Monday, March 22, 2010

KBC Banking & Insurance

Central European Weekly

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

Czech Republic

Koruna sets fresh 5-month high

Hungary

Forint extend gains despite Fidezs warnings that it wants to re-negotiate IMF programme

Poland

Mixed bag of eco data lead to zloty's underperformance

The Week Ahead

The CNB stays on hold, but its comments should be dovish

Overview

Too bullish environment might provoke sharp correction

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.35	-0.61%	↗	→
EUR/PLN	3.887	-0.14%	↗	→
EUR/HUF	263.2	-0.98%	↗	→
3M PRIBOR	1.43	-0.02	→	→
3M WIBOR	4.12	0.00	→	→
3M BUBOR	5.62	-0.13	→	↘
10Y CZK	4.02	0.01	↗	↗
10Y PLN	5.62	-0.16	↗	↗
10Y HUF	6.81	-0.20	→	→
3M EURIBOR	0.57	-0.01	→	→
10Y EMU	3.11	-0.09	↘	↗

Last values from Friday 15:30 CET

Last week, Central European financial markets again confirmed that the attractiveness of this region's assets is increasing. For example, the Czech koruna firmed to a five-month high, while the forint even hit the strongest level since the end of 2008. Likewise, Hungarian and Polish government bond yields dropped to the lowest levels of the last few months.

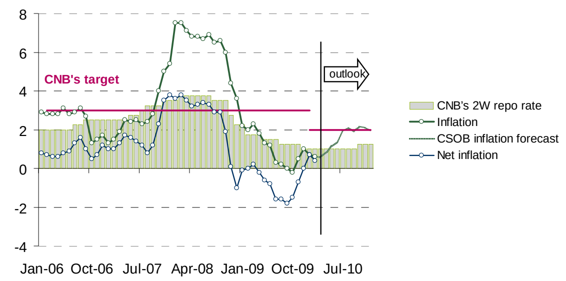
Although the upswing data across the global economy, including Central Europe, bears out the strong recovery scenario, the current bullish euphoria on regional forex and bond markets encourages us to cautiousness. Too rapid an appreciation of currencies and bonds may lead to a very rapid correction, which is usually triggered by negative news from leading markets; nevertheless, we cannot even rule out that the reason for the correction might stem from Central Europe. Such a correction stimulus might, for example, be generated by Central European central banks, which, scared of rapidly strengthening currencies, might adopt a very dovish attitude. This could especially affect Central European currencies, should a stronger wave of an increase in the aversion to risk hit global markets. Equally, we should not underestimate the impact of the outcomes of the parliamentary elections to be held in Hungary and the Czech Republic in the next two months, as those outcomes might increase the market uncertainty as to the future fiscal developments in those countries.

Czech Republic

Macro review

The CNB Board will very likely to leave interest rates unchanged at its forthcoming meeting (March 25). The central bank does not have, and within the next six months will not have, any reason to raise rates from the current lows. Inflation is developing better than the Czech National Bank anticipated in its latest forecast (by 0.3% at the moment), while GDP figures are slightly worse than the central bank's expectations. What particularly surprised the CNB was the decline in household consumption, which the bank did not anticipate in late 2009. The economy continues to suffer from low domestic demand – both consumer and investment demand – and thus the main factors that determine its direction are exports and inventories. In addition, we do not believe that domestic demand will recover as early as this year, and thus inflationary pressures will remain strongly curbed. While inflation will start to rise slightly in the second half of the year, this will be primarily due to the base effects and the impact of administrative measures. Not even next year, do we expect that domestic demand might pressure inflation higher to any great extent, and therefore the CNB will not need to raise rates anytime soon. Hence the central bank is unlikely to raise rates until late this year. Moreover, the koruna, which has returned to the long-term appreciation trend, and thus surpasses the central bank's forecasts, will continue to curb the determination to raise rates. We believe that the CNB's base rate will go up from the current 1% to 1.5% within the next twelve months.

Inflation and CNB's Target
(%)



Not even January saw any turnaround in the retail sector, and thus **retail sales are continuing to decline steadily**, this time by 5%. The fall has affected not only the automotive segment, but also other retail sales. Perhaps only food sellers may boast an improved figure, with their sales rising by 0.3% in real terms. However, given the decline in food prices, the nominal sales of these retailers are also falling. Thus, retail sales data sprang no surprise in January either, because it still bears out the existing trend of curbed household consumption, which was strongly evident as early as last year. This trend is completely consistent with wage developments in the economy; that is to say, not with the rate of the average wage, which is strongly affected by layoffs of the lowest-income staff, but rather with the development of the median wage. It comes to light that, due to layoffs, the development of the average wage and that of the median wage have diverged from each other to such a great extent that both provide a completely different view of households' financial situation. The decline in the median wage quite clearly explains the reductions in consumption, and consequently in retail spending, over the last year.

While the trend of declining consumption came as a surprise to the central bank, it provides a low-inflation environment even for the coming period. The decreasing demand will thus continue to drive the prices of consumer goods down, with certain market services likely to follow suit. Domestic demand is unlikely to resume improving until next year, provided, however, that the situation on the domestic labour market, which has shown a continuous rise in unemployment thus far, improves.

Currency

The koruna traded strongly last week; it opened the week at EUR/CZK 25.485, while slowly appreciating, closed the week at EUR/CZK 25.36 on Friday. The Czech currency again jumped on the bandwagon of the upbeat sentiment towards riskier assets, while it shrugged off domestic statistics (the decline in the producer price index, followed by the similarly pessimistic drop in retail sales). At the end of the week, the EUR/CZK currency pair even temporarily tested EUR/CZK 25.250 support (5-month highs), but failed to stay at that level.

The spotlight will be taken by Thursday's CNB Board meeting this week. Of course, no rate change is being anticipated, and the accompanying comment should be more moderate, without suggestions of monetary tightening. With no further stimuli, the EUR/CZK currency pair should not strengthen to more than EUR/CZK 25.25. Nevertheless, the situation in Greece is still relevant, and may hit the global sentiment significantly. Recall that EU leaders meet at the end of the week, with Greece and the solutions to such crises to be among the items on their agenda. This may also influence Central European currencies, including the koruna.

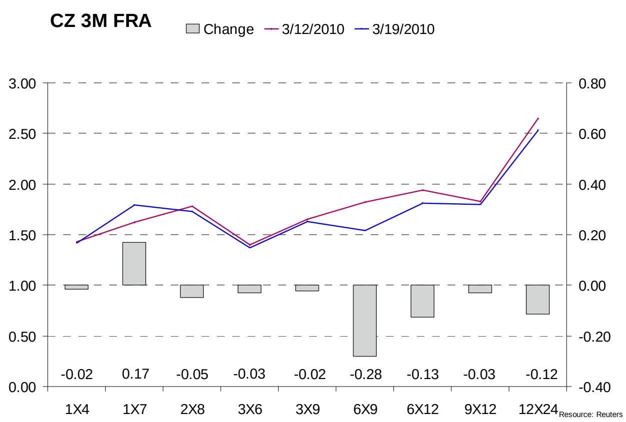
EUR/CZK technical picture

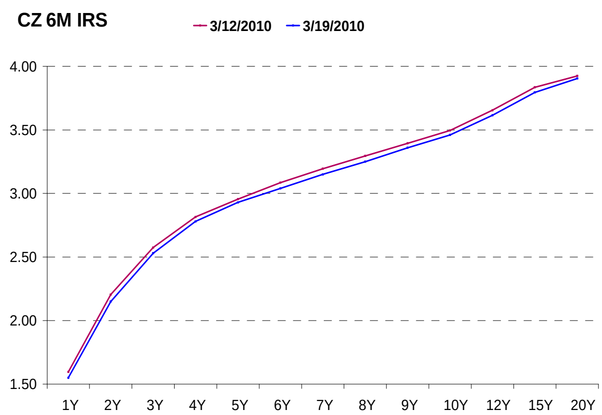
(25.3600) Double Top while below 25.7700 (see graph).
1st support area at 25.2500/ .2350 current year low/ 1st target off 25.7700), where pause favored.
If wrong, next levels 25.0350 (2nd target), ahead of 24.9750 (Sep low): tough on 1st attempts.
Resistance area at 25.7600/ .7700 (breakdown daily/ see above): ideal area to stay below to keep current mood on CZK.
Failure to cap would see next levels at 26.0500 (Feb 25 high), where pause favored.

DAILY CHARTS:

Fixed income

The Czech yield curve flattened somewhat last week, but the changes were negligible. The curve went up by slightly more than 1 bps at the short end, and down by nearly 0.5 bps at the long end. We should mention that, at the meeting of EU Ministers of Finance, the Czech Minister stated that, if he were to prepare the budget for 2011, the deficit would not exceed 4.8% of GDP, in compliance with the government's convergence programme.
The auction of the 3.40%/2015 government bond, held on Wednesday of last week, was no great success. The Ministry of Finance supplied securities for CZK 7 bn. The demand of CZK 8.659 bn was lower than expected, and only exceeded supply 1.36 times. Bonds for CZK 6.509 bn, at the average yield of 3.283%, were sold in the end. By comparison, the demand in the previous tranche of the same securities, held in late February, exceeded supply 2.896 times, at the average yield of 3.303%.
The main event of this week will be Thursday's CNB Board meeting. No rate change is being anticipated, but eventual dovish comments could bring short and medium segment of the curve lower. Rumours concerning bond issues denominated in euros could be interesting information too, as they would thus reduce the supply of koruna securities on the domestic market. A confirmation of such an issue would encourage demand for koruna bonds, the planned volume of which is CZK 32 bn for the second quarter.



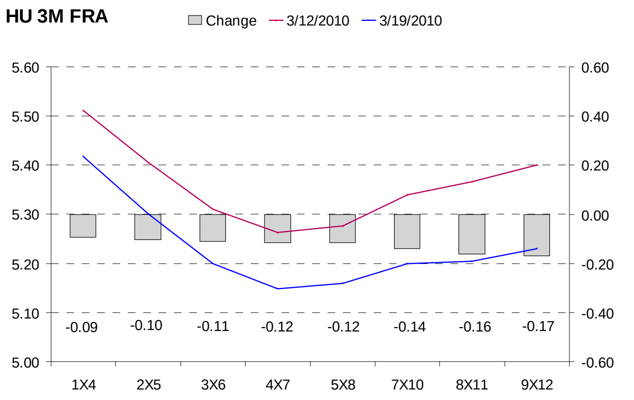


Hungary

Currency

The forint strengthened against the euro last week. It opened the week at EUR/HUF 265.55 and closed at the EUR/HUF 262.75 level, while the intra-week and 15-month low was set at the 260.93 level. In the first half of the week, the Hungarian currency benefited from the positive domestic statistics of the previous week and the favourable sentiment towards Central European currencies. The statements by opposition party Fidesz, which opened its election campaign with a promise to re-negotiate the strict austerity plan ordered by the IMF, had virtually no effect.
This week's interesting domestic events include only domestic retail sales. The austerity measures required by the IMF and high unemployment indicate that the data may again be less favourable. Thus the forint should stand little chance of a further appreciation. Nonetheless, the sentiment towards riskier assets and the developments related to Greece will also influence the Hungarian currency. If the EU summit scheduled for the end of the week agrees on the form of aid to Greece, the forint may also benefit from this. Until then, however, the Hungarian currency might continue to give up some of its previous gains. Moreover, the forint might be cautious ahead of the upcoming MNB meeting (held on Monday, March 29th), which will probably bring another rate cut (of 25 bps).

FRA rates point to more MNB easing



Resource: Reuters

EUR/HUF technical picture

(262.50): New reaction low off high on move below neckline of a Short Term Double Top (265.95) and currently below Triangle pattern (see graph), but near apex.
Resistance at 264.40/ 265.95 (breakdown daily/ see above): ideal area to stay below to keep current mood on HUF.
Failure to cap would see next levels at 268.15/ .88 (March 03 high/ medium term breakdown hourly), where pause favored.
Support at 260.93 (current year low?), where pause favored.
If wrong, next levels at 258.00/ 257.95 (Nov 2008 low/ 1st Irregular B off 283.60), ahead of 256.40/ 254.92 (1st target off 265.95/ 2nd Irregular B): tough on 1st attempts.

DAILY CHARTS:

Poland

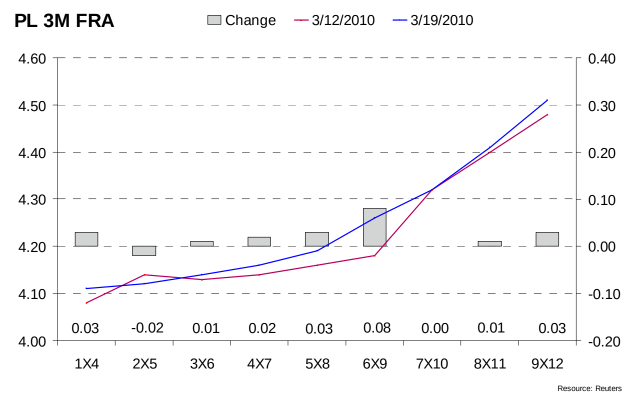
Currency

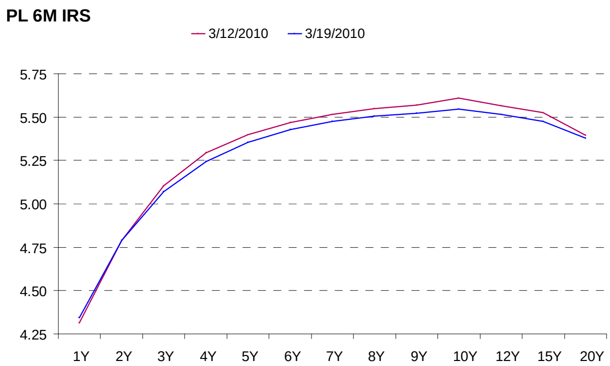
Steeper decline in inflation, continuing labour market deterioration and dovish talk of central bankers limited the gains of the Polish zloty. The currency clearly underperformed regional neighbours and by the end of the week it came to 3.9 EUR/PLN. Lower inflation and further decline in employment point to weak domestic demand at the beginning of the year. Beside that, the solid outcome of industrial output led by a nearly 11% growth in manufacturing confirms our base scenario of strong export growth compensating for weaker domestic demand at least for the first half of the year. That can make central bankers pretty comfortable with rates at current levels for some time especially when the zloty started to appreciate pretty fast.
Although both mid and long-term outlook remains bullish, we are currently fans of short term profit taking on the Polish markets. More important technical levels have already been reached at 3.86/6.85 EUR/PLN. Investors may be also more cautious after recent dovish comments. This week, the profit taking could be enhanced by further rise in unemployment and only moderate growth in retail sales - both pointing to weakening domestic demand.

EUR/PLN technical picture

(3.8755): Scored new reaction low off 4.9300, in channel off 4.5750 (see graph).
1st support area 3.8570/ .8500 (current new reaction low off 4.9300/ 1st target of long term daily Double Top off 4.2250), where pause favored.
If wrong, risk would extend towards 3.6100 (76.4% 3.2022 to 4.9300).
1st Resistance comes in at 3.9125 (March 11 high): ideal area to stay below to keep current mood on Zloty.
Failure to cap would see next levels at 3.9560/ .9713 (breakdown hourly/ daily), where pause favored.

DAILY CHARTS:





CE Weekly Preview

THU 13:00	CNB base rate	
	This meeting	Last change
rate level (in %)	**1.00**	12/2009
change in bps	**0**	-25

CZ: CNB to leave rates unchanged

The CNB Board is unlikely to change rates at its second meeting of this year, as it has no reason to do so. Inflation is developing better than the CNB expected, while the GDP developments are slightly worse. Therefore inflationary pressures are currently irrelevant within the horizon of monetary policy either. We do not expect a rate hike by the central bank until late this year. Thus the tenor of the CNB's comments will continue to be dovish. However, we cannot rule out that in its comment the bank will mention the unfavourable public finance developments in both 2009 and 2010.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
PL	22.3.2010	14:00	Core CPI (%)	01/2010			0.1	2.1	-0.2	2.6
HU	23.3.2010	09:00	Retail sales (%)	01/2010						-7.4
PL	24.3.2010	10:00	Unemployment rate (%)	02/2010			13.0		12.7	
PL	**24.3.2010**	**10:00**	**Retail sales (%)**	**02/2010**			**-1.1**	**3.6**	**-24.4**	**2.5**
CZ	**25.3.2010**	**12:30**	**CNB meeting (%)**	**03/2010**	**1.00**		**1.00**		**1.00**	

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	2/23/2010
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	*1.43*	1.55	1.65	1.80	2.05
Hungary	BUBOR	*5.71*	5.50	6.00	6.00	6.00
Poland	WIBOR	*4.12*	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.	*3.49*	3.50	3.70	3.85	4.02
Hungary	*6.675*	7.75	8.00	7.50	7.25
Poland	*5.535*	5.50	5.70	5.80	5.90

Exchange rates (end of the period)

		Current	Jun-10	Sep-10	Dec-10	Mar-11
Czech Rep.	EUR/CZK	*25.4*	25.8	24.8	23.8	25.5
Hungary	EUR/HUF	*263*	280	275	270	265
Poland	EUR/PLN	*3.89*	3.85	3.60	3.90	3.30

GDP (y/y)

	Q3 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010
Czech Rep.	*-4.5*	1.4	1.7	1.5	1.4
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*	1.1	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

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41		
Peter Wuyts	+32 2 417 32 35	Brussels	
Didier Hanesse	+32 2 417 59 43	Corporate Desk	+32 2 417 45 82
Joke Mertens	+32 2 417 30 59	Commercial Desk	+32 2 417 53 23
		Institutional Desk	+32 2 417 46 25
Dublin Research (KBC Bank Ireland)			
Austin Hughes	+353 1 6646892	London	+44 207 256 4848
Prague Research (CSOB)		Frankfurt	+49 69 756 19372
Jan Cermak	+420 2 6135 3578	Paris	+33 153 89 83 15
Zdenek Safka	+420 2 6135 3570	New York	+1 212 541 06 97
Jan Bures	+420 2 6135 3574	Singapore	+65 533 34 10
Bratislava Research (CSOB)			
Marek Gabris	+421 2 5966 8809	Prague	+420 2 6135 3535
		Bratislava	+421 2 5966 8436
Budapest Research (K&H)		Budapest	+36 1 328 99 63
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