Central European Weekly

Tuesday, 12 November 2013

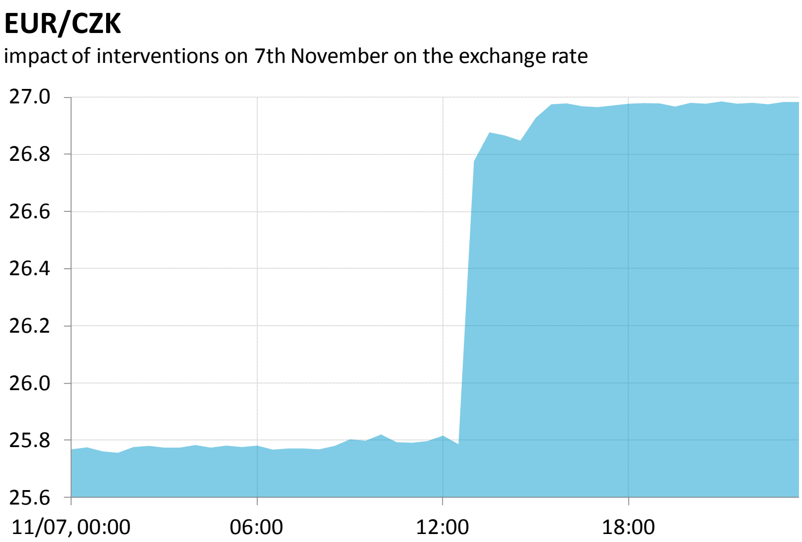
Table of contents

Weekly Highlights: 1
Chart of the Week 1
Market's editorial 2
Review of Economic Figures 3
In Focus: The CNB new macro projection 4
Weekly preview 5
Calendar 6
Fixed-income in Charts 7
Medium-term Views & Issues 8
CBs' Projections vs. Our Forecasts 9
Summary of Our Forecasts 10
Contacts 11

Weekly Highlights:

- Currency Wars : the CNB launches the Czech Episode
- The NBP signals a longer period of unchanged rates
- Further help for foreign-currency debtors in Hungary
- The CNB new macro projection

Chart of the Week



Year-on-year inflation rates diverge in Central Europe as Poland leads in the region, while the Czech inflation remain at the lowest levels.

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Market's editorial

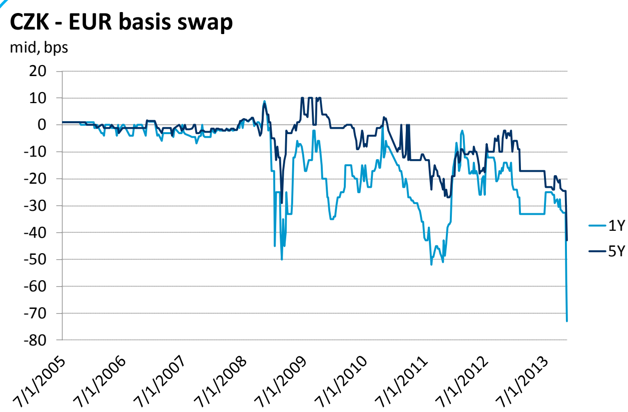
Currency Wars : the CNB launches the Czech Episode

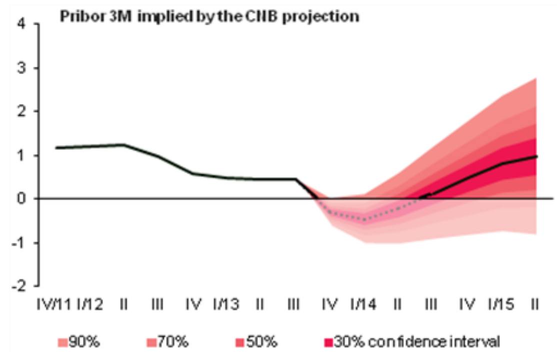
After a year of discussions and with an official rate at virtually zero, the Czech National Bank decided to use the Czech koruna actively as its policy tool. Many will see this as the start of a new episode in the currency war. The Bank Board announced it targets an EUR/CZK exchange rate of close to the 27.0 level. The new staff economic projections provided the trigger for the decision. They showed a further slide of inflation into negative territory for the monetary relevant inflation figure. The aim is to use the exchange rate as an additional monetary policy instrument to reach the 2% inflation target through either higher import prices or increasing postponed household consumption.

The CNB staff proposed, as usual, a baseline and an alternative scenario to the CNB Board. The baseline scenario, including negative interest rates, was considered as very unrealistic by the board, who decided, unusually, to follow the alternative scenario. This scenario put forward the use of FX interventions as a tool to steer economy and inflation. The CNB is unable to provide negative interest rates and thus chose for the alternative scenario, using the FX tool, to keep the koruna weak. The CNB is committed to intervene in such volumes and for such duration as required to keep the koruna weak, with the aim of hitting its inflation target in the medium term. This target for the exchange rate (close to EUR/CZK 27.0) has been set at such a level as to ensure that the central bank need not to change it anytime soon. The FEX target should be less frequent changed than interest rates were in the past. We expect it at least to remain unchanged until February when staff projections changes will be released. The CNB does not want to terminate its intervention regime until the bank is very certain that it will not need to re-launch the interventions. The Governor's comments on the press conference indicate that an exit is unlikely in 2014, a view we subscribe. Nevertheless, the CNB Board will formally vote on keeping or changing this regime and on the targeted level (EUR/CZK 27.0) at each of its monetary policy meetings (Dec 17th).

As concern the market reaction - the central bank truly surprised almost everybody. The koruna weakened on day one by almost 5%, ending almost spot on its target. Indeed, EUR/CZK moved to the 27.0 level due to the CNB interventions. It is estimated that the CNB bought already several billion euros into its forex reserves (the initial level of reserves was EUR 34bn). Following days and weeks will show how tolerant the CNB will be to any eventual koruna's strengthening. Naturally, room for koruna's easing remains unlimited like in the case of the Swiss franc (against the euro).

Regarding other markets – the huge forex (unsterilized) interventions created surplus of CZK liquidity, which flooded the koruna fixed-income market. As a result short-term CZK rates fell and one-was market, which wants to receive CZK rates brought so-called EURCZK cross-currency swaps into negative territory. We expect that this rare phenomenon will last some weeks or a few months.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*27.0*	*4.60%*	➔	➔
EUR/HUF	*297*	*0.33%*	➚	➚
EUR/PLN	*4.20*	*0.33%*	➚	➚

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*2.04*	*8.51*	➚	➚
10Y HUF	*5.45*	*6.24*	➚	➚
10Y PLN	*4.14*	*1.60*	➚	➚

Review of Economic Figures

The NBP signals a longer period of unchanged rates…

Unlike the CNB, the National Bank of Poland (NBP) sprang no significant surprises at its meeting. Leaving rates at all-time lows of 2.5% appeared to be very likely even before the meeting, and thus attention was quickly refocused onto the press conference, where NBP President Belka laid special emphasis on probably the most interesting innovation included in the official press statement, i.e., that rates should remain at the current level at least until the middle of next year (last time, the bank only suggested stability until the end of this year). Given that many in the market, including us, expected such a scenario, and the central bank essentially just ‘caught up with’ the market expectations, neither the zloty nor interest rates reacted significantly to the meeting.

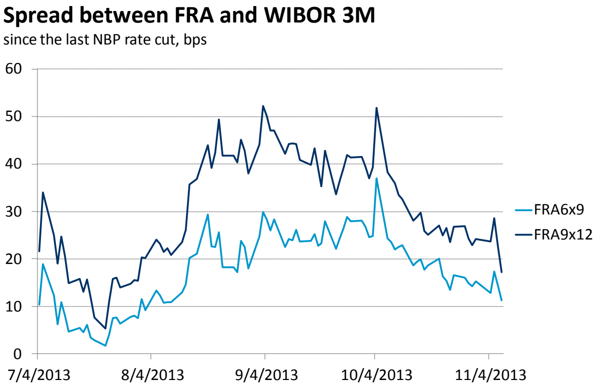
… and slightly improves its economic growth forecast

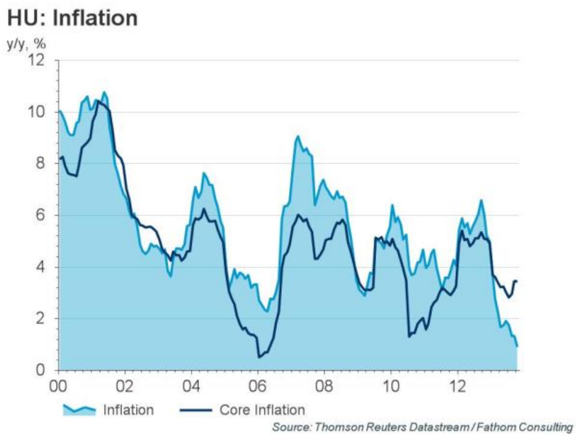
In its comment on the latest economic developments, the NBP recognised that economic growth was slowly recovering, and the bank even improved its forecast for 2014 accordingly. While the growth rate still remains slow by Polish standards, we believe that more detailed figures for the third quarter of the year, to be available in late November, should highlight greater balance in the growth structure. Growth should no longer depend on external demand alone, and a greater positive contribution may also come from household consumption (retail sales clearly went up in the third quarter). The contribution of investment is likely to remain negative, albeit even this has slightly improved recently, owing to the stabilising situation in construction.

Further help for foreign-currency debtors in Hungary

The Hungarian parliament approved the expansion of foreign currency denominated loan “rescue program”. From February 2014 those debtors who have more than 90 days delay of the monthly instalments, but less than 180 days can step into the existing fixation system, where the loan is calculated at 180 in case of CHFHUF and at 250 in case of EURHUF for five years. The differential between the market rate and fixed rate is accumulated on a new HUF loan account in case of the capital for 5 years, while the interest part is taken over half by the government and half by the banks. Additionally the government will give bank guarantee on the new HUF loan only if the banks cut back the size of the loan on the level of 95% LTV ratio for those who have more than 90 days delay. As the banks have already created provisions behind these loans it won’t create additional loss for the bank sector. The NPL ratio stays around 18%, so this opportunity may decrease the level of monthly instalments by more than 30% for more than 100thousand people, if they want to use this tool. Based on the NBH’s survey it is a big question, as 25% of the asked people are still waiting for better options, 20% has lack of confidence about the new loan and 30% has fear about that after 5 years their monthly instalments may jump substantially. So far (more than 1 year) 50% of the people – who are eligible – started to use this tool.

It will be interesting to see whether the above measures will help to boost the households’ consumption. The truth is that the public utility costs were decreased three times in 2013, which pushed inflation below 1% in October, so net real wage growth is above 4%. On the other hand the households’ consumption is still subdued, so based on some available monthly figures it looks like that government spending (road, stadium etc.), agriculture and export driven by the car manufacturer companies may be the main drivers of GDP performance.





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In Focus: The CNB new macro projection

The CNB Board refused negative rates and attacked the koruna.

At its last meeting, when the Czech National Bank essentially launched exchange rate targeting, there were two inflation forecast scenarios available to the CNB Board. The bank evaluated the first, the baseline scenario, as being unlikely, because it unrealistically envisaged negative market interest rates. As the CNB has already exhausted its ability to use interest rate instruments, having cut its base rate to almost zero and with cutting the rate into negative territory being out of the question, the bank's concerns about a failure to meet its inflation target or even about deflation have not disappeared.

The objective is to stir up inflation and encourage consumer spending.

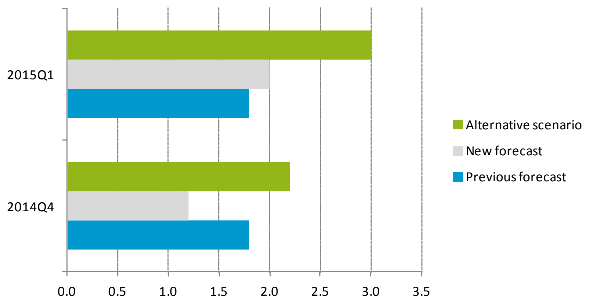
Hence the CNB does not see the baseline scenario of the forecast as realistic, and therefore the CNB Board had to switch to an alternative scenario, envisaging exchange rate interventions. According to the Governor, the alternative scenario is "the most probable description of expected future economic developments". This scenario envisages the depreciation of the koruna to close to CZK 27 per EUR, which will facilitate an earlier return of headline as well as monetary relevant inflation to the central bank target. As a side effect, GDP growth will recover more quickly and short-term market interest rates will be maintained at approximately their existing level. Owing to the FX interventions, inflation should climb to 2% in about a year. Through the weak koruna, i.e., increased import prices, the CNB thus wishes to stir up inflation in the CR, while also targeting 'consumption postponed for speculative reasons'.

The depreciation of the koruna by approximately 5% in one day, and the subsequent maintenance of the currency at such weak levels, will certainly have an impact on consumer prices as early as before Christmas. Fuel prices are likely to respond first. Afterwards, the weak koruna will also affect the prices of imported consumer goods, such as shoes, clothing, home electronics, and certain foods, etc. Therefore this price increase should actually offset the positive impact of this year's reduction of telecommunication and energy prices, stemming from competitive pressure and technological progress. Even domestic goods made of foreign components or materials may be affected by the weakened koruna. There is probably no need to elaborate on the fact that the weak koruna will also affect consumers buying goods and services while travelling abroad or buying them in foreign e-shops.

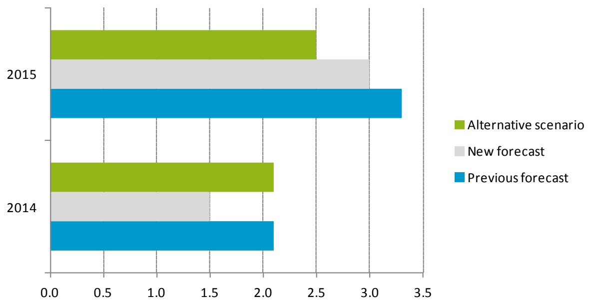
The first attack was successful and the market is getting used to the weak koruna.

The CNB does not want to terminate its intervention regime until the bank is very certain that it will not need to launch the interventions again, i.e., "until inflation pressures increase significantly". The Governor's comments for the press conference indicated that an exit is unlikely in 2014. For the sake of completeness, we should add that the CNB Board will vote on keeping or changing this regime at each of its monetary policy meetings. The central bank truly succeeded in surprising financial markets on Thursday. The koruna weakened by almost 5%, up to its target level. And even though the CNB is not going to release more information about its FX market operations in the future than it has released to date, it essentially confirmed that it had to intervene on the very first day of the new regime.

CNB forecast: Inflation
(Source: CNB)



CNB forecast: GDP
(Source: CNB)



Weekly preview

THU 9:00 **HU GDP (change in %)**

	2013Q3	2013Q2	2012Q3
GDP (y/y)	**1.0**	0.5	-1.7

HU: Growth supported by government's actions

The base for the first estimation of 3Q13 GDP is very low as last year GDP fell by 1.7% YoY. The outlook improved during previous months thanks to the better economic environment and the government's measures. While the public utility costs were decreased three times in 2013, which pushed inflation below 2% and net real wage growth above 4%, figures it looks like that government spending (road, stadium etc. constructions), agriculture and export driven by the car manufacturer companies may be the main drivers of 3Q13 GDP performance.

THU 9:00 **CZ GDP (change in %)**

	Q3-13	Q2-13	Q3-12
GDP (q/q)	**0.3**	0.6	-1.3
GDP (y/y)	**-0.7**	-1.3	-2.3

CZ: The economy continues to recover

The first preliminary GDP forecast for the third quarter of the year should confirm the improving condition of the Czech economy. While we do not expect the reoccurrence of the previous strong figure (+0.6% q/q for the second quarter), as it was significantly influenced by extraordinary effects, we will consider growth of around 0.3% to be very decent. We expect that growth will be primarily fuelled by the manufacturing industry on the one hand, and by exports on the other. The impact of consumer and investment demand is unlikely to be that strong.

THU 10:00 **PL GDP (y/y change in %)**

	2013Q3	2013Q2	2012Q3
GDP	**1.6**	0.8	1.3

PL: Poland's economic growth accelerates

While the rate of economic growth still remained slow in the third quarter of the year, by Polish standards, having reached 1.6% y/y according to our forecasts, more detailed figures for the third quarter, which will not be available before late November, may highlight greater balance in the growth structure. Growth should no longer depend on external demand alone, and a greater positive contribution may also come from household consumption (retail sales clearly went up in the third quarter). The contribution of investment is likely to remain negative, albeit even this has slightly improved recently, owing to the stabilising situation in construction.

THU 14:00 **PL Inflation (change in %)**

	Oct-13	Sep-13	Oct-12
CPI y/y	**1.1**	1.0	3.8
Food (ex Alc.) y/y	**2.5**	2.6	4.7
Transport (including fuel)	**-1.2**	-1.4	6.0

PL: Inflation returns to 1.1%

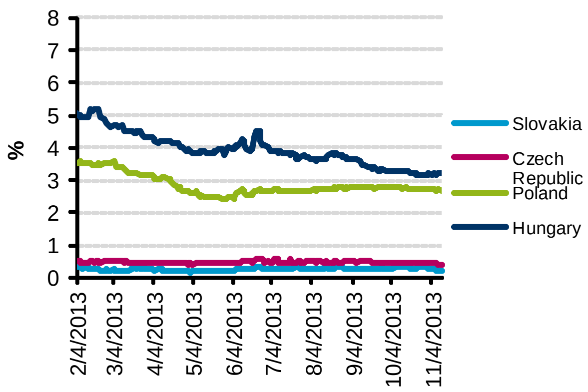
According to our forecasts, Poland's inflation returned to 1.1% y/y in October after a one-month break. The main contributors to the month-on-month price rise by 0.5% included the rise in food prices, although the rise might be slightly lower than usual for October. Clothing and shoe prices probably also rose significantly on the month-on-month basis (+3.5%), while we believe that a decline in oil prices led to a slower than usual rise in transport prices.

Calendar

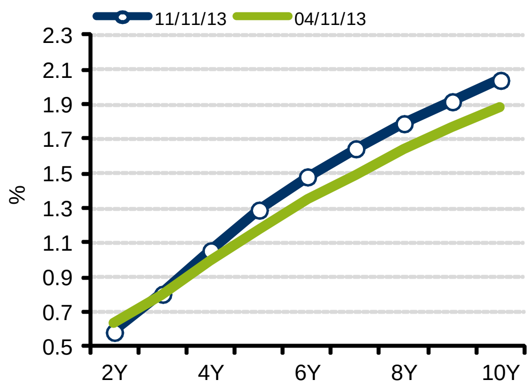
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	11/11/2013	9:00	CPI	%	10/2013	0.1	0.9	0.1	0.9	-0.4	1
HU	11/12/2013	9:00	CPI	%	10/2013			0.1	1.4	0.5	1.4
CZ	11/12/2013	10:00	Current account	CZK B	09/2013	3		-1		-14.2	
PL	11/12/2013	14:00	Current account	EUR M	09/2013			-905		-719	
PL	11/12/2013	14:00	Trade balance	EUR M	09/2013			550		264	
HU	11/14/2013	9:00	GDP	%	3Q/2013 *P			0.4	0.7	0.1	0.5
CZ	11/14/2013	9:00	GDP	%	3Q/2013 *A	0.3	-0.7	0.6	-0.4	0.6	-1.3
PL	11/14/2013	10:00	GDP	%	3Q/2013 *P		1.6	0.9	1.8	0.4	0.8
PL	11/14/2013	14:00	Money supply M3	%	10/2013			0.8		-0.3	
PL	11/14/2013	14:00	CPI	%	10/2013	0.5	1.1	0.3	1	0.1	1
HU	11/15/2013	9:00	Industrial output	%	09/2013 *F					1.8	3.1
CZ	11/15/2013	9:00	PPI	%	10/2013	0.1	0.5	0	0.4	0.1	0.6
PL	11/15/2013	14:00	Core CPI	%	10/2013			0.3	1.3	-0.1	1.3
PL	11/15/2013	15:00	Budget balance	PLN M	10/2013					-29602	

Fixed-income in Charts

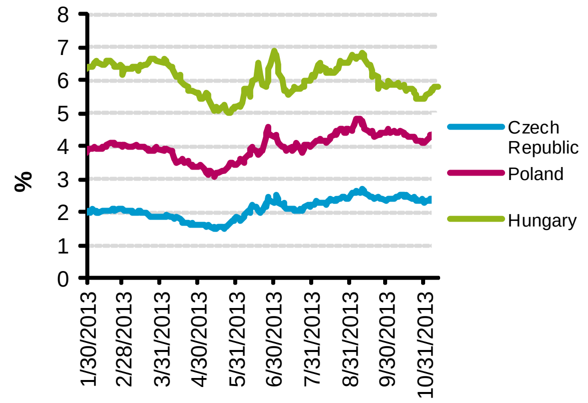
FRA 3x6



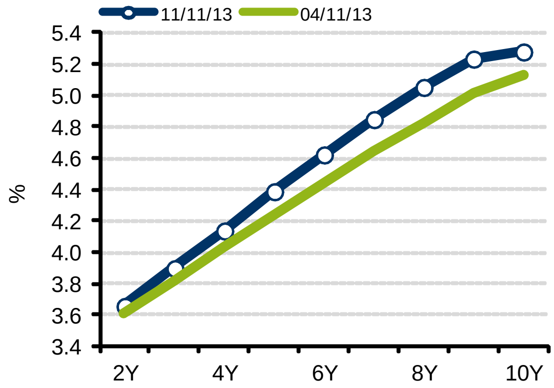
CZ IRS



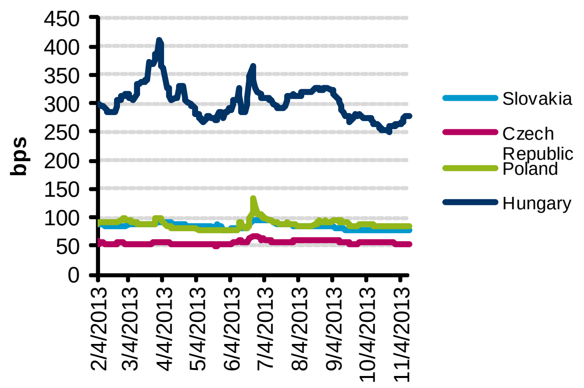
10Y GB Yields



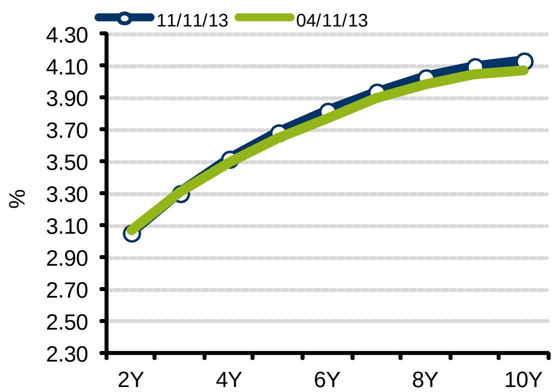
HU IRS



CDS 5Y



PL IRS



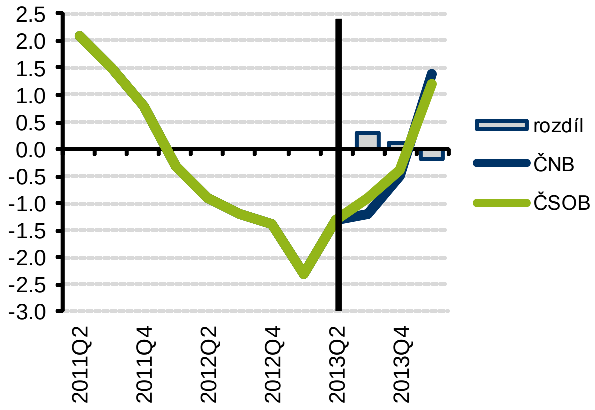
Source: Reuters

Medium-term Views & Issues

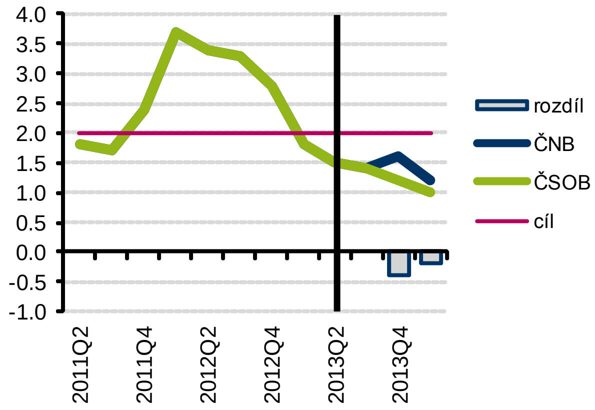
	The Czech Republic	Hungary	Poland
Growth & key issues	Three years after last elections the Prime Minister resigned and his cabined fell. The 2014 budget will be determined by the new Chamber of Deputies that comes out of the early election. After six consecutive quarters of falls the cyclical leading 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 started FX interventions. The CNB expects that the economy will fall this year by 1% and grow a bit faster next one (2.1 %). The rates should stay at technical zero for extended period.	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 CNB has started FX interventions and we expect the koruna to stay within the regime at least till mid 2014. Hence the currency should stay around 27.00 EUR/CZK at least in 6-month horizon. When the FX targeting regime is set to be abandoned, it may be difficult for CNB to stop the currency from fast appreciation.	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

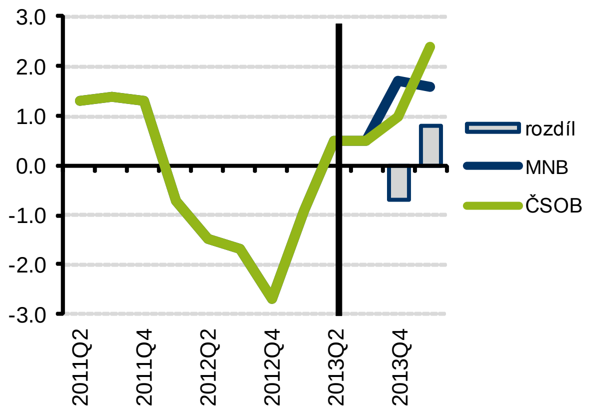
CZ: GDP outlook (Y/Y, %)



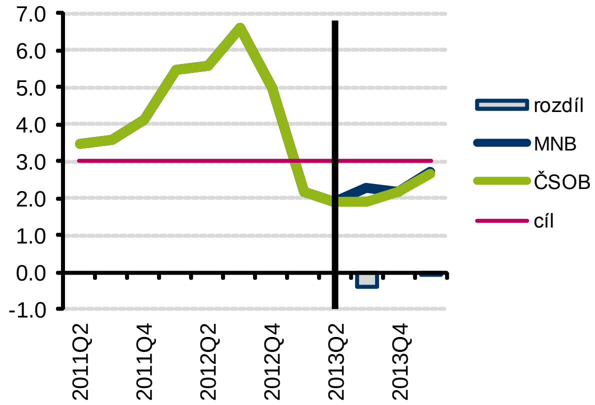
CZ: Inflation outlook (Y/Y, %)



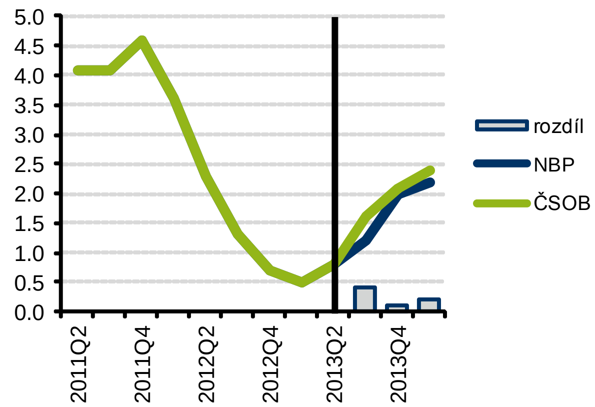
HU: GDP outlook (Y/Y, %)



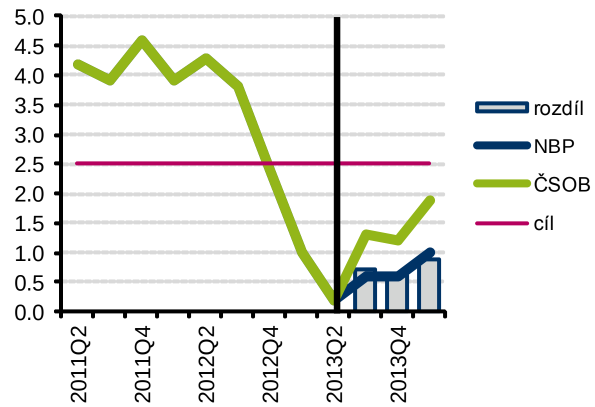
HU: Inflation outlook (Y/Y, %)



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	*0.43*	0.50	0.47	0.44	0.42	0.43
Hungary	BUBOR	*3.36*	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	*2.041*	1.37	1.31	1.97	2.06	2.15
Hungary	HU10Y	*5.45*	5.49	5.41	5.84	5.17	5.90
Poland	PL10Y	*4.14*	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	*27.0*	25.1	25.7	26.0	25.7	27.0
Hungary	EUR/HUF	*297*	291	304	295	297	300
Poland	EUR/PLN	*4.20*	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	1.6	2.1

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	1.2

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

Contacts

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	Brussels	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Joke Mertens	+32 2 417 30 59	Commercial Desk	+32 2 417 53 23
Mathias van der Jeugt	+32 2 417 51 94	Institutional Desk	+32 2 417 46 25
Dublin Research			
Austin Hughes	+353 1 664 6889	London	+44 207 256 4848
Shawn Britton	+353 1 664 6892	Frankfurt	+49 69 756 19372
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