KBC
Banking & Insurance

Central European Weekly

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Czech Republic

November's retail sales fell quite significantly.

Hungary

The short-end of the curve has discounted the three more rate cuts

Poland

Polish headline inflation should head downwards in 2010

The Week Ahead

Only Polish macro data might grab some attention and eventually support Zloty's rally

Overview

Bond Markets Continue to Diverge in Central Europe

	Last	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.93	↘	↗
EUR/PLN	4.037	↘	↗
EUR/HUF	266.9	→	↗
3M PRIBOR	1.55	→	↗
3M WIBOR	4.25	→	↗
3M BUBOR	0.00	→	→
10Y CZK	4.33	→	↗
10Y PLN	6.10	→	↗
10Y HUF	7.28	↘	↗
3M EURIBOR	0.67	↘	→
10Y EMU	3.26	↘	↘

Last values from Friday 13:30 CET

Bond markets in Central Europe continue to diverge in a movement that started at the beginning of the year. While bonds in Poland and Hungary have already recouped their December losses generated, bonds in the Czech Republic are not faring well, and their prices are still much lower than in early December. Why are foreign exchange rates and stock markets in Central Europe showing a reasonable correlation while bonds do not?

One of the reasons may be that Polish and Hungarian bonds bear higher yields than their Czech counterparts, making them more attractive items when demand is strong for emerging markets bonds in general. On the other hand, the relatively low yields (and thus also high prices) of Czech bonds may discourage investors, i.e., they may rather wish to wait for better times to buy, if they are aware of this year's hefty bond supply, given the record-breaking budget deficit.

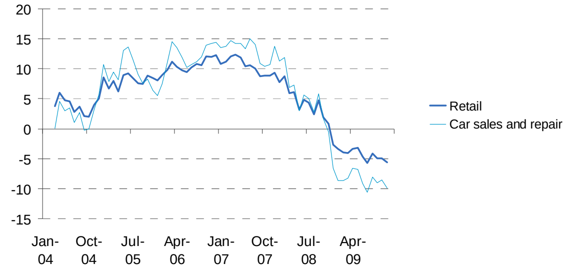
The lower attractiveness of Czech bonds, compared to Hungarian or Polish ones, may also be due to the different stage of the monetary policy cycles in Central Europe. While the Czech National Bank's official rates have probably hit bottom, and now the only possible way is up, the National Bank of Hungary is still in the middle of its base rate cutting cycle and the National Bank of Poland has been keeping rates unchanged for a prolonged period. While for the NBP (just like for the CNB) we expect that the next rate change will be upwards, the strong zloty alone will tighten monetary conditions, and thus it may postpone a rate hike (and keep bullish sentiment in the bond market intact).

Czech Republic

Macro review

November's retail sales fell quite significantly. They were down by 4.9% y/y, and this, given the low comparative baseline of the previous year, is a very poor figure. The automotive segment saw another strong decline, with its revenues having fallen by a huge 11%, and not even the low comparative baseline and one extra business day helped reverse this. However, consumers saved not only on cars but also on clothing and household equipment purchases. The main reasons why the consumer willingness to spend money remains low include concern about the future and the worsened financial situation of households. The rising unemployment, along with unfavourable wage developments, and the poor prospects for the future development of the economy, encourages consumers to be prudent. Thus the low consumer willingness to spend money puts pressure on retailers to cut their margins and come up with more attractive offers. Therefore sales results at the turn of the year might be encouraged by price reductions, which already started to occur around Christmas time. However, this is most probably not a fundamental factor that would completely change the consumer mood permanently. Therefore retail sales are very likely to continue to fall this year.
The consumer reluctance to spend their money creates good preconditions for consumer goods prices to develop favourably. Hence we do not expect – with the exception of administrative moves (an increase in indirect taxes and regulated prices) – any major inflationary pressures. The consumer unwillingness to spend money can even make retailers absorb at least part of the tax increase. This is also why inflation, at least in the first half of the year, might remain below the new inflation target, which has been 2% since January.

Retail sales
(y/y, %, 3m average)



One of the main reasons why the consumer willingness to spend money is not recovering has been the unfavourable development of the domestic labour market. This is borne out by the latest unemployment data, which broke through 9% at the end of last year. The current 9.2% is December's five-year high, yet a further unemployment rise is more than likely. As early as in January, the unemployment rate will approach 10%, and this will definitely not boost the appetite to spend money in the economy. In the second half of the year, the labour market situation might start to stabilise enough for domestic consumption to recover slightly. The full-year figure will most likely be in the red.

Currency

The koruna strengthened against the euro last week; after hitting CZK 26.245 per EUR on Monday morning, it gradually firmed against the common European currency to close the week below CZK 26.00 per EUR. The appreciation of the domestic currency was somewhat surprising, because the rise in unemployment and the decline in retail sales did not suggest any need to tighten the monetary policy at all. The moderate rise in year-on-year inflation had no impact on the currency pair either.
This week the domestic calendar is rather empty. Hence the Czech koruna should follow the US earning season. If the positive sentiment prevails, the koruna may try to get further below 25.85 EUR/CZK.

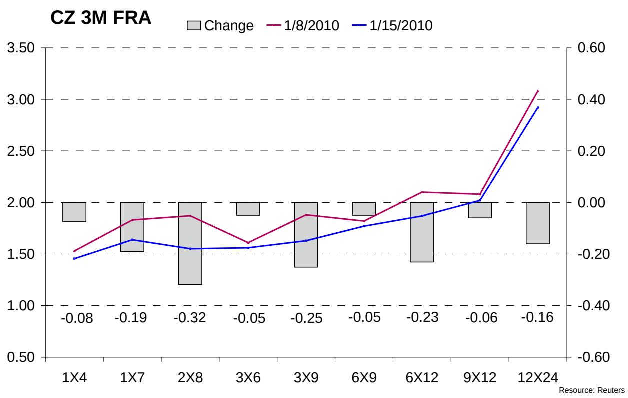
EUR/CZK technical picture

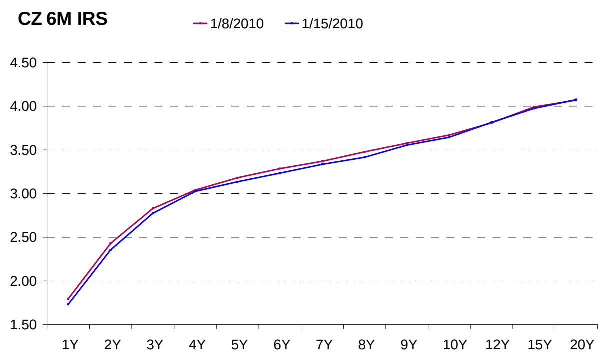
(25.8500) Approaching Uptrendline off 24.9750 (see graph).
1st support area at 25.8290 (weekly Bollinger mid-line + broken monthly channel top off 1999), where pause favored.
If wrong, next levels at 25.6700 (medium term re-action low hourly), ahead of 25.5800 (Dec 08 low) and 25.3250 (Nov 11 low): tough on 1st attempts.
Resistance area at 26.1240 (breakdown daily): ideal area to stay below to keep current mood on CZK.
Failure to hold would see next levels at 26.2850 (reaction high hourly), ahead of 26.3900 (Jan 07 high) and 26.4850/ .4950 (Dec 31/ Nov 27 highs), where pause favored.

DAILY CHARTS:

Fixed income

The Czech yield curve steepened last week. The short end of the curve fell by 2 bps, as the rise in unemployment and the fall in retail sales clearly indicated that the CNB has plenty of time before raising rates. The rise in yields at the long end corresponds to the rise, though moderate, in the CPI and to concern about the quantity of new bond issues required to cover this year's planned deficit. Remarkably, Thursday's comments by the ECB President, on Greece, also triggered sales of Czech bonds by foreign investors.
However, the main event of last week was this year's first auction of the 5.0%/2019 bond. Even though the supply of CZK 7 bn was fairly small, bonds for only CZK 6.492 were demanded and bonds for CZK 5.347 bn were sold in the first round. The Ministry sold no more bonds in the second round. The average yield in the auction was 4.303%. Thus poor demand at the very beginning of the year is not a good signal for the market. By comparison, the average yield in the previous auction of the same bond, held in the first half of November 2009, was 4.180%.
This week is free of new domestic statistics. Demand for bonds will be influenced by events related to Greece, albeit there is no reason for such consideration. The currently poorer domestic fundamentals should keep short-term yields down. However, the yield curve might steepen a little more.





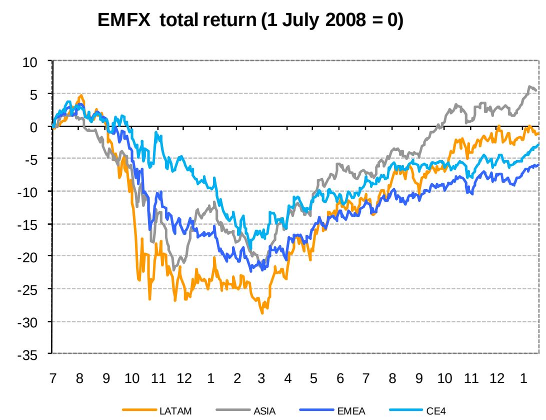
Hungary

Macro review

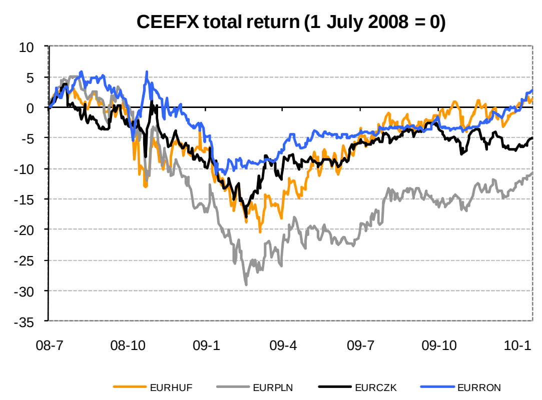
Despite the release of some important data last week, the macro situation left markets unaffected as the new information was broadly in line with the consensus view.
First, trade balance showed again the usual €411m surplus in November, which means that the full-year surplus could exceed €4.0bn or 4% of GDP. This would be a new record since transition began in 1990. Trade surplus allows exporters to set aside some euro proceeds onto bank accounts, which they can sell to foreign currency debtors to repay their debt.
Secondly, December inflation data came in just below the consensus' forecast of 5.7% Y/Y. The 5.6% Y/Y release was however tad above our 5.5% Y/Y projection due to sharper increases of fuel prices. We expected most of the fuel price increase to show up later in the January figure.
Other categories however continue to show a benign inflation picture, in line with the central bank's forecast that sees a peak above 6% Y/Y in January followed by a rapid decline to below 3% Y/Y by the year-end.
This week's highlights will be wage data from November on Tuesday, which might show a decline from a year-ago due to lower bonus payments this time. Thursday will see retail trade data about November with a likely outcome of another steep fall, like -7% Y/Y, which is even sharper, exceeding -10% Y/Y with auto sales. This shows that the economy is undergoing a deep and painful surgery from the credit-financed consumption boom of previous years.

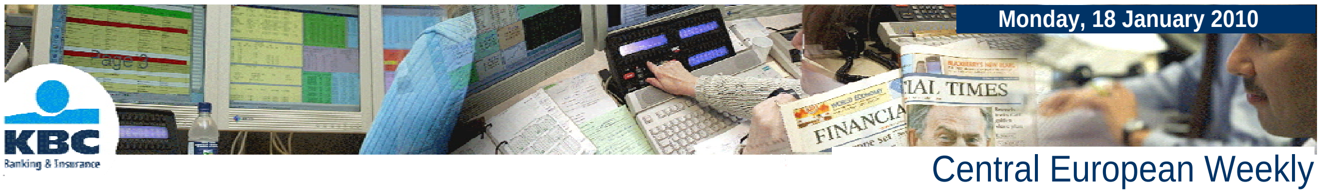
Currency

The forint continued this year's positive trend until Thursday, when global jitters reached the market and the pair declined from 266.50 to 268.00. Stronger dollar, lower equity prices have all contributed to the worries, but so far, these have remained contained and their effect limited.



Declining interest rates at the lower-end together with unchanged interest rate differential at long-term forward spreads could create some volatility for the forint and therefore some hedging against forint risk could be warranted before elections in April.
The EUR/HUF rate has been ranging within 265.00 and 282.00 for 7-months now. We are closer to the top of this range at the moment, but given that there could be some consolidation on global markets after recent losses, the forint may also try to test the 265.00 level next. That could be an opportunity to buy some euro before elections, which we think could bring risks to the market not just from the economic side, but also political, like a surprisingly strong result for the upcoming far-right wing party Jobbik.
Global emerging currencies have almost fully recovered their losses in the last 12-months (including the carry). In line with the fundamentals, Asia is first while EMEA has been lagging behind.





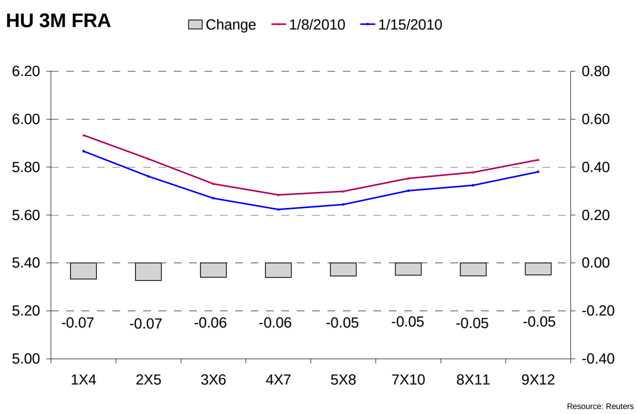
EUR/HUF technical picture

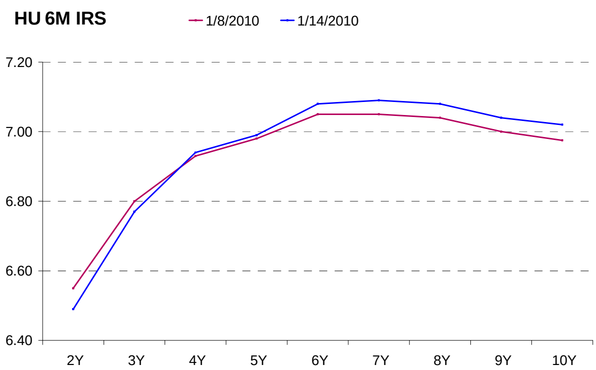
(266.50): Drop from 279.95 retesting the 1st Down-trendline off high (see graph).
Resistance at 269.60 (falling weekly Short Term Moving Average), with next levels at 270.75/ 271.00 (weekly Bollinger midline + flat weekly Medium Term Moving Average + current year high): ideal area to stay below to keep current mood on HUF.
Failure to hold would see next levels at 273.05 (reaction highs hourly): tough on 1st attempts.
Support at 265.95 (current year low?), where pause favored.
If wrong, risk towards 264.64/ .28 (Nov 16 low/ monthly envelope bottom + weekly Bollinger 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 had a stable week despite auctions of T-Bills and T-Bonds saw strong demand with b/c ratios close to 3.0. The short-end of the curve has been digesting the probability of three more cuts instead of two, which would bring the interest rate level to 5.50% from the current 6.25% level. It seems that there is some appetite for this scenario, so it can not be ruled out completely, but of course, this will largely depend on the stability of the forint until March.

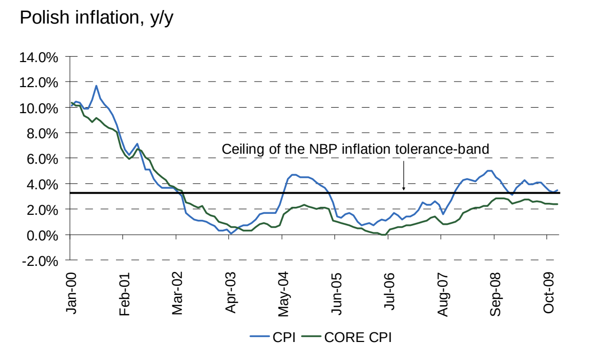


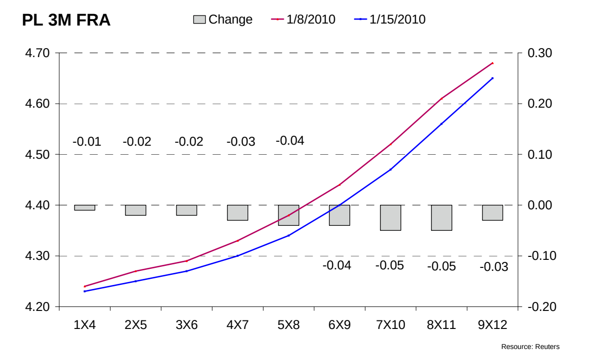


Poland

Macro review

Poland's inflation rose to 3.5% in December – the upper threshold of the NBP's tolerance band. The rise was primarily due to a lower comparative baseline, stemming from the rapid decline in fuel prices in late 2008, which did not reoccur in late 2009. During 2010, the effect of the low comparative baseline should be running out of steam and inflation should fall. Firstly, regulated prices should not go up that rapidly this year; secondly, we do not believe, in view of rising unemployment, that Polish retailers should be strong enough to drive core inflation upwards. Even if inflation permanently settles within the tolerance band of the NBP over the course of the year, the recovering economy might prompt the central bank to raise rates in the middle of the year.





Currency

The Polish zloty hit 1 year high by the end of the last week on growing optimism on Polish economy. Worse than expected current account deficit was widely ignored as it was caused by one-off dividend transfers. This week should see better industrial figures and slightly worse than expected deterioration of the labour market. Nevertheless the zloty should mainly focus on global emerging markets sentiment in light of ongoing US earnings season. If the bulls continue in winning race, we may see the pair to test 4.00 EUR/PLN soon.

EUR/PLN technical picture

(4.0350): Retesting Dec low of 4.0352.

1st support area 4.0221 (weekly Bollinger bottom + monthly envelope bottom), where pause favored.
If wrong, next Support would come in at 4.000 (psycho), ahead of 3.9707 (weekly projection band bottom): tough on 1st attempts.
1st Resistance comes in at 4.0900/ .1035 (falling weekly Short Term Moving Average/ breakdown hourly): ideal area to stay below to keep current mood on Zloty.
Failure to hold would see next levels at 4.1290/ .1310 (Jan 07 high/ falling weekly Medium Term Moving Average), where pause favored.

DAILY CHARTS:

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	19.1.2010	09:00	Wages (%, ytd.)	11/2009		-1.0		-0.6		-1.6
PL	19.1.2010	14:00	Wages (%)	12/2009			4.0	2.9	2.8	2.3
PL	21.1.2010	14:00	Core CPI (%)	12/2009					0.0	2.8
PL	**21.1.2010**	**14:00**	**Industrial output (%)**	**12/2009**			**-1.0**	**11.6**	**-3.3**	**9.8**
PL	21.1.2010	14:00	PPI (%)	12/2009			-0.3	2.2	-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	Jun-10	Sep-10	Dec-10	Jan-11	Last change	
Czech Rep.	2W repo rate	*1.00*	1.00	1.00	1.25	1.25	-25 bps	16/12/2009
Hungary	2W deposite r.	*6.25*	5.50	6.00	6.00	6.00	-25 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	Jun-10	Sep-10	Dec-10	Jan-11
Czech Rep.	PRIBOR	*1.55*	1.55	1.65	1.75	1.80
Hungary	BUBOR	*6.15*	5.50	6.00	6.00	6.00
Poland	WIBOR	*4.25*	4.15	4.20	4.30	4.40

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

	Current	Jun-10	Sep-10	Dec-10	Jan-11
Czech Rep.	*3.68*	3.50	3.70	3.85	4.02
Hungary	*7.01*	7.75	8.00	7.50	7.25
Poland	*5.67*	4.50	4.50	4.50	4.50

Exchange rates (end of the period)

		Current	Jun-10	Sep-10	Dec-10	Jan-11
Czech Rep.	EUR/CZK	*25.9*	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*267*	280	275	270	265
Poland	EUR/PLN	*4.04*	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	0.4	0.9
Hungary	*-6.0*	-1.5	0.5	1.0	2.0

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

	Dec-09	Jun-10	Sep-10	Dec-10	Jan-11
Czech Rep.	*1.0*	1.7	2.2	2.3	2.1
Hungary	*5.5*	3.5	3.5	3.5	3.5

Current Account as % of GDP

	2009	2010
Czech Rep.	-0.8	-0.9
Hungary	-1.0	-0.5

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

	2009	2010
Czech Rep.	-6.5	-5.5
Hungary	-3.9	-5.5

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