Monday, November 23,

Central European Weekly

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Czech Republic

CNB Board members play with words

Hungary

The bond market is becoming less optimistic about the convergence outlook

Poland

Lower wage growth points to decelerating domestic demand

The Week Ahead

While the MNB delivers another 50bp rate cut, the NBP is expected to stay on hold

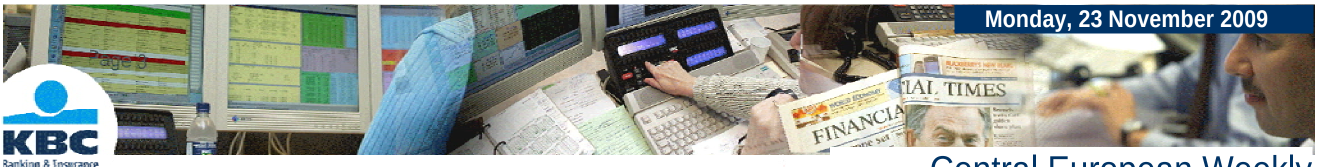
Overview

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.89	1.33%	↗	→
EUR/PLN	4.157	0.98%	↗	→
EUR/HUF	269.9	0.07%	↗	↗
3M PRIBOR	1.81	0.00	→	→
3M WIBOR	4.19	0.00	→	↗
3M BUBOR	0.00	-6.86	↗	↗
10Y CZK	4.15	-0.01	→	→
10Y PLN	6.17	0.07	↗	→
10Y HUF	7.05	0.09	↗	↗
3M EURIBOR	0.69	-0.02	→	→
10Y EMU	3.26	-0.10	↘	→

Last values from Friday 13:30 CET

CEE labor markets divergence

The divergent developments in the labour markets of the various Central European economies thus far haven't captured the attention. Nevertheless, significant differences among them do exist, and these may play an important role in the future monetary policy.
People in Central Europe generally lose jobs much faster than their western counterparts, notably Germany, where, owing to support for shortened working times, the unemployment rate went only slightly up, from 7.6% to 8.1%, notwithstanding the rapid economic downturn. The number of people registered with German labour offices has only increased by 7% since the start of the crisis. Central European economies, due to the lack of similar programmes and greater labour market flexibility, see much faster increases in unemployment.
The most striking developments are those in the Czech and Slovak Republics. In both economies, the number of people registered with labour offices has increased by almost 70% since the beginning of the crisis, and the unemployment rate has soared. In the similarly open Hungarian economy, which suffers of IMF prescribed austerity measures, unemployment had already been rising for some time before the crisis hit. Hence when the crisis emerged in full swing, the number of unemployed registered with labour offices went up by approximately 40%.
Poland again stands out when these economies are compared. Central European largest economy is more closed than the others and that works miracles. Not only the larger domestic market supported the Polish economy; the economy, in return, allowed for keeping more jobs and for encouraging consumption (positive multiplication). Thus the number of unemployed in Poland has increased by just a quarter since the start of the crisis.
In addition, the full launch of the construction preparations for the European Football Championship (2012) and faster economic growth should begin to change the labour market situation in Poland for the better at a faster rate than in Poland's neighbours. This is the key reason why a monetary tightening should be expected sooner in Poland than in other countries.



Czech Republic

Currency

The koruna weakened slightly last week and closed at the EUR/CZK 25.825 level. Given the lack of major domestic statistics, the Czech currency was influenced by the falling demand for riskier assets; however, the development was not straight, as the koruna partly offset its depreciation a couple of times. In addition, the depreciation of the Czech currency at the end of the week could also have been boosted by central bankers' slightly dovish statements on a possible rate change in either direction and on the risk of the strong domestic currency.

Given the empty domestic calendar, the koruna must excessively focus on core and regional markets. Along with global equity markets the forint and the zloty might provide some guidance, because both currencies might react to respective central bank meetings.

Fixed income

The Czech yield curve fell along its full length and steepened last week; however, changes in yields were not significant, with the short end going down by 5 bps, while the long end was down by only 1 bps. Trading was influenced by the national holiday, which reduced trading volumes to truly low levels. The beginning of the week was influenced by the decline in the producer price index. Later, CNB Deputy Governor Hampl added comments, saying that another rate change might go in either direction. This strengthens the position of the Governor, who has been outvoted in two central bank decisions on rates, as Hampl was one of the proponents of leaving rates unchanged. Finally, another Deputy Governor, Singer, also spoke of the risk of the strong koruna again and this, together with the development of Eurozone markets, supported bonds until the end of the week.

This week, the domestic eco calendar is free of major events. Thus, the main stimulus to the domestic market will be the developments in Eurozone (fixed-income) markets. However, domestically the volatile koruna could make some noise, though the market could be almost certain that inflation will not be a problem for a long time.

EUR/CZK technical picture

(25.7800) Rebound from 24.9750 failed to settle back above the neckline of long term Triple Top (26.3250), with drop from 26.6200 having retested the broken inverted channel top off 27.7000 (see graph).

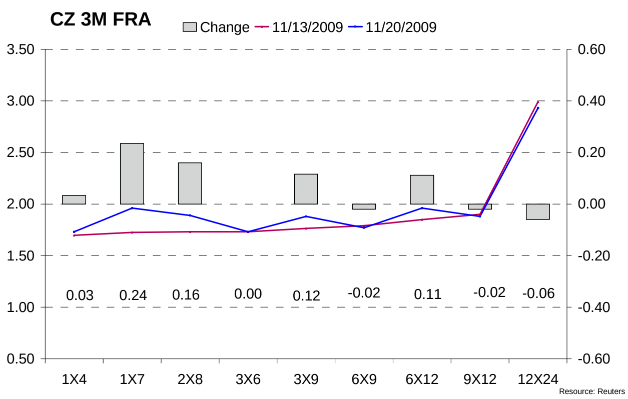
1st support area at 25.4100 (reaction low hourly), with next level at 25.3250 (Nov 11 low), where pause favored.

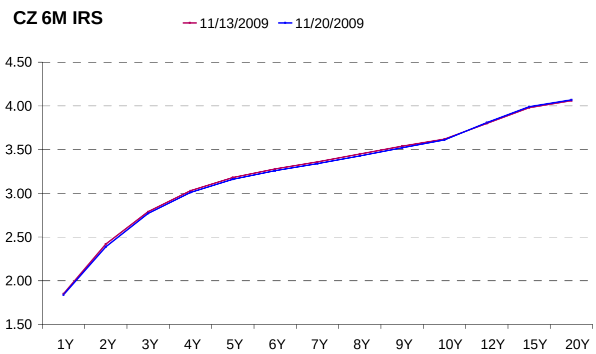
If wrong, next level would come in at 25.2050 (break-up daily Sept 29), ahead of 25.1200 (Sept 29 low) and 24.9750 (reaction low off 29.6900): tough on 1st attempts.

Resistance area at 25.8250 (falling weekly Short Term Moving Average), with next levels at 25.9500 (breakdown daily Nov 05), where pause favored.

If wrong, next Resistance at 26.1250 (61.8% 26.6200 to 25.3250), ahead of 26.2600 (weekly Bollinger top): tough on 1st attempts.

DAILY CHARTS:





Hungary

Macro review

Only wage data was released last week and therefore the outlook for Hungary remained unchanged.
Wages grew 0.7% Y/Y in September, close to August 0.6% Y/Y reading and in line with expectations for depressed wage growth amid the recession. This fits well with the outlook for a close to 7% recession this year and could also help to keep inflation under control.
Recent data suggests that the recession will be as deep as expected since the spring, while inflation could be lower than was seen some months ago.
It will be interesting to see how this fundamental background could affect the central bank's rate policy. The lower inflation path could allow for more rate cuts.
Consensus and we expect the MNB to lower the base rate to 6.50% from 7.00%. More important for the markets might be the accompanying statement that could reveal more about the probability of future rate cuts.

Currency

The forint spiked to the level of 271.00 on Friday amid the deteriorating global sentiment, but better news from abroad helped the pair to recover in the last hours of the day. This week started with the 268.00 level. Uncertainty usually follows rate cuts as the market digests the sustainability of the actual level beside a lower interest rate environment. This could expose the forint to the risk of weakening this week, while recovery of global markets could lend more support

Fixed income

The bond market lost about 20-30bps in yield terms at the long-end with the currency, while the short-end remained unchanged at around the 6.20% level.
The FRA market is convinced about a longer easing cycle that would reduce the base rate down to 5.50%. The 5y5y forward spread however widened to 218bps, up from the 200bps level two weeks ago. This has not yet recovered with the currency, so either we will see compression of the spread at the long-end in the coming weeks or the market is now becoming less optimistic about the convergence outlook for Hungary.

EUR/HUF technical picture

(268.50): Strong rebound off 262.85 puts the pair above the Downtrendline off high but failed to extend above 278.00 (see graph).
Resistance at 269.90/ 270.12 (reaction high hourly/ weekly Bollinger midline), with next levels at 270.79 (flat weekly Short Term Moving Average), ahead of 271.80/ 272.50 (reaction highs hourly), where pause favored.
If wrong, next level at 273.90 (breakdown daily Nov 06): tough on 1st attempts.
Support at 264.64 (Nov 16 low), with next levels at 263.50 (weekly Bollinger bottom), ahead of 262.85/ 262.08 (current new reaction low off 317.45/ 61.8% 227.87 to 317.45), where pause favored.

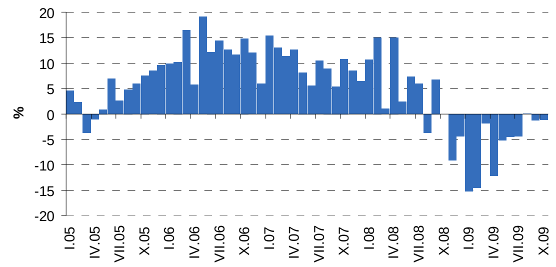
DAILY CHARTS:

Poland

Macro review

Solid performance of the Polish industry (1.9% m/m;-1.2% y/y) was driven mainly by construction and electricity. Manufacturing still lags behind and recovers pretty slowly and mining is even further behind. Also the labour market data still look weak. The wage growth in October decelerated faster than expected and points to moderating domestic demand at the end of the year. Nevertheless the figures still confirm the ongoing recovery process in the Polish economy which should form a space for monetary tightening in 2010.

Polish industrial production, y/y



Currency

The Polish zloty gave up testing important technical levels at 4.066 EUR/PLN and went through profit taking in the second half of the week. The domestic data generally confirms the recovery story, which is nothing new for global players. Hence the technically driven hunger for profit taking and deterioration of the sentiment on the emerging markets hit the zloty. The pair hence shot as high4.16EUR/PLN.

The zloty may trim some losses at the beginning of the week. We expect rather soft retail sales and a no change verdict of NBP on Wednesday. Nevertheless that should not be major surprise and the global emerging market sentiment should remain the main driver of the trading.

EUR/PLN technical picture

(4.1500): Drop from 4.3300 retested the broken Downtrendline off 4.9300 (see graph).
1st support area at 4.1065 (reaction low on hourly charts), with next levels at 4.0770/ .4.0656 (Nov 17 low/ reaction low off 4.9300), where pause favored.
If wrong, next Support would come in at 4.0239 (weekly Bollinger bottom): tough on 1st attempts.
1st Resistance comes in at 4.1665/ .1742 (break-down hourly/ weekly Bollinger midline), where pause favored.
If wrong, next level at 4.2035 (50% 4.3300 to 4.0770), ahead of 4.2333 (61.8%): tough on 1st attempts.

DAILY CHARTS:

CE Weekly Preview

Mon 14:00 **MNB base rate**

	This meeting	Last change
rate level (in %)	**6.50**	19/10
change in bps	**-50**	-50

HU: MNB should cut its base to 6.50 %

Consensus and we expect the MNB to lower the base rate to 6.50% from 7.00%. More important for the markets could be the accompanying statement that could reveal more about the probability of future rate cuts.

WED (25.11.) 14:00, **PL NBP meeting**

	This meeting	Last change
rate level (in %)	**3,5**	6/2009
change in bps	**0**	-25

PL: Polish Central bank in wait and see mode

The Polish central bank should be comfortable with the shift to the neutral mode. We bet on no change verdict now and balanced comments afterwards pointing to the interest rate stability.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	23.11.2009	09:00	Retail sales (%)	09/2009				-6.7		-7.2
HU	**23.11.2009**	**14:00**	**NBH meeting (%)**	**11/2009**	**6.50**		**6.50**		**7.00**	
PL	25.11.2009	10:00	Unemployment rate (%)	11/2009			11.1		10.9	
PL	25.11.2009	10:00	Unemployment rate (%)	10/2009			11.1		10.9	
PL	**25.11.2009**	**10:00**	**Retail sales (%)**	**10/2009**			**4.8**	**2.6**	**-0.7**	**2.5**
UK	**25.11.2009**	**10:30**	**GDP (%)**	**3Q/2009 *P**					**-0.4**	**-5.2**
PL	**25.11.2009**	**14:00**	**NBP meeting (%)**	**11/2009**	**3.50**		**3.50**		**3.50**	
CZ	26.11.2009	00:00	Industrial output (%)	10/2009 *P						-11.9
HU	26.11.2009	09:00	Unemployment rate (%)	10/2009			10.5		10.3	

m/m - monthly change; y/y - yearly change; s.a. - seasonally adjusted; n.s.a. - non-seasonally adjusted; P - preliminary; F - final
EMU, USA, UK, JPY - figures seasonally adjusted, if not stated otherwise; Central Europe - figures seasonally non-adjusted, if not stated otherwise
Government Bond Auction: period = auction settlement date; m/m = total bids; y/y = supply

Our forecast

Official interest rates (end of the period)

		Current	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Last change	
Czech Rep.	2W repo rate	*1.25*	1.25	1.25	1.25	1.25	1.25	-25 bps	8/6/2009
Hungary	2W deposite r.	*7.00*	6.50	6.00	6.00	6.00	6.00	-50 bps	20/10/200
Poland	2W inter. rate	*3.50*	3.50	3.50	3.50	3.75	4.00	-25 bps	6/25/2009

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

		Current	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Czech Rep.	PRIBOR	*1.81*	1.80	1.70	1.70	1.80	1.85
Hungary	BUBOR	*6.83*	6.50	6.00	6.00	6.00	6.00

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

		Current	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Czech Rep.		*3.65*	3.70	3.70	3.80	3.80	3.90
Hungary		*6.805*	7.25	7.00	7.00	6.75	6.75

Exchange rates (end of the period)

		Current	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Czech Rep.	EUR/CZK	*25.9*	25.3	26.0	24.8	24.8	25.5
Hungary	EUR/HUF	*270*	270	270	275	270	270
Poland	EUR/PLN	*4.16*	4.10	4.30	3.60	3.90	3.30

GDP (y/y)

		Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010
Czech Rep.		*-4.8*	-3.1	1.5	1.4	0.5	0.7
Hungary		*-7.3*	-6.1	-2.4	-1.6	0.9	0.0

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

		Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Czech Rep.		*0.0*	0.8	0.9	1.1	2.0	1.9
Hungary		*3.7*	5.0	4.5	3.8	3.8	3.5

Current Account as % of GDP

	2008	2009
Czech Rep.	-3.1	-2.5
Hungary	-6.0	-3.0

Public finance balance as % of GDP (in ESA95 standards)

	2008	2009
Czech Rep.	-1.6	-5.8
Hungary	-3.9	-4.5

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