Monday, April 12, 2010

KBC Banking & Insurance

Central European Weekly

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Czech Republic

The Czech economy starts to generate more favourable data

Hungary

Fidesz party will be the first able to form a government alone

Poland

The zloty fell after the Polish central bank intervened against the currency

The Week Ahead

PNB has intervened in the foreign exchange market, and Hungary held elections

Overview

Polish central bank decided to intervene in the forex market

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25,22	-0,54%	→	↘
EUR/PLN	3,881	0,95%	↗	↘
EUR/HUF	267,4	0,91%	→	↘
3M PRIBOR	1,44	0,01	→	→
3M WIBOR	3,96	-0,09	→	→
3M BUBOR	5,46	-0,01	↘	↘
10Y CZK	3,79	0,18	→	→
10Y PLN	5,62	0,12	→	→
10Y HUF	6,62	0,03	↘	↘
3M EURIBOR	0,63	0,03	→	→
10Y EMU	3,14	0,06	↗	↗

Last values from Friday 15:30 CET

The National Bank of Poland could not sit by and watch the zloty appreciate, and decided therefore to intervene in the forex market, for the first time in ten years. Keep in mind that forex interventions of the NBP against its own (strengthening) currency took place at the same time as when markets significantly raised their bets on the bankruptcy of one of the economically weaker countries of the euro area. There could probably be no stronger evidence that no infection is spreading from Greece to Central Europe; what is more, Central European currencies occasionally even seem to benefit from the fiscal problems of the euro zone. Of course, everything is a question of degree; however – we still believe that if Greece were to be really confronted with its state bankruptcy or an uncontrolled attack on its banking system, Central European currencies would certainly be hit by a strong negative correction. However, the experience from last year and a half indicates that a significant depreciation of the zloty or the koruna is rather a good reason to open new long positions in those currencies from the medium-term point of view.

This weekend might have been one of the factors determining whether the same may also be true of the Hungarian forint in the future, as the first round of the parliamentary elections were held in that country. This election handed power to the right-wing FIDESZ after eight long years. While this party, just like the ruling socialists, contributed to the macroeconomic imbalances by its past economic policy, investors hope that the change in the government and its strong mandate will provide a desirable stimulus to the Hungarian economy. The months to come will indicate whether this will actually be so.

Czech Republic

Macro review

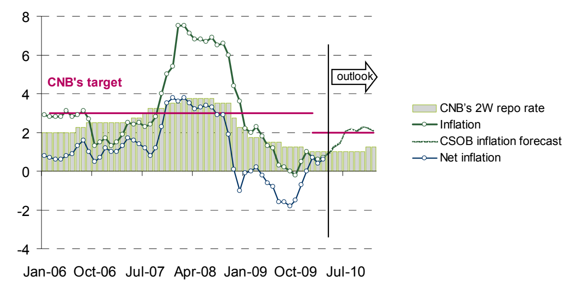
First, it was the trade balance, which showed a surplus of CZK 15.3 bn in February. This is an improvement by CZK 6 bn y/y and the highest surplus ever attained in February. What we consider to be positive is the fact that exports have risen for the fourth consecutive month, this time by a huge 11%, due primarily to car exports (+26%). Imports are also recovering, and indicating increased pressures in raw materials, due to rising raw material prices. On the one hand, trade confirms that the recovery of foreign demand is also starting to have a positive effect on the Czech economy. On the other hand, it shows that domestic demand – both consumer and investment demand – remains curbed. In addition, we should still bear in mind that the rates of the increases stem from the low comparative baselines of early 2009, when exports as well as imports were falling by more than 20%. Most probably, we will also see positive figures in the months to come. However, we need to anticipate that raw material prices will influence trade figures negatively this year, unlike last year.

The improved foreign demand is also having an effect on the developments in the Czech industry. February's data were a clear evidence of this. Industrial output was up by 7% y/y, due in particular to the automotive industry (+37.4%). Other strong industries have also shown very high increases – metal and electronics production. However, just as with exports, the year-on-year figures are strongly influenced by the very low comparative baseline of early 2009. Even so, the industry has obviously bottomed out, after it hit bottom in early 2009. The rise in output remains fairly moderate and, for the moment, does not even apply to all industries (e.g., engineering), although the worst is probably over even for those industries. Yet we can expect that this dominating sector of the economy will continue to generate relatively favourable data in the months to come. Thus the industrial sector is slowly returning to its role as the driver of the economy, after last year's fall.

After another rapid rise in early 2010, the unemployment rate fell at last, by 0.2% to 9.7% in March. This was primarily due to new seasonal jobs, which will continue to influence the unemployment development in the months to come. Thus we will see unemployment fall to less than 9.5% in the summer. By the end of the year, in contrast, unemployment is likely to climb to approximately 10%. The increase in the number of vacancies can be regarded as being positive, though not yet sufficient, as there are still a third fewer vacancies than last year. Therefore any quick reversal of the labour market trend is still rather unlikely at the moment. The CR's economic growth is not yet strong enough to generate a sufficient number of vacancies, which would lead to a permanent – and not just seasonal – decline in unemployment.

Consumer prices were up by 0.3% m/m in March, due primarily to a seasonal increase in food prices. However, fuel prices also went up this time, driven by the rising commodity prices and strengthening US dollar. Package tour prices, by contrast, went down, but this is nothing unusual for this period of the year. Year-on-year inflation rose from February's 0.6% to 0.7%, and thus remains far below the CNB's target, which has been set at 2% as of this year. Inflation also lags behind the latest central bank forecast; nevertheless, contrary to the CNB's expectations, it shrank from 0.3 to 0.1 percentage point.

Inflation and CNB's Target
(%)



As far as monetary policy and thus also rates are concerned, the future development of inflation is essential. Our opinion is that year-on-year inflation will remain below the target at least until the summer, when the increase in excise duties should fully make itself felt in inflation. Throughout the second half of the year, inflation might remain close to the target. Nonetheless, demand-pull inflation is still irrelevant in the CR. Consumer demand remains curbed, and its existing decline has tended to make retailers cut the prices of consumer goods. Thus inflation is at the mercy of administrative moves, whether the tax changes or regulated prices. However, raw material prices, which have put pressure on inflation across Europe in recent months, still pose a risk that the central bank cannot influence at all. Inflation should be close to the CNB's inflation target by the end of the year, and thus we do not expect the central bank to hasten to raise its rates. Rather the other way round, the CNB rates may remain unchanged for most of this year. Thus, monetary tightening is unlikely to occur until economic growth proves to be stable. There is still a risk, as also suggested by the minutes of the latest CNB Board meeting, of the W-shaped development of the economy. However, this does not mean that market rates will also remain unchanged. We can expect that long-term yields and rates will go up from their existing very low levels within the next few months, and the yield curve will continue to steepen further.

Currency

The Czech koruna, which closed last week at CZK 25.375 per EUR, fared well during the week. The reasonable foreign trade data and the upbeat mood on global stock markets helped the Czech currency hit CZK 25.20 per EUR at the end of the week. Neither concern about the Greek problems nor the strengthening dollar upset the koruna. The OECD's assessment report triggered no major reaction either. The currency only weakened slightly at the very end of the week, when it reacted somewhat to the increased aversion to risky assets and the slightly higher consumer price index.

Fixed income

The Czech yield curve flattened last week. While yields remained virtually unchanged at the short end, they fell by more than 8 bps at the long end. Demand for bonds was primarily maintained by low inflationary pressures, the vote for a rate cut by two CNB Board Members, and the intention of the Ministry of Finance to come out with a euro bond issue, which will consequently reduce the need to issue koruna bonds.

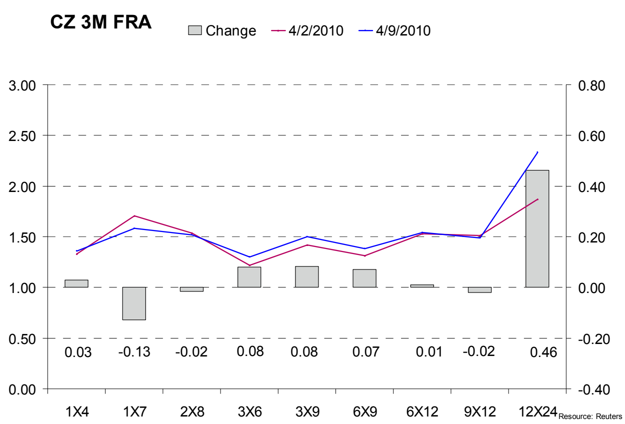
Naturally, the main event of last week on the domestic market was the auction of the 2.80%/2013 government bond. Demand exceeded the original supply of CZK 5 bn 2.37 times. The Ministry sold bonds for CZK 6.7 bn at the average yield of 2.41%, but of that volume kept bonds for CZK 1 bn in its book. By comparison, the average yield of the previous tranche, of late January, was 2.9%, with demand exceeding supply 2.31 times.

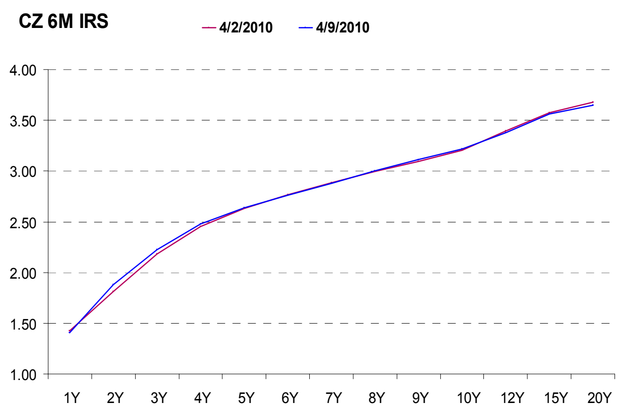
The bond market should be calmer this week. Major scheduled data releases include the producer price index; although a price rise is being anticipated, it should not be very dramatic. Nevertheless, the moderate CPI rise and the rise in industrial output, released at the end of the week, might reduce the demand for bonds and nudge yields higher this week. However, the strong koruna should keep the short end of the curve down.

EUR/CZK technical picture

(25.1700) Double Top off 25.7700 (see graph).
1st support area at 25.1400 (current year low?), ahead of 25.0550 (2nd target off 25.7700), where pause favored.
If wrong, next levels at 25.0280 (weekly Bollinger bottom), ahead of 24.9750 (Sep low) and 24.9360 (monthly envelope bottom): tough on 1st attempts.
Resistance area at 25.3250 (breakdown daily): ideal area to stay below to keep current short term mood on CZK.
Failure to cap would see next levels at 25.4850/ .4880 (March 30/ 23 highs), ahead of 25.6740 (falling weekly Medium Term Moving Average), where pause favored.

DAILY CHARTS:

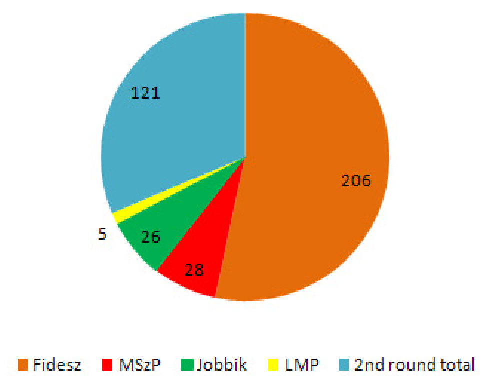




Hungary

Macro review

Hungary's first round election results came in broadly as expected. Fidesz got 52% of the list-votes and together with 119 winners of individual nominees, they have secured 206 seats in the new Parliament, which means that simple majority has already been reached. The second round in two weeks will decide whether they will be able to gain a two-thirds majority. If so, Fidesz will be the first party since 1990, which could form a government on its own.
Socialists came in second at 19%, while far-right wing Jobbik was third at 17%. Newcomer LMP, a liberal party, also passed the 5% threshold.



Just before the election-silence started on Friday, Fidesz leader Mr Orban spoke about directions of the new economic policy. He mentioned rationalisation of the local government system, fight against corruption, employment creation and tax reductions.
The main question for markets could be how the deficit path could change. The latest comments from the Fidesz were about a deficit path between 4.5% and 6.5%, whose centre point is above the consensus forecast of 4.7% of GDP.
The current IMF program matures in October, so two more reviews will be carried out until then and if the Fidesz program is accepted by the Fund, the new government will also be able to ask for the last tranche of the loan.
The main challenges could be how to deal with indebted state-owned companies, like the Hungarian Development Bank (MFB) or the railway company (MAV).

Currency

The forint reacted positively to the election results and appreciated to EUR/HUF 265.00, the following morning. News about Greece had a major role behind the currency moves last week, so the news about the rescue package could have also played a role in the recovery.

Albeit the market is fairly optimistic about the outlook, we still have fears from a higher deficit path this year. The new government will likely follow gradual deficit reduction, but the starting point in 2010 is not yet clear and in light of Hungary's weak track record from the last 20-years, we would not underestimate the risk of a higher fiscal gap in the election year.

EUR/HUF technical picture

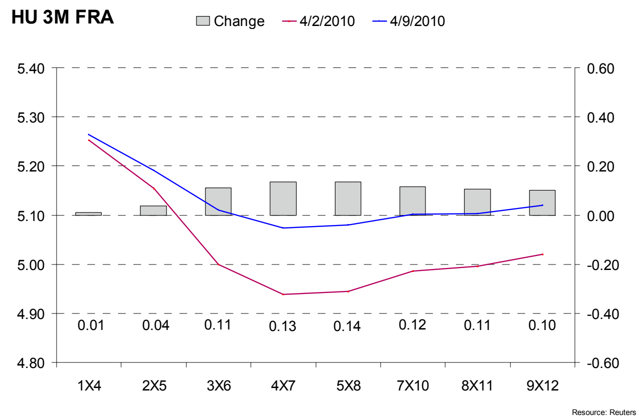
(266.60): New reaction low off high, but currently back above the neckline of a Short Term Double Top (265.95) and Triangle pattern near apex (see graph).
Resistance at 269.25 (breakdown daily Feb 26), ahead of 269.98 (flat weekly Long Term Moving Average): ideal area to stay below to keep current mood on HUF.
Failure to cap would see next levels at 270.41/ .44 (monthly envelope top/ 50% 279.95 to 260.93), ahead of 271.75/ 272.90 (Feb 25/ 19 highs), where pause favored.
Support at 264.25 (reaction low hourly), ahead of 262.85/ .70 (weekly Bollinger bottom/ break-up daily), where pause favored.
If wrong, next levels at 260.93 (new reaction low off 317.45), ahead of 259.38/ 258.00 (monthly envelope bottom/ Nov 2008 low): tough on 1st attempts.

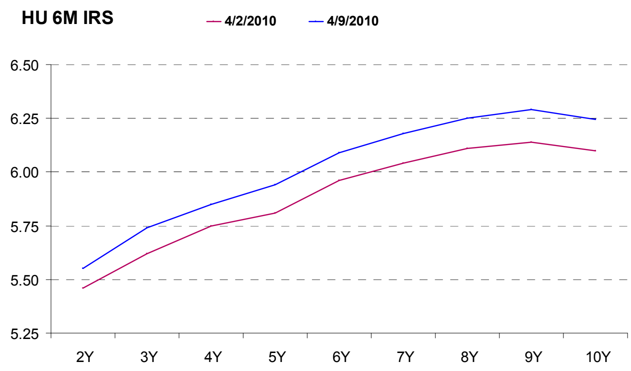
DAILY CHARTS:

Fixed income

The bond market rallied sharply last week and yields set a new record low. The short-end now sees further 50bps rate cut to 5.00%, while the long-end yield lowered to 6.60%. These levels are some 25-30bps lower than a week-ago.

The 5y5y forward spread narrowed to 217bps, down from the 250bps level a week before.
Compression of spreads could continue, except if the budget deficit is revised significantly higher.





Poland

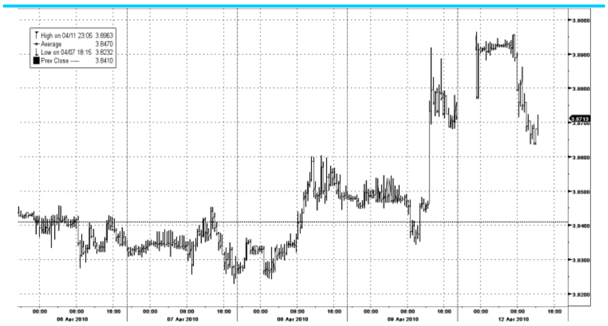
Currency

The zloty fell after the Polish central bank intervened against the currency for the first time in 10 years by the end of last week. Vice governor Witold Kozinski admitted that he could not rule out further interventions.

Nevertheless over the weekend attention shifted to the tragedy of the Polish plane, where several top officials including President Lech Kaczynski and Central bank governor Slawomir Skrzypek died. The immediate reaction of the markets was negative with the zloty coming back to the 3.90 EUR/PLN neighbourhoods.

Although all institutions including the central bank seem to function as usual, Polish markets should stay in a defensive mode at the beginning of the week. We do not expect further weakening of the zloty, but rather underperformance in comparison with the region and inability to benefit from the Greek support package details.

Skrzypek was seen as driving force behind last weeks interventions, but his death should not bring a major shift to the newly elected MPC. We continue to believe the board to stay on hold with rates untill the last quarter of 2010 and we bet on a moderate tightening afterwards. Further decreases of inflation at the end of this week should only play in favour of our no-change view for now.



Polish zloty in light of interventions and plane crash

EUR/PLN technical picture

(3.8400): Scored new reaction low off 4.9300, in channel off 4.5750 (see graph).

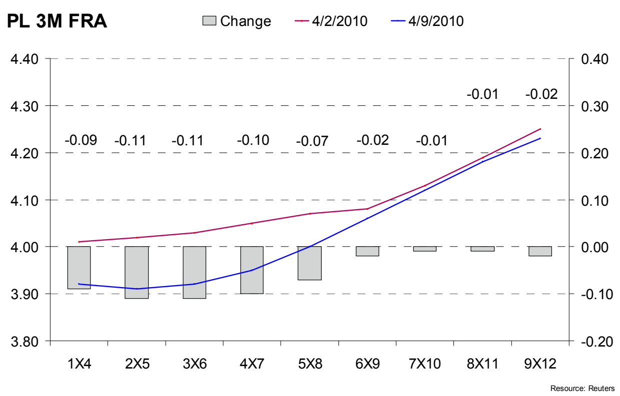
1st support area 3.8225 (current new reaction low off 4.9300?), where pause favored.

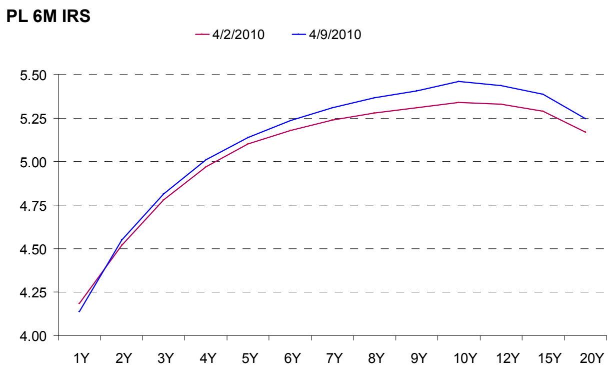
If wrong, next levels at 3.7768 (weekly Bollinger bottom), ahead of 3.7449 (monthly envelope bottom): tough on 1st attempts.

1st Resistance comes in at 3.8610 (current reaction high off 3.8225?), ahead of 3.8700/ .8740 (reaction highs hourly): ideal area to stay below to keep current mood on Zloty.

Failure to cap would see next levels at 3.9150 (March 26 high + weekly Stop And Reverse) and 3.9189/ .9290 (monthly envelope top/ March 22 high + see graph), where pause favored.

DAILY CHARTS:





Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	**13.4.2010**	**09:00**	**CPI (%)**	**03/2010**			**0.4**	**5.6**	**0.3**	**5.7**
CZ	13.4.2010	10:00	Current account (CZK B)	02/2010	22.0		12.8		15.6	
PL	13.4.2010	14:00	Current account (EUR M)	02/2010					-710	
PL	13.4.2010	14:00	Trade balance (EUR M)	02/2010					-171	
HU	14.4.2010	09:00	Industrial output (%)	02/2010 *F					-1.7	8.4
PL	14.4.2010	14:00	Money supply M3 (%)	03/2010					0.7	
CZ	15.4.2010	09:00	PPI (%)	03/2010	0.2	-0.7	0.2	-0.7	-0.3	-2.0
PL	**15.4.2010**	**14:00**	**CPI (%)**	**03/2010**					**0.2**	**2.9**
HU	16.4.2010	09:00	Wages (%, ytd.)	02/2010				4.1		6.5
PL	16.4.2010	15:00	Budget balance (PLN M)	03/2010					-11 907	

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	3,50	3,75	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	*1,44*	1,50	1,65	1,80	1,95
Hungary	BUBOR	*5,46*	5,50	6,00	6,00	6,00
Poland	WIBOR	*3,96*	3,90	4,10	4,30	4,30

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

	Current	VI.10	IX.10	XII.10	III.11
Czech Rep.	*3,23*	3,45	3,70	3,85	4,02
Hungary	*6,39*	7,75	8,00	7,50	7,25
Poland	*5,44*	5,00	5,00	5,20	5,50

Exchange rates (end of the period)

		Current	VI.10	IX.10	XII.10	III.11
Czech Rep.	EUR/CZK	*25,2*	25,8	24,8	23,8	25,5
Hungary	EUR/HUF	*267*	280	275	270	265
Poland	EUR/PLN	*3,88*	3,80	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)

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

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