
Banking & Insurance



# Central European Weekly

Written by CSOB Prague, Kredyt Bank Warsaw and K&H Budapest

**Due to the Christmas Holidays no reports will be available from December 21th till January 4th.**
**The next Central European Weekly will be published on January 11th 2010.**

## Czech Republic

### The Czech Economy is Slowly Starting to Recover

## Hungary

### November's inflation surprised on the upside, though a rate cut in December is still likely

## Poland

### Polish inflation should stay at elevated levels

## The Week Ahead

### We expect another tight outcome of the CNB meeting – this time a rate cut should finally come

# Overview

## Greek Uncertainty in Central Europe

| | Last | Change 1W | Outlook 1W ahead | Outlook 1M ahead |
|---|---|---|---|---|
| EUR/CZK | 25.77 | 0.47% | ↗ | ↗ |
| EUR/PLN | 4.139 | 2.49% | → | ↗ |
| EUR/HUF | 272.2 | 1.54% | → | ↗ |
| | | | | |
| 3M PRIBOR | 1.72 | 0.03 | ↓ | ↘ |
| 3M WIBOR | 4.22 | 0.02 | → | → |
| 3M BUBOR | 6.41 | -0.01 | ↘ | ↘ |
| | | | | |
| 10Y CZK | 3.99 | -0.01 | → | ↗ |
| 10Y PLN | 6.20 | 0.04 | → | ↗ |
| 10Y HUF | 7.25 | 0.06 | ↘ | ↗ |
| | | | | |
| 3M EURIBOR | 0.70 | 0.01 | → | ↗ |
| 10Y EMU | 3.21 | -0.04 | ↗ | ↗ |

Last values from Friday 13:30 CET

Things are starting to get hot in indebted Greece. After Dubai, this is another warning for global investors that (sovereign) credit risk has definitely not completely disappeared; the risk is just transforming itself, and moving from the financial institutions to the government balance sheet.

This may have two basic implications for Central Europe. Increased global aversion to risk in general has never been favourable for the regional mood. Thus, if it comes to light early next year that Greeks or Ukrainians have problems borrowing more funds on markets, all Central European currencies may come under strong selling pressure, and the credit premiums imposed on CE bonds should go up.

The second implication should be greater discrimination, even within the Central European region. Unlike with the sale of risky assets in early 2009, investors could draw more distinctions within the region today. The economy with the lowest requirements for foreign funding is clearly Czech one, and therefore the koruna and Czech government bonds should outperform their neighbours in the case of a sell off. On the other hand, increased attention may also be paid to the preparations of and compliance with the 2010 budget – this is where problematic Hungary, by contrast, may be ahead of the others, as this country has to curb expenditure, under the strict supervision of the International Monetary Fund. This is one of the reasons why the country, painfully but quickly, is succeeding in reducing its twin deficit problem – those of the budget and the current account.

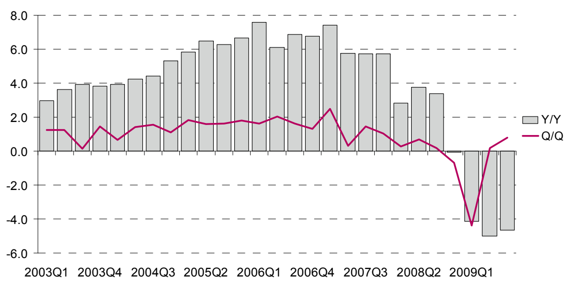


# Czech Republic

## Macro review

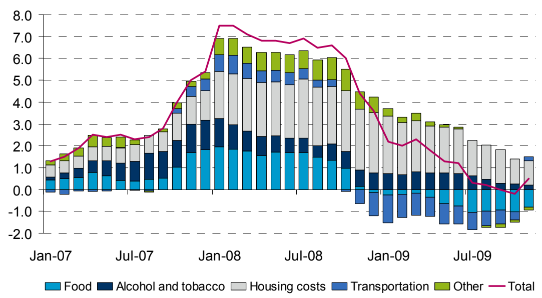
The economy grew by 0.8% q/q in the third quarter of this year. Nevertheless, expressed in year-on-year figures, the economy is still declining (by 4.1% after seasonal adjustment), but is starting to do so at a significant slower pace.
Household consumption fell this time, compared to the previous quarter, reflecting the negative developments in the labour market. With rising unemployment and frozen wage growth, consumers are starting to curb their expenditure more significantly, and they will continue to do so in the next quarter. Nonetheless, businesses are also curbing their expenditure, and cutting their investment (by 1.7% q/q, and 9.5% y/y). Thus they are reacting to lower demand for their products, as this has been, for a year now, preventing them from fully utilising their existing production capacities, let alone encouraging them to invest in new capacities. The declines of investment in machinery (-22.1%) and means of transport (-19.6%) are particularly strong. Exports were higher this time, benefiting from the growth-stimulating – though just temporary – measures taken in Western Europe. The latest data however confirm that the economy has already hit bottom and is starting to rebound slightly. Even so, we cannot expect the economy to return to its previous high growth trend. Domestic demand remains curbed, and most likely will remain so, while foreign demand is currently recovering just very modestly and uncertainly. For this year, we anticipate a GDP fall by 4.5%. In 2010, the economy might already show growth, though it would be rather negligible (1%). Household consumption will continue to be curbed by rising unemployment and probably also by low real wages. Investment will remain curbed due to the strong reduction in investment activities by industrial and development firms. Unlike this year, inventories might increase, as may exports. By and large, however, a W-shaped recovery is still possible, and the increased uncertainty in the whole economy still persists.

**GDP Growth**
(%)



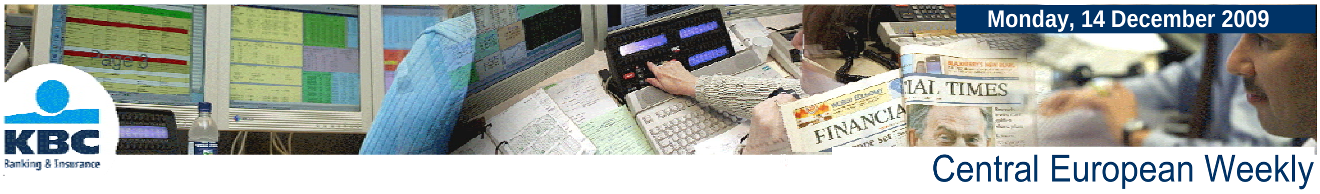

In line with expectations, **consumer prices** went up slightly in November. Particularly food and fuel prices were up somewhat on the month-on-month basis (+0.2%). Year-on-year inflation rose from the previous -0.2% to 0.5%. This is primarily due to the base effect. Although inflation is back and has started to rise slightly, the economy remains a low-inflation one, and this may easily persist. While December's consumer prices are likely to continue to rise, inflation will remain below 1%. One of the reasons is consumers' low willingness to spend their money, and this limits retailers in raising their prices. In January, we can expect another increase in regulated rents and VAT, which will drive inflation upwards during the year. Yet the central bank should not have a problem complying with its inflation target for most of next year. Current inflation will be one of the most relevant figures to influence the central bank's decision next week, particularly now that the divergence of inflation from the value predicted by the Czech National Bank has again increased.

**Inflation**
(consumer basket decomposition in percentage points)




## Currency

The Czech currency remained within a narrow band against the euro last week, and closed the week at around CZK 25.750 per EUR. It was not even stirred by the statements from the CNB indicating increased chances of a rate cut, or by the slightly increased consumer price index, or the confirmed quarter-on-quarter GDP growth.





## EUR/CZK technical picture

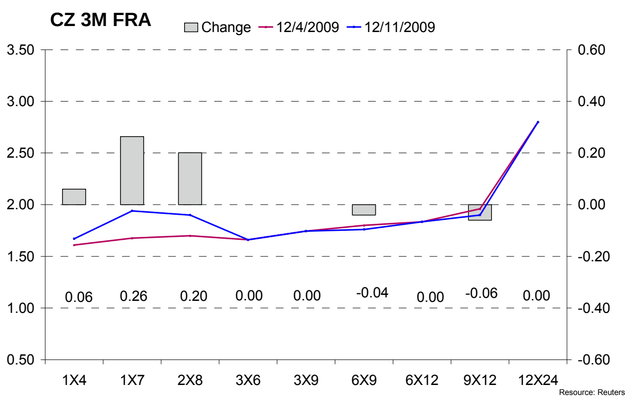
(25.7700) Failed to sustain above the neckline of long term Triple Top (26.3250: see graph).
1st support area at 25.5800 (Dec 08 low), with next level at 25.4900 (break-up daily), where pause favored.
If wrong, next level would come in at 25.4100 (Nov 18 low), ahead of 25.3250 (Nov 11 low): tough on 1st attempts.
Resistance area at 26.0700 (breakdown daily Nov 30): ideal area to stay below to keep CZK on safe side.
Failure to cap would see risk towards 26.1600 (reaction high hourly), ahead of 26.3070 (weekly Bollinger top), where pause favored.
It wrong, next levels at 26.4950 (Nov 27 high), ahead of 26.6200 (reaction high off 24.9750): tough on 1st attempts.

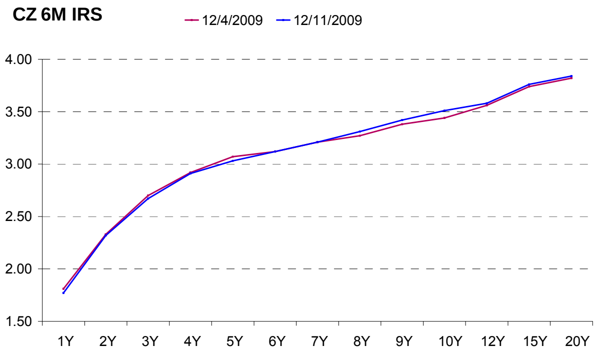
**DAILY CHARTS:**


## Fixed income

Czech bonds fared well last week, with the yield curve falling along its full length and steepening slightly. Nevertheless, the declines in yields were lower than 4.5 bps, with the market influenced by the developments in eurozone markets, notably the problems of Greece. Investors were also surprised at the statement by a CNB Board Member, who did not rule out that she would vote for a rate cut at this week's meeting. Thus she would probably join the three other members, who had already voted for a rate cut at the last meeting. Neither the demands in respect of increased expenditure in next year's budget, approved by the Lower House of Parliament, nor the moderate, yet greater than expected, rise in consumer prices, have had any impact on the market so far. Trading volumes were surprisingly large, due probably to portfolio modifications before the end of the year.

The main event of this week will be the CNB meeting. Following the above-mentioned comments from the CNB Board Member, rates may be cut by 0.25%, i.e., to the ECB level. Such expectations may maintain demand for bonds until Wednesday's CNB meeting; however, the market will also be influenced by developments in the EMU markets. Nevertheless, with the end of the year drawing near, trading volumes should go down.

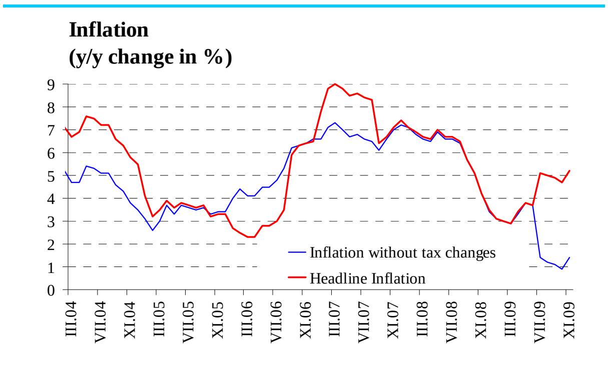


# Hungary

## Macro review

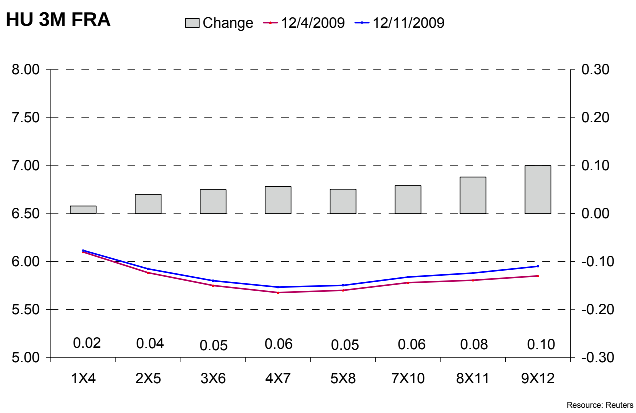
After four surprising declines, **Hungarian CPI** surprised on the upside of expectations and accelerated to 5.2% Y/Y in November compared to 4.7% Y/Y in October. Looking at the details, the slowing in utility prices continued, but other components like prices of food, motor fuels and services accelerated. On a monthly basis, prices rose by 0.3%, the first monthly rise since July, when the VAT rate was hiked (causing prices to spike higher). In a first reaction the forint strengthened to 271.98 versus the euro, but the move was not sustained and the pair reverted higher. We currently don't amend our outlook for monetary policy after the release of the CPI report
After all, MNB President Simor confirmed this in his subsequent comment, saying that the pace at which the bank would continue to cut interest rates would be determined by the appetite for risk on global and domestic markets. As this appetite remains fairly high, notwithstanding the uncertainty surrounding the debts of Dubai or Greece, the MNB is likely to cut its base rate again next Monday.

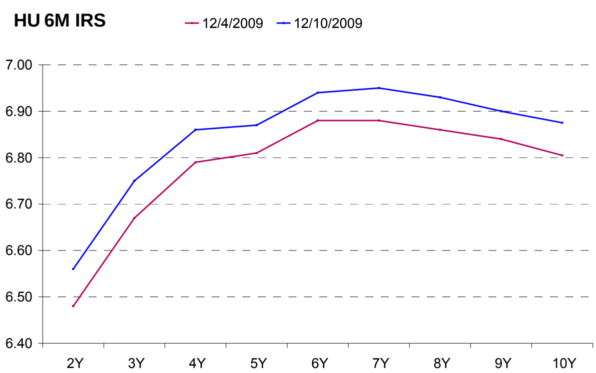



## EUR/HUF technical picture

(272.60): Rebound off 262.85 failed to sustain above 278.00 (see graph).
Resistance at 275.67/ 276.35 (weekly Bollinger top/ 61.8% 283.60 to 264.64), where pause favored.
If wrong, next level at 277.46 (1st C Wave off 264.64), ahead of 279.12/ 280.53 (76.4%/ flat 50 Week Moving Average): tough on 1st attempts.
Support at 270.80 (break-up daily), with next levels at 266.66/ 265.40 (Nov 24 low/ reaction low hourly + weekly Bollinger bottom), where pause favored.
If wrong, risk towards 264.64 (Nov 16 low), 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:**

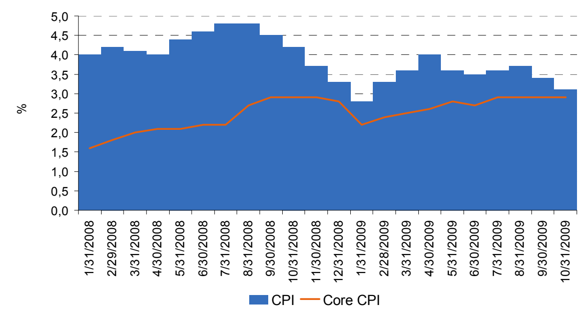


# Poland

## Currency

The **Polish zloty** weakened at the beginning of the last week due to Greek woes. The downgrade of Greek rating by Fitch triggered a sell off in emerging Europe and the EUR/PLN shot as high as 4.17 EUR/PLN. At the end of the week the currency appreciated positive US re-tail sales and trimmed part of the losses.
This week is full of interesting domestic news. The markets should eye especially inflation and industrial output figures. We believe the macro-data should confirm solid ongoing recovery and persisting elevated inflation. Although in both cases this is partly because of base effect, it should anyway play in favour of monetary tightening in the mid-2010. This should be good news for the zloty. But the pair is going to face declining liquidity as the year end approaches. Hence we do not expect any strong gains by the year end.

**Polish inflation, y/y (%)**

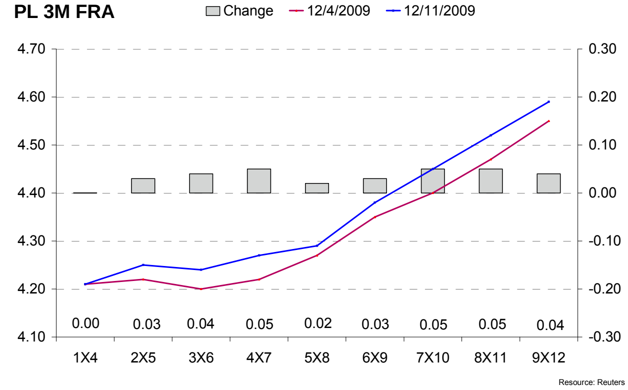



## EUR/PLN technical picture

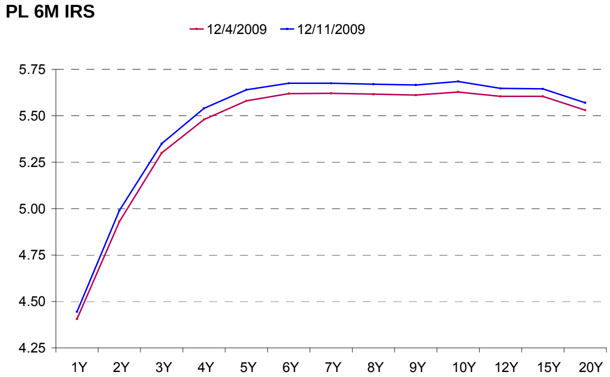
(4.1400): New reaction low scored but the broken Downtrendline off 4.9300 acted as Support (see graph).
1st support area at 4.1155 (break-up hourly), with next levels at 4.0810 (break-up daily Dec 07), ahead of 4.0352 (new reaction low off 4.9300 + weekly Bollinger bottom), where pause favored.
If wrong, next Support would come in at 4.000/ 3.9900 (psycho/ weekly projection band bottom): tough on 1st attempts.
1st Resistance comes in at 4.1730/ .1770 (Dec 09 high/ falling weekly Medium Term Moving Aver-age↓), where pause favored.
If wrong, next levels at 4.1826 (50% 4.3300 to 4.0352), ahead of 4.2000/ .2173 (Nov 27 high/ 61.8% 4.3300 to 4.0352): tough on 1st attempts.

**DAILY CHARTS:**


**PL 3M FRA**




**PL 6M IRS**



# CE Weekly Preview

**WED 12:00** **CNB base rate**

| | This meeting | Last change |
|---|---|---|
| rate level (in %) | **1.00** | 8/2009 |
| change in bps | **-25** | -25 |

## CZ: CNB Rates Stand a Good Chance of Falling

This year's last decision on central bank rates will be one of the most exciting ones of the year. As recently as in the previous meeting, three CNB Board Members voted for a rate cut, and thus the rate cut failed by a margin of just a single vote. Although nothing of any great importance has happened in the economy over the last month and a half, such as would have changed the view of the economic development, the likelihood of a rate cut has increased. Inflation is slowly rising, but this is a result of factors that are absolutely outside the central bank's influence. Thus inflation is and will continue to be probably the very last problem of the Czech economy.

# Calendar

| | Date | Time | Indicator | Period | Forecast | | Consensus | | Previous | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | m/m | y/y | m/m | y/y | m/m | y/y |
| CZ | 14.12.2009 | 09:00 | Construction output (%) | 10/2009 | | | | | | 3.6 |
| CZ | 14.12.2009 | 09:00 | Industrial output (%) | 10/2009 *F | | -8.0 | | | | -7.3 |
| CZ | 14.12.2009 | 09:00 | Retail sales (%) | 10/2009 | | -5.0 | | -4.6 | | -7.6 |
| PL | 14.12.2009 | 14:00 | Money supply M3 (%) | 11/2009 | | | -1.0 | | 2.8 | |
| HU | 15.12.2009 | 09:00 | Industrial output (%) | 10/2009 *F | | | | | 1.8 | -10.8 |
| CZ | 15.12.2009 | 09:00 | PPI (%) | 11/2009 | 0.0 | -2.8 | 0.0 | -2.8 | -0.2 | -4.6 |
| **PL** | **15.12.2009** | **14:00** | **CPI (%)** | **11/2009** | | | **0.4** | **3.4** | **0.1** | **3.1** |
| PL | 15.12.2009 | 15:00 | Budget balance (PLN M) | 11/2009 | | | | | -2 570.7 | |
| HU | 16.12.2009 | 09:00 | Unemployment rate (%) | 11/2009 | | | 10.6 | | 10.4 | |
| HU | 16.12.2009 | 09:00 | Wages (%, ytd.) | 10/2009 | | 0.5 | | 0.7 | | 0.7 |
| **CZ** | **16.12.2009** | **12:30** | **CNB meeting (%)** | **12/2009** | **1.00** | | **1.25** | | **1.25** | |
| PL | 16.12.2009 | 14:00 | Wages (%) | 11/2009 | | | 3.4 | 2.9 | 0.9 | 2.0 |
| **PL** | **17.12.2009** | **14:00** | **Industrial output (%)** | **11/2009** | | | **-5.6** | **6.8** | **1.9** | **-1.2** |
| PL | 17.12.2009 | 14:00 | PPI (%) | 11/2009 | | | 0.1 | 2.4 | 0.3 | 2.0 |

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* | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 | -25 bps | 06/08/2009 |
| **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 | 25/06/2009 |

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

| | | *Current* | Dec-09 | Mar-10 | Jun-10 | Sep-10 | Dec-10 |
|---|---|---|---|---|---|---|---|
| **Czech Rep.** | PRIBOR | *1.72* | 1.55 | 1.50 | 1.55 | 1.65 | 1.75 |
| **Hungary** | BUBOR | *6.41* | 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.** | *3.52* | 3.48 | 3.50 | 3.70 | 3.85 | 3.98 |
| **Hungary** | *6.995* | 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 | *25.8* | 25.3 | 26.0 | 24.8 | 24.8 | 25.5 |
| **Hungary** | EUR/HUF | *272* | 270 | 270 | 275 | 270 | 270 |
| **Poland** | EUR/PLN | *4.14* | 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.** | *-4.1* | -3.0 | 1.2 | 1.0 | 0.3 | 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* | 0.9 | 0.8 | 1.2 | 1.9 | 2.2 |
| **Hungary** | *3.7* | 5.0 | 4.5 | 3.8 | 3.8 | 3.5 |

*Current Account as % of GDP*

| | 2008 | 2009 |
|---|---|---|
| **Czech Rep.** | -3.1 | -1.5 |
| **Hungary** | -6.0 | -3.0 |

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

| | 2008 | 2009 |
|---|---|---|
| **Czech Rep.** | -2.1 | -6.5 |
| **Hungary** | -3.9 | -4.5 |

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