Monday, June 21, 2010

KBC
Banking & Insurance

Central European Weekly

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Czech Republic

The Czech current account shows a high surplus in April

Hungary

Long-term forward spreads have been compressing as confidence returns

Poland

Poland is waking up from its winter slumber

The Week Ahead

Both CNB and MNB stay on hold

Overview

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.77	0.23%	↘	↘
EUR/PLN	4.069	-0.61%	↘	↘
EUR/HUF	280.4	-0.04%	↘	↘
3M PRIBOR	1.23	0.00	→	→
3M WIBOR	3.84	-0.03	→	→
3M BUBOR	5.25	0.00	↘	↘
10Y CZK	4.21	-0.02	↘	↘
10Y PLN	5.82	0.03	↘	↘
10Y HUF	7.46	0.16	↘	↘
3M EURIBOR	0.78	0.07	↗	↗
10Y EMU	2.70	0.12	→	↗

Last values from Friday 15:30 CET

No way for Czech Rep and Poland to adopt the euro early

The prospects for adopting the euro in the Czech Republic and Poland are poor at the moment. The coincidence of several factors has contributed to the fact that the adoption of the common European currency has been postponed in both countries at least indefinitely. What has happened?

First, given the cyclical drop in their respective budgets, none of those countries is currently able, nor will be able within the next few years, to comply with the Maastricht budget criteria (the deficit below 3% of GDP). What is more, the debt crisis of eurozone countries leaves us in no doubt that compliance is likely to be very strictly required.

Second, sociological polls have unveiled an interesting phenomenon. Popular opinion in both the Czech Republic and Poland, which had been fairly euro-friendly until recently, has recently been losing its enthusiasm for adopting the euro. It is no wonder that the Poles and the Czechs are concerned, as they watch the development of the crisis inside the euro area; and the idea that the domestic economy might find itself in the position of the Greek or Spanish ones is not very attractive.

In addition, politicians in both countries need to take account of both the budget reality and opinion polls. This is why Poland, through its Prime Minister, has recently given up its ambitious plan to adopt the euro, with no new deadline set. Politicians in Czech Republic (i.e., the representatives of the emerging government coalition) even seem to go beyond their Polish counterparts, because they are not willing to discuss the deadline for adopting the euro until the current debt problems of the euro area are resolved. In other words, the deadline for adoption of the euro in the Czech Republic is completely unforeseeable at the moment.

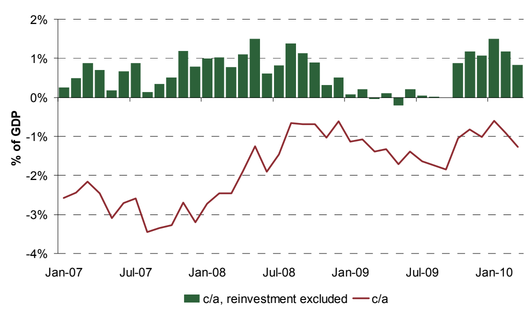
And what is the market reaction to the ‘frozen’ ambitions of Poland and the Czech Republic, in terms of adopting the euro? While information of this sort would have, at least temporarily, upset markets in the past (for example, this happened after the 2006 general election in the Czech Republic), it is virtually ignored today. This provides yet more evidence that the times are changing.

Czech Republic

Macro review

While the market expected that April's current account would post a deficit of CZK 8bn, the reality was very different – a surplus of CZK 12.4bn. This is a very good figure, which is primarily due to the significant foreign trade surplus (CZK 21.2bn) and a pause in dividend payments by enterprises under foreign control. While the dividend season was in full swing in April last year, this year's April was very weak in terms of dividends (1bn). As we could already anticipate in March, and as the fairly favourable results of the largest domestic firms have indicated, this is rather a divergence, which will not last for long. We therefore expect that the dividend outflow will again increase in the months to come and drive the current account back into the red. Services, where for a long time we used to see fairly stable surpluses, are also developing unusually. Since the beginning of this year, the balance of services has posted stable deficits. Even so, thus far, both transport and tourism have shown better figures than last year. The main reason why the trade in services is falling into a deficit is what is known as branding. In other words, it reflects supranational firms' transactions related to an increase in the value of imported goods in the CR and their subsequent export to foreign countries.

Current account on annual basis



By and large, the current account has been developing favourably this year, with its full-year deficit standing a great chance of being just around -1% of GDP, just like last year. In addition, this favourable figure includes the reinvested profits of businesses under foreign control, which remain in the CR. That said, with this reinvestment excluded, the current account would even continue to be in the black. For the sake of completeness, let us add our view of foreign direct investment. For the first four months, the net FDI volume stood at CZK 40bn. Of that amount, investment worth almost CZK 60bn flowed into the CR, half of which being the repayments of loans made by foreign parent companies to Czech businesses. On the other hand, Czech firms invested CZK 19bn abroad, i.e., 75% of the investment made for last year as a whole.

Currency

EUR/CZK technical picture

(25.6700) Rebound from year low failed to regain the broken Uptrendline off low (see graph).
1st support area 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 25.1300 (weekly Bollinger bottom), ahead of 25.0380/ 25.0150 (monthly envelope bottom/ year low) and 24.9750 (Sept 2009 low): tough on 1st attempts.
Resistance area at 25.8800/ .8880 (breakdown hourly/ daily), ahead of 26.0800/ .0940 (June 07 high + medium term breakdown hourly + weekly Bollinger top/ 5th wave off 25.3000 on hourly charts), where pause favoured.
Failure to cap would see next levels at 26.3000 (current recovery high off 25.0150) and 26.3330 (Feb 08 high): tough on 1st attempts.

DAILY CHARTS:

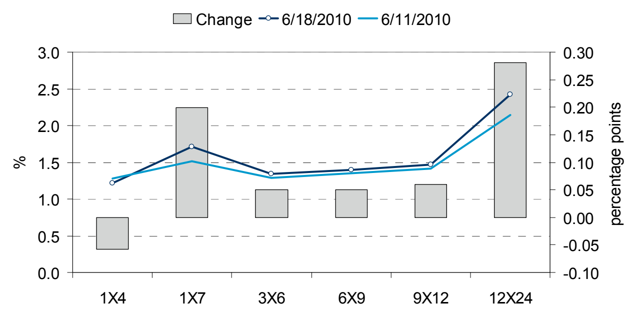
The Czech koruna underperformed the region without any clear domestic trigger. As bulls were quietly getting back on the global stage, probably higher yielding regional currencies including the zloty felt more relief than higher yielding Czech currency. Hence overall the Czech koruna stayed slightly weaker near 25.70 EUR/CZK.
For this week, the CNB meeting may be interesting for the Czech koruna. Although we do not expect any change in interest rates, the persisting dovish tone of central bankers could be tough to withstand for the koruna. On the other hand, if current risk-friendly sentiment on the global markets prevails, it should be only a matter of time, when the Czech koruna starts to attack 25.50 EUR/CZK level.

Fixed income

As far as the Czech bond market is concerned, two major events occurred last week. The first one was the 15Y government bond auction. It was significantly oversubscribed, and it thus confirmed that attractive yields can attract investors. The fact that Czech bond prices are currently more attractive than a few weeks ago is not yet evident on the secondary market. Nevertheless, demand in recent auctions has been very strong, and this may, after some time, also make itself felt on the market in bonds that are already being traded.

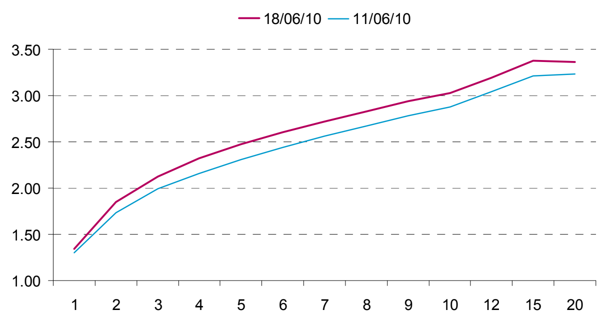
The second major event that is of long-term relevance is the appointment of the new CNB Governor. The Czech President has decided to maintain continuity at the Czech National Bank, and thus Governor Tůma will be replaced by Deputy Governor Singer. As far as future monetary policy is concerned, this is no fundamental change, save that Miroslav Singer was certainly an advocate of a more pro-active policy than Zdeněk Tůma. As a matter of fact, this could mean that the CNB may proceed to its official rate changes faster, or more flexibly, than it did in the past.

CZ FRA



Source: Reuters

CZK IRS



Hungary

Macro review

The April wage data were the only macro event last week. Goss wage growth decelerated to 1.1% Y/Y from 9.4% Y/Y a month ago. Net wages grew faster at 7.8% Y/Y as the tax reduction at the beginning of the year pushed up net wages, albeit this is a bit misleading because the official wage statistics do not include tax allowances, which were tightened significantly.

Due to lower employment, wage inflation seems to be a moderate risk in the economy now, but the introduction of the 16% flat personal income tax rate could keep net wage growth elevated, which may be a risk over the long-run.

Besides that, the new government has been fairly quiet about the details of the 29-steps program announced two weeks ago and thus the exact effects of the new measures are uncertain.

The central bank may also try to evaluate the program in greater details, but the real test could be the upcoming IMF review in July. The review has been postponed from May because of the elections thus the government will have a tight schedule to work on the details of the program. The government has so far emphasised several times that the 3.8% of GDP deficit target will be maintained, but measures backing this could be scrutinised in order to assess the risks surrounding the baseline scenario.

The central bank decided this afternoon to keep the base rate unchanged at 5.25%. This may remain so in July-August in our view, as the talks with the IMF/EU could be noisier as they could be more demanding after the Greek crisis.

Currency

The forint had a quiet week and the pair was traded within the narrow range of EUR/HUF 278.00 and 282.00. China's announcement about its exchange rate policy has triggered a break of this range today and the forint opened almost 2% stronger this morning at 276.00. This could open the room for establishing a new appreciation trend if the pair is able to establish a firm ground above the 278.50 level.

EUR/HUF technical picture

(279.50): 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 282.25/ 283.50 (reaction highs hourly), ahead of 286.00 (reaction high hourly + weekly Bollinger top), where pause is favoured.

Failure to cap would see next levels at 287.55 (medium term reaction high 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 273.75 (June 03 low), ahead of 272.13/ 272.00 (rising weekly Long Term Moving Average/ May 28 low) and 271.15 (May 12 low): tough on 1st attempts.

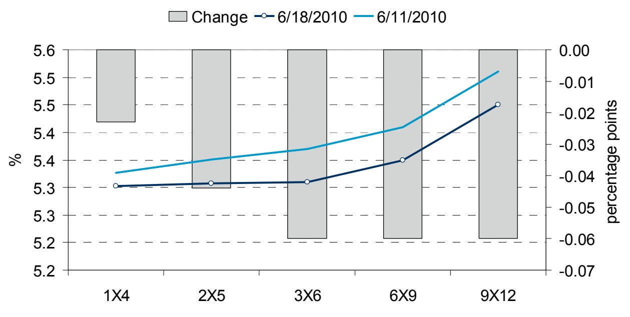
DAILY CHARTS:

Fixed income

The Hungarian bond market finished the week with a correction and yields rose about 20bps, despite bond auctions which saw decent demand. Foreign bond holdings fell 1% to Ft2200bn during the week because of redemption and foreign players may try to reinvest these proceeds in the coming days.

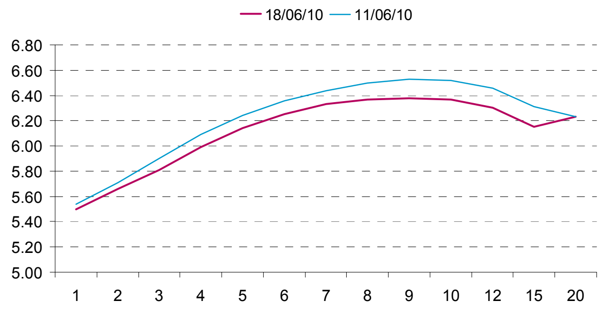
A good sign is that long-term forward spreads have been compressing and the 5y5y forward moved almost 50bps from the peak of 310bps two weeks ago. This suggests that the market has started to rebuild confidence in the Hungarian convergence story, which could be the basis for stability in the long-run.

HU FRA



Source: Reuters

HUF IRS



Poland

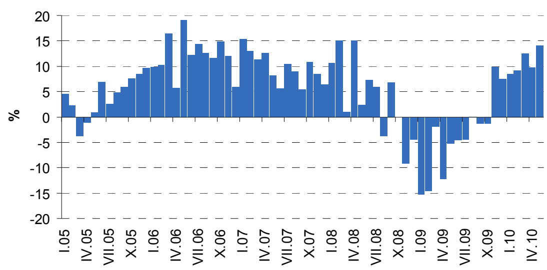
Macro review

So far, the latest data have reliably corroborated our theory that Poland is slowly, but certainly waking up from its deep winter sleep. That hibernation alone should not pose a major obstacle to the continuing recovery, which should ride the wave of a strong rise in construction and of a recovery of the export-oriented manufacturing industry.

It was the impact of the tough winter on construction that drove Poland into its deep slumber and contributed to the growth deceleration in the first quarter of 2010. While construction makes up less than 7% of Poland's GDP, its relevance has increased during the crisis, because of the generation of new jobs rather than the generation of added value. The share of people employed in construction has increased decently, and while the manufacturing industry dismissed plenty of its staff in 2009, construction firms, owing primarily to the influx of funds from Brussels, maintained a reasonable rate of real growth (5%) and continued to recruit employees, with almost 100,000 more people employed in construction now than before the crisis.

However, the increased share of construction in employment and in added value has made the Polish labour market as well as GDP more cyclical, because the share of highly cyclical sectors (agriculture, construction) in the overall employment has increased to almost 22% in Poland. This is why the unusually tough winter had such a strong impact on the performance of the Polish economy – due to a lower direct contribution to GDP and an indirect negative effect of large seasonal layoffs. Nevertheless, spring has started to return what the winter took away, with the labour market and industry looking as if they were watered by an elixir in May. The 14% growth is based on 'thawing' construction and a rising number of export contracts in the manufacturing industry. If Germany, the country's main trading partner, withstands the problems of the undisciplined south of the euro area, Poland will see its GDP continuing to accelerate in the rest of the year. Construction, fuelled by EU funds and by the start of the preparations for the 2012 European Football Championship, will continue to be the driver.

Polish industrial output, y/y



EUR/PLN technical picture

(4.0750): Rebound off 3.8225 retested the neckline of the long term Double Top (4.2250: see graph).

1st Support area at 4.0405 (May 28 low + broken falling weekly Long Term Moving Average + neckline Double top on hourly charts + weekly projection band bottom), where pause favored.

If unable to hold, next levels at 4.0166 (break-up hourly), ahead of 4.0088 (rising weekly Medium term Moving Average) and 3.9700/ .9578 (break-up daily May 13/ monthly envelope bottom): tough on 1st attempts.

1st Resistance comes in at 4.1195/ .1250 (broken rising weekly Short Term Moving Average/ reaction high hourly), ahead of 4.1450/ .1495 (reaction highs hourly), where pause favored.

If wrong, next level at 4.1842 (weekly Bollinger top).

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

DAILY CHARTS:

CE Weekly Preview

WED 13:00 **CNB base rate**

	This meeting	Last change
rate level (in %)	**0.75**	5/2010
change in bps	**0**	-25

CZ: The CNB unlikely to change rates

We expect that the CNB Board will leave its base interest rate unchanged this time. Inflation is above the Czech National Bank's latest forecast. On the other hand, economic growth lags behind the CNB's expectations. Nonetheless, the monetary policy instruments to address these issues are highly limited; the CNB's base rate is already at an all-time low, even below the ECB's main rate. In addition, the koruna is approximately 2% weaker than forecasted. Therefore a wait-and-see attitude is the most appropriate policy until at least the end of this year. We believe that a long period of low and stable central bank interest rates is still ahead of us.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	**21.6.2010**	**14:00**	**NBH meeting (%)**	**06/2010**	**5.25**		**5.25**		**5.25**	
PL	22.6.2010	14:00	Core CPI (%)	05/2010			0.2	1.7	0.2	1.9
CZ	**23.6.2010**	**12:30**	**CNB meeting (%)**	**06/2010**	**0.75**		**0.75**		**0.75**	
HU	24.6.2010	09:00	Retail sales (%)	04/2010				-2.7		-4.0
PL	24.6.2010	10:00	Unemployment rate (%)	05/2010			12.0		12.3	
PL	**24.6.2010**	**10:00**	**Retail sales (%)**	**05/2010**			**2.0**	**3.4**	**-5.6**	**-1.6**

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	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Last change	
Czech Rep.	2W repo rate	*0.75*	0.75	0.75	0.75	1.00	1.25	-25 bps	5/6/2010
Hungary	2W deposite r.	*5.25*	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	3.50	3.75	4.00	-25 bps	6/25/2009

*Short-term interest rates 3M *IBOR (end of the period)*

		Current	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Czech Rep.	PRIBOR	*1.23*	1.20	1.15	1.22	1.35	1.60
Hungary	BUBOR	*5.25*	5.30	5.10	5.00	5.00	5.00
Poland	WIBOR	*3.84*	3.90	3.90	4.10	4.30	4.30

Long-term interest rates 10Y IRS (end of the period)

		Current	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Czech Rep.		*3.03*	3.25	3.45	3.65	3.80	3.95
Hungary		*6.385*	6.00	6.00	6.00	6.00	6.00
Poland		*5.43*	5.00	5.00	5.00	5.20	5.50

Exchange rates (end of the period)

		Current	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Czech Rep.	EUR/CZK	*25.8*	25.3	24.8	24.8	23.8	25.5
Hungary	EUR/HUF	*280*	275	270	265	265	260
Poland	EUR/PLN	*4.07*	3.90	3.80	3.60	3.90	3.30

GDP (y/y)

		Q2 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011
Czech Rep.		*1.7*	1.5	1.4	1.7	2.3	2.6
Hungary		*-5.3*	-3.0	-1.5	0.5	1.0	2.0

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

		Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
Czech Rep.		*1.4*	2.1	2.1	2.0	1.9	1.9
Hungary		*5.9*	4.7	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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