Banking & Insurance

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Central European Weekly

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Czech Republic

January's foreign trade ended with a historical surplus of CZK 13.1 bn.

Hungary

Central bank sees drop in inflation from 6% to 4% until early summer

Poland

Polish GDP confirms solid recovery, rate hikes seen in the second half of the year

The Week Ahead

Week in a sign of Czech and Hungarian inflation

Overview

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25,64	-1,19%	↘	↘
EUR/PLN	3,873	-2,18%	↘	↘
EUR/HUF	266,3	-1,25%	↘	↘
3M PRIBOR	1,43	-0,04	→	→
3M WIBOR	4,14	-0,01	→	→
3M BUBOR	5,75	-0,02	↘	↘
10Y CZK	3,99	-0,08	↗	↗
10Y PLN	5,96	-0,02	↗	↗
10Y HUF	7,08	-0,19	→	→
3M EURIBOR	0,95	0,32	→	↗
10Y EMU	3,16	0,06	↗	↗

Last values from Friday 15:30 CET

The NBP Noted the Possibility of a Rate Hike and Unleashed the Zloty

The Polish zloty has been unleashed. It strengthened by 5% against the euro over the last month. The bullish run on the Polish forex market is more than understandable, because Poland has felt the real impact of the global crisis on the economy to a lesser extent than most of Europe, and is the only economy of the EU that posted positive growth in 2009. Thus the convergence story (catching up with the developed countries, in real terms, accompanied by the real appreciation of the exchange rate) still holds true, and the Polish current account has even improved significantly over the last two years, being only slightly in the red. Given this, it is probably no surprise to hear new calls coming from the National Bank of Poland, that the bank should, in the near future, be one of the first in the EU to raise rates. The prospects for the widening interest rate differential between Poland and the euro area are, during the ever greater global recovery, another huge stimulus for taking long positions in the zloty. What is more, we believe that it would be worth holding those positions for a longer time than just a few weeks or months.

The reason is that even the medium-term outlook for the zloty remains highly positive. The Polish economy is among those in the EU that are the most immune to the economic crisis, and thus the real convergence story continues virtually uninterrupted. In addition, over the next two years, Poland will be encouraged by the increasing inflow of funds from Brussels and the preparations for the 2012 European Football Championship, as well as by positive demographic trends. All of this together will contribute to the swift improvement in domestic demand, stronger inflationary pressures, and thus the need to keep interest rates higher…

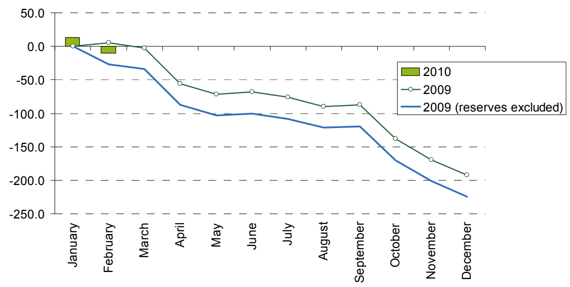
Czech Republic

Macro review

The state budget ended up with a deficit of almost CZK 11 bn after the first two months of the year. At first glance, this is a much worse figure than in 2009, but last year's budget revenue was boosted by Ministries' reserves of more than CZK 30 bn being transferred at that time. Tax revenue has been fuelled by the increased excise duties and VAT, while the revenue from insurance contributions, which are actually the taxation of labour, has decreased this time. The reasons for this are the rising unemployment rate and less favourable wage developments, due to which the taxable amount for the purposes of this tax is decreasing. We will not see a clearer picture of tax revenues until about April, by when the refunds of personal income tax and the advance payments of corporate income tax will have been made.

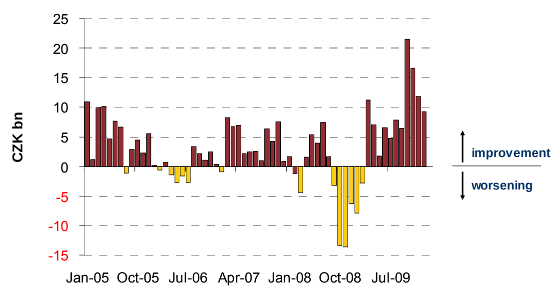
At the moment, we can only speculate whether the budget deficit will be maintained at the approved CZK 163 bn; nevertheless, we can hardly expect a better figure. Thus the data from the Debt Management Strategy still applies; according to this Strategy, **the Ministry of Finance will need to borrow CZK 280 bn this year, to cover maturing debts and the pending deficit**. For the moment, the Ministry of Finance has planned CZK 74 bn in bond issues for the first half of the year. Although another government bond issue in euros is very likely, the State will probably need to significantly step up the issuance of its debt instruments in the second half of the year. In an extreme case, the State may need to almost double the volume of its issues, compared to the first two quarters of this year. While the market will soon struggle with the lack of new government bonds, continuing to make yields go down, the situation is likely to be reversed in the second half of the year. Unless we anticipate any huge volumes of foreign issues, bond yields are likely to go up quite rapidly until then. And developments in leading global financial markets will boost this.

State budget balance
(CZKbn)



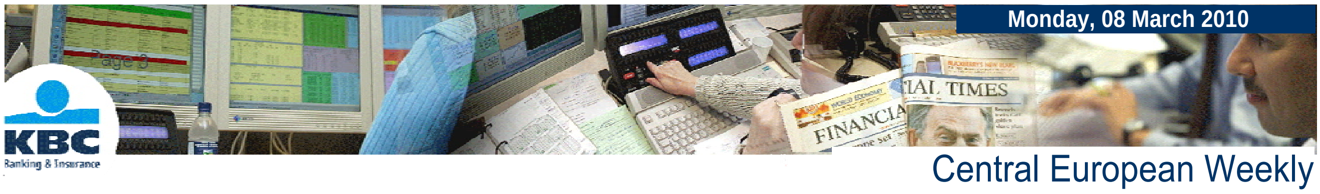
January's foreign trade ended with a historical surplus of CZK 13.1 bn. The very favourable figure was backed by an increase in exports and the continuing reduction of imports. The year-on-year increase in exports by 9.1 [percent] is definitely a positive result, but we still have to be mindful of the fact that it is being compared with a very low statistical baseline. At this time last year, exports were down by twenty-five percent. Better foreign orders in recent months are propelling production as well as exports; on the other hand, the unwillingness to spend and invest in the domestic economy continues to retard imports. The export of automobiles continues to grow, and electronics are also helping to improve the export results, as they are becoming one of the dominant features of Czech industry. The situation will be similar in the months to come. Foreign trade thus has a chance to maintain its role as the motor of Czech economy this year, because we definitely cannot rely on domestic demand. This year's GDP result will be influenced by inventories, but it will be exports that will determine the direction of the economy. Nothing changes in terms of monetary policy. The koruna may strengthen slightly thanks to the favourable foreign trade results, whereas interest rates will remain low for most of the year.

Y/Y change of the monthly trade balance



Currency

The koruna hovered within narrow bounds below CZK 26.00 per EUR last week. Domestic events did not stir the market significantly, and thus the trading in the koruna was practically uninteresting. The Czech currency did not jump on the band-wagon of the appreciation of the neighbouring zloty, which benefited from favourable fundamental data.



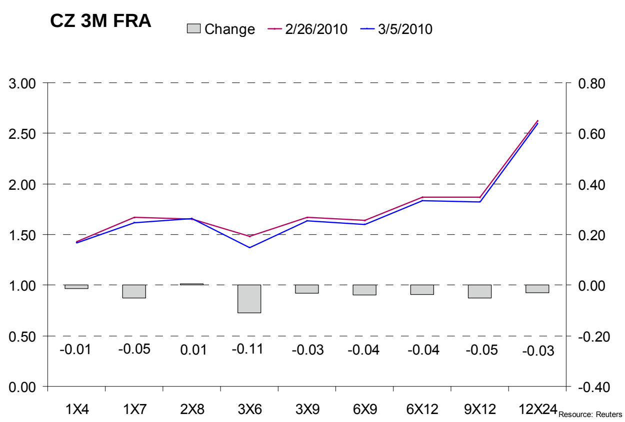
EUR/CZK technical picture

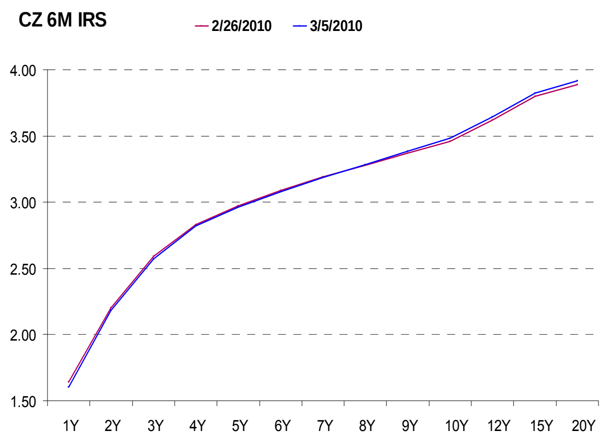
(25.7850) Below triangle, but pattern at apex (see graph).
1st support area at 25.6200/ .6110 (Feb 19 low/ broken monthly channel top off 1999 high), ahead of 25.5800 (Dec 08 low), where pause favored.
If wrong, next levels 25.4580/ .4320 (weekly Bollinger bottom/ monthly envelope bottom), ahead of 25.3800 (Nov low): tough on 1st attempts.
Resistance area at 25.9500 (breakdown hourly), ahead of 26.0290/ .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 26.1100 (broken flat Weekly Moving Average), ahead of 26.1300/ .1600 (reaction highs hourly).

DAILY CHARTS:

Fixed income

The Czech yield curve flattened in the first week of March. Thus it developed in line with the fluctuations on the euro-zone bond markets. Demand for bonds was also encouraged by the intention of the Ministry of Finance to borrow some of the money by issuing bonds denominated in euros, thus reducing the future supply of koruna bonds.
However, the main event of the week was the auction of the 5.0%/2019 bond. The Ministry originally supplied bonds for CZK 6 bn. However, high demand, which exceeded supply by 2.25 times, enabled the Ministry to increase its supply. Thus the Ministry sold bonds for CZK 7.277 bn overall, but retained bonds for CZK 1.48 bn. The average yield was 4.031%, i.e., lower than that of the previous tranche of mid-January.
A few interesting statistics will be released this week, including the final GDP figure for last year and particularly February's inflation; however, forecasts of this inflation indicate that inflationary pressures are not imminent, and this should prevent yields from potentially rising.





Hungary

Macro review

Last week was relatively quiet on the domestic macro front. Further improvement of producer price inflation to -0.6% Y/Y from 1.3% Y/Y suggested that input price pressure could be low for companies, but local press report risks about the future. Energy price regulator said that there could be 15-20% price increase of the retail gas price in April, which would pushed up headline inflation by 0.3-0.4pp in that month. Retail gas price is always subject to intensive political debate in Hungary. After these comments, the Socialist party immediately stood up and claimed that there is no reason to hike the gas price. Largest gas importer and distributor E.ON then said that even higher gas price increase could be necessary later in the summer if the process is delayed.
Fuel prices are also reported to rise significantly this week due to the stronger dollar and higher crude prices. Overall, there seems to be the risk that energy prices will add about 0.5pp or more to the headline inflation. Central bank sees sharp fall of inflation from 6% to 4% until early summer, but these risks could push it up to around 5%, which may not allow inflation to fall to the 3% target by the year-end.
Beside mounting inflation concerns, the budget is also not looking good either. The February deficit jumped to Ft380bn – except the 2006 december figure, which was distorted by one-off items – this has been the biggest monthly gap in the last 10-years. The cumulated deficit reached 44% of the full-year target in February and is expected to reach 74% in March.
Overall, domestic fundamentals remain a concern for us, while this week's inflation data may not be that bad. Consensus expects February figure at 6.2% Y/Y, down from 6.4% in January, while our model put it even lower at 6.0% Y/Y. Preliminary industrial output data about January may also be of key importance since there is high uncertainty about the cycle after output plunged in December, while sentiment was strong in January.

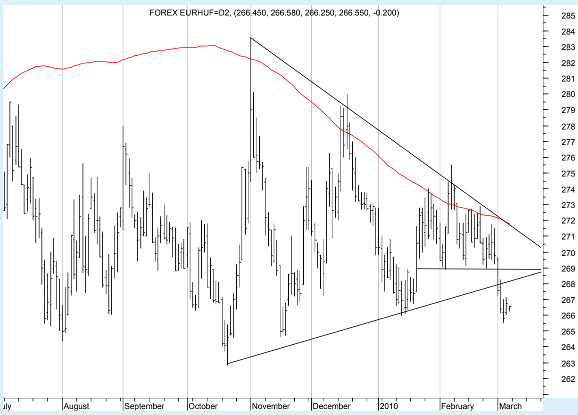
Currency

The forint remained in an upbeat mood during the week and the pair appreciated to a fresh 4-months high after US data came out better. The pair rallied almost 2% W/W and narrowed the key level of 265.50/€, in line with other emerging market currencies. International sentiment however continues to dominate the market trend, while domestic fundamentals are largely ignored, hence there could be a growing risk of a correction once the background support fades a bit. The political risk is probably also getting bigger as the far-right wing Jobbik party seems to increase its popularity in some regions. At the national level it is now neck and neck with the Socialists, while in some areas polls showed even higher popularity than leading opposition Fidesz. If Jobbik gets strong support in the April 11 election, markets may get concerned about a less friendly economic policy.

EUR/HUF technical picture

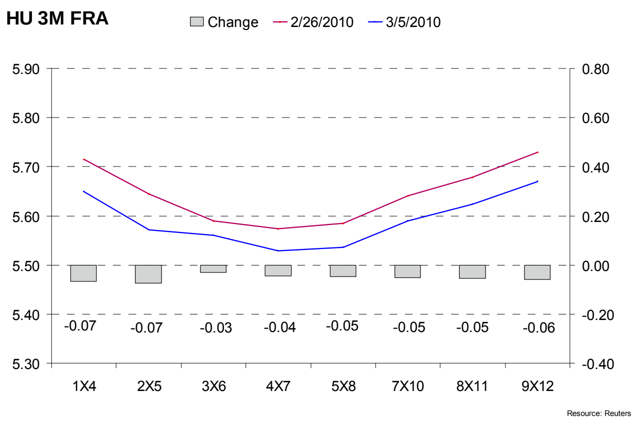
(266.55): Short term Head And Shoulders Top while below 268.90 and currently below Uptrend-line off 262.85 (see graph).
Resistance at 268.90/ 269.61 (see above/ falling weekly Short Term Moving Average): ideal area to stay below to keep current mood on HUF.
Failure to cap would see next levels at 271.04/ 271.75 (falling monthly Short Term Moving Average/ Feb 25 high), where pause favored.
Support at 265.55 (current year low?), ahead of 264.64 (Nov low), where pause favored.
If wrong, next level at 263.58 (monthly envelope bottom), ahead of 262.85/ .08 (current reaction low off 317.45/ 61.8% 227.87 to 317.45): tough on 1st attempts.

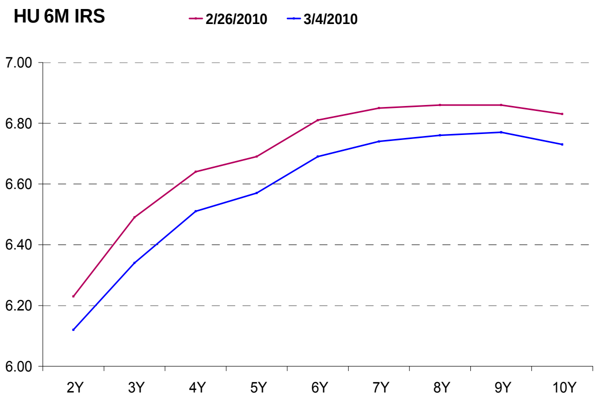
DAILY CHARTS:



Fixed income

The bond market rallied sharply last week and yields set new yearly lows. Yield at the 10-year benchmark fixing for example came down to 7.33% on Friday from 7.51% a week ago. It is still higher than the 7.08% record low from last year, but generally the market saw good demand from foreign investors, as well. The short-end of the curve remained unchanged at the 5.50% level implying one more 25bps rate cut from the central bank this month.
The outlook however could also be clouded by concerns about domestic fundamentals and the elections, hence we see little room for further yield lowering in the coming weeks. Inflation data on Thursday may spark some additional demand if data turns out to be better, but we would use that opportunity rather as an exit point in order to establish a safer position before April.


HU 3M FRA
Change
2/26/2010
3/5/2010
5.90
5.80
5.70
5.60
5.50
5.40
5.30
0.80
0.60
0.40
0.20
0.00
-0.20
-0.40
-0.07
-0.07
-0.03
-0.04
-0.05
-0.05
-0.05
-0.06
1X4
2X5
3X6
4X7
5X8
7X10
8X11
9X12
Resource: Reuters


HU 6M IRS
2/26/2010
3/4/2010
7.00
6.80
6.60
6.40
6.20
6.00
2Y
3Y
4Y
5Y
6Y
7Y
8Y
9Y
10Y

Poland

Currency

The Polish zloty initially profited 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. The Polish zloty extended its gains on better GDP figures and as market sentiment on Greece improved.

The GDP grew 3.1% y/y (2.8% seasonally adjusted) in the fourth quarter. It was driven mainly by restocking and net exports. The domestic consumption still contributed in a positive way, but it had clearly cooled down by the end of the year. Overall the figures are in line with our view of an ongoing domestic recovery, which should build the case for monetary tightening in the second half of the year. This was also confirmed by hawkish comments from NBP, which together with US payrolls outcome helped to fuel the rally as far as 3.87 EUR/PLN.

Nevertheless we are somewhat suspicious whether recent hawkish comments represent prevailing sentiment on the newly reelected board. Although we expect the monetary tightening to come in the second half of the year, it may be difficult for the board to be too aggressive in case of a sharp appreciation of the Polish zloty.

This week is empty on the domestic scene. We are curious to hear any comments from key policy-makers on recent gains of the Polish currency. If the situation in Greece continues to improve, the zloty may try to test another important technical level at 3.85 EUR/PLN.

EUR/PLN technical picture

(3.8855): Scored new reaction low off 4.9300).
1st support area 3.8788/ .8750 (weekly Bollinger bottom/ 1st target of weekly Double Top off 4.2250), ahead of 3.8622 (61.8% 3.2022 to 4.9300), where pause favored.
If wrong, next Support would come in at 3.8500 (1st target of long term daily Double Top off 4.2250: see graph), ahead of 3.8272 (monthly envelope bottom): tough on 1st attempts.
1st Resistance comes in at 3.9537/ .9560 (falling weekly Short Term Moving Average/ breakdown hourly): ideal area to stay below to keep current mood on Zloty.
Failure to cap would see next levels at 4.0115/ .0175 (monthly envelope top + Feb 25 high/ Feb 19 high), where pause favored.

DAILY CHARTS:

CE Weekly Preview

TUE 9:00 — **CZ Inflation (change in %)**

	Feb-10	Jan-10	Feb-09
CPI m/m	**0.3**	1.2	0.1
Food m/m	**0.8**	1.9	-0.4
Housing, energy	**0.1**	1.3	0.1

CZ: Inflation Remains Steadily Low

February's consumer prices were primarily influenced by the seasonal rise in food prices. In addition, the inflation rise was driven by fuels and the increased excise duties imposed on cigarettes and alcohol. The rise in winter package tour prices could also be anticipated. On the other hand, prices went down due to the clearance sales of consumer goods, such as clothing, shoes, home electronics, and other household equipment.
Year-on-year inflation still remains well below the Czech National Bank's target, and thus is not compelling the central bank proceed to an early move. We expect that inflation will begin to rise slowly in the months to come, but this will be primarily due to administrative moves, i.e., regulated prices and tax changes. The rise in market prices will continue to be strongly curbed by poor consumer demand.

TUE 9:00 — **CZ Industry (y/y change in %)**

	Jan-10	Dec-09	Jan-09
Měsíčně	**2.5**	1.8	-22.0
cummulative (YTD)	**2.5**	-13.4	-22.0

CZ: Industry Resumes Rising

January's industrial output was probably in the black, in spite of a lesser number of business days. Yet we should still bear in mind that the increasing year-on-year pace stems from the low comparative baselines of the beginning of last year, when output fell by more than 20%. The automotive and electrical industries are likely to show reasonable figures for January. Nevertheless, the prospects for contracts, which have started to rise quite reasonably in recent months, continue to be much more interesting than the data from industry in early 2010. For this year as a whole, we believe that industrial output will rise by approximately 3%. Foreign demand continues to be the critical factor.

TUE 9:00 — **HU Inflation (change in %)**

	Feb-10	Jan-10	Feb-09
CPI y/y	**6.0**	6.4	3.0
core CPI y/y	**4.9**	5.1	3.3
Food y/y	**3.2**	2.9	4.9

HU: The February inflation rate is lower than in January

February inflation is expected to lower from January, but we see possibility of a bigger fall to 6.0% instead of consensus' estimate for 6.2%.

WED 9:00 — **HU Foreign trade (EUR m)**

	Jan-10	Dec-09	Jan-09
Balance	**300.0**	375.4	-183.0
cummulative (YTD)	**300.0**	4569.6	-183.0
Exports (y/y in %)	**105.0**	108.8	68.9
Imports (y/y in %)	**100**	98.7	70.72

HU: The January trade balance shows a strong surplus?

January trade balance could show another strong surplus and the main question will be whether this surplus recovers to €500m we saw before or remains at around €300m we saw in December.

FRI 10:00 — **CZ Cur. Account (CZK bn)**

	Jan-10	Dec-09	Jan-09
C/A monthly	**4.5**	-11.3	1.0
cummulative (YTD)	**4.5**	-25.4	1.0
Trade bal. monthly	**12.2**	5.1	6.5
cummulative (YTD)	**12.5**	182.0	6.5

CZ: Current Account in the Black

Just like in previous years, the current account should remain in the black in the first months of the year, primarily because of the surplus of foreign trade in goods and services. The minimal outflow of dividends, typical of these months, will also have a positive effect. For this year as a whole, we believe that the current account deficit will be just around 1% of GDP.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
CZ	**8.3.2010**	**09:00**	**Trade balance (CZK B)**	**01/2010**	**10.0**		**10.0**		**2.8**	
CZ	**9.3.2010**	**09:00**	**CPI (%)**	**02/2010**	**0.3**	**0.9**	**0.2**	**0.8**	**1.2**	**0.7**
CZ	9.3.2010	09:00	Industrial output (%)	01/2010 *F		2.5		2.5		1.8
CZ	9.3.2010	09:00	Construction output (%)	01/2010						3.5
CZ	9.3.2010	09:00	Wages (%)	4Q/2009						4.7
CZ	9.3.2010	09:00	Unemployment rate (%)	02/2010	10.1		10.0		9.8	
HU	9.3.2010	09:00	Industrial output (%)	01/2010 *P					-5.8	-1.4
HU	**10.3.2010**	**09:00**	**GDP (%)**	**4Q/2009 *F**						**-4.0**
CZ	10.3.2010	10:00	Current account (CZK B)	4Q/2009					-778.6	
HU	**11.3.2010**	**09:00**	**CPI (%)**	**02/2010**		**6.0**	**0.0**	**5.9**	**1.4**	**6.4**
CZ	**11.3.2010**	**09:00**	**GDP (%)**	**4Q/2009 *F**			**0.8**		**0.8**	**-4.1**
HU	11.3.2010	09:00	Trade balance (EUR M)	01/2010 *P		300.0			375.4	
CZ	12.3.2010	10:00	Current account (CZK B)	01/2010	4.5		4.4		-11.3	
PL	12.3.2010	14:00	Trade balance (EUR M)	01/2010					-711	
PL	12.3.2010	14:00	Current account (EUR M)	01/2010					-1 034	
PL	12.3.2010	14:00	Money supply M3 (%)	02/2010					-1.4	

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	VI.10	IX.10	XII.10	III.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	25.6.2009

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

		Current	VI.10	IX.10	XII.10	III.11
Czech Rep.	PRIBOR	*1,53*	1,55	1,65	1,80	2,05
Hungary	BUBOR	*5,95*	5,50	6,00	6,00	6,00
Poland	WIBOR	*4,16*	4,60	4,70	4,80	4,80

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

	Current	VI.10	IX.10	XII.10	III.11
Czech Rep.	*3,61*	3,50	3,70	3,85	4,02
Hungary	*7*	7,75	8,00	7,50	7,25
Poland	*5,74*	5,50	5,70	5,80	5,90

Exchange rates (end of the period)

		Current	VI.10	IX.10	XII.10	III.11
Czech Rep.	EUR/CZK	*26,0*	25,8	24,8	23,8	25,5
Hungary	EUR/HUF	*272*	280	275	270	265
Poland	EUR/PLN	*3,99*	3,85	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)

	XII.09	VI.10	IX.10	XII.10	I.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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