
KBC
Banking & Insurance

# Central European Weekly

Written by CSOB Prague, Kredyt Bank Warsaw and K&H Budapest

## Czech Republic

### Business sentiment still on the rise

## Hungary

### MNB surprised with a 25 bps rate hike ending its 17 month easing cycle

## Poland

### Polish rates remain stable for now, in line with expectations

## The week ahead

### Poland's GDP growth should bring another surprise on the upside

# Overview

| | Last | Outlook 1W ahead | Outlook 1M ahead |
|---|---|---|---|
| EUR/CZK | 24.72 | ↗ | ↗ |
| EUR/PLN | 4.025 | ↗ | ↗ |
| EUR/HUF | 279.5 | ↗ | ↗ |
| | | | |
| 3M PRIBOR | 1.23 | → | → |
| 3M WIBOR | 3.85 | → | ↗ |
| 3M BUBOR | 5.37 | ↗ | ↗ |
| | | | |
| 10Y CZK | 3.61 | ↗ | ↗ |
| 10Y PLN | 6.09 | ↗ | ↗ |
| 10Y HUF | 7.97 | ↗ | ↗ |
| | | | |
| 3M EURIBOR | 1.15 | → | → |
| 10Y EMU | 2.72 | ↘ | ↘ |

Last values from Friday 15:30 CET

## Contagion from EMU periphery arriving in Central Europe

The contagion from the debt crisis in the periphery of the euro area has, in the end, also hit Central Europe. The sale of Hungarian bonds was followed by a decline in Polish bond prices and the depreciation of all Central European currencies. Nevertheless, aside from the fall in Hungarian bond prices, which was reinforced by investors' concerns about the impact of the de facto nationalisation of the pension funding system, the developments in the forex and bond markets of the region have not been very dramatic thus far.
One of the reasons may be that export-oriented Central European economies, tied to the strong German industry, are performing reasonably well. The industry has been contributing to the ongoing recovery practically throughout the entire region. In addition, Poland's recovery also been supported by the strong performance of retail sector.

This week's Polish GDP release should confirm that consumer demand and domestic demand in Poland are improving, and this should be a signal for the Monetary Policy Council (MPC) to start its monetary tightening cycle soon (in December). Unfortunately, the crisis inside the euro area has interfered in this decision-making process. While the crisis has weakened the zloty, thus eliminating one of the obstacles to a rate hike, it added another strong element of uncertainty to the MPC's decisions. We will therefore monitor very closely the Polish central bankers' comments in reaction to the Q3 GDP report and its structure, before we draw our final conclusions as to whether the National Bank of Poland will really raise its official interest rate next month or not.

# Czech Republic

## Macro review

Confidence in the Czech economy is on the rise. Consumers and businesses alike viewed the further development of the economy optimistically in November. The business mood has reached a two-year high, i.e., a level last attained just before the economic crisis. Particularly evident is the increase in confidence among industrial firms (currently at a two-and-a-half-year high) and among firms active in trade. The outcome of the research on investment is very positive, as it indicates that businesses are going to increase their investment activities by a huge 7% as early as in 2011. While this should primarily include investments in their existing production, according to the Statistical Office, it still means a change in the trend, given the existing fall. Optimism in industry is on the rise, but the construction sector, suffering from a lack of contracts, shows a steady decline in confidence. Confidence among construction firms is starting to approach the record-breaking lows hit in 1999, and it is probably just a question of a few months before new lows will be hit. While industry and construction show a clear trend, the consumer mood is fairly variable. Although the consumer mood is currently improving, it has not yet reached the level of last summer. People expect their financial position to worsen, likely because of austerity measures, and that their savings to be lower. Looking forward, consumers still face several factors of uncertainty. The situation on the labour market will have to be clarified. Currently a rise of more than 50,000 new unemployed is expected. Secondly, the impact of the government's austerity measures on family budgets will also become clearer in the months to come. As far as industry is concerned, its trend of positive expectations may persist, as signalled by the contracts as well as by sentiment indicators in Germany. Nonetheless, the existing optimism may slightly cool in early 2011, even in industry.

## Currency

In the first half of last week, the Czech koruna hovered slightly below the technical level at EUR/CZK 24.71 and kept stable in spite of good news from Germany. The increasingly tense situation on the Korean peninsula, along with the rising bond spreads in the troublesome countries of the euro zone had still no negative impact on the koruna on Wednesday. The Czech currency seemed to have withstood the pressures. However, Friday's trading was marked by increased volatility and another escape into the safe dollar, and the koruna even temporarily weakened to more than EUR/CZK 24.80.

From a technical point of view, the koruna, by having broken through the resistance level of EUR/CZK 24.71, is now in a position to depreciate to EUR/CZK 24.99. In addition, the worsening problems of the countries at the periphery of the eurozone favour the scenario that envisages a depreciation of the Czech currency.

## EUR/CZK technical picture

(24.7800) Double Top off 25.0150 (previous year low), but currently above the neckline of a short term Double Bottom (24.7100: see graph).
1st support area at 24.6820/ .6600 (weekly rising Short Term Moving Average/ reaction low hourly), with next levels at 24.5800 (Nov 17 low) and 24.5240 (weekly modified Alpha Beta trend bottom), where pause favored.
If wrong, next level at ahead of 24.3450 (current reaction low off 29.6900), ahead of 24.2890 (weekly Bollinger bottom): tough on 1st attempts.
Resistance area at 24.8250 (current reaction high off 24.3450?), with next levels at 24.8600 (Aug 31 high) and 24.8960 (weekly modified Alpha Beta trend top), where pause favored.
24.9450/ .9900 = Aug 25/ 16 highs: key area to stay below to keep medium term mood on CZK.

**DAILY CHARTS:**

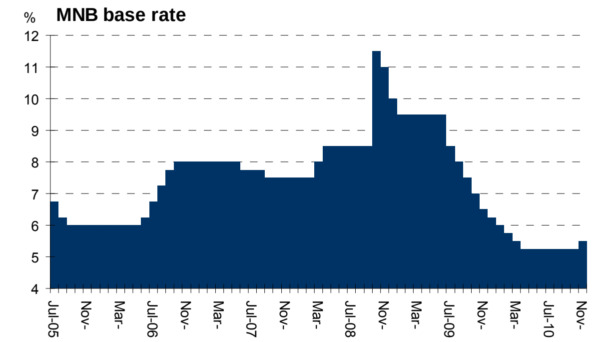

## Fixed income

The trading in Czech bonds was calm last week. The yield curve steepened slightly. The greatest rise, by 9 basis points, occurred in the 7Y bond segment, with the yield hitting a three-month high. In spite of the problems of the European peripheries, a new 11Y auction for a total of almost CZK 6bn was successfully subscribed on Wednesday. The average yield of the sale was 3.813%.
For this week, we expect that interest rates at the short end of the curve will go up (driven by the depreciation of the koruna), while we anticipate rate stability at the long end, with the spread between Czech bonds and Czech swap rates likely to widen.

# Hungary

## Macro review

The central bank surprised us with a 25bps rate hike on Monday and lifted the base rate to 5.50%. It seems that the central bank became worried about markets' confidence and decided on a pre-emptive hike before the forint weakens too much or yields go too far at the long-end. Future moves could thus depend on the market volatility.




The major event was, however, the government's announcement that those who do not return to the state pillar of the pension system will not get pension from the state system. More precisely they will get only the amount they are entitled until 31 January 2011. In other words, their contribution to the state pillar will be taken into account only until this date. In order to achieve this, the pension contribution paid by the employer will be renamed to pension tax from next year.

This will mean that those who remain in the mandatory private pension system (PPF) will continue to accumulate their assets with the 10% contribution paid by the employee. This however will hardly offset the state pension as pensions from the PPF were estimated to give only 25% of the pension amount and therefore non-returning members will loose 75% of their pension hope.

In theory, the choice is free but there has been quite a strong incentive now for PPF members to return to the state pillar, which is relying on Ft530bn (20% of assets) of revenue from asset sales in the 2011 budget. This would come from selling equities and mutual funds from the PPF assets, which is 50% of the total. The rest is in government bonds, which will simply return to the issuer and decrease the amount of public debt. As total PPF assets amount to 7% of GDP and 30% is planned to be used to generate revenue for 2011 and 2012, while the rest 7% of GDP will lower public debt ratio, which is currently at 81% of GDP.

Released data was broadly neutral for the outlook. November economic confidence improved slightly further and retail sales picked up to 0.9% Y/Y growth from 0.0% Y/Y in September. The unemployment rate stagnated at 10.9% level.

## Currency

The government's program is not helping the forint nowadays as investors are worried that funding from asset sales could undermine long-term sustainability of fiscal policy. The forint became an underperformer in its peer group in November and last week it weakened through the key level of 280/€.

### EUR/HUF technical picture

(280.00): Pair currently above 278.40 (see graph: neckline Triple Bottoms) and approaching Down trendline off 292.10.

Resistance at 281.05 (current reaction high off 268.70?), ahead of 282.92/ 283.16 (weekly modified Alpha Beta trend top/ 61.8% 292.10 to 268.70), where pause favored.

If unable to cap, next levels at 284.36 (1st target off 278.40), ahead of 286.57 (76.4%).

288.88/ 289.55 = weekly Bollinger top/ Sept 08 high: tough on 1st attempts.

Support at 276.00 (break-up hourly + rising weekly Short Term Moving Average↑), with next levels at 272.44 (Nov 22 low), ahead of 270.40/ 270.00 low (weekly modified Alpha Beta trend bottom/ Nov 02 low), where pause favored.

If wrong, next levels at 269.46/ 268.70 (weekly Bollinger bottom/ current reaction low off 292.10) and 268.28 (76.4% 260.93 to 292.10): tough on 1st attempts.

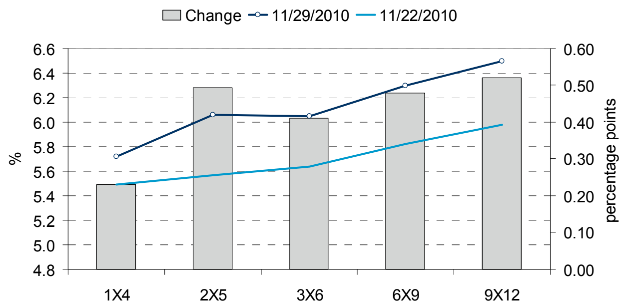
**DAILY CHARTS:**


Central bank's unexpected rate hike kept it below 281/€ on Monday, but sentiment seems to be vulnerable amid the global correction, which may keep the market on a tiptoe. However, should the international sentiment improve, the forint may also find strong support from the change in monetary policy.

## Fixed income

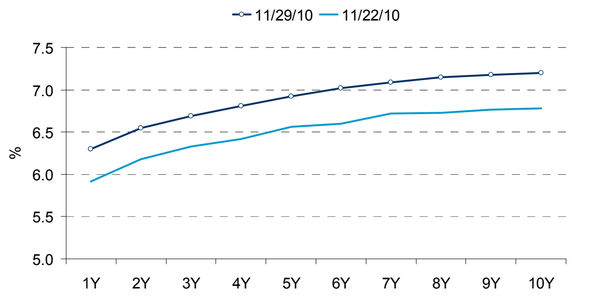
The bond market remained in a bearish mode last week and yields at the long-end came close to the key 8.25% level. The short end rose especially sharply as FRAs priced in more than 100bps of rate hikes over the next 12-months, of which 25bps has been delivered. This surprised us as domestic demand has been depressed and as the underlying inflation trend looks to be modest. The rate outlook thus has became highly uncertain, which may keep investors on the sideline despite the relatively high yields.

**HU FRA**




Source: Reuters

**HU IRS**




Source: Reuters

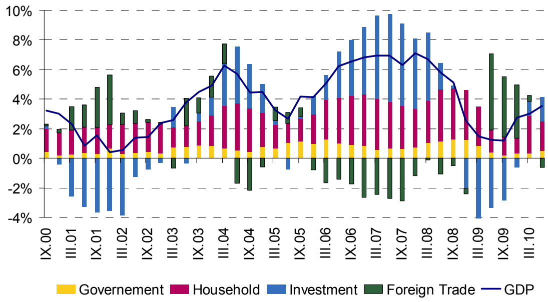
# Poland

## Macro review

Quite a lot of macroeconomic figures were released in Poland last week, but they sprang no significant surprises. Similarly anticipated was the decision by the National Bank of Poland to keep interest rates unchanged. In our opinion, the GDP growth forecast for the third quarter, to be released on Tuesday (November 30), will be key for the central bankers' assessment on monetary policy.

The **industrial output** figure, released at the end of last week, slightly disappointed markets, as it unveiled just an 8% year-on-year rise in October (the forecast was 10.1%), while the month-on-month figure showed a drop by 1.6% rather than the anticipated stagnation. The rise in October's retail sales, by contrast, sprang a pleasant surprise, as it easily surpassed the median expectations on both the year-on-year basis (9% compared to 8.2%) and the month-on-month basis (4.3% compared to 3.1%). October's unemployment rate, which went down by 0.1% to 11.5% compared to September, highlighted the labour market recovery. Core inflation was 1.2% y/y in October, in line with expectations. The producer price index, which stagnated on a month-on-month basis, rose by 4% y/y, slightly lower than predicted.

**Polish GDP, y/y**

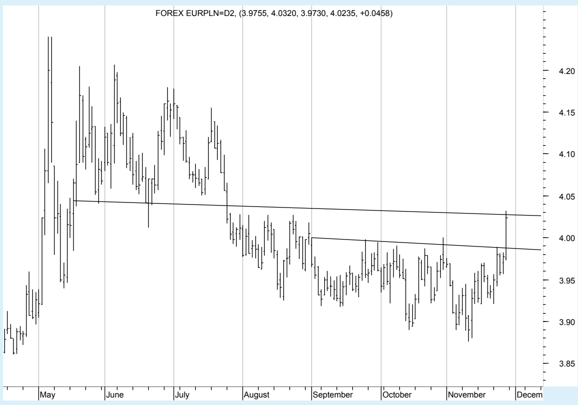



On Tuesday the Monetary Policy Council (MPC) as expected left its base rate unchanged at 3.5%. The existing positive development of Poland's real economy did not seem to generate any significant demand-pull pressures, either on prices or wages to rise, at the moment. The rise in the consumer price index, which is currently 0.3% above the central bank's inflation target, is primarily due to energy and food prices. The information released from the MPC meeting does not indicate any major change in the tenor of the central bankers' assessment. The opinion promoted by Governor Belka still predominates slightly. He is afraid that the rapid inflow of funds, triggered by a hike in Poland's interest rates, might rapidly strengthen the zloty. We still believe that, if the GDP for the third quarter shows a sound increase in investment (excluding inventories), this may fundamentally strengthen the position of the hawks on the MPC. On the other hand, we will also need to monitor the tension at the periphery of the eurozone, which has also started to impact on Polish markets. Should the global aversion to risk persist, some of the undecided central bankers might stick to their wait-and-see attitude in the end, irrespective of reasonable GDP data.

## EUR/PLN technical picture

(4.0240): New reaction low off 4.2400 has met 2nd target of daily Triple Top off 4.0405 (see graph), with this area being now reapproached.
1st Support area at 3.9515 (rising weekly Medium Term Moving Average), with next levels at 3.9210 (Nov 22 low) and 3.9122/ .9075 (weekly modified Alpha Beta trend bottom/ break-up daily), where pause favored
If unable to hold, next levels at 3.8760/ .8705 (Nov 10 low/ weekly Bollinger bottom): tough on 1st attempts.
1st Resistance comes in at 4.0380 (current reaction high off 3.8760?), ahead of 4.0580 (50% 4.2400 to 3.8760) and 4.0700/ .0783 (weekly Bollinger top/ 1st target off 3.9980: see graph: neckline short term Triple Bottoms), where pause favored..
Failure to cap would see next level at 4.1060 (2nd target) and 4.1325 (weekly Starc top).

**DAILY CHARTS:**



# CE Weekly Preview

| TUE 14:00 | PL GDP ( y/y change in %) | |
|---|---|---|
| | **2010Q3** | 2010Q2 |
| GDP | **3.7** | 3.5 |
| Fixed Investment | **8.3** | 7.3 |
| Consumption | **2.7** | 2.7 |

## PL: Poland’s growth should might surprise on the upside

Poland’s GDP should accelerate to 3.7% y/y and surprise the market positively. Nonetheless, the growth structure will be of primary importance for the central bank. We believe that growth will be driven not only by domestic consumption but also, at last, by core investment (adjusted for inventory changes). Foreign trade, by contrast, may have a slightly negative effect, owing to the nicely developing private demand.

# Calendar

| | Date | Time | Indicator | Period | Forecast | | Consensus | | Previous | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | m/m | y/y | m/m | y/y | m/m | y/y |
| **HU** | **29.11.2010** | **14:00** | **NBH meeting (%)** | **11/2010** | **5.25** | | **5.25** | | **5.25** | |
| HU | 30.11.2010 | 09:00 | PPI (%) | 10/2010 | | | | 6.6 | -0.9 | 7.9 |
| **PL** | **30.11.2010** | **10:00** | **GDP (%)** | **3Q/2010** | | **3.7** | | **3.7** | | **3.5** |
| CZ | 30.11.2010 | 11:00 | Money supply M2 (%) | 10/2010 | | | | | | 4.7 |
| CZ | 1.12.2010 | 14:00 | Budget balance (CZK B) | 11/2010 | | | | | -96.7 | |
| HU | 2.12.2010 | 09:00 | Trade balance (EUR M) | 09/2010 *F | | | | | 548 | |

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* | Dec-10 | Mar-11 | Jun-11 | Sep-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. | *5.50* | 5.50 | 5.50 | 5.50 | 5.50 | 25 bps | 11/29/2010 |
| **Poland** | 2W inter. rate | *3.50* | 3.75 | 4.00 | 4.00 | 4.00 | -25 bps | 6/25/2009 |

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

| | | *Current* | Dec-10 | Mar-11 | Jun-11 | Sep-11 |
|---|---|---|---|---|---|---|
| **Czech Rep.** | PRIBOR | *1.23* | 1.23 | 1.25 | 1.45 | 1.60 |
| **Hungary** | BUBOR | *5.37* | 5.60 | 5.60 | 5.60 | 5.60 |
| **Poland** | WIBOR | *3.85* | 3.90 | 4.10 | 4.30 | 4.30 |

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

| | *Current* | Dec-10 | Mar-11 | Jun-11 | Sep-11 |
|---|---|---|---|---|---|
| **Czech Rep.** | *2.99* | 3.00 | 2.90 | 3.10 | 3.35 |
| **Hungary** | *6.99* | 6.50 | 6.25 | 6.00 | 6.00 |
| **Poland** | *5.52* | 5.00 | 5.60 | 5.60 | 5.80 |

*Exchange rates (end of the period)*

| | | *Current* | Dec-10 | Mar-11 | Jun-11 | Sep-11 |
|---|---|---|---|---|---|---|
| **Czech Rep.** | EUR/CZK | *24.7* | 24.5 | 24.6 | 24.6 | 25.5 |
| **Hungary** | EUR/HUF | *280* | 280 | 275 | 275 | 275 |
| **Poland** | EUR/PLN | *4.03* | 3.80 | 3.60 | 3.70 | 3.60 |

*GDP (y/y)*

| | Q3 2010 | Q4 2010 | Q1 2011 | Q2 2011 | Q3 2011 | Q4 2011 |
|---|---|---|---|---|---|---|
| **Czech Rep.** | 3.0 | 2.2 | 2.0 | 1.2 | 1.0 | 2.5 |
| **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 | 2.2 | 2.5 | 2.4 | 2.4 |
| **Hungary** | 4.2 | 3.5 | 3.4 | 3.2 | 2.8 | 3.2 |

*Current Account as % of GDP*

| | 2009 | 2010 |
|---|---|---|
| **Czech Rep.** | -1.0 | -2.2 |
| **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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