



# Central European Weekly

Monday, 13 January 2014

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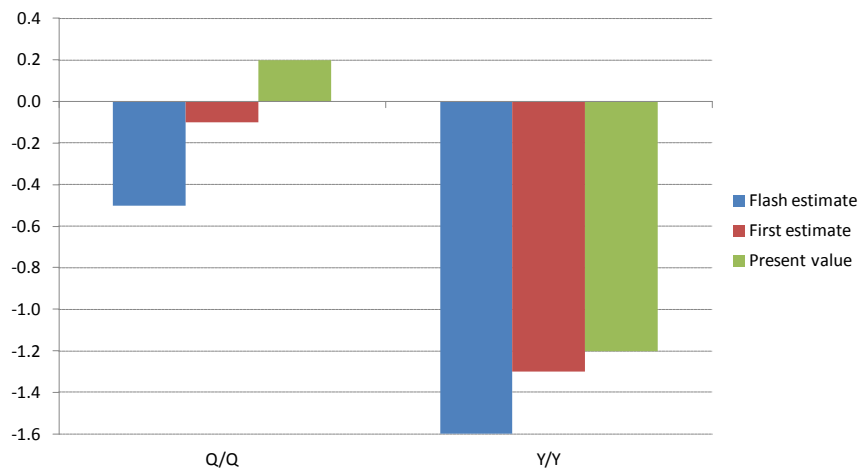
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## Weekly Highlights:

- Bullish start of the year for regional forex and fixed-income markets
- The Polish FinMin wants to cover a half of this year's financing needs by the end of Jan
- Encouraging retail sales figures both in the Czech Republic and Hungary
- The Hungarian inflation to fall to fresh lows thanks to lower utility cost prices

## Chart of the Week: Czech GDP and its revisions

**CZ: GDP in Q3 2013 (%)**



The Czech Statistical Office delivered another positive revision of GDP for the third quarter of 2013. Instead of the 0.5% q/q decline declared in the flash estimate the Czech economy actually grew by 0.2% q/q.

# Market's editorial

## Bullish start of the year supported by strong retail sales

At a glance, the beginning of the new year was successful for the Central European region. The markets have been faring well in all aspects, while the macroeconomic data released since December 31 has also looked very promising; however, we should point out that the hard macroeconomic data from the Central European region still applied to last year. Nevertheless, November's figures from Hungarian and Czech industries as well as retail sales were really encouraging and indicated that the end of last year was not at all bad.

We should still be somewhat cautious about Czech data, where household consumption and price rise were temporarily encouraged by the intentional weakening of the Czech koruna, launched by the Czech National Bank in early November. The impacts of this macroeconomic move may also be evident in the data for the first quarter of the year, but they may completely peter out over a longer period of time. Nevertheless, the effectiveness of the CNB's interventions will be reckoned (i.e., evaluated) at the end of this year, when the effects of the depreciation of the koruna begin to disappear completely from the timelines and, by contrast, a high comparative baseline may start to have an adverse effect (on year-on-year data).

## The Polish bond issuance might be high in January

Regarding other regional news, the most interesting one came probably from Poland, where the Minister of Finance, Mr. Szczurek, said that the ministry wanted to cover a half of this year's financing needs by the end of January. Along with maybe unduly pessimistic growth forecasts of the Ministry (which, if proved wrong, would mean a lower-than-expected budget deficit), this might be another positive factor (or a factor easing pressure stemming from QE tapering) able to support the zloty in months to come.

## The Hungarian inflation at historical lows in December

As concerns the weekly preview – the most interesting might be Hungarian and Polish inflation figures for December. In our view, the data will show again very low headline inflation in both cases, while the Hungarian inflation will probably set fresh historical lows. The main reason behind this moderation is the second round of public utility cost reduction of gas, electricity and district heating.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.4	-0.35%	↘	↗
EUR/HUF	299	-0.38%	↘	→
EUR/PLN	4.15	-0.55%	↘	↘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.04	-3.09	↘	↗
10Y HUF	4.95	-6.34	↘	↗
10Y PLN	4.25	-1.96	↘	↗

# Review of Economic Figures

## Another upward revision of the Czech GDP for Q32013

The makro data released last week evoke moderate optimism. Especially Czech and Hungarian retail sales and Czech industrial output delivered nice results in November. Additionally, it is worth noting an upward revision of the Czech GDP. The quarter-on-quarter GDP growth for the third quarter of 2013 was revised from -0.1% to +0.2% (while the first flash estimate was -0.5%).

## Czech retail sector benefited from CNB's action

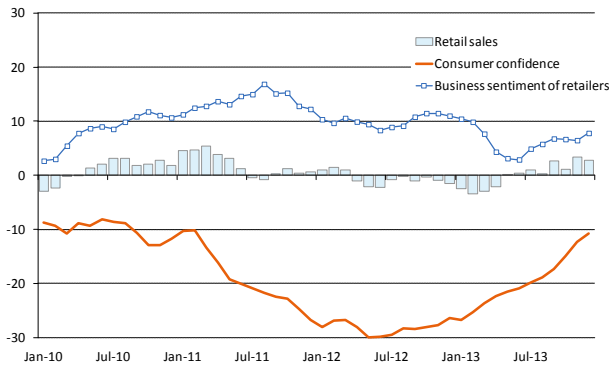
Czech industrial output surprised markets with its rise by 6.2% y/y and 1.3% m/m in November. This almost doubled the market expectations and, adjusted for the effect of the number of business days in the month, the rise was even 8.8%. More good news is that the rate of increase in new orders, both domestic and foreign, is accelerating. Hence the rise may continue this year. On the other hand, construction output gives no reason for optimism. Construction continued to decline in November – this time by a huge 9.3% y/y. Retail sales sprang even a greater pleasant surprise, when October's decline was followed by a

6.1% rise in November. The greatest contributors to the year-on-year sales rise included the sales of motor-vehicles and non-food goods. This confirms the CNB's hypothesis that the prospects for price increases will encourage consumers to increase their spending of money. However, the question still is whether this is not just an inter-temporal substitution, when the spending appetite may again disappear after the beginning of this year.

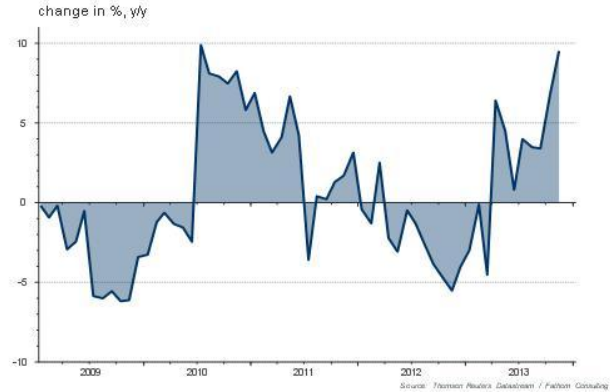
## Mixed results of the Hungarian industry in last quarter 2013

The spending appetite also influenced Hungarian retail sales, which rose by a firm 4.9% in November. By contrast, industrial output figures do not look so good. Adjusted for the effect of the number of business days in the month, industry grew by 5.8% y/y in November, but month-on-month figures indicate something else. Month-on-month industrial output fell by 0.5% for a second consecutive month. If this trend persisted in December, it could mean that last quarter of 2013 was very poor for the industry.

**CZ: Retail sales & Confidence**



**HU: Retail sales**



# Weekly preview

**WED 9:00**
**HU Inflation (change in %)**

	XII.13	XI.13	XII.12
CPI m/m	<b>-0.7</b>	-0.5	-1.0
CPI y/y	<b>0.2</b>	5.8	-3.0

## HU: Inflation falls to zero

Consumer price index may drop from 0.9% year-on-year in November to 0.2% year-on-year in December. CPI may decrease by 0.7% compared to the previous month. The main reason behind the moderation is the second round of public utility cost reduction of gas, electricity and district heating. Additionally fuel price decreased in December as well. Based on the information coming from the retail sector after the Christmas shopping, there were less discount prices compared to last year as the demand substantially increased this year, so tradable goods price may push the inflation slightly upward. It means that core inflation may accelerate further from 3.5% Y/Y level.

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

	Dec-13	Nov-13	Dec-12
CPI y/y	<b>0.6</b>	0.6	2.4
Food (ex Alc.) y/y	<b>1.1</b>	1.7	3.9
Transport (including fuel)	<b>-1.7</b>	-2.3	1.1

## PL: Inflation still well below the NBP

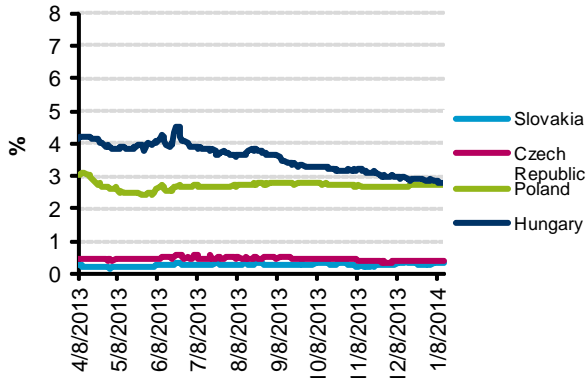
Poland's inflation rate stagnated at 0.6% Y/Y in December, according to our forecasts. The moderate month-on-month price rise by 0.1% was likely fuelled the most by food and alcoholic drink prices, which might rise slightly faster than is seasonally usual (+0.5% M/M). By contrast, falling transport prices continued to curb the price rise, although we believe that the decline was only negligible this time (-0.3% M/M) compared to the rate in the previous two months. By and large, Poland's inflation rate was likely below 1% on average last year, i.e., well below the level of the previous year (3.7%).

# Calendar

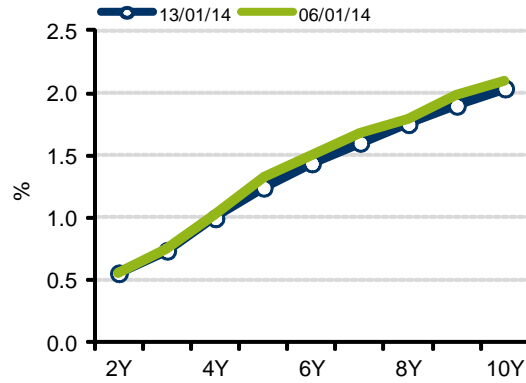
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	01/14/2014	9:00	Industrial output	%	11/2013 *F					-0.5	5.8
PL	01/14/2014	14:00	Money supply M3	%	12/2013			2.3	5.9	-0.2	5.7
CZ	01/15/2014	9:00	PPI	%	12/2013	0.4	1.3	0.4	1.4	0.8	0.7
HU	01/15/2014	9:00	CPI	%	12/2013			-0.5	0.4	-0.1	0.9
CZ	01/15/2014	12:00	CZ bond auction 2013-2028, 2.50%		CZK B	01/2014					
CZ	01/15/2014	12:00	CZ bond auction 2007-22, 4.70%		CZK B	01/2014					
PL	01/15/2014	14:00	CPI	%	12/2013	0.1	0.6	0.1	0.7	-0.2	0.6
PL	01/15/2014	15:00	Budget balance		PLN M	12/2013					-38541
PL	01/16/2014	14:00	Core CPI	%	12/2013			0	1.1	-0.2	1.1
CZ	01/17/2014	10:00	Current account		CZK B	11/2013	7.7		7.85	7.76	
PL	01/17/2014	14:00	Current account		EUR M	11/2013			-1050	-466	
PL	01/17/2014	14:00	Trade balance		EUR M	11/2013			-76	53	

# Fixed-income in Charts

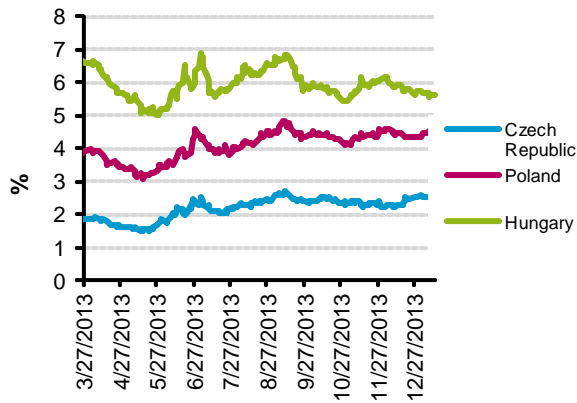
**FRA 3x6**



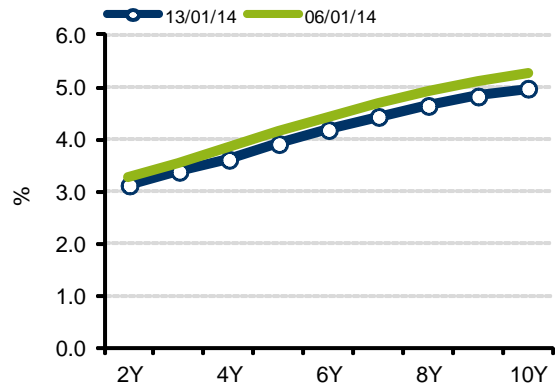
**CZ IRS**



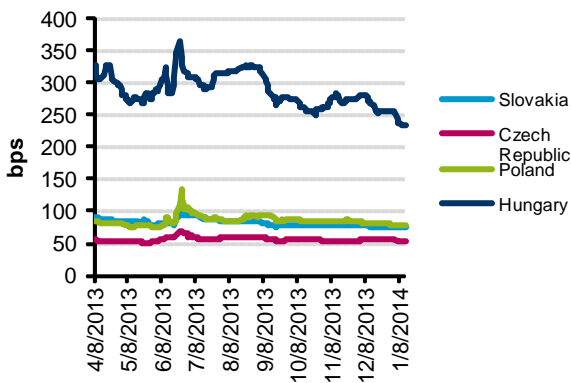
**10Y GB Yields**



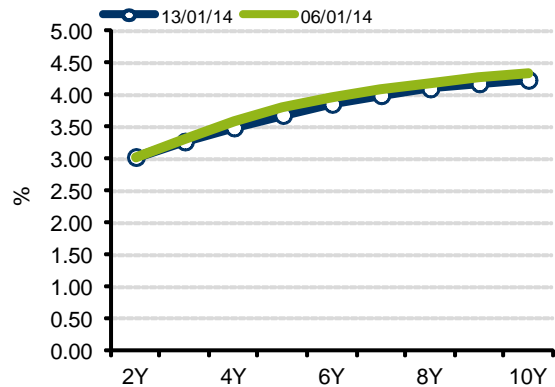
**HU IRS**



**CDS 5Y**



**PL IRS**



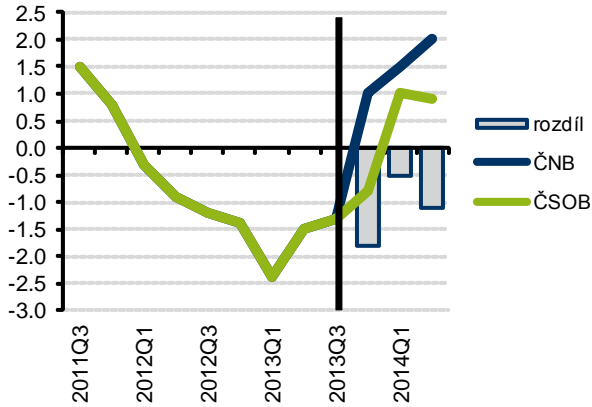
Source: Reuters

# Medium-term Views & Issues

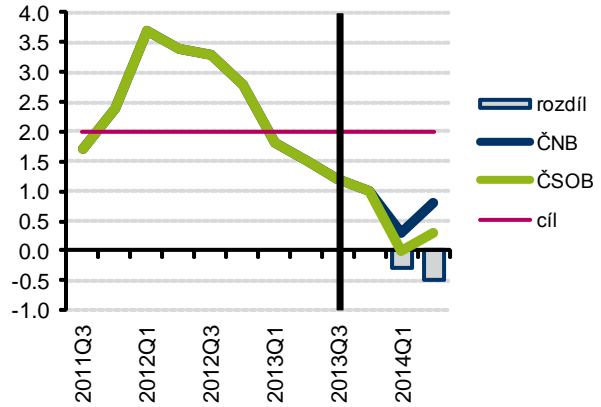
	The Czech Republic	Hungary	Poland
Growth & key issues	<p>The Czech Republic is still led by a government that has stepped down, while the negotiations by winners of the early election have begun only recently, hence it is too soon to predict what exactly the economic policy of the future government will look like. 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 also may continue loose monetary policy. So, we maintain our expectation that NBH may cut base rate a bit further in 2014 despite the fact that it's already at all time lows..</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

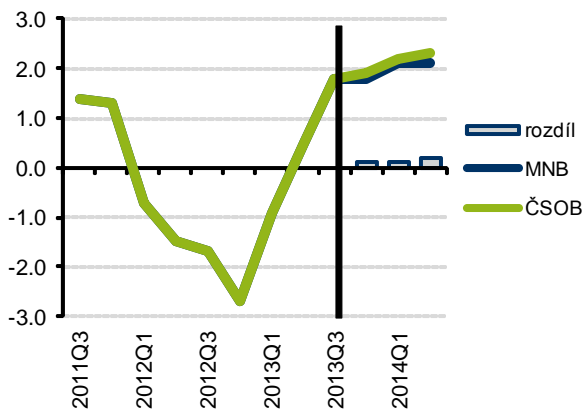
**CZ: GDP outlook (Y/Y, %)**



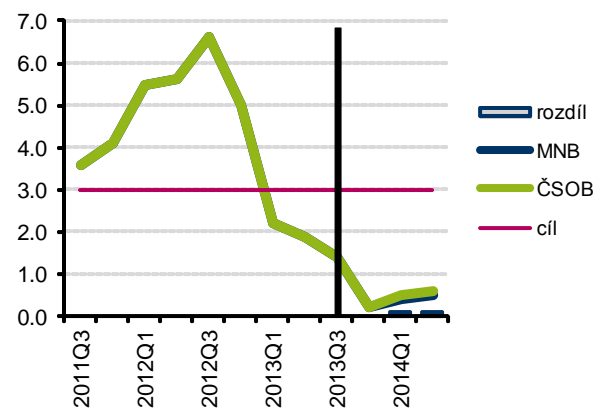
**CZ: Inflation outlook (Y/Y, %)**



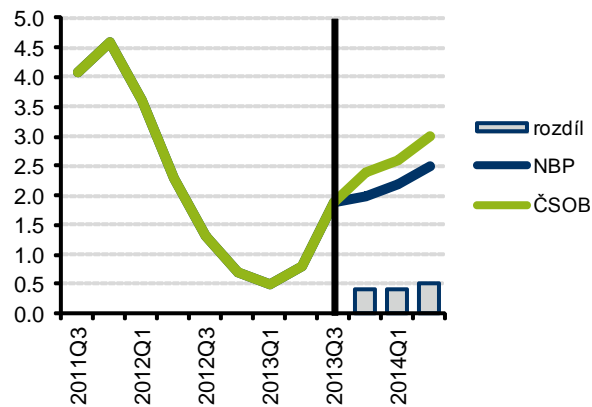
**HU: GDP outlook (Y/Y, %)**



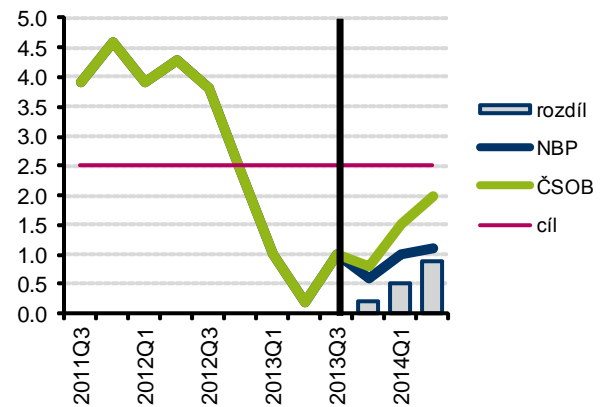
**HU: Inflation outlook (Y/Y, %)**



**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.	3.00	4.25	3.60	3.00	4.00	4.50	-20 bps	12/17/2013
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	0.38	0.45	0.48
Hungary	BUBOR	2.99	4.20	3.56	2.99	3.50	3.70
Poland	WIBOR	2.7	2.73	2.67	2.71	2.75	3.00

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

		Current	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2
Czech Rep.	CZ10Y	2.04	1.97	2.06	2.09	2.26	2.38
Hungary	HU10Y	4.95	5.84	5.17	5.25	6.10	6.20
Poland	PL10Y	4.25	4.14	4.24	4.25	4.05	4.35

## Exchange rates (end of the period)

		Current	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2
Czech Rep.	EUR/CZK	27.4	26.0	25.7	27.3	27.2	27.0
Hungary	EUR/HUF	299	295	297	297	300	300
Poland	EUR/PLN	4.15	4.33	4.22	4.16	4.20	4.10

## GDP (y/y)

	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2
Czech Rep.	-1.4	-2.4	-1.5	-1.3	-0.8	1.0	0.9
Hungary	-2.7	-0.9	0.5	1.8	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	0.3	0.6
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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