Monday, December 07,

Central European Weekly

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Czech Republic

Foreign trade surplus on the way to double from last year

Hungary

Bets on another rate cut should stay in place

Poland

EUR/PLN touches January lows after US payrolls

The week ahead

Czech and Hungarian inflation figures might surprise in opposite directions

Overview

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.65	-2.23%	↘	↗
EUR/PLN	4.038	-3.35%	↘	↗
EUR/HUF	268.1	-2.07%	↘	→
3M PRIBOR	1.69	-0.07	→	→
3M WIBOR	4.20	0.01	→	→
3M BUBOR	6.42	0.00	↘	↘
10Y CZK	4.00	-0.08	↘	↗
10Y PLN	6.17	-0.02	↘	↗
10Y HUF	7.19	-0.15	↘	↗
3M EURIBOR	0.69	-0.02	→	↗
10Y EMU	3.25	0.09	↘	↗

Last values from Friday 13:30 CET

Domestic events might support a bullish end of the year

The negative reaction to the Dubai debt affair proved to be short-lived and therefore Central European (forex and bond) markets, just like global stock markets, quickly offset their losses. Markets remained in an upbeat mood ahead of Christmas, especially after the optimistic news from the U.S. labour market.

There are only four weeks left before the end of the year. For the Central European economies, there are only a few domestic events left that may influence the forex or bond markets in the region. Figuring among such data will certainly be the Hungarian and Czech inflation figures for November and, to a lesser extent, October's trade balance data from both countries. We expect very strong trade balance data which are supportive to the current appreciation trend of the koruna (which has already happened) and of the forint.

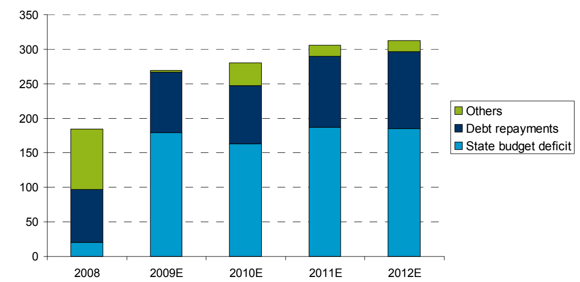
At first glance, the situation might be somewhat different as to inflation, but in the end inflation data may also encourage both currencies. Czech inflation may come out on the upside of expectations. This might convince the market that the Czech National Bank will not consider another rate cut (and this could subsequently also support the koruna). A lower inflation rate in Hungary, by contrast, might increase bets on another cut in the base rate of the National Bank of Hungary and thus boost demand for Hungarian government bonds and basically also for the forint.

Czech Republic

Macro review

The State generated a deficit of CZK 169.4 bn for the first eleven months of this year. Remarkably, the state budget deficit for the same period of last year was only CZK 6.5 bn. The budget deficit is the highest in the CR's history. On top of that, it was actually improved by the use of reserves, which exceed CZK 30 bn. With the reserves excluded, the deficit would already have hit CZK 200 bn. On the one hand, the rising deficit of state finances is due to a drop in taxes because of the economic recession. Budget revenue dropped by -7.8%Y/Y. On the other hand, expenditure was up by almost 9.5% y/y. The drop affects all major taxes, particularly the corporate income tax, insurance contributions and personal income tax. The state budget figures are unlikely to improve in the last month of the year either. Thus the budget deficit will continue to rise. This will push the all-time record deficit even much higher.

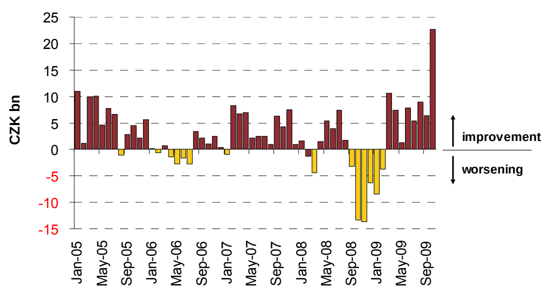
Public sector borrowing requirements
(CZKbn, Source: Ministry of Finance)



At the moment, however, the discussion over the state budget for 2010 is much more interesting, as it could lead to individual items (even mandatory ones) being shifted, while in theory leaving the proposed deficit unchanged. Nevertheless, of fundamental importance will be what exactly the approved budget revenue and expenditure will look like. This is needed to get a more detailed view of the budget deficit for next year and of the sources the state will use to finance it. The "Strategy of Financing and Managing the State Debt for 2010" is already available and, according to it, the State will borrow just a slightly higher amount of funds next year than this year. The Ministry of Finance anticipates that it will need CZK 280 bn from financial markets (compared to CZK 278.8 bn this year), with CZK 84.1 bn being the repayments of maturing bonds. The largest and the least certain amount will again be the one required to cover the state budget deficit, which should reach CZK 163 bn. The State will acquire CZK 12.7 bn of the CZK 280 bn from the European Investment Bank. The remaining part will mostly come from the domestic market (CZK 102.3-292.3 bn) and the foreign market (CZK 0-140 bn). The 20% limit on the proportion of short-term debt to overall debt still applies and the band for the average maturity of the debt remains 5.5-7 years. Obviously, if the State does not wish to drive bond yields on the domestic market excessively upwards, it will again need to return to foreign markets to gain funding. So, this will raise the dependence on the mood of foreign financial investors. This is no short-term question as we can see from the borrowing plans for 2011 and 2012, when the state's reliance on money from financial markets will increase to more than CZK 300 bn and CZK 310 bn respectively.

The balance of trade ended October with a record surplus. In October, the trade surplus reached CZK 17.5 billion, the best trade figure for October in the history of the CR. This extraordinary balance of trade figure is in particular due to the year-on-year fall in imports of oil and natural gas, thanks both to lower prices and also the lower volumes of these resources actually imported. Exports were positively influenced by automobiles, which still benefitted from the closing stages of the scrapping bonus in Germany. On the other hand, however, we should not celebrate too much over the development in exports. Year-on-year exports dropped by 11.2 %, despite a low comparison base. This shows that demand for Czech goods has not shown a significant change for the better over recent months. No significant interest in imported goods of any type can be seen even on the domestic market. Imports have fallen by over one fifth, not only thanks to cheaper raw materials, but in particular as a consequence of weak consumer and investor demand. This year's foreign trade figure will unequivocally post a new record. The figures for November and December will not change this to any significant extent. The trade surplus will thus most probably exceed CZK 120 billion, meaning that it will be approximately double the figure for 2008.

Y/Y change of the monthly trade balance



Currency

The Czech currency fared well last week. It opened the week at the weaker level of CZK 26.13 per EUR but strengthened slightly every day, returning to less than CZK 26.00 per EUR, and closed the week below CZK 25.70 per

EUR. Domestic statistics had only a negligible impact on the currency pair. The koruna thus took advantage of the predominant upbeat sentiment towards riskier assets after the Dubai debt situation calmed down.

We expect Czech figures to come out on positive side and more or less play in favour of the Czech currency. Nevertheless the major obstacle may be lower liquidity at the end of the year and that is why we are more in favour of sideways scenario for now.

EUR/CZK technical picture

(25.8400) Failed to sustain above the neckline of long term Triple Top (26.3250: see graph).
1st support area at 25.7500 (break-up daily + rising weekly Medium Term Moving Average), with next levels at 25.6710 (weekly Bollinger midline), ahead of 25.5850/ .4900 (break-up hourly/ daily), where pause favored.
If wrong, next level would come in at 25.4100 (Nov 18 low), ahead of 25.3250 (Nov 11 low): tough on 1st attempts.
Resistance area at 26.1600 (reaction high hourly): ideal area to stay below to keep CZK on safe side.
Failure to cap would see risk towards 26.3080 (weekly Bollinger top), ahead of 26.4950/ .6200 (Nov 27 high/ reaction high off 24.9750): tough on 1st attempts.

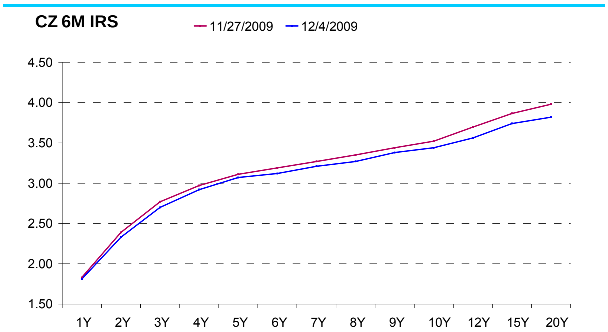
DAILY CHARTS:

Fixed income

Czech bond prices went up last week. The yield curve declined along its full length and flattened, going down by 5 bps at the short end and by more than 8 bps at the long end. However, trading volumes were well below average. The short end of the curve fell partly because of the strong koruna. The adjustment of positions before the end of the year probably influenced the overall developments.

However, the main event of the week was this year's last auction of the 5.70%/2024 bond. With the planned volume of CZK 6 bn, bonds for only CZK 4.87 bn were sold, while the Ministry of Finance kept as much as CZK 1 bn of that amount in its book. The average yield was 4.779%: The average yield in the previous tranche of early October was 5.276%.
During the week, the Minister of Finance also updated its issue intentions for 2010. The Ministry wishes to sell CZK 292 bn of bonds, with the gross need to be CZK 280 bn, to be compared with this year's CZK 269.3 bn. By 2012, the amount of bonds issuance will increase to CZK 312.9 bn. The deficit will stagnate at that time but the costs of financing and repaying the debt will rise.

A few interesting figures will be released this week. In addition to the trade balance data and the final GDP figure for Q3 2009, these will primarily include November's inflation data. According to forecasts, prices should start to rise slightly and this, together with the ECB preparing the exit of unconventional policy measures in the Eurozone, may reduce demand for bonds. However, trading volumes are likely to be low again.



Hungary

Macro review

Last week saw only the PMI data release and therefore markets focused on the global sentiment for impetus.
The PMI figure inched down to 47.5 from 48.3 in November pointing for some softening of economic activity last month. Final foreign trade data from September confirmed a large (€478m) surplus, which is reassuring about the external balance recovery process after previous months saw a temporary blip.
Overall, Hungary seems to have been tracking the consensus view on recovery escorted by a large foreign trade surplus.
This week's key figure will be Monday's budget data from November. The government has to try hard if it wants to meet this year's 3.8% of GDP budget surplus as the deficit increased to 4.0% by October. The 0.2% budget surplus is not impossible to achieve, but there is considerable risk of an overshoot, thus the market could keep an eye on this.

Currency

The forint established a stable recovery path last week that resulted in an overall 2% appreciation from 272.00 to 268.00 by Friday. Lack of domestic news allowed the currency to follow the international sentiment, where the better US employment data helped it to recover. This situation could remain the same this week and the pair may retest the key 265.00 level next, which was a barrier limiting the upside in the last 3-months. It will be interesting to see, whether this pattern will repeat. The central bank's likely rate cut in 2-weeks time could support such a scenario.

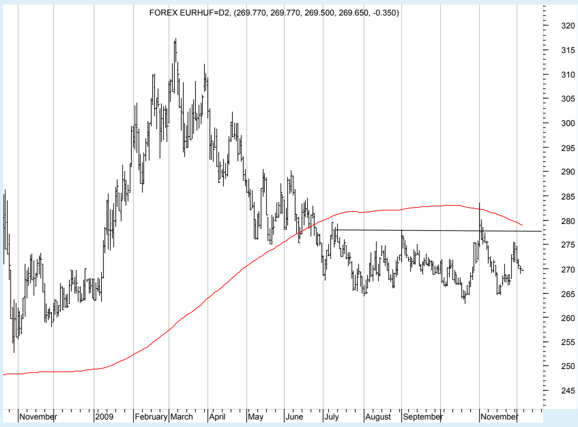
Fixed income

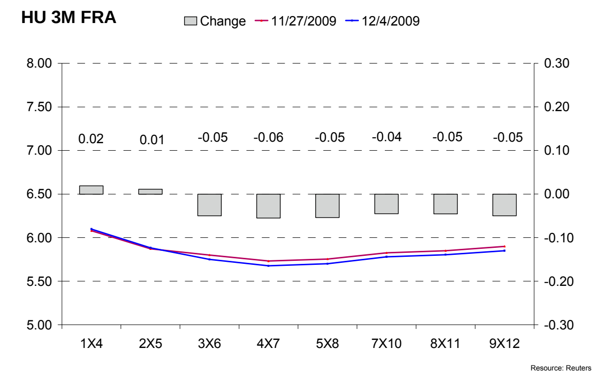
The bond market also recovered with the currency and yields declined some 15bps during the week. The short-end has lost its lure since the market priced in further rate cuts down to 5.75%. The long-end with a yield pick-up of about 100bps is thus attracting some new interest as investors are hunting for yield. This carry-play could keep the market in a bullish trend as long as the global backdrop is positive.

EUR/HUF technical picture

(269.60): Rebound off 262.85 failed to sustain above 278.00 (see graph).
Resistance at 272.70 (reaction high hourly), with next levels at 274.37/ 275.40 (falling weekly Long Term Moving Average/ Nov 27 and 30 highs), where pause favored.
If wrong, next level at 276.35 (61.8% 283.60 to 264.64): tough on 1st attempts.
Support at 268.80 (break-up daily), with next levels at 266.66/ 265.40 (Nov 24 low/ reaction low hourly), where pause favored.
If wrong, risk towards 264.64/ .40 (Nov 16 low/ 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

Currency

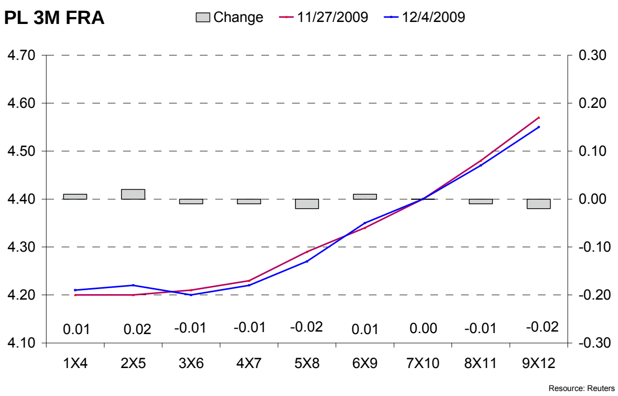
The **Polish zloty** gained quite significantly during last week. The better than expected US payrolls triggered massive gains at the end of the week. The Polish zloty even ignored the strength of the US dollar and the subsequent pull back on the global equity markets. Hence the pair touched the January lows at 4.04 EUR/PLN on Friday. The nomination of new board members to the MPC, who both seem to be in favour of fast euro adoption, did not move the market.

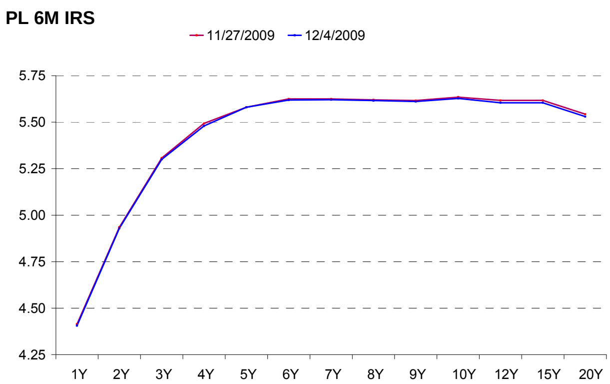
This week, the domestic eco calendar is more or less empty. The technical picture of the zloty looks pretty nice but the pair may have problems to get further through 4.00 EUR/PLN. We are afraid of low year-end liquidity and a stronger US dollar as major obstacles for the way further. Hence we prefer a sideways scenario for now.

EUR/PLN technical picture

(4.0950): Drop from 4.3300 retested the broken Downtrendline off 4.9300 (see graph).
1st support area at 4.0770/ .0656 (Nov 17 low/ re-action low off 4.9300), ahead of 4.0475 (weekly Bollinger bottom), where pause favored.
If wrong, next Support would come in at 4.000/ 3.9920 (psycho/ 1st target of an hourly Double Top off 4.1450): tough on 1st attempts.
1st Resistance comes in at 4.1156 (falling weekly Short Term Moving Average↓), ahead of 4.1450 (see above) and 4.1719/ .1834 (Nov 30 high/ flat weekly Medium Term Moving Average), where pause favored.
If wrong, next levels at 4.2000/ .2035 (Nov 27 high/ 50% 4.3300 to 4.0770?): tough on 1st attempts.

DAILY CHARTS:





CE Weekly Preview

WED 9:00 — **CZ Inflation (change in %)**

	Nov-09	Oct-09	Nov-08
CPI m/m	**0.1**	-0.2	-0.5
Food m/m	**0.0**	-0.4	-0.9
Housing, energy	**0.1**	-0.2	0.1

CZ: Inflation to return into positive territory

November's consumer prices were primarily influenced by the increase in fuel prices, which was partly counterbalanced by cheaper package tours. As usual, food prices involve the greatest uncertainty, as their prices are hard to predict on a month-on-month basis. Year-on-year inflation is returning to the black and is likely to end up 0.3-0.4% above the central bank's forecast. Even so, the inflation outlook remains favourable. Deregulations and currently also tax changes will continue to play a significant role, while demand-driven inflationary pressures will continue to be strongly curbed.

WED 9:00 — **HU Foreign trade (EUR m)**

	Oct-09	Sep-09	Oct-08
Balance	**400.0**	485.6	-143.4
cummulative (YTD)	**3722.2**	3322.2	-315.0
Exports (y/y in %)	**80.0**	82.4	97.5
Imports (y/y in %)	**77.0**	76.4	101.28

HU: Foreign trade to show a recrod surplus

The Trade surplus could be somewhat lower in October suggested by a lower PMI reading, which might point to mean deterioration of the export performance. The surplus could however remain quite large, helping the economy to repay its external debt faster.

FRI 9:00 — **CZ GDP (change in %)**

	Q3-09	Q2-09	Q3-08
GDP (y/y)	**-4.1**	-4.7	2.3
GDP (q/q)	**0.8**	0.3	0.2

CZ: The economic downturn is easing

The Statistical Office will release another GDP release for the third quarter of the year as well as the GDP structure. Although the figure may differ from the preliminary forecast, released on November 13 (-4.1% y/y), we do not expect any great difference. The development of investment and consumption will be more important. While consumption tended to continue to rise, according to the introductory information, its potential is significantly running out of steam because of labour market developments.

TUE 9:00 — **HU Inflation (change in %)**

	Nov-09	Oct-09	Nov-08
CPI y/y	**4.9**	4.7	4.2
core CPI y/y	**5.0**	4.9	4.2
Food y/y	**2.7**	2.8	4.9

HU: expectations overdone?

Inflation could have accelerated a bit in September on the very low base from last year, when fuel prices dropped sharply. The consensus however expects a bigger increase to 5.1% Y/Y, which may not be reached thus creating room for a modest positive market reaction.

FRI 10:00 — **CZ Cur. Account (CZK bn)**

	Oct-09	Sep-09	Oct-08
C/A monthly	**-11.0**	-3.7	-22.4
cummulative (YTD)	**-32.0**	-21.0	-78.1
Trade bal. monthly	**8.3**	20.1	-1.3
cummulative (YTD)	**146.8**	138.5	108.7

CZ: current account to post a moderate deficit

October's current account deficit was probably much lower than that of the same period last year. This was primarily due to the reasonable trade balance surplus and a lower deficit in the balance of income. By and large, this year's current account developments are much better than last year's and the current account deficit may go down to as low as 2.3% of GDP this time from the previous 3.1%.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
CZ	**7.12.2009**	**09:00**	**Trade balance (CZK B)**	**10/2009**	**6.0**		**8.6**		**17.8**	
HU	7.12.2009	17:00	Budget balance (HUF B)	11/2009	-1 050.0				-1 047.7	
HU	8.12.2009	09:00	Industrial output (%)	10/2009 *P	1.0	-13.4			-3.7	-15.0
CZ	8.12.2009	10:00	Current account (CZK B)	3Q/2009					-1 086.2	
CZ	9.12.2009	09:00	Unemployment rate (%)	11/2009	8.6		8.6		8.5	
CZ	**9.12.2009**	**09:00**	**CPI (%)**	**11/2009**	**0.1**	**0.5**	**0.1**	**0.4**	**-0.2**	**-0.2**
CZ	**9.12.2009**	**09:00**	**GDP (%)**	**3Q/2009 *F**		**-4.1**				**-4.7**
HU	9.12.2009	09:00	Trade balance (EUR M)	10/2009 *P	400.0				485.6	
HU	**9.12.2009**	**09:00**	**GDP (%)**	**3Q/2009 *F**		**-7.2**				**-7.2**
HU	**11.12.2009**	**09:00**	**CPI (%)**	**11/2009**	**-0.3**	**4.9**	**0.5**	**5.0**	**0.0**	**4.7**
CZ	11.12.2009	10:00	Current account (CZK B)	10/2009	-11.0		-11.0		-3.7	
PL	11.12.2009	14:00	Current account (EUR M)	10/2009					-57	
PL	11.12.2009	14:00	Trade balance (EUR M)	10/2009					-4	

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.	*6.50*	6.25	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	*1.69*	1.80	1.70	1.70	1.80	1.85
Hungary	BUBOR	*6.42*	6.30	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.	*3.49*	3.70	3.70	3.80	3.80	3.90
Hungary	*6.885*	7.00	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	*25.7*	25.3	26.0	24.8	24.8	25.5
Hungary	EUR/HUF	*268*	270	270	275	270	270
Poland	EUR/PLN	*4.04*	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
Poland	-5.4	-6.0

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

	2008	2009
Czech Rep.	-1.6	-5.8
Hungary	-3.9	-4.5
Poland	-6.0	-6.0

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