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Central European Weekly

Monday, 07 October 2013

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Weekly Highlights:

- Regional PMIs and leading indicators suggest the recovery in industry is gaining momentum
- The Czech koruna at four-week highs
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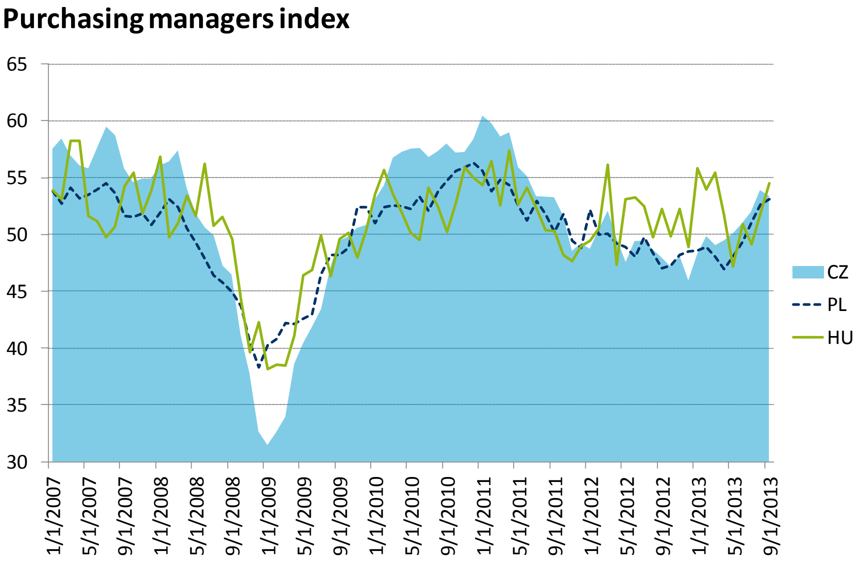
Chart of the Week: Regional PMIs up again



Regional PMIs confirmed the ongoing recovery which had already occurred in previous months.

Market's editorial

Regional bussine sentiment in a recovery mode

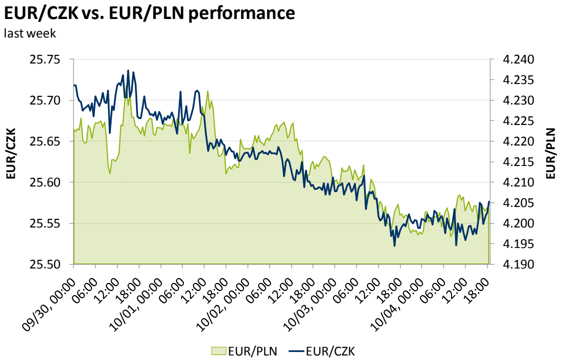
While the meeting of the National Bank of Poland, in line with expectations, did not attract any great attention from regional markets, more interesting information came from September's business sentiment indices. Regional PMIs confirmed the ongoing recovery which had already occurred in previous months and which had signalled that the upswing in Central Europe's export-oriented industry is gathering momentum. This is also clearly evident from our forward-looking indicators (our Flashes – see the next page) for individual Central European countries, which continued to improve, suggesting that the hard data from industry may not at all be bad in the months to come. This feeeling has already confirmed by strong results of the Czech industrial production in August. Recall that the Czech industrial output expanded by 1.6% Y/Y in August (mainly thanks to manufacturing of motor vehicles) which was a much better outcome than markets expected (-1.3% Y/Y). Significant rebound in new orders (+12.3% Y/Y) is another good piece of news.

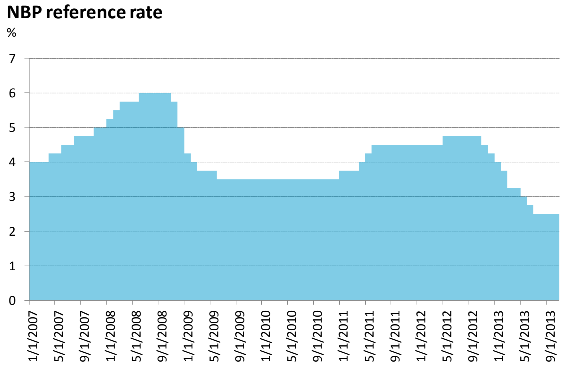
After all, this may also be why Central European currencies have fared very well recently, even though, as concerns the koruna, the market is still influenced by the aftermath of the last CNB meeting, where interventions were not launched (moreover, the minutes of the CNB Board meeting cast doubt on the sense of the interventions).

The US debt ceiling threat looms

As usual, if any hitch is to occur soon, it will again come from outside. At the moment, a significant risk to the development of business as well as consumer sentiment globally is posed by the political squabbling over the U.S. budget and, above all, over the increase of the ceiling for the U.S. federal debt. While we believe that Washington will resolve both issues – i.e., the funding of the Federal Government as well as the increase of the debt ceiling (avoidance of a selective default), the longer the solution is postponed, the greater the (temporary) damage may be.

Nevertheless, Central Europe's trade links to the United States are very weak, and thus a deceleration of U.S. growth would not affect the region to any great extent. On the other hand, the contagion that might spread into the region from vulnerable emerging markets, which would start to collapse if Washington was about to fail to reach an agreement, would clearly make itself felt.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.6	-0.44%	↗	→
EUR/HUF	297	-0.12%	↗	→
EUR/PLN	4.21	-0.27%	↗	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.06	1.28	↗	↗
10Y HUF	5.27	1.25	↗	↗
10Y PLN	4.28	0.83	↗	↗

In Focus: Central European leading indicators point to strenghening recovery

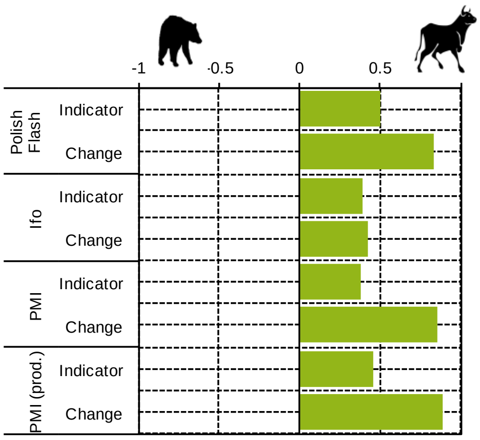
Our forward-looking indicators (Flashes) confirm the strengthening recovery of industry in all Central European economies. Thus the end of the year is likely to be positive for Central European industry, unless tension surprisingly increases in global markets; for example, as a result of failed talks on raising the debt ceiling in the U.S. The Polish Flash currently indicates the best prospects, while its Hungarian counterpart indicates the least optimistic..

The Polish leading indicator rose for an eleventh consecutive month, showing significant increases across all of its components (albeit they no longer accelerated last month). Thus the indicator has hit its highest levels in more than two years. Particularly the domestic PMI is improving rapidly, as is its production sub-index, which climbed to its highest levels since May 2011.

The positive development of the index favours our bets on Poland being the first Central European economy to hike rates in 2014.

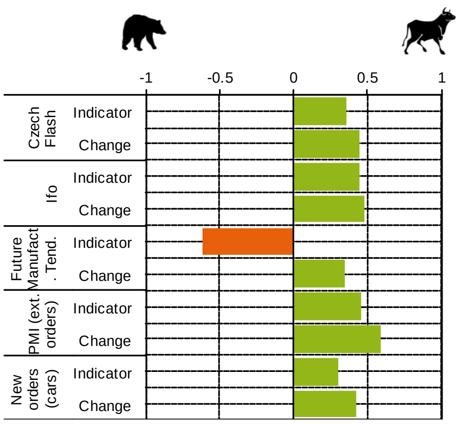
In the Czech Republic, just as in Poland, the overall Flash has been rising for 11 consecutive months. On the other hand, its improvement has been slower, with the rate of increases decelerating for a third consecutive month. This is also why it has hit approximately 1.5-year highs. The future expectations in industry according to the OECD are continuing to be fairly low. However, the hard data shows that industry has been slowly rising from its bottom, along with the Flash, for six consecutive months. Hence it should continue to expand in late 2013 unless any great global shocks occur.

The Polish Flash- leading indicator



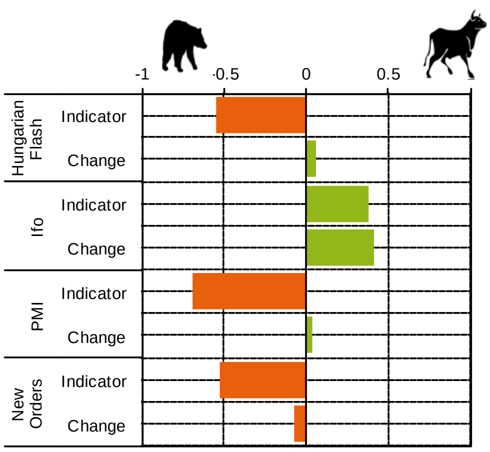
Hungary's performance is the most contradictory. The positive increases in its Flash are very small at the moment, confronted with poor new orders and high volatility of the PMI during recent months. Thus the development of the Flash warns us to be cautious concerning the positive increases in the Hungarian industry (hard data) we have seen in the last 5 months.

The Czech Flash- leading indicator



*Indicator: the level of the indicator vis-à-vis historical values
**Change: the change in the indicator vis-à-vis historical values
(1 = the current value is the maximum historical value; -1 = the current value is the minimum historical value)

The Hungarian Flash- leading indicator



Weekly preview

TUE 9:00 HU Industry (y/y change in

	Aug-13	Jul-13	Aug-12
Monhtly	**1.8**	2.5	2.3

HU: The industry confirms recovery

Industrial production started to accelerate in 2Q13 and except of May working day adjusted figure increased every month since April. As the European conjuncture improved we expect that this tendency may continue and we expect 1.8% Y/Y growth for August vs. consensus of 1.5% Y/Y.

WED 9:00 HU Foreign trade (EUR m)

	Aug-13	Jul-13	Aug-12
Balance	**570.0**	448.2	606.0

HU: A huge trade surplus narrows slightly

Investment and retail sales started to pick up slightly, which may boost the import, while export may expand with the same speed as last month. We expect that trade balance surplus may be slightly smaller than last year. Our forecast is EUR570m for August vs market consensus of EUR600m.

WED 9:00 CZ Inflation (change in %)

	Sep-13	Aug-13	Sep-12
CPI m/m	**-0.3**	-0.2	-0.1
CPI y/y	**1.1**	1.3	3.4
Monetary relevant inflation	**0.5**	0.5	2.1

CZ: The disinflation trend is not over

September likely saw another fall in the inflation for which the central bank sets its targets. This time, the expected month-on-month decline in the consumer price index was attributable to seasonally cheaper package tours and food, slightly encouraged by lower prices of household equipment. Year-on-year inflation may continue to approach the lower threshold of the CNB's tolerance band, and this will certainly encourage doves on the CNB Board, who are in favour of forex interventions against the koruna. In addition, the inflation outlook continues to improve, owing to the expected reduction of electricity prices in early 2014. As consumer demand will continue to be subdued, the latitude for the occurrence of inflationary pressures will continue to be negligible next year.

FRI 9:00 HU Inflation (change in %)

	IX.13	VIII.13	IX.12
CPI y/y	**1.1**	1.3	6.6

HU: Inflation keeps falling

Consumer price index delivered the biggest surprise last month as it fell from 1.8% Y/Y in July to 1.3% Y/Y in August. Although we don't expect such a huge drop for September, the trend is still further decrease thank to the poor domestic demand and government measures. We see CPI at 1.1% Y/Y for September vs. consensus of 1.2% Y/Y.

FRI 10:00 CZ Cur. Account (CZK bn)

	Aug-13	Jul-13	Aug-12
C/A monthly	**-15.5**	4.1	-26.5
cummulative (YTD)	**-2.8**	12.7	-48.8
Trade bal. monthly	**8.0**	13.0	4.6
cummulative (YTD)	**132.3**	124.3	102.7

CZ: The dividend season continues

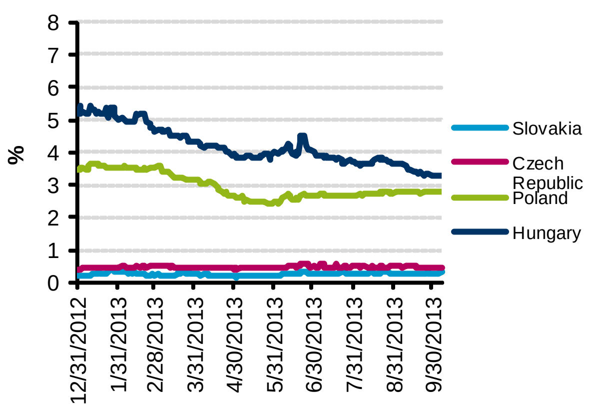
The positive foreign trade and balance of services for August likely could not counterbalance the effect of dividends flowing to foreign countries. In spite of a moderate current account deficit, the current account has still developed very well since the beginning of the year, particularly if we take account of the inclusion of reinvested profits in the overall current account figure. Adjusted for this, the current account even remains in the black, and thus the Czech Republic's external balance is still in a surplus, without hampering the exchange rate of the Czech currency in the future.

Calendar

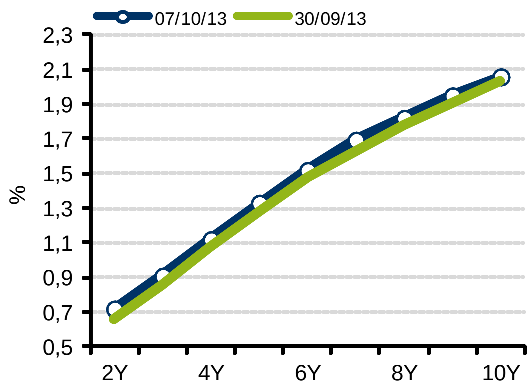
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	10/07/2013	9:00	Construction output	%	08/2013						0.2
CZ	10/07/2013	9:00	Industrial output	%	08/2013		-1.8		-1.3		2.1
CZ	10/07/2013	9:00	Trade balance	CZK B	08/2013	20.7		21.1		28.2	
HU	10/07/2013	17:00	Budget balance	HUF B	09/2013					-961.2	
HU	10/08/2013	9:00	Industrial output	%	08/2013 *P		1.8		1.7	0.3	2.5
CZ	10/08/2013	9:00	Unemployment rate 15-64	%	09/2013	7.6		7.5		7.5	
HU	10/08/2013	9:00	Trade balance	EUR M	08/2013 *P	570		616		448.2	
CZ	10/09/2013	9:00	CPI	%	09/2013	-0.3	1.1	-0.2	1.2	-0.2	1.3
CZ	10/09/2013	12:00	CZ bond auction 2013-2019, 1.50%	CZK B	10/2013						
CZ	10/09/2013	12:00	CZ bond auction 2013-2028, 2.50%	CZK B	10/2013						
HU	10/11/2013	9:00	CPI	%	09/2013		1.1	0.4	1.3	-0.3	1.3
CZ	10/11/2013	10:00	Current account	CZK B	08/2013	-15.5		-12.5		4.09	
PL	10/11/2013	14:00	Current account	EUR M	08/2013					-178	
PL	10/11/2013	14:00	Trade balance	EUR M	08/2013					293	

Fixed-income in Charts

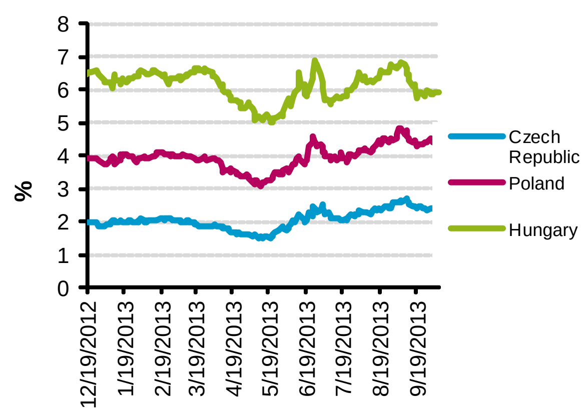
FRA 3x6



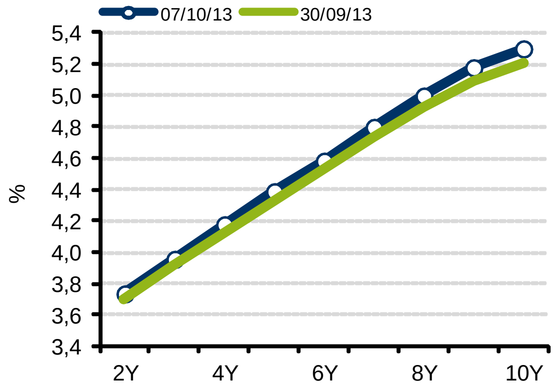
CZ IRS



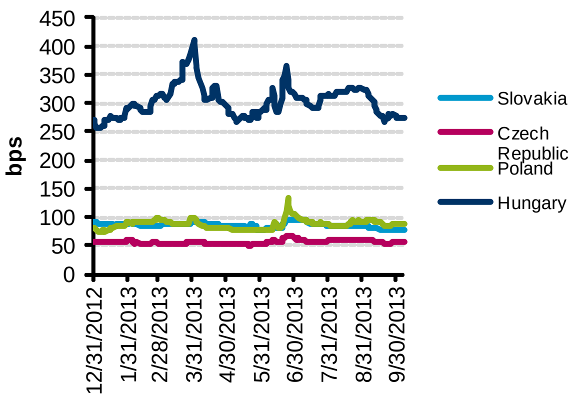
10Y GB Yields



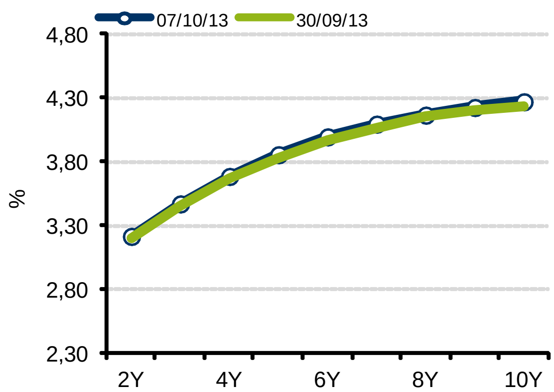
HU IRS



CDS 5Y



PL IRS



Source: Reuters

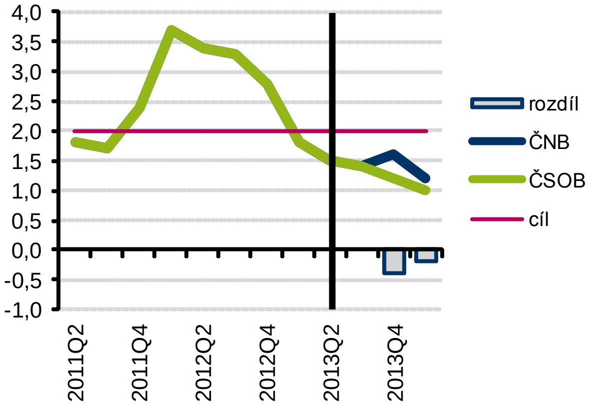
Medium-term Views & Issues

	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 the NBP is probably ready to intervene above 4.35 level (the last intervention occurred at EUR/PLN 4.32).

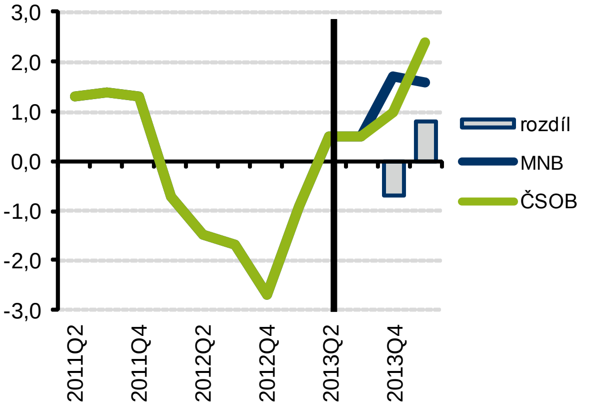
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

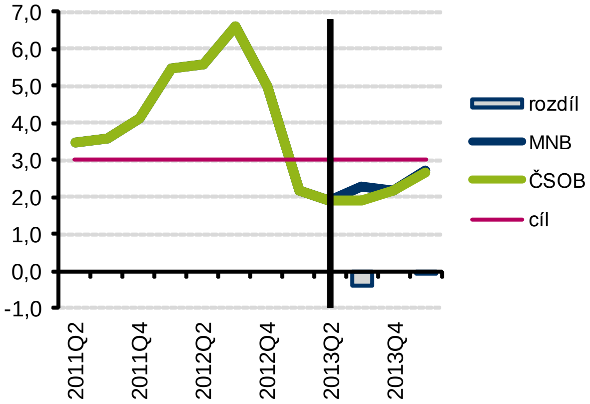
CZ: Inflation outlook (Y/Y, %)



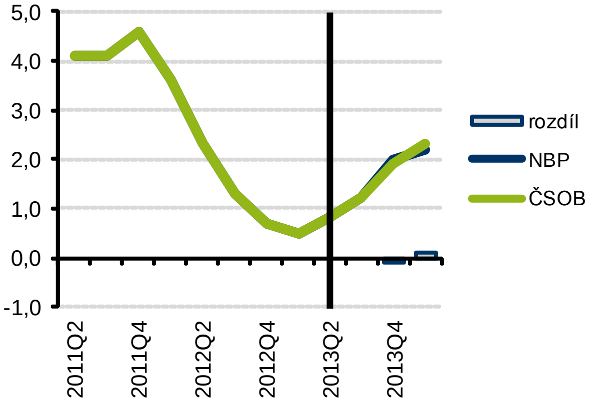
HU: GDP outlook (Y/Y, %)



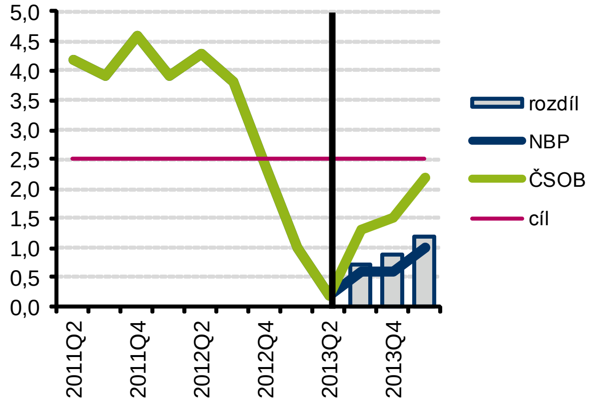
HU: Inflation outlook (Y/Y, %)



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.	*3.60*	5.75	5.00	4.25	3.60	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	0.42	0.43
Hungary	BUBOR	*3.55*	5.75	4.90	4.20	3.56	3.90
Poland	WIBOR	*2.68*	4.11	3.39	2.73	2.67	2.75

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

		Current	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	CZ10Y	*2.061*	1.37	1.31	1.97	2.06	2.15
Hungary	HU10Y	*5.27*	5.49	5.41	5.84	5.17	5.90
Poland	PL10Y	*4.28*	3.60	3.61	4.14	4.24	3.95

Exchange rates (end of the period)

		Current	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	EUR/CZK	*25.6*	25.1	25.7	26.0	25.7	25.5
Hungary	EUR/HUF	*297*	291	304	295	297	300
Poland	EUR/PLN	*4.21*	4.08	4.18	4.33	4.22	4.20

GDP (y/y)

	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4
Czech Rep.	-0.9	-1.2	-1.4	-2.3	-1.3	-0.9	-0.4
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	1.1	1.4
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	-1.7
Hungary	1.5	2.0
Poland	-4.0	-3.8

Public finance balance as % of GDP

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

Source: CSOB, Bloomberg

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