Central European Weekly

Monday, 17 February 2014

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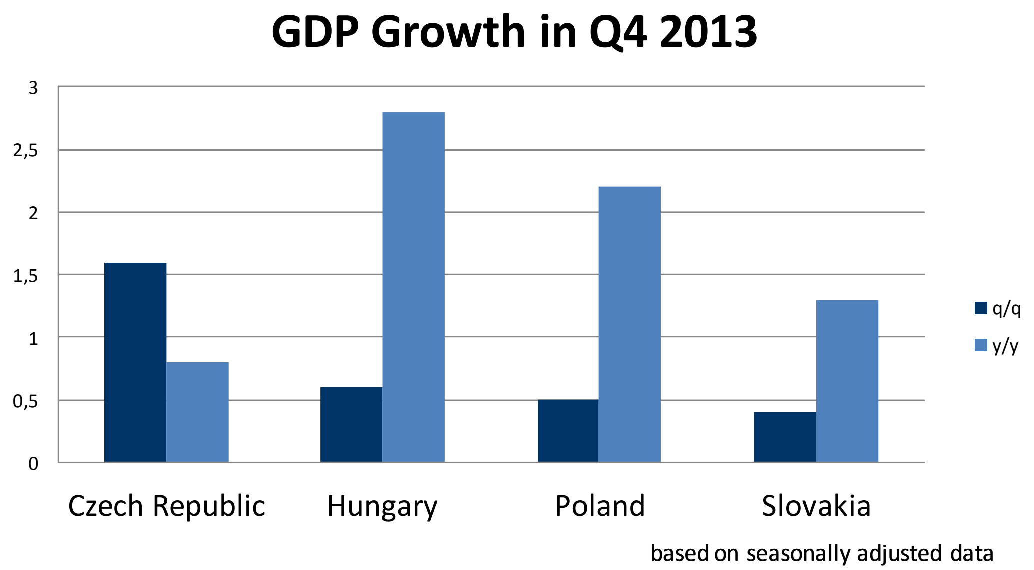
- Central Europe surprises by strong growth in 2013Q4
- The koruna finally strengthened after GDP data
- The Hungarian and Czech headline year-on-year inflation at zero levels
- The NBH should deliver a 10 bps rate cut

Chart of the Week: Regional growth figures



Strong GDP growth data surprised positively across the region.

Central European Daily

Monday, 17 February 2014

Market's editorial

Super-low inflation versus accelerating growth

Last week saw key macroeconomic data releases, not only from the entire region, but the entire European Union.

Let us begin with economic growth, which mostly sprang positive surprises across the continent. Especially in Central Europe we saw several pleasant surprises. Quite contrary to expectations, growth was strong in the Czech Republic, which is partly attributable to the rising investment in means of transport and machinery. The question is how long the investing into cars – albeit very attractive in terms of prices – may keep pace. Another question is how much the investment rise is influenced by the fear of price increases in the wake of the devaluation of the koruna. This is why we should be cautious about the Czech figure. On the other hand, we need to note that growth was likely also driven by exports, and this will also likely apply to the other economies in the region (including the German one).

Another set of data that must have caught the eye during the week was January's inflation figures. These were very low across the region, thus reflecting several inter-related facts – low commodity prices, reductions in regulated prices (of energy, gas, public services), and permanently low demand. As a result, inflation across the region is at record-low levels. Inflation in the Czech Republic and Hungary even stands practically at zero, and this will, in effect, make the Czech National Bank satisfied with its monetary-intervention regime and encourage the National Bank of Hungary (as early as this Tuesday) to continue to cut its base interest rate.

Strong growth brings gains for CE currencies

The reaction of CEE currencies on released data was immediate. The Czech koruna finally firmed (by 0.5%), and the Polish zloty hit its one-month high. GDP figures boosted also the most vulnerable currency of the region – the forint, which gained 0.7 % and ended the session at 309.2 EUR/HUF.

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	27.4	-0.41%	➔	➚
EUR/HUF	309	-0.85%	➚	➚
EUR/PLN	4.15	-0.83%	➚	➚

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	1.89	-1.82	➔	➚
10Y HUF	5.40	0.09	➚	➚
10Y PLN	4.22	0.48	➚	➚

Review of Economic Figures

Czech Inflation met expectations and approached zero

The consumer price index was up by only 0.1% m/m in early 2014. Year-on-year inflation, for which the central bank sets its targets, dropped to 0.2%. Compared to December, January's consumer prices went up in the food category, while electricity prices went down (-9.9%), as did healthcare fees. A positive factor is that people may see their housing costs go down for the first time in a longer while. This primarily applies to electricity and gas expenditure. Due, inter alia, to the shale gas boom in the United States, commodity prices and subsequently electricity prices dropped. Thus we are benefiting from a positive cost shock, which will be certainly appreciated by households, whose real purchasing power fell for several consecutive years, as well as by businesses, which are still struggling with high energy prices. Year-on-year inflation is currently falling way below the target of the CNB, which expected inflation of 0.4%. Thus inflation is lower but, for the moment, this should not imply a new central bank intervention through another forced weakening of the koruna, even if inflation continues to be very close to zero. Inflation will go up in the second half of the year, yet it will scarcely exceed a 1% mark.

Poland's inflation still below 1%.

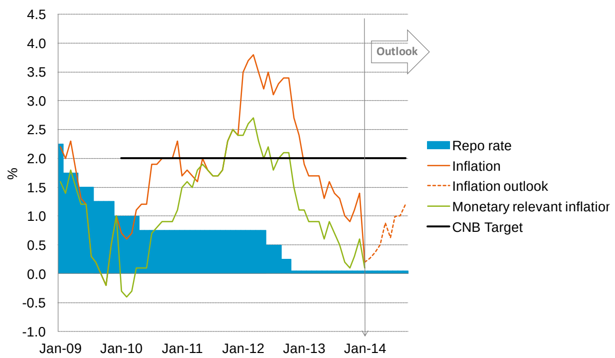
In January this year, Poland's inflation was up by 0.1% m/m and 0.7% y/y, i.e., less than expected by us as well as the market. The main surprises to us in terms of structure included the stagnation of housing prices and a moderate decline in transport prices (-1% m/m). By contrast, January's food and soft drink prices rose faster than we expected (+1.4% m/m). Bear in mind that the above data may change after taking account of the new weightings given to individual items in the consumer basket, to be put in place next month.

As concerns the outlook for this year, January's fairly slow price rise indicates that average inflation may only reach 1.3%, enabling the central bank to leave interest rates unchanged until the end of this year.

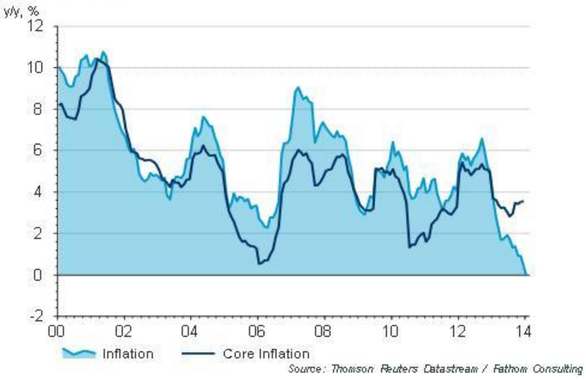
The Hungarian inflation hits zero

The Hungarian consumer price index released this morning was 0% Y/Y in January, well below the market consensus of 0.2% Y/Y. The main driver of the low figure is still regulated prices (public utility cost reduction, public transport fee moderation), the good harvest in 2013 and the subdued domestic consumption. It is interesting that the good harvest pushed down the prices of the unprocessed food, but there was no disinflation process in the group of processed food. The gap between a core inflation and headline CPI widened further, as the core inflation moderated only to 3.4% Y/Y in January from 3.5% Y/Y in December, so we cannot identify any disinflation process among the core inflation products in the last 4 months. The headline inflation will start to increase from February as the first round of public utility cost reduction will fall out from the base, but the rise will be gradually during the year (as the government approved further cost cuts) and may reach above 2.5% Y/Y CPI level in December. The average inflation may be around 1.1% Y/Y in 2014, which is well below the inflation target of 3% Y/Y and also below the inflation the government planned the 2014 budget.

CZ: Inflation and interest rates



HU: Inflation



The Czech growth - very strong in the last quarter of 2013

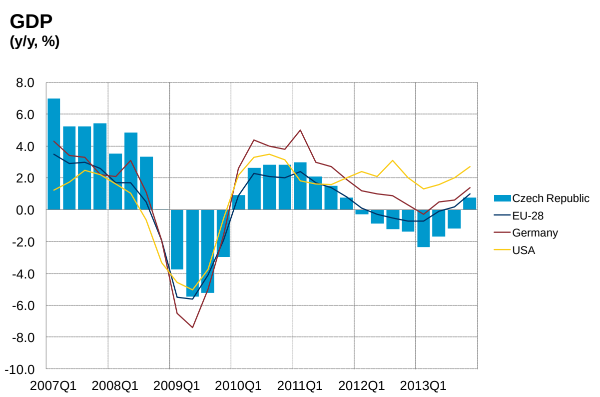
According to a preliminary forecast, the GDP grew by 1.6% q/q and 0.8% y/y in the last quarter of 2013. This was well above market expectations. However, this is just a preliminary figure that may change greatly – as we saw with the figure for the previous quarter. According to the Statistical Office, the economy was primarily fuelled by investment in means of transport and machinery and also by the impact of indirect taxes on tabaco. The question is how long the investing into cars – albeit very attractive in terms of prices – may keep pace. Another question is how much the investment rise is influenced by fear of price increases in the wake of the devaluation of the koruna. Hence we would not in any way like to overestimate the effect of investment, albeit dominant, particularly if neither consumption nor foreign trade had an effect on the performance of the economy in late 2013. As concerns supply, it is evident that the manufacturing industry contributed to growth, while most services, construction, and agriculture did not. In spite of a very decent GDP figure in late 2013, the Czech economy as a whole continued to fall in 2013. For the last two years, the economy declined by 2% and returned to the level of the late 2009 and early 2010. The growth prospects of the Czech economy for this year remain very favourable. Positive factors include Germany's persisting growth, soft indicators from the Czech Republic and nearby countries and, above all, decent orders, which are rising at a double-digit rate in industry.

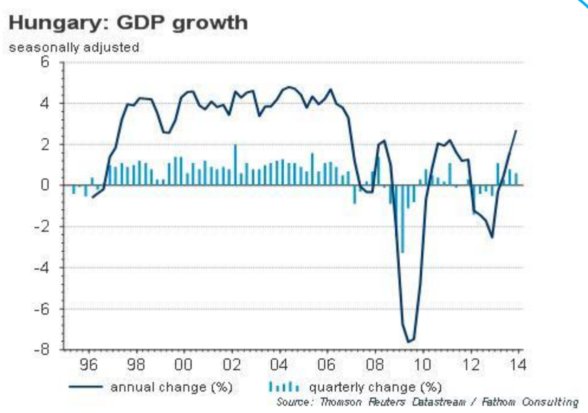
Hungary: back at the top of growth league?

The 4Q13 preliminary GDP figures delivered positive surprise in most of the countries in Europe. As 80% of Hungary's foreign trade is linked to the European Union, the favorable environment helped Hungarian economic growth as well, so it increased by 0.6% Q/Q and 2.7% Y/Y. The working day adjusted GDP growth was 1.2% Y/Y in 2013. The preliminary figure doesn't include the details of the growth, so we can make some conclusion from other statistics, which suggests that agriculture, construction and services sector performance may boost the growth on supply side, while the new swing may come from domestic consumption and investment on the demand side. The main – although only partly good news – as GDP growth accelerated on quarter-on-quarter basis in Hungary's main trading partners and also in the CEE region – that Hungary's economic growth slowed (from 0.8% Q/Q in 3Q13 to 0.6% Q/Q in 4Q13) less than expected. It confirms our view that economy may grow by 2% Y/Y in 2014.

Strong GDP figures from Poland confirmed

The Polish economy grew slightly slower in late 2013 than we had expected on the basis of a flash forecast of the annual GDP released two weeks ago. Even so, the first growth forecast for the fourth quarter of 2013 is 2.7% y/y (0.5% q/q and 2.2% y/y seasonally adjusted), and this is a very good figure compared to the rest of Europe. As in previous quarters, growth was likely driven by net exports in particular. On the other hand, the contribution of household consumption and likely also investment continued to rise. For this year, we predict economic growth of 3.4%.





Weekly preview

TUE 14:00	NBH base rate	
	This meeting	Last change
rate level (in %)	**2.75**	1/2014
change in bps	**-10**	-15

HU: The NBH to cut rates by 10bps this time

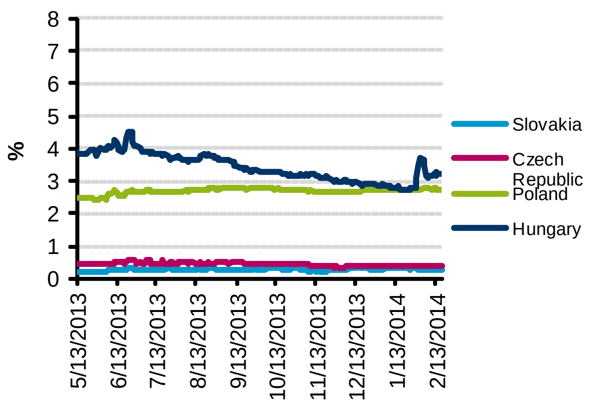
The NBH Council was already divided in this question, there are two members, how are more hawkish than the other seven members. The council emphasized in the last statements that headline inflation will remain below the inflation target in the next 6 quarters, which allows further rate cut. This situation hasn't changed, so it suggests that monetary easing may continue. The main question that the two hawkish members can convince at least three members about the clear fact, that the underlying inflation is around or rather slightly above 3% Y/Y, and the unreasonable rate cut increases Hungary's vulnerability and adds less to the economic growth. The last statements of the dovish members emphasized that EURHUF around 307 won't change the monetary policy, but they don't like the high volatility the HUF. So the two main options for next MPC meeting (held on 18 Feb) on hold or 10bp cut, but if EURHUF remains below 310 till Tuesday the chance for 10bp cut is increasing.

Calendar

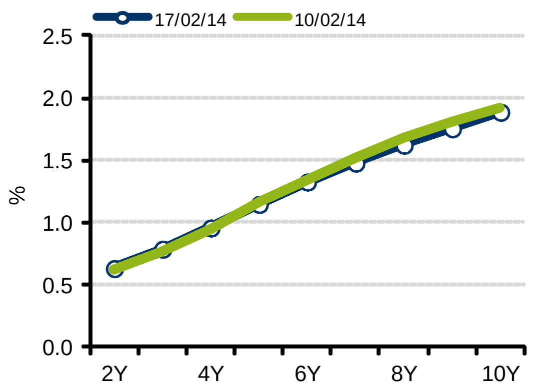
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	02/17/2014	15:00	Budget balance	PLN M	01/2014						
HU	02/18/2014	14:00	NBH meeting	%	02/2014	2.75		2.75		2.85	
PL	02/18/2014	14:00	Wages	%	01/2014			-10	3.2	8.3	2.7
PL	02/19/2014	14:00	Industrial output	%	01/2014			2.7	3.5	-9.7	6.6
PL	02/19/2014	14:00	PPI	%	01/2014			0.1	-0.8	0	-0.9

Fixed-income in Charts

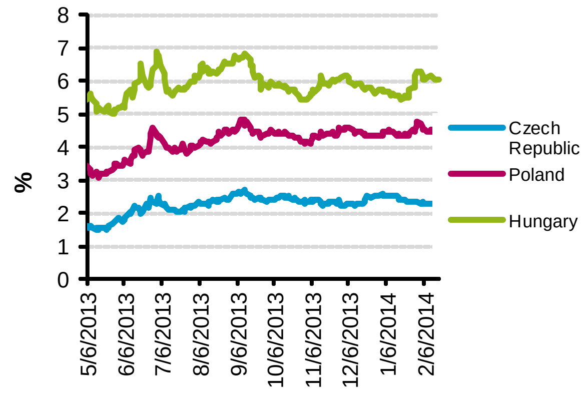
FRA 3x6



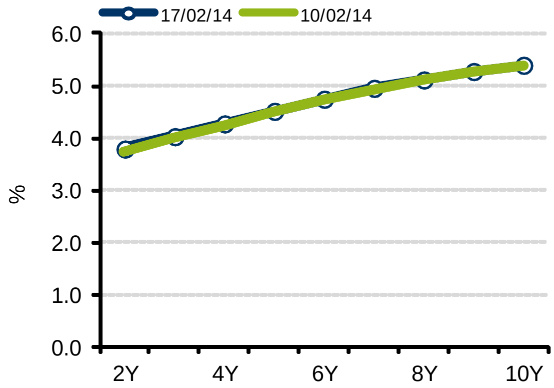
CZ IRS



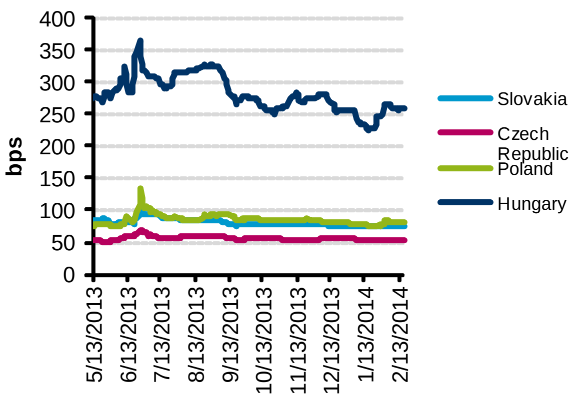
10Y GB Yields



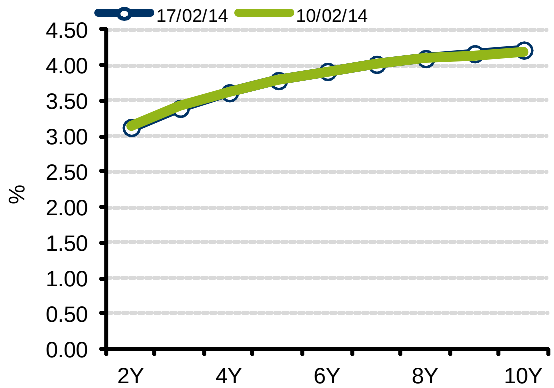
HU IRS



CDS 5Y



PL IRS



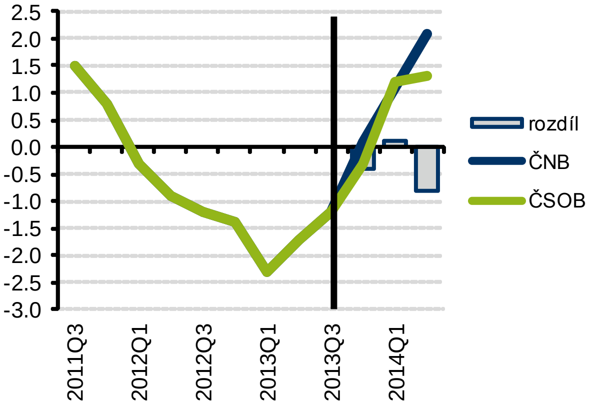
Source: Reuters

Medium-term Views & Issues

	The Czech Republic	Hungary	Poland
Growth & key issues	The president appointed a new coalition government a few months after the election. The programme of the future government is likely to be consistent with the concluded coalition agreement, which envisages keeping the government deficit below 3% of GDP throughout the government's electoral term. Statistics for the last six months confirm that the worst is over for the economy. The economy is being driven by the manufacturing industry, notably passenger car production, while construction, as well as many of services, are struggling to bottom out.	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. as GDP growth accelerated on quarter-on-quarter basis in Hungary's main trading partners and also in the CEE region – that Hungary's economic growth slowed (from 0.8% Q/Q in 3Q13 to 0.6% Q/Q in 4Q13) less than expected. It confirms our view that economy may grow by 2% Y/Y in 2014.	The preliminary estimate of GDP growth in Poland (1.6%) for 2013 indicates the growth rate of around 3% y/y in the fourth quarter 2013. For this year, the growth could significantly exceed 3%. Household consumption should support growth, owing to the improving labour market situation as well as to low inflation. Investment should also develop favourably, owing to the replenishment of inventories as well as to gross capital formation In addition, lower government debt could also give a greater lift to the economy. By contrast, net exports are likely to curb rather than boost growth.
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 2.2% this year. The CNB is very unlikely to change rates, and just as likely to maintain its intervention regime throughout this year.	The NBH emphasized in the last statements that headline inflation will remain below the inflation target in the next 6 quarters, which allows further rate cut. This situation hasn't changed, so it suggests that monetary easing may continue. The main question that the two hawkish members can convince at least three members about the clear fact, that the underlying inflation is around or rather slightly above 3% Y/Y, and the unreasonable rate cut increases Hungary's vulnerability and adds less to the economic growth. The last statements of the dovish members emphasized that EURHUF around 307 won't change the monetary policy, but they don't like the high volatility the HUF. So the chance for anther 10bp cut is there.	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 end 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.	The EUR/HUF was affected by the emerging market sell-off and moved suddenly above 310 levels, which is the highest read in the last two years. Technically, we see important EUR/HUF resistance levels at around 314, 317 and 324, while on the strong side around 310, 308 and 305.	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. The Zloty is also more vulnerable to the emerging markets sell offs due to higher CA deficit and lower FX reserves.

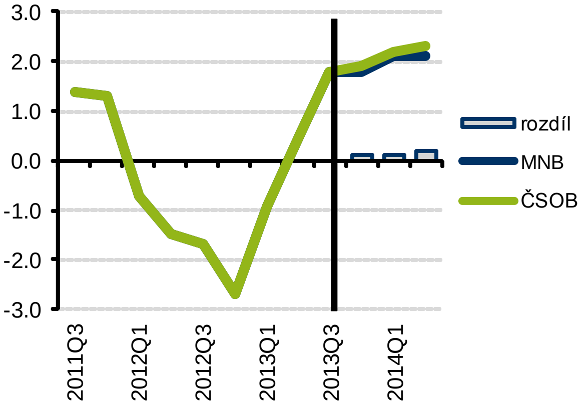
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

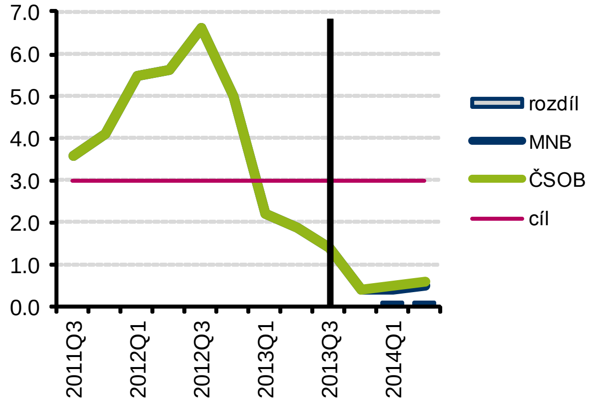


CZ: Inflation outlook (Y/Y, %)

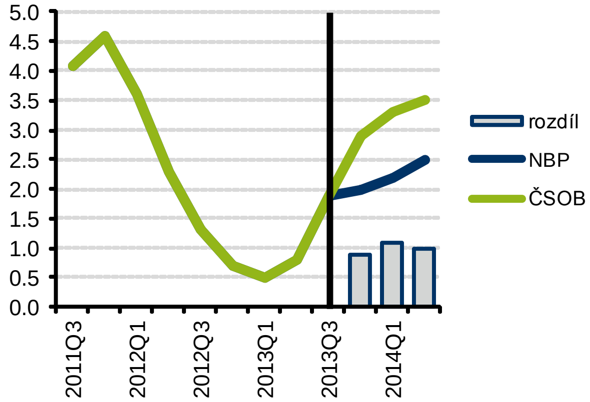
HU: GDP outlook (Y/Y, %)



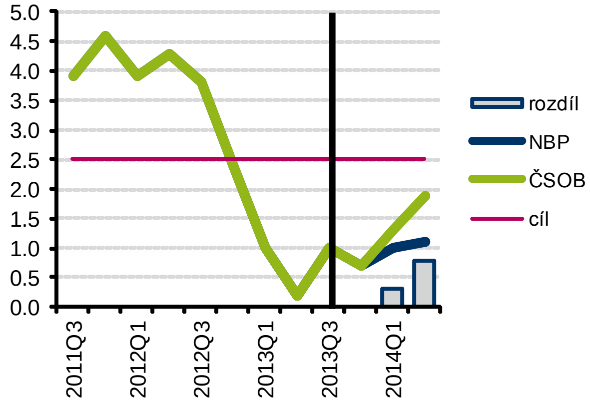
HU: Inflation outlook (Y/Y, %)



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	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.	*2.85*	4.25	3.60	3.00	4.00	4.50	-20 bps	1/21/2014
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	*0.37*	0.44	0.42	0.38	0.37	0.36
Hungary	BUBOR	*2.85*	4.20	3.56	2.99	3.50	3.70
Poland	WIBOR	*2.71*	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	*1.89*	1.97	2.06	2.09	1.95	2.15
Hungary	HU10Y	*5.40*	5.84	5.17	5.25	6.10	6.20
Poland	PL10Y	*4.22*	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	27.4	27.2
Hungary	EUR/HUF	*309*	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	-2.3	-1.7	-1.2	-0.3	1.2	1.3
Hungary	-2.7	-0.9	0.5	1.8	1.9	2.2	2.3
Poland	0.7	0.5	0.8	1.9	2.9	3.3	3.5

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	0.4	0.5	0.6
Poland	2.4	1.0	0.2	1.0	0.7	1.3	1.9

Current Account

	2012	2013
Czech Rep.	-1.9	-1.1
Hungary	1.5	2.0
Poland	-3.5	-1.7

Public finance balance as % of GDP

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

Source: CSOB, Bloomberg

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