



Central European Weekly

Monday, 02 December 2013

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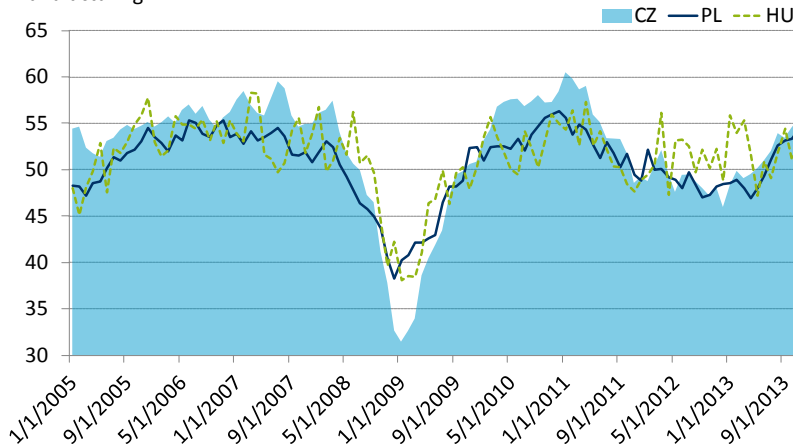
Weekly Highlights:

- The Hungarian forint at week lows after a dovish hit from the NBH President
- PMI and GDP details point to stronger recovery in Poland
- Short-term view on the CZK remains bearish as a cut in energy prices send inflation into negative territory
- Preview: the NBP firmly on hold

Chart of the Week

CE: Purchasing Managers' Indices

manufacturing



HSBC PMI's point to further improvement in manufacturing across Central Europe.

Market's editorial

Is NBH's mantra of the stable and firm HUF dead?

Both the forint and the Czech koruna weakened quite significantly last week. Although the reasons for the depreciation of the Hungarian and Czech currencies were domestic, they were essentially common to both countries, based on a monetary policy, which, owing to super-low inflation, is not troubled by a weak currency now. The Czech National Bank's effort to weaken the local currency is even an explicit instrument. For the National Bank of Hungary a weak local currency had been a double-edged sword until recently, as the depreciation of the forint made the payments of previously taken household loans in Swiss francs and euros more expensive; however, with the declining volume of those loans, the NBH is also likely to be more courageous in its statements against the forint. The latest statement by the NBH Governor, by which he significantly weakened the forint, may be such a signal.

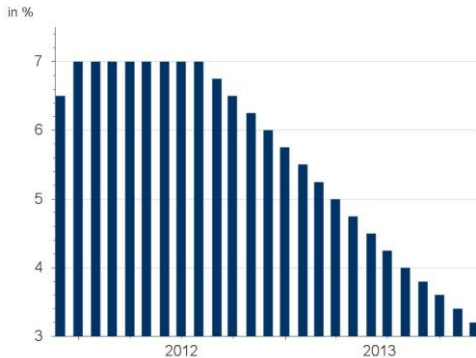
Nonetheless, this week is likely to be more interesting for the releases of 'soft' cyclical data about business

sentiments, specifically PMI indices. The latest hard data, notably from Poland and partly from Hungary, indicated that the economic recovery in the region was gaining momentum. November's PMI data have confirmed that impression, which might lead to stabilization of both the forint and koruna. On the other, in the latter case is a question whether the Czech currency might experience some relief.

Short-term view on the koruna remains bearish as a cut in energy prices will send inflation into negative territory

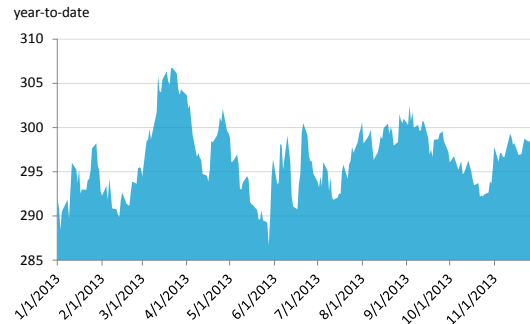
On Friday, interesting news came from the Czech Energy Regulatory Office which announced that the price of electricity would fall by 10.9 on average as of January 2014. This fact may push Y/Y inflation below zero at the beginning of 2014 and probably trigger market speculations about a shift of the EUR/CZK exchange rate floor (27.0) set by the central bank. In our view, at the end of the day it will not happen), but the Czech currency might remain weak meanwhile.

HU: NBH base rate



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.4	0.48%	→	↗
EUR/HUF	303	1.55%	↗	→
EUR/PLN	4.20	0.01%	↗	→

EUR/HUF



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.06	1.99	→	↗
10Y HUF	5.61	5.45	→	↗
10Y PLN	4.29	3.01	→	↗

Review of Economic Figures

Economic growth in Poland gains momentum

GUS confirms Poland's economic growth of 1.9% y/y in Q3

Revised data from Poland's Statistical Office (GUS) on GDP growth in the third quarter of the year confirmed the flash forecast released in the middle of the month (1.9% Y/Y) as well as our hypothesis that household consumption had also significantly contributed to growth for the first time in a longer while. Household consumption, along with a slightly positive contribution of investment, is likely the most positive information. The GDP grew by 0.6% vis-à-vis the second quarter, the fastest rate since the last quarter of 2011.

Household consumption is a great contributor while investment also contributes positively

While the contribution to year-on-year GDP growth continued to be dominated by net exports (+1.4 percentage point), the above-mentioned household consumption contributed 0.6 percentage point (pp), its greatest positive contribution since the second quarter of 2012. This even exceeded the contribution of public expenditure to consumption. We were slightly surprised by a negligibly positive contribution of investment (+0.1pp), which occurred in spite of another year-on-year drop in gross value added in construction, albeit it was a shade lower

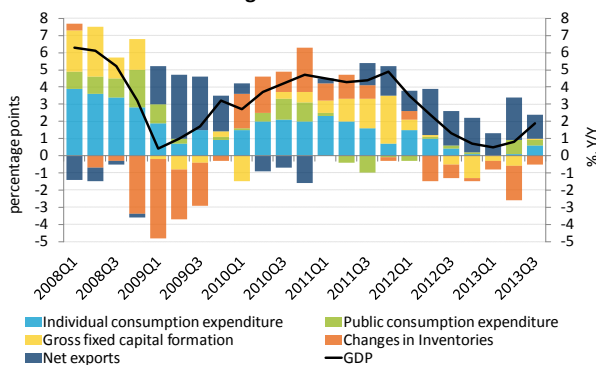
than in the second quarter (this is due to the huge investment in the infrastructure ahead of last year's UEFA European Championship). The only component with a negative contribution to GDP growth was again inventory (-0.5pp).

Figures from the Statistical Office have confirmed that the Polish economy is out of the woods and that its growth is starting to be based on more robust foundations. Regarding growth in the following quarters, the above-mentioned elimination of inventories for a sixth consecutive quarter, which is not a sustainable trend, may also be positive in the end. For this year as a whole, the Polish economy should grow by approximately 1.4%, despite its poor performance at the beginning of the year.

Even November's PMIs point to further improvement

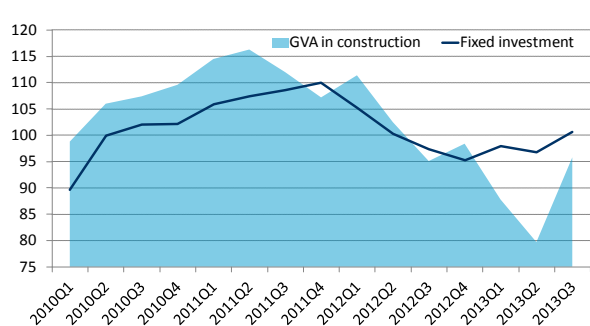
Even fresh PMI figures for November reflect further improvement in business conditions in manufacturing in all three Central European economies. The Polish index hit its highest level since April 2011 and the fastest rise in the sub index of new orders since the start of this year unveiled strong demand both from domestic and export markets. Recalls that even the Czech PMI hit a 2½ year high on yet another sharp increase in new export orders. The Hungarian PMI also improved and reached 52.6 in November.

PL: Contributions to GDP growth



PL: Investment and construction

Y/Y (%); gross fixed capital formation, gross value added in construction



Weekly preview

THU 9:00

CZ Retail Sales (change in %)

	Oct-13	Sep-13	Oct-12
Sales	0.5	4.1	2.2
cummulative (YTD)	0.1	0.0	-0.5

CZ: Real wages little changed

We believe that the average wage trend has not substantially changed. The wage growth rate for the third quarter was slightly greater, but this was due, inter alia, to three additional business days in the month.

The average real wage is likely to go up after some time, owing to falling inflation. In any event, the last quarter will see a fall in both the real wage and the nominal wage, and this year's year-on-year wage growth rate will have been the lowest since the monitoring of these statistics began.

WED 14:00

NBP rate (in %)

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

PL: The NBP on hold

The National Bank of Poland (NBP) will leave rates unchanged at its meeting. While inflation remains well below the central bank target, new and more detailed GDP figures confirm a fairly robust recovery, which is even to a great extent based on the rising domestic consumption. We expect that the NBP will keep rates at all-time lows until the end of the year, with the first change (upwards) unlikely to be made before late in the first half of 2014, which is also the nearest possible date cited by the NBP itself.

WED 9:00

CZ Wages (y/y change in %)

	Q3-13	Q2-13	Q3-12
Nominal wages	1.8	1.2	1.7
Real wages	0.6	-0.3	-1.5

CZ: Retail sales growth again close to zero

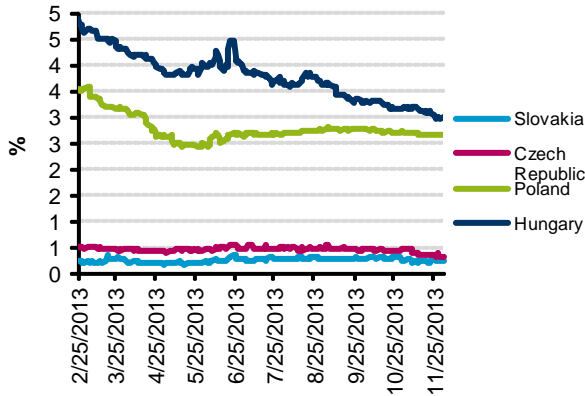
The rise in retail sales decelerated to close to zero in October. Domestic demand remains weak and October also included one less business day. Passenger car sales are again likely to be the primary driver of retail sales and, of course, e-commerce has seen an unusual boom this year. A temporary acceleration of retail sales will already be evident in November's data, as the forced weakening of the koruna has made many of consumers hasten their Christmas shopping.

Calendar

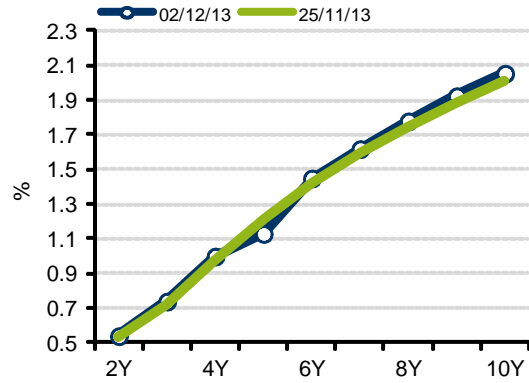
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	12/02/2013	9:00	PMI manufacturing		11/2013					51	
PL	12/02/2013	9:00	PMI manufacturing		11/2013					53.4	
CZ	12/02/2013	9:30	PMI manufacturing		11/2013					54.5	
CZ	12/02/2013	14:00	Budget balance	CZK B	11/2013					-47.7	
HU	12/03/2013	9:00	Trade balance	EUR M	09/2013 *F					847.3	
HU	12/04/2013	9:00	GDP	%	3Q/2013 *F					0.8	1.7
CZ	12/04/2013	9:00	Real wages	%	3Q/2013		0.6				-0.3
CZ	12/04/2013	9:00	GDP	%	3Q/2013 *F					-0.5	-1.6
HU	12/04/2013	9:00	Retail sales	%	10/2013						0.3
PL	12/04/2013	14:00	NBP meeting	%	12/2013	2.5		2.5		2.5	
CZ	12/05/2013	9:00	Retail sales	%	10/2013		0.5				3.7
HU	12/06/2013	9:00	Industrial output	%	10/2013 *P				4.5	1.8	3.1
CZ	12/06/2013	10:00	Current account	CZK B	3Q/2013						-196.8

Fixed-income in Charts

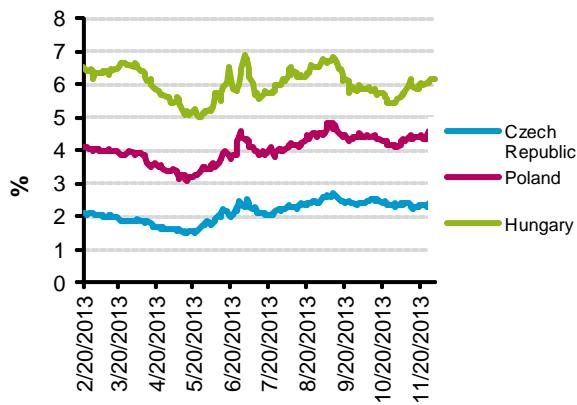
FRA 3x6



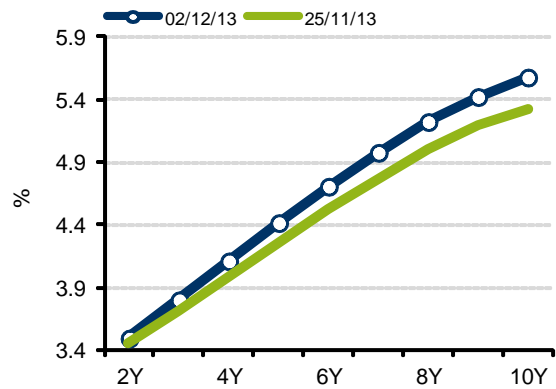
CZ IRS



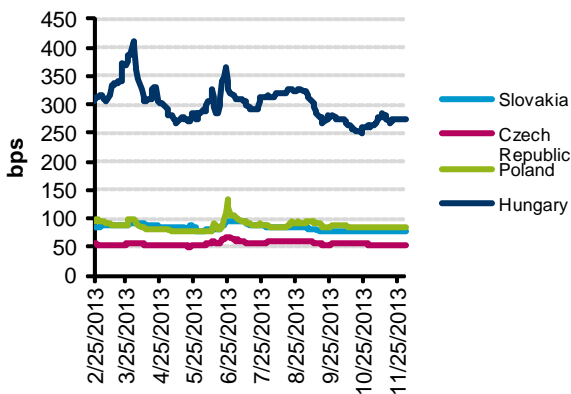
10Y GB Yields



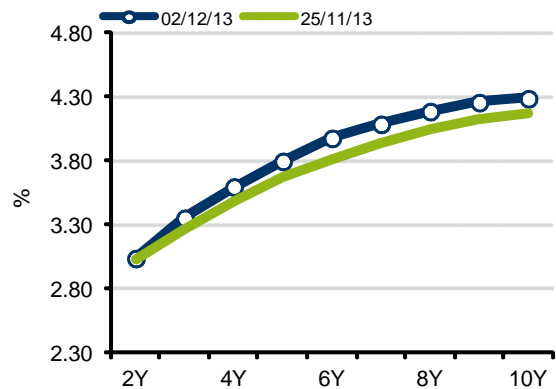
HU IRS



CDS 5Y



PL IRS



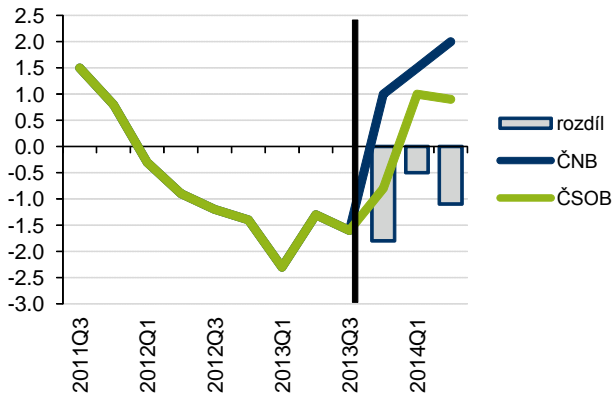
Source: Reuters

Medium-term Views & Issues

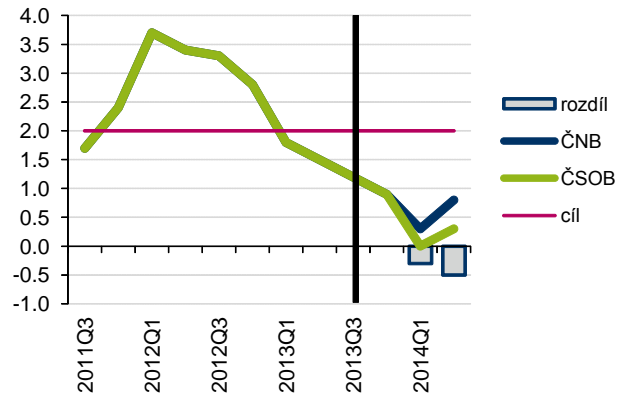
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The CR is still led by a government that has stepped down, while the negotiations by winners of the early election have begun only recently, hence it is too soon to predict what exactly the economic policy of the future government will look like. 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.</p>	<p>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.</p>	<p>The Polish economy grew by 1.9% Y/Y and 0.6% Q/Q in 2013Q3. While the growth was again mainly driven by net exports, household consumption contributed 0.6 percentage point (pp) and, maybe even more importantly, data unveiled a negligibly positive contribution of investment (+0.1pp). Figures have confirmed that growth of the Polish economy is starting to be based on more robust foundations. For this year as a whole, the Polish economy should grow by approximately 1.4%, despite its poor performance at the beginning of the year.</p>
Outlook for official & market rates	<p>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.</p>	<p>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.</p>	<p>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 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.</p>
Forex Outlook	<p>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.</p>	<p>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.</p>	<p>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.</p>

CBs' Projections vs. Our Forecasts

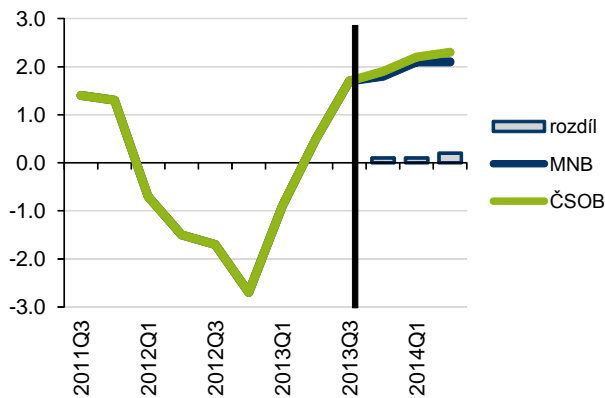
CZ: GDP outlook (Y/Y, %)



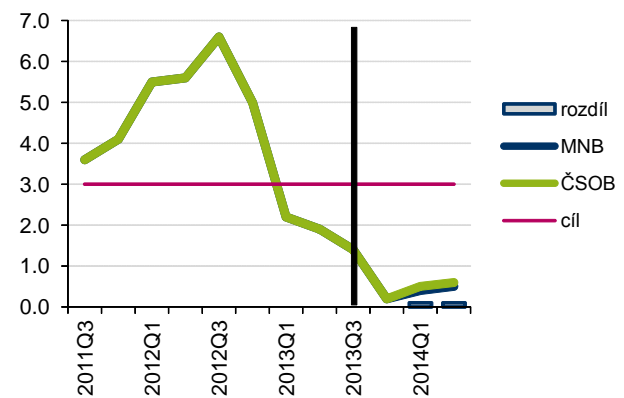
CZ: Inflation outlook (Y/Y, %)



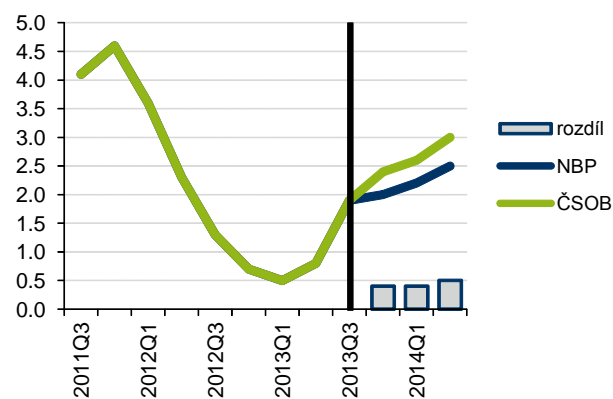
HU: GDP outlook (Y/Y, %)



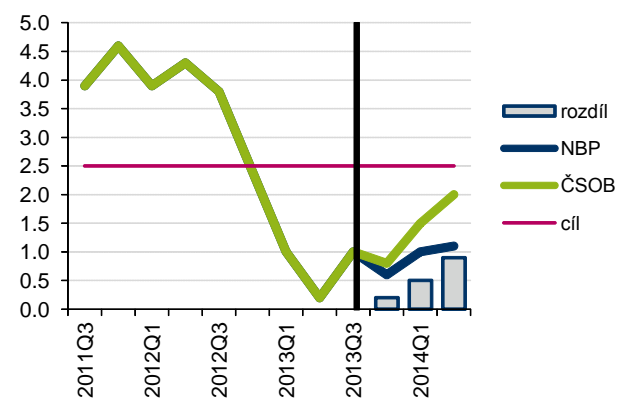
HU: Inflation outlook (Y/Y, %)



PL: GDP outlook (Y/Y, %)



PL: Inflation outlook (Y/Y, %)



Source: CNB, NBP, MNB, CSOB

Summary of Our Forecasts

Official interest rates (end of the period)

		Current	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	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.	3.20	4.25	3.60	3.75	4.00	4.50	-20 bps	11/26/2013
Poland	2W inter. rate	2.50	2.75	2.50	2.50	2.50	2.75	-25 bps	7/3/2013

Short-term interest rates 3M *IBOR (end of the period)

		Current	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2
Czech Rep.	PRIBOR	0.38	0.44	0.42	0.43	0.45	0.48
Hungary	BUBOR	3.18	4.20	3.56	3.50	3.50	3.70
Poland	WIBOR	2.65	2.73	2.67	2.75	2.75	3.00

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

		Current	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2
Czech Rep.	CZ10Y	2.055	1.97	2.06	2.15	2.26	2.38
Hungary	HU10Y	5.61	5.84	5.17	5.90	6.10	6.20
Poland	PL10Y	4.29	4.14	4.24	3.95	4.05	4.35

Exchange rates (end of the period)

		Current	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2
Czech Rep.	EUR/CZK	27.5	26.0	25.7	27.1	27.2	27.0
Hungary	EUR/HUF	303	295	297	300	300	300
Poland	EUR/PLN	4.20	4.33	4.22	4.20	4.20	4.10

GDP (y/y)

	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2
Czech Rep.	-1.4	-2.3	-1.3	-1.6	-0.8	1.0	0.9
Hungary	-2.7	-0.9	0.5	1.7	1.9	2.2	2.3
Poland	0.7	0.5	0.8	1.9	2.4	2.6	3.0

Inflation (CPI y/y, end of the period)

	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2
Czech Rep.	2.4	1.7	1.6	1.0	1.4	0.5	0.7
Hungary	5	2.2	1.9	1.4	0.2	0.5	0.6
Poland	2.4	1.0	0.2	1.0	0.8	1.5	2.0

Current Account

	2012	2013
Czech Rep.	-1.9	-1.7
Hungary	1.5	2.0
Poland	-3.5	-1.7

Public finance balance as % of GDP

	2012	2013
Czech Rep.	-4.4	-2.7
Hungary	-2.5	-2.7
Poland	-3.9	-4.6

Source: CSOB, Bloomberg

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