Tuesday, April 27, 2010

Central European Weekly

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Czech Republic

Dovish talk on the koruna continues

Hungary

The centre-right Fidesz party gains 2/3 majority in the new Parliament

Poland

Strong industrial production and retail sales point to fast GDP growth in the 3rd quarter

The Week Ahead

The MNB cuts rates to all-time low, NBP to sound dovish despite strong economy

Overview

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.40	1.08%	↘	↗
EUR/PLN	3.889	0.31%	↘	↗
EUR/HUF	264.4	0.45%	→	↗
3M PRIBOR	1.39	-0.04	→	→
3M WIBOR	3.87	-0.02	→	→
3M BUBOR	5.46	0.04	↘	↘
10Y CZK	3.56	0.05	→	↗
10Y PLN	5.53	0.03	→	↗
10Y HUF	6.33	0.13	→	↗
3M EURIBOR	0.62	0.01	→	↗
10Y EMU	3.06	-0.03	→	↗

Last values from Friday 15:30 CET

The starting recovery = a rate cut?

The yields on Greek bonds had to exceed the magic and almost unbelievable level of 10% for the Central European currency markets to feel at least some of the negative impact of the Greek fiscal crisis. Even so, the depreciation of Central European currencies has been very moderate thus far; moreover, how much of the depreciation has actually been the result of contagion from Greece.

Indeed, both the CNB and the NBP are highly interested in weakening the Czech koruna and the Polish zloty respectively. While the latter did not hesitate to use a direct forex intervention against the strengthening currency and is threatening with another intervention, its Czech counterpart has started to make aggressively dovish statements against the koruna, and almost daily some of the CNB Board Members threaten with an intervention.

Practically, this means the re-occurrence of the scenario witnessed during the previous cycle in the Czech Republic, when the recession was drawing to a close and the global recovery was starting. At that time, which was also at the beginning of a European and consequently domestic upswing, the CNB was also confronted with the strengthening currency and this, given very low inflation, made the CNB Board cut rates, although the trend abroad was rather the opposite. Thus it seems now that history might repeat itself with the advent of the new economic cycle. This could mean that, with the advent of the global recovery and the accelerating domestic (open) economy, we cannot rule out the scenario that official interest rates will be initially cut rather than raised, as they should do according to the textbooks.

Czech Republic

Currency

The Czech koruna weakened last week, as the EUR/CZK currency pair opened the week at CZK 25.195 per EUR on Monday and closed the week above CZK 25.40 per EUR. However, the fluctuation of the koruna was not straightforward. A partial correction was first initiated by the Polish zloty, which, in the wake of strong industrial output, drove the entire region. In addition, the koruna was encouraged by the successful auction of the 5.70%/2024 bond, which also attracted significant demand from abroad. This was combined with lower or higher aversion to risky assets and thus also to the Czech currency.
However, it was the Czech National Bank, that is to say the daily comments from CNB Board Members that delivered the strongest stimuli to the fluctuations in the currency pair. These comments virtually unanimously expressed concern about the strong koruna, about the slowing recovery of the economy and about inflation below the CNB target, and suggested the chance of another rate cut at the CNB Board meeting scheduled for May.
This week is free of new statistics. **The EUR/CZK currency pair will again be influenced by the sentiment towards Central European assets.** Strong Polish fundamentals may also help the koruna offset its previous week's losses. Nevertheless, reactions by CNB Board Members also remain relevant, i.e., whether they will continue to make verbal interventions against the Czech currency. However, given the number of those statements, their effect should be slowly waning. By and large, the koruna should therefore stand a chance of appreciating somewhat.

Fixed income

The **Czech yield curve steepened** last week, falling by almost 2 bps at the short end and rising by more than 7 bps at the long end. The rise in stock markets, including the Czech one, had a negative effect on bonds, while the short end was maintained by central bankers' comments on the possibility of a rate cut.
The main event of the week on the bond market was the auction of the 5.70%/2024 government bond. As expected, the auction was successful. Compared to the original plan by the Ministry of Finance to supply securities for CZK 6bn, the demand was 1.91 times higher. In the end, the Ministry sold bonds for CZK 8.14bn, but kept bonds for CZK 1bn in its book. The average yield was 4.332%. By comparison, the average yield in the previous tranche of mid-February was 5.158%. Also, the Ministry's intention to issue euro bonds to the detriment of koruna bonds proved to fuel the demand for domestic issues.
Next week is free of interesting domestic events. Verbal interventions, even if there are to be no more of them, should keep the short end of the curve around the current levels. However, yields at the long end may continue to rise; for example, the yield of the Czech 10Y bond is still below that of its U.S. counterpart.

EUR/CZK technical picture

(25.3700) Has met potential of Double Top from 25.7700 (see graph) at 25.0550, with rebound from 25.0150 having broken the Downtrendline off Feb high.
1st support area at 25.2220 (break-up daily), with next level at 25.0150 (current year low + weekly Bollinger bottom), where pause favored.
If wrong, next levels at 24.9750 (Sept 2009 low) and 24.9360 (monthly envelope bottom): tough on 1st attempts.
Resistance area at 25.4850/ .4880 (March 30/ 23 highs + see graph).
Failure to cap would see next levels at 25.6010/ .6280 (falling weekly Medium Term Moving Average/ 38.2% 26.6200 to 25.0150), ahead of 25.7600/ .7860 (medium term breakdown daily/ weekly Stop And Reverse), where pause favored.

DAILY CHARTS:

Hungary

Macro review

The second round of the Parliamentary elections brought a 2/3rd majority for the centre-right Fidesz party with 68% of the seats in the new Parliament. This is the first time in Hungary's transition history that a party gains such a high lead and this will allow the new government to change important laws, like the municipality law, which limits the room of the government to improve the efficiency of the health care sector and education, where institutions are owned and operated by local governments.
The ruling Socialists came in second with 15% of the seats, while far-right wing Jobbik came in third at 12%. Newcomer liberal LMP was the last party that will enter the Parliament with 16 seats.
The new government's major challenge will be to carry out a general fiscal overhaul and improve competitiveness via lower taxes, while the most important short-term question is how it may deal with the IMF.
The current IMF/EU program matures in October, so the first question is whether Hungary needs the extension of it or it can try to rely fully on market-based financing. The former could probably include some kind of a compromise between a higher deficit target around 5.5% of GDP instead of the actual 3.8% of GDP level. The new deficit target could be even higher if the government decided to take over some of the 3% of GDP debt that has been accumulated by state-owned enterprises, like the railway company.
Lingering fears about the higher deficit and its implications for domestic bond market supply could cast some cloud over markets for the coming weeks.

Currency

The forint reacted positively to the political developments, similarly to what it did two-weeks ago. The forint's exchange rate appreciated to 262.00, close to this year's high at 261.80. This was 1.5% stronger level than the 266.00 bottom last week.
Risks are stemming from the Greek situation and concerns about Hungary's deficit target revision, while the general backdrop of emerging market currencies seems to be supportive. Overall, we expect neutral trading range between the key levels of 262.00 and 265.00.

EUR/HUF technical picture

(265.00): Currently toying back with the neckline of a Short Term Double Top (265.95) and Triangle pattern near apex (see graph).
Resistance at 267.28/ .77 (falling weekly Medium Term Moving Average/ reaction high hourly), 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/ .40 (April 15 low/ weekly Bollinger bottom), ahead of 260.93 (new reaction low off 317.45), where pause favored.
If wrong, next levels at 259.38/.02 (monthly envelope bottom/ Irregular B off 269.00), ahead of 258.00 (Nov 2008 low): tough on 1st attempts.

DAILY CHARTS:

Fixed income

The bond market had a quiet week as yields stalled at record low levels. Money market rates have continued to price in several more rate cuts down to 4.75% from the current 5.50% level. Today's rate decision delivered the next step of this easing cycle with another 25bps rate cut.

Poland

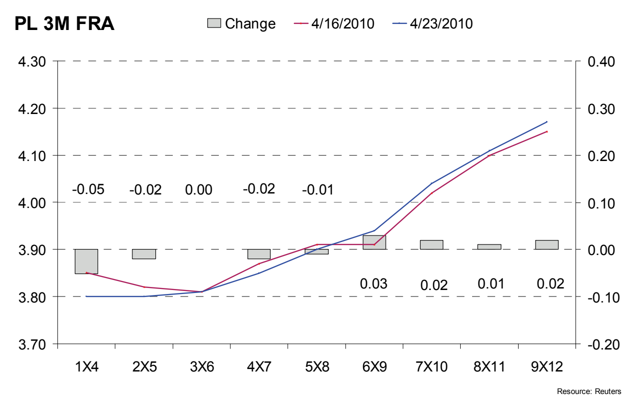
Currency

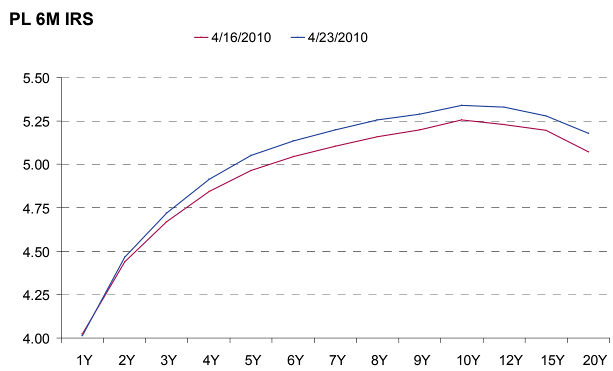
The zloty hovered within fairly narrow bounds around the EUR/PLN 3.89 last week. Although external circumstances were rather unfavourable for riskier assets, the strong domestic fundamentals maintained demand for the Polish currency throughout the week. First, it was the strong rise in industrial output, later followed by the 5Y bond auction for PLN 2bn, which triggered reasonable demand. The end of the week saw the forecasts of GDP, which might have grown by as much as 3% y/y in the first quarter. Even the Deputy Governor of the NBP, who did not rule out another possible intervention against the zloty, tried to prevent the potential appreciation of the Polish currency.
This week is free of any new statistics. Hence the most important event will be Wednesday's NBP meeting. A rate change is not being anticipated, and therefore the accompanying comment, if any, will be of particular interest. The comment should confirm good domestic fundamentals but, possibly, also concerns about the appreciation of the zloty. **Nonetheless, the main stimuli to the fluctuations of the currency pair will come from global markets and from the development of the aversion to riskier assets. Overall, however, we believe that the zloty may strengthen this week**, but the above-mentioned comments from the NBP meeting could be slightly negative for the zloty.

EUR/PLN technical picture

(3.8800): Scored new reaction low off 4.9300, in channel off 4.5750 (see graph).
1st support area 3.8523/ .8470 (April 15 low/ break-up hourly), ahead of 3.8225 (current new reaction low off 4.9300), where pause favored.
If wrong, next levels at 3.7682 (weekly Bollinger bottom), ahead of 3.7449 (monthly envelope bottom): tough on 1st attempts.
1st Resistance comes in at 3.8962 (weekly projection band top), ahead of 3.9120/ .9150 (April 19 high/ March 26 high) and 3.9290 (March 22 high + see graph), where pause favored.
Failure to cap would see next levels at 3.9380 (38.2% 4.1250 to 3.8225), ahead of 3.9422 (23.6% Nov high to 3.8225): tough on 1st attempts.

DAILY CHARTS:





CE Weekly Preview

MON 14:00 **MNB base rate**

	This meeting	Last change
rate level (in %)	**5.25**	3/2010
change in bps	**-25**	-25

WED 14:00 **NBP rate (in %)**

	This meeting	Last change
rate level	**3.50**	6/2009
change in bps	**0**	-25

HU: The MNB cuts its base rate to fresh all-time low

Central bank decided in favour of another 25bps rate cut to 5.25%.

PL: The NBP has its hands tied by the strong zloty

We believe that the NBP will change neither rates nor its fundamental position on the monetary policy. In view of the latest data, the NBP is likely to improve its outlook for the real economy, but the strong zloty (in spite of the intervention) and low core inflation will not enable it to voice aloud any intention of tightening its monetary policy soon.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	**26.4.2010**	**14:00**	**NBH meeting (%)**	**04/2010**	**5.25**		**5.25**		**5.50**	
HU	28.4.2010	09:00	Unemployment rate (%)	03/2010			11.5		11.4	
PL	**28.4.2010**	**14:00**	**NBP meeting (%)**	**04/2010**	**3.50**		**3.50**		**3.50**	
HU	30.4.2010	09:00	PPI (%)	03/2010				-3.5	0.9	-2.8
CZ	30.4.2010	11:00	Money supply M2 (%)	03/2010						2.8

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	*1.39*	1.50	1.60	1.70	1.85
Hungary	BUBOR	*5.42*	5.00	4.80	4.60	4.60
Poland	WIBOR	*3.87*	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.	*3.12*	3.45	3.70	3.85	4.02
Hungary	*6*	6.00	6.00	6.00	6.00
Poland	*5.34*	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	*25.4*	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*264*	270	265	265	260
Poland	EUR/PLN	*3.89*	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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