Central European Weekly

Monday, 04 November 2013

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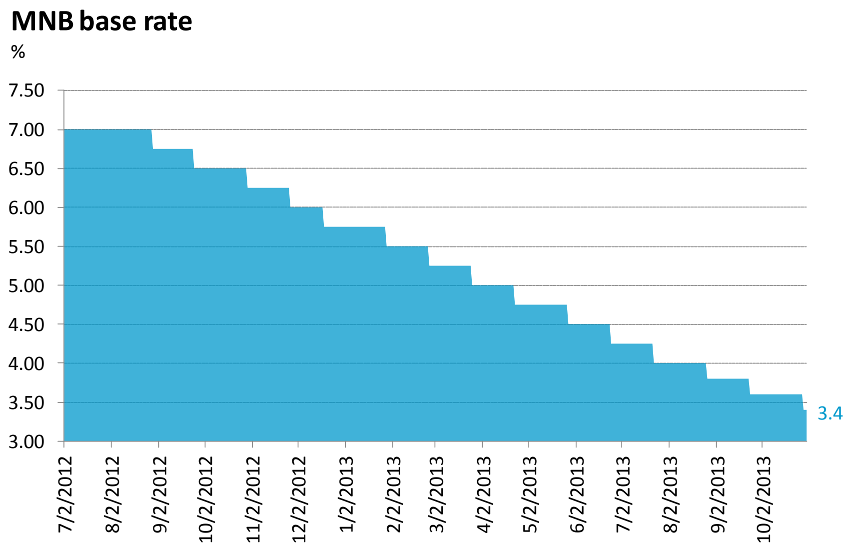
Weekly Highlights:

- The Czech forex market fails to react to election results as it focuses on the CNB Bank Board meeting
- Czech and Polish PMIs beat expectations again
- The Hungarian unemployment falls to pre-crises levels
- The CNB should leave its policy unchanged, which means that FX interventions will not be activated

Chart of the Week



Hungarian central bank cut its main interest rate for the fifteenth time in a row to a new all-time low of 3.4%.

Market's editorial

From the election back to the CNB

A week after the Czech general election, it is clear that the new government will not be formed anytime soon. It is also clear that the election result has had no affect on Czech financial markets. On the contrary, although the new government's policy paper is still unavailable (it may be available in weeks or even months), it is already clear that the new composition of the Lower Chamber of Parliament should not lead to fiscal easing and should prevent a corporate income tax increase. While Czech stocks welcomed the latter post-election implication for the Czech Republic's future economic policy, the government bond market welcomed the former.

Nevertheless, Czech market, notably the forex market, will certainly start to shift attention from the election result to the approaching CNB meeting. Just as it has twice before, the CNB Board will vote on whether a new monetary policy instrument – interventions against the Czech koruna – will need to be activated for any further monetary easing. Although inflation is even deeper below the Czech National Bank target now, the cyclical data released since the last macroeconomic forecast were for the most part better than the CNB as well as markets had expected (see, for example, the GDP and PMI). Hence we believe that the activation of the forex intervention policy will again fail to pass by a narrow margin, as also indicated by cautious comments from Czech central bankers.

Let us add that, if our scenario is met, the Czech koruna, which has always tended to weaken ahead of CNB meetings in recent months, should quickly strengthen after Thursday's decision.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.8	0.47%	➚	➘
EUR/HUF	296	1.12%	➚	➚
EUR/PLN	4.18	-0.07%	➔	➔

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.88	-3.79	➚	➚
10Y HUF	5.19	6.13	➚	➚
10Y PLN	4.10	4.99	➚	➚

Review of Economic Figures

Czech and Polish PMIs beat expctations again

The positive result of Czech manufacturing PMI for October showed an ongoing improvement in business conditions (the index surpassed the neutral 50 points level for the sixth consecutive month). Even more encouraging than the result itself was maybe the fact that the pace of growth of the employment sub-index was the fastest in more than two years.

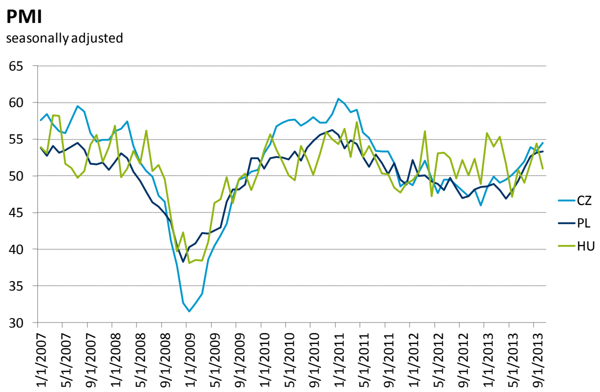
As concern other regional PMI indices – they brought from sloigfhtly diferent picture Poland and Hungary, but generally support our view that recovery in manufacturing has been on it way. While more volatile Hungarian index slightly fell in comparison with September, the Polish PMI reached the highest level in 2-½ years, driven by exceptional increase in new export orders (which hit survey-record in October). The index thus supports trends that have been apparent in "hard" data, that is, a significant pick-up in activity in export-oriented industries such as manufacture of motor vehicles (about 7 percent of gross value added in manufacturing), which grew by 14.3 percent Y/Y in September.

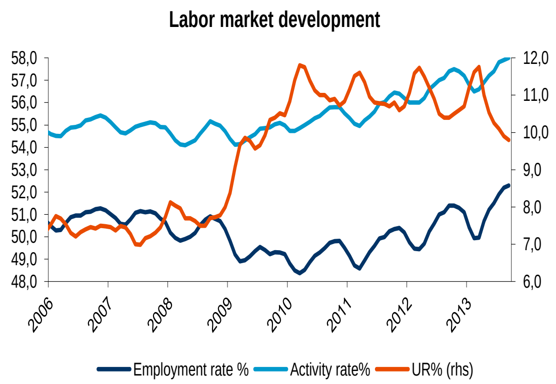
The Hungarian unemployment falls to pre-crises levels

Hungary's labour market data indicate that the economic recovery (although still externally driven) is finally coming so it might deliver the response of the retail sector and the domestic demand should rise.

Increasing number of the employees and the net real wage growth may strengthen the households' consumption for the coming months. The figures released yesterday showed that Unemployment rate (UR) moderated to 9.8% in July-September period from 9.9% in June-August period, which is 4 years low level. Last time we saw UR below 9.8% was in July 2009, but at that time activity rate was substantially lower. Moreover, The activity rate reached new peak with its 58% level and the number of employees are around the pre-crises levels close to 4 million people.

In a year time employment rate increased by 0.9ppt from 51.4% to 52.3%, while the unemployment rate decreased by 0.6ppt from 10.4% to 9.8%. Both in the male and female group we can identify substantial improvement, which is definitely positive.





Weekly preview

TUE 9:00 **CZ Retail Sales (change in %)**

	Sep-13	Aug-13	Sep-12
Sales	**4.1**	-0.3	-3.2
cummulative (YTD)	**0.0**	-0.5	-0.8

CZ: A greater number of business days and car sales drive trade upwards

Two additional business days in the month and decent new car sales likely sped up the rise in retail sales beyond 4%. E-commerce is likely to show another very strong increase, while brick-and-mortar shops likely also saw their sales go up, owing only to the above-mentioned effect of the number of business days in the month. Food and fuel sales, in particular, are likely to be less favourable, in our opinion. By and large, however, it is still true that the consumer mood and the adverse development of the real financial position of households are curbing consumption in this sector of the economy.

WED 9:00 **CZ Industry (y/y change in %)**

	Sep-13	Aug-13	Sep-12
Monhtly	**7.0**	1.6	-5.8
cummulative (YTD)	**-1.5**	-2.6	0.3

CZ: Industry at the mercy of carmakers

Just as in the retail sector, September's figures from industry were influenced by a greater number of business days in the month. In recent months, however, industry has benefited from rising foreign orders, notably among carmakers, thus making its way back into the black. We also expect positive figures in other sectors of industry, notably the plastics industry and the manufacture of metal products and electrical equipment. By contrast, we again expect poor figures in the mining industry. We will again see new orders, which stand a good chance of rising by approximately 10%, as the most important figure.

WED 9:00 **CZ Foreign trade (CZK bn)**

	Sep-13	Aug-13	Sep-12
Balance	**37.3**	20.6	30.0
cummulative (YTD)	**292.4**	255.1	233.8

CZ: Exports driven by cars

A positive turnaround in the sale of new cars on the European market, which has been fairly evident in recent months, has a positive impact on the performance of domestic industry as well as exports. Thus passenger car exports were likely again responsible for the anticipated trade balance improvement. Imports, curbed by poor domestic demand, still contribute to the increase in the foreign trade surplus. It is almost certain that this year's trade balance surplus will set a new record, this time at CZK 350 bn.

WED 14:00 **NBP rate (in %)**

	This	Last change
rate level	**2.50**	7/2013
change in bps	**0**	-25

PL: MPC meeting

The National Bank of Poland (NBP) will leave rates unchanged at its Wednesday meeting. While inflation still remains well below the central bank target, the figures from industry released in recent months have confirmed an economic recovery. Retail sales are also improving somewhat (though only slightly). We believe that the NBP will leave rates at all-time lows until the end of the year, with their first change (upwards) likely to occur in the late first half of 2014.

THU 14:00 **CNB base rate**

	This meeting	Last change
rate level (in %)	**0.05**	11/2012
change in bps	**0**	-20

CZ: No change in the CNB policy

Although Czech National Bank representatives have talked about the possibility of forex interventions to weaken the koruna for virtually a year, no actual intervention has taken place. Even so, the verbal interventions have worked as a reasonable curb, preventing the koruna from returning below CZK 25.50 per EUR. No doubt, the CNB Board will again vote on forex interventions at its November meeting, particularly if a new inflation forecast will indicate lower inflation for next year. Yet the way of encouraging inflation by weakening the koruna seems to be cumbersome and may in the end even have negative impacts on the incipient recovery of household consumption.

TUE 9:00	HU Industry (y/y change in		
	Sep-13	Aug-13	Sep-12
Monhtly	**2.5**	0.9	0.7

HU: Industry output should confirm recovery

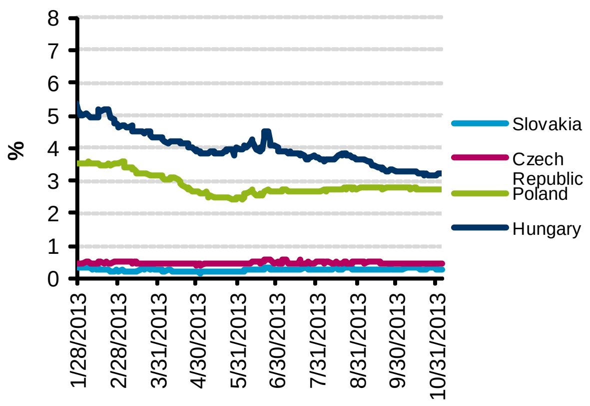
We expect 2.5% YoY growth of industrial production for September. The export is the main driver of the growth, mainly the car manufacture companies. The fall of production for domestic sales may moderate, but we still don't expect expansion from this area.

Calendar

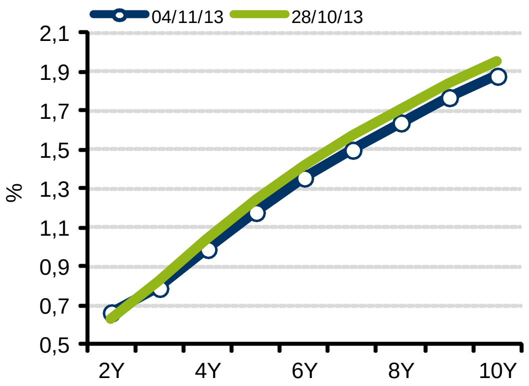
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	11/04/2013	9:00	PMI manufacturing		10/2013					54.5	
PL	11/04/2013	9:00	PMI manufacturing		10/2013					53.1	
CZ	11/05/2013	9:00	Retail sales	%	09/2013		4.1				-0.3
CZ	11/06/2013	9:00	Construction output	%	09/2013						-8.1
CZ	11/06/2013	9:00	Industrial output	%	09/2013		7				1.6
CZ	11/06/2013	9:00	Trade balance	CZK B	09/2013	37.3				20.6	
HU	11/06/2013	9:00	Retail sales	%	09/2013						1.5
PL	11/06/2013	14:00	NBP meeting	%	11/2013	2.5		2.5		2.5	
CZ	11/07/2013	13:00	CNB meeting	%	11/2013	0.05		0.05		0.05	
HU	11/07/2013	17:00	Budget balance	HUF B	10/2013					-949	
HU	11/08/2013	9:00	Industrial output	%	09/2013 *P					0.7	0.9
CZ	11/08/2013	9:00	Unemployment rate 15-64	%	10/2013	7.6				7.6	

Fixed-income in Charts

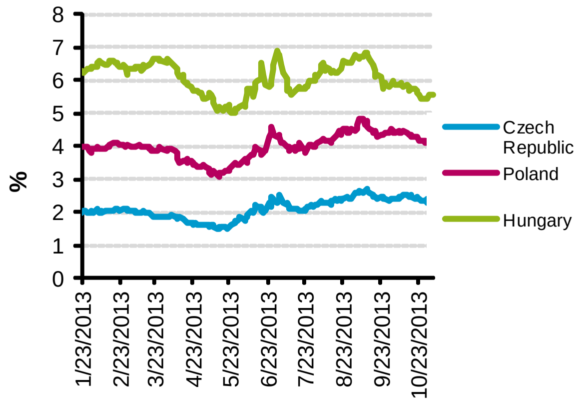
FRA 3x6



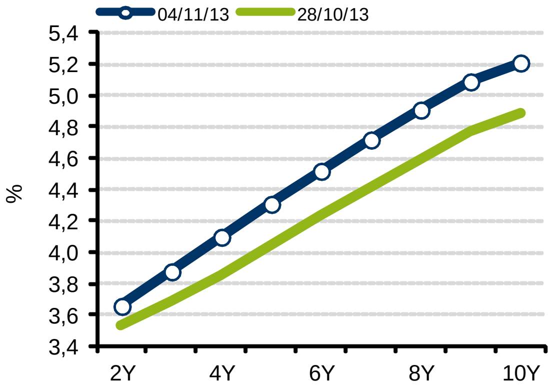
CZ IRS



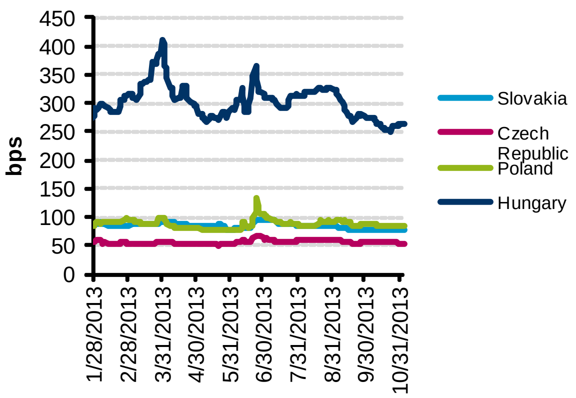
10Y GB Yields



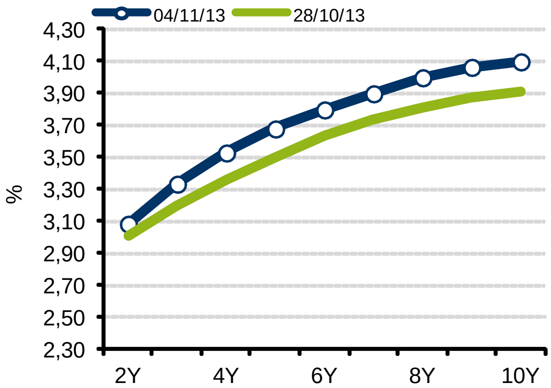
HU IRS



CDS 5Y



PL IRS



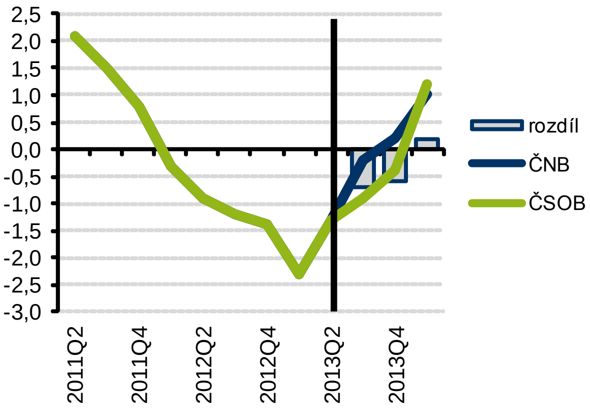
Source: Reuters

Medium-term Views & Issues

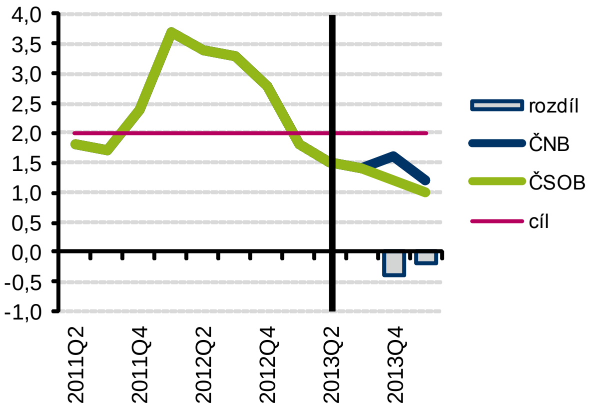
	The Czech Republic	Hungary	Poland
Growth & key issues	Three years after last elections the Prime Minister resigned and his cabined fell. With minor exceptions, the bulk of political scene in the CR refuses to call premature elections a less than year before regular parliamentary elections. Newly formed “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

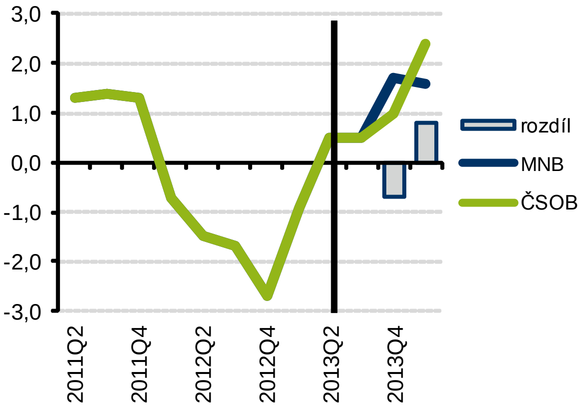
CZ: GDP outlook (Y/Y, %)



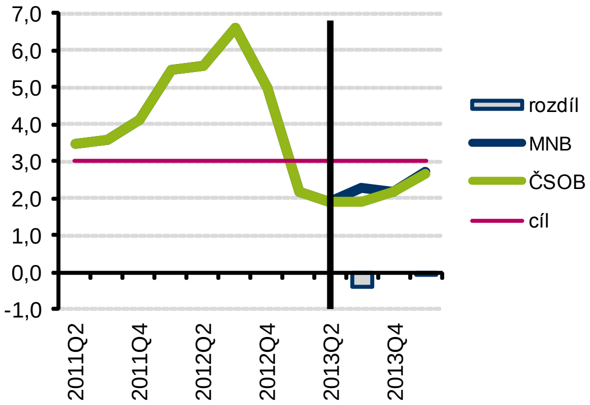
CZ: Inflation outlook (Y/Y, %)



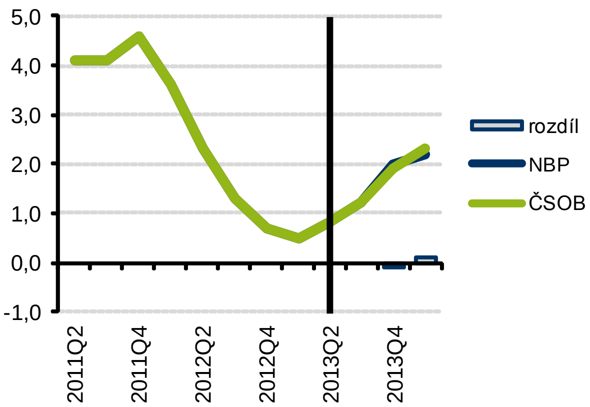
HU: GDP outlook (Y/Y, %)



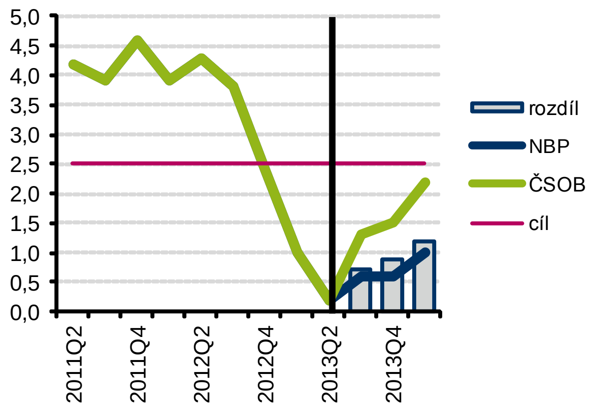
HU: Inflation outlook (Y/Y, %)



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.	*3.40*	5.75	5.00	4.25	3.60	3.75	-20 bps	10/29/2013
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	*0.44*	0.50	0.47	0.44	0.42	0.43
Hungary	BUBOR	*3.35*	5.75	4.90	4.20	3.56	3.50
Poland	WIBOR	*2.66*	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	*1.881*	1.37	1.31	1.97	2.06	2.15
Hungary	HU10Y	*5.19*	5.49	5.41	5.84	5.17	5.90
Poland	PL10Y	*4.10*	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	*296*	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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