Monday, December 06,

KBC Banking & Insurance

Central European Weekly

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

Czech Republic

EUR/CZK at the key 25.0 resistance level

Hungary

Moody's downgrades Hungary's sovereign rating to one notch above the speculative grade

Poland

Poland posts strong 3Q GDP growth

The Week Ahead

Inflation figures and GDP final figures in Hungary and the Czech Republic might be interesting

Overview

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.00	-0.03%	↗	→
EUR/PLN	3.995	-0.02%	↗	→
EUR/HUF	277.7	0.03%	↗	↗
3M PRIBOR	1.23	0.00	→	→
3M WIBOR	3.90	0.00	→	↗
3M BUBOR	5.90	0.30	↗	↗
10Y CZK	3.84	0.00	→	→
10Y PLN	5.93	0.00	↗	↗
10Y HUF	7.87	0.00	↗	↗
3M EURIBOR	1.15	0.00	→	→
10Y EMU	2.84	0.00	→	→

Last values from Friday 15:30 CET

Central banks in Central Europe start tightening cycle

The National Bank of Hungary (NBH) surprisingly raised its policy rate last week. There is every indication that the bank wants to protect the forint from a potential depreciation. Hungarian households are very vulnerable to such a development as they are up to their ears in debt denominated in euros and Swiss francs. The forint might come under pressure, not only because of tensions at the periphery of the euro area, but mainly due to the numerous non-standard measures taken by the Hungarian Cabinet in recent weeks – the nationalisation of pensions, extraordinary selective taxes and the quick rewriting of Constitutional Acts.

The question of the first rate hike is also on the agenda in Poland. The Monetary Policy Council (MPC) is desperately divided between hawks and doves. For the first group, the recovery, which is confirmed, is a clear argument for the normalisation of rates. On the other hand, the doves are afraid that a rate hike will trigger a rapid appreciation of the Polish currency. The GDP figure for the third quarter of the year has not significantly helped to resolve their dispute. The 4.2% Y/Y growth surpassed our forecast and the market consensus. However, a look into the structure unveiled a deplorably slow rise in investment. Thus the MPC remains desperately divided. The only 'deserter' from the doves to the hawks thus far has been Anna Zielinska-Glebocka. However, the overall ratio between the two groups is 5:5 now. We still slightly prefer the scenario of a December rate hike, but the decision will certainly be made by a very narrow margin. Much will depend on the degree of tension at the peripheries of the euro area (which favours doves) and/or on the weakness of the zloty (which favours hawks).

The first hawkish comments were also made by Czech central bankers. Nevertheless, given the pessimistic tenor of the latest forecast (our forecasts are slightly more optimistic), monetary tightening in the Czech Republic is not on the agenda at the moment.

Czech Republic

Currency

The **Czech koruna** finally got under pressure. Partly because of the ongoing tensions surrounding Hungary and partly due to the correction on the PLN/CZK pair. The zloty touched one year lows towards the low yielding koruna as risk aversion spiked by the end of November. A certain calm down triggered profit taking in recent days and caused a financing of long positions in the zloty from the Czech koruna. Hence, the Czech currency has broken through critical psychological level of 25.00 EUR/CZK.

From a technical point of view, it is critical whether the pair stays below 200-day moving average and whether it will manage to come back below 25.00 subsequently. Nevertheless as we slowly enter year-end low-volume trading, we may be surprised by higher volatility. Under current global circumstances, it is highly improbable that the koruna will profit from solid domestic figures. Given the bearish forecast of the CNB for next year, optimistic figures probably won't change the outlook for monetary policy.

Fixed income

Czech bonds experienced a modest sell off last week as the yield curve steepened in a bearish fashion. The Czech market tracked German Bunds rather than volatile markets in the Euro-zone periphery. The sell-off was also supported by two comments from Czech central bankers, who warned that the current level of the official rate was unsustainably low.

The main event even for the upcoming week will be an auction of a 5Y benchmark. While the recent sell-off has made bond prices more attractive, the uncertainty in the euro bond markets and low liquidity conditions at the end of the year could bring slightly weaker bids in the auction.

EUR/CZK technical picture

(25.0000) Rebound off year low now trying to settle back above 25.0150 (previous year low + neckline Double Top), with 2nd target off 24.7100 (neckline of a short term Double Bottom: see graph) at 25.0750

1st support area at 24.8250/ .7940 (break-up daily/ weekly rising Short Term Moving Average), with next levels at 24.6790/ .6600 (weekly Bollinger midline/ Nov 24 low) and 24.6150 (weekly modified Alpha Beta trend bottom), where pause favored.

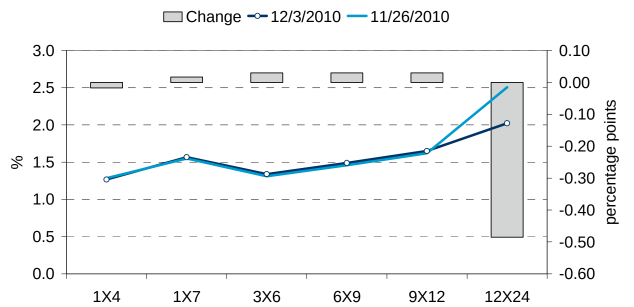
If wrong, next level at ahead of 24.5800 (Nov 07 low), ahead of 24.4660 (weekly Bollinger bottom): tough on 1st attempts.

Resistance area at 25.0550/ .0750 (current reaction high off 24.3450?/ see above), where pause favored.

If unable to cap, next levels at 25.0920 (38.2% 26.3000 to 24.3450), ahead of 25.1400 (monthly envelope top) and 25.2520 (weekly modified Alpha Beta trend top): tough on 1st attempts.

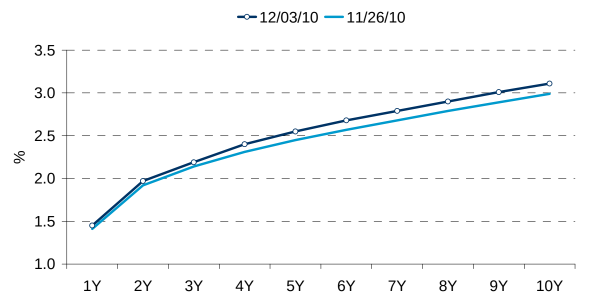
DAILY CHARTS:

CZ FRA



Source: Reuters

CZ IRS



Source: Reuters

Hungary

Macro review

Last week's **macro data** were broadly in line with expectations. Producer prices decelerated to 7.1% Y/Y from 7.9% Y/Y as wholesale good prices moderated. This could be important for the outlook at a time when the central bank started a tightening cycle on inflation risks.
The PMI index improved to 54.9 from 51.7 in November. Good news on the economic recovery is necessary to achieve the targeted 3% growth in 2011.
Today, **Moody's downgraded its credit rating of Hungary** by two notches from Baa1 to Baa3 with a negative outlook. It cited sustainability concerns of the fiscal outlook due to heavy reliance on temporary revenue measures offsetting tax cuts.
This means that Moody's has now the same rating on Hungary like S&P, just one notch above non-investment grade and a negative outlook. Fitch could announce its assessment in the coming weeks.

Currency

News about the downgrade stopped **the forint's** recovery and pushed back the currency 1% lower to the key level of 280.50/€. Panic selling after the rate hike bottomed out at 284.60 followed by a sharp appreciation of about 3% within days. This lesson kept investors more cautious about going deeply short on the forint.
For us, it seems that the market has been hit by the negative news more severely at the beginning than over a longer-term period. So, we may see recovery quickly after panic selling ends. The government's risky plans of tax cuts funded by temporary measures and the longer-term fix coming from growth, could keep investors nervous about the forint. However, since the growth momentum is pretty strong, we would not rule out that budget targets will be met. Thus, for us these panic selling events could be a good opportunity to buy the forint and build a position for a stronger currency if growth revives in 2011.

Fixed income

The **bond market** suffered with the currency at the beginning of last week and yields at the long-end rose to this year's high of 8.35%. This was followed by a quick recovery in the second half of the week, which ended on Monday with the Moody's announcement.
Last week's bond auction went successfully, albeit at higher yields as investors found Hungary's high-yielding bond market more appealing.

However, investors at the short-end of the curve remained convinced that the central bank will continue to hike the base rate from the current level of 5.50% to as high as 6.50% over the next 6-months. This is not impossible, but it could mainly depend on the investor sentiment as higher inflation is caused by food prices rather than demand-pulled inflation.

EUR/HUF technical picture

(278.00): Pair currently toying back with 278.40 (see graph: neckline Triple Bottoms) and back below Downtrendline off 292.10.
Resistance at 280.61/ 281.15 (reaction highs hourly), ahead of 282.00 (weekly modified Alpha Beta trend top) and 283.00 (breakdown hourly), where pause favored.
If wrong, next levels at 285.00 (current reaction high off 268.70), ahead of 285.89/ 286.57 (weekly Bollinger top/ 76.4% 292.10 to 268.70): tough on 1st attempts.
Support at 276.06 (broken falling weekly Medium Term Moving Average), with next levels at 274.92 (61.8% 268.70 to 285.00) and 272.80/ 272.44 (monthly envelope bottom/ Nov 22 low + weekly modified Alpha Beta trend bottom), where pause favored.
If wrong, next levels at 270.42/ 270.00 (weekly Bollinger bottom/ Nov 02 low): tough on 1st attempts.

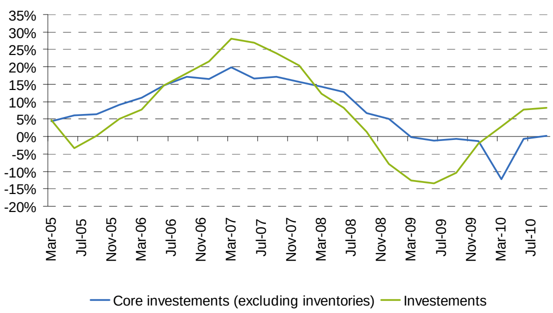
DAILY CHARTS:

Poland

Macro review

The growth of the Polish economy for the third quarter of this year was a pleasant surprise to markets. The gross domestic product was up by 4.2% y/y exceeding analysts' forecasts by 0.6%.
If we have a closer look into the index structure, we find that growth was primarily driven by domestic demand. Government consumption rose most dynamically, by 4.3% y/y and, compared to the second quarter, continued to accelerate by 2.1%. Along with rising household consumption, the overall contribution of consumption to GDP growth was 2.9%.

Polish investement activity, y/y



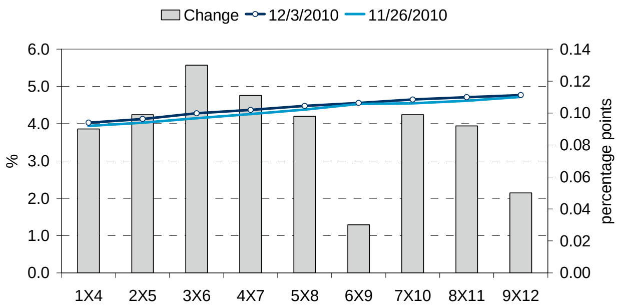
Compared to the previous two quarters of this year, investment adjusted for inventory changes also went up on the year-on-year basis (+0.4%). Nevertheless, as far as the contribution to GDP growth is concerned, the changes in inventories were still predominant within investment (1.2% as opposed to the 0.1% contribution of investment without inventory). The impact of foreign trade on the rate of GDP growth was neutral.
In terms of the gross value added from individual sectors of the economy, industry, which was up by 10.2% y/y, was the greatest contributor to economic growth.

EUR/PLN technical picture

(3.9965): Rebound off 3.8760 sent the pair above 3.9980 (see graph: neckline Triple Bottoms), with this area being now retested and Downtrendline off 4.2400 broken.
1st Support area at 3.9700/ .9690 (break-up weekly/ rising weekly Medium Term Moving Average), with next levels at 3.9473/ .9431 (monthly envelope bottom/ weekly modified Alpha Beta trend bottom), where pause favored.
If wrong, next levels at 3.9210 (Nov 22 low) and 3.9100/ .9075 (break-up hourly/ daily): tough on 1st attempts.
1st Resistance comes in at 4.0300/ .0315 (reaction highs hourly), ahead of 4.0520/ .0557 (breakdown hourly/ weekly modified Alpha Beta trend top), where pause favored.
If wrong, next levels at 4.0905 (monthly envelope top), ahead of 4.1100/ .1200 (current reaction high off 3.8760/ last target off 3.9980): tough on 1st attempts.

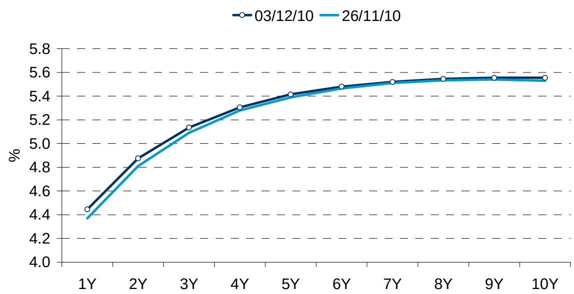
DAILY CHARTS:

PL FRA



Source: Reuters

PL IRS



Source: Reuters

CE Weekly Preview

TUE 9:00 **CZ Retail Sales (change in %)**

	Oct-10	Sep-10	Oct-09
Sales	**0.7**	3.5	-5.2
cummulative (YTD)	**1.0**	1.0	-5.0

CZ: Retail sales rise only slightly

We expect that retail sales went up only slightly in October. The reasons include a lower number business days and poor car sales (-7.6%). Thus the automotive segment again curbed the rise of retail sales. By and large, we can say, however, that the rate of sales remains moderate. Until the economic recovery starts to clearly make itself felt in the financial position of households, we don't expect rates of sales seen before the recession to reoccur. On the other hand, the moderate rise in consumption curbs inflation and contributes to the extension of the period of low interest rates.

TUE 9:00 **CZ Industry (y/y change in %)**

	Oct-10	Sep-10	Oct-09
Monhtly	**8.0**	11.8	-6.2
cummulative (YTD)	**9.2**	9.4	-15.0

CZ: Industrial output on the rise

Czech industry most likely continued to grow rapidly in October. The moderate deceleration against the previous two months, evident at first glance, is due to a lower number of business days. A high rate of output can be expected in the engineering and electrical industries. The automotive industry and metal production are also likely to show reasonably good figures. After all, the new contracts of industrial enterprises in the preceding months already signaled favourable figures for the months to come.

TUE 9:00 **CZ Foreign trade (CZK bn)**

	Oct-10	Sep-10	Oct-09
Balance	**12.0**	12.4	16.4
cummulative (YTD)	**110.8**	98.8	132.4
Exports (y/y in %)	**14.0**	17.7	-9.6
Imports (y/y in %)	**17.7**	21.8	-19.0

CZ: Trade balance posts a double-digit surplus

We expect again a double-digit trade surplus for the month of October. While the figure is lower than that of October last year, it is worsened by more than CZK 3bn due to the increased prices of energy raw materials. Thus the rate of import growth was most likely again higher than that of exports. Yet the latter continues to show double-digit rates. This year's foreign trade figure will be much worse than last year's, but this will be primarily due to two temporary factors. The first factor is the year-on-year increase in the koruna prices of raw materials, while the second factor is the huge import of equipment for solar power plants. Nonetheless, both of these factors will wane over the next few months.

THU 9:00 **CZ GDP (y/y change in %)**

	Q3-10	Q2-10	Q3-09
GDP	**3.0**	2.4	-4.4

CZ: GDP update will confirm the first forecast

As the Statistical Office unveiled in its first forecast, the economy grew by 3% in the third quarter of the year. Now the Office is about to release an update and the detailed structure of the supply and demand sides of the economy. Most likely, it will come to light that inventories and probably also foreign trade are primarily driving the economy. Consumption may also be a small contributor. As far as individual sectors are concerned, the industry is continuing to drive the Czech economy, followed by certain services, which lie well behind the former. However. as we can expect no dramatic turnover in the last weeks of the year, the Czech economy is likely to show growth of slightly above 2% for this year – due primarily to inventories.

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

	Nov-10	Oct-10	Nov-09
CPI m/m	**0.1**	-0.2	0.2
Food m/m	**1.0**	-0.5	0.5
Housing, energy	**0.0**	0.0	0.0

CZ: Inflation slightly below the target

Consumer prices likely went up only very slightly in November. The increase by 0.1% is primarily due to food, the prices of which are going up in line with seasonal developments and with regard to the increasing prices of agricultural commodities. Clothing and shoe prices likely also went up, while package tour prices, as usual in this period of the year, went down. Fuel prices had no significant impact on inflation this time. Year-on-year inflation, which is monitored by the central bank, was likely slightly below the target value, from which it will not significantly diverge within the next few months either.

THU 9:00	HU Foreign trade (EUR m)		
	Oct-10	Sep-10	Oct-09
Balance	**500**	540	442
cummulative (YTD)	**4700**	4200	2980

HU: Foreign trade still on a positive note

The foreign trade balance has likely remained above €500m per month as exports continued to beat imports in recent moths.

FRI 9:00	HU Inflation (change in %)		
	Nov-10	Oct-10	Nov-09
CPI m/m	**4.3**	4.2	5.2
Core CPI y/y	**1.9**	1.8	5.0

HU: Inflation higher due to food prices

Inflation could have increased slightly further on higher food prices, but demand-pull inflation elements could have remained moderated.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
CZ	6.12.2010	09:00	Wages (%)	3Q/2010						1.2
CZ	7.12.2010	09:00	Construction output (%)	10/2010						-7.3
CZ	7.12.2010	09:00	Industrial output (%)	10/2010		8.0				12.2
HU	7.12.2010	09:00	Industrial output (%)	10/2010 *P					0.5	10.9
CZ	7.12.2010	09:00	Retail sales (%)	10/2010		0.7				3.5
CZ	**7.12.2010**	**09:00**	**Trade balance (CZK B)**	**10/2010**	**12.0**				**12.4**	
HU	7.12.2010	17:00	Budget balance (HUF B)	11/2010					-1 132.7	
CZ	8.12.2010	09:00	Unemployment rate (%)	11/2010	8.6				8.5	
CZ	**8.12.2010**	**12:00**	**CZ bond auction 3.40%/2015 (CZK B)**	**12/2010**			**6**			
HU	9.12.2010	09:00	Trade balance (EUR M)	10/2010 *P	500		488		540.4	
HU	**9.12.2010**	**09:00**	**GDP (%)**	**3Q/2010 *F**		**1.6**				**1.6**
CZ	**9.12.2010**	**09:00**	**GDP (%)**	**3Q/2010 *F**		**3.0**			**1.1**	**3.0**
CZ	**9.12.2010**	**09:00**	**CPI (%)**	**11/2010**	**0.1**	**1.9**			**-0.2**	**2.0**
HU	**10.12.2010**	**09:00**	**CPI (%)**	**11/2010**		**4.3**		**4.2**	**0.4**	**4.2**

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	Dec-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*	5.75	5.75	5.75	5.75	5.75	25 bps	11/29/2010
Poland	2W inter. rate	*3.50*	3.75	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	Dec-11
Czech Rep.	PRIBOR	*1.23*	1.20	1.22	1.26	1.45	1.60
Hungary	BUBOR	*5.61*	5.75	5.75	5.75	5.75	5.75
Poland	WIBOR	*3.9*	3.90	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	Dec-11
Czech Rep.	*3.14*	3.00	3.00	3.15	3.35	3.50
Hungary	*7.28*	8.00	7.75	7.75	7.50	7.50
Poland	*5.577*	4.95	5.40	5.60	5.60	5.80

Exchange rates (end of the period)

		Current	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Czech Rep.	EUR/CZK	*25.0*	24.8	24.5	24.6	24.6	25.5
Hungary	EUR/HUF	*278*	280	280	277	273	270
Poland	EUR/PLN	*4.00*	4.00	3.90	3.60	3.70	3.60

GDP (y/y)

	Q4 2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012
Czech Rep.	2.4	2.2	1.5	1.2	2.4	2.3
Hungary	2.0	2.4	2.8	3.2	3.5	3.5

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

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
Czech Rep.	1.9	2.0	2.2	2.5	2.4	2.0
Hungary	4.4	4.0	3.8	3.5	3.5	3.5

Current Account as % of GDP

	2009	2010
Czech Rep.	-1.0	-2.6
Hungary	0.5	1.0

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

	2009	2010
Czech Rep.	-5.9	-5.3
Hungary	-3.8	-2.9

Brussels Research (KBC)		**Global Sales Force**	
Piet Lammens	+32 2 417 59 41		
Peter Wuyts	+32 2 417 32 35	Brussels	
Didier Hanesse	+32 2 417 59 43	Corporate Desk	+32 2 417 45 82
Joke Mertens	+32 2 417 30 59	Commercial Desk	+32 2 417 53 23
Mathias Van der Jeugt	+32 2 417 51 94	Institutional Desk	+32 2 417 46 25
Dublin Research (KBC Bank Ireland)			
Austin Hughes	+353 1 6646892	London	+44 207 256 4848
Prague Research (CSOB)		Frankfurt	+49 69 756 19372
Jan Cermak	+420 2 6135 3578	Paris	+33 153 89 83 15
Jan Bures	+420 2 6135 3574	New York	+1 212 541 06 97
		Singapore	+65 533 34 10
Bratislava Research (CSOB)			
Marek Gabris	+421 2 5966 8809	Prague	+420 2 6135 3535
		Bratislava	+421 2 5966 8436
Budapest Research (K&H)		Budapest	+36 1 328 99 63
Gyorgy Barcza	+36 1 328 99 89	Warsaw	+48 22 634 5210
		Moscow	+7 495 228 69 61

Our reports are also available on: www.kbc.be/dealingroom