Monday, May 10, 2010

Central European Weekly

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

Czech Republic

Figures from the Czech economy tend to be positive

Hungary

Budget deficit may be higher than the forecast of GDP

Poland

Zloty can regain the lost ground

The Week Ahead

Modest economic recovery continues in CR

Overview

The CNB cuts rates, in spite of the contagion in the region

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.93	1.46%	↘	↘
EUR/PLN	4.169	6.18%	↘	↘
EUR/HUF	281.0	4.96%	↘	↘
3M PRIBOR	1.24	-0.14	→	→
3M WIBOR	3.87	0.01	→	→
3M BUBOR	5.46	0.22	→	↘
10Y CZK	4.06	0.10	→	↘
10Y PLN	5.82	0.24	→	↘
10Y HUF	7.27	0.80	→	↘
3M EURIBOR	0.78	0.15	→	↗
10Y EMU	2.74	-0.21	→	↗

Last values from Friday 15:30 CET

Last week, the contagion from the south of the eurozone fully hit the Central European region, almost as if the story known from the real estate crisis of 2008-2009 were repeating itself to some extent. At that time, the Central European economies had no direct relationships with the U.S. real estate or financial sector, just as they have none today in the case of Greece or Portugal; however, the belonging (of the Czech and Polish economies, which are sound in fundamental terms) to what are known as the emerging markets was enough to trigger a capital outflow, which caused a depreciation of their respective currencies as well as a decline in bond prices (to say nothing of stock markets).

Remarkably, the Czech National Bank showed a great deal of assertiveness in this delicate situation, when, amidst the fully spreading contagion from Greece, it surprisingly decided to cut rates to new all-time lows. Perhaps this move by the CNB came more as a surprise to analysts than to the markets, which, at least in part, had anticipated such a move. In any case, our opinion is that the CNB had only weak reasons, in fundamental terms, for cutting its repo rate to a new all-time low, because the impact of that move on the real economy will be negligible. The cut may have an effect on the exchange rate of the koruna rather than on market interest rates, which are still encumbered by risk premiums (and with the debt crisis in the eurozone they will hardly go down). However, a weaker koruna will scarcely give a lift to exports. What is more, should the situation in Greece escalate, the extremely low rates could make the koruna weaken far beyond the current imagination of the CNB Board, and this could push short-term interest rates upwards in the end, thus completely negating the effect of the repo rate cut.

Czech Republic

Macro review

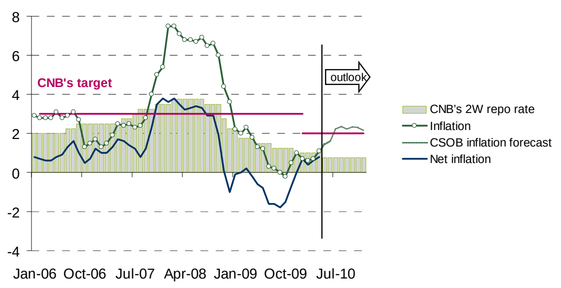
A few positive figures from the Czech economy were released on the last business day of last week. These primarily included the high foreign trade surplus, rising exports, and favourable data from domestic industry. Foreign trade for March was very decent. While the surplus is not as high as last year's, March 2009 was too exceptional (CZK 21bn). The continuing rise in exports, notably of machinery and means of transport, is a particularly positive fact. The European recovery – though still very fragile – is also proving to make itself felt in the Czech economy. However, we should bear in mind that the current rates of the increases stem from the very low baselines of the previous year. The rise in imports has also sped up recently. After a year, imports are rising faster than exports. Higher oil prices are already starting to have negative impacts, as they are increasing the value of imports to the CR in accounting terms, and will continue to impact on this year's trade balance in the months to come. Even so, this year's overall trade surplus might be around CZK 150bn.

Industrial output was up by 0.7% m/m, while the year-on-year rise exceeded the ten percent mark (10.2%). However, just as with other indicators, the current rates of the increases are based on very low statistical baselines. In addition, the March figure was influenced by there being one more business day in the month. Although there is no cause to be clearly optimistic until such time as private consumption in Europe again starts to improve to a greater extent, we can be slightly optimistic for the forthcoming months. New contracts (+15.8%) are evidence of this. Especially metal producers and carmakers are seeing their order books fill up. Thus industry has resumed rising, with the rise likely to reach approximately 4% this year.

Retail sales also returned to the black for the first time in a long while, when the year-on-year rise in retail sales (unadjusted) hit 3.9%. The automotive segment saw a reasonable rise in sales. Nevertheless, April's automotive sales statistics (passenger cars and LUV's) indicate that this still does not represent a new trend. In addition, we do not overestimate the rise in sales of the entire retail sector either, because unemployment remains high and wages are likely to fall in real terms. By and large, we therefore expect that the retail sector will again show a moderate sales decline in real terms this year.

April's rise in consumer prices springs no surprises. The month-on-month price rise of 0.3% was primarily due to costlier fuels, which reflect the depreciation of the koruna against the dollar, and increased oil prices on global markets. In line with expectations, inflation was affected by the increase in natural gas prices for households. The increased prices of seasonal goods and food came as no surprise either. Year-on-year inflation, for which the central bank sets its targets, has exceeded 1% (1.1%) and will continue to rise in the months to come. While inflation may be close to 2% as early as in the summer, this is not a problem for the economy. Demand-pull inflationary pressures remain subdued, and thus Czech inflation is primarily 'driven' by energy prices, deregulation and excise duties. There is still no leeway for the prices of market goods to rise. Until consumer demand recovers enough, there will not be any room for retailers to raise their prices either. Hence the Czech National Bank may leave its rates unchanged in the coming months.

Inflation and CNB's Target
(%)



Currency

The koruna weakened last week. The EUR/CZK currency pair opened the week at the strong level of CZK 25.50 per EUR and the Czech currency continued to strengthen during the day. However, the fear of the Greek-related developments and of the possible problems of other countries increased the aversion to riskier assets on the following days, thus pushing the currency pair to CZK 26.30 per EUR. At the end of the week, the approval of the austerity scheme by the Greek Parliament and the release of the German aid overshadowed the CNB's surprising rate cut and improved the demand for riskier assets, and this also strengthened the Czech currency. The EUR/CZK currency pair subsequently closed the week at .25.65.
The eurozone mega-rescue-package may play in favour of the Czech koruna. Nevertheless we do not expect it to come back to the 25.00 EUR/CZK after a sharp rally at the end of the last week.

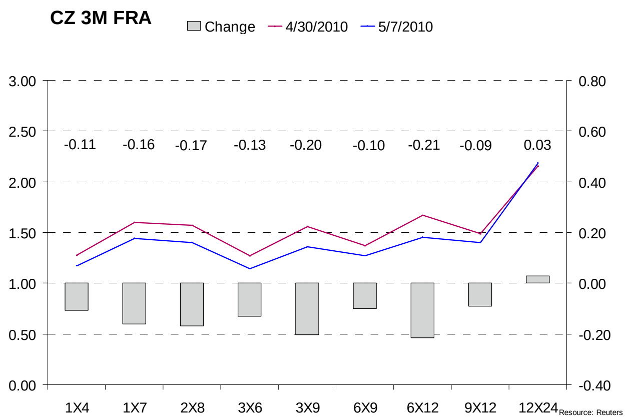
EUR/CZK technical picture

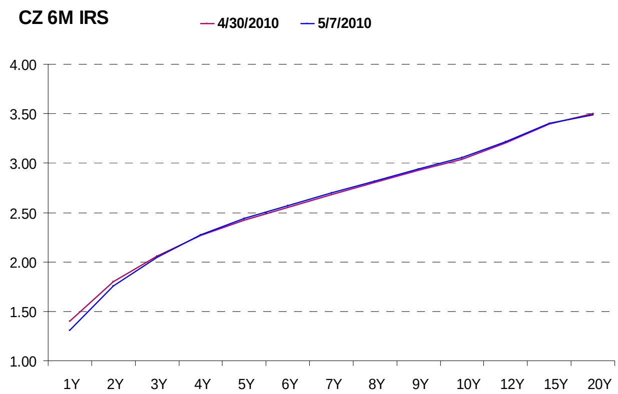
(26.0100) Rebound from 25.0150 trying to regain the broken Uptrendline off low (see graph).
1st support area at 25.7150 (break-up hourly), with next levels at 25.6000 (break-up daily + rising weekly Short Term Moving Average), ahead of 25.4100 (April 30 low), where pause favored.
If wrong, next levels at 25.2220 (break-up daily), ahead of 25.0150 (current year low + weekly Bollinger bottom): tough on 1st attempts.
Resistance area at 26.3000 (current recovery high off 25.0150?), where pause favored.
Failure to cap would see next levels at 26.3330 (Feb 08 high), ahead of 26.3830 (weekly Starc top) and 26.4850 (Jan highs).

DAILY CHARTS:

Fixed income

Czech bond prices went up last week. Their yield curve declined along the full length and steepened slightly, having fallen by 22.5 bps at the short end and 20 bps at the long end; however, trading was volatile. Although the trend of rising bond prices prevailed, every rise was usually followed by a moderate correction. The finally improved demand for domestic bonds was primarily encouraged by the CNB, which surprisingly cut rates. The decline in yields was also fuelled by losses on stock markets, while the announcement by the Ministry of Finance that, due to the uncertainty on global markets, it would issue a larger volume of koruna bonds to the detriment of euro bonds in 2010, had virtually no effect.
This week, the domestic bond market should be influenced by major statistical figures, such as inflation and the first GDP forecast for the first quarter of this year. According to forecasts, low inflation should maintain demand for bonds, while GDP growth should rather offset some of the gains.
However, the main event of the week will be the auction of the 3.40%/2015 government bond in the anticipated volume of CZK 5bn. Although the Ministry of Finance is considering an increase in the volume of koruna bonds, we expect that demand will not be very high this time and that the Ministry will have to tolerate a higher yield to subscribe the entire volume.

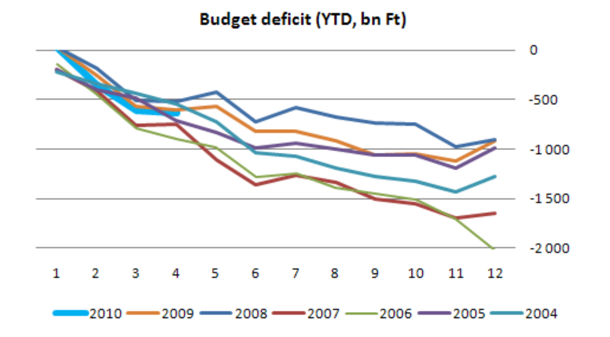




Hungary

Macro review

Last week was dominated by the news about Greece and its possible contagion effect on the EU. On the domestic front, the April budget deficit came in tad better as probably ministries spent less than a year-ago. The year-to-date deficit reached close to 70% of the full-year target, which is high, but not much higher than what we have seen in recent years. This could mean that the budget deficit may be higher than the 3.8% of GDP forecast, but probably will remain close to our 5.5% of GDP deficit forecast.
New economic minister Mr Matolcsy said that the government may try to take over the fx risk from households. This is a completely new story and the source for such a transaction is yet unknown. Foreign reserves amount to roughly twice the foreign currency debt of households, but lower reserves could also make things less stable, so hard to see any win-win situation.



Industrial output disappointed in April with 2.8% Y/Y growth after having posted a rate of 8.4% Y/Y in March. This April blip could undermine the recovery process, but it could also just be a temporary slowdown after strong growth earlier.
Most surprisingly, foreign trade balance posted a large, €636m surplus in March. This means that the stronger currency has not yet affected the foreign trade balance negatively. This could support the current recovery process and may keep a positive light on the forint.

Currency

The forint spiked to a 1-year low of 284.00 on Friday as the Greek crisis widened into a global one. Steps from the EU brought a sharp rally to the market and the forint appreciated almost 4% to the 274.00 level in the morning on Monday. The exchange rate was around 262.00-264.00 before the crisis, so there could be a long-way recovery route ahead.

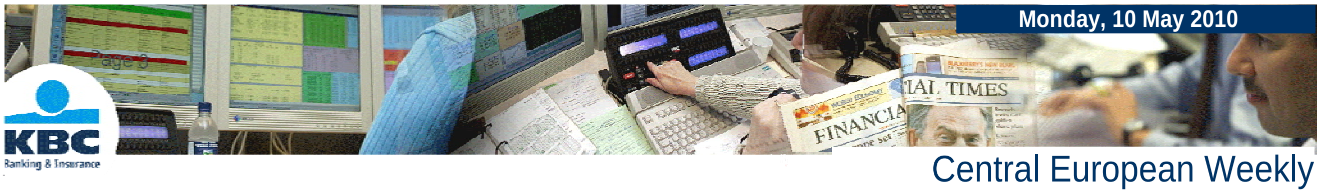
EUR/HUF technical picture

(282.55): Rebound from year low testing 283.60 (see graph).
Resistance at 285.20 (current reaction high off year low), where pause favored.
Failure to cap would see next levels at 289.19 (50% 317.45 to 260.93), ahead of 290.07 (2nd target of daily Double Bottom off 275.50): tough on 1st attempts.
Support at 279.70 (break-up daily), with next levels at 274.45 (break-up hourly) and 272.55/ 272.40 (previous reaction high/ break-up hourly), where pause favored.
If wrong, next levels at 270.10 (rising weekly Long Term Moving Average), ahead of 269.08 (weekly Bollinger midline): tough on 1st attempts.

DAILY CHARTS:

Fixed income

The bond market saw sharply higher yields last week and the long-end reached the key 7.50% level again. We may see sharp recovery here, as well and yields could get back closer to the pre-crisis levels around 6.50% at the long-end and 5% at the shorter-end.



Poland

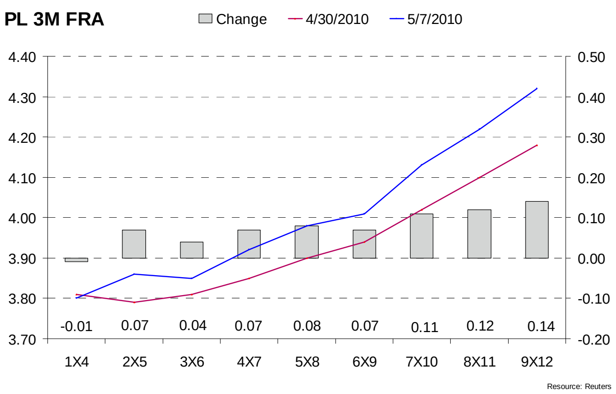
Currency

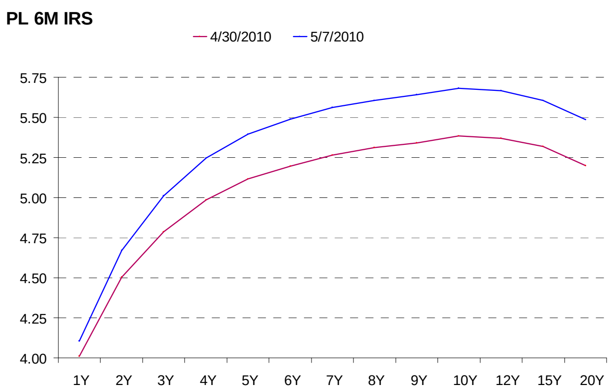
Polish zloty came under heavy selling pressure. The Greek melodrama continued to weigh on the markets. Meanwhile Polish PM comments on euro not being priority for now were not really supportive. Foreign investors are probably afraid that without euro perspective the motivation for reduction of huge structural deficit will diminish. Poland does not face acute financing problems due to lower debt levels and privatisation revenues. Nevertheless the situation can change without reforms as the structural deficit may even grow in a run up to the general elections (2011) and European football championship (2012).
Nevertheless for the week to come the zloty may regain lost positions as emerging markets should appreciate the euro-zone mega-bailout package. The zloty may test 4.00 EUR/PLN and should more or less ignore further decline in headline inflation due to favourable base effects.

EUR/PLN technical picture

(4.1800): Rebound off 3.8225 sent the pair above the channel top off 4.9300 and retested the neck-line of the long term Double Top (4.2250: see graph).
1st support area at 4.0240/ .0150 (break-up daily/ rising weekly Short Term Moving Average), with next levels at 3.9860/ .9800 (weekly Bollinger mid-line/ break-up hourly) and 3.9400 (rising weekly Medium Term Moving Average), where pause favored.
If wrong, next levels at 3.8885/ .8850 (break-up daily/ hourly): tough on 1st attempts.
1st Resistance comes in at 4.2400/ .2455 (current reaction high off 3.8225/ 38.2% 4.9300 to 3.8225), where pause favored.
Failure to cap would see risk towards 4.3300 (Nov high): tough on 1st attempts.

DAILY CHARTS:





CE Weekly Preview

FRI 9:00 **CZ GDP (change in %)**

	Q1-10	Q4-09	Q1-09
GDP (y/y)	**1.4**	-3.1	-4.0
GDP (q/q)	**0.4**	0.7	-4.1

CZ: The modest economic recovery continues

We believe that the economy will show year-on-year growth of around 1.4%. On the demand side, positive growth will be primarily driven by exports, while consumption and investment probably fell at the beginning of this year. On the supply side, industry again drove the economy after a one-year break, while construction, and probably also agriculture, slipped into the red. By and large, we can say that the worst is over for the economy. Even so, economic growth will continue to be moderate, and it will take at least two years to surmount its decline of last year. Nonetheless, given the unpredictable development of foreign demand, the Czech economy will also be vulnerable in the future.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	10.5.2010	09:00	Trade balance (EUR M)	03/2010 *P	300.0		450.0		373.3	
CZ	**10.5.2010**	**09:00**	**CPI (%)**	**04/2010**	**0.3**	**1.1**	**0.3**	**1.1**	**0.3**	**0.7**
CZ	10.5.2010	09:00	Unemployment rate (%)	04/2010	9.5		9.4		9.7	
HU	**11.5.2010**	**09:00**	**CPI (%)**	**04/2010**	**0.3**	**5.7**	**0.5**	**5.6**	**0.7**	**5.9**
HU	**12.5.2010**	**09:00**	**GDP (%)**	**1Q/2010 *P**		**-1.0**		**-2.2**		**-4.0**
CZ	**12.5.2010**	**09:00**	**GDP (%)**	**1Q/2010 *P**		**1.4**	**0.3**	**1.2**	**0.7**	**-3.1**
CZ	**12.5.2010**	**12:00**	**CZ bond auction 3.40%/2015 (CZK B)**	**05/2010**			**5**			
HU	14.5.2010	09:00	Industrial output (%)	03/2010 *F					-0.4	2.8
PL	**14.5.2010**	**14:00**	**CPI (%)**	**04/2010**			**0.4**	**2.3**	**0.3**	**2.6**
PL	14.5.2010	14:00	Money supply M3 (%)	04/2010			1.3		0.9	

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

		Current	Sep-10	Dec-10	Mar-11	Jun-11	Last change	
Czech Rep.	2W repo rate	*0.75*	0.75	0.75	1.00	1.25	-25 bps	5/6/2010
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	*1.24*	1.15	1.22	1.35	1.60
Hungary	BUBOR	*5.26*	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.	*3.1*	3.45	3.65	3.80	3.95
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	*25.9*	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*281*	270	265	265	260
Poland	EUR/PLN	*4.17*	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	-0.7
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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