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KBC Banking & Insurance

Central European Weekly

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Czech Republic

The CNB will have its new Governor sooner than expected

Hungary

Forint and bonds await the second round of the Parliamentary elections

Poland

Zloty still quite strong despite the Forex intervention

The Week Ahead

Polish industrial production figures and Czech bond auction in the spotlight

Overview

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.13	-0.35%	↘	↘
EUR/PLN	3.877	-0.10%	↘	↘
EUR/HUF	263.2	-1.56%	→	↘
3M PRIBOR	1.43	-0.01	→	→
3M WIBOR	3.89	-0.07	→	→
3M BUBOR	5.46	0.00	→	↘
10Y CZK	3.50	-0.28	→	↗
10Y PLN	5.50	-0.12	→	→
10Y HUF	6.20	-0.42	→	↘
3M EURIBOR	0.61	-0.02	→	→
10Y EMU	3.09	-0.05	↗	↗

Last values from Friday 15:30 CET

Czech and Poles are looking for new central bank heads

Poland and the Czech Republic are confronted with an unexpected problem – they are seeking new governors of their central banks. This has been very surprising news for Polish and Czech markets in recent days. While the Governor of the NBP is gone because of the terrible plane crash, the Governor of the CNB has himself decided to leave before his term of office expires. However, CNB Governor Tůma would have served 'just' a few months longer if he waited for the expiration of his term. Even so, his early departure came as a surprise. Of course, the markets in both countries are now interested to see who will succeed their previous central bank heads and whether this will change the policies of the NBP and the CNB respectively.

We don't expect any of the two banks to change their monetary policies significantly after their new Governors take the helm. After all, the Governor of the NBP as well as that of the CNB is just one of the members of a collective body which decides on monetary policy settings. In addition, the members of both the Polish MPC and the CNB Board were already scheduled to be replaced (the NBP this year and the CNB in February 2011), even in case their Governors' seats would not have become vacant. So, we need to wait for the years to come, after a number of important votes by both the MPC and the CNB Board have taken place, to see how these important bodies of the NBP or the CNB will (re)position themselves.

If there is one factor that a new person on the post of NBP or CNB Governor may influence, it would be the bias of these central banks on euro adoption. The impact of the vacancies left by Governors Skrzypek and Tůma could be a reversal their respective approach. While the Polish Governor belonged to the euro-sceptics inside the NBP, his Czech counterpart was considered to be a neutral person inside the mostly euro-sceptical CNB Board. The new Governor of the NBP may be more in favour of the euro than his deceased predecessor, while the new CNB Governor may come from the euro-sceptical party within the CNB.

Czech Republic

Macro review

In case everything had proceeded as scheduled, the term of office of the current CNB Governor would have expired in February 2011. Nevertheless, he caught markets by surprise on Thursday as he announced that he would leave his post at the end of June 2010. He cited the effort to shorten the uncertainty surrounding the replacement of CNB Board Members as the reason for his surprise move, because the term of office of four out of the seven CNB Board Members would otherwise expire in February – apart from the Governor, it is also the term of office of one of the Deputy Governors and two Members. In addition, the outgoing Governor said he believed it was reasonable to separate the period of the mandate of the head of the central bank and of the mandates of the other Members of the Board. Thus the fact that the CNB's top representative is surprisingly leaving has somewhat sped up the speculation about the future Governor. The new head of the central bank is more likely to come from the current members of the CNB Board. Nonetheless, it does not make a great deal of sense to speculate about this very much at the moment.

Nevertheless the question on how the CNB rates will continue to develop remains a relevant one. At the latest CNB Board meeting, two of its Members voted for cutting the base rate by 25 basis points. This scenario is still possible. At its next meeting (May 6), a new inflation forecast will be available. This could cause some other Board Members to vote for another rate cut, too. We can only speculate as to how much the new forecast would have to differ from the previous one in order to 'provide' enough support for a rate cut. We expect the inflation outlook to change only slightly this time and the GDP forecast is unlikely to change significantly either. Thus the only 'problematic' item is still the koruna, which has strengthened to a greater extent thus far than the central bank had anticipated. At the moment, the koruna is almost 1.5% stronger compared to the latest forecast, but the divergence is still not dramatic enough to require any prompt action.

As indicated by the decline in FRA rates, the market basically anticipates a cut in the CNB's base rate. Nonetheless, the only reason for another easing of the monetary policy is the slightly stronger koruna. This would not be the first time, and probably not even the last one, for the koruna to play the main role in the central bank's decision on rates. In this respect, the development of the exchange rate of the Czech currency has become a parameter to follow closely in the weeks to come and it will also determine the rate anticipations. Nevertheless, we still keep our rate scenario unchanged (expecting stability), even though we admit that the likelihood of another rate cut is not negligible.

Currency

The Czech currency hovered up and down near the EUR/CZK 25.20 level during the week. This does not mean, however, that the week was uneventful for the koruna. In the first half of the week, the koruna kept strengthening, trying to break through the psychological barrier of EUR/CZK 25.00, encouraged by the preliminary agreement of the EMU Ministers and the IMF to support Greece. The currency was not even affected by the dovish comments from CNB Board Members. At the end of the week, however, the koruna was hit by the surprise resignation of CNB Governor Zdeněk Tůma. Markets hate unexpected events. Moreover, the announcement was augmented by the mostly euro-sceptical nature of both Deputy Governors who, in addition, are considering another rate cut. This pushed the currency pair back to the vicinity of its opening level.
The sentiment on global markets will continue to be of primary importance for the development of the Czech forex market in the short term. As far as domestic events are concerned, we expect the effect of the Governor's resignation to peter out. So, the koruna should return to its appreciation trend and the EUR/CZK currency pair should again approach EUR/CZK 25.00. Nevertheless, we do not expect the koruna will break through that level this week.

Fixed income

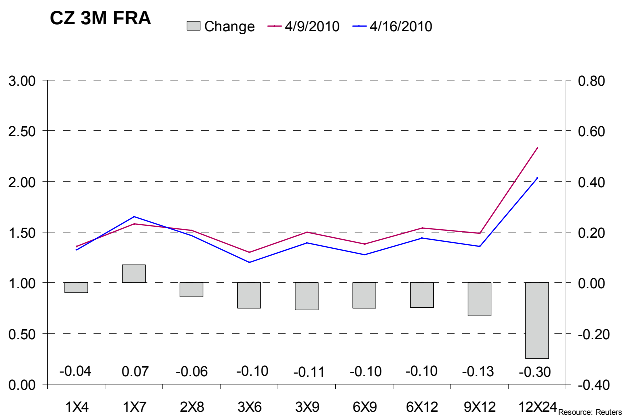
Czech bonds fared well last week. Their prices went up along the full length of the curve, which flattened. That said, yields fell by 11 bps at the short end and more than 25 bps at the long end. Trading volumes were above-average from the middle of the week, due probably to the Ministry of Finance, which sold bonds for approximately CZK 500m from its book.
Comments from certain Members of the CNB Board favouring another rate cut contributed to the decline in yields. Only Ms. Zamrazilová suggested that she was in favour of leaving rates unchanged, but she will be absent from the next CNB meeting. Another stimulus to bonds is the intention of the Ministry of Finance to issue bonds denominated in euros rather than in korunas. Naturally, this will reduce the volumes of koruna bonds.
We should mention that the Parliament decided on Friday that what is known as the bonds for people would be subject to a 15% tax. However given the belated discussion, the Ministry of Finance doubts whether the issue will be prepared this year.
Finally, another contributor to the demand for bonds was the surprising resignation of current CNB Governor Tůma. Note that both Deputy Governors voted for a rate cut by another 0.25% at the last CNB Board meeting.

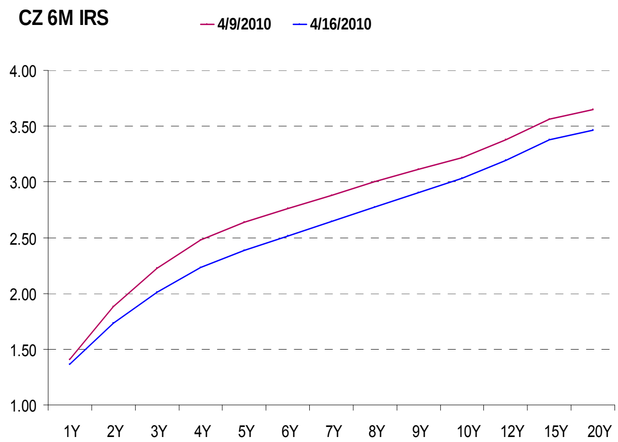
The whole of this week is free of any new attractive statistics. Nevertheless, the existing constructive market sentiment should continue to support demand for bonds.
The main event of the week will be the 5.70%/2024 bond sale for the planned volume of CZK 6bn. Although longer maturities are usually less in demand, concerns about this year's lack of koruna issues should help to subscribe the entire volume without problems. To be honest, the previous tranche of the same bond, in the first half of February, was not very successful.

EUR/CZK technical picture

(25.1700) Has met potential of Double Top from 25.7700 (see graph) at 25.0550
1st support area at 25.0150 (current year low?), where pause favored.
If wrong, next levels at 24.9750 (Sept 2009 low) and 24.9500/ .9360 (weekly Bollinger bottom/ 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 25.6340 (falling weekly Medium Term Moving Average), where pause favored.

DAILY CHARTS:

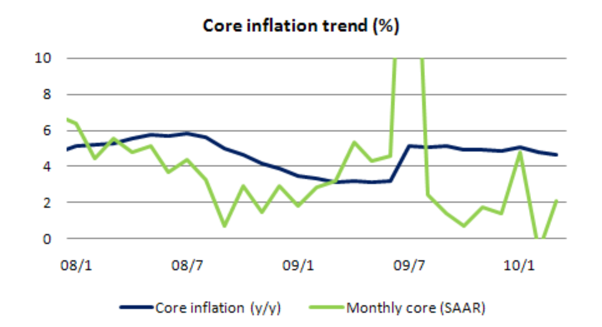




Hungary

Macro review

Before the second round of the Parliamentary elections take place on April 25, Hungary had some interesting macro data releases last week.
March inflation was higher-than-expected this time at 5.9% Y/Y as the consensus was looking for a downward move from February's 5.7% level to 5.6%. Instead, fuel prices rose 3% during the month and together with higher prices of raw materials, inflation did not decline. Core inflation however remained modest and the annualised monthly change remained close to 2% suggesting that apart from tax- and energy-effects prices remained broadly stable. This fits into the consensus and central bank's view about a steep fall of inflation to around 3% by the year-end. However, we are a tad more sceptical on this due to Hungary's persistently high inflation record and the possible negative effect of the recovery of domestic demand due to the personal income tax cut that took place on 1 January 2010.



On the positive side, wage growth moderated further in February and the annual growth rate lowered to 0.9% Y/Y from 3.5% Y/Y. Net wages however accelerated to almost 10% Y/Y as afore mentioned tax cut boosted take home wages. Unsurprisingly in such an environment, retail trade accelerated a bit, but remained negative at -5.0% Y/Y, up more than 2pp from last November's bottom of -7.4% Y/Y. This bodes well form a slow recovery of domestic demand, which at the same time may bite into the large foreign trade surplus that the country accumulated in 2009.

Currency

The forint kept on the post-election good mood until Friday and approached the 1-month high of 261.85 by Thursday before disappointing news from the US turned the equity market sentiment sour again, which hit risk appetite and high-yielding currencies. The pair lost more than 1% shortly and tested the key level of 265.25 on Friday night, which could be the theme for this week, as well.
The very low yield environment, rate cut hopes from the central bank amid a deteriorating risk environment could undermine the sentiment behind the forint, especially if the new government would announces worse picture about the budget in June. So, we would recommend to sell the forint above the 265.00 level and target a weaker currency at 275.00 for the next 2-months with a stop-loss of 261.50.

EUR/HUF technical picture

(263.10): Currently back below the neckline of a Short Term Double Top (265.95) and Triangle pattern near apex (see graph).
Resistance at 267.77 (reaction high hourly + falling weekly Medium Term Moving Average), ahead of 269.00/ .25 (current reaction high off 260.93/ breakdown daily Feb 26) and 269.85 (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 261.80 (April 15 low), ahead of 260.93 (new reaction low off 317.45 + weekly Bollinger bottom), where pause favored.
If wrong, next levels at 259.38 (monthly envelope bottom), ahead of 258.00 (Nov 2008 low): tough on 1st attempts.

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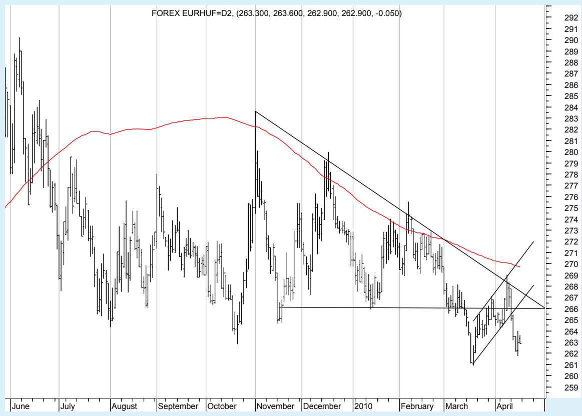
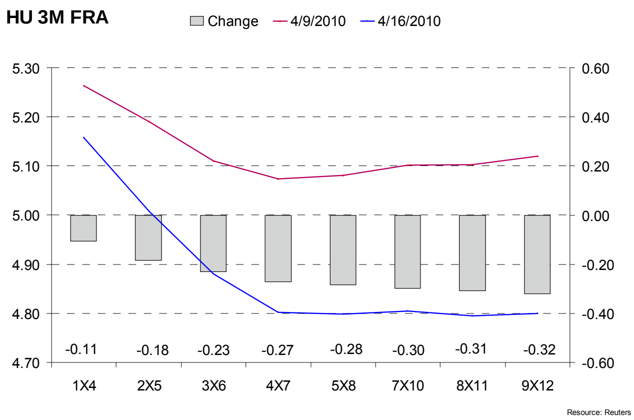


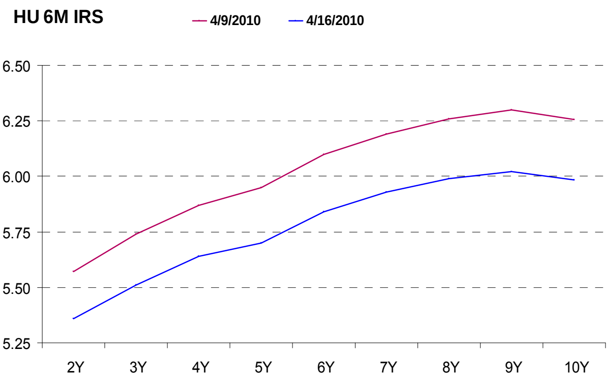
Fixed income

The bond market rallied slightly further with the currency last week and yields reached new historic low levels. Auctions of 3- and 12-month Bill resulted in yield levels below the key 5.0% threshold as the market hoped for more rate cuts from the current 5.50% level. The FRA market had a bottom at 4.80% at the 3x6 maturity and above, which implies three more 25bps cuts starting next week on the 26th.
Minutes of the March meeting showed a narrow margin for the 25bps move as three members out of 7 voted for a big-

ger, 50bps step. The strong currency at 265.00 that time could have been a major factor for the doves, who may want to see the currency probably around 280/€ in order to help exporters to recover. The IMF warned two weeks ago that a too strong currency could backfire later, so deeper rate cuts may just fit into this line.

Nevertheless, next week's 25bps move seems very likely now and the last move could come in May, in our view, just before the publication of the budget situation in June, which could redraw the picture about Hungary.





Poland

Currency

The zloty strengthened slightly last week, from EUR/PLN 3.889 at the start of the week to EUR/PLN 3.855 at the end of it, with the currency pair hovering within a narrow range over the period. At the very beginning of the week, the zloty was influenced by the previous intervention of the National Bank of Poland. This protected the currency from the negative effect of the plane crash tragedy and the death of the central bank governor. Not even the year-on-year inflation fall or the unfavourable trade balance figure had any major impact on the currency pair. Thus the overall appreciation of the zloty can be attributed to the good domestic fundamentals as well as to the improved sentiment towards riskier assets.

A series of attractive figures will be released this week. The producer price index and the core consumer price index should fall, according to forecasts, just like unemployment, while industrial output and, more strongly, retail sales should rise. Favourable fundamentals should therefore support the Polish currency. Some concerns about the chance of another intervention may curb the intensity of the appreciation. The mood on global markets will also be relevant.

EUR/PLN technical picture

(3.8700): Scored new reaction low off 4.9300, in channel off 4.5750 (see graph).
1st support area 3.8470 (break-up hourly), ahead of 3.8225 (current new reaction low off 4.9300), where pause favored.
If wrong, next levels at 3.7821 (weekly Bollinger bottom), ahead of 3.7449 (monthly envelope bottom): tough on 1st attempts.
1st Resistance comes in at 3.8962 (current reaction high off 3.8225 + weekly Stop And Reverse): ideal area to stay below to keep current mood on Zloty.
Failure to cap would see next levels at 3.9150 (March 26 high) and 3.9189/ .9290 (monthly envelope top/ March 22 high + see graph), where pause favored.

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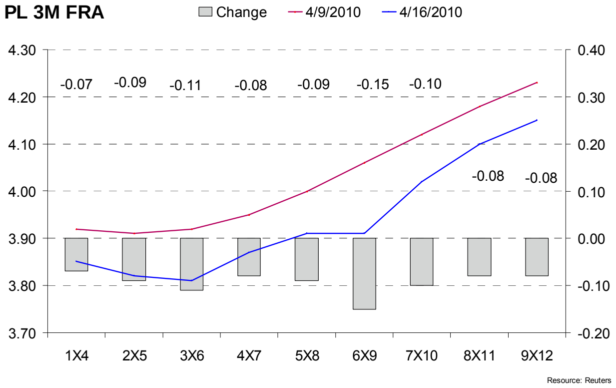

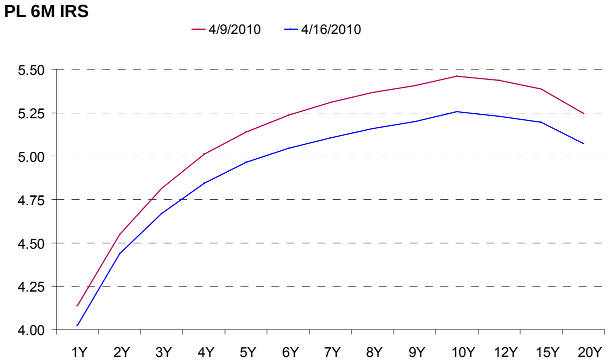

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
PL	19.4.2010	14:00	Wages (%)	03/2010			3.9	2.8	1.8	2.9
PL	**20.4.2010**	**14:00**	**Industrial output (%)**	**03/2010**			**18.2**	**10.7**	**3.1**	**9.2**
PL	20.4.2010	14:00	PPI (%)	03/2010			-0.1	-2.6	-0.1	-2.4
CZ	**21.4.2010**	**12:00**	**CZ bond auction 5.70%/2024 (CZK B)**	**04/2010**			**6**			
PL	21.4.2010	14:00	Core CPI (%)	03/2010				2.1	0.0	2.2
HU	23.4.2010	09:00	Retail sales (%)	02/2010				-5.0		-5.6
PL	**23.4.2010**	**10:00**	**Retail sales (%)**	**03/2010**			**17.0**	**4.1**	**-4.0**	**0.1**
PL	23.4.2010	10:00	Unemployment rate (%)	03/2010			12.9		13.0	

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	Sep-10	Dec-10	Mar-11	Jun-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*	5.00	4.75	4.50	4.50	-25 bps	2/23/2010
Poland	2W inter. rate	*3.50*	3.50	3.50	3.75	4.00	-25 bps	6/25/2009

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

		Current	Sep-10	Dec-10	Mar-11	Jun-11
Czech Rep.	PRIBOR	*1.43*	1.50	1.60	1.70	1.85
Hungary	BUBOR	*5.42*	5.00	4.80	4.60	4.60
Poland	WIBOR	*3.89*	3.90	4.10	4.30	4.30

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

	Current	Sep-10	Dec-10	Mar-11	Jun-11
Czech Rep.	*3.06*	3.45	3.70	3.85	4.02
Hungary	*5.99*	6.00	6.00	6.00	6.00
Poland	*5.255*	5.00	5.00	5.20	5.50

Exchange rates (end of the period)

		Current	Sep-10	Dec-10	Mar-11	Jun-11
Czech Rep.	EUR/CZK	*25.1*	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*263*	270	265	265	260
Poland	EUR/PLN	*3.88*	3.80	3.60	3.90	3.30

GDP (y/y)

	Q4 2009	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Czech Rep.	*-3.1*	1.7	1.5	1.4	1.7
Hungary	*-5.3*	-1.5	0.5	1.0	2.0

Inflation (CPI y/y, end of the period)

	Mar-10	Sep-10	Dec-10	Mar-11	Jun-11
Czech Rep.	*0.7*	2.1	2.1	2.0	1.9
Hungary	*5.9*	4.2	3.5	3.5	3.5

Current Account as % of GDP

	2009	2010
Czech Rep.	-1.0	-1.0
Hungary	-1.0	-0.5

Public finance balance as % of GDP (in ESA95 standards)

	2009	2010
Czech Rep.	-5.9	-5.5
Hungary	-3.9	-5.5

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