Monday, September 27,

Central European Weekly

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Czech Republic

The CNB votes 6-to-1 for stable rates

Hungary

Audi and GM’s Opel lift long-term prospects as they expand their production.

Poland

Strong retail sales support the case for a strong zloty

The Week Ahead

NBP should stay on hold again

Overview

	Last	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.61	→	→
EUR/PLN	3.970	↗	↗
EUR/HUF	278.9	↗	→
3M PRIBOR	1.21	→	→
3M WIBOR	3.83	→	↗
3M BUBOR	0.00	↗	→
10Y CZK	3.36	→	→
10Y PLN	5.49	→	→
10Y HUF	6.74	↗	→
3M EURIBOR	0.87	→	↘
10Y EMU	2.28	↘	↘

Last values from Friday 15:30 CET

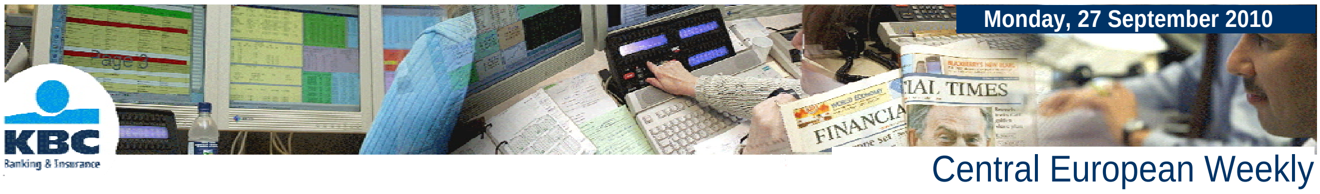
Finally good news from Hungary

As tensions returned to the European financial markets and credit spreads increase, it is worth watching the impact on the CEE region.

The same old story suggests Hungarian markets would be the most affected by the risk, and the Czech markets the least, such was not the case. While Czech yields safely followed on the heels of their German counterparts and the koruna remained more or less unaffected, the Hungarian forint fared best last week. Attention went to new investments by the carmakers General Motors (Opel, EUR 500m) and Volkswagen (Audi, EUR 900m). However, the resistance of the forint may be based on more than just the two decisions of more investments.

The reason is that Hungary, owing to its austerity programmes, is currently one of the most fiscally responsible European countries. Also, the country generates reasonable current account surpluses (+2% of GDP, as opposed to -2.8% of GDP in Poland), and consequently is not dependent on uncertain funding through global markets. That said, why did Hungary not outperform the region a long time ago, yet still lags behind it instead year to date?

One of the problems may be the persisting high debt of Hungarian households in foreign currencies. Nevertheless, given Hungary’s significantly improved current account balance, the foreign debt of households shouldn’t have a too big importance for the country and its currency. Maybe foreign investors, as well as rating agencies, are still somewhat cautious in respect of the current government, which has fallen out with the IMF, and therefore they will continue to hesitate to bet on Hungary. Hence the road to a stronger forint may be slightly longer than indicated by the apparently promising fundamentals.



Czech Republic

Macro review

The Czech National Bank met expectations and left rates unchanged, saying that inflationary risks remained balanced. On the other hand, numerous statements about a rate hike had been made before the CNB Board meeting. One member of the CNB Board even believes that, given the persisting inflationary risks, now is the right time to start tightening the monetary policy. Nonetheless, we need to wait until the end of this week, i.e., Friday, for the release of the minutes of that meeting, to see how the individual members voted.

The comparison of the forecast to the latest data is ambiguous. Economic growth in the second quarter of the year was higher (2.4%, as opposed to 1.8%), inflation was slightly lower (1.9%, as opposed to 2.0%), and so was unemployment. The average wage, by contrast, rose 0.5% faster than expected by the central bank. Apart from the average wage indicator, (which is a confusing indicator), there are not many reasons for tightening the monetary policy at the moment. Not even economic growth, driven by inventories, provides much optimism. Thus the conclusion from the CNB forecast, i.e., that rates should not be raised until the second half of next year, still holds true. Although the central bank currently views inflationary risks as balanced, these exist on both sides. Major risks on the upside include the labour market and real economy, as opposed to the strong koruna and fiscal consolidation on the downside.

As far as inflation is concerned, we can only state that the inflation outlook is highly uncertain. Speculations about an increase in the lower VAT rate have occurred, and an increase in regulated electricity prices, because of the ongoing solar boom, is also unclear. Both of these administrative moves will restrict consumption, and thus also potential demand-pull inflation. In addition, the Czech National Bank has no influence whatsoever on those measures. Therefore they should be irrelevant for the monetary policy, except for their possible secondary impacts. In addition, we can also expect food prices to go up, but this will be due to increased costs, based on the rising prices of agricultural commodities.

Hence we continue to stick to our scenario of rate stability until the first half of next year. We recommend monitoring the latest news from the European economy, which is starting to signal that Europe's economic recovery is not as optimistic as in the first half of the year.

Currency

The Czech koruna hovered in a tight range past week as the CNB meeting sent little guidance to the market. Even big swing in the eurodolar and other regional currencies did not trigger a bigger price action and the EUR/CZK remained just above the 24.6 level.

The domestic eco calendar for the upcoming week is completely empty, thus the koruna will rather watch core and regional markets as they could bring stronger stimuli for the koruna volatility. So far, however, probability that such an event occurs look quite low.

EUR/CZK technical picture

(24.6000) Below Uptrendline off low, with broken Downtrendline off 29.6900 having played Support role so far (see graph).

1st support area at 24.4800 (current new reaction low off 29.6900), where pause favored.

If wrong, next levels at 24.3120/ .3050 (weekly modified Alpha Beta trend bottom/ monthly envelope bottom) and 24.2150 (weekly Bollinger bottom): tough on 1st attempts.

Resistance area at 24.7000 (weekly modified Alpha Beta trend top), with next levels at 24.7500/ .77000 (Sept 16/ 07 highs): ideal area to stay below to keep current short term mood on CZK intact.

Failure to cap would see next levels at 24.8110 (breakdown hourly), ahead of 24.8600 (Aug 31 high).

24.9450/ .9900 (Aug 25/ 16 highs): key area to stay below to keep current medium term mood on CZK.

DAILY CHARTS:

Fixed income

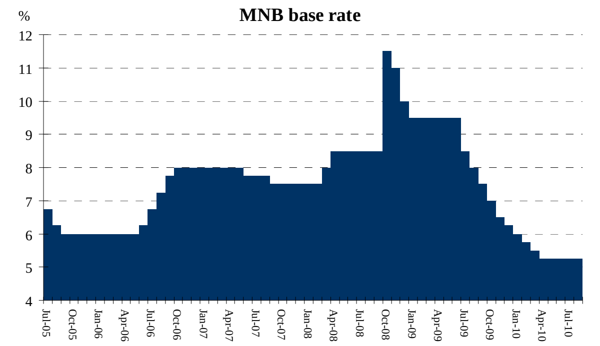
The Czech fixed market experienced some divergence last week as the bond curve steepened, while the swap curve flattened. Both the bonds and swaps were only marginally influence by the outcome of the CNB meeting, which matched the market expectations.

Given the empty domestic calendar (the Czech PMI index has only little importance for the market) and a national holiday on Tuesday, one might expect a calm week ahead much more interesting data (the industrial production and CPI), which will be available the week after.

Hungary

Macro review

The only macro data last week was July's retail sales figure, which showed a 1.7% Y/Y increase against expectations for a 3% Y/Y decline. It seems that consumption has also been recovering slowly in Hungary and this has become now visible after last year's VAT hike effect is fading from the index.
Beside this the key event was the central bank policy meeting this Monday (Sep 27), where nobody expected a change, but the hawkish tone of the August meeting was toned down. Last time the governor and one outside member voted for a hike, which could have disappeared now. We will know this for sure two weeks later, when the minutes is published.
Beside, the Economic Minister said that Hungary will introduce the 16% flat personal income tax rate from 2011 after the Ministry's secretary said that it can be introduced only gradually over a 3-year period due to its negative effect on revenues. The key issue is however still the composition of the 2011 budget, which however may not be known before the Municipality election on the 3rd of October.
News leaked that the special 'bank tax' could be extended over utility and telecom companies. Those could be bad news for growth, but together with a flat personal income tax, it could be overall positive for the economy.
The long-term growth outlook improved significantly after Audi and GM's Opel announced that they would expand production in Hungary. The combined investment could reach €1bn over the next years, which could result in an export boost of around 8% and may generate 2%.



MNB leaves its base rate at 5.25 % as widely expected.

Currency

The forint established a stable appreciation trend last week and the pair climbed from 282.00 to 276.50 by the end of the week. The 276-277 levels have been the resistance levels of the trading range in the last 4-months, hence it could be interesting to see whether they hold on know.

Fixed income

The bond market rallied with the currency last week despite Thursday's auction saw demand just twice the amount offered, which is less than two weeks before. Yields however later declined from the 6.90%-7.00% territory to around 6.75%, while long-term forward spread narrowed to 314bps at the 5y5y swap. Low volume on the secondary market together with lower demand on auctions suggest that investors are probably waiting on the sideline before the government reveals its main policy goals after the elections.

EUR/HUF technical picture

(279.85): Failure to regain the broken Uptrendline off 262.05 has sent the pair back towards 276.70/ 276.35 (see graph).
Resistance at 282.20/ .61 (neckline hourly Double Top/ falling weekly Medium Term Moving Average), ahead of 284.40 (reaction high hourly + weekly modified Alpha Beta trend top), where pause favored.
Failure to cap would see next levels at 286.70 (breakdown daily), ahead of 289.34/ .55 (weekly Bollinger top/ Sept 08 high): tough on 1st attempts.
Support at 278.45 (current reaction low off 289.55), were pause favored.
If unable to hold, next levels at 276.70/ 276.35 (see graph: neckline multiple Tops + weekly modified Alpha Beta trend bottom/ Aug 18 low): tough on 1st attempts.

DAILY CHARTS:

Poland

Currency

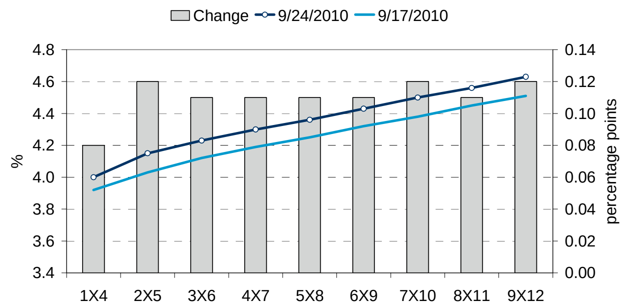
The Polish zloty stayed more or less unchanged over the week. The start was nervous due to growing Irish jitters and worse European PMI. Nevertheless the bulls came back to the market by the end of the week on stronger German Ifo. The zloty came back to 3.95 EUR/PLN on late global equity markets rally and on better than expected retail sales. The nominal growth in sales accelerated to 6.6% despite ongoing sluggish growth in prices. Durables and cars were driving the sales, which is a positive signal, if it is confirmed in the coming months (especially in case of fast growing car sales). Putting together, solid retail sales with a further decline in unemployment increases the probability of our base scenario of one interest rate hike by the end of the year.
The start to the week may be positive. Nevertheless we continue to be suspicious to current global optimism that is more kind of relief than start of a new bull market. That is why for now we do not see potential for breaking below 3.92 EUR/PLN. We are also curious to hear the comments after MPC meeting (on Wednesday), especially in light of recent strong domestic data.

EUR/PLN technical picture

(3.9700): Currently below long term triangle pattern, but near apex (see graph).
1st Support area at 3.9295 (Sept 22 low), with next levels at 3.9177 (current reaction low off 4.2400), ahead of 3.9020/ .9004 (1st target of daily Triple Tops off 4.0405/ rising 50 Month Moving Average), where pause favored.
If unable to hold, next levels at 3.8831 (weekly Bollinger bottom), ahead of 3.8760/ .8750 (last targets off 4.0405): tough on 1st attempts.
1st Resistance comes in at 3.9922/ 4.0001 (breakdown daily/ falling weekly Medium Term Moving Average)
4.0180/ .0270 (Aug 31 high/ Aug 04 + 24 highs): ideal area to stay below to keep current mood on Zloty.

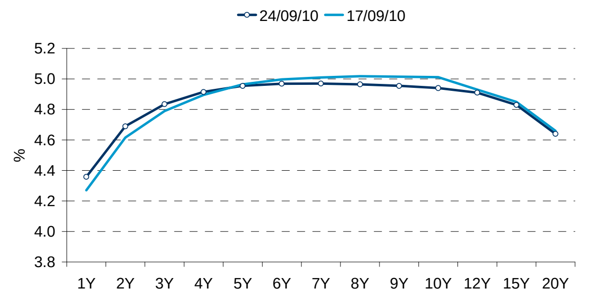
DAILY CHARTS:

PL FRA



Source: Reuters

PL IRS



Source: Reuters

CE Weekly Preview

WED 14:30 **NBP base rate**

	This meeting	Last change
rate level (in %)	3.50	6/2009
change in bps	0	-25

Polish central bank will stay on hold again

Polish central bank should once again keep the rates on hold. Nevertheless the comments can attract more attentions now. As strong domestic figures continue to point to solid domestic demand we would expect certain shift from more neutral stance (recently communicated by governor Belka) to moderately hawkish stance. Especially as fiscal policy continues to be clearly expansionary.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
HU	**27.9.2010**	**14:00**	**NBH meeting (%)**	**09/2010**	**5.25**		**5.25**		**5.25**	
HU	28.9.2010	09:00	Unemployment rate (%)	08/2010			10.9		11.0	
PL	28.9.2010	14:00	Current account (EUR M)	2Q/2010			-2 215		-1 064	
HU	29.9.2010	09:00	PPI (%)	08/2010					0.2	8.7
PL	**29.9.2010**	**14:00**	**NBP meeting (%)**	**09/2010**	**3.50**		**3.50**		**3.50**	
HU	**30.9.2010**	**08:30**	**Current account (HUF B)**	**2Q/2010**			**550**		**344**	
HU	30.9.2010	09:00	Trade balance (EUR M)	07/2010 *F					240.7	
CZ	30.9.2010	11:00	Money supply M2 (%)	08/2010						4.8
CZ	1.10.2010	14:00	Budget balance (CZK B)	09/2010					-78.7	

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	5/6/2010
Hungary	2W deposite r.	*5.25*	5.25	5.25	5.25	5.25	5.25	-25 bps	2/23/2010
Poland	2W inter. rate	*3.50*	3.50	3.75	3.75	4.00	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	Sep-11
Czech Rep.	PRIBOR	*1.21*	1.20	1.20	1.25	1.35	1.55
Hungary	BUBOR	*5.37*	5.25	5.25	5.25	5.25	5.25
Poland	WIBOR	*3.83*	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.	*2.6*	2.65	2.75	2.90	3.05	3.15
Hungary	*6.375*	6.50	6.50	6.25	6.00	6.00
Poland	*4.95*	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	*24.6*	24.8	24.5	24.6	24.6	25.5
Hungary	EUR/HUF	*279*	280	280	275	275	275
Poland	EUR/PLN	*3.97*	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.	2.0	1.4	1.5	1.1	2.0	3.0
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.	1.9	2.0	2.0	2.1	2.4	2.5
Hungary	4.2	3.5	3.4	3.2	2.8	3.2

Current Account as % of GDP

	2009	2010
Czech Rep.	-1.0	-1.5
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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