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Central European Weekly

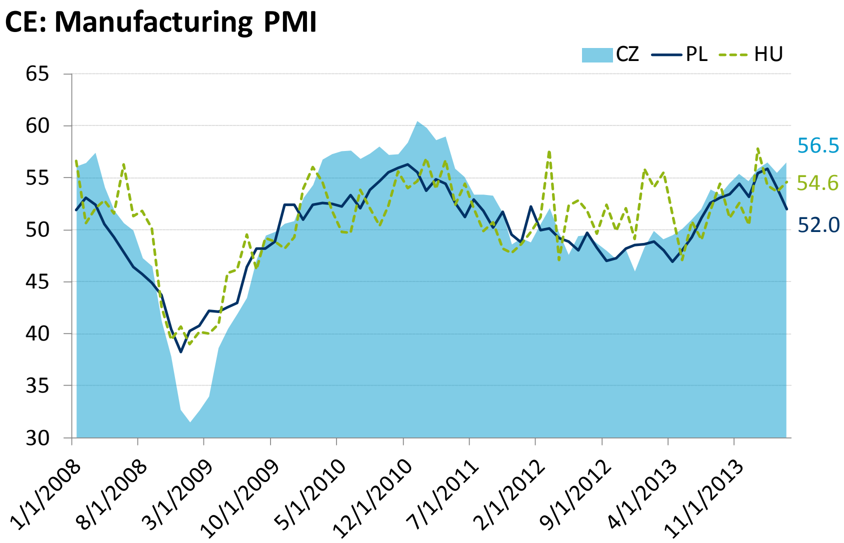
Monday, 05 May 2014

Table of contents

Weekly Highlights:

- The Ukrainian crisis remains in focus
- Polish PMI hit an eight-month low in April
- The CNB will downgrade its outlook for 2014 inflation
- The NBP will maintain dovish tone

Chart of the Week: regional PMIs



Polish PMI lagged behind both Czech and Hungarian one in April as the tensions between Russia and Ukraine escalated. (Source: Bloomberg, CSOB)

Market's editorial

Ukraine and low PMIs do not help the zloty

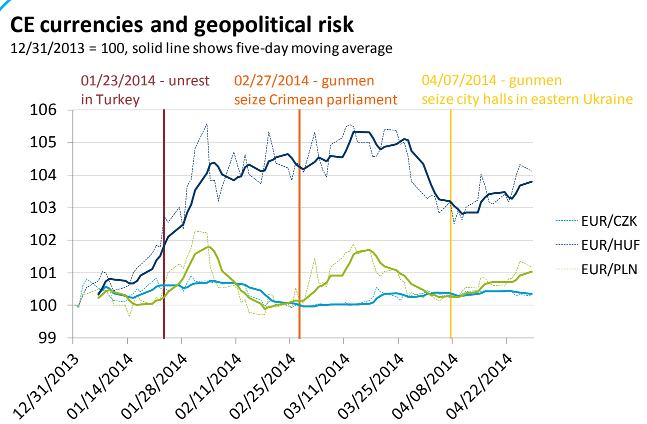
So it seesm that mounting tensions between pro-Russian parts of Ukraine and Kiev authorities had a negative impact mostly on the Polish zloty, which was further hurt by a surprisingly weak PMI for April (slowdown in new export orders, whose sub index reached mere 50.5 points, was to blame there see). Interestingly, Polish PMIs decoupled significantly from Czech and Hungarian indicies, which moved higher in April (the chart on the cover page).

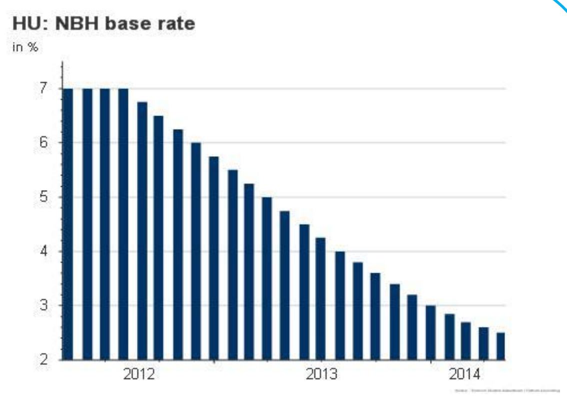
So, the zloty swung back over the EUR/PLN 4.20 level, while other regional currencies and all government bonds in Central Europe have perfomend quite well in recent dayds despite the fact that there has been more violance in the east part of Ukraine.

Regarding the week ahead, well-filled calendar with scheduled releases of interesting macroeconomic figures (especially in the Czech Republic) hardly diverts markets´ attention from further developments in Ukraine and Wednesday meetings of CNB and NBP. We see no material change in rhetoric either in Prague, or in Warsaw and expect both banks to maintain their dovish stance, which could provide additional mild support to regional bond yields (having dropped significantly over the past week). In addition, the ECB will conclude its meeting on Thursday.

Ukraine will remain worth watching ahead its elections

Regarding Ukraine, a vote on independence from Kiev to be held in the unilaterally declared People's Republic of Donetsk next Sunday can further escalate tensions between central government and pro-Russian separatists and therefore have adverse impact on the regional currencies (see the chart).





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*27.5*	*-0.03%*	↗	→
EUR/HUF	*308*	*-0.83%*	↗	↗
EUR/PLN	*4.21*	*-0.02%*	↗	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*1.65*	*-0.60*	↘	↗
10Y HUF	*4.73*	*-3.17*	↘	↗
10Y PLN	*3.92*	*-1.75*	↘	↗

Weekly preview

WED 9:00 CZ Retail sales (y/y change in %)

	Mar-14	Feb-14	Mar-13
Monhtly	**7.0**	8.1	-3.5
cummulative (YTD)	**7.1**	7.2	-3.0

CZ: Retail driven by cars and e-commerce

Retail sales likely continued to rise rapidly for a fifth consecutive month, primarily boosted by the automotive segment, specifically new car sales. The e-commerce sales are rising at a double-digit rate, and the related sales of electronics, benefiting from the long-term decline in the prices of those goods. Sales of fuel and food, where prices are on the rise, are likely to be low. Thus the retail sector continued to benefit from car sales in March; however, this is attributable in part to business purchases and in part probably to re-sales abroad, which have nothing to do with domestic demand.

WED 9:00 CZ Industry (y/y change in %)

	Feb-14	Jan-14	Feb-13
Monhtly	**8.0**	6.7	-6.1
cummulative (YTD)	**6.8**	6.2	-5.4

CZ: Industry still headed by the car sector

The production of the automotive industry is likely rising rapidly for an eighth consecutive month, driving the performance of the entire sector steeply upwards. Given the previous developments in new orders, notably foreign ones, this should also be true of March. All major sectors of the manufacturing industry were likely in the black, particularly the production of computers, metal products, plastics, and chemicals. We expect a double-digit rise in new orders, notably foreign ones, and orders for the automobile industry.

WED 13:00 CNB base rate

	This meeting	Last change
rate level (in %)	**0.05**	11/2012
change in bps	**0**	-20

CZ: New macro projection with lower inflation

As the inflation remains well below the target as well as its forecast, the CNB can remain present low interest rates as well as exchange rate regime unchanged. The CNB is still satisfied with its new monetary policy regime and continues to point out imminent downside risks to inflation. The Board will discuss new inflation prognosis which could be less optimistic about inflation compared the current one. We expect that the CNB will decrease its inflation forecast for 2015 and will postpone its expected timing of the first rate hike and the fx regime exit. Thus far, the CNB plans to leave its exchange rate regime and raise rates early next year. We see such timing as being too early, at the moment. New prognosis can postpone expected monetary policy tightening by app. 6 months.

WED 14:00 NBP rate (in %)

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

PL: The NBP again with no policy change

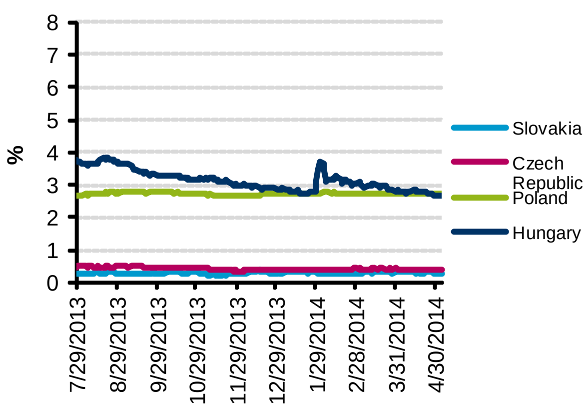
A meeting of the National Bank of Poland (NBP) will produce no substantial news. The NBP will reiterate its ‘commitment’ to keep interest rates unchanged until at least the end of the third quarter of the year, and NBP President Belka will support the overall dovish tenor of the meeting by his comments at the subsequent press conference. As regards any possible rate cut, Belka explicitly stated after the last meeting that, given the continuing economic recovery, the NBP was not considering such a move. The ‘commitment’ to keep rates unchanged until at least the end of the year, which is a very likely scenario, will not be extended before the July meeting, when a new forecast becomes available to the NBP.

Calendar

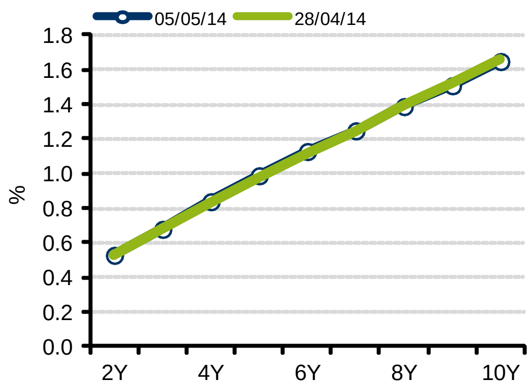
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	05/05/2014	9:00	PMI manufacturing		04/2014					53.7	
HU	05/05/2014	9:00	Trade balance	EUR M	02/2014 *F					765.9	
HU	05/06/2014	9:00	Retail sales	%	03/2014						6.7
CZ	05/06/2014	9:00	Trade balance (national)	CZK B	03/2014	13.5		16.9		13.6	
CZ	05/06/2014	9:00	Trade balance	CZK B	03/2014	41		37		34	
CZ	05/07/2014	9:00	Retail sales	%	03/2014		7		7.3		8.1
CZ	05/07/2014	9:00	Industrial output	%	03/2014		8		8		6.7
CZ	05/07/2014	9:00	Construction output	%	03/2014						6.1
CZ	05/07/2014	13:00	CNB meeting	%	05/2014	0.05		0.05		0.05	
PL	05/07/2014	14:00	NBP meeting	%	05/2014	2.5		2.5		2.5	
HU	05/08/2014	9:00	Industrial output	%	03/2014 *P					1.6	8.1
HU	05/08/2014	9:00	Trade balance	EUR M	03/2014 *P					759.3	
HU	05/09/2014	17:00	Budget balance	HUF B	04/2014					-701.2	

Fixed-income in Charts

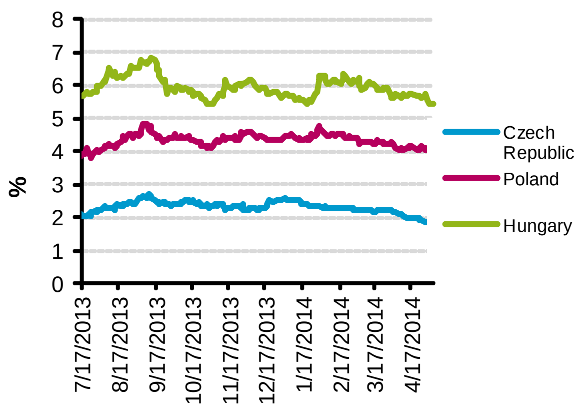
FRA 3x6



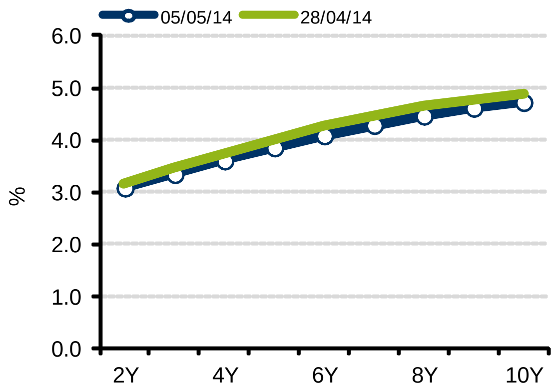
CZ IRS



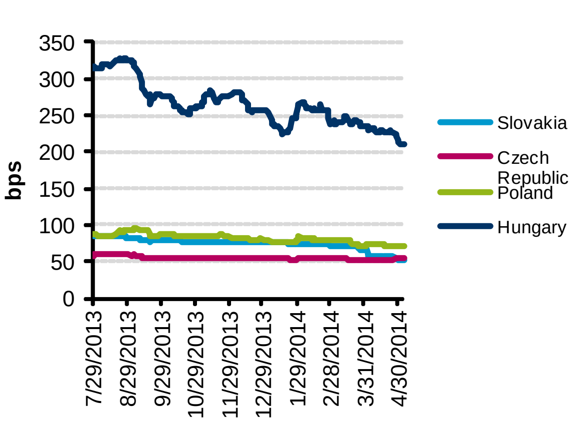
10Y GB Yields



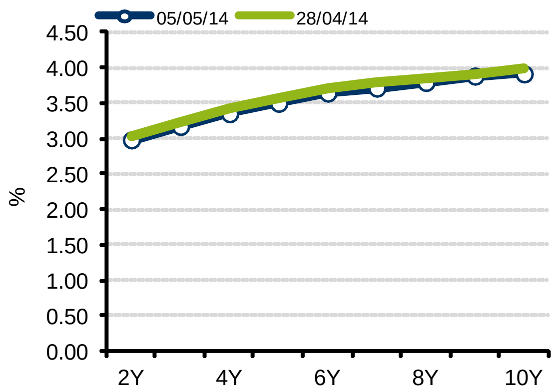
HU IRS



CDS 5Y



PL IRS



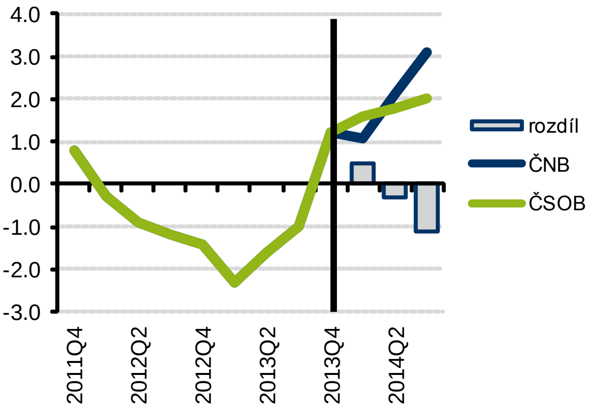
Source: Reuters

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.	We don't expect radical changes of Fidesz/government policy after April's election. 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.	According to the GUS estimates the Polish economy grew by 2.7% in 2013Q4. For this year, the growth should significantly exceed 3%. Household consumption should support growth, owing to the improving labor market situation as well as to low inflation. Investment should also develop favorably, 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 tone of the statement is definitely more hawkish than previous months and it suggests strongly that the NBH may stop the rate cut cycle in May, although it still leaves open the door for another 10bp cut in case of the international sentiment improves further. We think that the more cautious tone is also because of the new monetary policy tools and regulations the NBH announced yesterday and last week (there will be two-week deposit despite of two-week NBH bill from 1 August and banks has to use above 1-year financing tools for funding of long-term foreign currency loans). We expect that in case of no change of Hungary's risk premium and no strengthening of HUF, NBH may keep base rate unchanged in May.	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 3.6% growth while we estimate 3.4% 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 at the end of 2014 at earliest.
Forex Outlook	The CNB has started FX interventions and we expect the koruna to stay within the regime at least till the mid 2015. 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.	We don't expect fast and substantial forint movement after the April election.	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 as well as to development in Ukraine.

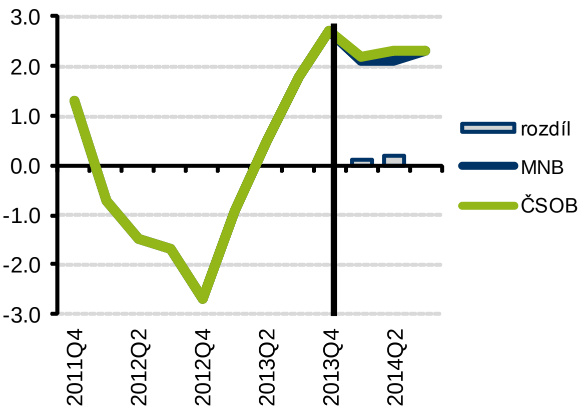
CBs' Projections vs. Our Forecasts

CZ: GDP outlook (Y/Y, %)

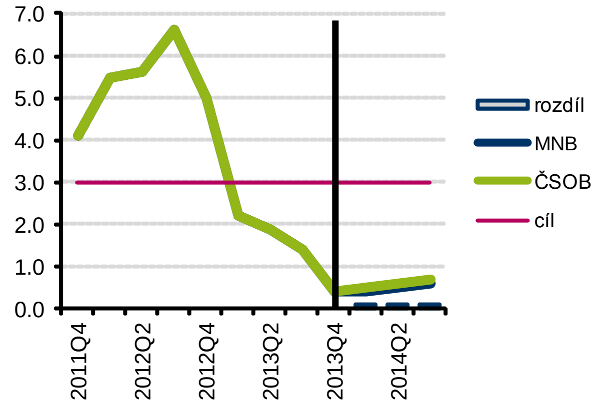


CZ: Inflation outlook (Y/Y, %)

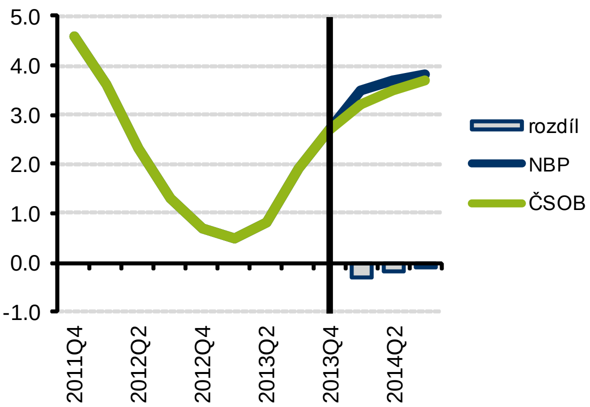
HU: GDP outlook (Y/Y, %)



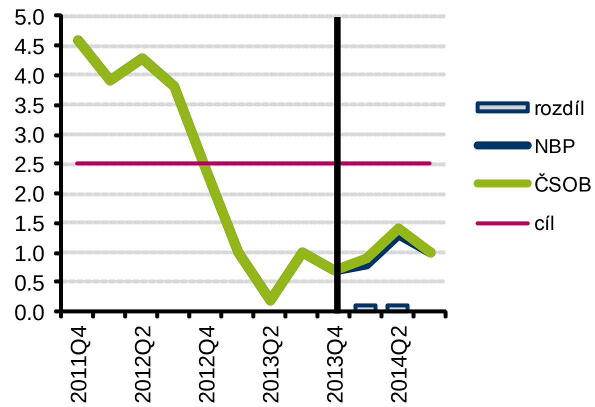
HU: Inflation outlook (Y/Y, %)



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	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	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.	*2.50*	3.60	3.00	2.60	2.50	2.50	-15 bps	4/29/2014
Poland	2W inter. rate	*2.50*	2.50	2.50	2.50	2.50	2.50	-25 bps	7/3/2013

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

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	PRIBOR	*0.37*	0.42	0.38	0.37	0.36	0.36
Hungary	BUBOR	*2.56*	3.56	2.99	2.67	2.50	2.50
Poland	WIBOR	*2.72*	2.67	2.71	2.71	2.75	2.75

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

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	CZ10Y	*1.65*	2.06	2.09	1.84	1.90	2.15
Hungary	HU10Y	*4.73*	5.17	5.25	4.95	5.00	5.30
Poland	PL10Y	*3.92*	4.24	4.25	4.03	4.10	4.45

Exchange rates (end of the period)

		Current	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	EUR/CZK	*27.5*	25.7	27.3	27.4	27.2	27.2
Hungary	EUR/HUF	*308*	297	297	307	300	300
Poland	EUR/PLN	*4.21*	4.22	4.16	4.17	4.10	4.00

GDP (y/y)

	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	-2.3	-1.6	-1.0	1.2	1.6	1.8	2.0
Hungary	-0.9	0.5	1.8	2.7	2.2	2.3	2.3
Poland	0.5	0.8	1.9	2.7	3.2	3.5	3.7

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

	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3
Czech Rep.	1.7	1.6	1.0	1.4	0.2	0.6	1.3
Hungary	2.2	1.9	1.4	0.4	0.5	0.6	0.7
Poland	1	0.2	1.0	0.7	0.9	1.4	1.0

Current Account

	2013	2014
Czech Rep.	-1.4	-1.4
Hungary	2.0	2.2
Poland	-1.2	-2.5

Public finance balance as % of GDP

	2013	2014
Czech Rep.	-1.4	-2.5
Hungary	-2.7	-3.0
Poland	-4.4	-3.5

Source: CSOB, Bloomberg

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