KBC Banking & Insurance

Central European Weekly

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Czech Republic

Economy grew by 1.1% y/y in the first quarter, primarily driven by foreign trade.

Hungary

The forint recovered strongly after the government sticks to the budget deficit target

Poland

Marek Belka appointed as NBP governor

The week ahead

Set of key Polish macro figures in the spotlight

Overview

Hungarian government quickly reversed bearish talk

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.71	-0.75%	→	↘
EUR/PLN	4.094	-1.61%	→	↘
EUR/HUF	280.5	-1.86%	→	↘
3M PRIBOR	1.23	-0.02	→	→
3M WIBOR	3.87	0.01	→	→
3M BUBOR	5.25	0.02	→	↘
10Y CZK	4.24	-0.06	→	↘
10Y PLN	5.80	-0.02	→	↘
10Y HUF	7.30	-0.36	→	↘
3M EURIBOR	0.71	0.02	→	→
10Y EMU	2.59	0.00	→	↗

Last values from Friday 15:30 CET

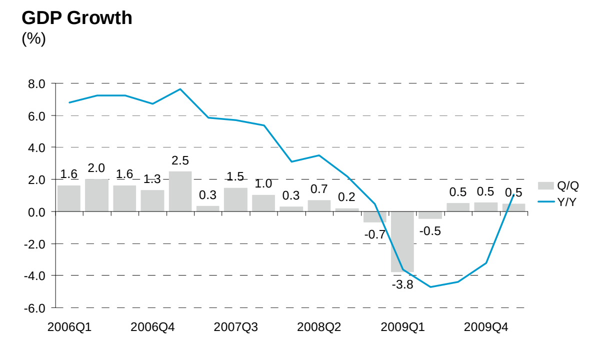
The contagion from Hungary seems to be disappearing as fast as it appeared. This is due not only to the improved global sentiment but also to Prime Minister Orbán's new government, which quickly figured out how to communicate with markets properly, and presented quite a reasonable plan, which might help the economy out of the crisis. The most important fact in terms of financial markets' confidence is probably that the government has endorsed the existing fiscal objectives, which envisage that the government will return public finances to a sustainable trend.
As far as structural reforms are concerned – there is a mix of positive and negative proposals, including, on the one hand, growth-encouraging suggestions such as an income tax reduction, and on the other hand the somewhat controversial idea of a ban, which would remain in force until 2020, on the eviction of those who have run into problems repaying their mortgage loans.

Another, maybe less spectacular event in the region, which, however, may have a more lasting impact on the financial market, is the appointment of a new chief of the National Bank of Poland. The appointment of Marek Belka, a respected economist from the IMF, ex-Minister of Finance and ex-Prime Minister, is clearly very good news for markets. From the outset, he joined the dovish members of the Monetary Policy Council – he believes that inflation is not a great problem, while risks for growth are much more serious. He has also clearly supported the central bank's current efforts to curb the excessive volatility of the Polish zloty by interventions, and he will definitely not push for a quick adoption of the euro. The new central bank chief says that the eurozone needs to put its own house in order first.

Czech Republic

Macro review

The **Czech economy** grew by 1.1% y/y in the first quarter of the year, primarily driven by foreign trade and inventories. While the GDP grew by 0.5% q/q, which is a fairly good figure, year-on-year growth was reduced to 1.1% after the previous data had been reviewed. The decline in investment and household consumption is no surprise. Consumption has only increased in the government sector. Household consumption has fallen because of the uncertain prospects of their financial position, affected by relatively high unemployment and restrained wage growth. Businesses are not investing, given the amount of unused capacity. The performance of the economy continues to be completely at the mercy of foreign demand, as domestic demand does not hold any great hopes. It is only likely to continue to fall. Hence the outlook for the next quarter remains unchanged. For this year as a whole, the economy might grow by 1.5%. There is a risk for the pace of growth slow in the second half of the year, due to a possible slowdown in foreign demand.



Currency

The **Czech koruna** strengthened slightly last week. It opened the week at EUR/CZK 25.90. It was affected by the unfortunate statements from the Hungarian government, on the Hungarian finances being threatened with the Greek scenario. The fairly favourable domestic statistics (GDP, CPI) were not able to counterbalance the negative headlines from Hungary. This even increased the aversion to risky assets, including Central Europe as a whole. Therefore the EUR/CZK currency pair bounced above the 26.00 mark for the first time in a long while. The disclaimer by Hungary's new Prime Minister and the general decrease in the aversion to risk also strengthened the koruna slightly from the middle of the week and the Czech currency closed the week at EUR/CZK 25.670.
This week could be more favourable for the Czech currency. Bears on the global markets are apparently a bit tired and we could see more significant progress in talks on a right-wing coalition.

EUR/CZK technical picture

(25.7300) Rebound from year low failed to regain the broken Uptrendline off low (see graph).
1st support area at 25.5280 (rising weekly Medium Term Moving Average), with next levels at 25.4200 (May 31 low), ahead of 25.3000 (May 12 low) and 25.2220 (April break-up daily), where pause favored.
If wrong, next levels at 25.0650 (weekly Bollinger bottom), ahead of 25.0150 (year low) and 24.9750 (Sept 2009 low): tough on 1st attempts.
Resistance area at 26.0800/ .0940 (June 07 high + medium term breakdown hourly/ 5th wave off 25.3000 on hourly charts), where pause favored.
Failure to cap would see next levels at 26.2000/ .3000 (weekly Bollinger top/ current recovery high off 25.0150) and 26.3330 (Feb 08 high): tough on 1st attempts.

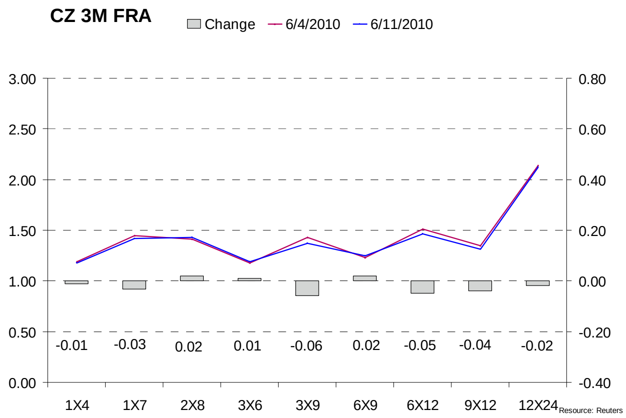
DAILY CHARTS:

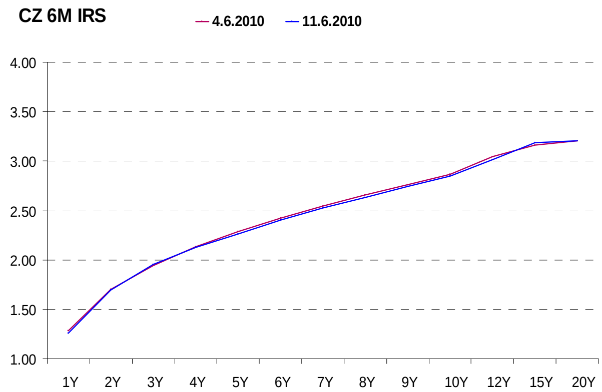
Fixed income

The **Czech yield curve** flattened last week, with yields rising by almost 6 bps at the short end and falling by almost 5 bps at the long end of the curve. However, trading volumes were low in the first half of the week. The decision by the Ministry of Finance to issue larger volumes of koruna bonds in the third quarter of the year had a negative effect on bonds.

Nevertheless, the main event of the week was the auction of the 2.80%/2013 government bond. With the original supply of CZK 5bn, the Ministry of Finance eventually sold securities for CZK 9.82bn in the auction, but kept bonds for CZK 1bn on its book. Demand was CZK 14.72bn, and exceeded the sold volume 1.7 times. The average yield was 2.572%.

By comparison, the average yield at the previous auction of the same tranche, held in early April, was 2.41%.
Larger volumes of bonds, to be issued by the Ministry, will also influence the domestic market this week. The next auction is scheduled for as soon as Wednesday, June 16. The Ministry will supply the 5.7%/2024 bond for a planned amount of CZK 5bn. These securities are again likely to attract reasonable demand but, given the current yield of 4.554%, investors may require a higher yield. In the wake of last week's auction, we cannot even rule out that the volume supplied will be increased.



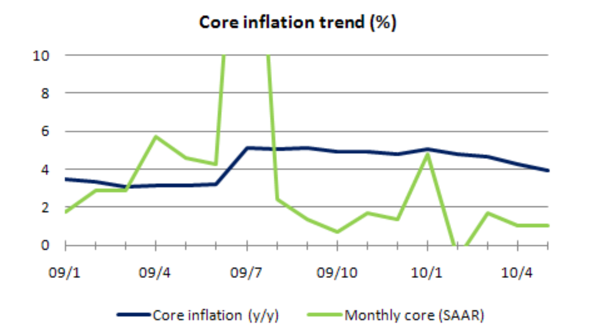


Hungary

Macro review

Hungary's fundamentals remained on the expected path and the market welcomed the new action plan of the government, which aims at lowering taxes in order to stimulate employment.
The Foreign trade balance posted a larger-than-expected surplus of €536m in April, slightly less than a year-ago, when the super weak currency basically stopped imports. This time, the currency was at a more normal level around 275/€, some 10% stronger than in last April, which could have caused some deterioration of the balance, but the overall picture is still a large, about 5% of GDP foreign trade surplus for this year.
First quarter revised GDP data confirmed the preliminary reading of 0.1% Y/Y growth and 0.9% Q/Q on the back of strong net export contribution and inventory build up. The economy is expected to post a growth rate around 0.8% for this year.
Inflation data from May brought some minor surprise as the headline inflation rate fell to 5.1% Y/Y from 5.7% Y/Y in April, a tad more than expected. Core inflation dropped more sharply to 4.0% Y/Y from 4.3% Y/Y as durable goods' prices fell from a year-ago, when the aforementioned exchange rate shock occurred.

The core inflation trend – captured by the annualised rate of the seasonally-adjusted monthly changes – remained low at 1%, pointing for a further decrease of the underlying inflation trend over the coming months. June-July last year had relatively high core inflation monthly changes, so the base effect should help core inflation to lower significantly over the coming months.



Currency

The **forint** recovered strongly during last week after the government confirmed that it will stick to the budget deficit target of 3.8% of GDP this year.
The exchange rate appreciated more than 3% from 289/€ to 280/€ during the week and this week's question will be whether the 280/€ resistance level will hold on or not. If not, the next key level of 275.00 could come into the picture as it was the starting point of the sharp weakening triggered by Mr Kosa's comments.

EUR/HUF technical picture

(279.00): Rebound from year low retested 283.60 (see graph: neckline Long Term Double Bottom) but currently back below this area and in Flag pattern off 262.05.
Resistance at 284.50 (weekly Bollinger top), where pause favored.
Failure to cap would see next levels at 286.00/ 287.55 (reaction highs hourly) and 290.55 (current reaction high off year low): tough on 1st attempts.
Support at 276.85 (break-up daily), ahead of 275.74 (50% 260.93 to 290.55), where pause favored.
If wrong, next levels at 273.02 (rising weekly Long Term Moving Average), ahead of 272.00/ 271.15 (May 28 low/ May 12 low): tough on 1st attempts.

DAILY CHARTS:

Fixed income

The bond market had also a sharp recovery and yields declined from crisis' highs around 8.00% to below the key 7.50% at the longer-end during the week.
Appetite from foreign investors has also been strong and long-term forward spreads narrowed, underpinning the fundamental improvement of the fiscal policy outlook.
Short-end interest rates have also declined and the market priced out the possibility of a rate hike, while the FRA curve flattened out at the 5.25% level.
Similarly to the currency, the outlook is probably positive here as well and the market may continue to advance cautiously ahead over the next weeks.

Poland

Currency

The Polish currency appreciated due to improving sentiment on the global equity markets and a weaker US dollar last week. Furthermore the Polish parliament approved respected economist Marek Belka as central bank governor. After the vote, Belka said there was no need to set a new target date for euro entry as the euro zone should tackle its own problems first. He also said that zloty is relatively weak at current levels and that the currency was on a firming trajectory that could last for years, underpinned by strong fundamentals. Nevertheless at the current stage he is more concerned with growth than with inflation and he also backed the attempts to limit excessive volatility of the Polish currency.

Although we continue to remain somewhat cautious for the near term, it seems to be only a matter of time when foreign investors will start to appreciate solid mid-term fundamentals once again. A lot will depend on whether bears on global markets get out of the stage this week. Beside that, we might see a favourable outcome of domestic data in the second half of the week including industrial output and employment, confirming the ongoing recovery. We see potential for seasonal hiring and faster growth in construction already in May after a severe winter.

EUR/PLN technical picture

(4.0920): Rebound off 3.8225 sent the pair above the channel top off 4.9300 and retested the neckline of the long term Double Top (4.2250: see graph).

1st support area at 4.0585/ .0405 (June 03 low/ May 28 low + broken falling weekly Long Term Moving Average + neckline Double top on hourly charts), where pause favored.

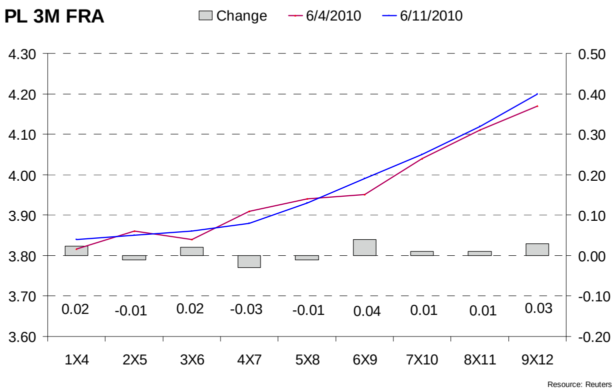
If unable to hold, next levels at 4.0166 (break-up hourly), ahead of 3.9965 (rising weekly Medium term Moving Average): tough on 1st attempts.

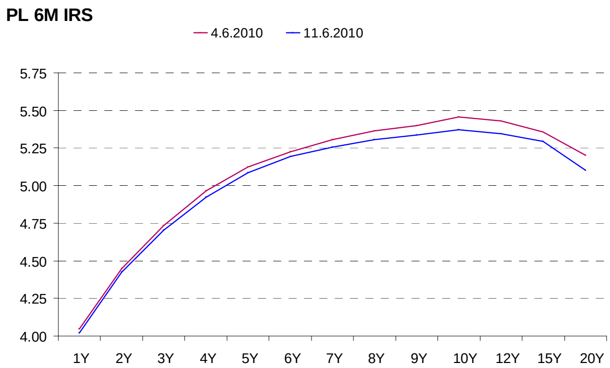
1st Resistance comes in at 4.1140 (breakdown hourly), ahead of 4.1450/ .1495 (reaction highs hourly), where pause favored.

If wrong, next level at 4.1795 (weekly Bollinger top).

4.2050/ .2060 = May 20 high/ June 04 high: tough on 1st attempts.

DAILY CHARTS:





CE Weekly Preview

WED 10:00	CZ Cur. Account (CZK bn)		
	Apr-10	Mar-10	Apr-09
C/A monthly	**-7.0**	-12.6	3.6
cummulative (YTD)	**6.3**	13.3	28.6
Trade bal. monthly	**17.9**	21.3	15.8
cummulative (YTD)	**72.6**	54.7	57.5

CZ: The current account only shows a moderate deficit

After the release of the great foreign trade data, we are also likely to see a fairly good current account figure. It will be influenced by the trade balance surplus on the one hand, and by the balance of income deficit, stemming from dividends, on the other. Just like in previous months, services involve a great deal of uncertainty, as they slipped into a deficit of more than CZK 4bn in March (the highest over the period when monthly balance of payments data has been monitored). In any case, this year's current account deficit is likely to be around 1% of GDP.

WED 12:00	CZ Bond Auction	
	This Auction	Last auction
offer (bn), 5.7%24Y	**5.00**	21.4
bid-cover ratio		1.91

CZ: The auction of the 5.70%/2024 bond

The Ministry of Finance will supply the 5.7%/2024 bond for the planned amount of CZK 5bn in that auction. The securities are again likely to attract reasonable demand but, given the current yield of 4.554%, investors may require a higher yield. In the wake of last week's auction, we cannot even rule out that the volume supplied will be increased.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
PL	14.6.2010	14:00	Current account (EUR M)	04/2010			-650		-559	
PL	14.6.2010	14:00	Money supply M3 (%)	05/2010			0.9		-0.1	
PL	14.6.2010	14:00	Trade balance (EUR M)	04/2010			-397		-514	
CZ	15.6.2010	09:00	PPI (%)	05/2010	0.2	1.0	0.3	1.1	0.7	0.4
PL	**15.6.2010**	**14:00**	**CPI (%)**	**05/2010**			**0.4**	**2.3**	**0.4**	**2.4**
CZ	16.6.2010	10:00	Current account (CZK B)	04/2010	-7.0		-4.0		-12.6	
CZ	**16.6.2010**	**12:00**	**CZ bond auction 5.70%/2024 (CZK B)**	**06/2010**			**5**			
PL	16.6.2010	15:00	Budget balance (PLN M)	05/2010					-4 334.4	
PL	17.6.2010	14:00	Wages (%)	05/2010			-1.9	3.9	-2.7	3.2
HU	18.6.2010	09:00	Wages (%, ytd.)	04/2010				3.0		9.4
PL	18.6.2010	14:00	PPI (%)	05/2010			0.8	0.5	1.2	-0.5
PL	**18.6.2010**	**14:00**	**Industrial output (%)**	**05/2010**			**-3.5**	**7.8**	**-9.1**	**9.9**

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

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.	*5.25*	5.00	5.00	5.00	5.00	-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	*1.23*	1.15	1.22	1.35	1.60
Hungary	BUBOR	*5.25*	5.10	5.00	5.00	5.00
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.	*2.89*	3.45	3.65	3.80	3.95
Hungary	*6.47*	6.00	6.00	6.00	6.00
Poland	*5.37*	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	*25.7*	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*280*	270	265	265	260
Poland	EUR/PLN	*4.09*	3.80	3.60	3.90	3.30

GDP (y/y)

	Q2 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011
Czech Rep.	*1.7*	1.4	1.7	2.3	2.6
Hungary	*-5.3*	-1.5	0.5	1.0	2.0

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

	Jun-10	Dec-10	Mar-11	Jun-11	Sep-11
Czech Rep.	*1.4*	2.1	2.0	1.9	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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