Monday, May 17, 2010

KBC Banking & Insurance

Central European Weekly

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Czech Republic

Czech economy continues to grow

Hungary

Trade surplus hits new record and supports rebound in growth

Poland

Polish industry to profit from German recovery

The week ahead

Polish figures should confirm ongoing recovery despite certain headwinds caused by severe winter

Overview

	Last	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.45	→	↘
EUR/PLN	4.004	→	↘
EUR/HUF	276.9	→	↘
3M PRIBOR	1.25	→	→
3M WIBOR	3.85	→	→
3M BUBOR	5.46	→	↘
10Y CZK	4.00	→	↗
10Y PLN	5.60	→	↗
10Y HUF	6.80	→	→
3M EURIBOR	0.67	→	→
10Y EMU	2.85	→	↗

Last values from Friday 15:30 CET

Growth has returned to Central Europe

The preliminary **GDP growth** data for the first quarter of the year confirmed general expectations that the CE region is on its way out of the recession. We don't know the data from the region's largest economy yet, but we can be reasonably sure that most economies in the region are already showing positive year-on-year growth. This hasn't been the case anymore since the third quarter of 2008 – i.e., closely before these export-oriented economies were hit by an unprecedented drop in industrial orders, after the fall of Lehman Brothers. The figures for Poland are not published yet, but there are enough good reasons to believe that Poland's growth (the statistical data on the GDP will not be released until late May) was well in the black. The Hungarian economy delivered also a pleasant surprise, as it grew unexpectedly (Q/Q).

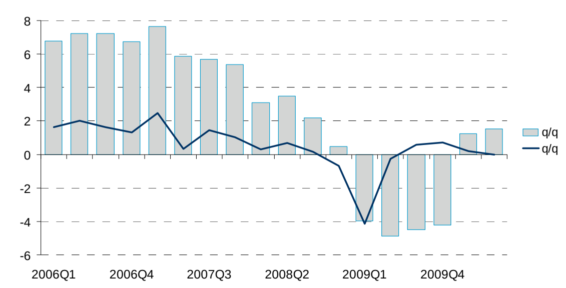
A key question is now to what extent this promising start of the recovery may be affected by the current debt crisis in the eurozone, which is not only leading to a necessary fiscal tightening in the south-eastern part of the euro area, but also to a tightening of financial conditions through another rise in credit risk spreads. We believe that Central European economies may not necessarily be hit by this crisis to any great extent, because they are structurally linked to the German export industry. A significant share in output is also generated by plants that are based on foreign direct investment by Japanese and South Korean firms. The performance of this segment of industry may not be at risk, provided that the global economy (driven by large Asian countries) will continue to fare well. So will the export-oriented German economy. Should the opposite happen, the debt crisis in the eurozone may only serve to be a catalyst for a switch to a double-dip scenario, which would trouble not only Germany but also the whole Central Europe.

Czech Republic

Macro review

According to the first forecast by the Czech Statistical Office, the Czech GDP grew by 1.2% y/y and 0.2% q/q in the first quarter of this year. Both figures are 0.2 percentage points lower than the financial market anticipated but the market was much less optimistic than the Czech National Bank, which predicted GDP growth of 1.8%. However, this is only the first forecast, which is based on incomplete data and subject to further updates by statisticians. As the Statistical Office itself stated, the current GDP forecast is based on a very limited set of data from administrative sources. Hence we believe that the subsequent update to the data may involve a decent surprise upwards. Therefore the comparison of the first-quarter performance of the economy to that of other countries should be taken with a grain of salt. As the figures from industry and foreign trade signalled previously, the economy has resumed growing. The influence of the manufacturing industry is primarily evident, as it grew by more than 8% in the first quarter. Carmakers fared particularly well, but we can also consider the growth in metal production, which was hit by a significant fall last year, to be positive. On the other hand, construction, which was affected by muted building activity due to the preceding economic recession, has stopped performing well. More detailed GDP data will not be available until June. Nevertheless, we expect economic growth to be primarily based on exports by industrial enterprises, while consumption and investment remained subdued. The same is likely to hold true in the quarters to come. Economic growth will probably remain weak, vulnerable, and primarily dependent on foreign demand. For this year as a whole, the Czech economy might grow by approximately 1.5%.

GDP Growth
(%)



Currency

The koruna fared rather well last week. It opened the week at the EUR/CZK 25.595 and, with moderate deviations; it slowly strengthened, virtually ignoring the price moves in the EUR/USD currency pair. Other Central European currencies fluctuated in much the same manner. The Q1 GDP also helped the Czech to currency appreciate, as year-on-year growth proved to be in the black for the first time since the fall of Lehman Brothers. In addition, the koruna was also encouraged by the European Commission's positive assessment of Estonia, implying its early accession to the EMU. The end of the week saw the EUR/CZK currency pair at the EUR/CZK 25.555.
This week the nervousness on the global markets may put some pressure on the Czech koruna. Furthermore there are no important domestic data that could help to offset negative global trends.

EUR/CZK technical picture

(25.5200) Rebound from 25.0150 failed to regain the broken Uptrendline off low (see graph).
1st support area at 25.3000 (May 12 low), with next level at 25.2220 (break-up hourly), where pause favored.
If wrong, next levels at 25.0250/ .0150 (weekly Bollinger bottom/ current year low), ahead of 24.9750 (Sept 2009 low): tough on 1st attempts.
Resistance area at 25.6750 (reaction high hourly), ahead of 25.8660 (weekly envelope top) and 25.9250 (breakdown daily), where pause favored.
Failure to cap would see next levels at 26.0800 (breakdown hourly), ahead of 26.3000/ .3330 (current recovery high off 25.0150/ 26.3330 (Feb 08 high).

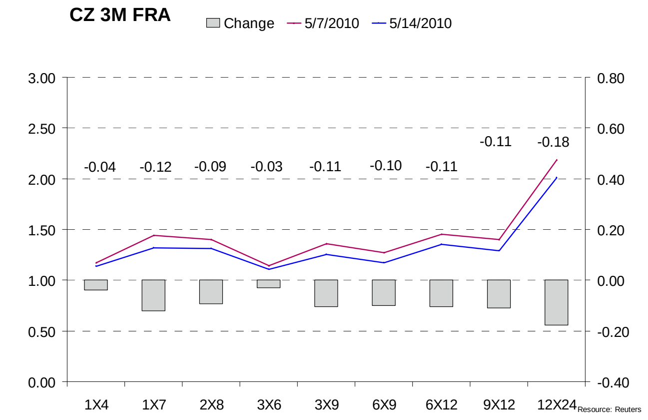
DAILY CHARTS:

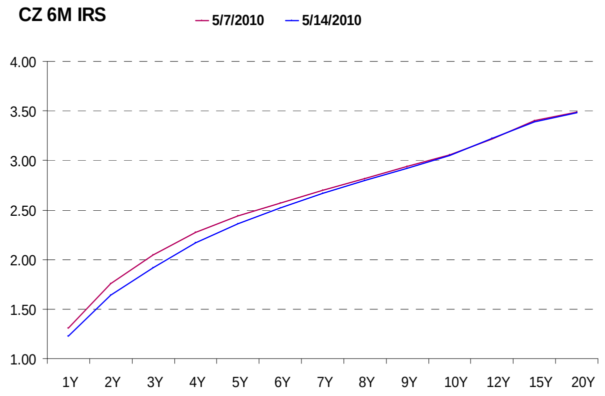
Fixed income

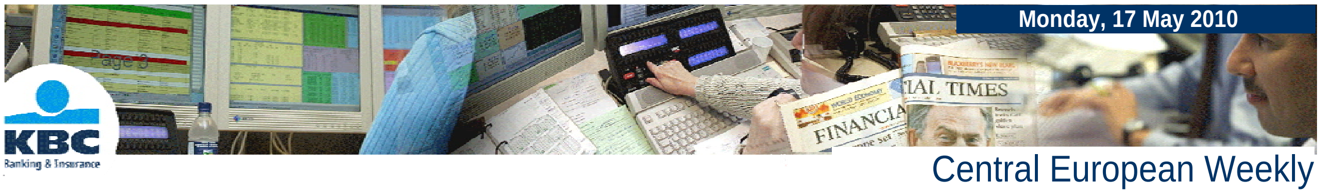
Czech bond prices went up last week. The yield curve fell along the full length, by more than 6 bps at the short end and over 5 bps at the long end, and steepened slightly. In this way, the domestic bond market probably continued to absorb the surprising rate cut made at the latest Czech National Bank's meeting. On the other hand, bonds were encouraged by only slightly rising inflation and probably also by the appreciation of the koruna. GDP growth, which was, however, lower than expected, had virtually no effect on bond prices.

The main event on the market was the 3.40%/2015 bond auction, which attracted average demand. While it exceeded the supply of CZK 5bn by only 1.29 times, the Ministry of Finance could sell bonds for a total of CZK 6.593bn, but kept CZK 0.5bn of that volume in its book. The average yield of the auction was 2.936%. By comparison, at the previous auction, held in the middle of March, the average yield was 3.283%, with demand exceeding supply by 1.36 times.

This week should be calm on the domestic bond market. The producer price index, which will be the only major statistical figure, is likely to indicate that no inflationary pressures are currently imminent. However, the low yields are unlikely to provide much latitude for their further decline.



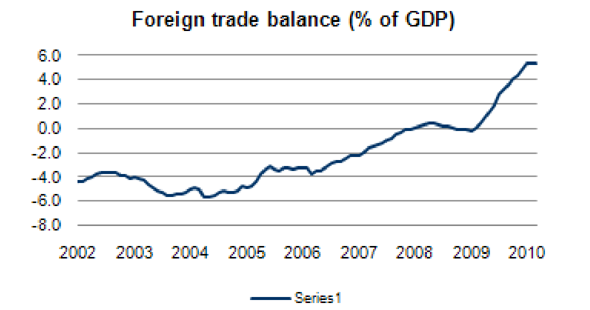




Hungary

Macro review

Last week was full of important data releases. Trade balance and growth surprised positively, while inflation ticked a tad above expectations. The overall picture has remained broadly the same: a gradual recovery, which could be a bit faster in 2010, a large trade balance surplus and slowly declining inflation.
First, the March foreign trade balance posted a bigger-than-expected surplus of €653m, 34% more than in the same month a year-ago. The 12-month cumulated sum-to-GDP ratio rose to 5.5%, a new record high since 1990. The forint was relatively strong in March at around 264.00, thus it seems that strong forint levels earlier in the year had no bad impact on the export lead recovery.



Secondly, inflation lowered to 5.7% Y/Y in April from 5.9% as last year's base effect of higher fuel prices did not repeat this year and other inflation categories remained muted. The Central bank's February report expected first quarter's average inflation at 5.8% Y/Y, almost exactly matched, but a bigger challenge will be to meet the second quarter's estimate of 4.8%.

Thirdly, preliminary growth data revealed 0.9% Q/Q growth rate and -2.0% Y/Y rate in the first quarter, significantly better than consensus estimate or the central bank's -3.4% Y/Y prediction. Growth thus seems to be positive for this year in Hungary and it may be between 0.5%-1.0% for the full-year depending mainly on the export sector in the remainder of the year.

Currency

The forint had a quick recovery at the beginning of the week and the currency appreciated back to the EUR/HUF 273.00 level from 280.00. However, this did not last long as fears about Greece and the eurozone returned on Friday and the exchange rate dropped back to the 279.00 level at the end of the week. Overall, the market still seems to be stabilising within a narrowing range around the 275.00 level after the contagion of the Greek crisis. Persistence of risk aversion could be a risk for the market, but if stabilisation continues we may see a slow and gradual recovery of the forint.

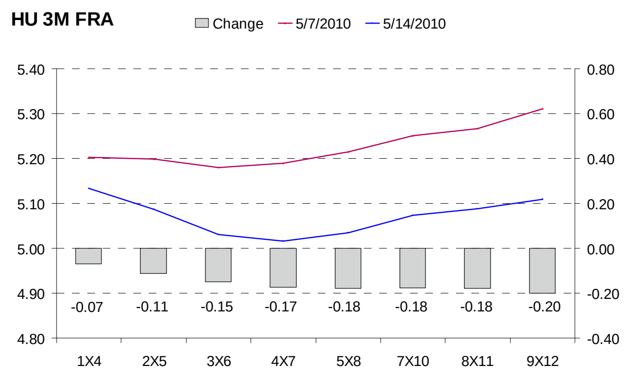
EUR/HUF technical picture

(277.00): Rebound from year low tested 283.60 (see graph).
Resistance at 279.32 (weekly Bollinger top), where pause favored.
Failure to cap would see next levels at 282.00/ 282.56 (reaction high hourly/ weekly Starc top): tough on 1st attempts.
Support at 274.65/ 273.72 (weekly envelope bottom/ rising weekly Short Term Moving Average), with next levels at 271.15/ 270.57 (May 12 low/ weekly Bollinger midline), where pause favored.
If wrong, next level at 270.20 (rising weekly Long Term Moving Average + 61.8% 260.93 to 285.20), ahead of 268.91 (rising weekly Medium Term Moving Average: tough on 1st attempts.

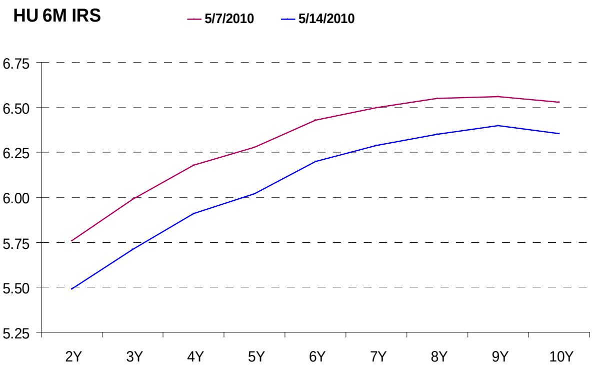
DAILY CHARTS:

Fixed income

The bond market copied the trading pattern of the currency. After a sharp rally early in the week, the market took another dive and prices plunged. Yields rose back to the key 7.00% level at the long-end and the short-end started to question the feasibility of a rate cut this month. Vice Governor Ms Julia Kiraly said that another rate cut is possible, which would see the base rate down 25bps to 5.00%. However, given that the FRA market is flat at 5.10%, there could be some unwanted risk attached to this scenario as the curve would lose its inversion.



Resource: Reuters



Poland

Currency

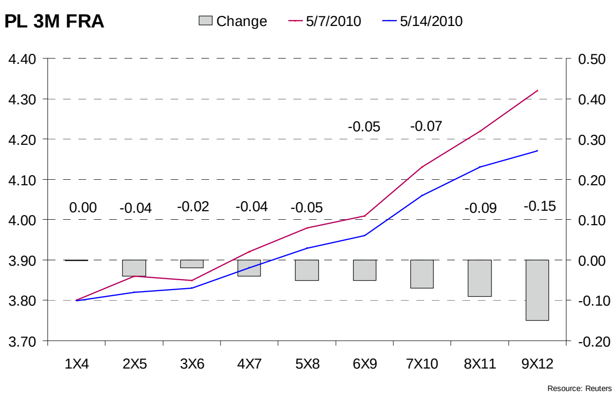
The **Polish zloty** initially appreciated the IMF/eurozone rescue mega-package and the pair got as low as 3.94 EUR/PLN. Nevertheless the bears reappeared on the global markets by the end of the week. Hence the Polish zloty weakened above the psychological level of 4.00 EUR/PLN due to ongoing nervousness on the future shape of the euro zone and the sell off on the global equity markets on Friday. Nevertheless, the zloty managed to hold on to a part of the gains recorded earlier last week. Furthermore it more or less ignored dovish comments from rate setter Andrzej Kaz-mierczak, who said the zloty must not be allowed to strengthen below 3.6 EUR/PLN.

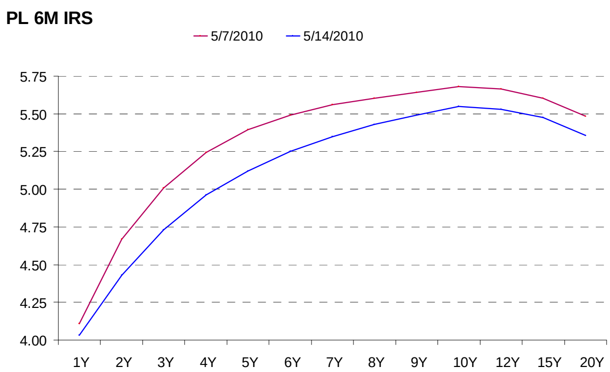
This week is full of important domestic data including labor market and industrial production figures. We expect a less favorable employment picture as the strong winter could have continued to weigh on the figures even during April. On the other hand, this should be more than offset by a good performance of industry, led by exports to Germany. Overall we expect solid figures to confirm an ongoing recovery and sound domestic fundamentals. Nevertheless if the current bearish sentiment on global markets would prevail, the zloty should not get much chance to appreciate on sound domes-tic fundamentals. From a technical point of view the pair may try to test 200-day moving average – currently at 4.066 EUR/PLN.

EUR/PLN technical picture

(4.0200): 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 3.9900/ .9827 (rising weekly Short Term Moving Average/ weekly envelope bot-tom), with next levels at 3.9710 (weekly Bollinger midline) and 3.9400/ .9288 (May 13 low/ 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 4.0546/ .0675 (falling weekly Long Term Moving Average/ reaction high hourly), where pause favored.
If wrong, next levels at 4.1155/ .1164 (weekly en-velope top/ falling 50 Week moving Average): tough on 1st attempts.

DAILY CHARTS:





Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
CZ	17.5.2010	09:00	PPI (%)	04/2010	0.2	-0.2	0.2	-0.2	0.1	-0.8
CZ	17.5.2010	10:00	Current account (CZK B)	03/2010	5.0		10.4		10.3	
PL	17.5.2010	14:00	Trade balance (EUR M)	03/2010			-550		-248	
PL	17.5.2010	14:00	Current account (EUR M)	03/2010			-578		106	
PL	17.5.2010	15:00	Budget balance (PLN M)	04/2010					-5 870.9	
HU	18.5.2010	09:00	Wages (%, ytd.)	03/2010		1.0				0.9
PL	19.5.2010	14:00	Wages (%)	04/2010			-2.5	4.1	6.2	4.8
PL	20.5.2010	14:00	Core CPI (%)	04/2010			0.2	1.7	0.2	2.0
PL	**20.5.2010**	**14:00**	**Industrial output (%)**	**04/2010**			**-8.0**	**10.9**	**18.9**	**12.3**
PL	20.5.2010	14:00	PPI (%)	04/2010			0.2	-1.2	0.0	-2.4

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	*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	*1.25*	1.15	1.22	1.35	1.60
Hungary	BUBOR	*5.23*	5.00	4.80	4.60	4.60
Poland	WIBOR	*3.85*	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.	*3.08*	3.45	3.65	3.80	3.95
Hungary	*6.495*	6.00	6.00	6.00	6.00
Poland	*5.52*	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	*25.5*	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*277*	270	265	265	260
Poland	EUR/PLN	*4.01*	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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