Tuesday, April 03, 2012

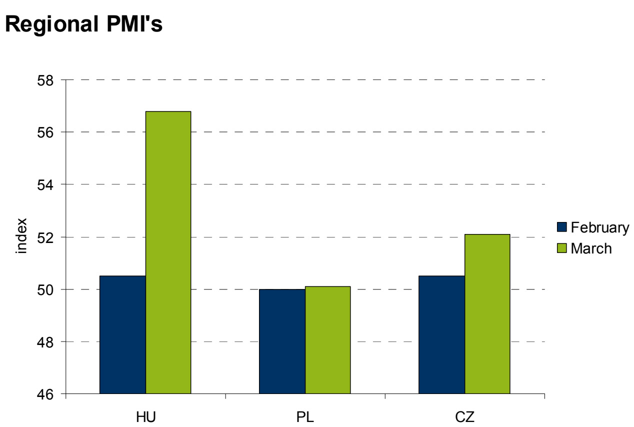
Central European Weekly

Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- Central banks in the region are taking increased inflation into account
- Regional PMI's improved significantly in March
- The MNB significantly increases its 2012 inflation forecast
- The NBP still in neutral bias; Cars continue to drive Czech industry

Chart of the Week: Business Sentiment in Manufacturing



The Czech and Hungarian PIM indices improved significantly in March.

Table of Contents:

Market's editorial

CE Central banks take high inflation into account.

Inflation in the region is on the rise; this week, it was evident that, for the first time in long while, Central European central banks are also starting to reflect this.

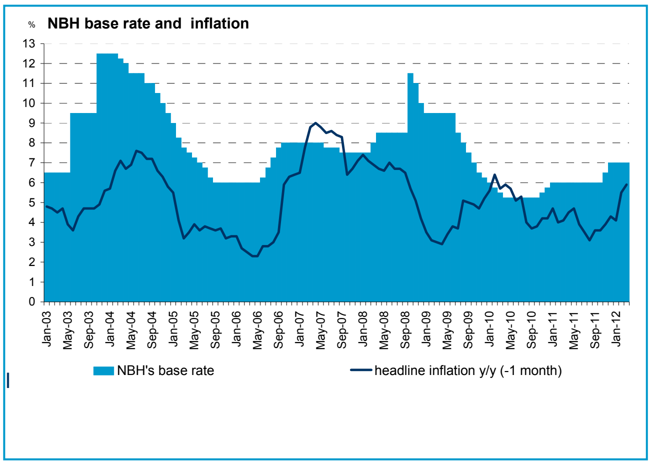
The MNB policy will still dictate risk premium

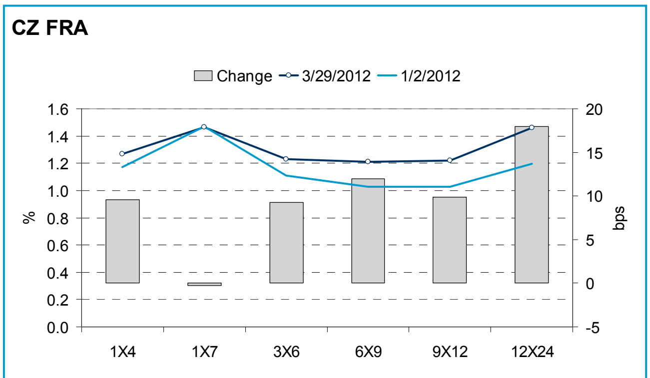
The National Bank of Hungary (MNB), which released its new inflation forecast on Tuesday, was the first. It cited a significant increase in the anticipated inflation for this year. Although Hungary's inflation went up due to increased indirect taxes, hardly any institution, including the MNB, had expected at the beginning of the year that inflation would climb towards 6%. Hence the National Bank of Hungary took account of the unfavourable inflation developments, which in effect is likely to temporarily subdue the calls for a cut in the base rate inside the MNB Monetary Council. Nonetheless, the dovish bias within the MNB may not be put into effect until the Hungarian government acquires a new IMF loan, which guarantees the long-term stability of the currency.
In this respect, the latest rumours seem to be encouraging: The daily Magyar Nemzet said, the IMF/EU will grant a two-year credit line of EUR 10bn-15bn and the deal could be signed three weeks after the government resolves its dispute with the EU. This could mean, that the external financing of the country is granted until the 2014 elections, the Hungarian State can repay its debt independent from the situation of the capital markets.

The CNB and The NBP should sound less dovish

The worsened situation as concerns inflation also influenced the CNB Board meeting, where, for the first time in a long while, one vote was cast for a repo rate hike,. Although rates are not going to be raised any time soon, it is another signal that the Czech National Bank cannot remain completely indifferent to almost 4% inflation.

Finally, the National Bank of Poland will also have a chance to comment on increased inflation this week. Both the headline inflation rate and inflation expectations have been above 4% for five consecutive months, and this upsets some Members of the Monetary Policy Council. While NBP Governor Belka will scarcely admit a scenario in the months to come other than that of the official interest rate remaining unchanged, hawkish statements from the National Bank of Poland may resound louder next time.





Source: Reuters

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.8	0.69%	↘	↘
EUR/HUF	295	0.94%	↘	↘
EUR/PLN	4.14	-0.03%	↘	↘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.29	-1.51	→	→
10Y PLN	7.32	0.97	→	→
10Y HUF	4.97	-0.40	↘	↘

Review of Economic Figures

Regional PMI's improved significantly in March

Regarding the fresh PMI figures, they have showed an improvement in business sentiment across the whole region. The most significant increase took place in Hungary – the overall index surged to 56.8 point in March (from 50.5 in February). Thus, the figure suggests that the Hungarian industry is on a positive path. The latest known "hard" data on industrial production (January) unveiled that the most significant branches (as far as the value added is concerned), namely the car industry and the manufacture of machinery and equipment, remain in a good shape.

Like in Hungary, the result of the Czech PMI indicates that Czech enterprises managed to take advantage of a positive development in Germany. Moreover, it is encouraging to see that the result was driven by stronger new orders.

On the contrary, Polish PMI showed only a negligible improvement by 0.1 point. However, we think that this is more or less a result of a still-good condition of the Polish economy and a higher interest rate, which should weigh on the growth in 2012.

NBH significantly increases its inflation forecast

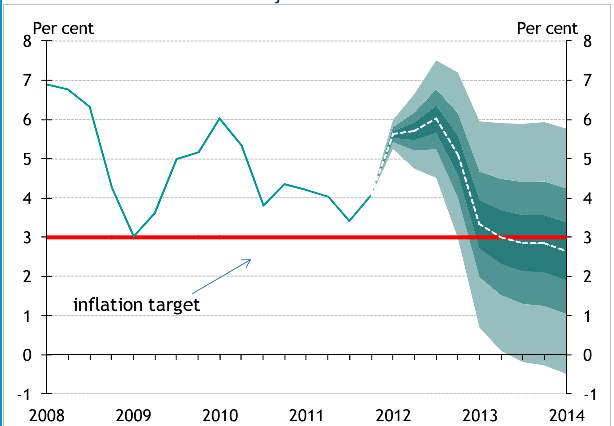
The MNB released its new quarterly forecast, in which it had to take into account the latest highly negative inflation developments. The MNB now expects that inflation will climb to 6%, due to an increase in indirect taxes, and high petrol and food prices. Although the MNB believes that, owing to the favourable comparative baseline, inflation is likely to return to 3% in 2013, a precondition of this scenario is a gradual decline in the risk premium on Hungarian bonds over a prolonged period. And it is our belief that the development of the risk premium, associated with inflation, as well as the development of the exchange rate of the forint, will, in the end, (as always) determine when the MNB is able to cut its base rate. This is very unlikely to happen before it is clear whether the government can acquire another bridging loan from the IMF. This should be decided in May or no later than June this year.

The CNB leaves its repo rate unchanged, but one Board member votes for a rate hike.

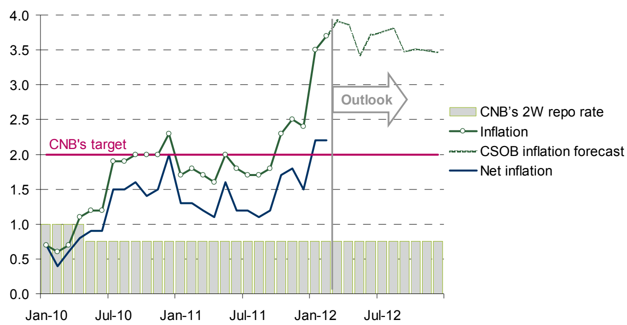
Last week as we might expect, the Czech National Bank left rates unchanged. Probably the most interesting outcome from the CNB Board meeting is that, while the six CNB Board Members voted for rate stability, one vote was cast for a rate hike, for the first time in a longer while. We believe that CNB Board Member Zamrazilová, who had already advocated hawkish views in the past and was thus prepared to raise rates earlier, was likely the one who voted for a repo rate hike.

Otherwise, markets may be interested in the fact that, even though the latest forecast favoured a rate cut this year, now the CNB cites balanced risks; while the upside risks to inflation include the currently higher inflation, the downside risks include a stronger koruna and lower rates abroad. Thus it is no wonder that most CNB Board Members are still of the opinion that they should keep official rates unchanged and wait for more figures from the economy. Bear in mind that neither the GDP forecast nor the inflation forecast has materialised thus far. At its next meeting, the CNB Bank Board will have a new outlook available, which is likely to differ only slightly from the existing one, as concerns the latter two parameters mentioned. We keep our baseline scenario for this year unchanged, and this is why we do not expect the CNB to change its repo rate in the months to come either.

HU: MNB's New Inflation Projection



CZ: Inflation and CNB's Target
(%)



Weekly Preview

WED 9:00	CZ Retail Sales (change in %)		
	Feb-12	Jan-12	Feb-11
Sales	**0.0**	1.3	5.9
cummulative (YTD)	**0.6**	1.3	6.6

CZ: Retail sector to be subdued

After January's increase, primarily driven by the automotive market segment, it is likely that the retail sector is slowly heading for a depression. While car sales went up, the rise was much slower than in January, and thus the overall retail data will not be great either. The deceleration of sales reflects poor domestic demand, which remains at the mercy of consumer pessimism and declining real earnings of households. The new data will most likely reaffirm the fact that there is basically no demand-pull inflation in the Czech Republic.

WED 14:00	NBP rate (in %)	
	This	Last change
rate level	**4.50**	5/2011
change in bps	**0**	25

PL: The NBP to leave rates unchanged again

The National Bank of Poland (NBP) is unlikely to change rates at its Wednesday meeting. Persisting high inflation, which has remained above 4% for five consecutive months, just like inflation expectations, has upset some Members of the Monetary Policy Council, yet calls for another rate hike are still rare. In addition, Governor Belka said in a fairly clear and open manner last week that rates were unlikely to change in either direction. Hence we view rate stability throughout 2012 as a credible scenario at the moment.

FRI 9:00	CZ Foreign trade (CZK bn)		
	Feb-12	Jan-12	Feb-11
Balance	**22.0**	29.6	13.4
cummulative (YTD)	**51.7**	29.6	31.5
Exports (y/y in %)	**10.0**	11.0	17.4
Imports (y/y in %)	**6.5**	6.3	20.1

CZ: Exports fuelled by cars

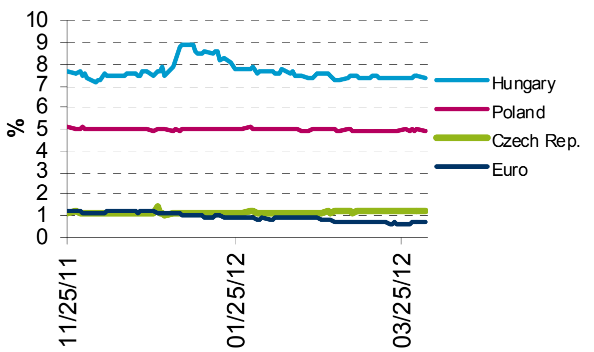
The automotive industry continues to be the primary contributor to the rise in exports and consequently to the good trade balance data. February's imports were still inflated by the increased import prices of raw materials, while the need for imports has been increasingly reduced by poor domestic demand. We expect a very good foreign trade figure for February again, albeit the trade balance will not improve as rapidly as in January.

Calendar

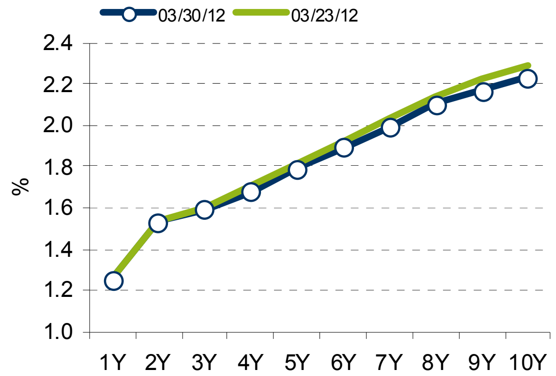
Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	04/02/2012	9:00	PMI manufacturing		03/2012					50.5	
PL	02.04.2012	9:00	PMI manufacturing		03/2012					50	
CZ	02.04.2012	9:30	PMI manufacturing		03/2012					50.5	
CZ	02.04.2012	14:00	Budget balance	CZK B	03/2012					-16.6	
HU	03.04.2012	9:00	Trade balance	EUR M	01/2012 *F					423.5	
CZ	04.04.2012	9:00	Retail sales	%	02/2012		0		1		1.3
CZ	04.04.2012	12:00	CZ bond auction 3.85%/2021	CZK B	04/2012						
PL	04.04.2012	14:00	NBP meeting	%	04/2012	4.5		4.5		4.5	
HU	05.04.2012	17:00	Budget balance	HUF B	03/2012					-286.6	
CZ	06.04.2012	9:00	Construction output	%	02/2012						-5.3
CZ	06.04.2012	9:00	Trade balance	CZK B	02/2012	22		23		29.6	
HU	06.04.2012	9:00	Industrial output	%	02/2012 *P				-1	2.1	-2.7
HU	06.04.2012	9:00	Trade balance	EUR M	02/2012 *P			814.8			
CZ	06.04.2012	9:00	Industrial output	%	02/2012		3		3		3.2

Fixed-income in Charts

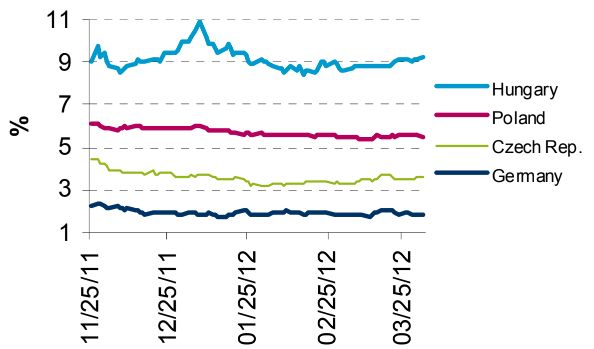
FRA 3x6



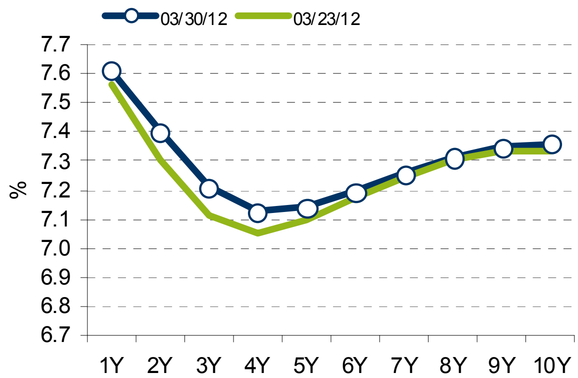
CZ IRS



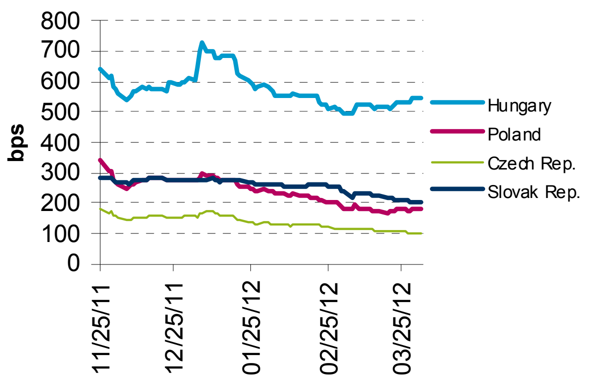
10Y GB Yields



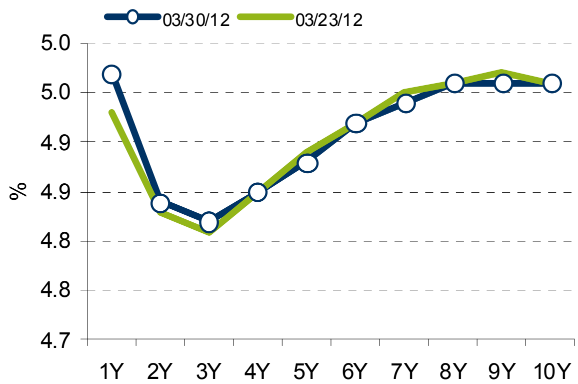
HU IRS



CDS 5Y



PL IRS



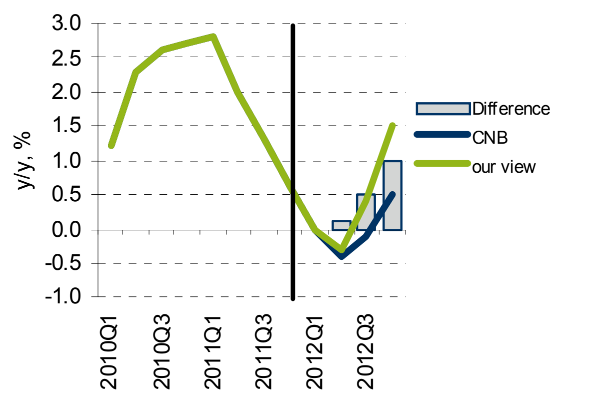
Source: Reuters

Medium-term Views & Issues

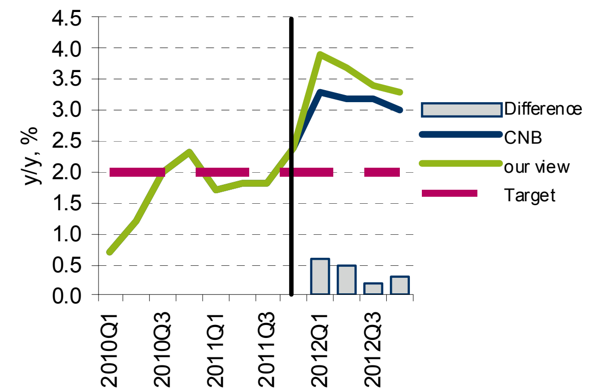
	The Czech Republic	Hungary	Poland
Growth & key issues	The state budget for 2012 is based on the unrealistic assumption of economic growth by 2.5%. Achieving the deficit target of 105 billion remains very uncertain. It will require further austerity measures. In addition to saving, a further discussion of tax increases may be considered. It can not therefore exclude the growing tensions in the government coalition. The government does not intend to set a target date for the euro adoption in the Czech Republic. On the other hand, CR will lend more money to the IMF to address the debt crisis Eurozone.	In the Hungarian outlook the IMF agreement will evidently have a crucial role. The EU/IMF talks have been ongoing in the background and the government sent its reply to the Commission, where it stand up to its demand about the oath of the central bank leaders and the retirement age of judges. We think it would be unlikely if Hungary does not get the loan facility because of these issues and the loan agreement could come in May- June.	According to preliminary estimates, the Polish economy grew by 4.3% last year. Nevertheless, we expect that factors that kept the Polish economy growing during the World Financial Crisis will gradually step aside and we estimate that the economy will grow at a slower pace next year. More specifically, a room for relatively loose fiscal policy seems to have diminished and higher interest rates should, in our view, contribute to a slowdown in both households' consumption as well as private and public investment.
Outlook for official & market rates	Inflation increased above the central bank's target in October driven by food and fuel prices. Fuel prices as well as prices of agricultural commodities continue to pose a risk for future inflation. In January the inflation will jump above the 3% as a result of V.A.T. increase. On the other hand, weak domestic demand should counter a rise in inflation. We expect the CNB to maintain its wait-and-see policy at least until the end of the next year. The first rate hike delivered by the Czech central bank is probable in 2013H1.	The MNB announced three new measures to boost forint credit in the banking system. Overall, I could help somewhat in the current deleveraging world, but the central bank also admits that current situation is more of the case of lack of willingness, where these may not help much. Meanwhile, the headline inflation accelerated to above 5% Y/Y on VAT hike. Further tightening does not look needed now, but definitely the VAT hike does not seem to pass on smoothly. Overall, cautious monetary policy is warranted, ie. the MNB may stay in a wait-and-see mode.	Although the inflation should somewhat decelerate and growth slow down in 2012, we do not believe in monetary easing. The inflation should still remain above the target for the whole year and the volatility of the zloty could have impact on inflationary expectations, if the NBP started with easing once again. On the other hand pretty low job creation should keep also the hawks on hold. Hence we bet on interest rate stability over the whole year 2012.
Forex Outlook	The Czech koruna has strengthened on the second Greek bailout deal and may extend gains in reaction to the global optimism On the other hand stronger US dollar may keep further gains limited. Also the Czech domestic factors do not look very supportive - slow continuation of real convergence does not argue for dramatic gains of the Czech currency over 2012. That said, at levels near 24.00 EUR/CZK, the koruna may be more vulnerable to potentially negative news from eurozone We see the koruna in 12- month horizon near current levels at 24.50 EUR/CZK.	EURHUF stays around 290 levels. As we have a look at the situation of EU countries in crisis, HUF strengthening in the past few weeks is remarkable. It is important to be aware of the international trends and investors' sentiment as the volatility of bond yields would not drop in the near future.	The Polish zloty has strengthened on Greek hope. Similarly to the koruna, the Greek deal may help to ensure further gains. Nevertheless the fundamentals should not permit gains below 4.00 EUR/PLN – the economy should slow down in second half and the rates remain flat. During the summer we may see some renewed selling pressure after the European championship in football takes place and the Greek/Portugal issue potentially comes back to the table. The motivation by official authorities to defend the zloty may be weaker this time due to changed methodology of debt/GDP calculation and lower sensitivity to FX volatility...

CB's Projections vs. Our Forecasts

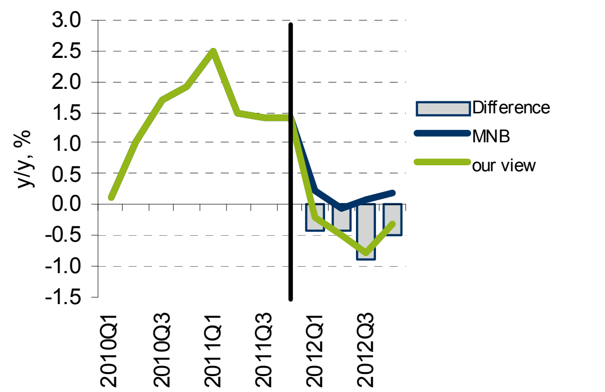
CZ: GDP Outlook



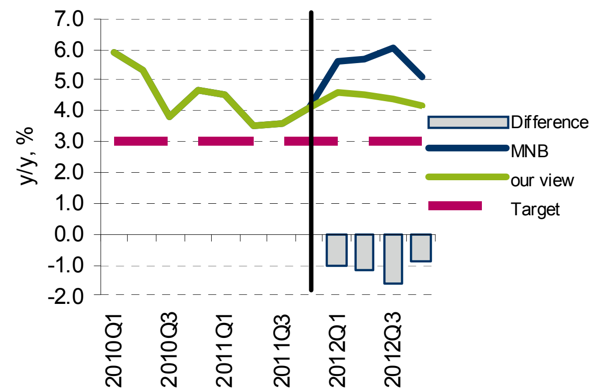
CZ: Inflation outlook



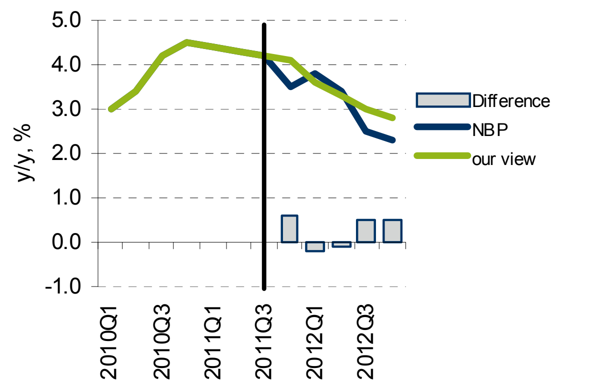
HU: GDP Outlook



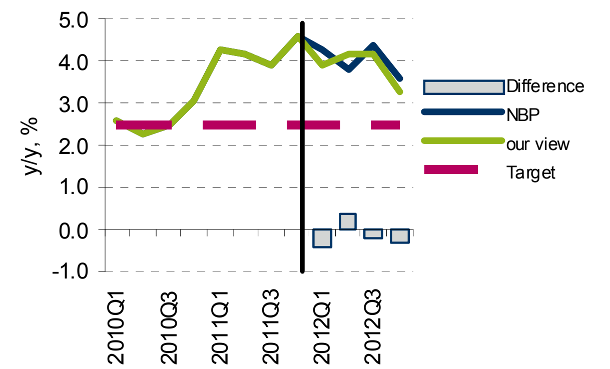
HU: Inflation outlook



PL: GDP Outlook



PL: Inflation outlook



Source: CNB, NBP, MNB, CSOB

Summary of Our Forecast

Official interest rates (end of the period)

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	Last change	
Czech Rep.	2W repo rate	*0.75*	0.75	0.75	0.75	0.75	0.75	-25 bps	5/7/2010
Hungary	2W deposit r.	*7.00*	6.00	7.00	7.00	7.00	7.00	50 bps	12/20/2011
Poland	2W inter. rate	*4.50*	4.50	4.50	4.50	4.50	4.50	25 bps	6/9/2011

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

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	PRIBOR	*1.23*	1.17	1.17	1.24	1.18	1.20
Hungary	BUBOR	*7.25*	6.00	6.50	7.00	7.00	7.00
Poland	WIBOR	*4.94*	4.60	4.60	4.60	4.75	4.80

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

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	CZ10Y	*2.23*	2.05	2.24	2.23	2.40	2.60
Hungary	HU10Y	*7.36*	7.50	7.50	7.10	6.80	7.20
Poland	PL10Y	*4.97*	4.80	5.00	5.00	5.10	5.20

Exchange rates (end of the period)

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	EUR/CZK	*24.8*	25.0	26.0	24.8	24.5	25.0
Hungary	EUR/HUF	*295*	295	280	290	290	290
Poland	EUR/PLN	*4.14*	4.35	4.10	4.10	4.00	4.30

GDP (y/y)

	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	2.8	2.0	1.3	0.6	0.0	-0.3	0.4
Hungary	2.5	1.5	1.4	1.4	-0.2	-0.5	-0.8
Poland	4.4	4.3	4.2	4.1	3.6	3.3	3.0

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

	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Czech Rep.	1.8	1.8	2.4	3.9	3.7	3.4	3.3
Hungary	3.5	3.6	4.1	4.6	4.5	4.4	4.2
Poland	4.2	3.9	4.6	3.9	4.2	4.2	3.3

Current Account

	2010	2011
Czech Rep.	-3.9	-2.9
Hungary	0.5	2.9
Poland	-2.1	-5.0

Public finance balance as % of GDP

	2010	2011
Czech Rep.	-4.8	-3.1
Hungary	-3.8	-2.9
Poland	-7.1	-6.9

Source: CSOB, Bloomberg

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