KBC Banking & Insurance

Central European Weekly

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Czech Republic

Growth of industrial output back in positive territory.

Hungary

Change in market sentiment could make an end to rate cuts

Poland

The unstoppable zloty is testing the EUR//PLN 4.0 level

The week ahead

The CNB stays on hold and it will release its new inflation report

Overview

Most CE markets still shrug-off Greek debt problems

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	26.19	0.14%	↗	↗
EUR/PLN	4.045	-1.36%	↗	↗
EUR/HUF	271.2	-0.23%	↗	↗
3M PRIBOR	1.55	0.00	→	→
3M WIBOR	4.19	-0.03	→	→
3M BUBOR	6.00	-0.13	→	↗
10Y CZK	4.35	-0.04	↗	↗
10Y PLN	6.10	0.00	↗	↗
10Y HUF	7.41	-0.03	↗	↗
3M EURIBOR	0.61	-0.01	→	↗
10Y EMU	3.21	0.02	→	↗

Last values from Friday 15:30 CET

The crisis surrounding the financing of Greece's government debt moved on to a new stage as the risk premium on Greek bonds soared by another 100 basis points. What is more, Greek bonds may undergo another ordeal this week as the European Commission will give its assessment of Greece's austerity programme on Wednesday. Markets will also look for comments from ECB president Trichet on the issue after Thursday's ECB meeting. On top of that, the release of key U.S. statistics will have an impact on global market sentiment and thus on CE markets.

So, global markets will continue to monitor the Greek debt issue in the days to come. However, the question is how much the swings in the Greek bond spread will affect Central Europe. Until now, the Greek contagion has not spread into Central Europe to any great extent, and if it has, it has surprisingly influenced Central European markets in a greatly differentiated manner. The forint and partly also the koruna came under some pressure. The spread between the yields of Czech Government bonds and koruna swaps has widened, too.

We doubt whether the different reactions of specific Central European markets to the problems of Greece are well-founded in terms of fundamentals. While Polish macroeconomic fundamentals are currently much better than those of Hungary, and partly better than those of the Czech Republic, it is somewhat overbold to bet on those fundamentals protecting the zloty and Polish bonds from the effects of a potential culmination of the Greek problems, which would lead to a more aggressive form of contagion.

Czech Republic

Macro review

Czech production for the month December came out in positive territory (2.1% Y/Y) after fourteen months of decline. When adjusted for the effect of a greater number of business days, however, the industry is still in the red (-0.4%).
The situation in industry has stabilised and industrial output is starting to recover, due primarily to a rise in foreign contracts. Further developments in the Czech industrial sector – how fast it will return to normality – will primarily depend on demand from Western Europe. In any event, the figures to be released in the months to come will be in the black.
Nonetheless, the expiration of Germany's bonus for scrapping cars will curb the recovery somewhat, as it is likely to involve lower demand for cars made in the Czech Republic.
This year's data from the industrial sector will be compared to very poor months at the start of 2009, when output fell by more than 20%. While production/orders have increased, this has not yet influenced employment.

Currency

The koruna weakened last week, staying above EUR/CZK 26.00 for most of the week. Apart from Friday's data on the rise in December's industrial output, the domestic scene lacked any major events. So, the overall moderate depreciation of the koruna should probably be attributed to the effect of the Greece-related crisis and the increased aversion to risky assets. In addition, compared to neighbouring currencies, the low Czech interest rates are also working against the koruna.

Even as the sentiment on the global equity markets is uncertain, the CEE currencies are quite resilient, mainly thanks to the strong performance of the zloty. If that remains the case, we may see mild gains in the CZK, too, supported by a slightly more hawkish CNB rhetoric.

Fixed income

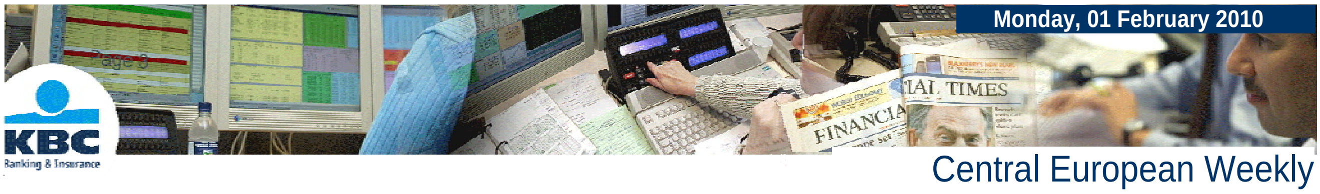
The Czech yield curve flattened somewhat last week, when yields at the short end of the curve went up by more than 1 bp, while those at the long end went down by approximately 3.5 bps. The weaker koruna and, at last, also December's rise in industrial output indicated that the chance of a rate hike might not be that distant, i.e., no later than the third quarter of this year, as CNB Board Member Tomšík mentioned at the beginning of last week. On top of that, the Minister of Finance announced that he had stopped supporting a bond issue for the general public. Although such an issue has already been prepared, none of large political parties are in favour of it.

The main event of the week was the auction of the 3Y 2.80%/2013 bond. The Ministry of Finance offered securities for CZK 8 bn. In line with expectations, demand was robust and two times the supply. In the end, the Ministry sold bonds for CZK 8.309 bn at the average yield of 2.909%. However, the Ministry kept bonds for CZK 1 bn of that amount in its book. After the 10Y bond auction held two weeks ago, which was not very successful, this is certainly a good signal, which suggests that short-term domestic bonds are in demand.
The unfavourable mood on global markets may also affect demand for domestic bonds this week. In addition, the weaker koruna may keep short-term maturities under pressure. A CNB Board meeting is scheduled for Thursday. No rate change is anticipated but the accompanying comments may have an effect on the demand for bonds, as might be the case for further developments in the 'problematic' EMU countries.

EUR/CZK technical picture

(26.2200) Drop from 26.4950 tested the Uptrendline off 24.9750 (see graph).
Now reapproaching the neckline of long term Multiple Tops (26.3250).
1st support area at 25.9620 (weekly Bollinger midline), with next levels at 25.90000 (break-up hourly), ahead of 25.7700 (Jan 19 low + weekly projection band bottom), where pause favored.
If wrong, next levels at 25.6700 (medium term reaction low hourly) and 25.5800 (Dec 08 low): tough on 1st attempts.
Resistance area at 26.3900 (Jan 07 high), where pause favored.
Failure to hold would see next levels at 26.4850/ .4950 (Dec 31/ Nov 27 highs): tough on 1st attempts.

DAILY CHARTS:



Hungary

Macro review

Last week's main event was the central bank's monthly Monetary Council meeting. The 9-members body decided on a 25bps rate cut to 6.00%, which is the record low level from 2008. The accompanying statement however highlighted that yields at the long-end had not declined since December and that appetite for Hungarian assets remained key in setting rates. This could point for the central bank's increasing concern about how far the current easing cycle could go. It may also mean that a change in market sentiment could make an end to rate cuts. This could occur anytime soon in light of recent developments on global markets.

On the fundamental front, GKI's confidence indices worsened in January, while the PMI index jumped above 50, reflecting expansion in the manufacturing sector. The PMI index has thus returned to pre-crisis levels forecasting probably a faster recovery than expected.

Beside these, November retail sales dropped 7.8% Y/Y, in line with expectations, while producer prices rose by 1.3% Y/Y as fuel got more expensive.

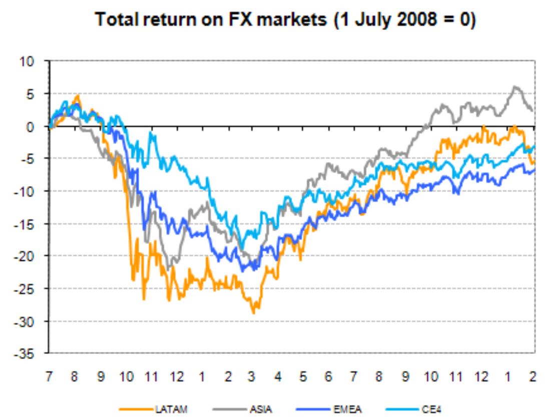
The outlook could be altered by this week's industrial output data from December, which is expected to rise close to 5.0% Y/Y after a 2-years long decline. The January budget deficit could be high as the government is planning a front-loaded deficit path for the year, which later could turn out risky if the market would come to the conclusion that the full-year deficit target would be at risk.

Currency

The forint's two-week old correction came to a pause at the end of last week as the recovery of equity markets around the world together with a strong Polish zloty helped the Hungarian currency to recover. The pair appreciated a little bit more than 1% from the peak of 274.00 to 270.00 and seemed to have established a new trading range of 270.00-272.00.

The longer-term prospects are however clouded by the global backdrop, which seems to have been slowly deteriorating. Peek performers of 2009, like the KRW or BRL have both formulated a weakening trend this year and together with a stronger US dollar these carry positions could be at risk of unwinding should markets take a correction tone.

In terms of total return, the EMEA region's currencies have been holding up quite well vis-á-vis other regions. This could however be just a late reaction to global developments, like in 2008 and during the 2009 recovery, when Emerging Europe fell behind.



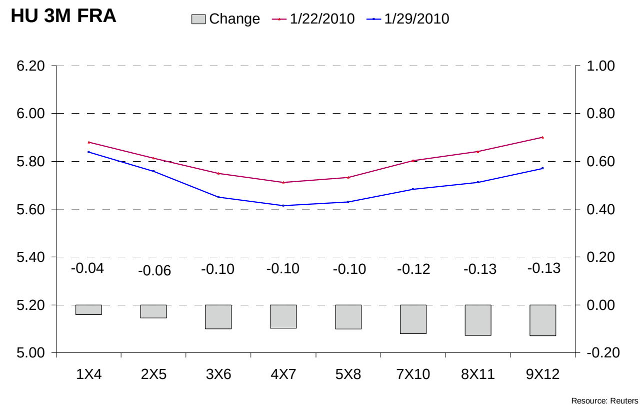
EUR/HUF technical picture

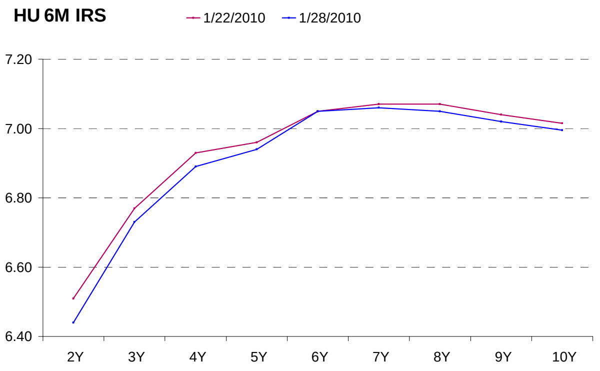
(271.00): Tested Triangle top (see graph).
Resistance at 274.00/ 274.60 (Jan 26 high/ 61.8% 279.95 to 265.95), where pause favored.
Failure to hold would see next levels at 276.32/ 276.64 (weekly Bollinger top/ 76.4%): tough on 1st attempts.
Support at 269.60 (reaction low hourly), with next levels at 267.80 (idem), ahead of 265.95/ 265.13 (current year low/ 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): tough on 1st attempts.

DAILY CHARTS:

Fixed income

The bond market saw weaker demand on last week's auction due to increasing uncertainty amid the forint's volatility. The agency even had to cut back on the supplied amount for the 3-, 5- and 10-year bonds. This could be another sign that markets see Hungarian assets less attractive than in previous months. So far, yield levels did not change much and there could be a period of quietness short-term. For the longer-term we would be cautious with Hungarian bonds and would also recommend considering reducing the exposure before the elections.





Poland

Currency

The Polish zloty extended its gains last week and tried to retest the key psycho-level at 4.00 EUR/PLN. Polish markets ignored global investors' nervousness around Greece and the subsequent sell off on the global equity market. Beside that, the zloty was supported by strong retail sales figures. These were partly driven by higher gasoline prices. However, even after adjustment, the figures point to a solid development of domestic demand at the end of the last year. The pretty ambitious plan to cut public deficits and meet the Maastricht criteria by 2012 was also widely welcomed.
This week is rather uneventful on the domestic scene. Although we are quite sceptical about the global sentiment, the zloty may decouple from other emerging markets and retest 4.00 EUR/PLN. In case of a successful break-through, there is room for further gains.

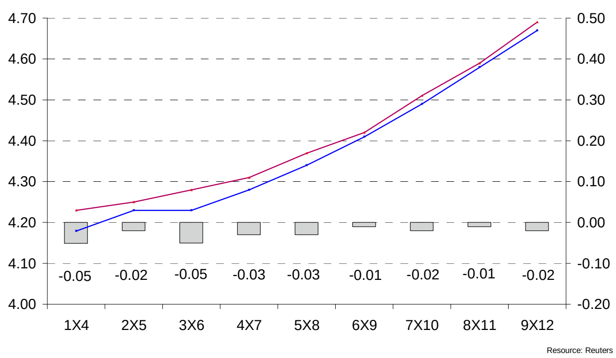
Retail sales and unemployment (%)

EUR/PLN technical picture

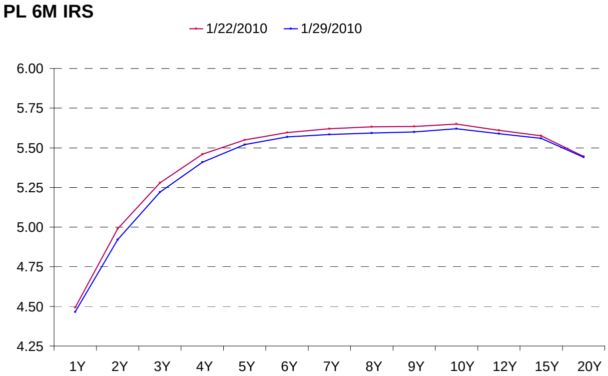
(4.0640): Scored new reaction low off 4.9300, in falling wedge pattern (see graph).
1st support area 4.0290 (break-up hourly charts), with next levels at 4.0001/ .0000 (current new reaction low + weekly Bollinger bottom/ psycho), where pause favored.
If wrong, next Support would come in at 3.9795 (5th wave projection on hourly charts: sequence off 4.3300): tough on 1st attempts.
1st Resistance comes in at 4.1079 (falling weekly Medium Term Moving Average), with next levels at 4.1135/ .1261 (current reaction high off 4.0001/ 38.2% 4.3300 to 4.0001) and 4.1290 (Jan 07 high), where pause favored.

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	12/2009
change in bps	0	-25

CNB will not change rates this week

The board members will discuss the new inflation forecast. The economic outlook is improving slightly and inflation forecasts are moving moderately up due to the V.A.T. consumption tax changes. However, we don't expect the CNB to change rates in the first half of 2010. The central bank will be careful and won't tighten monetary policy until the recovery of the economy will be more stable and sure. Household consumption as well as investment have continued to go down. Only export demand and changes of inventories might be the main driving forces of economic growth this year. The central bank should not be afraid of demand-driven inflationary pressures or second round effects of the administrative price changes. On the other hand, some board members announced that the CNB would be one of the first central banks in Europe to hike rates. However, it's soon for that and therefore a sit-and-wait policy is the most probable scenario for the first half of the year.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
CZ	1.2.2010	14:00	Budget balance (CZK B)	01/2010					-192.2	
HU	2.2.2010	09:00	Trade balance (EUR M)	11/2009 *F					411.3	
CZ	**4.2.2010**	**12:30**	**CNB meeting (%)**	**02/2010**	**1.00**		**1.00**		**1.00**	
HU	5.2.2010	09:00	Industrial output (%)	12/2009 *P					-1.3	-9.2
HU	5.2.2010	17:00	Budget balance (HUF B)	01/2010					-918.6	

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	Mar-11	Last change	
Czech Rep.	2W repo rate	*1.00*	1.00	1.00	1.25	1.50	-25 bps	16/12/2009
Hungary	2W deposite r.	*6.00*	5.50	6.00	6.00	6.00	-25 bps	21/12/2009
Poland	2W inter. rate	*3.50*	3.50	3.75	4.00	4.00	-25 bps	6/25/2009

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

		Current	Jun-10	Sep-10	Dec-10	Mar-11
Czech Rep.	PRIBOR	*1.55*	1.55	1.65	1.80	2.05
Hungary	BUBOR	*6.00*	5.50	6.00	6.00	6.00
Poland	WIBOR	*4.19*	4.60	4.70	4.80	4.80

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

	Current	Jun-10	Sep-10	Dec-10	Mar-11
Czech Rep.	*3.62*	3.50	3.70	3.85	4.02
Hungary	*7.04*	7.75	8.00	7.50	7.25
Poland	*5.64*	4.50	4.50	4.50	4.50

Exchange rates (end of the period)

		Current	Jun-10	Sep-10	Dec-10	Mar-11
Czech Rep.	EUR/CZK	*26.2*	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*271*	280	275	270	265
Poland	EUR/PLN	*4.05*	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*	1.8	1.7	0.9	1.4
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*	1.6	2.1	2.2	2.0
Hungary	*5.5*	3.5	3.5	3.5	3.5

Current Account as % of GDP

	2009	2010
Czech Rep.	-0.8	-1.0
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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