Monday, February 15,

Central European Weekly

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

Czech Republic

GDP fell by more than 4% at the end of 2009

Hungary

Foreign trade reached 4.2% of GDP surplus in 2009

Poland

Polish PM plans to change the constitution to prepare for the euro adoption

The Week ahead

Polish employment picture may deteriorate due to seasonal factors

Overview

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.96	-0.87%	↗	↗
EUR/PLN	4.015	-2.12%	↗	↗
EUR/HUF	270.5	-1.31%	↗	↗
3M PRIBOR	1.53	0.00	→	→
3M WIBOR	4.17	-0.03	→	→
3M BUBOR	5.99	0.00	→	↗
10Y CZK	4.34	-0.13	↗	↗
10Y PLN	6.10	-0.01	↗	↗
10Y HUF	7.49	-0.18	↗	↗
3M EURIBOR	0.62	0.01	→	→
10Y EMU	3.20	0.10	→	↗

Last values from Friday 15:30 CET

Central Europe's recovery is very fragile

Looking at the late 2009 performance of Central European economies, we cannot be very optimistic. The GDP in Hungary and the Czech Republic again fell by approximately 0.5% q/q in Q4 2009 (-0.6% q/q in the Czech Republic and -0.4% q/q in Hungary). Slovakia's figure is much better at first glance (+2% q/q), but is not yet seasonally adjusted, unlike the data from the other economies.

At first sight, one is inclined to attribute the poor performance of the economy to the poor performance of the main trading partners, Germany in particular. The story on the waning effect of the bonus for scrapping cars is attractive to the media and would correspond to the poor improvement in German domestic demand in late 2009. However, this is not very consistent with either the fairly reasonable car sales in Germany in the fourth quarter, when the effect of the scrapping bonus probably still persisted, or the fairly reasonable development of Czech and Hungarian exports in late 2009. There is every indication, that households in the Czech Republic and Hungary have significantly curbed their expenditure.

This is not very encouraging news for the future. The unfavourable situation on the labour market and the restrictive effects of the fiscal policy will continue to curb private demand in the first half of this year. In addition, the termination of Germany's scrapping bonus will ultimately impact on carmakers. Although the other industries (machinery, metallurgy) may perform well, due to the further improvement in German business sentiment, the drop in demand for cars will impact on both the Czech and Hungarian economies. Thus the recovery across Central Europe appears to be very fragile at the moment. We look out whether this picture will change after revisions, the seasonal adjustment of Slovakia's figures, and the release of Poland's data.

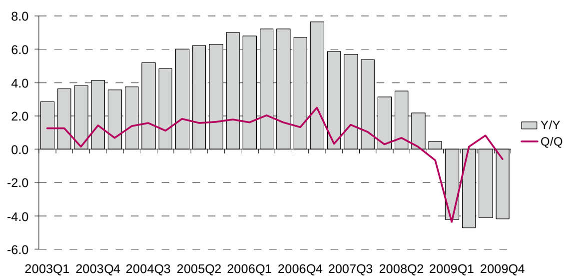
Czech Republic

Macro review

Not even our pessimistic forecast of -3.0% was low enough to match the actual figure, which suggests a fall by more than 4% (-4.2%). The preliminary end-of-year GDP is worse than the central bank anticipated in its latest forecast, where it envisaged a decline by only 2.7%. In addition, the economic activity fell also against the third quarter (by 0.6%). So, while the situation in industry started to stabilise at the end of the year, the decline has shifted to the service sector, notably the retail sector. However, more detailed information on the development of the GDP structure will not be available until March 11.

Poor economic growth for the last quarter of 2009 indicates that the economic recovery is delayed and likely to be slow, small, and still very vulnerable. In addition, we should expect that it will be difficult for the economy to find any growth stimuli this year. Investment has been steadily falling thus far and household consumption is likely to be affected too. We can't expect people will easily spend more money than they did last year when unemployment is rising and wage growth is curbed. The data on the development of average wages look optimistic, but we believe that wages are tending to stagnate and that the relatively high rate of average wage growth is just a statistical divergence, caused by layoffs of low-income staff. What is more, as far as future economic developments are concerned, optimistic news is not coming from other EU countries either, and thus we have left our conservative outlook for this year unchanged.

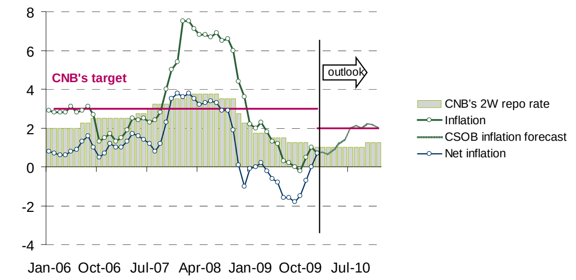
GDP Growth
(%)



In spite of the VAT and excise duty increase, consumer prices went up by only 1.2% m/m in January. Year-on-year inflation eased to 0.7% from December's 1.0%. January's month-on-month price rise is largely due to taxes and regulated prices. The Statistical Office predicts the effect of tax changes to be up to 1 percentage point. Thus market prices in many cases continue to go down. In line with expectations, January's food, alcohol, and fuel prices were higher than December's. Housing-related prices, particularly regulated rents, by contrast, went up at a slower rate than expected (even in comparison with the previous year).

January's consumer price index clearly indicates that inflation is not and will not be a problem soon for the economy. One of the main factors keeping inflation down is low consumer demand, which is even driving numerous prices downwards. As we don't expect consumption to recover this year, demand-driven inflationary pressures are not at all imminent. The contrary is true. Poor wage growth, along with rising unemployment, are more likely to make households reduce their expenditure and thus also consumption, even more so.

Inflation and CNB's Target
(%)



The central bank, whose inflation target has been 2% since this year, can also be satisfied with the development of inflation. Inflation will easily remain below this target at least in the first half of the year and only temporarily exceed the CNB's target in the second half of the year. However, this will again be due to administrative moves, along with the low comparative baseline of the previous year. Therefore the central bank doesn't need to consider a rate hike within the next few months. This is why we still expect that the CNB will not proceed to a monetary tightening until the second half of the year, more in particular, the last quarter of the year. There is really no need to hasten to raise rates.

Currency

The Czech koruna hovered around CZK 26.00 per EUR for most of last week. However, it did not break through that level until late last week, when it was supported by the favourable mood on financial markets after the EU's promises, though unspecific, to help resolve the problems of Greece. The koruna also remained at stronger levels at the end of the week, although the low domestic GDP temporarily nudged the currency back to CZK 26.11 per EUR.

EUR/CZK technical picture

(25.9800) Drop from 26.4950 testing the Up-trendline off 24.9750 (see graph).
1st support area at 25.8700/ .8480 (Feb 03 low/ weekly projection band bottom + flat weekly Long Term Moving Average), ahead of 25.7770/ .7700 (monthly envelope bottom/ Jan 19 low), 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 26.1600 (reaction high hourly), with next levels at 26.3330 (Feb 08 high), ahead of 26.3900 (Jan 07 high), where pause favored.
Failure to hold would see next levels at 26.4850/ .4950 (Dec 31/ Nov 27 highs), ahead of 26.6200 (Oct high): tough on 1st attempts.

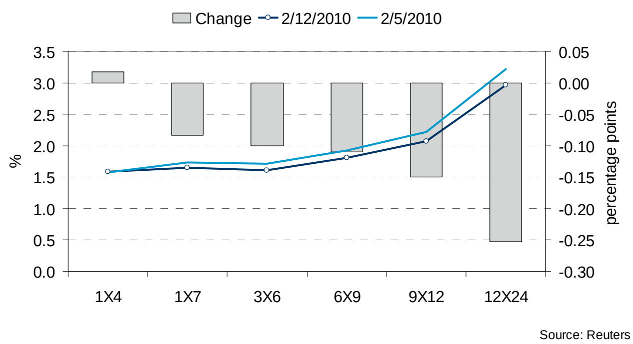
DAILY CHARTS:

The **Czech yield curve** steepened last week. By and large, however, the changes were moderate, as yields fell by 1.5 bps at the short end and rose by approximately 0.5 bps at the long end. Low inflationary pressures, notwithstanding the administrative measures such as tax increases, thus kept bonds free of sales' pressures.

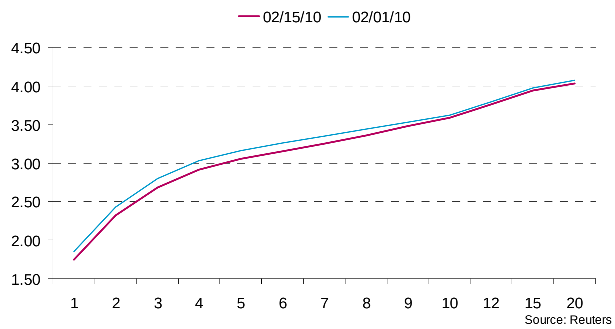
The main event on the domestic bond market was the auction of the 5.70%/2024 government bond. The Ministry of Finance supplied securities for CZK 6 bn. Demand, mostly from abroad, surprisingly reached CZK 13.1 bn, i.e., much more than the CZK 7.9 bn in the auction of the previous tranche, held in December. The Ministry in the end sold bonds for only CZK 5 bn, of which it kept securities for CZK 2 bn in its books. The average yield of the auction was 5.158%, compared to 4.779% in December's auction. The demand for a higher yield probably demonstrated concerns about a possible Greek infection and this made the Ministry selling a smaller amount of bonds.
Retail sales, to be released at the very beginning of the week, following the poor GDP figure for the last quarter of 2009, are again unlikely to please anyone. However, bonds will be primarily influenced by the developments surrounding Greece and by whether the willingness to help will prevail and whether an appropriate form of the help will be found. Unless unexpected reversals occur, we expect that yields will tend to go down, with the curve continuing to steepen.

Fixed income

CZ FRA



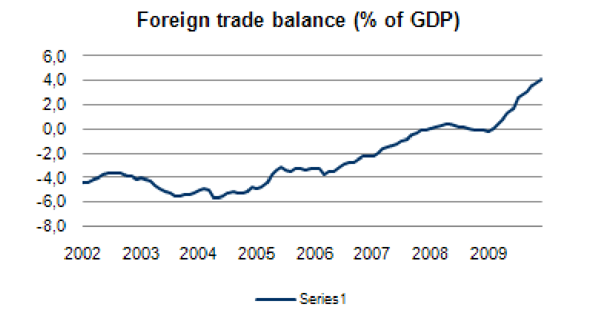
CZK IRS



Hungary

Macro review

Foreign trade reached a 4.2% of GDP surplus in 2009 according to preliminary data. This equals to €4.4bn in nominal terms and is better than earlier expectations or our projection. The Large surplus could mean that the current account gap could have been close to zero or even turned to a small surplus, which could help Hungary to reduce its external indebtedness quicker.



Preliminary fourth quarter GDP data was better than hoped at -4.0% Y/Y, but the Q/Q change remained in the red at -0.4% Q/Q. This was the fifth consecutive quarter with a decline. So, the country remained in recession at the end of 2009. Overall, the economy seems to be on the expected recovery track compared to the central bank's August projection, which sees the economy reviving in the second half of 2010.

The January budget had a Ft31bn surplus, similarly to last year, but there are signs that this year's outcome could be significantly worse.

First, the Finance Ministry forecasts the first quarter deficit at Ft651bn or 74% of the full-year target. Since 2004, there has not been any year with the full-year amounting to at least twice the first quarter one. This 200% would mean Ft 1300bn or 5.2% of GDP. Close to our 5.5% of GDP forecast.

Secondly, the Finance Ministry has already changed the forecast and lowered tax revenue forecast by Ft180bn or 0.7% of GDP. In order to keep the deficit target unchanged at 3.8% of GDP, they increased the projected revenue of ministries by the same amount. For us, the latter may bear a high risk of undershooting revenues.

Hungary had a worrying track record with fiscal deficits around elections and these signs could mean that we are facing comparable risks again in 2010. In light of the opposition party's warning that the deficit could be between 7% or 8% of GDP, there are reasons now to stay cautious or even become negative on the fundamental outlook.

EUR/HUF technical picture

(270.70): Downtrendline off high under threat (see graph).

Resistance at 275.50 (Feb 05 high), ahead of 276.64 (76.4% 279.95 to 265.95 + weekly Bollinger top), where pause favored.

Failure to hold would see next levels at 277.98 (monthly envelope top) and 279.95 (Dec 17 high + weekly projection band top): tough on 1st attempts.

Support at 268.90 (Feb 03 low), ahead of 268.70/ .30 (break-up hourly/ daily), where pause favored.

If wrong, next levels at 265.95/ 265.61 (current year low/ monthly envelope bottom): tough on 1st attempts.

DAILY CHARTS:

Currency

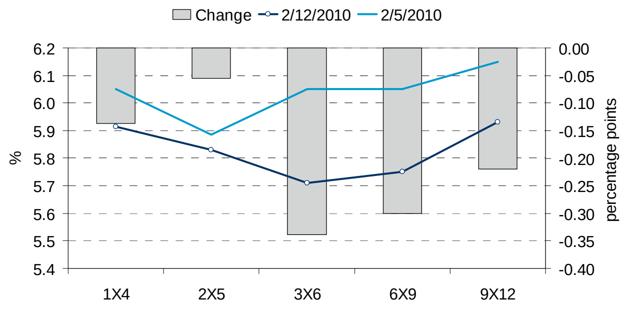
In line with a more supportive global background, the forint performed a rebound from this year's low at 275.00 during the week before. The pair hovered in the range of 270.00/272.00 in the second half of the week and finished closer to the weaker side of the range on Friday.

Mounting risks about the fundamental outlook make the currency vulnerable to come under weakening pressure over the coming weeks.

Fixed income

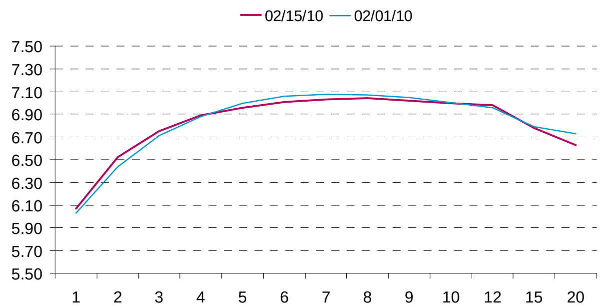
The bond market followed the currency and recovered most of the losses last week. The long-end of the curve came back to the key 7.75% level, which could be a strong resistance level. The short-end remained slightly below the 5.75% level, implying at least one more small rate cut from the current 6.00% level. The rate cut decision is due next week and that could be the last cut of the current easing cycle that started in July 2010.

HU FRA



Source: Reuters

HUF IRS



Source: Reuters

Poland

Currency

The **Polish zloty** clearly outperformed the rest of the region last week. The hope on a Greek bailout ahead of the EU summit drove the pair as far as 4.00 EUR/PLN. Nevertheless the lack of detail in EU approach towards Greece was seen as disappointing by the end of the week. Also the news that China is tightening monetary conditions further was not welcomed. Besides that, also the much worse that expected Czech GDP figures weighed on the CEE sentiment. Nevertheless the zloty managed to stay in a pretty tight range 4.00-4.04 EUR/PLN. That was partly thanks to the announcement made by PM Donald Tusk. He plans to change the constitution as soon as possible to prepare the legal system for euro adoption.

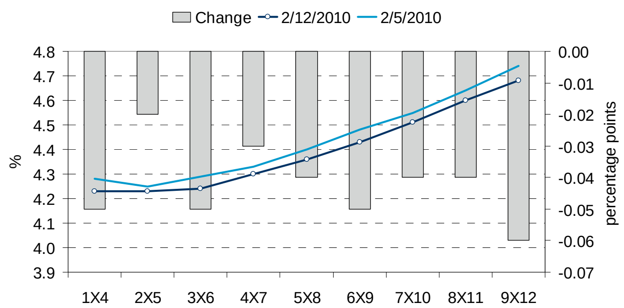
This week is full of interesting domestic data. We expect slightly lower than expected inflation, slower wage growth, a seasonally deteriorated employment picture and slightly worse than expected industrial production. Overall the figures should be slightly discouraging for the zloty, which may find it hard to test 4.00 (3.9550) EUR/PLN seriously now. We are also afraid that the Greek problems might continue to keep the whole region in a defensive mode.

EUR/PLN technical picture

(4.0050): Scored new reaction low off 4.9300, in falling wedge pattern (see graph: bottom being retested).
1st support area 3.9790 (weekly Bollinger bottom), with next levels at 3.9550/ .9472 (current new reaction low/ monthly envelope bottom), where pause favored.
If wrong, next Support would come in at 3.9206 (5th wave projection on hourly charts off 4.0770 in sequence from 4.3300): tough on 1st attempts.
1st Resistance comes in at 4.0450 (breakdown daily), with next levels at 4.0940 (reaction high hourly + falling weekly Medium Term Moving Average), where pause favored.
If wrong, next levels at 4.1250/ .1290 (Feb 05 high/ Jan 07 high): tough on 1st attempts.

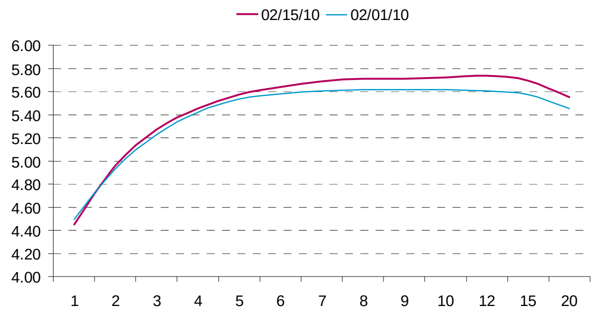
DAILY CHARTS:

PL FRA



Source: Reuters

PLN IRS



Source: Reuters

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	15.2.2010	09:00	Industrial output (%)	12/2009 *F					-5.7	-1.4
CZ	15.2.2010	09:00	Retail sales (%)	12/2009		7.0		-3.0		-4.9
CZ	15.2.2010	09:00	PPI (%)	01/2010	0.6	-1.3	0.4	-1.4	0.1	-0.8
PL	**15.2.2010**	**14:00**	**CPI (%)**	**01/2010**			**0.5**	**3.5**	**0.0**	**3.5**
PL	15.2.2010	15:00	Budget balance (PLN M)	01/2010					552.1	
PL	16.2.2010	14:00	Wages (%)	01/2010			-9.8	2.9	7.3	6.5
PL	**18.2.2010**	**14:00**	**Industrial output (%)**	**01/2010**			**-6.8**	**6.9**	**-5.4**	**7.4**
PL	18.2.2010	14:00	PPI (%)	01/2010			0.6	0.6	-0.2	2.1
HU	19.2.2010	09:00	Wages (%, ytd.)	12/2009				-2.0		-3.0

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	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	*1.53*	1.55	1.65	1.80	2.05
Hungary	BUBOR	*5.99*	5.50	6.00	6.00	6.00
Poland	WIBOR	*4.17*	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.	*3.63*	3.50	3.70	3.85	4.02
Hungary	*6.98*	7.75	8.00	7.50	7.25
Poland	*5.72*	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	*26.0*	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*271*	280	275	270	265
Poland	EUR/PLN	*4.02*	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*	1.4	1.2	0.9	2.2
Hungary	*-5.3*	-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*	1.4	2.1	2.3	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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