



Central European Weekly

Monday, 09 December 2013

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Weekly Highlights:

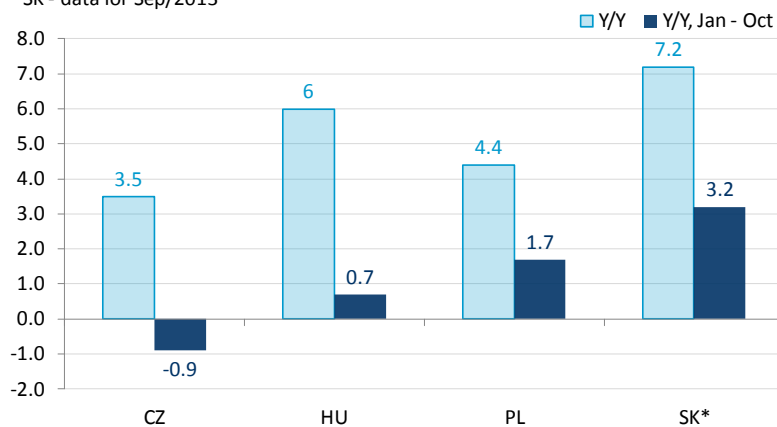
- Regional recovery in on the way in industry
- The NBP on hold longer than we previously expected
- The Czech November inflation in line with expectations despite koruna's depreciation
- Preview: Hungarian and Polish inflation probably remained

Chart of the Week: CE industry in 2013

Industrial production

%

*SK - data for Sep/2013



Soft as well as hard data from Central Europe has confirmed that the recovery in the industrial sector, which is the backbone of exports and of the economy as a whole, is on the rise. (Source: CSU, GUS, KSH, SUSR, CSOB).

Dear clients,

We wish you Merry Christmas and Happy New Year. Next CE Weekly will be issued on January 6th, 2014.

Market's editorial

Regional recovery on the way,...

Soft as well as hard data from Central Europe has confirmed that the recovery in the industrial sector, which is the backbone of exports and of the economy as a whole, is on the rise. November's PMI indices as well as the detailed structure of the Hungarian and Polish GDP and also, after all, Czech and Hungarian industrial output, essentially included only good news about the Central European economy. All the more surprising then may be the fact that Central European currencies are not fairing very well.

..., but CE currencies remain in a wait-and-see mode

Perhaps surprising for some are the weaker positions of the Czech koruna and forint, after all, the stagnation of the zloty. They are due to very favourable inflation outlooks for practically all Central European economies (which are likely to be confirmed by the data to be released in the coming week). The Czech inflation outlook is even so 'positive' that despite the 6% depreciation of the currency triggered by the CNB. Moreover, we anticipate a temporary flirt with deflation, with January's inflation figure to be -0.2%. No wonder, the koruna is nervous because of such expectations, and is weakening even without the central bank's contribution. There is fear that after the CNB Board

sees January's inflation, it may contemplate whether even the exchange rate of EUR/CZK 27.0 is not too strong. Yet we believe that the CNB will not re-evaluate its recently set floor for the EUR/CZK pair, and this may be the right moment to bet on the appreciation of the Czech currency (at least back to its barrier of the EUR/CZK).

The NBP on hold longer than we previously expected

As concerns Poland, for instance, even its steadily low inflation quite significantly curbs the ambitions of the zloty, which primarily stemmed from the anticipation of a future rate hike. However, as we could see from the last meeting of the NBP, this is unlikely to happen in Poland either. While the NBP welcomes the improving prospects of the Polish economy, NBP President Belka reiterated at a press conference that all members of the Monetary Policy Council agreed on the need to keep rates at their current level until at least the middle of next year. The prospects for next year's low inflation and the mood at the NBP have made even us re-evaluate our scenario for official rates. Newly, we expect that official rates in Poland may go up in the late-third and early-fourth quarter of 2014, rather than in the late first half of next year.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27,5	0,12%	→	→
EUR/HUF	301	-0,97%	↗	→
EUR/PLN	4,19	-0,36%	↗	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2,06	6,42	↗	↗
10Y HUF	5,40	-3,40	↗	↗
10Y PLN	4,28	-0,81	↗	↗

Review of Economic Figures

The NBP sees stable rates at least until the end of 2014H1

Regarding the meeting of the National Bank of Poland (NBP), it delivered more or less expected outcomes. While the central bank acknowledged improving conditions in the domestic economy and its positive consequences for labour market, it added that the demand and cost pressures remain limited. Although Mr. Belka, the NBP president, admitted in a press conference that the pace of recovery may be faster than indicated by current forecast, the NBP kept the forward guidance that the official interest rates should remain at current levels at least until the end of the first half of 2014 unchanged.

Although the recent development has supported our bets on faster economic recovery in Poland (in 2014, the central bank expects 2.9% growth while we estimate 3.1% with upside risks), outlook for persistently low inflation and NBP's strong emphasis on forward guidance along with the fact that all members of the Monetary Policy Council agreed upon it, made us review our scenario and we newly expect that the first rate hike (25 bps) may come rather at the turn of the third and the fourth quarter of 2014.

The Hungarian industry in a good shape

The Hungarian industrial output rose by 6% YoY (both unadjusted and working-day adjusted figure) in October, which is the highest read since 2011. Although the figure is quite impressive, the base effect plays a very important role in the acceleration of the production. Last year the European economic outlook deteriorated substantially in the last quarter, and the companies started to moderate their production as a response on the worsening outlook. Unfortunately seasonally and working day adjusted figure reflects 0.5% MoM decrease. It is only the second time (first was in May) in this year, when production could not

increase compared to the previous month, which makes the recovery a little bit gloomy, but in September reached the highest MoM (1.8%) growth in 2013.

Since there was no news in the media about decreasing of activities of the companies so far, the industrial production may accelerate further even close to 10% YoY. YTD industrial production increased only by 0.7% YoY but two outstanding good figures around 8-10% YoY in November and December may push the average industrial output to around 2% YoY.

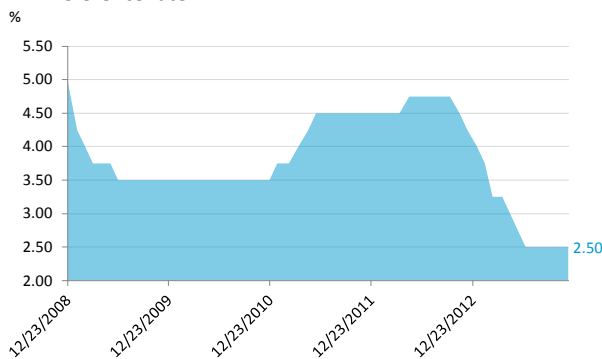
Czech industry maintained strong momentum in October

Regarding Czech macroeconomic figures released today, it surprised moderately to the upside, mainly thanks to better than expected industrial output figures. In October, Czech industrial production grew by 3.5% Y/Y and after the seasonal adjustment even by 6% Y/Y. The figures confirmed our expectations as it unveiled that the result was driven by manufacture of motor vehicles that had shown sharp increase in new orders over the past several months. Moreover, new orders kept their strong momentum in October and showed year-on-year growth of nearly 10% Y/Y (20% Y/Y in car industry).

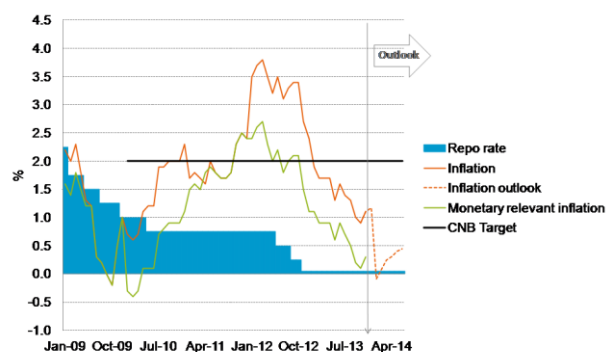
Czech inflation in November in line with expectations

As for inflation figures, it came out in line with expectations as it reached 1.1% Y/Y in November. Although the rate of inflation will likely stay above 1% Y/Y in December as well (November's figures have not fully reflected a sharp depreciation of the koruna) we expect it to fall substantially in January next year due to lower energy prices. In our view, below-zero reading (i.e., deflation) cannot be excluded and this means further downside risks for the koruna in the beginning of the next year.

NBP reference rate



CZ: Inflation and interest rates



Weekly preview

TUE 9:00 CZ Foreign trade (CZK bn)

	Oct-13	Sep-13	Oct-12
Balance	35.9	19.2	32.8
cumulative (YTD)	306.6	270.8	266.6

CZ: Exports catching breath

The very good figures from industry go hand in hand with the rising exports. The primary drivers still include machinery and means of transport, i.e., passenger cars and electrical and optical devices. On the other hand, imports still lack any strong rising tendency, due to poor domestic consumer demand and notably investment demand. There should also be the aftermath of the temporarily increased fuel imports, before the obligation to obtain concessions was imposed on traders. Thus the overall foreign trade surplus may go up by almost CZK 6 bn y/y in October.

FRI 10:00 CZ Cur. Account (CZK bn)

	Oct-13	Sep-13	Oct-12
C/A monthly	4.5	-2.9	-8.8
cumulative (YTD)	0.0	-4.5	-73.3
Trade bal. monthly	23.0	19.7	12.0
cumulative (YTD)	173.1	150.1	132.2

CZ: The dividend season is drawing to an end

The current account, which has so far developed extremely favourably this year, should close October in the black. The surplus of foreign trade in goods and services should contribute to this in particular. Besides, the deficit in the balance of income should go down with the end of the year drawing to a close. The dividend season is ending, and therefore this deficit should also slowly fall. The existing data suggests that this year's current account figure will have been the best since 2005.

FRI 14:00 PL Inflation (change in %)

	Nov-13	Oct-13	Nov-12
CPI y/y	0.8	0.8	2.8
Food (ex Alc.) y/y	1.6	1.9	3.9
Transport (including fuel)	-1.9	-2.3	-1.2

PL: Inflation remains below 1%

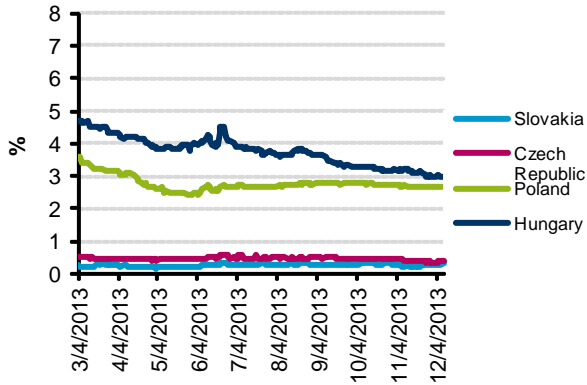
Poland's inflation was up by 0.1% m/m and stagnated at 0.8% y/y in November, according to our forecasts. The primary contributors to the month-on-month rise likely included food and non-alcoholic beverages prices, which rose by approximately 0.5% in November, after their seasonally unusual stagnation in October. By contrast, month-on-month inflation was primarily curbed by transport prices, which, we believe, were down by 0.8%.

Calendar

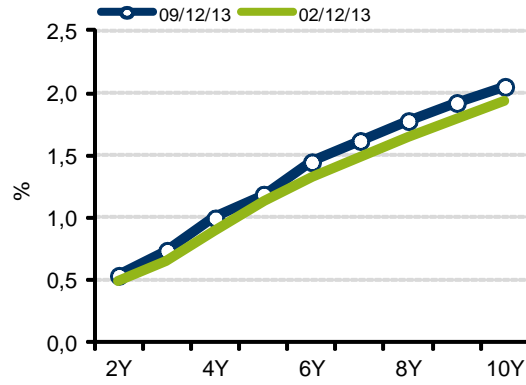
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	12/09/2013	9:00	Trade balance	EUR M	10/2013 *P			695		830,3	
CZ	12/09/2013	9:00	Construction output	%	10/2013						-9,5
CZ	12/09/2013	9:00	Industrial output	%	10/2013		2,5		2		7,1
CZ	12/09/2013	9:00	CPI	%	11/2013	0,1	1,3	0	1,1	0,2	0,9
CZ	12/09/2013	9:00	Unemployment rate 15-64	%	11/2013	7,6		7,6		7,6	
HU	12/09/2013	17:00	Budget balance	HUF B	11/2013						-887,7
CZ	12/10/2013	9:00	Trade balance	CZK B	10/2013	35,9		37,7		35,1	
HU	12/11/2013	9:00	CPI	%	11/2013			-0,3	0,7	-0,3	0,9
HU	12/13/2013	9:00	Industrial output	%	10/2013 *F					-0,5	6
CZ	12/13/2013	10:00	Current account	CZK B	10/2013	4,5		0,6		-2,94	
PL	12/13/2013	14:00	Current account	EUR M	10/2013			-586		-1024	
PL	12/13/2013	14:00	Trade balance	EUR M	10/2013			534		673	
PL	12/13/2013	14:00	Money supply M3	%	11/2013			0,8	6,4	0,9	5,9
PL	12/13/2013	14:00	CPI	%	11/2013			0,1	0,9	0,2	0,8

Fixed-income in Charts

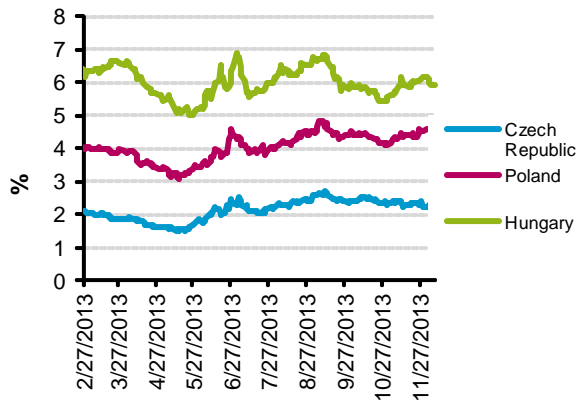
FRA 3x6



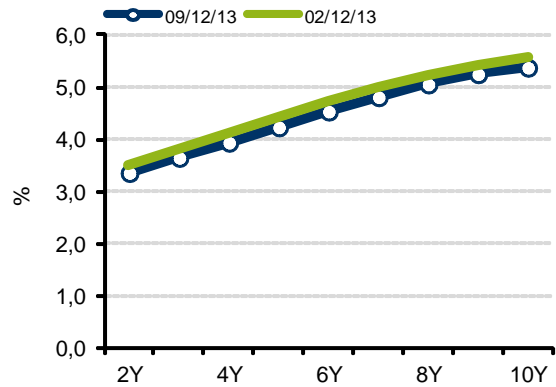
CZ IRS



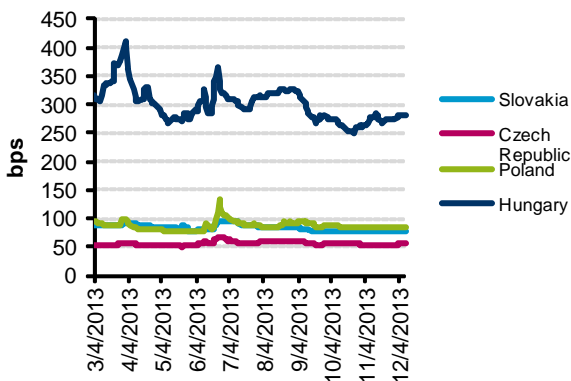
10Y GB Yields



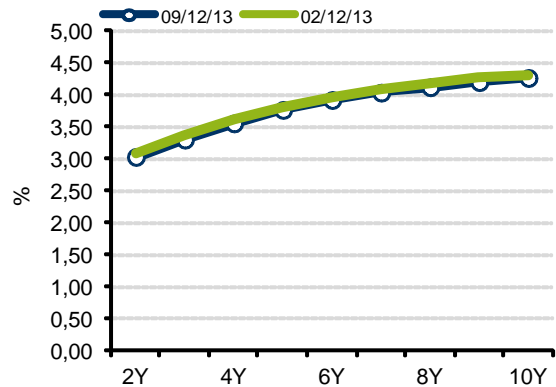
HU IRS



CDS 5Y



PL IRS



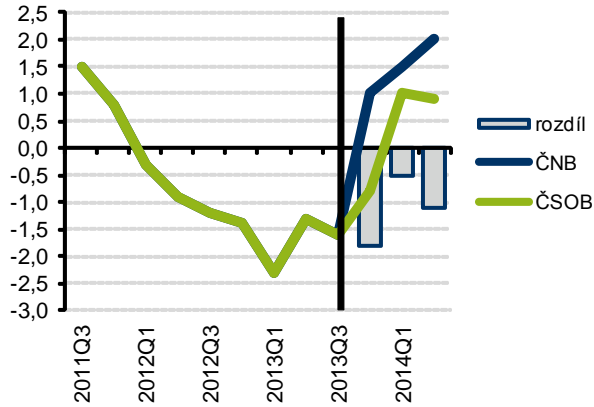
Source: Reuters

Medium-term Views & Issues

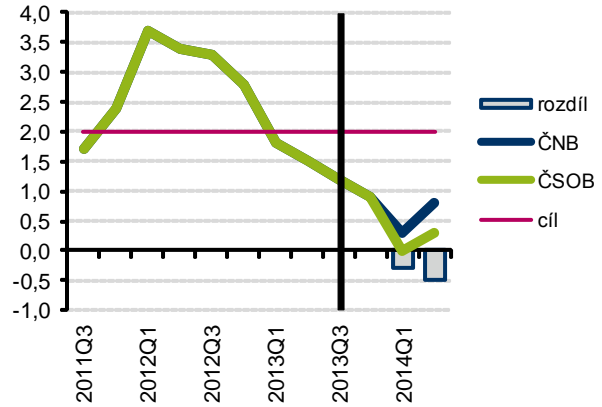
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The CR is still led by a government that has stepped down, while the negotiations by winners of the early election have begun only recently, hence it is too soon to predict what exactly the economic policy of the future government will look like. 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 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. Although the recent development has supported our bets on faster economic recovery in Poland (in 2014, the central bank expects 2.9% growth while we estimate 3.1% with upside risks), outlook for persistently low inflation and NBP's strong emphasis on forward guidance along with the fact that all members of the Monetary Policy Council agreed upon it, made us review our scenario and we newly expect that the first rate hike (25 bps) may come rather at the turn of the third and the fourth quarter 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

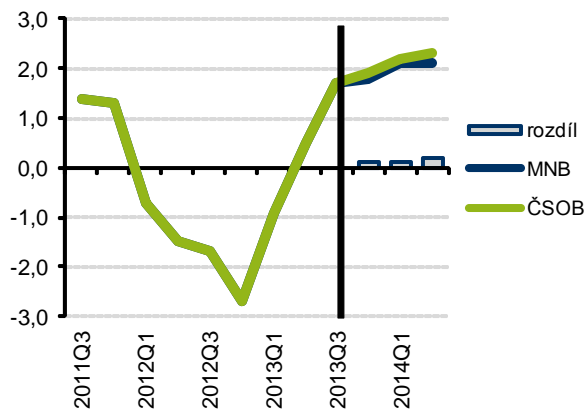
CZ: GDP outlook (Y/Y, %)



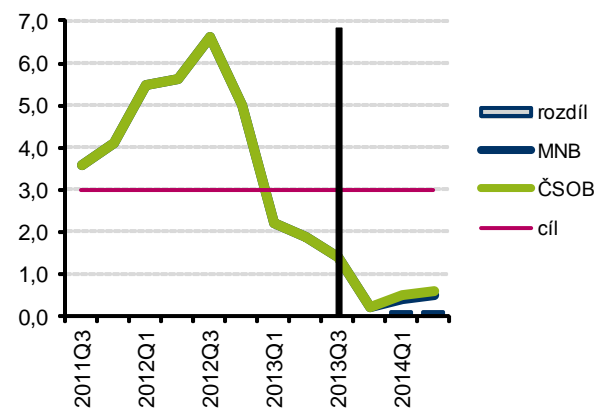
CZ: Inflation outlook (Y/Y, %)



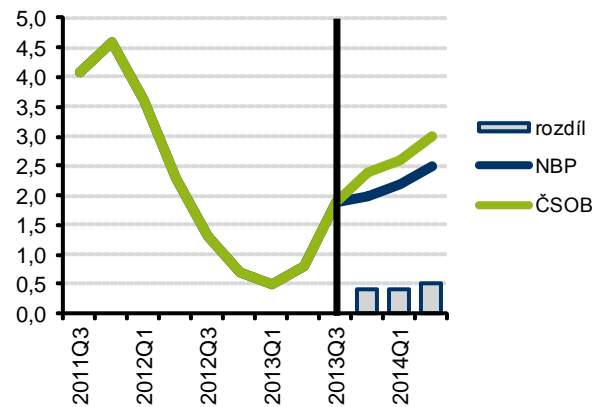
HU: GDP outlook (Y/Y, %)



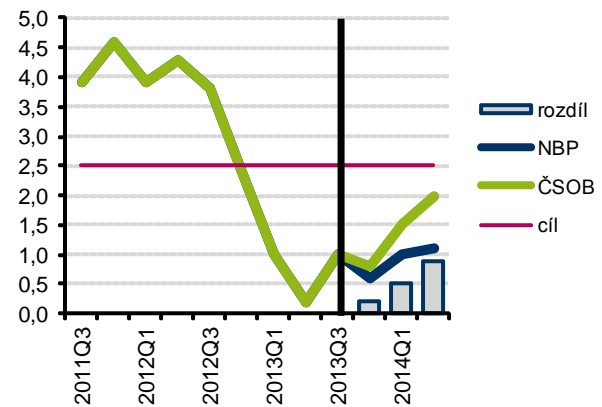
HU: Inflation outlook (Y/Y, %)



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	5,40	5,84	5,17	5,90	6,10	6,20
Poland	PL10Y	4,28	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	301	295	297	300	300	300
Poland	EUR/PLN	4,19	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

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
Prague Research (CSOB)		Paris	+33 153 89 83 15
Jan Cermak	+420 2 6135 3578	New York	+1 212 541 06 97
Jan Bures	+420 2 6135 3574	Singapore	+65 533 34 10
Petr Baca	+420 2 6135 3570		
Bratislava Research (CSOB)		Prague	+420 2 6135 3535
Marek Gabris	+421 2 5966 8809	Bratislava	+421 2 5966 8436
Warsaw Research		Budapest	+36 1 328 99 63
Budapest Research			
David Nemeth	+36 1 328 9989		

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