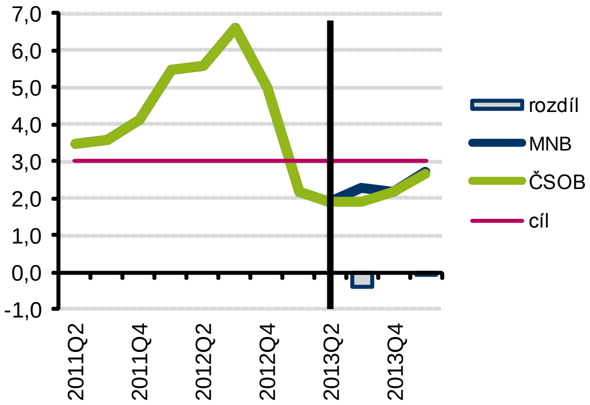


CZ: Inflation outlook (Y/Y, %)

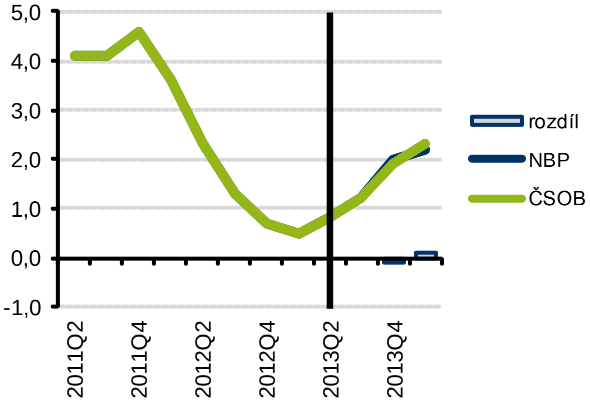
HU: GDP outlook (Y/Y, %)



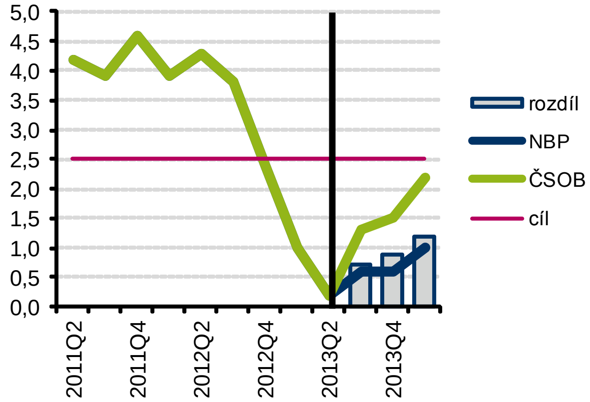
HU: Inflation outlook (Y/Y, %)



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	*3.75*	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	*2.31*	1.37	1.31	1.97	2.05	2.15
Hungary	HU10Y	*6.00*	5.49	5.41	5.84	5.50	5.90
Poland	PL10Y	*4.56*	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	*25.8*	25.1	25.7	26.0	26.0	25.5
Hungary	EUR/HUF	*301*	291	304	295	300	300
Poland	EUR/PLN	*4.28*	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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