Economics

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CEEMEA Edition

- **Poland — Unexpected rate hike but communication does not convince.** We believe a rate hike is unlikely in June and possibly rates can be left on hold until the year end.
- **Czech Republic — Order-book for retail bonds opens today.** In other news, the pre-election polls suggest a stronger majority of left-wing parties and growing support for a possible centre-left coalition.
- **Slovakia — Lower industrial production in March/April likely.** Industrial confidence worsened in April reflecting lower order-books and expected production in the near-term.
- **Industrial Countries** — The **BOE**'s Monetary Policy Committee will announce today's policy decision. The position for this meeting is finely balanced; however, on balance, we expect the recent deterioration in growth prospects will prompt the MPC to expand QE by £25bn-£50bn on top of the £325bn programme already completed. **US** *initial jobless claims* likely rose by 10,000 following a surprise plunge the week before. Fed Chairman Bernanke is to speak at Conference on Bank Structure and Competition at Chicago Fed. **German** Chancellor Angela Merkel will address Parliament's lower house today on her aims for this month's G-8 and NATO summits. **France**'s President-Elect Francois Hollande is scheduled to meet with Eurogroup president Jean-Claude Juncker this afternoon.

Figure 1. Event Calendar

Time	Country	Indicator	Period	Actual	Citi	Market	Previous (revision)
Yesterday's events							
08:00	Hungary	Trade Balance (HUF mn)	Mar	608	850	815	691
08:00	Romania	Trade Balance (€mn)	Mar	-714		-	-512 (-517)
08:00	Slovakia	Trade Balance (€mn)	Mar	390	-	-	348 (341)
09:00	Czech Rep.	International Reserves (US$bn)	Apr	43.6	-	-	43.0
11:00	Poland	Interest Rate Announcement (%)	May	4.75	4.50	4.50	4.50
13:00	Hungary	Central Bank Minutes	-	-	-	-	-
Today's events							
-	Egypt	Consumer Prices (%YoY)	Apr		-	-	9.1
-	Egypt	Production Index (% MoM)	Mar				-1.4
08:00	Czech Rep.	Consumer Prices (%YoY)	Apr		3.6	3.6	3.8
08:00	Czech Rep.	Construction Output (%YoY)	Mar		-	-	-16.0
08:00	Czech Rep.	Industrial Output (%YoY)	Mar		-0.3	1.5	4.7
08:00	Czech Rep.	Unemployment Rate (%)	Apr		8.5	8.5	8.9
08:00	Slovakia	Industrial Production, wda(%YoY)	Mar		4.7	-	8.4
10:30	South Africa	Manufacturing Production (%YoY)	Mar		-	3.3	4.1

Source: National Sources, Bloomberg, Citi Investment Research and Analysis (CIRA)

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Poland

Unexpected rate hike but communication fails to convince

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On Wednesday the Monetary Policy Council (MPC) raised the base rate by 25bps to 4.75% in a move that came as a surprise to the market and us. Although we had expected the decision would be a close call we also believed stable rates were slightly more likely. The statement justified the decision by pointing to strong retail sales growth, somewhat improved business sentiment (at least according to some indicators) and elevated inflation expectations of households. As far as inflation is concerned the MPC said it would fall gradually in the medium term on the back of weaker economic activity but at the same time the Council emphasised that external factors remaining beyond the central bank's control could hinder the CPI's return to the target. The statement also included a list of numerous factors that suggest a weakening of inflation pressures in the future: slower industrial and construction output, high jobless rate, low employment growth, weak household credit expansion and moderate wage growth.

We don't expect a rate hike in June. Contrary to April, this time the MPC statement didn't include any indication of an imminent rate hike but said that incoming data will show whether more policy adjustment could be justified. However, we expect the data to see a further slowdown of economic activity (including lower-than-expected industrial output) and weakness in the labour market. Taking this into account as well as more neutral comments from Governor Belka we believe a rate hike is less likely in June and possibly rates can be left on hold until the year end. In other words we don't think the May hike was a beginning of a long monetary tightening cycle.

We did not find the reasons given by the MPC for the unexpected move to be compelling. First, the key arguments behind the decision appear to be much weaker than arguments against a hike. Although retail sales indeed remain strong, the sales data covers mostly big stores and therefore it does not accurately reflect actual trends in consumption. For example according to Polish statistical office data, sales in big stores rose in March by around 6.9%YoY in real terms, while data from Eurostat suggests growth of only 1.5% (Eurostat statistics also cover small stores but exclude car sales). As far as inflation expectations of households are concerned they have proved to be highly adaptive and to have little predictive power for future inflation. Given labour market developments we doubt inflation expectations could translate into any form of wage pressures. Furthermore the fact the MPC decided to raise rates by 25bps and then moved to a much more neutral rhetoric could be confusing. Given that rate hikes in Poland tend to have a very small and delayed (by at least 4-6 quarters) impact on CPI and economic growth we believe it makes sense to adjust rates only when the Council sees a need for a more substantial cumulative adjustment (of say 75bps or more). The tone of the statement however suggests this is not the case and the MPC is not convinced that more policy adjustment will be needed. All in all it appears to us that either the MPC wanted to raise rates by only 25bps (but did not communicate this) or it still sees room for more substantial tightening (but didn't send this signal to the market). Whatever the strategy, we would look for clearer communication in the coming months.

Czech Republic

Order-book for retail bonds opens today

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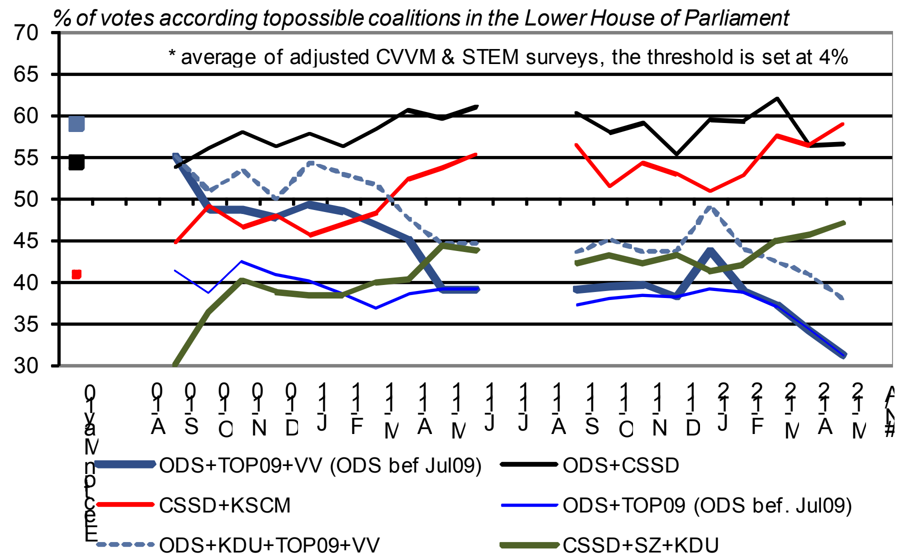
The MinFin will start to accept orders for its retail bonds (saving state bonds) today. There are four kinds of retail bonds on offer: 1.5Y, 5Y with gradually rising coupon, 5Y with reinvested rising coupon and 7Y CPI linker. The books are open until the end of May and the issuance will be on 12 June. The MinFin plans to issue CZK20-40bn of these bonds this year according to its strategy. As it is also planning an autumn auction of these bonds, the volume of the June auction could reach up to CZK20bn, if there is sufficient demand. In fact, the issuance in November 2011 was doubled to CZK20bn due to large demand. While households' demand may be somewhat lower due to a lower actual real yield (real 5Y yield likely currently around -1.5%, it was -0.3% in October 2011), the demand is likely to be supported by more eligible entities that could buy these bonds as the issuance is now also open to public entities like municipalities, heath insurance companies and Czech TV and Radio.

In other news, the pre-election polls suggest a stronger majority for the left-wing parties and growing support for a possible centre-left coalition. There were two polls conducted in late April, when the government faced the restructuring and the confidence vote. Both polls showed stronger support of left-wing parties (see red line in Figure below), weaker of right-wing parties (blue line), a high share of undecided voters (17%) and many votes for parties below the 5% threshold (15.5%) – if the Green and Christian parties breach the threshold, there would be a chance for a centre-left coalition (see grey line). Further support for the opposition parties is likely to depend on the outcome of planned strikes by the unions, which are going to start on 22 May after large protests by unions and civic platforms on 21 April – there were around 90,000-120,000 attendees.

Figure 2. Possible coalitions in the Lower House according to polls



Source: CIRA calculation based on STEM, CVVM and Factum/Median. Note: We include the parties that have more than 3.9%.

Elsewhere, we expect CPI inflation to ease in April due to lower food prices, but it is likely to remain above the CNB target until 4Q12. The CZSO's monthly food price survey suggests a decline of food prices in April. As a result, we expect consumer price inflation to ease to 3.6%YoY from its 40-month peak of 3.8%YoY in March 2012, which was mainly driven by higher food (eggs) and fuel prices as well as the VAT hike. However, CPI inflation is likely to remain elevated on average at 3.5%YoY until 4Q12, when we would then expect it to ease to below 3%. From there we expect CPI inflation to ease to 2.8%YoY in 2013, when VAT rates will be hiked by another 1% pt to 15% and 21%.

We expect a temporary positive correction in the industrial output in April. It is likely to increase by 1%MoM after a cumulative decline by 1.6% in Dec11-Feb12. This should reflect an improvement in the confidence survey that reported a better assessment of recent trends in manufacturing production in Feb-Mar. As a result, we expect the seasonally adjusted measure of growth to accelerate to 2.6%YoY (swda) from 0.3% a month ago. However, the headline outturn that is not adjusted for working day effects is likely to worsen to -0.3%YoY from 4.7% a month ago. While we had expected a temporary industrial production improvement in later 1Q12, our forecast for 2012 as a whole remains weak at between 1% and 2%YoY from the 7% in 2011. By contrast, the services improved in Jan-Feb 2012 (owing to transport) that represents some upside risk to our forecast of an easing of GDP growth to -0.1%YoY in 1Q12 from 0.6% in 4Q11.

Both these data are likely to support the recent dovish tone from the CNB, while we expect a flat policy rate until mid 2013 due to a weaker koruna. While the koruna has weakened to 25.5 against the euro, it would have to be at 26 for the rest of 2Q to prompt a discussion of a hike in the CNB's policy rate.

Slovakia

Lower industrial production in March/April likely

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We expect industrial production growth to stabilise around 5%YoY in March/April after it was boosted recently by the car sector due to new production capacities and the utility sector due to adverse weather in February. Industrial confidence worsened in April reflecting lower order-books and expected production in the near-term.

Selected Market Indicators

Figure 3. Selected Market Indicators

Currency Performance

	Spot (Prev Close)	Change (%) 1 Day	1 M
Europe (vs euro)			
Bulgaria Lev	1.96	-0.01%	0.01%
Croatia Kuna	7.51	0.00%	0.35%
Czech Koruna	25.2	0.52%	1.99%
Hungary Forint	288	0.51%	-2.84%
Poland Zloty	4.21	0.48%	1.01%
Romania Lei	4.41	0.08%	0.88%
Russia Ruble	39.1	-0.13%	1.03%
Serbia Dinar	112	0.09%	0.30%
Turkey Lira***	1.78	1.18%	-0.74%
Ukraine Hryvnia***	8.04	0.00%	0.28%
Middle East (vs USD)			
Bahrain Dinar	0.38	0.00%	-0.01%
Egypt Pound	6.04	-0.04%	0.00%
Israel Shekel	3.81	0.25%	1.79%
Jordan Dinar	0.71	0.08%	0.11%
Kuwait Dinar	0.28	0.04%	-0.14%
Lebanon Pound	1502	-0.23%	-0.13%
Qatar Rial	3.64	0.00%	0.00%
S Arabia Riyal	3.75	0.00%	0.00%
UAE Dirham	3.67	0.00%	0.00%
Sub-Saharan Africa (vs USD)			
Botswana Pula	0.13	-0.74%	-0.59%
Ghana Cedi	1.88	0.54%	4.90%
Kenya Shilling	83.3	0.23%	0.26%
Malawi Kwacha	241	-3.98%	45.71%
Nigeria Naira	157	0.11%	-0.13%
S. Africa Rand	7.93	1.46%	0.55%
Tanzania Shilling	1590	0.03%	0.06%
Zambia Kwacha	5153	-0.83%	-2.11%
Commodities			
Gold $/troy oz.	1604	-2.22%	-2.25%
Platinum $/troy oz.	1505	-1.58%	-6.17%
Silver $/troy oz.	29.32	-2.77%	-8.02%
Copper US$/ton	8254	0.00%	-1.53%
Tin US$/lb	1128	-3.55%	-1.76%
Natural Gas US$	2.3	0.00%	15.58%
Oil US$ Brent Crude	110.5	-2.39%	-10.30%
CRB All Commod	294	-1.19%	-4.10%

Local Rates*

	Last Close	Change 1 Day	1 M
Europe			
Bulgaria	0.24	-0.01	-0.02
Croatia	0.43	0.02	-0.02
Czech	0.74	0.00	-0.03
Hungary	6.27	-0.01	-0.07
Poland	4.28	-0.02	-0.11
Romania	4.17	-0.03	1.83
Russia	5.98	0.00	1.20
Serbia	NA	NA	NA
Turkey	10.56	0.01	0.16
Ukraine	2.70	0.00	0.60
Middle East			
Bahrain	0.50	0.00	0.00
Egypt	9.73	0.00	0.01
Israel (1M)	2.50	0.00	0.00
Jordan	3.76	0.06	0.27
Kuwait (1M)	#N/A N/A	#VALUE!	#VALUE!
Lebanon	NA	NA	NA
Qatar	NA	NA	NA
S Arabia	0.60	0.00	0.01
UAE (1M)	0.98	0.00	0.00
Sub-Saharan Africa**			
Botswana	NA	NA	NA
Ghana	NA	NA	NA
Kenya	NA	NA	NA
Malawi	NA	NA	NA
Nigeria (1M)	NA	NA	NA
S. Africa (1M)	5.50	0.00	0.01
Tanzania	11.75	0.00	0.00
Zambia	NA	NA	NA
FX Volatility			
EUR - CZK	6.65	3.74%	-5.51%
EUR - HUF	9.87	-0.13%	-12.64%
EUR - PLN	8.00	-0.68%	-10.50%
EUR - RON	5.00	0.00%	11.11%
USD - RUB	8.97	-0.06%	-9.96%
USD - ZAR	13.23	0.00%	-8.21%
USD - TRY	8.90	4.34%	-8.06%
USD - ILS	6.58	-0.72%	-8.96%

Equities

	Last Index Level	Change (%) 1 Day	1 M
Europe			
Bulgaria SOFIX	299	-0.72%	-2.32%
Croatia CROBEX	1809	-0.27%	-1.87%
Czech PX50	916	0.00%	-1.23%
Hungary BUX	17553	-1.22%	-3.57%
Poland WIG020	2178	-1.76%	-3.76%
Romania BSE	5373	0.46%	1.13%
Russia RTS (US$)	1480	-0.61%	-8.29%
Serbia BELEX15	491	-0.93%	-5.29%
Turkey ISE	58749	-0.10%	-3.59%
Ukraine PFTS	498	-2.30%	-6.50%
Middle East			
Bahrain BHSE All-Sh	1160	-0.11%	1.50%
Egypt HERMES	501	0.71%	6.41%
Israel TA-100	1046	-0.15%	-0.15%
Jordan ASE	1975	-0.04%	-1.30%
Kuwait KWSE	6485	-0.12%	5.38%
Lebanon BLOM (US$)	1184	0.00%	-1.55%
Qatar DSM 20	8667	0.17%	-1.27%
S Arabia TASI	7371	0.17%	-4.49%
UAE ADSMI	2486	-0.07%	-2.82%
Sub-Saharan Africa			
Botswana DCIBT	7146	0.04%	1.21%
Ghana GSE	1038	-1.40%	-2.14%
Kenya NSEK	3599	0.00%	5.84%
Malawi	NA	NA	NA
Nigeria NGSE	22817	1.08%	8.95%
S. Africa JALSH	33595	-1.06%	-0.41%
Tanzania	NA	NA	NA
Zambia	NA	NA	NA
Major Indices			
US NYSE	1353	-1.20%	-3.21%
US NASDAQ	2907	-1.70%	-5.62%
UK FTSE 100	5584	-1.26%	-2.44%
France CAC 40	3130	-2.63%	-5.73%
Germany DAX	6463	-1.61%	-4.60%
Japan Nikkei 225	9182	0.69%	-5.23%
FTSE Global	364	-1.13%	-3.34%
FTSE Emerging	589	-0.89%	-4.38%

Source: Bloomberg, Citi Investment Research and Analysis. Note: Equities are local currency unless otherwise stated; FX Volatility is the mid price At-the Money (ATM) 1M term; * Overnight unless otherwise stated. **Weekly data on 3 month rates except S Africa. *** Turkey Lira & Ukraine Hryvnia are against the US dollar.

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