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Central European Weekly

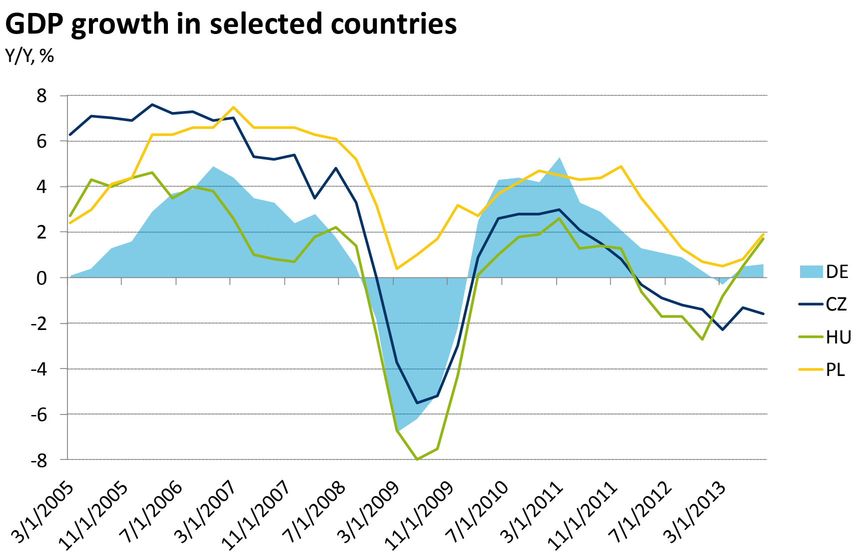
Monday, 18 November 2013

Table of contents

Weekly Highlights:

- The Czech economy – the sick man of Central Europe?
- The Hungarian economy gathers momentum
- Hungary's and Poland's inflation fall below 1%

Chart of the Week



Year-on-year GDP growth accelerated in Hungary, Poland and Germany while the Czech one dipped deeper below zero in the third quarter. (Source: CSU, KSH, GUS, SB, CSOB)

Market's editorial

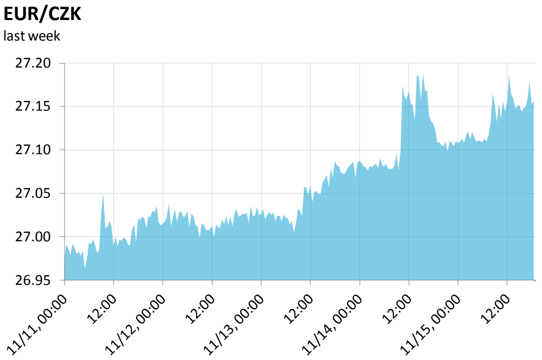
The Czech economy – the sick man of Central Europe?

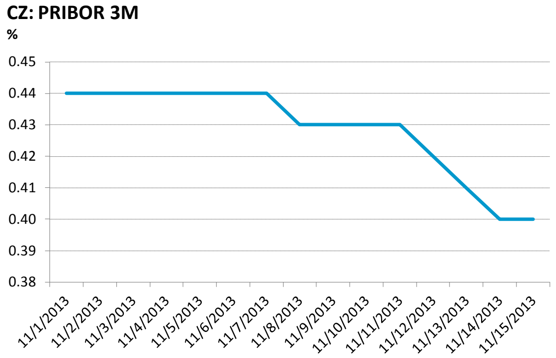
The GDP data for the third quarter of the year stirred up the stabilising situation of the Central European region. Moreover, what stands out is an evident divergence between the languishing Czech economy, on the one hand, and the recovering Hungarian and Polish economies on the other.

Bear in mind that the Czech GDP fell by 0.5% vis-à-vis the second quarter and by as much as 1.6% y/y (see the next page). The stockpiling of oil products, which was evident in higher imports ahead of the introduction of mandatory security deposits, might play a negative role. However, even if we disregard this one-off factor, the development of the Czech economy appears to be very sad in the regional comparison, as the other economies in Central Europe are obviously growing. Not only are Germany and Poland standing on their feet, but even the previously vulnerable Hungarian economy is recovering strongly, with growth of 1.7% y/y. In other words, the persisting economic downturn clearly makes the Czech Republic the sick man of the region.

EUR/CZK above the 27.0 level even without interventions

From the market point of view, the question is whether this means anything to the Czech National Bank, which launched a new round of its expansive policy the week before last, with the aim of helping the Czech economy out by deliberately weakening the koruna. Just as we did, the central bank's baseline as well as alternative scenarios envisaged a continuing recovery and a year-on-year decline by only 0.8% (rather than -1.6%). No wonder that part of the market has started to talk about the possibility of the central bank weakening its target for the koruna even more in the future. Although we do not expect anything like that, such bets may tend to keep the koruna above the EUR/CZK 27.00 in the weeks and months to come, particularly if inflation surprises the CNB by falling significantly in January.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.2	0.40%	↘	↘
EUR/HUF	297	-0.54%	↘	↘
EUR/PLN	4.18	-0.81%	↘	↘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.97	-3.19	↗	↗
10Y HUF	5.22	-5.52	↗	↗
10Y PLN	4.09	-1.09	↗	↗

Review of Economic Figures

The Czech economy back in the red

The Czech GDP fell by 0.5% vis-à-vis the second quarter of the year, and even by 1.6% y/y. These figures have been adjusted for a different number of business days in the month. Fairly favourable figures for the second quarter were followed by the cold shower of a GDP fall by 0.5% in the third quarter. The Czech economy is still being dragged down by poor investment, curbed by the public sector as well as private businesses, meaning that the investment trend is not changing unfortunately. Not even household consumption, affected by the persisting adverse development of the financial position of households, has helped the economy. Long-term demand will hardly recover as long as real income fails to rise and people are afraid of losing their jobs. Foreign trade, which we used to see as the driver of the Czech economy, also had an adverse impact this time. By contrast and in line with expectations, it was no surprise to see that the economy was still primarily fuelled by the manufacturing industry, while the rest of the economy has not started to recover yet. Thus, owing to the market recovery and rapid innovations, the automotive industry is again returning to a good condition, driving the performance of industry as well as exports upwards. The Czech GDP data certainly does not look good, as it suggests that the economy lacks a reasonable growth rate to eliminate its previous losses completely. A recovery is still not evident in services, not to mention construction. We can only be pleased by the figures if we forget that the third quarter of this year included three additional business days.

The Hungarian economy accelerates further

One huge surprise delivered from the Hungarian economy was the GDP figure for the third quarter. Recall that GDP accelerated from 0.5% Y/Y growth in 2Q13 to 1.7% Y/Y in 3Q13. Although further details of the GDP were not published yet, but based on some monthly available data we can make some conclusion, what could boost Hungarian economy in 3Q13 beside of the very low base. Most likely the main drives of the growth from supply side were industrial production, construction and agriculture. The construction increased around 10% Y/Y in 3Q13 thanks to road, railway and other public investments. The industrial production is boosted by the car manufacturer companies, while agriculture had an average year after the very weak harvest in 2012. On the demand side the biggest open question, which we can answer now, that what was the contribution of the households consumption to the GDP growth. What we can see that net export and investments thanks to the above mention public constructions and orders played important role in the accelerating economic performance.

The trend is definitely positive in short term, despite of the weaker European conjuncture. Hungary had one of the highest GDP growths in 3Q13 and as parliamentary election in coming in 2014, the government may do everything to maintain the relatively good performance. The NBH's funding for lending program may boost the economy by 0.2-0.4% Y/Y in the following quarters; the net real wage growth (around 3-4% Y/Y) may help the domestic consumption, while public investments are likely to continue at least till mid-2014. Additionally there were temporary stop of production in some industrial sectors end of last year, which provides very low base for this year, so we expect around 2.5% Y/Y GDP growth for 4Q13 and around 1% Y/Y average growth for 2013, which may accelerate to around 1.6% Y/Y in 2014.

Polish economy outperforms its peers

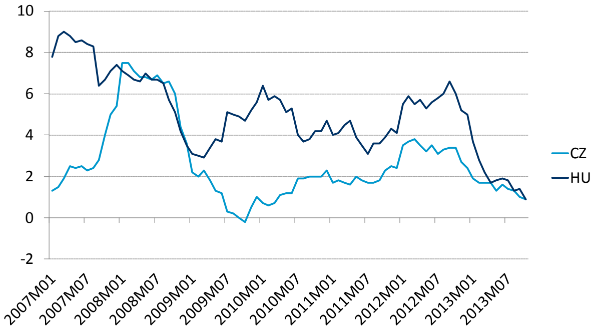
Preliminary estimates of the Polish statistical office (GUS) showed that the economy grew by 1.9% Y/Y in the third quarter, i.e. slightly better result than both we and market expected. On quarter-on-quarter basis, the economy grew by 0.6% Q/Q. The most significant change we expect from detailed Q3 figures (that will be released along with revision of preliminary estimates on 29th November) in comparison with previous ones is significant positive contribution of domestic consumption to GDP growth.

Hungary's and Poland's inflation fall below 1%

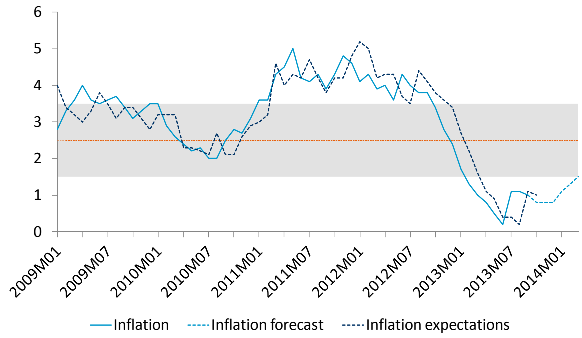
The year-on-year price rise in Poland returned to less than 1% in October, and this surprised us as well as the market on the downside. The main reason for the slow month-on-month price rise was a negligible decline in food prices, which we had not expected: instead of their seasonally typical rise by nearly 1%, food prices even fell slightly. A 1% decline in transport prices sprang a similar surprise. By and large, prices were up by 0.2% m/m. The overall price rise in Poland remains subdued (notably if compared to previous years), and an inflation rise to at least the lower threshold of the tolerance band of the National Bank of Poland has been postponed, likely to the end of the first quarter of next year.

The Hungarian consumer price index slowed from 1.4% year-on-year in September to 0.9% year-on-year in October vs. market expectation of no change. The main reasons behind the lower inflation are mainly non-core elements, like fuel, energy and regulated prices, but inflation is very low in the group of tradable goods as well. Core inflation moderated from 3.5% Y/Y in September to 3.4% Y/Y in October and it was only once below 3% Y/Y (in July) this year. As the government approved and implemented further cut (11%) of prices of energy prices (gas, electricity and district heating) from November, moderated the VAT of pork from 27% to 5% from January, reduced the price of public transport by 10% in the Budapest, cash withdrawal will be free tow times per months for households up to HUF 150,000 from February, CPI may drop below 0.5% Y/Y in November and average inflation may be around 1.5% Y/Y in 2014.

Rate of inflation
Y/Y, %



PL: Inflation and inflation expectations
Y/Y in %; NBP tolerance band is grey, inflation target is orange dotted line

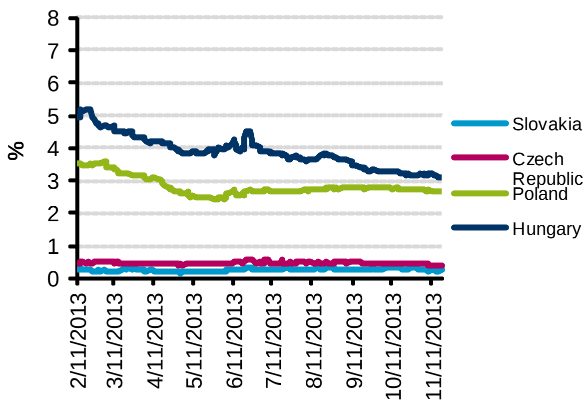


Calendar

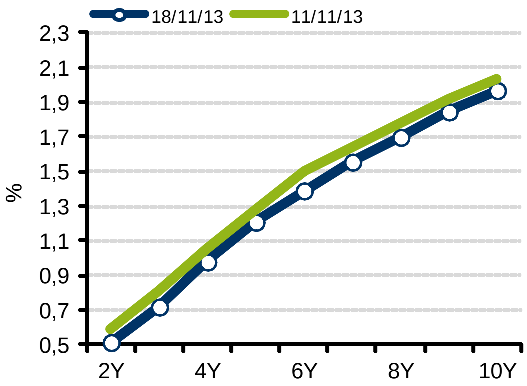
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	11/19/2013	14:00	Wages	%	10/2013			1.5	2.9	0.3	3.6
PL	11/21/2013	14:00	Industrial output	%	10/2013			6.1	4.4	9.6	6.2
PL	11/21/2013	14:00	PPI	%	10/2013			-0.3	-1.2	0.2	-1.4

Fixed-income in Charts

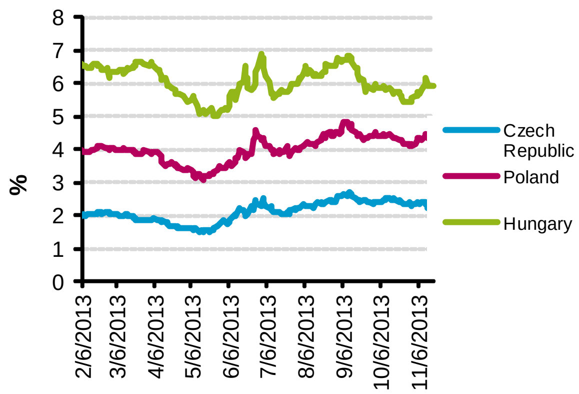
FRA 3x6



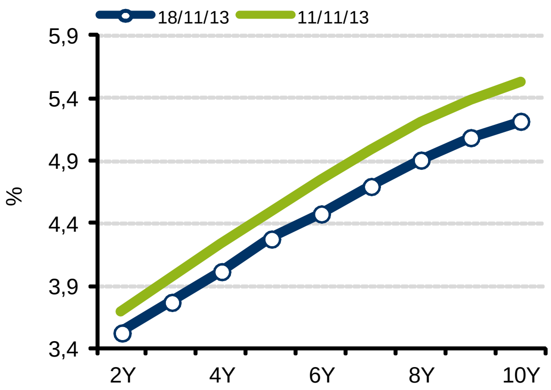
CZ IRS



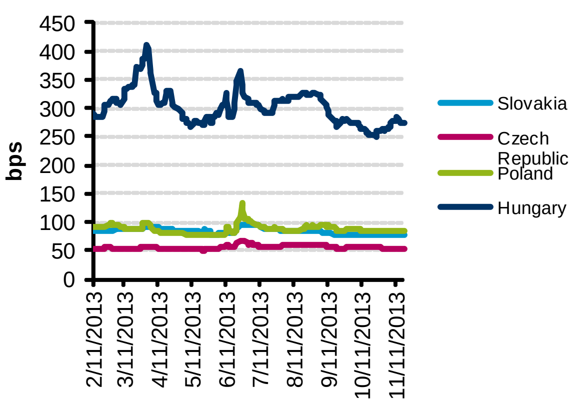
10Y GB Yields



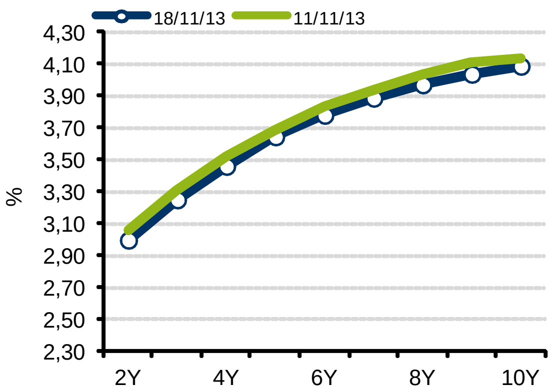
HU IRS



CDS 5Y



PL IRS



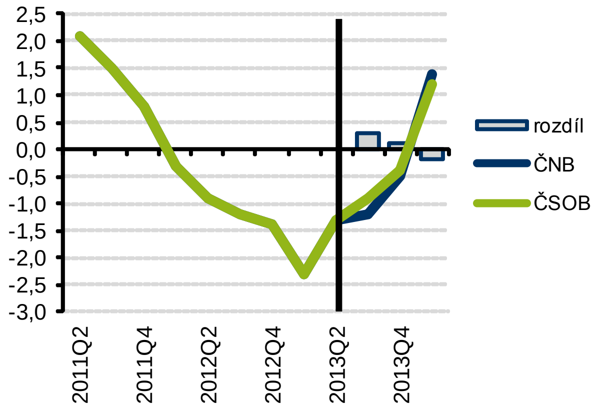
Source: Reuters

Medium-term Views & Issues

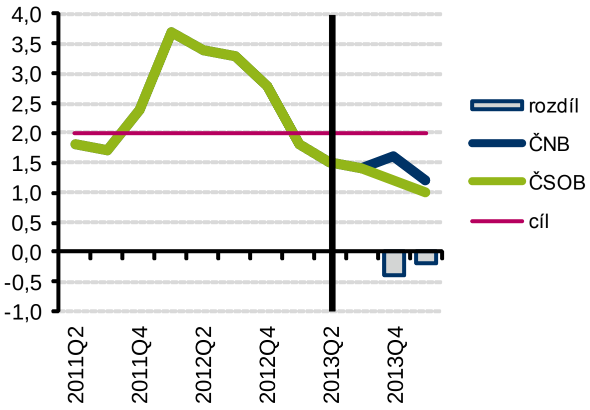
	The Czech Republic	Hungary	Poland
Growth & key issues	The CR is still led by a government that has stepped down, while the negotiations by winners of the early election have begun only recently, hence it is too soon to predict what exactly the economic policy of the future government will look like. The CR is unlikely to avoid an interim budget in early 2014, but this alone should not prevent the economy from growing soon. As confirmed by production statistics, industry continues to drive the economy; however, agriculture, construction and services dragged the economy back into the red in Q3.	As elections are coming in 2014, the government may do everything to maintain the relatively good performance. The NBH's funding for lending program may boost the economy by 0.2-0.4% Y/Y in the following quarters; the net real wage growth may help the domestic consumption, while public investments are likely to continue at least till mid-2014. Additionally there were temporary stop of production in some industrial sectors end of last year, which provides very low base for this year, so we expect around 2.5% Y/Y GDP growth for 4Q13 and around 1% Y/Y average growth for 2013, which may accelerate to around 1.6% Y/Y in 2014.	According to the preliminary estimates, the Polish economy grew by 1.9 % Y/Y and 0.6% Q/Q in the third quarter 2013. Although the figures might be revised along with the release of detailed information on 29th November, it is clear that the economy bottomed-out in the second quarter. Moreover, detailed information should confirm a return to more balanced structure of growth, which should be driven not only by export-oriented industry but also by domestic consumption.
Outlook for official & market rates	The CNB has completely exhausted the possibility of easing its monetary policy through interest rates, and therefore it has decided to weaken the koruna and keep it close to CZK 27 per EUR. Statements from the CNB representatives indicate that the CNB would like to maintain that level for a prolonged period, until strong inflation pressures become evident in the economy. The CNB believes that the depreciation of the koruna should enable the economy to avoid deflationary pressures and boost its growth up to 2.1% next year.	GDP and inflation figures clearly leaves to door open for further cut of base rate especially the ECB and FED also may continue loose monetary policy. So we maintain our expectation that NBH may cut base rate by 20bp from 3.4% to 3.2% on 26 November and most likely to 3% in December, but after it NBH may slow down further the rate cut cycle even if international sentiment remains positive and supportive for Hungary.	Inflation pressures in Poland remain subdued and year-on-year prices growth is seen well below the lower tolerance band of the inflation target. On the other hand, improving prospects of the Polish economy were confirmed by preliminary estimates of GDP for the third quarter. Better GDP should persuade members of the Monetary Policy Council to stick to forward guidance given at the November meeting, i.e. promise to keep interest rates unchanged until the end of the first half of 2014.
Forex Outlook	The CNB has started FX interventions and we expect the koruna to stay within the regime at least till the end of 2014. Hence the currency should stay above 27.00 EUR/CZK at least in 12-month horizon. When the FX targeting regime is set to be abandoned, the CNB will have to intervene on the market much more aggressively to stop the spot koruna from appreciation. As a side effect, the forward koruna can appreciate significantly before the regime is abandoned.	While on one hand the forint could be constrained by relaxed NBH's policy, on the other it can profit from loose ECB's and Fed's policies. So, we see the EUR/HUF traded in the range and we expect low volatility. The narrow range at the moment is between 296.5 and 300, the wider range is 292 and 302. We don't expect to break out from this range for the next weeks, we would rather bet on short term on some strengthening.	Low inflation pressures and improving prospects of the economy may support the zloty in months ahead. The Polish currency might perform particularly well in comparison with the koruna as the room for koruna's appreciation remains virtually closed and the economic recovery in Poland is likely to continue. In our view, Fed's QE tapering remains the main risk for the zloty.

CBs' Projections vs. Our Forecasts

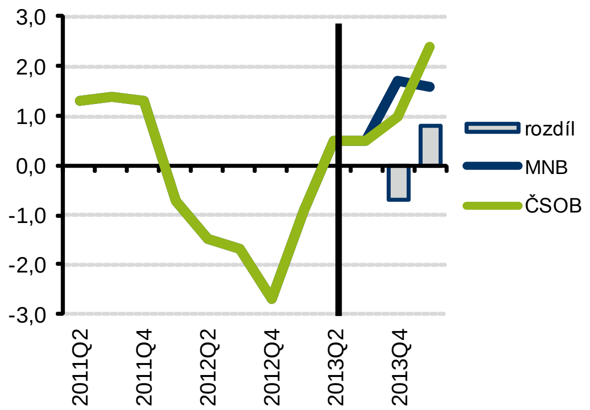
CZ: GDP outlook (Y/Y, %)



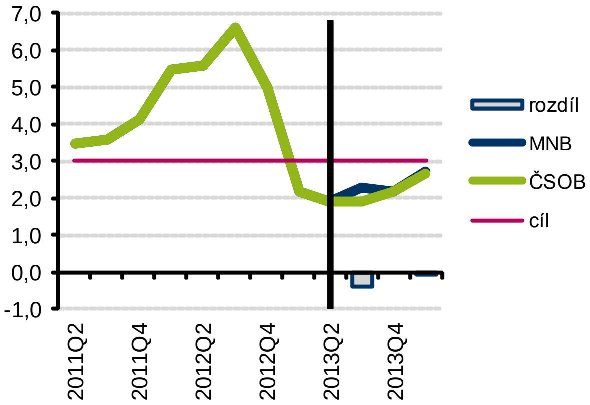
CZ: Inflation outlook (Y/Y, %)



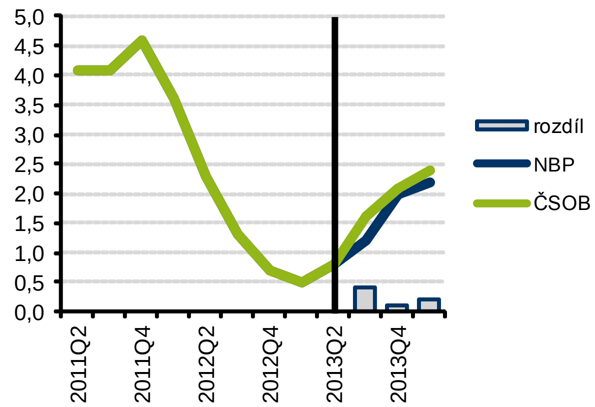
HU: GDP outlook (Y/Y, %)



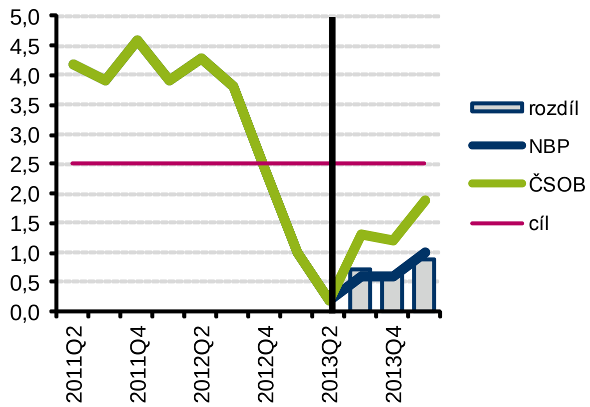
HU: Inflation outlook (Y/Y, %)



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	*0.40*	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	*2.65*	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	*1.97*	1.37	1.31	1.97	2.06	2.15
Hungary	HU10Y	*5.22*	5.49	5.41	5.84	5.17	5.90
Poland	PL10Y	*4.09*	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	*27.2*	25.1	25.7	26.0	25.7	27.0
Hungary	EUR/HUF	*297*	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	1.6	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

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