Monday, January 11,

Banking & Insurance

Central European Weekly

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

Czech Republic

Inflation and employment readings in line with expectations

Hungary

The 2009 cash-flow budget deficit outcome better then expected

Poland

Polish zloty gains on weak US dollar and hawkish comments

The Week Ahead

Regional headline year-on-year inflation will move up due to negative base effect

Overview

	Last	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	26.27	↘	↗
EUR/PLN	4.084	↘	↗
EUR/HUF	268.5	↘	↗
3M PRIBOR	1.54	→	↗
3M WIBOR	4.26	→	↗
3M BUBOR	9.69	→	→
10Y CZK	4.22	↘	↗
10Y PLN	6.12	→	↗
10Y HUF	7.29	→	↗
3M EURIBOR	0.65	→	→
10Y EMU	3.36	↘	↗

Last values from Friday 13:30 CET

Czech Bond Sell-off Related to Upcoming Supply

The beginning of the new year involved no significant reversals in Central Europe. No wonder, because attractive regional events were few, indeed, unlike events in the core markets.

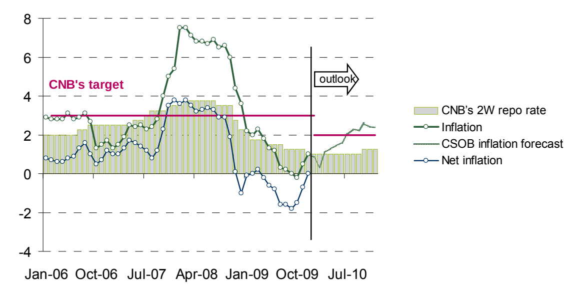
From a market point of view, at least the developments in the Czech bond market were interesting, especially in the context of December's repo rate cut by the Czech National Bank to a record-breaking 1.0%. Czech bond yields soared at the start of the year and the rise, notably at the long end of the curve, was truly enormous. Three factors may be responsible for this: firstly, the Czech market might be catching up with the post-Christmas sell off on core markets; secondly, not long after the rate cut, the market was confronted with clearly hawkish comments from two CNB Deputy Governors; and finally, probably the most important factor was concern about the future bond supply on the primary market. This may be the main bearish factor on the Czech bond market for the next half-year, during which an overwhelming majority of the debt issues have been scheduled. Czech bond prices may be under pressure, notwithstanding the moderate development of Czech inflation and possibly temporary rises in bond prices in developed countries.

Czech Republic

Macro review

Consumer prices went up by 0.2% m/m in December, half a percentage point above the central bank's forecast. Annual inflation reached 1.0% due to higher regulated rents and other costs related to housing. Other consumer prices mostly dropped, especially food, health care and telecommunication prices. We expect that inflation will increase faster especially in the second half of 2010 and will jump slightly over the central bank's target. On the other hand, we don't expect that the CNB should hike its rates faster because the inflation will be driven fist of all by increased taxes (V.A.T. and consumer taxes) and regulated prices.

Inflation and CNB's Target
(%)



Currency

The koruna virtually stabilized around EUR/CZK 26.35-26.40 in the first week of the year, when it failed to return to less than EUR/CZK 26.00. Thus the Czech currency continued to face pressures triggered by the December cut in Czech rates, while last year's government deficit, which was close to the pessimistic forecasts, had practically no effect on the currency. The koruna was not even encouraged by statements from the CNB, suggesting that rates might go up, approximately in the middle of the year.
The positive sentiment in the CEE may prevail in the upcoming sessions as the weak US dollar environment is favourable for carry trades. Nevertheless the Czech koruna may continue to lag behind the regional counterparts due to significantly lower carry. Hence it should not be easy to get below 26.00 EUR/CZK.

EUR/CZK technical picture

(26.3100) Toying back with the neckline of long term Triple Top (26.3250: see graph).
1st support area at 26.0600 (reaction low hourly + rising weekly Medium Term Moving Average), with next levels at 25.9320/ .9060 (monthly envelope bottom/ break-up daily Dec 14), ahead of 25.8640 (weekly Bollinger midline): must sustain below to signal better mood for CZK.
Failure to hold would see next levels at 25.6700 (medium term reaction low hourly), ahead of 25.5800 (Dec 08 low) and 25.3250 (Nov 11 low): tough on 1st attempts.
Resistance area at 26.4850/ .4950 (Dec 31/ Nov 27 highs), where pause favored.
Failure to cap would see risk towards 26.6200 (Oct 28 high), ahead of 26.7100 (weekly Bollinger top): tough on 1st attempts.

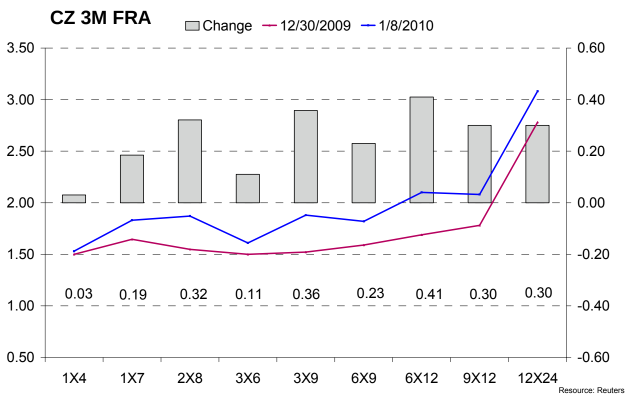
DAILY CHARTS:

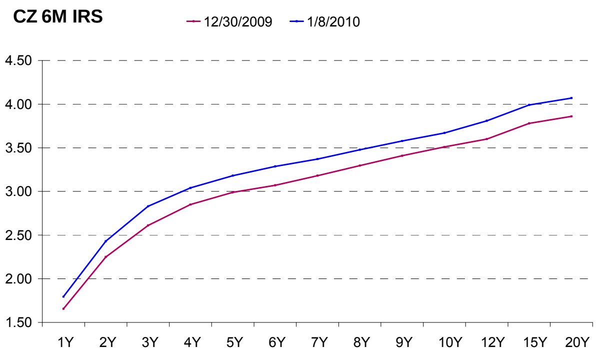
Fixed income

The **Czech yield curve** went up along its full length and steepened at the beginning of the year, when yields were up by more than 9 bps at the short end and up to 21 bps at the long end. Several factors worked against bonds. Above all, it was the expectation that the easy monetary policy would slowly draw to a close, with two CNB Deputy Governors having supported this by their comments. Another, and no less significant, stimulus was the planned government deficit for this year, requiring fairly large bond sales. Finally, the rise in the stock market also contributed to the rise in yields.
The existing mood on global markets, including the Czech one, has not been very favourable for bonds. Although this week's statistics might tend to encourage the demand for bonds, due to low inflation and another anticipated decline in retail sales, the mood is likely to remain negative and should drive yields even slightly higher, even as the poorer

U.S. payrolls may curb the rise in yields. However, the main event of the week will be Wednesday's auction of the 5.0%/2019 government bonds. An amount of CZK 7 bn is planned. We expect that, given the low volume and the existing prices, these securities could be in demand, and the entire volume may be easily subscribed.

According to the Finance Ministry's plan, this year's value of medium-term and long-term government bond issues in koruna's on the domestic market should not exceed CZK 292.3 bn. The plan envisages a state budget deficit of CZK 163 bn, while an additional CZK 94 bn will be required for the repayments and buyouts of existing bonds. Let us add, however, that, on January 26, the Lower House of Parliament will discuss the possibility of another budget deficit increase by approximately CZK 14 bn, primarily in favour of social security expenditure.





Hungary

Macro review

In Hungary, the well established economic trend in vogue for more than half a year was confirmed in the first trading week of the year. These include improving fiscal and external balance, gradual monetary easing and a generally benign inflation environment.

The only difference has been the speed of monetary easing, which became slower in December due to central bank's more cautious approach to rate cuts on uncertainties surrounding investors' appetite for Hungarian assets. The inflation has not been mentioned by the bank, yet. However, the November CPI data was 0.2pp higher than consensus' 5.0% Y/Y view, while the recent increase of fuel prices could accelerate it further. On the other hand, the government decided to cheapen the cost of district heating by lowering the VAT rate and subsidising local governments more. Overall, this could at least partly counterbalance the effect from fuels and some experts said that it may even lower the Y/Y figure in December, before a sharp rise in January. Statistical methodology could be a reason for this volatility as the heating price change may show up in the index already in December, while higher fuel prices will kick in only a month later in January. Currently, the market expects the December CPI index at 5.7% Y/Y this week on Thursday. We think this could be undershoot (5.5% Y/Y could be released in our view) this time, followed by probably an overshoot of the January reading.

Last week's main item was the 2009 cash-flow budget deficit outcome, which came out 0.3pp better than the 3.9% of GDP target on a higher-than-planned December surplus. The market was slightly sceptical about the target due to large revenue fallouts in the preceding months, but it seems that the government was able to deliver. The question is whether this was achieved by one-off items and to what extent these were used. Press reports cited accelerated income from state-owned electricity operator MVM of Ft20bn and excise duty payments from tobacco companies worth about Ft20-30bn. These together with a possible delay of spending items onto January (like bonus payments at Ministries) could overall explain the Ft70bn better outcome, which would still allow for a 3.9% reading, matching the target. In this case, the next question is whether the European based ESA figure would differ from this cash-flow based figure or not. Unfortunately, we will see the first ESA data only in March and the revised figure only in September.

The trend of external balance improvement seems to be undisturbed and the November trade surplus was again close to €500m (at €411m).

Comments from Monetary Council member Mr Csaky raised the possibility that the easing cycle could continue to 5.75%, implying two more 25bps cuts in January and February before a pause could start in March, before elections in April.

Currency

The forint's exchange rate market was very stable at the beginning of last week at the 270.00 level, but the market finished the week in a good mood after the release of the US payroll data. The relief pushed the forint 1% stronger to 267.00, a new 6-week high.

Positive global sentiment could continue to lend more support behind emerging market currencies, including the forint and then we may see a test of the key 265.00 level again soon. This was the bottom of the trading range since the recovery began last spring and the market could try to break it in the next weeks.

EUR/HUF technical picture

(268.90): Rebound off 262.85 failed to sustain above 278.00 (see graph), with drop from 279.95 having retested the broken Downtrendline off high (see graph).

Resistance at 271.10 (weekly Bollinger midline + flat weekly Medium Term Moving Average), ahead of 272.15 (falling weekly Long Term Moving Average), where pause favored.

If wrong, next levels at 273.05 (reaction highs hourly), ahead of 275.98 (idem).

279.95 = Dec 17 high + falling 50 Week Moving Average): tough on 1st attempts.

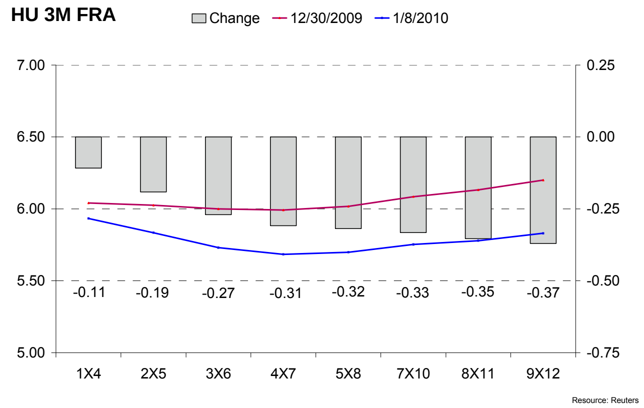
Support at 267.20 (Dec 04 low), with next levels at 266.66/ 265.75 (Nov 24 low/ weekly Bollinger bottom), where pause favored.

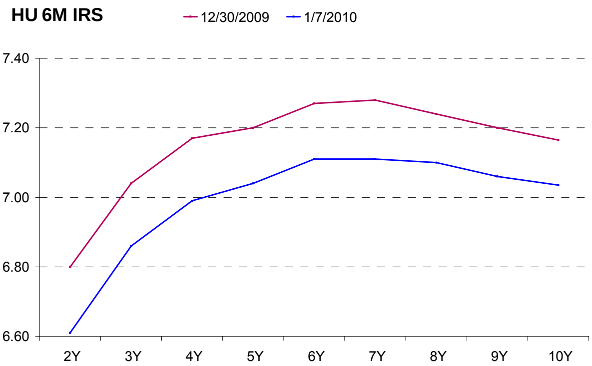
If wrong, risk towards 264.64/ .28 (Nov 16 low/ monthly envelope bottom), ahead of 262.85/ 262.08 (current new reaction low off 317.45/ 61.8% 227.87 to 317.45): tough on 1st attempts.

DAILY CHARTS:

Fixed income

The bond market rallied sharply throughout the week as the December selloff was reversed on strong demand from local institutional investors. Especially yields at the long-end decline rapidly to 7.50% (10-year) from 8.00% at the end of the year as this sector was hit the most before. The short-end of the curve priced in the longer monetary easing path and rates declined below the 6.00% level, while auctions of T-Bills showed considerable interest.





Poland

Currency

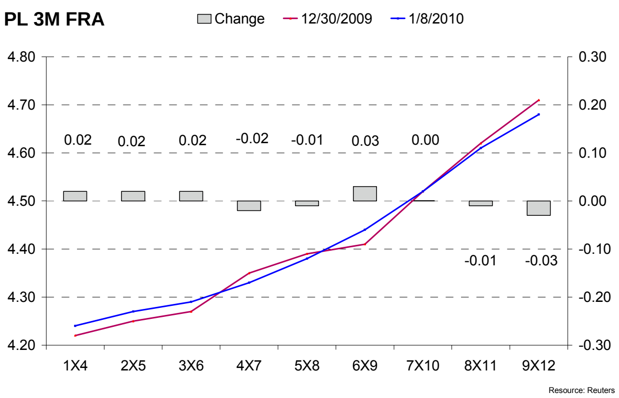
The **Polish zloty** stayed in the defensive in the week ahead of the payrolls. Nevertheless it strengthened quite sharply with the EUR/PLN breaking to the 4.05 area after the payrolls release. Weaker than expected US payrolls triggered a sell off on the US dollar and caused a build-up of carry trades. The zloty also benefited from hawkish comments of new MPC member Elzbieta Chojna-Duch, who sees pretty strong growth and inflation risks ahead. Beside that also the sale of 10% of copper mine KGHM helped the pair. It is good news for the government budget in 2010 as the deficit may exceed 7% GDP and any relief on the financing is highly welcome.

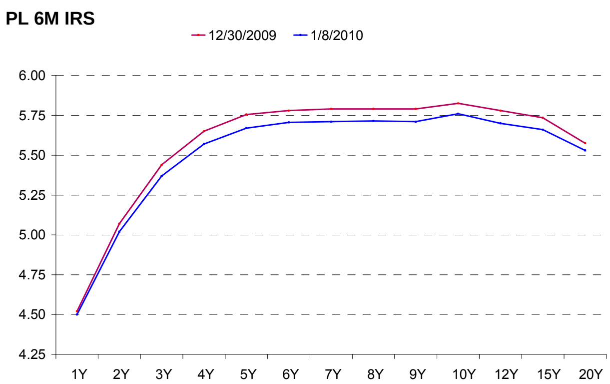
The positive sentiment may prevail in the week ahead. As investors are heading toward the US earning season in the light of a weaker US dollar, the appetite for carry trades could stay intact. Beside that, inflation should go back above 3.5% in December and the new MPC members so far seem to be rather hawkish. Hence the pair could test the important psychological level at 4.00 EUR/PLN.

EUR/PLN technical picture

(4.1000): New reaction low scored but the broken Downtrendline off 4.9300 acted as Support (see graph).
1st support area at 4.0660 (Jan 05 low), with next levels at 4.0450/ .0352 (weekly Bollinger bottom/ (new reaction low off 4.9300), where pause favored.
If wrong, next Support would come in at 4.0221 (monthly envelope bottom), ahead of 4.000/ 3.9943 (psycho/ weekly projection band bottom): tough on 1st attempts.
1st Resistance comes in at 4.1290 (Jan 07 high), ahead of 4.1444 (falling weekly Medium Term Moving Average↓), where pause favored.
If wrong, next level at 4.1655 (medium term reaction high hourly + weekly Bollinger midline): tough on 1st attempts.

DAILY CHARTS:





CE Weekly Preview

WED 9:00 **HU Inflation (change in %)**

	Dec-09	Nov-09	Dec-08
CPI y/y	**5.5**	5.2	3.5
core CPI y/y	**5.3**	5.0	3.8
Food y/y	**3.6**	3.3	4.3

HU: Month-on-month inflation unchanged in December

Inflation could have increased in December as fuel prices went up, but the increase could be below expectations as the government intervened into district heating costs, which could have declined during the month.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	11.1.2010	09:00	Trade balance (EUR M)	11/2009 *P	411.0		430.0		471.0	
CZ	11.1.2010	09:00	Unemployment rate (%)	12/2009	9.2		9.3		8.6	
CZ	**11.1.2010**	**09:00**	**CPI (%)**	**12/2009**	**0.2**	**1.0**	**0.2**	**1.0**	**0.2**	**0.5**
CZ	13.1.2010	09:00	Retail sales (%)	11/2009		-1.0		-1.0		-4.7
HU	**14.1.2010**	**09:00**	**CPI (%)**	**12/2009**	**0.0**	**5.5**	**0.2**	**5.7**	**0.3**	**5.2**
CZ	14.1.2010	09:00	Construction output (%)	11/2009						0.1
CZ	14.1.2010	09:00	Industrial output (%)	11/2009 *F						0.2
PL	**14.1.2010**	**14:00**	**CPI (%)**	**12/2009**			**0.1**	**3.6**	**0.3**	**3.3**
PL	14.1.2010	14:00	Money supply M3 (%)	12/2009					-1.6	
CZ	15.1.2010	09:00	PPI (%)	12/2009	0.2	-0.7	0.1	-0.9	0.4	-2.4
HU	15.1.2010	09:00	Industrial output (%)	11/2009 *F		-9.3			-1.3	-9.3
CZ	15.1.2010	10:00	Current account (CZK B)	11/2009	-3.5		-2.8		12.4	
PL	15.1.2010	14:00	Trade balance (EUR M)	11/2009					-819	
PL	15.1.2010	14:00	Current account (EUR M)	11/2009					-991	
PL	15.1.2010	15:00	Budget balance (PLN M)	12/2009					-498.2	

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	Mar-10	Jun-10	Sep-10	Dec-10	Last change	
Czech Rep.	2W repo rate	*1.00*	1.00	1.00	1.00	1.25	-25 bps	16/12/2009
Hungary	2W deposite r.	*6.25*	6.00	6.00	6.00	6.00	-50 bps	21/12/2009
Poland	2W inter. rate	*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	Mar-10	Jun-10	Sep-10	Dec-10
Czech Rep.	PRIBOR	*1.54*	1.50	1.55	1.65	1.75
Slovakia	BRIBOR	*2.98*	1.05	1.20	1.45	
Czech Rep.		*3.7*	3.50	3.70	3.85	3.98

Exchange rates (end of the period)

		Current	Mar-10	Jun-10	Sep-10	Dec-10
Czech Rep.	EUR/CZK	*26.3*	26.0	24.8	24.8	25.5
Hungary	EUR/HUF	*269*	270	275	270	270
Poland	EUR/PLN	*4.09*	4.30	3.60	3.90	3.30

GDP (y/y)

		Q3 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010
Czech Rep.		*-4.1*	1.2	1.0	0.3	0.7
Hungary		*-7.3*	-2.4	-1.6	0.9	0.0

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

		Sep-09	Mar-10	Jun-10	Sep-10	Dec-10
Czech Rep.		*0.0*	0.8	1.2	1.9	2.2
Hungary		*3.7*	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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