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Central European Weekly

Monday, 16 September 2013

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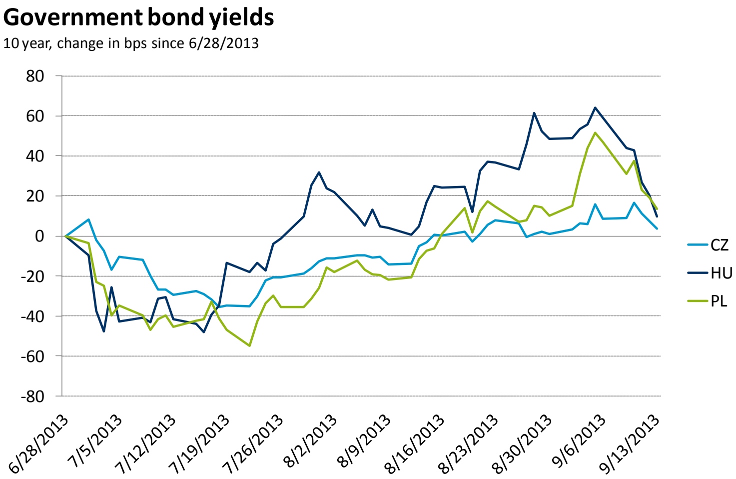
Weekly Highlights:

- Central European markets await the FOMC meeting
- The Hungarian inflation extends its fall, so the NBH may continue in its easing cycle
- The Czech forex market prepares for the CNB Bank Board meeting, which is getting closer

Chart of the Week



The August favourable inflation figures and the improving mood in risk asset markets contributed to the government bond markets in Central Europe having partly offset their previous losses. (Source: Bloomberg, CSOB)

Market's editorial

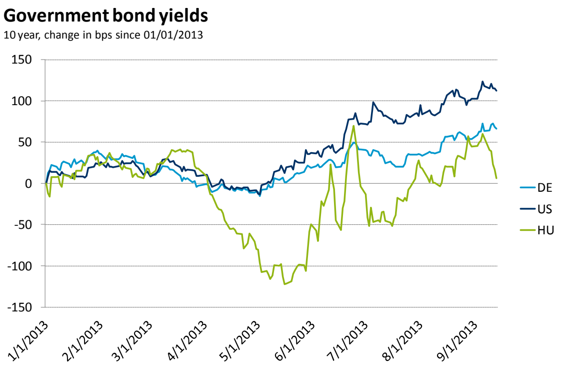
Even Central Europe is awaiting the FOMC meeting

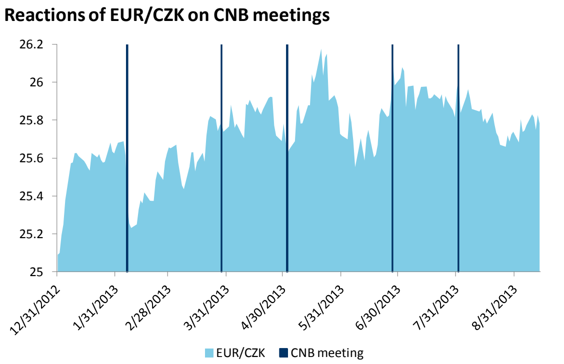
The August favourable inflation figures and the improving mood in risk asset markets contributed to the government bond markets in Central Europe having partly offset their previous losses. The decline in bond yields is even more evident in contrast with the rise in yields from safe government bonds in the United States and Western Europe.

Regional markets in government bonds and, after all, also forex markets will now wait for what the U.S. central bank will come up with in the middle of the week. The Fed is expected to begin the process of tapering off its monetary expansion. The regional calendar is empty this week and thus the focus will be on global markets – first of all on the upcoming Fed decision concerning reduction of its monetary stimuli. The FOMC meeting will conclude on Wednesday with the usual statement, the publication of the economic and rate projections and a press conference by chairman Bernanke. All three have the potential to affect emerging and CE markets too. The decision about the start of the tapering of the bond purchases is the key issue of this meeting. We still believe that the tapering will start, but slowly via a reduction of the monthly amount of purchases by $15B to $70B. Consensus is for a $10B reduction. Second item is the forward guidance. Will the Fed combine tapering with tweaking the forward guidance in a dovish sense, by reducing the unemployment rate threshold to 6% (from 6.5%) and/or by installing an inflation bottom? We don't expect the former to happen at this meeting (and maybe never), as a 6% unemployment rate threshold would be close to the 5.6% the Fed considers currently as full employment. We believe the above mentioned outcome of the Fed may not necessarily give a positive signal for risky assets, and this may again complicate the situation not only of currencies in emerging markets, which might bring some negative spill over effects to CE forex and fixed-income markets too.

The koruna gets ready for the upcoming CNB's meeting

As concerns the Czech koruna, it may find itself in a difficult position, because it might be afraid of a negative contagion from the other regional markets, while the Czech forex market may soon begin to fear the Czech National Bank. Another CNB Board meeting is slowly drawing near, with interventions against the Czech koruna to be certainly discussed seriously, and this could make things even more complicated for the koruna in the days to come.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.7	-0.34%	↗	↗
EUR/HUF	299	-0.30%	↗	↗
EUR/PLN	4.19	-1.80%	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.30	0.00	↗	↗
10Y HUF	5.34	-9.03	↗	↗
10Y PLN	4.23	-6.22	↗	↗

Review of Economic Figures

Hungary's inflation surprisingly falls

The Hungarian consumer price index fell substantially from 1.8% Y/Y in July to 1.3% Y/Y in August. The core inflation contrary to the headline figure increased from 2.8% Y/Y in July to 3% Y/Y in August.

So the main drivers of the disinflation process were rather temporary factors, like the low fuel price, moderating food and vegetables prices thanks to the good harvest and mainly the cut of public utility cost like water, sewage disposal or rubbish carriage fees. The latter action by the government moderated the inflation by 0.3ppt in August. One of the main surprises came from tobacco as the retail price increased only by 2% although the retail price margin was increased to 10% from 2-3%. The poor domestic demand keeps tradable goods prices at a low level despite of the relatively weak HUF.

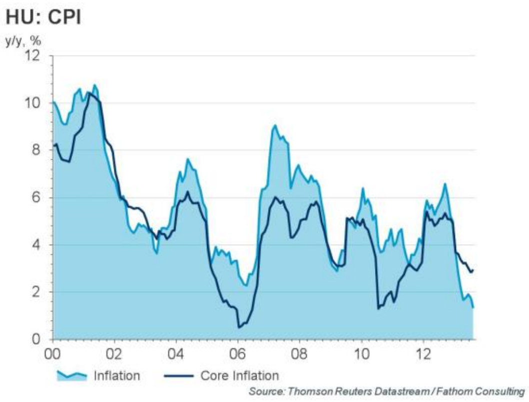
In the following months inflation may drop further, especially at the end of the year, as the government approved the next round of public utility cost reduction from 1 November. This time the gas, electricity and district heating price will be cut by 11.1%, resulting 20% price moderation including the January movement as well. As this public services have quite high portion in the basket of the consumer price index, the effect of the November price cut my be around 0.9-1ppt, which may push headline inflation below 1% Y/Y temporary. As the core inflation still running around 3% Y/Y it suggest that once the one-off effects will run out from the base consumer price index may go back to NBH's inflation target of 3% Y/Y.

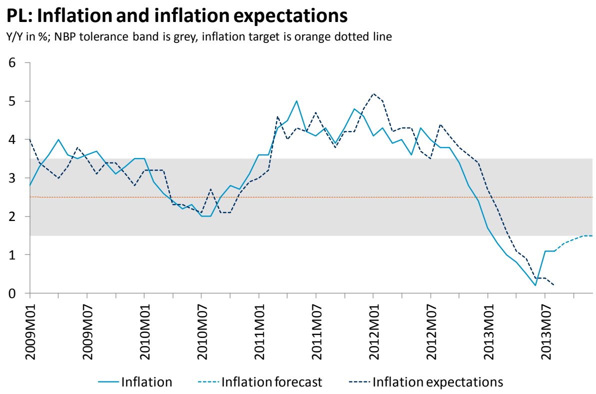
It is still clear that inflationary developments are not limiting the maneuvering room of NBH, so Monetary Council may continue to focus mainly on stability aspect in the following months. As the markets looks quite optimistic in the last days, NBH may continue the rate cut cycle, although sticking EURHUF around 300 in a positive global market environment may increase the concerns that Hungary's vulnerability is increasing. If EURHUF cannot broke 297 level during the week, we expect that NBH may slow down rate cut speed from the last time delivered 20bp to 10-15bp in September.

Poland's inflation stagnates as expected in August

Unlike Hungary (and as compared to the previous month), the release of Poland's inflation figures has sprung no surprises. Year-on-year as well as month-on-month price rises (1.1% and -0.3% respectively) hit exactly the values that we as well as the market had anticipated. As concerns the structure, the greatest surprise to us was a 0.2% slower rise in transport prices. The main contributor to the month-on-month price fall by 0.3% was the seasonal decline in food prices (-1.2%, with a 24% weight in the consumer basket). By contrast, the above-mentioned transport prices rose the most (0.5% m/m).

August inflation has confirmed that another rate cut in Poland, which some politicians would likely wish to see, is improbable. Inflation should continue to rise towards the end of the year, and may reach levels close to the lower threshold of the tolerance band of the National Bank of Poland (1.5%) in December. Moreover, owing to the base effect, another rise is likely to occur as early as in January. In addition, the latest data from the Polish economy suggests a gradual improvement of its condition, even in construction, where private activity starts to better make up for the rapid year-on-year falls in civil engineering construction (down by 20% y/y in July). Furthermore, the situation may even improve in that segment, if we take into account that the government is trying to free its hands for greater spending, by its controversial reform of the pension system.



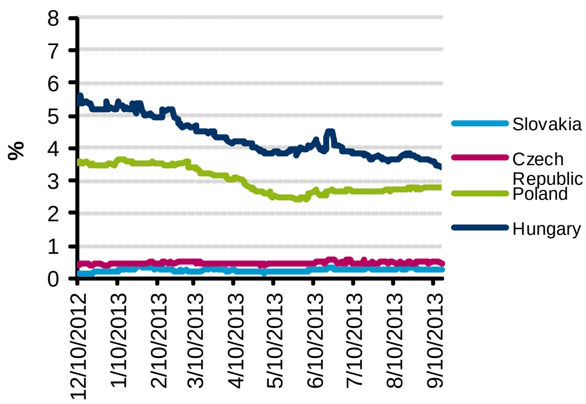


Calendar

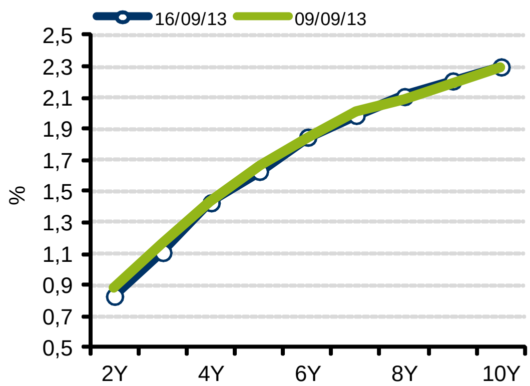
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	09/16/2013	9:00	PPI	%	08/2013	0.1	0.7	0.1	0.7	0.2	1.1
PL	09/16/2013	15:00	Budget balance	PLN M	08/2013					-25917	
PL	09/17/2013	14:00	Wages	%	08/2013			-1	2.8	0.6	3.5
CZ	09/18/2013	12:00	CZ bond auction floating rate/2023	CZK B	09/2013						
CZ	09/18/2013	12:00	CZ bond auction 2013-2019, 1.50%	CZK B	09/2013						
PL	09/18/2013	14:00	Industrial output	%	08/2013			-3.8	2.8	1.5	6.3
PL	09/18/2013	14:00	PPI	%	08/2013			0.1	-0.7	0.2	-0.8

Fixed-income in Charts

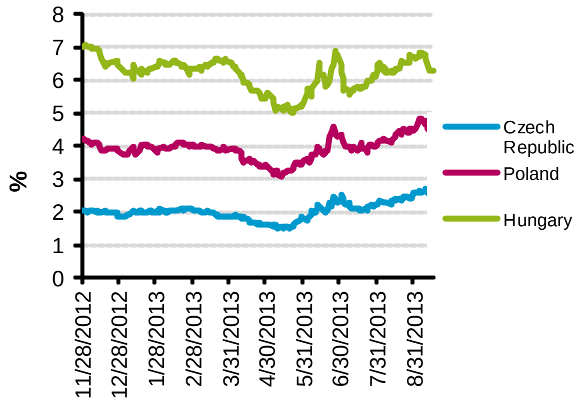
FRA 3x6



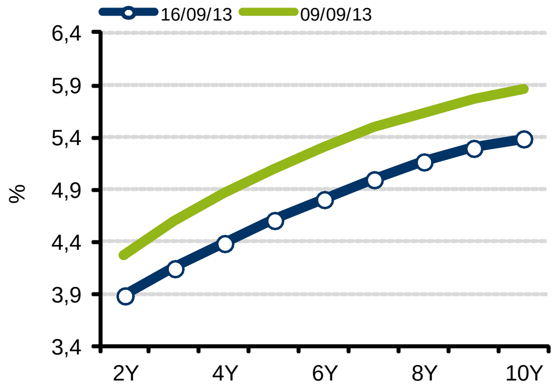
CZ IRS



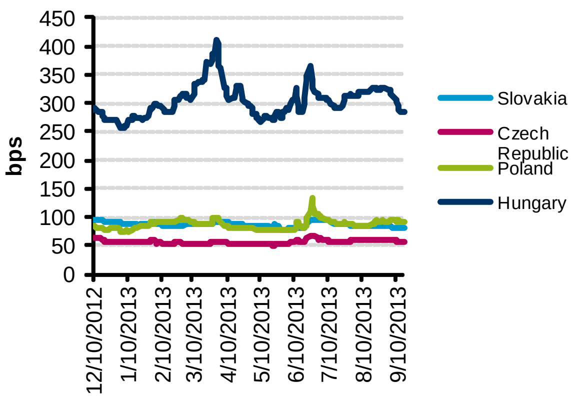
10Y GB Yields



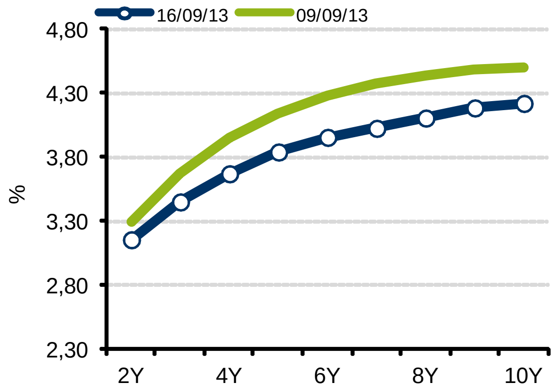
HU IRS



CDS 5Y



PL IRS



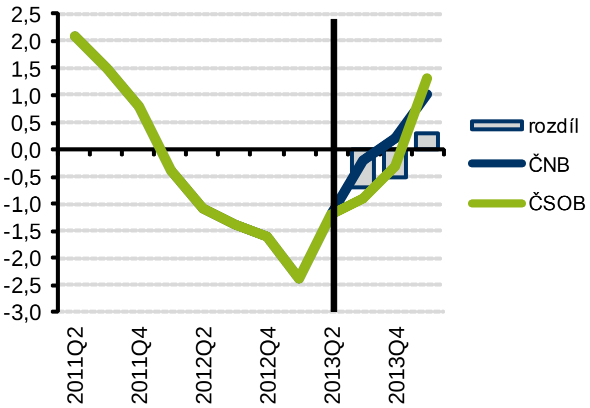
Source: Reuters

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% Y/Y. 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 Q/Q basis from the very impressive 0.7% Q/Q growth in 1Q13, but may remain in the positive territory. We expect 0.3% Y/Y 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).

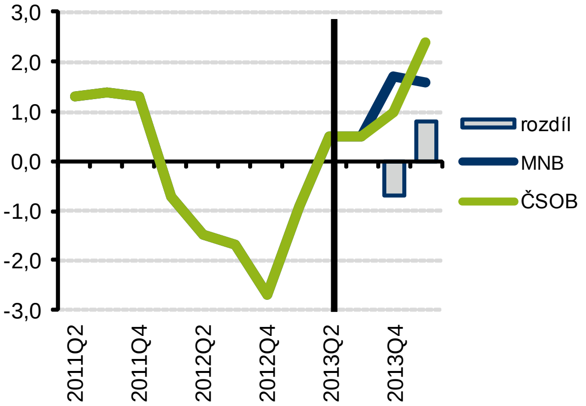
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

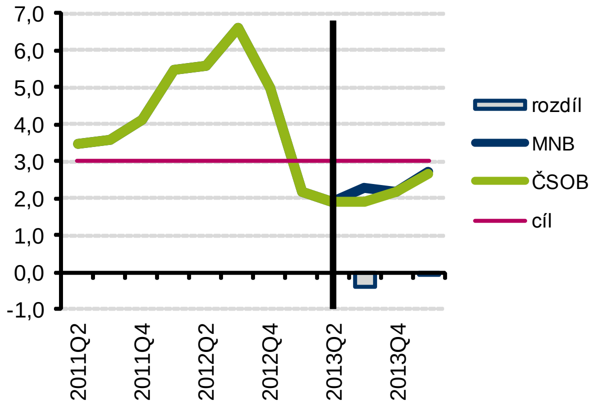


CZ: Inflation outlook (Y/Y, %)

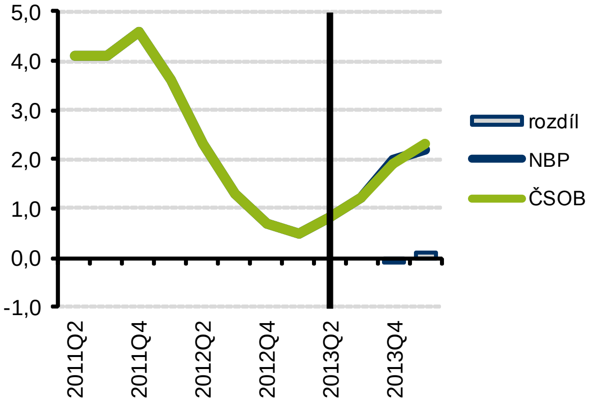
HU: GDP outlook (Y/Y, %)



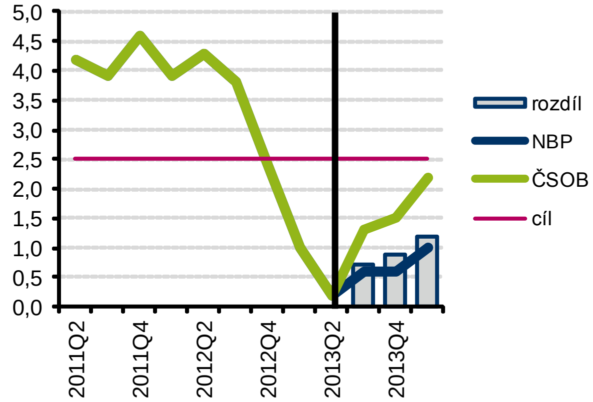
HU: Inflation outlook (Y/Y, %)



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	*0.45*	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	*2.3*	1.37	1.31	1.97	2.05	2.30
Hungary	HU10Y	*5.34*	5.49	5.41	5.84	5.50	5.90
Poland	PL10Y	*4.23*	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	*299*	291	304	295	300	300
Poland	EUR/PLN	*4.19*	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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