



Central European Weekly

Monday, 30 September 2013

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Weekly Highlights:

- The CNB refused to active a new policy instrument – forex interventions against the koruna
- The NBH cuts to 3.6% - as expected
- The NBP to leave rates unchanged again
- Reginal PMIs in focus

Chart of the Week: The CZK after the CNB



The Czech koruna strengthened immediately after the CNB indicated that forex interventions were not on the table yet.

Market's editorial

The CNB refused to active a new policy instrument –forex interventions against the koruna

As concern the The Czech National Bank - it did not in the end resort to forex interventions at its September meeting. As a result the koruna immediately strengthened to the level of EUR/CZK 25.60 after the decision. The CNB decided not to launch the interventions even though the August forecast's risks to inflation were slightly on the downside and the exchange rate was slightly stronger ahead of the September meeting.

Why then are the central bankers hesitating to launch the interventions? Simply because a number of them are not sure whether the benefit of the forex interventions would counterbalance the costs associated with their launch. Still, CNB's decision does not mean that interventions will be impossible in the future. We believe that some central bankers (Singer, Tomšík, Lízal) would be willing to launch them immediately. Determining the matter will be the attitudes of some of the other 'hesitant' median bankers (Mojmír Hampl in our opinion). These bankers likely need to see stronger arguments for the interventions than at present, arising from the current forecast and the spot exchange rate. As we do not anticipate a significant deterioration of the current (August) forecast in November, the CNB's interventions may essentially only be triggered by a greater appreciation of the koruna. Such appreciation is not ruled out, at least in the forthcoming weeks – as some market participants are already tired of the endless intervention threats. Nevertheless, the question is the levels at which the hesitant CNB members would decide to intervene. We bet on levels around CZK 25.40 per EUR. So, investors should pay attention to a release the CNB Minutes (this Friday) or to any change in the statements from Bank Board members Mojmir Hampl or Kamil Janáček in particular.

The NBH cuts to 3.6% - as expected

National Bank of Hungary (NBH) has continued the gradual and cautious rate cut cycle (started in August 2012). Base rate was moderated by 3.4%pt achieving historic low level of 3.6%. The last decision was 20bp cut again, just like in August (which

confused the market at that time), in line with market expectations.

The statement focused on the three main pillars of MPC's decision making methodology. The Council sees inflation developments in line with them expectation and they see that the low inflation is mainly because of the poor domestic demand. Although they highlighted that in short-term public utility cost reduction played also important role in the drop of inflation and in medium term some government measures causes some upward pressure on CPI, they see this pressure very limited as the output gap is in deep negative territory. So MPC doesn't see substantial risk of CPI development on the relevant time horizon.

The Council expects further moderation of external debt of Hungary. They see that markets were affected mainly by the decision made by developed markets' national banks. The global sentiment had positive effect on Hungary's risk judgment. The statement was finished with the sentence: considering the outlook for inflation and the real economy and taking into account perceptions of the risks associated with the economy, further cautious easing of monetary conditions may follow.

The sharp drop of August inflation figure from 1.8% YoY to 1.3% YoY renewed the expectations that NBH may cut base rate even to 3%. Market prices roughly 40bp rate cut within 3 months, while we expect only 10-20bp rate cut for this period, but it definitely highly depends on FED's monetary policy.

Regional PMIs in focus again

Apart from global factors (such as the debt ceiling in the United States or political mass in Italy), Central European markets will have to shift their attention to macroeconomic data, which will also include key cyclical indicators, i.e., PMI indices, this week. In the past two or three months, even regional PMI indices showed that the recovery in Central Europe was on the rise, and this was certainly good news for the regional currencies. Nevertheless, preliminary PMI indices in the Eurozone (from industry) failed to confirm such a great improvement, and thus there is a risk that Central Europe will follow suit.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.7	-1.23%	→	→
EUR/HUF	298	-0.16%	↗	↗
EUR/PLN	4.21	-0.40%	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.06	-5.72	↗	↗
10Y HUF	5.19	-1.14	↗	↗
10Y PLN	4.22	2.42	↗	↗

Weekly preview

WED 14:00

NBP rate (in %)

	This	Last change
rate level	2,50	7/2013
change in bps	0	-25

PL: The NBP to leave rates unchanged again

The National Bank of Poland (NBP) should leave rates unchanged at its meeting to be held this week. According to forecasts, the economy grew by 0.8% in the second quarter of the year, while forward-looking indicators suggest that the worst should be over for the Polish economy. In addition, the positive start of the third quarter has also been confirmed by figures from industry, and a certain (though only moderate) improvement has also been evident in retail sales. Thus the main problem continues to be construction. We expect that the NBP will leave rates at all-time lows until the end of the year, and the first change (upwards) might occur in the late first half of next year.

FRI 9:00

CZ Retail Sales (change in %)

	8.13	7.13	8.12
Sales	-1,5	4,0	0,0
cummulative (YTD)	-0,6	-0,5	-0,5

CZ: Lower car sales drove retail sales down

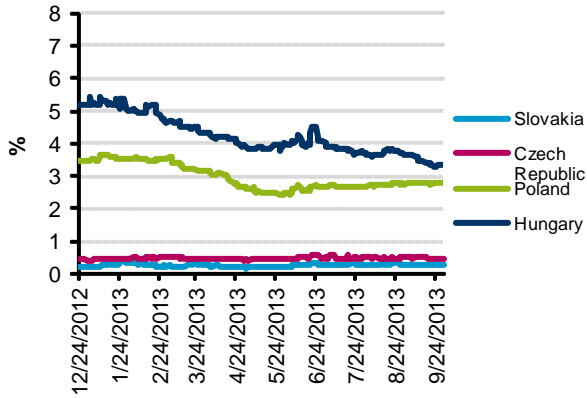
We believe that August's retail sales were poorer because of a lower number of business days in the month, by one day, as well as because of lower sales of new passenger cars. Thus retail sales have been slightly in the red since the beginning of the year, due to persisting poor consumer demand. The situation in the retail sector may start to improve moderately in the months to come. Falling inflation, which is heading towards the lower threshold of the CNB's tolerance band, should also contribute to this.

Calendar

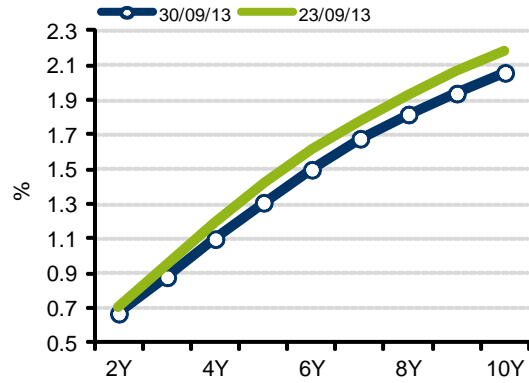
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	09/30/2013	9:00	PPI	%	08/2013				2.1	0.2	1.3
CZ	09/30/2013	11:00	Money supply M2	%	08/2013						5.1
PL	09/30/2013	14:00	Current account	EUR M	2Q/2013			1453			-2055
HU	10/01/2013	9:00	PMI manufacturing		09/2013						51.7
PL	10/01/2013	9:00	PMI manufacturing		09/2013						52.6
CZ	10/01/2013	9:00	Czech National Bank Gov ernor Singer Spea		10/2013						
CZ	10/01/2013	9:30	PMI manufacturing		09/2013						53.9
CZ	10/01/2013	14:00	Budget balance	CZK B	09/2013						-36.2
HU	10/02/2013	9:00	Trade balance	EUR M	07/2013 *F						421.6
PL	10/02/2013	14:00	NBP meeting	%	10/2013	2.5		2.5			2.5
CZ	10/04/2013	9:00	Retail sales	%	08/2013		-1.5		-1		4
HU	10/04/2013	9:00	Retail sales	%	08/2013						1.2

Fixed-income in Charts

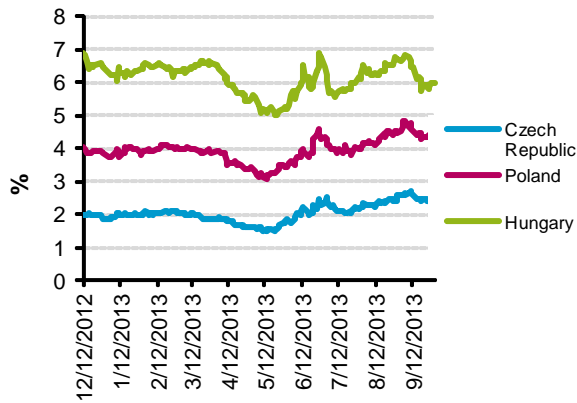
FRA 3x6



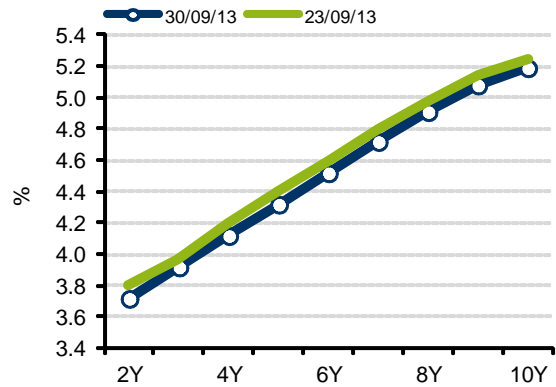
CZ IRS



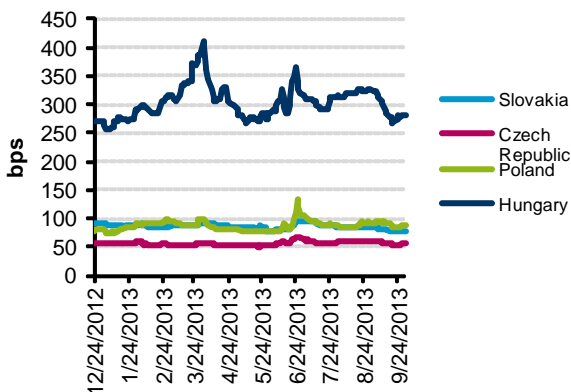
10Y GB Yields



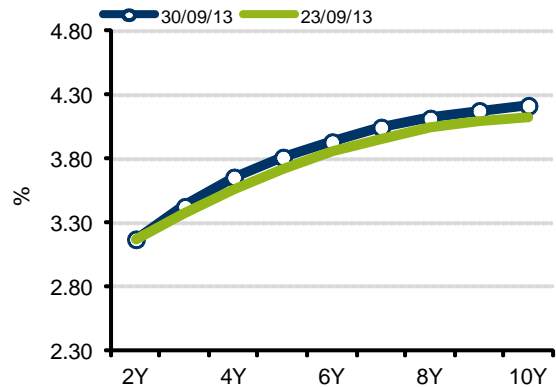
HU IRS



CDS 5Y



PL IRS



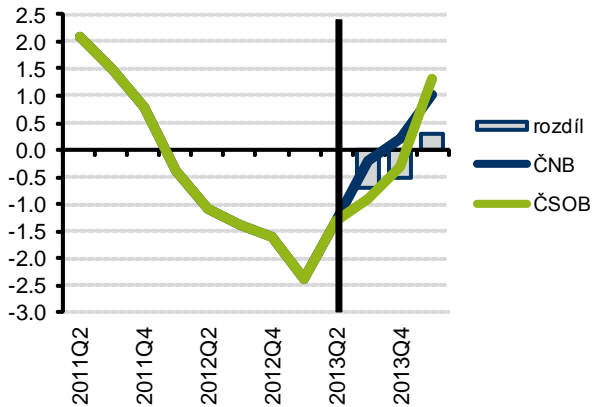
Source: Reuters

Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	<p>Three years after last elections the Prime Minister resigned and his cabinet 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.</p>	<p>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.</p>	<p>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.</p>
Outlook for official & market rates	<p>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).</p>	<p>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.</p>	<p>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.</p>
Forex Outlook	<p>The new CNB forecast implies the weaker koruna and the lower rates. The implied exchange rate (adjusted for the difference between actual and forecasted 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).</p>	<p>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 be affected not just by rate decision, but it will face some headwinds, if situation in emerging markets deteriorates further.</p>	<p>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 the NBP is probably ready to intervene above 4.35 level (the last intervention occurred at EUR/PLN 4.32).</p>

CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)



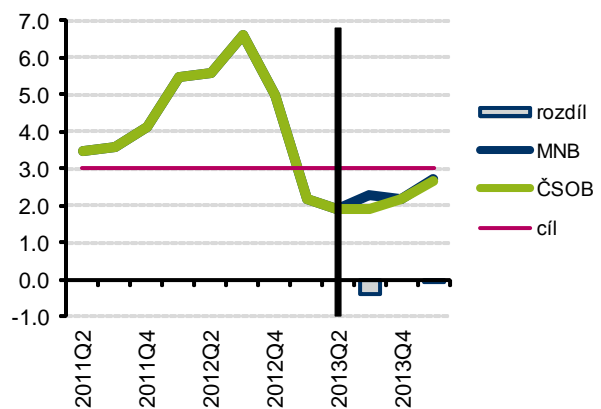
CZ: Inflation outlook (Y/Y, %)



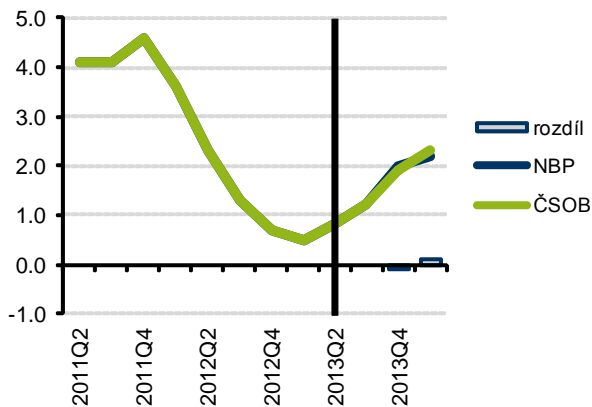
HU: GDP outlook (Y/Y, %)



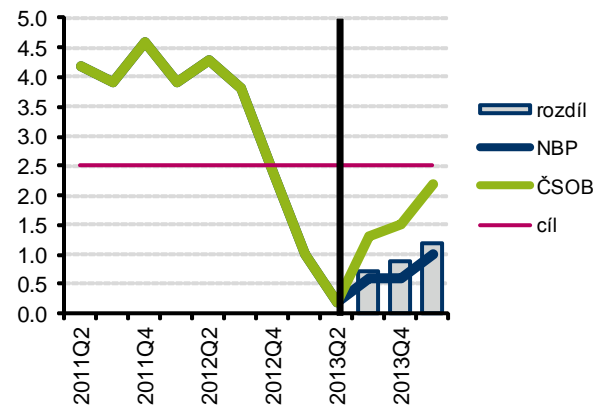
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outlook (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.	3.60	5.75	5.00	4.25	3.75	3.75	-20 bps	9/24/2013
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	3.57	5.75	4.90	4.20	3.80	3.90
Poland	WIBOR	2.67	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	2.06	1.37	1.31	1.97	2.05	2.30
Hungary	HU10Y	5.19	5.49	5.41	5.84	5.50	5.90
Poland	PL10Y	4.22	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	298	291	304	295	300	300
Poland	EUR/PLN	4.21	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	-1.3	-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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