



# Central European Daily

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## Headlines

Currencies: [Zloty rallies, undeterred by Sunday's elections](#)

Fixed Income: [Polish MPC members speak more hawkish](#)

## Currencies

Currencies	Close	change
EUR/CZK	27.49	0.0%
EUR/HUF	248.9	-0.3%
EUR/PLN	3.731	-0.4%
USD/PLN	2.625	-0.8%
EUR/SKK	33.55	-0.1%
EUR/USD	1.421	0.3%
USD/JPY	117.6	0.3%

Despite the failed attempt to break lower past the EUR/PLN 3.70 mark yesterday the **Polish zloty** seems destined to keep trying to reach fresh highs against the euro. Today's opening suggests that the pair might consolidate in the lower section of the 3.68-3.72 range as the sentiment seems to have improved somewhat overnight judging from strong equity performance in Asia and in the second part of yesterday's US session. We keep up our view that the zloty should do better than its regional peers as interest rate hike expectations have re-emerged in recent days after the data and comments by rate setters.

**Today** the domestic calendar heats up once again as the industrial output and PPI numbers are up for release later in the day. Our estimate shows a visible decline in the annual rate of increase in industrial production primarily because September this year had fewer working days than a year ago. This is also what the market expects so the data are unlikely to be much of a market mover. Given the tight situation on the labor market the output softness should not hurt rate hike expectations even if the numbers come in below consensus, as this would point to an even more radical rise in unit labor cost growth. Regarding the PPI, we are also looking for a consensus-like 1.8% y/y as the strengthening dollar helped mitigate the impact of rising oil prices.

The **Hungarian forint** recovered slightly after previous day's losses of other major emerging currencies like the Turkish Lira were seen excessive and many used the cheaper prices to buy into the carry trades. This brought the HUF back to below 251, but it could not extend the gain into back to below the 250 territory it were two days ago, and lost ground in late afternoon trading, hence we are skeptical about the sustainability of yesterday's appreciation. Instead, risk/reward is for probably further weakness in general as carry trade currencies rallied substantially worldwide and their recent sideways move together with volatility suggests that we may have seen the end that could be followed by some correction, especially if fears about the US economy's outlook return.



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The **Czech koruna** joined the bullish sentiment in the region and tracked the gains of the Polish zloty. The EUR/CZK moved as far as EUR/CZK 27.437 at the end of yesterday's session and it is moving not far from the all-time highs.

Today we believe the Czech koruna to be tied to the Polish FX market once again. In case the zloty breaks through EUR/PLN 3.70, we might see significant gains on the Czech koruna as well and the pair could test the all time highs at 27.385 EUR/CZK.

The **Slovak koruna** benefited from the generally positive regional FX market mood and strengthened to EUR/SKK 33.60 from 33.70 in the morning. The words of NBS governor Sramko, that the central bank will increase its inflation forecast (due to a jump in food prices) on its October meeting did not have any impact on the trading. He added that the bank does not feel "a serious risk of endangering the Maastricht inflation criterion so far". This is also our view. The increase of food prices is a general phenomenon and will hit all countries not only in the region, but also in the whole Europe.

Since no domestic macro events are scheduled for today, the koruna will be predominately driven by the global and regional sentiment. However, we do not expect any change of the trading pattern. The calm atmosphere should continue, with exchange rate moves limited within the established range of EUR/SKK 33.50 – 33.75.



EUR/PLN: Zloty becomes ever stronger, even ahead of strongly disputed elections

## Fixed income

Bonds 2Y	Close	
Czech Rep.	3.93	0.04
Hungary 3Y	7.08	-0.04
Poland	5.27	-0.02
Slovakia	4.46	-0.04
Eurozone	4.11	0.04
USA	4.19	0.03

Bonds 10Y	Close	
Czech Rep.	4.55	0.00
Hungary	6.75	-0.03
Poland	5.71	0.01
Slovakia 7Y	4.75	0.10
Eurozone	4.39	0.03
USA	4.69	0.03

**Polish rate setters**, apparently impressed by the September CPI, have stepped their rhetoric up a notch in recent days, cementing expectations of the November hike and leading the market to serious speculating on the chances that the move would take place this month. While the hawkishness from Halina Wasilewska-Trenkner was no surprise, since despite some softer wording recently, she has always been at the far end of the hawkish side of the MPC spectrum, the tougher wording from moderate Andrzej Wojtyna certainly did make a strong impression. Wojtyna stressed that the balance of risks to inflation was little changed and hence that the situation was far from comfortable for the Council. Wojtyna reiterated that the hypothetical policy stance was restrictive and added that two more hikes – one in 2007 and another in 2008 - were likely. Apart from the tight labor market conditions, which have been the major risk to price stability for some time now, the rate setter pointed to rising food prices (also in a global perspective), which according to Wojtyna, may have a long lasting effect on inflation in countries such as Poland where food has a relatively large weight in the CPI basket.

Just clarify, our outlook regarding monetary Policy has not changed. We still believe that while the MPC may have to go somewhat further to keep the risks contained in its view, it is unlikely to rush into an aggressive tightening campaign as growth is expected to moderate over the next quarters and as major central banks contemplate rate cuts.

The **Hungarian bonds** were again in a currency-dependent mode and yields decreased some basis points, but market activity was modest. August gross wage growth was a tad better at 7.8% y/y, below consensus expectation for a 10% figure, which might have also contributed to the slightly positive sentiment. However, we keep our call that this month's rate cut is at odds and cautiousness would warrant a move later in November. A delayed rate cut however may not help bonds, especially if the currency shows further signs of weakness.

**Czech yields** dipped by just 1 bps along the whole curve yesterday. This decrease was visibly lower compared to the slide of EMU yields (4 basis points), which means that the spread between Czech and German long yields widened. Given the empty domestic calendar the Czech market will once again with some delay react to developments in the EMU. Should we see some profit taking on core bond markets, the Czech bonds might stay rather flat as yesterday's rally was not followed in a full range.

## Tables of rates

IBOR 3M			Close			FRA 3x6			Close			Central Bank Rate		
Czech Rep.	3.54	0.02	Czech Rep.	3.67	0.03	Czech Rep.	3.25	25						
Hungary	7.43	0.00	Hungary	7.07	-0.03	Hungary	7.50	-25						
Poland	5.09	0.00	Poland	5.23	-0.02	Poland	4.75	25						
Slovakia	4.32	0.00	Slovakia	4.40	0.00	Slovakia	4.25	-25						
Eurozone	4.73	-0.02	Eurozone	4.45	-0.10	Eurozone	4.00	25						
USA	5.24	0.00	USA	4.93	-0.03	USA	4.75	-50						

  

IRS 2Y			Close			IRS 10Y			Close			STOCKS			close		
Czech Rep.	3.97	0.02	Czech Rep.	4.48	0.02	PX	1900.7	1.0%									
Hungary	6.94	-0.06	Hungary	6.60	-0.07	BUX	28237.3	1.7%									
Poland	5.47	-0.01	Poland	5.66	0.03	WIG	63793.2	1.0%									
Slovakia	4.67	0.01	Slovakia	4.81	0.03	Eurostoxx	4475.68	1.1%									
Eurozone	4.57	0.01	Eurozone	4.73	0.04	DAX	8031.3	0.7%									
USA	4.84	-0.02	USA	4.93	0.02	S&P	1571.7	0.8%									

Closing or snapped values at 16:30 CET, change is over previous day, last change in bps

## Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
CZ	18.10.2007	09:00	Retail sales (%)	08/2007		7.0		8.0		8.9
PL	18.10.2007	14:00	PPI (%)	09/2007			0.1	1.8	0.1	1.7
PL	18.10.2007	14:00	Industrial output (%)	09/2007				6.7		9.0
PL	21.10.2007		Parliamentary elections							victory of PiS

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