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Central European Weekly

Monday, 21 October 2013

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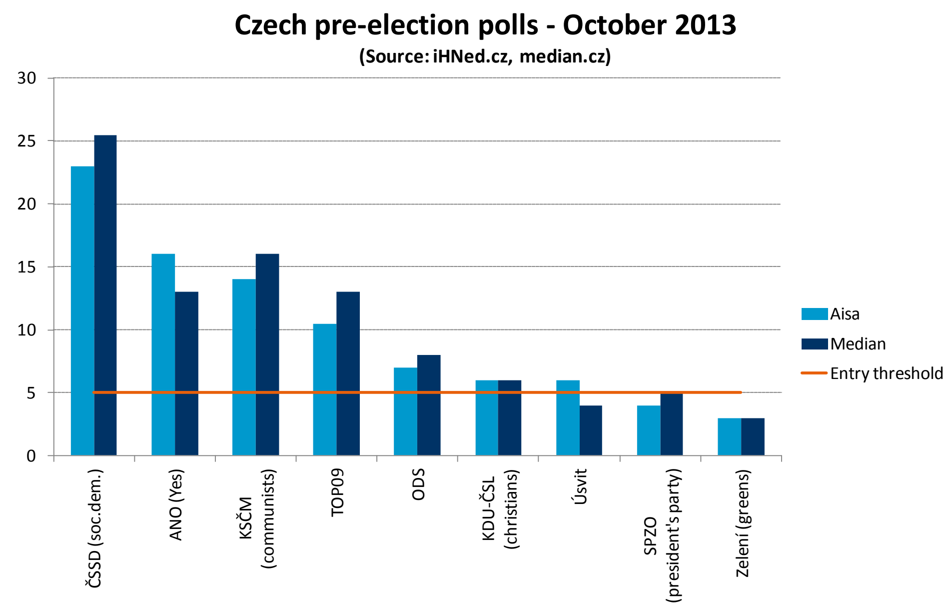
Weekly Highlights:

- The forint and polish government bonds – regional winners of the US debt ceiling debate
- While the Polish industry continues to recover, domestic inflation pressures remain negligible
- Outcome of the Czech early elections is hard to predict – no market reaction is expected

Chart of the Week: Tight election race



Market's editorial

The end of the debt ceiling issue will help regional assets

The end, i.e., the postponement , of the debt ceiling issue in the United States had a clearly positive impact on risk asset markets, and this also influenced Central Europe. As usual, this relieved Hungarian assets the most out of Central European currencies and government bonds. Regional financial markets, just like global stock markets, will benefit from the prevailing conviction of investors that the postponement of the Congressional debate on the federal budget and debt ceiling in the U.S. until early 2014 will likely cause the U.S. central bank to delay the start of its tapering of the monetary expansion. This element of uncertainty may again delay the discussion on the deceleration of quantitative easing, with a detailed look into the calendar indicating that, as concerns timing, the Fed may find it difficult to decide to take such an important action before its March 19 meeting. At that time, the debt ceiling issue should be resolved and the new Fed Chief Yellen should be firmly seated in her new position (succeeding Ben Bernanke).

Outcome of the Czech early elections is hard to predict

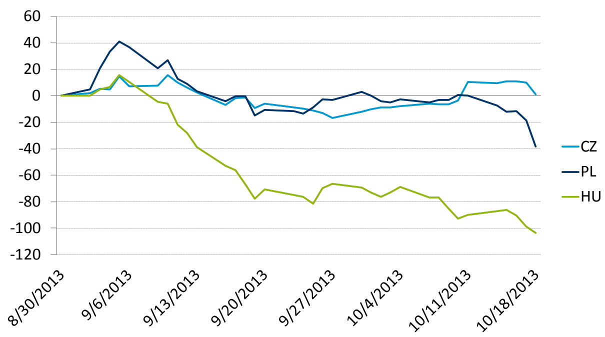
Regarding the week ahead, scheduled releases of regional economic figures are not particularly interesting. Attention will therefore focus on the delayed release of US labor data for September on Tuesday. Czech early general elections next Friday and Saturday should become the top regional eye-catcher. Predictions of election´s outcome, let alone of the impact of post-election government coalition on economic policy, are quite tricky, for major parties´ preferences are not stable and public support for several smaller parties hovers around the 5% threshold required for entry into the Parliament. Regarding pre-election and post-election markets behaviour, we do not expect dramatic changes or responses, just as we did not expect them in the past. The koruna and Czech government bonds will tend to adopt a wait-and-see position ahead of the election, because, as we mentioned already above, various election outcome are possible.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.8	0.77%	➔	➔
EUR/HUF	294	-0.89%	➔	➔
EUR/PLN	4.18	-0.04%	➔	➔

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.05	-0.87	↗	↗
10Y HUF	5.05	-4.36	↗	↗
10Y PLN	4.02	-4.06	↗	↗

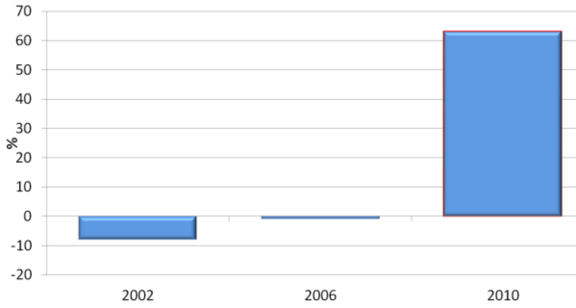
CE: Government bond yields

10 year, %



EUR/CZK: Deviation from normal volatility during the elections

Daily volatility 3-weeks after the elections minus the daily volatility over the whole election year; in %



Review of Economic Figures

The Polish industry continues to fare well

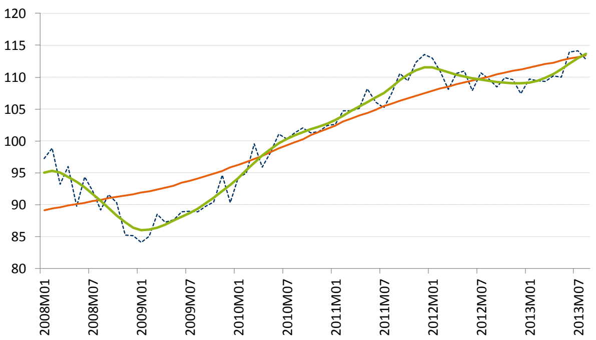
The data released last week has confirmed that the economic recovery in Poland is heading in the right direction. The main indicator of improvement was again the data from industry. While September's rise in industrial output slightly lagged behind expectations, it was still fairly robust and, after seasonal adjustment, reached 1.4% M/M. Year-on-year output rose in a great majority of sectors (28 of 34). Among the encouraging news is the year-on-year rise in the automotive industry by 14% (about 7% of the gross value added in the manufacturing industry). By contrast, as concerns major sectors, one of those performing below last year's levels was again the production in the chemical industry (-2% Y/Y). Good news included not only the favourable figures from industry but also the news from the labour market – while the rise in employment slightly lagged behind expectations, September's wage growth was faster than predicted. Faster wage growth and labour market improvement are the necessary preconditions of any stronger recovery of household consumption, whose contributions to GDP growth have been virtually zero in the last four quarters.

Inflation pressures remain negligible

The lack of domestic inflation pressures was also confirmed by the data on September's inflation, which was 1% Y/Y. A 0.1% slower price rise than we had expected was primarily due to a significant decline in education prices (down by 6.9% M/M), which, even with the 1.2% weight of those items in the consumer basket, counterbalanced the month-on-month stagnation of food prices (where we had anticipated a moderate decline). Nonetheless, the development of food prices and the rapid rise in transport prices (+0.8% M/M) have confirmed that the price rise in Poland primarily depends on external factors and, where applicable, on administrative moves. This is why we still believe that the official interest rates will remain at all-time lows in the months to come (with a possible change in the late first half of next year).

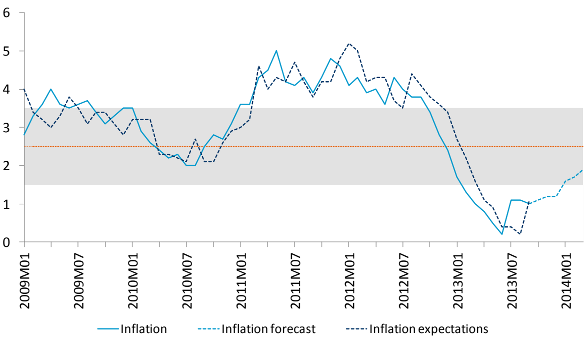
PL: manufacturing

seasonally adjusted, long-term & short-term trends



PL: Inflation and inflation expectations

Y/Y in %; NBP tolerance band is grey, inflation target is orange dotted line

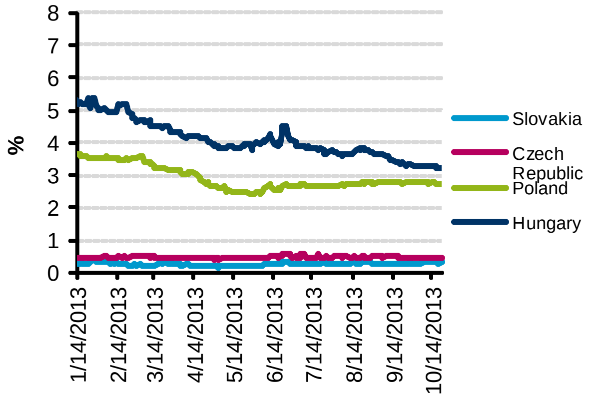


Calendar

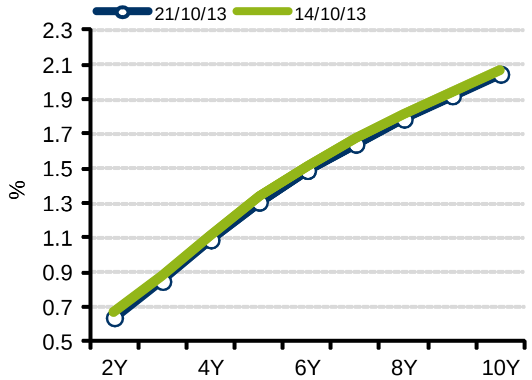
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	10/22/2013	10:00	Unemployment rate	%	09/2013			13		13	
PL	10/22/2013	10:00	Retail sales	%	09/2013			-0.2	4.7	-0.7	3.4
CZ	10/23/2013	12:00	CZ bond auction 2013-2016, 0.50%	CZK B	10/2013						
CZ	10/23/2013	12:00	CZ bond auction 2013-2019, 1.50%	CZK B	10/2013						

Fixed-income in Charts

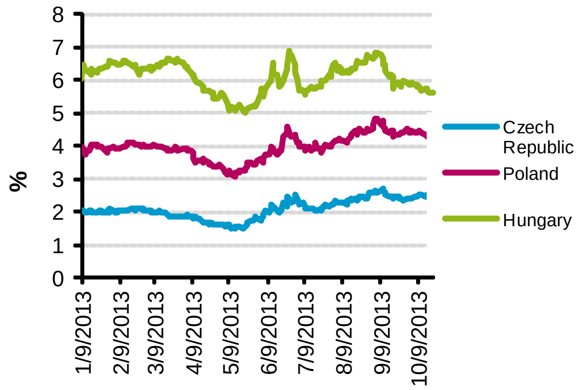
FRA 3x6



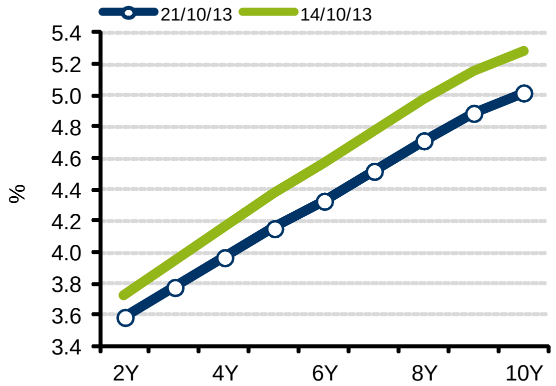
CZ IRS



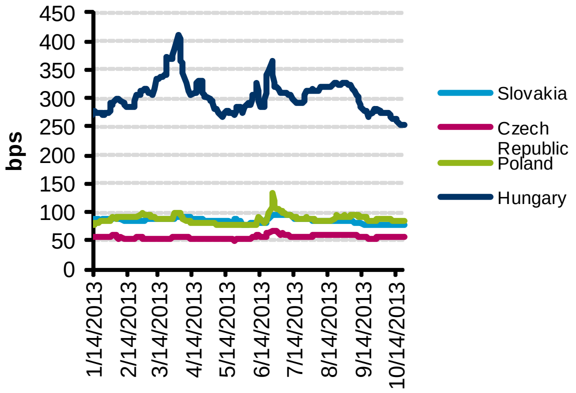
10Y GB Yields



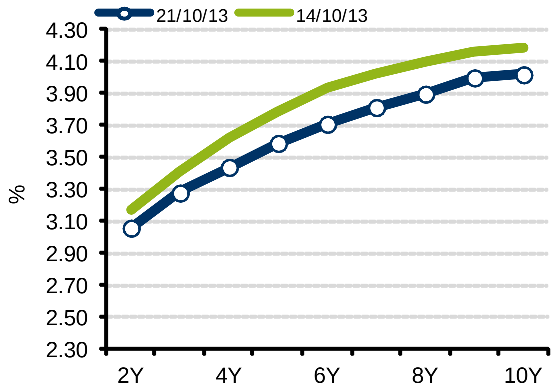
HU IRS



CDS 5Y



PL IRS



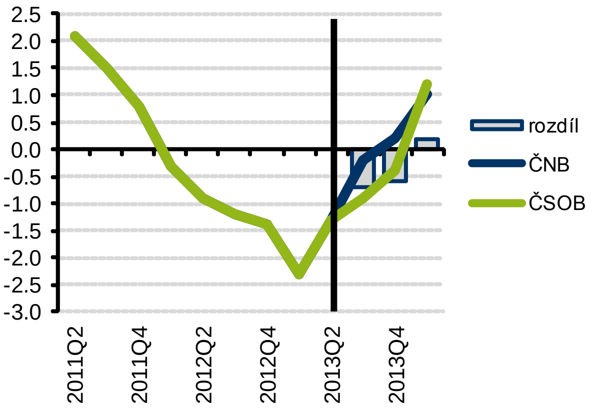
Source: Reuters

Medium-term Views & Issues

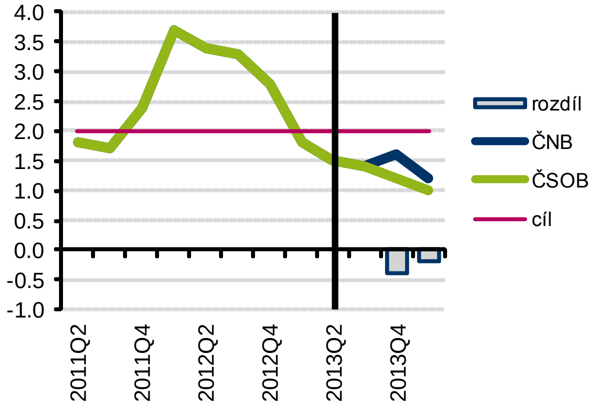
	The Czech Republic	Hungary	Poland
Growth & key issues	Three years after last elections the Prime Minister resigned and his cabined fell. With minor exceptions, the bulk of political scene in the CR refuses to call premature elections a less than year before regular parliamentary elections. Newly formed “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 25.40 (see the FX outlook).	For the upcoming NBH meeting, which will be held on 29 October, the most likely outcome is 20bp cut again, especially if we take it account that last time (in September) 6 members from 7 voted on 20bp cut, while only one voted for 10bp cut. In the meantime 2 new members were appointed into the council, who may have a dovish approach as well.	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

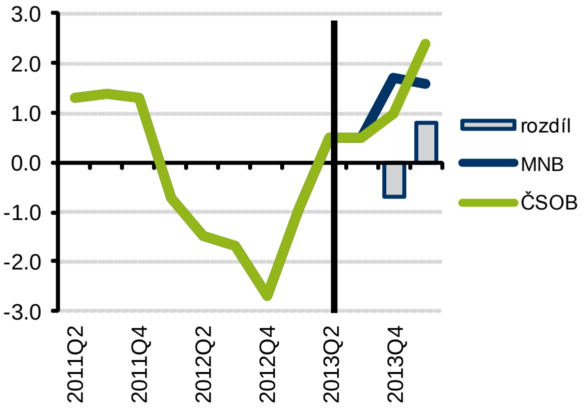
CZ: GDP outlook (Y/Y, %)



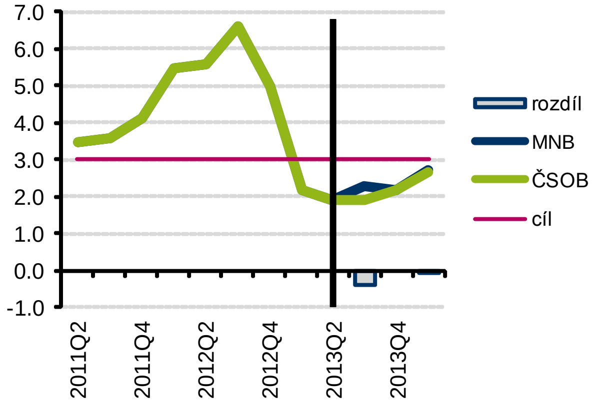
CZ: Inflation outlook (Y/Y, %)



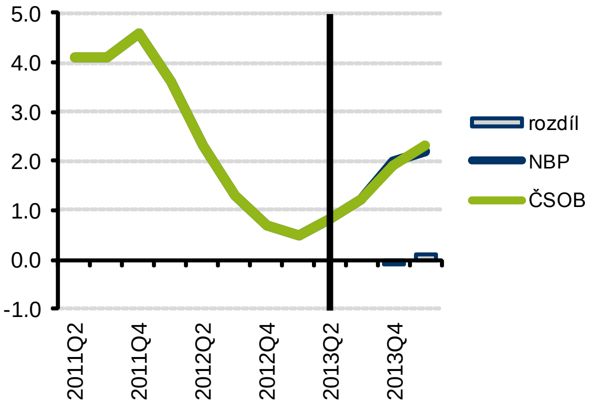
HU: GDP outlook (Y/Y, %)



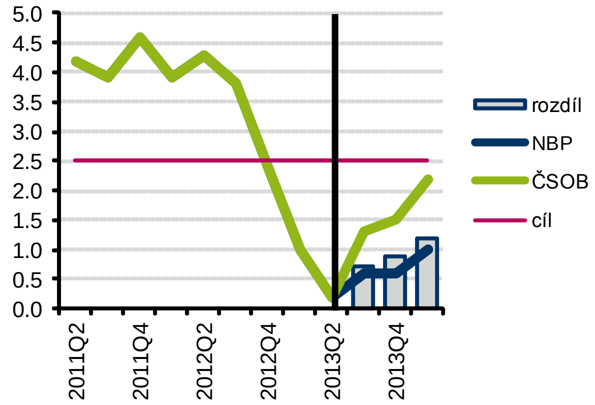
HU: Inflation outlook (Y/Y, %)



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	3.50
Poland	WIBOR	*2.67*	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	*2.048*	1.37	1.31	1.97	2.06	2.15
Hungary	HU10Y	*5.05*	5.49	5.41	5.84	5.17	5.90
Poland	PL10Y	*4.02*	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	*25.8*	25.1	25.7	26.0	25.7	25.5
Hungary	EUR/HUF	*294*	291	304	295	297	300
Poland	EUR/PLN	*4.18*	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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