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KBC Banking & Insurance

Central European Weekly

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Czech Republic

Bond auction attracts strong bid

Hungary

MNB cuts the base rate to the new historical low, despite worsening inflation outlook

Poland

EUP/PLN drops again below the 4.0 level

The Week Ahead

Czech industrial output should show another month-on-month gain

Overview

No contagion from Greece, so let's face tough winter now

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.95	-0.04%	↗	↘
EUR/PLN	3.960	-1.39%	→	↘
EUR/HUF	269.7	-0.31%	↗	↘
3M PRIBOR	1.47	-0.06	→	→
3M WIBOR	4.15	-0.02	→	→
3M BUBOR	5.77	-0.22	↗	↘
10Y CZK	4.06	-0.28	→	↗
10Y PLN	5.98	-0.12	→	↗
10Y HUF	7.27	-0.22	↗	↘
3M EURIBOR	0.63	0.01	→	↗
10Y EMU	3.10	-0.10	→	↗

Last values from Friday 15:30 CET

The anticipated rate cut by the National Bank of Hungary, to an all-time low was the only major event in the Central European region last week. This week will be similarly poor, as regional news is certainly going to be overshadowed by the key events, such as the ECB meeting, U.S. labour market statistics, or, for example, the Greek attempt to issue more government debt.

However, Central Europe, including both forex and bond markets, is continuing to show incredible resistance from possible contagion from Greece. The forint, zloty and koruna remain stable, while bond prices might continue to rise. We will see whether this picture of Central European markets will be maintained, when the markets will be confronted with poorer hard data from the United States or the euro area. Such data might be due, at least partly, to the extreme winter weather that hit the economies on both sides of the Atlantic in January and February. After all, the weather was also very cold in Central Europe, and thus we may also be in for a surprisingly strong seasonal divergence in certain sectors of our economies (particularly construction).

In conclusion, however, we need to point out that the impact of weather on the performance of the economy, albeit significant, might eventually be discounted by markets in core countries as well as in the region, leaving both CE currencies and bonds largely untouched.

Czech Republic

Currency

The **Czech koruna** weakened slightly against the euro last week. The domestic scene lacked major stimuli and new statistics, and thus the fluctuations of the koruna reflected concerns about the possible impact of the Greek problems on other currencies. Nevertheless, the depreciation of the koruna was modest and the currency pair did not break through EURCZK 26.00.
The Czech currency should follow the destiny of the Polish zloty in the 4.00 EUR/PLN area. The domestic scene is rather empty. If the Greek concerns are put aside for some time and the zloty breaks further south, we may see the koruna to go the 25.60 EUR/CZK area.

EUR/CZK technical picture

(25.9600) Below triangle, but pattern at apex (see graph).
1st support area at 25.8410 (flat weekly Long Term Moving Average), with next levels at 25.6200 (Feb 19 low), ahead of 25.5800 (Dec 08 low), where pause favored.
If wrong, next levels 25.4760 (weekly Bollinger bottom), ahead of 25.3800 (Nov low): tough on 1st attempts.
Resistance area at 26.0380/ .0500 (weekly Bollinger midline/ Feb 25 high): ideal area to stay below to keep current mood on CZK.
Failure to cap would see next levels at 26.0800 (falling Weekly Moving Average), ahead of 26.1300/ .1600 (reaction highs hourly).

DAILY CHARTS:

Fixed income

The **Czech yield curve** went down along the full length and steepened very slightly in the last week of February, having fallen by more than 10 bps at the short end and more than 9 bps at the long end. Given the lack of major domestic stimuli, the demand for bonds should be attributed to concerns about the impact of the Greek problems on other countries and is consistent with the developments in the neighbouring developed markets of the euro area. During the week, the Minister of Finance also confirmed his intention of issuing bonds denominated in euros in the first half of 2010, but did not divulge further details.
However, the main event of the week was the auction of the 3.40%/2015 government bond, which, after several less successful auctions held earlier this year, at last had a favourable reception. With the supply of CZK 8 bn, demand climbed to CZK 19.69 bn. In the end, the Ministry of Finance sold bonds for CZK 8.722 bn, although it kept securities for exactly CZK 1 bn of that volume on its book. The average yield was 3.303%.
The main event of this week will be the issue of the 5%/2019 government bond for CZK 6 bn. Demand for bonds, under the current geo-political situation and after the recent announcement by the Ministry of Finance that it would not sell bonds at all costs, is also likely to be sufficient with this longer maturity, and thus the entire volume might be easily subscribed.
Otherwise, this week is also free of new statistical data. Therefore the bond market is again likely to react to events in core markets. Although low bond prices may initiate profit taking, unless the problems surrounding Greece and its debt are resolved, we are unlikely to see the prices of Czech securities go down. We should note, however, that the Greek government is planning a 10Y bond issue for this or next week. The favourable reception of, or the lack of demand for, this issue may also influence the demand for Czech bonds.

Hungary

Macro review

The Central bank cut the base rate by another 25bps to the new historical low level of 5.75% last Monday. The statement highlighted again improving risk assessment of Hungary, which largely means lower interest rates on the bond and money markets.
Compelling Inflation Report was also close to the previous one from November and the general view remained optimist on the inflation front due to the large slack in the economy caused by the recession. However, the short-term inflation outlook has been worsened significantly from the 2009-average inflation forecast of 3.9% to 4.4%, mainly on higher regulated price increases like energy. The 2010 outlook has also deteriorated from 1.9% to 2.3%, which is still way below the 3% medium-term target.
Growth outlook now mirrors the governments -0.2% Y/Y forecast for this year, while budget risks were again emphasised. There is no agreement with the government even for last year's deficit figure as cash flow data showed higher deficit for local governments. Taking this into account, the central bank sees the 2009 general government deficit at 4.0% of GDP versus government's 3.9% of GDP reading, but the latter argues that the accrual based figure will be better than the cash based one. For this year, the fiscal outlook was also worsened from 4% of GDP deficit to 4.2%. Albeit close to the 3.8% of GDP target, it is now higher than before and central bank this time excluded one-off items, which amounted to 2.7% of GDP in the previous report.
Vice president of the biggest opposition party Fidesz – the likely winner of the April elections – repeated that they see this year's deficit at 7.5% of GDP without any new decisions because several items are missing from the budget.
In the meantime, the government has also leaked the possibility of a large, one-off revenue item that could amount to as high as 0.5% of GDP without naming where this money could come from.
Press reports also highlighted risk of a significant price increase of the retail gas price in April, which together with the phase out of state subsidies could increase prices by 10-15%. This would have 0.2-0.3pp effect on the total inflation figure, which would derail the path of having a sharp fall in inflation in the coming months.
Overall, Hungary is getting more vulnerable in our view as fundamental concerns are growing, while the central bank has been lowering rates. So far, so good we could say, while we remain very cautious before the elections as there is risk of a significant change to the outlook.

Currency

The forint had a stable trading pattern last week between the levels of 270.00 and 272.00. Better US growth data on Friday helped the currency to break this range on the strong side and appreciated to 269.00. It seems that the forint exchange rate is largely omitting news about the fiscal risks and mainly follows the international sentiment as probably players think that the IMF program will limit any deterioration of the fundamentals.
Elections however usually bring large adjustment to expectations and wide swings in the exchange rate, thus it could be interesting how it will develop this time.

EUR/HUF technical picture

(270.25): Above Downtrendline off high (see graph).
Resistance at 272.90 (Feb 19 high), with next levels 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 level at 279.95 (Dec 17 high): 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 level at 265.95 (current year low): tough on 1st attempts.

DAILY CHARTS:

Fixed income

The bond market continued to recover amid the stable exchange rate and growing appetite for risky assets. Yields at the long-end got below the key 7.50% level and now only bids are above that. Interest rates at the short-end have also advanced slightly towards the 5.50% level, which could be the next level of the base rate if the central bank repeats the 25bps step in March.

Poland

Currency

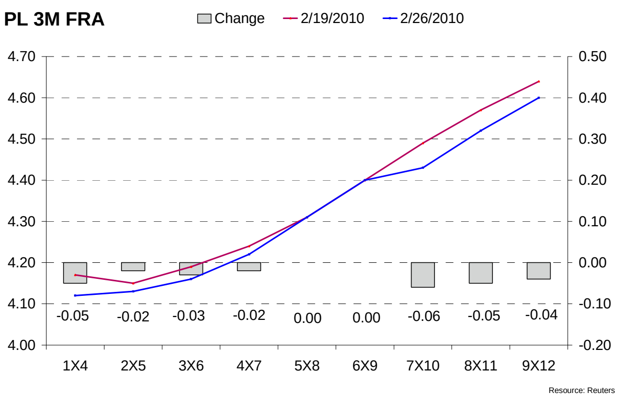
The Polish zloty stayed below 4.00 EUR/PLN and even slightly extended gains below 3.95 EUR/PLN by the end of the month. The eco data were mixed. Unemployment increased slightly lower than expected as has already pointed more favourable development of employment. Although the labour markets does not deteriorate as fast as expected, increase in unemployment and wage moderation weighed on domestic consumption. The significant slow down in spending (2.5% y/y in January versus 7.2% y/y in December) probably reflected a deterioration on the labour market in recent months. The Polish labour market still seems to be one of the most resilient in a European context. Nevertheless, the increase in unemployment and wage moderation weighed especially on the car and durables purchases. The figure could have been even worse in real terms taking into account the effect of higher fuel prices. It profited maybe also from an announcement of the Finance ministry as it said it would sell a large chunk of debt in March and as it should have covered this year's financing needs by the summer.

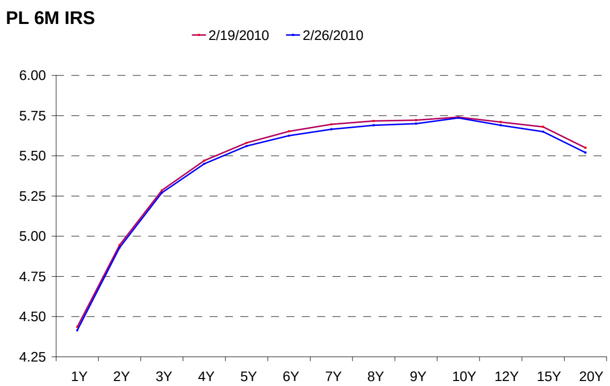
We believe the GDP figures to confirm ongoing recovery. If the Greek woes get aside for some time, we may see the zloty breaking through further south. The technical picture looks once again pretty encouraging and next stop is at 3.85 EUR/PLN.

EUR/PLN technical picture

(3.9755): Scored new reaction low off 4.9300, in falling wedge pattern (see graph: bottom has been retested).
1st support area 3.9493/ .9440 (weekly Bollinger bottom/ current new reaction low off 4.9300), 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 level at 4.0627 (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:





Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	1.3.2010	09:00	PPI (%)	01/2010					0.1	1.3
CZ	1.3.2010	14:00	Budget balance (CZK B)	02/2010					13.1	
PL	**2.3.2010**	**10:00**	**GDP (%)**	**4Q/2009**				**3.0**		
HU	4.3.2010	09:00	Trade balance (EUR M)	12/2009 *F	300.0				375.4	
HU	5.3.2010	17:00	Budget balance (HUF B)	02/2010	-50.0				31.3	

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.	*5.75*	5.50	6.00	6.00	6.00	-25 bps	23/2/2010
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	*1.47*	1.55	1.65	1.80	2.05
Hungary	BUBOR	*5.77*	5.50	6.00	6.00	6.00
Poland	WIBOR	*4.15*	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.	*3.5009*	3.50	3.70	3.85	4.02
Hungary	*6.915*	7.75	8.00	7.50	7.25
Poland	*5.73*	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	*270*	280	275	270	265
Poland	EUR/PLN	*3.96*	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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