Monday, September 06,

KBC
Banking & Insurance

Central European Weekly

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Czech Republic

The Ministry of finance cuts the domestic supply and issues a eurobond denominated in euro.

Poland

No clear signs of inflationary pressure according to central bank governor

The week ahead

Will the Polish C/A deficit again be close to EUR 1bn?

Overview

Market conditions for debt financing look quite favorable

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.68	-0.36%	→	→
EUR/PLN	3.937	-1.08%	→	→
EUR/HUF	283.3	-0.45%	→	↗
3M PRIBOR	1.24	0.00	→	→
3M WIBOR	3.81	0.00	→	↗
3M BUBOR	5.36	0.03	↗	↗
10Y CZK	3.23	-0.01	↗	→
10Y PLN	5.58	0.19	↗	↗
10Y HUF	7.22	0.02	↗	↗
3M EURIBOR	0.89	-0.01	→	→
10Y EMU	2.35	0.23	↗	↗

Last values from Friday15:30 CET

Central European governments are currently completing their draft state budgets for 2011. At the same time, they are also unveiling their plans as to how the state budget deficits and the bonds due next year will be (re)financed. The preparation of the issuance strategies for next year may have two common features.

Firstly, there is every indication that the interest costs of financing will continue to go down as nominal interest rates in all of the region's countries (except for Poland) remain at all-time lows. Central banks in the region may start tightening their monetary policies next year. However, as this will happen in the context of a continuing recovery, risk premiums on the government bonds concerned may continue to fall. So, the impact of the tightening of monetary policy may not be dramatic to any great extent.

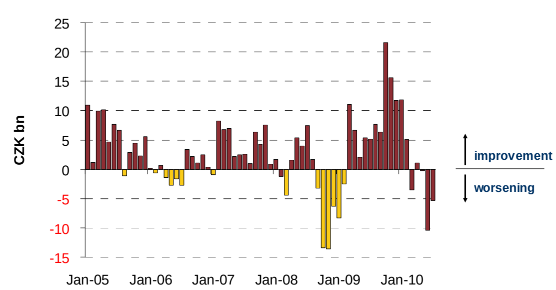
Secondly, given further improvements in the conditions of the financing the government debt, the respective governments should, as much as possible, take advantage of those highly favourable conditions on the domestic market. They might try to extend the duration of their government debt accordingly before tighter monetary conditions will make themselves felt in higher yields in the future. The details on the issuance strategy of the of the different countries still need to be published but a similar strategy would be more than logical.

Czech Republic

Macro review

The foreign trade surplus (CZK 6.3 bn) was slightly below the consensus forecast but generally corresponds to the previous developments. Exports rose by 16% y/y while imports were more than 20% higher. Higher commodity prices played an important role in this. Imports of mineral fuels, this time increased by 5 billion CZK. In addition, the rise in imports was also supported for an important part by demand for components that are used for export-oriented production of industrial companies. Domestic demand remained subdued and thus it didn't raise the pressure on the growth of imports to the CR. Our overall view of the trade balance remains unchanged. We expect a surplus of CZK 150 billion for this year.

Y/Y change of the monthly trade balance



Currency

The Czech koruna strengthened on favourable US statistics, but failed to break out of the tight range 24.61-25.00 EUR/CZK. The domestic calendar was rather empty and new issuance calendar of finance Ministry did not have any side effects on the FX market.

This week is full of important domestic events and is rather calm on global markets. Nevertheless none of the figures has potential to have a dramatic impact on the Czech koruna. Industrial output should slow down, but mainly due to less working days. Inflation should stay on the CNB target. Current sentiment in the CEE is rather optimistic. If we see the bulls on the stage for a while, the EUR/CZK and the EUR/PLN cross rates could try to break further to the south.

EUR/CZK technical picture

(24.7200) Below Uptrendline off low, with broken Downtrendline off 29.6900 having played Support role so far (see graph).
1st support area at 24.6110 (Aug 04 low + current new reaction low off 29.6900), where pause favored.
If wrong, next levels at 24.5210 (76.4% 22.9250 to 29.6900), ahead of 24.3610 (weekly modified Alpha Beta trend bottom) and 24.3050 (monthly envelope bottom): tough on 1st attempts.
Resistance area at 24.9900 (Aug 16 high), ahead of 25.0150/ .0220 (previous year low/ breakdown daily): ideal area to stay below to keep current short term mood on CZK intact.
Failure to cap would see next levels at 25.1120 (falling weekly Medium Term Moving Average), ahead of 25.2560 (38.2% 26.3000 to 24.6110?) and 25.3400 (weekly Bollinger midline).
Inability to cap would be indication of something more serious for CZK.

DAILY CHARTS:

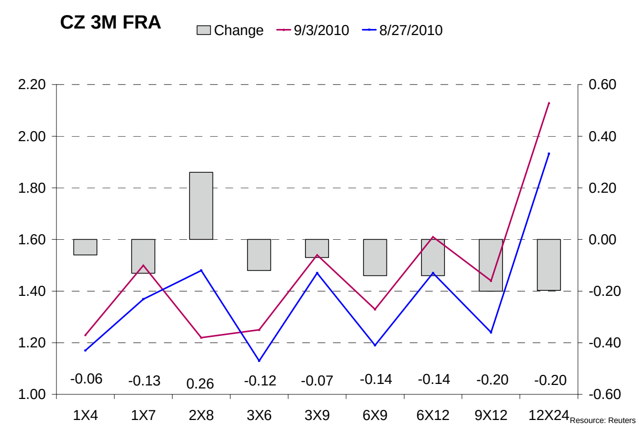
Fixed income

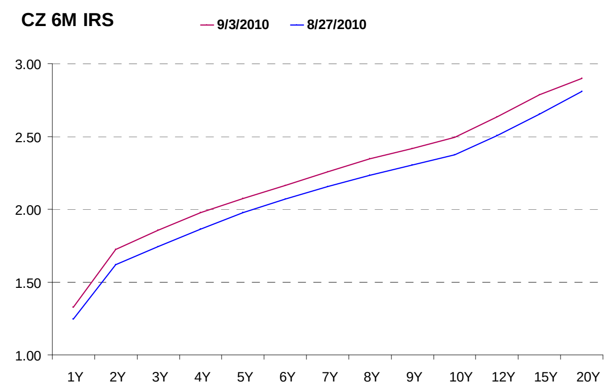
According to the original government programme for funding the state needs in 2010, this year's final deficit should be CZK 163bn. This amount needs to be increased by approximately CZK 94bn, earmarked for the repayments of bonds due and for bond buy-backs and replacements. An additional CZK 23.2bn is earmarked for the creation of reserves and other transactions. Thus, the plan envisaged a total gross government issuance of CZK 280bn. The existing development of the state budget deficit indicates that the full-year need might be roughly in line with the original plan.

Early September, the Ministry of Finance unveiled the issuance schedule for bonds and Treasury bills for the last quarter of 2010. The schedule indicates that government bonds for CZK 30bn will be issued in five auctions. The bonds will be complemented with issuance of Treasury bills for CZK 25bn.

However, **the issuance schedule** raises more questions. The bonds issued thus far, for CZK 129bn (until September 1, 2010, inclusive), should be increased by the above-mentioned CZK 30bn in Q4 2010, and by an additional CZK 15bn of the issues planned by the end of September. Furthermore, we need to add CZK 25bn in T-bills for the last quarter of the year, plus more T-bills for CZK 23bn for the period by the end of September. An additional CZK 12.7bn will be acquired by the state from an EIB loan. While the end of the year will be eventful, the volume of Treasury bills will hardly cover the CZK 280bn of this year's gross planned government borrowings. So, there is room for a possible bond sale denominated in a foreign currency exists. Hence, the Ministry of Finance also confirmed that it was considering a foreign currency issue.

According to the latest news the MinFin is just preparing the sale of the 10Y Eurobond. The expected amount of the sale will be between 1.5 to 2 billion euros. This will more than cover any potential gap in state financing this year, so such news is again a bullish signal for government bonds denominated in CZK.





Poland

Currency

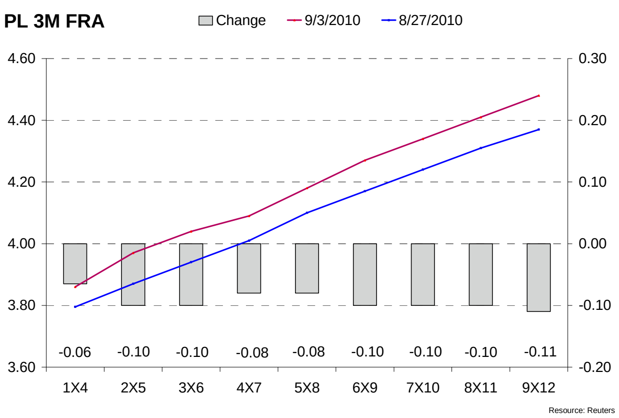
The **Polish zloty** gained further after a series of surprisingly favourable US data including the payrolls and manufacturing ISM. The pair started to test important levels at 3.92 EUR/PLN (lows from August 2010). The Polish government could have helped the zloty as it approved the final 2011 budget draft. The target for 2011 is set at 40.2 billion zloty, lower than the 48 billion for this year. Nevertheless the deficit is still seen to significantly exceeding the 3% of GDP ceiling. As high deficits (7% of GDP for this year) come together with solid growth, this continues to pose threats to the mid-term stability of public finances. Investors could get nervous especially due to the existing fiscal rules. Breeching the safety level (55% of GDP for government debt) automatically triggers severe spending cuts.
Investors ignored neutral comments by central bank governor Belka. He sees no acute pressure for a change in policy setting and says the bank is still in a wait and see mode. On one side, solid growth points to interest rate hikes, on the other there are no clear signs of inflationary pressure for now.

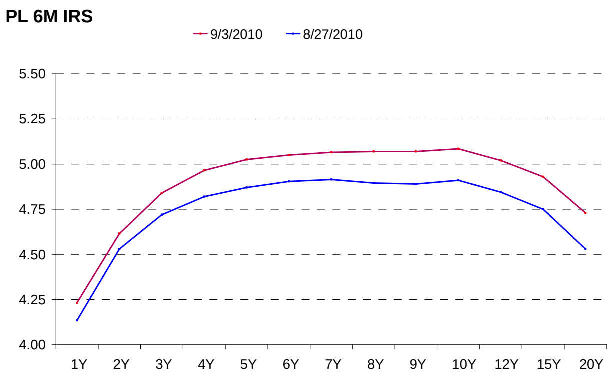
This week should be rather calm due to US Labour Day Holiday and rather empty calendar both at the domestic and global stage. Nevertheless if the bulls remain on the stage, the EUR/PLN may be pushed further down below 3.92. This would open the door for an appreciation to the 2010 lows at 3.822.

EUR/PLN technical picture

(3.9600): Currently trying to extend below long term triangle pattern, but near apex (see graph).
1st Support area at 3.9511 (current reaction low off 4.0270?), where pause favored.
If unable to hold, next levels at 3.9250/ .9210 (Aug 19 low/ 76.4% 3.2022 to 4.2400 + monthly envelope bottom), ahead of 3.9004 (rising 50 Month Moving Average): tough on 1st attempts.
1st Resistance comes in at 4.0270 (Aug 04 + 24 highs): ideal area to stay below to keep current mood on Zloty.
If unable to cap, next levels at 4.0410/ .0453 (falling weekly Moving Average/ 38.2% 4.2400 to 3.9250), ahead of 4.0560 (breakdown daily): tough on 1st attempts.

DAILY CHARTS:





CE Weekly Preview

CZ: Economic growth above 2%

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

	Q2-10	Q1-10	Q2-09
GDP (y/y)	**2.2**	1.1	-4.7
GDP (q/q)	**0.8**	0.5	-0.5

The new GDP release for the second quarter of the year should not significantly differ from the first (flash) estimate. Hence of particular importance will be the growth structure, i.e., the trend of the individual GDP components on both the demand and supply sides. It is probably beyond a shadow of a doubt that the growth was primarily fuelled by industry, with exports and inventories on the demand side. Consumption and investment are big unknowns. The new figure should not even influence the full-year economic growth forecast for this year, which we currently predict to be around 1.7%.

CZ: Inflation hits the CNB target

THU 9:00 **CZ Inflation (change in %)**

	Aug-10	Jul-10	Aug-09
CPI m/m	**-0.1**	0.3	-0.2
Food m/m	**-1.0**	0.1	-1.1
Housing, energy	**0.1**	0.5	0.1

Consumer prices most likely fell slightly in August compared to July. This was primarily due to the usual decline in certain food prices and the seasonal clearance sales of shoes and clothing. Fuel prices also went down this time. Travel agencies, by contrast, probably raised their prices of foreign package tours; nevertheless, package tour prices should have only gone up slightly compared to previous years. Year-on-year inflation has hit the Czech National Bank's target, with inflation still primarily driven by regulated prices and taxes. Thus demand-pull inflation is irrelevant, and there is still time enough to consider a rate hike. Inflation will mostly remain above the CNB's target in the months to come. And this will also be true of 2011. Next year's increase in electricity prices, which may raise inflation by up to 0.5%, continues to be a big unknown.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	6.9.2010	17:00	Budget balance (HUF B)	08/2010					-997.5	
HU	7.9.2010	09:00	Trade balance (EUR M)	07/2010 *P					563.9	
CZ	7.9.2010	10:00	Current account (CZK B)	2Q/2010					620.9	
CZ	**8.9.2010**	**09:00**	**GDP (%)**	**2Q/2010 *F**					**0.8**	**2.2**
CZ	8.9.2010	09:00	Unemployment rate (%)	08/2010	8.8		8.7		8.7	
HU	8.9.2010	09:00	Industrial output (%)	07/2010 *P			12.4		0.8	12.6
HU	**8.9.2010**	**09:00**	**GDP (%)**	**2Q/2010 *F**						**1.0**
CZ	**8.9.2010**	**12:00**	**CZ bond auction 2.80%/2013 (CZK B)**	**09/2010**			**7**			
CZ	**9.9.2010**	**09:00**	**CPI (%)**	**08/2010**	**-0.1**	**2.0**	**-0.2**	**2.0**	**0.3**	**1.9**
HU	**10.9.2010**	**09:00**	**CPI (%)**	**08/2010**			**-0.3**	**4.0**	**0.1**	**4.0**
PL	10.9.2010	14:00	Current account (EUR M)	07/2010			-950		-1 004	
PL	10.9.2010	14:00	Trade balance (EUR M)	07/2010			-530		-287	

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	Sep-11	Last change	
Czech Rep.	2W repo rate	*0.75*	0.75	0.75	0.75	0.75	1.00	-25 bps	06/05/2010
Hungary	2W deposite r.	*5.25*	5.25	5.25	5.25	5.25	5.25	-25 bps	23/02/2010
Poland	2W inter. rate	*3.50*	3.50	3.75	3.75	4.00	4.00	-25 bps	25/06/2009

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

		Current	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
Czech Rep.	PRIBOR	*+1.24*	1.20	1.20	1.25	1.40	1.60
Hungary	BUBOR	*+5.36*	5.25	5.25	5.25	5.25	5.25
Poland	WIBOR	*+3.81*	3.90	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	Sep-11
Czech Rep.	*+2.6100*	2.65	2.85	3.10	3.30	3.35
Hungary	*+6.615*	6.50	6.50	6.25	6.00	6.00
Poland	*+5.0550*	4.95	5.00	5.60	5.60	5.80

Exchange rates (end of the period)

		Current	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
Czech Rep.	EUR/CZK	*+24.671*	24.8	24.5	24.6	24.6	25.5
Hungary	EUR/HUF	*+283.500*	280	280	275	275	275
Poland	EUR/PLN	*+3.9395*	4.00	3.90	3.60	3.70	3.60

GDP (y/y)

	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011
Czech Rep.	1.5	1.4	1.7	2.3	2.6	0.0
Hungary	0.5	1.0	1.2	1.4	2.0	2.5

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

	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Czech Rep.	2.1	2.1	2.0	1.9	1.9	0.0
Hungary	4.2	3.5	3.4	3.2	2.8	3.2

Current Account as % of GDP

	2009	2010
Czech Rep.	-1.0	-1.4
Hungary	0.5	1.0

Public finance balance as % of GDP (in ESA95 standards)

	2009	2010
Czech Rep.	-5.9	-5.5
Hungary	-3.8	-3.0

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