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KBC Banking & Insurance

Central European Weekly

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Czech Republic

All-eyes on the CNB: Will it deliver following its dovish rhetoric?

Hungary

Government will announce the revised deficit target for this year before the IMF agreement

Poland

Zloty only slightly down on Greek contagion

The Week Ahead

CNB will disappoint the market with keeping its repo rate on hold

Overview

Greek contagion as an instrument of monetary policy

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.56	0.62%	↘	↘
EUR/PLN	3.926	0.95%	↘	↘
EUR/HUF	267.7	1.26%	→	↘
3M PRIBOR	1.38	-0.01	↗	↗
3M WIBOR	3.86	-0.01	→	→
3M BUBOR	5.46	0.04	→	→
10Y CZK	3.96	0.41	↗	↗
10Y PLN	5.58	0.05	→	↗
10Y HUF	6.47	0.14	→	↗
3M EURIBOR	0.63	0.01	→	↗
10Y EMU	2.96	-0.10	→	↗

Last values from Friday 15:30 CET

The debt crisis in the euro area, which had had practically no effect on Central Europe prior to last week, finally hit Central European markets. Even so, the sale on the forex and bond markets could be regarded, for the time being, as the natural profit taking that had to occur sooner or later in any case.

Paradoxically, the central banks in the region will view the depreciation of Central European currencies as a welcome change, which, with virtually no change in short-term interest rates, will ease the overall monetary conditions in the individual countries. This might soften concern about the strong local currencies, expressed by members of central bank boards in both the Czech Republic and Poland, as well as, for example, by representatives of the winning party of Hungary's parliamentary election.

In the end, it is likely to be the exchange rate of the koruna that will determine the outcome of the exciting vote of the CNB Board this Wednesday. Nevertheless, in terms of fundamentals, **we believe that there is no reason to change rates, and this should also be confirmed by a new forecast of the Czech National Bank**. Several recent statements from CNB Board Members have given the impression that the stronger koruna ought to be a reason to cut Czech official interest rates to a new low. Many market participants (in both the money market and the forex market) have also started to bet on this. These expectations should disappear from prices after the CNB Board meeting, and this should lead to higher rates at the short end of the yield curve as well as a stronger koruna again in the weeks to come.

Czech Republic

Currency

The Czech koruna weakened slightly against the euro last week. It depreciated in the first few days of the week in particular, when the market was constrained by concern as to whether or not the Greek problems would spread to other countries, including Central Europe. The go-ahead by the German Chancellor, for granting of the loan, and the Greek austerity package to cut its deficit, reduced the aversion to risk. The koruna jumped on the bandwagon, and offset some of its losses. The EUR/CZK currency pair subsequently closed the week at CZK 25.52 per EUR.

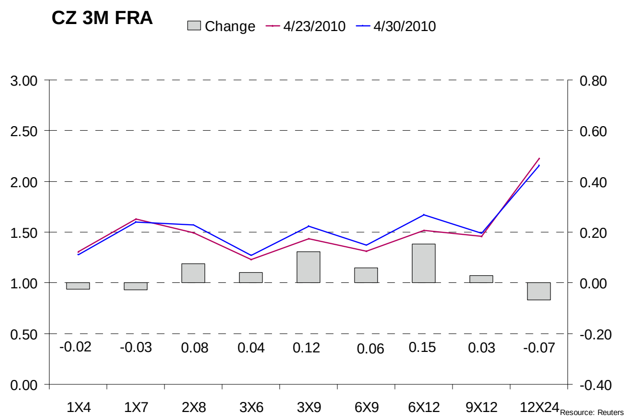
EUR/CZK technical picture

(25.4600) Has met potential of Double Top from 25.7700 at 25.0550, with rebound from 25.0150 sending the pair back towards the neckline (see graph).
1st support area at 25.2220 (break-up daily), with next level at 25.0150 (current year low), where pause favored.
If wrong, next levels at 24.9750/ .9610 (Sept 2009 low/ weekly Bollinger bottom): tough on 1st attempts.
Resistance area at 25.6800 (current recovery high off 25.0150), ahead of 25.7600/ .7700 (breakdown daily/ see above), where pause favored.
Failure to cap would see next levels at 25.8170 (50% 26.6200 to 25.0150 + weekly Bollinger midline) and 25.8800 (weekly projection band top).

DAILY CHARTS:

Fixed income

Czech bonds did not fare well last week. The yield curve went up along the full length, by 7 bps at the short end and more than 11 bps at the long end, and thus steepened. Bonds were primarily affected by the depreciation of the koruna, and this reduced the relevance of the rate cut considerations by certain central bankers, as a reaction to the strong local currency. Another negative stimulus to bonds came from the Minister of Finance, who is considering a postponement of the euro issue until the situation on global markets calms down. This means that the supply of new koruna securities will increase. Also, the Ministry of Finance would like to buy up bonds before their due dates. Hence it is preparing new issues, the proceeds of which will be used for bond repayments from next year. Securities for CZK 210.3bn should mature in the Czech Republic in 2011 and 2012.
The anticipated calming of the situation after the approval of the financial aid to Greece should lead to lower demand for bonds, including Czech ones. In addition, the yield curve should steepen somewhat. However, the main event of the week will be Thursday's CNB meeting. We expect that, given the depreciation of the koruna, the number of advocates of another rate cut among central bankers will decrease, rates will remain unchanged, and the meeting will not influence bond market developments.



Hungary

Macro review

Last week's main macro event was the central bank's rate cut on Monday. The 7-member Monetary Council decided on another 25bps rate cut to 5.25%, in line with expectations. The statement repeated the message that the inflation outlook requires lower interest rates, while financial stability – aka the exchange rate – allows for monetary easing.
The deeply negative output gap has been confirmed by the further increase of the unemployment rate in March to 11.8% from 11.4%. This is however not against the slow recovery process as the number of active people increased, while the level of employment remained stable.
Lastly, producer prices fell 3.5% in March, more than a month-ago as the stronger exchange rate cheapened import.
On the political front, PM designate Mr Orban announced some names for the new cabinet and hinted some information about the timetable. He said that tax cut could take place on July 1 and that the new government may agree with the IMF by the end of August.
This suggests that the government will announce the revised deficit target for this year before the IMF agreement, which may be a risk for markets, especially if tax reductions will also point for a higher deficit. The consensus sees the deficit at 5% of GDP instead of the 3.8% of GDP target, while first quarter data points for a deficit about 5.5% of GDP (our projection) and historical overshoot record from the last 5 election years suggests that it could be closer to the 7-8% of GDP figure that was first leaked by Fidesz several months ago. Later they fine tune it to between 4.5% and 6.5% of GDP, but that still bears the risk of a disappointment for markets.
The new government may have the first meeting at the beginning of June, the earliest and most likely it will take place around mid-June. That could be the next 'big deal' for Hungarian markets, while they could just follow the international sentiment for now.

Currency

The forint spiked to a 3-months low of 272.50 on the back of Greek worries, but the rescue package announcement helped to calm fears and the market settled at 266.50 by the end of the week.
Lower interest rates however may keep the forint more vulnerable to bad news than before and it is now harder to expect good news to help it again as the government's next messages could err on the side of fiscal loosening.
Calming fears about Greece could be the main reason for an improvement in risk appetite towards high-yielders, but that may not be enough to set a new appreciation trend and thus the market may see occasional strength as periods of consolidation, which could form the basis of a new, bear market trend.

EUR/HUF technical picture

(265.90): Downtrendline off 283.60 under threat (see graph).
Resistance at 268.15 (breakdown hourly), ahead of 272.55/ 272.90 (current reaction high off year low/ Feb 19 high), where pause favored.
Failure to cap would see next levels at 274.26 (23.6% 317.45 to 260.93), ahead of 275.46/ 50 (76.4% 279.95 to 260.93/ Feb 05 high): tough on 1st attempts.
Support at 263.90 (break-up daily), with next levels at 262.05/ 261.80 (April 26/ 15 lows), ahead of 260.93 (year low + weekly Bollinger bottom), where pause favored.
If wrong, next levels at 258.00/ 257.95 (Nov 2008 low/ Irregular B off 283.60): tough on 1st attempts.

DAILY CHARTS:

Fixed income

The **bond market suffered with the currency and yields rose about 20bps during the week amid low volume**. Earlier buyers have become very cautious amid the risk aversion, while sellers also refrained from activity as the yield advantage kept risk/reward in a good light due to the lack of risks in sight. Calmness however could also be a source of risk if risks about the budget materialise in about June and there-fore we recommend reducing positions over the coming weeks in May at times of consolidation. June may see the truth about the budget and that is usually not good news for the Hungarian bond market.

Poland

Currency

The Polish zloty went through pretty hectic week. Series of downgrades in Southern Europe (Spain, Portugal, Greece) and escalation of problems in Greece triggered flow to quality from most of European emerging markets. Even resilient central European markets finally suffered with the zloty touching nearly two months lows.

The central bank meeting could have added to the nervousness with markets being prepared for the possibility of interventions in case of further zloty appreciation. Nevertheless the no change verdict and moderately dovish comment still more or less fit into our base scenario of extended interest rate stability and first hike by the end of 2010.

This week the domestic data front is empty. We believe the sentiment on the global equity markets should be crucial once again. Hence the UK elections and US payrolls should be major highlights of the week. Nevertheless even in a case of positive global sentiment, we remain cautious regarding the zlotys short term prospects. The technical picture is not very encouraging and the threat of central bank interventions could prevent the zloty-bulls from the market.

EUR/PLN technical picture

(3.9040): Rebound off 3.8225 sent the pair towards the channel top off 4.5750 (see graph).

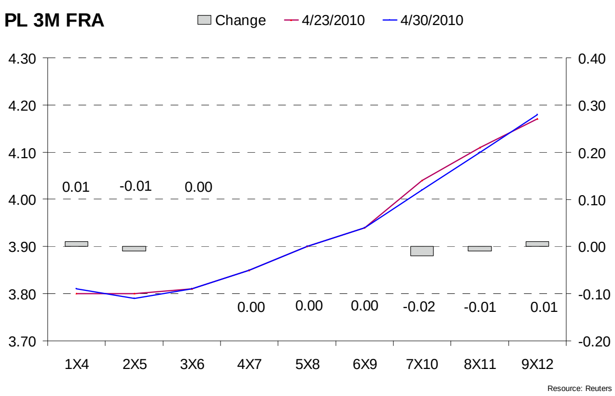
1st support area at 3.8885/ .8850 (break-up daily/ hourly), with next levels at 3.8605/ .8523 (April 21/ .15 lows), ahead of 3.8250/ .8225 (weekly Stop And Reverse/ current new reaction low off 4.9300), where pause favored.

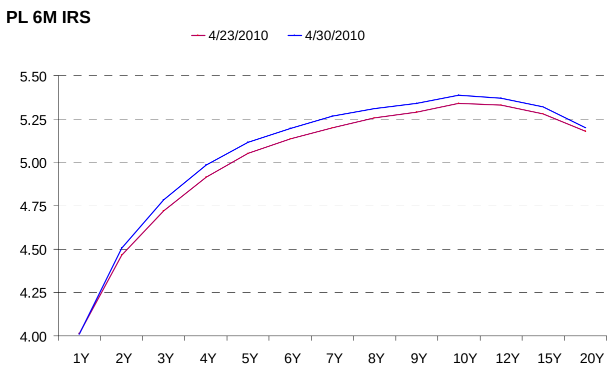
If wrong, next level at 3.7774 (weekly Bollinger bottom): tough on 1st attempts.

1st Resistance comes in at 3.9595 (current reaction high off 3.8225), ahead of 3.9713/ .9735 (break-down daily + weekly Bollinger midline/ 50% 4.1250 to 3.8225), where pause favored.

Failure to cap would see next levels at 4.0070/ .0094 (weekly projection band top/ 61.8% 4.1250 to 3.8225): tough on 1st attempts.

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: The CNB will likely leave rates unchanged

In recent weeks, the Czech National Bank has made comments that suggested a chance of a rate cut, but we do not believe that this will actually come to pass. The CNB Board will have a new forecast available, which might only slightly differ from the previous one, and thus it would probably be difficult to find sufficiently strong arguments for another cut in the CNB's base interest rate. All the more so if we take into account that nobody wished to change rates even after the previous forecast. However, the last meeting already saw two members vote for a rate cut. But even the exchange rate of the koruna no longer favours a rate cut, as the currency is basically at the level predicted for the second quarter of this year. Therefore we believe that rates will remain unchanged this time, although the rate change scenario will probably remain on the agenda. Yet the new inflation figures, which will, however, only be available after the CNB meeting, will indicate the acceleration of year-on-year inflation to more than 1%. As we can see from a poll conducted by Reuters, 16 of 19 analysts on the financial market do not expect the CNB to change its rates this time. We believe that rate stability also appears to be the optimal scenario for the months to come. As the economic recovery will be very moderate and inflationary pressures muted (inflation is primarily stimulated by administrative measures and raw materials), the CNB need not change rates at all for most of this year.

FRI 9:00	CZ Foreign trade (CZK bn)		
	Mar-10	Feb-10	Mar-09
Balance	**18.5**	15.3	21.0
cummulative (YTD)	**48.2**	29.7	34.3
Exports (y/y in %)	**9.0**	11.0	-8.9
Imports (y/y in %)	**11.5**	7.9	-14.9

CZ: Foreign trade to show a surplus

We expect another very decent trade balance surplus in March. However, given the rising prices of raw materials, the figure is unlikely to be as high as last year. Nonetheless, it might still be between CZK 15bn and CZK 20bn. Our opinion is that the rate of imports was higher than that of exports this time, due to costlier raw materials and the comparative baseline (the same period of last year started to reflect the introduction of Germany's bonus for scrapping cars). However, the March data should again confirm that foreign trade will drive the Czech economy this year.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
CZ	3.5.2010	14:00	Budget balance (CZK B)	04/2010					-45.9	
HU	5.5.2010	17:00	Budget balance (HUF B)	04/2010					-609.9	
HU	6.5.2010	09:00	Industrial output (%)	03/2010 *P					-1.7	8.4
CZ	**6.5.2010**	**12:30**	**CNB meeting (%)**	**05/2010**	**1.00**		**1.00**		**1.00**	
CZ	7.5.2010	09:00	Retail sales (%)	03/2010		0.0				-2.1
CZ	**7.5.2010**	**09:00**	**Trade balance (CZK B)**	**03/2010**	**18.5**				**15.3**	
CZ	7.5.2010	09:00	Construction output (%)	03/2010						-23.6
CZ	7.5.2010	09:00	Industrial output (%)	03/2010		7.3				7.0

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	*1.38*	1.50	1.60	1.70	1.85
Hungary	BUBOR	*5.24*	5.00	4.80	4.60	4.60
Poland	WIBOR	*3.86*	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.	*3.07*	3.45	3.70	3.85	4.02
Hungary	*6.14*	6.00	6.00	6.00	6.00
Poland	*5.41*	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	*25.6*	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*268*	270	265	265	260
Poland	EUR/PLN	*3.93*	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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