Monday, December 13,

KBC
Banking & Insurance

Central European Weekly

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

Due to the annual Christmas Holidays, there will be no Central European Weekly on the 20th and 27th of December and the 3rd of January. Next Central European Weekly will be published on the 10th of January.

Czech Republic

EUR/CZK breaks above the 200 day moving average

Hungary

November budget deficit figures were alarming – the 3.8% of GDP target at risk

Poland

MPC members remain split

The Week Ahead

Last important set of monthly data ahead of the key NBP meeting

Overview

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.18	0.68%	↗	↗
EUR/PLN	4.032	0.93%	→	→
EUR/HUF	278.1	0.15%	↗	→
3M PRIBOR	1.23	0.00	↗	↗
3M WIBOR	3.91	0.01	↗	↗
3M BUBOR	5.61	0.00	↗	↗
10Y CZK	3.82	-0.02	↗	↗
10Y PLN	5.98	0.04	↗	↗
10Y HUF	7.75	-0.12	↗	↗
3M EURIBOR	1.18	0.03	→	→
10Y EMU	2.96	0.11	→	↗

Last values from Friday 15:30 CET

Czech koruna lagging its PEER's due to carry trades?

The latest series of macroeconomic data from the Czech Republic and Hungary didn't bring any big surprises. Nevertheless, interesting developments were taking place in Central European forex markets. The Czech koruna surprisingly lagged other currencies in the region. In a weekly perspective, the koruna weakened by 2%, not only against the euro but also against the Hungarian forint.

In our view, this 'strange' behaviour of Central European currencies, led by the koruna, cannot be attributed to the development of macroeconomic indicators. Thus we suspect that the Czech koruna has lagged behind the rest of Central Europe primarily due to speculative behaviour of a part of the market, which has started to make use of the fact that interest rate settings among Central European economies differ as individual central banks find themselves in different monetary policy modes.

That said, it is quite possible that the low Czech interest rates, moreover with the prospect of remaining low for a prolonged period, along with the high interest rates in Hungary and Poland (which, by contrast, stand a good chance of continuing to rise), are encouraging investors to launch carry trades. These are funded from the low-yielding Czech koruna. Consequently, at a time when leading financial markets are relatively calm, this strategy can make the koruna depreciate against the other Central European currencies. How long may this persist?

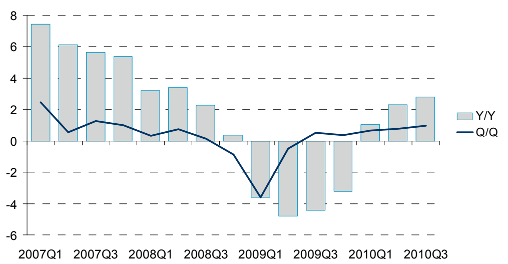
It is clear that these speculations could be thwarted, not only by dramatic developments in global markets, but also by the National Bank of Hungary or the National Bank of Poland adopting a more moderate strategy or, on the other hand, by a surprisingly hawkish tenor from the CNB. We anticipate neither the former nor the latter. However, we cannot rule out surprises particularly now that the next meetings of the CNB, NBH, and NBP will be held just before Christmas in thin market conditions.

Czech Republic

Macro review

The **Czech economy** is again being driven by the manufacturing sector. The extent to which consumption and investment contributed to growth in the third quarter of the year is noteworthy. Households rode the wave of the labour market improvement, which will, unfortunately, not last for a long time, as also signalled by the first figures for the last quarter of the year. Thus we likely cannot overly rely on the continuation of the rapid increase in consumption. Investment was driven by the solar boom, which will not last for long either because of a reduction of the generous support. We should also bear in mind that inventories play a key role on the demand side. In addition, we are heading for a time of austerity in public budgets, and this will lead to cuts in all sorts of expenditure – i.e., wages, ordinary operations, as well as government investment. For this year as a whole, GDP is expected to grow by approximately 2.2%, compared to a drop by 4.1% last year. The latest data has not changed our outlook for next year. We expect the CR's economic growth will decelerate to 1.8%. The uncertain strength of foreign demand still poses a risk to the further growth of the economy. For the sake of completeness, let us add that the Czech National Bank predicts growth of 1.2%, and thus better figures from the economy may speed up its decision to raise rates, with the central bank currently anticipating a rate hike within as long as 1 to 1.5 years.

GDP Growth
(%)



Retail consumer prices were up by 0.2% m/m and 2% y/y. The accelerated rise in November's prices was primarily due to food prices; seasonal food prices on the one hand, and the food prices influenced by the high prices of agricultural commodities on the other. Inflation remained in line with the CNB's targets for another consecutive month and indicates that it does not require any urgent response from the central bank, particularly if both headline inflation and monetary policy inflation were again lower than their respective forecasts. The months to come are likely to show another increase in food prices, which will be accompanied by an increase in fuel prices. In addition, housing costs, including the prices of energy, water, and heat, are also about to rise from next year. Thus year-on-year inflation will soon climb to slightly above 2%, and therefore will be slightly higher than envisaged by the CNB's latest forecast. However, inflation will only rise slightly from its current levels. Yet, it will outpace wage growth next year. Hence we cannot rule out that the average real wage will decline for the first time in a few years, consequently strengthening consumers' reluctance to spend money.

Currency

EUR/CZK technical picture

(25.1100) Rebound off year low now trying to settle back above 25.0150 (previous year low + neckline Double Top) and testing 200 Day Moving Average (see graph).
1st support area at 24.8250 (break-up daily Nov 26), with next levels at 24.6600 (Nov 24 low) and 24.5800 (Nov 07 low + monthly envelope bottom), where pause favored.
If unable to hold, risk would be back towards 24.3450/ .2460 (current year low/ monthly Bollinger bottom): tough on 1st attempts.
Resistance area at 25.1270/ .1400 (current reaction high off 24.3450?/ monthly envelope top), where pause favored.
If unable to cap, next levels at 25.3230/ .3450 (50% 26.3000 to 24.3450/ falling monthly Medium Term Moving Average), ahead of 25.5220 (July 19 high) and 25.6070 (23.6% 29.6900 to 24.3450): tough on 1st attempts.

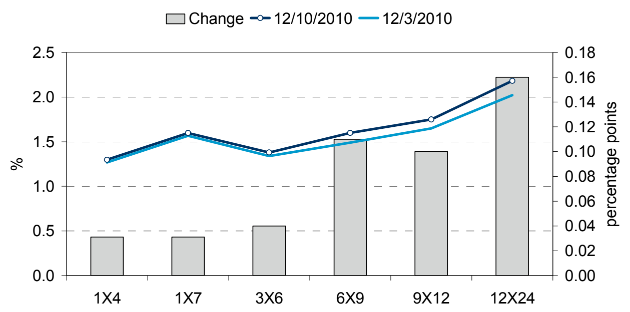
DAILY CHARTS:

The Czech koruna was heavily testing 200-day moving average and finally succeeded in breaking above it. This further deteriorates the short-term picture for the Czech currency. Next stops are at 25.32 and 25.52 EUR/CZK (July 19 high). We believe the way to these levels has been opened. The weakness on the Czech FX market may be further enhanced by growing global yields and ongoing tensions on eurozone peripheries. The Czech currency may feel some support after the CNB meeting with more hawkish comments on the table.

Fixed income

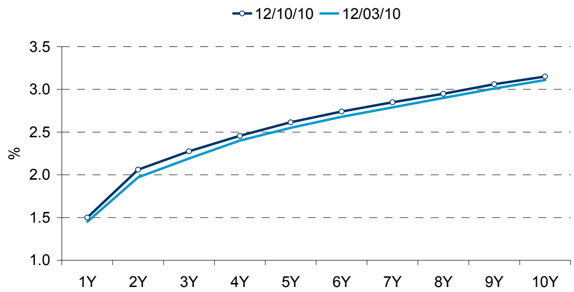
The **Czech bonds** extended their losses and the yield curve flattened in a bearish fashion. The short end of the curve moved up by around 10 bps, which was the result of three factors: the generally bearish environment in core bond markets, the weaker koruna and slightly hawkish comments form the CNB: Recall that the most significant comment came from CNB's vice governor Holman, who indicated that he would like to bring a first rate hike several months earlier than the latest central bank projection implies (it sees the beginning of a tightening cycle at the end the next year). We think that this conclusion could be an outcome of the next CNB meeting, which is held just before Christmas.

CZ FRA



Source: Reuters

CZ IRS



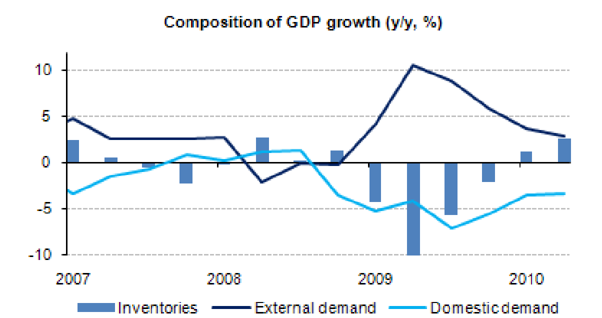
Source: Reuters

Hungary

Macro review

Macro figures were broadly in line with expectations last week. The recovery seems to continue at a gradual pace and inflation risks are also looking moderate.
October's preliminary output declined 1% M/M, while the Y/Y figure remained close to 10% as the expansion has probably moderated in the autumn. The year-end could show better Y/Y figures due to the low base in November and December, when output declined a total of 6% last year.

The **November budget deficit figures were alarming** at Ft170bn deficit, which pushed up the YTD figure to Ft1304bn or 151% of the full-year target. Therefore the government will need more than Ft400bn in December to achieve the 3.8% of GDP target and most of this could come from special taxes on banks and other sectors, which are roughly in line with this. Still, the government has to control ministry spending very tightly in order to minimise the chance of a failure to meet the target.
Detailed **growth numbers from the third quarter** reflected the ongoing recovery as Y/Y change was revised higher to 1.7% from 1.6%, while the Q/Q change remained unchanged at 0.8%. The composition of GDP growth is also favourable as inventory downscaling has ended and domestic demand seems to recover slowly. The recovery is however still one-footed and based on exports, which makes it vulnerable to a slowdown in global growth.



October's preliminary trade balance was a tad weaker at €408m, below expectations for a €488m surplus. Imports probably rose ahead of Christmas as retailers could expect stronger demand this year. Almost 40% of the annual retail sales volume takes place in December. So Christmas shopping plays an important role for import. Nevertheless, the 12-month rolling trade balance sum is high at €5.2bn or 5% of GDP, which is higher than last year's 4.2% of GDP level.
Lastly, consumer prices rose 0.3% M/M and 4.2% Y/Y in November, in line with expectations. Food and energy prices are still on the rise, but some elements, like processed food showed signs of easing and the low underlying inflation level of 1.9% Y/Y confirms that demand-driven inflationary pressures are low in the economy.

Currency

The forint had a relatively stable week in the narrow range of EUR/HUF 276.50 and 279.70. Investors are generally non-interested in the forint as it seems too risky, but it is still good enough to prevent the establishing of a negative position. The market may continue to do so until the year-end and Fitch's possible downgrade could create some volatility in the days to come.

EUR/HUF technical picture

(277.55): Pair currently toying back with 278.40 (see graph: neckline Triple Bottoms) and back below Downtrendline off 292.10.
Resistance at 280.70/ 281.15 (reaction highs hourly), ahead of 283.00 (breakdown hourly), where pause favored.
If wrong, next levels at 285.00 (current reaction high off 268.70), ahead of 285.92/ 286.57 (monthly envelope top/ 76.4% 292.10 to 268.70) and 288.10/ 289.55 (last target off 278.40?/ Sept 08 high): tough on 1st attempts.
Support at 276.40 (break-up daily), with next levels at 274.92 (61.8% 268.70 to 285.00 + monthly Bollinger midline) and 272.80/ 272.44 (monthly envelope bottom/ Nov 22 low), where pause favored.
If wrong, next levels at 270.82/ 270.00 (monthly modified Alpha Beta trend bottom/ Nov 02 low): tough on 1st attempts.

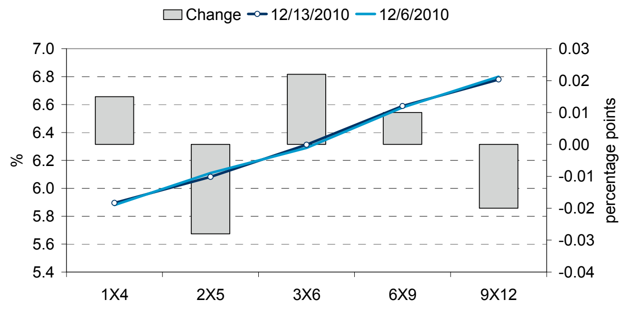
DAILY CHARTS:

Fixed income

The bond market recovered with the currency and benefited from the relatively stable forint. Yields lowered to below

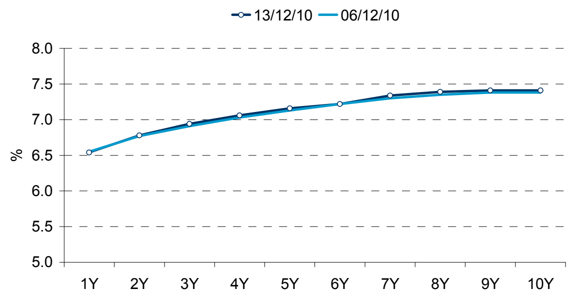
8.00% at the long-end, while the short-end remained convinced that the central bank will continue to raise rates further in 25bps steps until the 6.50% level.
The 5y5y forward spread stabilised at 350bps underpinning investors' sidelined positioning. The market could continue to trade in the current narrow range and the next trend could depend on the incoming activity data as it may help to decide on the outcome of the government's pro-growth program.

HU FRA



Source: Reuters

HU IRS



Source: Reuters

Poland

Macro review

The previous week was poor as far as domestic releases were concerned. Despite the rich harvest of comments of polish central bankers the key question of this month still remains to be answered. To hike or not to hike – that is the question. Current situation regarding the Polish economy reminds a classical drama. Monetary Policy Council (MPC) remains almost evenly split between hawks and doves.

Among the former, the loudest MPC members were Andrzej Bratkowski, who said that central bank should raise interest rates during December's meeting or wait two or three months in order to curb prospective wage increases and to slow lending growth. Clearly, Bratkowski again changed his mind and turned back to the hawks.
The latter are best represented by central bank governor Marek Belka, who again (quite self-confidently) stressed that he was not worried about the pace of current economic recovery, as far as the inflation rate was concerned. Andrej Kazmierczak politely accompanied his supervisor's comments as he said that prospective increase in interest rates might fail to curb rising inflation, but could stop the economic recovery and jeopardize positive development in labor market.
All this means that December's rate setting decision will undoubtedly be accompanied with lively discussion…

Currency

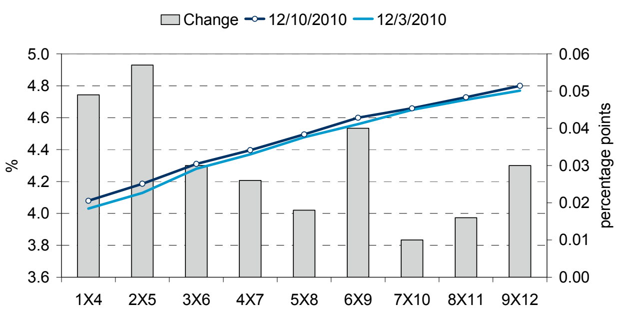
The currency pair **EUR/PLN** was trading slightly higher, compared to the week before. The polish zloty was trading above 4 EUR/PLN for most of the week. Higher US bond yields supported the US dollar and limited any gains of the zloty. It could be quite a similar story this week.

EUR/PLN technical picture

(4.0385): Rebound off 3.8760 sent the pair above 3.9980 (see graph: neckline Triple Bottoms) above Downtrendline off 4.2400.
1st Support area at 3.9700 (break-up weekly), with next levels at 3.9473/ .9312 (monthly envelope bottom/ 76.4% 3.8760 to 4.1100), 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 4.0734 (reaction high hourly), ahead of 4.0905 (monthly envelope top), where pause favored.
If wrong, next levels at 4.1100 (current reaction high off 3.8760), ahead of 4.1200/ .1250 (last target off 3.9980/ monthly modified Alpha Beta trend top): tough on 1st attempts.

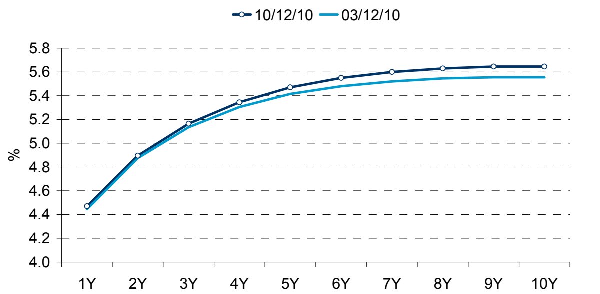
DAILY CHARTS:

PL FRA



Source: Reuters

PL IRS



Source: Reuters

CE Weekly Preview

TUE 10:00	CZ Cur. Account (CZK bn)		
	Oct-10	Sep-10	Oct-09
C/A monthly	**-9.0**	-18.6	10.3
cummulative (YTD)	**-88.6**	-79.6	-19.2
Trade bal. monthly	**20.0**	19.4	18.8
cummulative (YTD)	**176.9**	156.9	157.2

CZ: The current account posts another deficit

October's current account figure is likely to be around CZK -9bn. Although the trade balance will show a high surplus, services will continue to be in the red, because of what is known as branding. The balance of income will also post a deficit, with a further dividend outflow to become evident and most likely also transfers. This year's current account has been developing much worse than last year's, mainly because of the deterioration in the performance of services (branding) and revenue (dividends, reinvestment). For this year as a whole, the current account will thus show a deficit of around 2.6% of GDP.

Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
PL	13.12.2010	14:00	Current account (EUR M)	10/2010			-1 130		-1 417	
PL	13.12.2010	14:00	Trade balance (EUR M)	10/2010			-805		-537	
CZ	14.12.2010	10:00	Current account (CZK B)	10/2010	-9.0		-10.8		-18.6	
PL	14.12.2010	14:00	Money supply M3 (%)	11/2010			0.7		0.4	
PL	**14.12.2010**	**14:00**	**CPI (%)**	**11/2010**			**0.3**	**2.9**	**0.5**	**2.8**
HU	15.12.2010	09:00	Industrial output (%)	10/2010 *F					-1.0	8.3
CZ	15.12.2010	09:00	PPI (%)	11/2010	0.2	2.5	0.2	2.5	0.0	2.6
PL	16.12.2010	14:00	Wages (%)	11/2010			3.5	4.5	1.1	3.9
PL	16.12.2010	15:00	Budget balance (PLN M)	11/2010					-41 820	
HU	17.12.2010	09:00	Wages (%, ytd.)	10/2010				2.5		2.3
PL	**17.12.2010**	**14:00**	**Industrial output (%)**	**11/2010**			**-1.1**	**10.1**	**-1.6**	**8.0**
PL	17.12.2010	14:00	PPI (%)	11/2010			0.1	4.5	0.0	4.0

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	4.00	4.25	4.25	4.25	-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	*3.91*	4.10	4.15	4.35	4.35	4.35

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

	Current	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Czech Rep.	*3.12*	3.00	3.00	3.15	3.35	3.50
Hungary	*7.365*	8.00	7.75	7.75	7.50	7.50
Poland	*5.66*	5.80	5.95	6.00	6.00	6.00

Exchange rates (end of the period)

		Current	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Czech Rep.	EUR/CZK	*25.2*	24.8	24.5	24.6	24.6	25.5
Hungary	EUR/HUF	*278*	280	280	277	273	270
Poland	EUR/PLN	*4.03*	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.	2.6	2.1	1.6	1.4	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.	2.2	2.2	2.5	2.5	2.2	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
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