Monday, May 09, 2011

Central European Weekly

Written by CSOB Prague and K&H Budapest

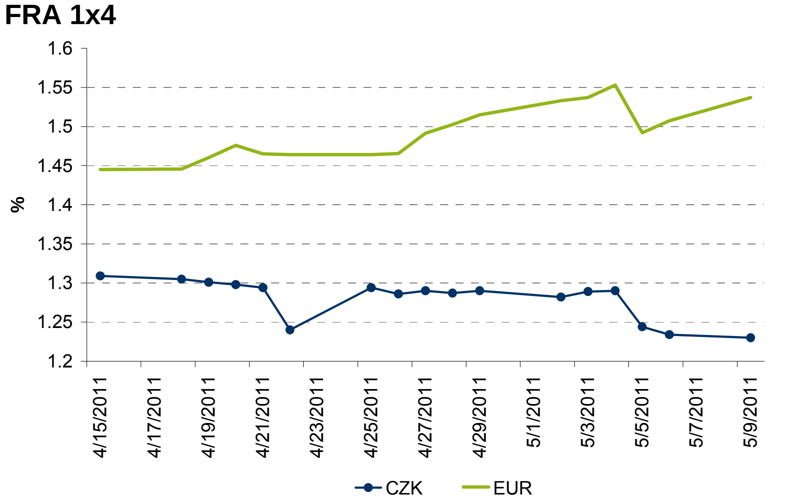
Weekly Highlights:

- Less hawkish ECB might ease monetary conditions in Central Europe
- CNB leaves rates unchanged, while new projection brings little new

CE Weekly Preview:

- Polish NBP should stay on hold, despite headline inflation at 4.5%
- Czech and Hungarian GDP figures to confirm gradual recovery

Chart of the Week: Interest rate expectation in EMU and Czech Republic



Interestingly, while FRA rates fell just temporarily in the euro-zone after ECB meeting, koruna's FRA have been falling continuously since last Thursday.

Table of Contents:

Market's Editorial

CE currencies might benefit from less hawkish ECB

The Czech National Bank completely met our expectations by leaving rates unchanged last Thursday. However, it was the ECB meeting, which brought a surprise the same day, which also caused a rise in volatility on Central European markets. The ECB postponing another rate hike until the summer has also somewhat changed the assumptions as to the external conditions on which our scenario for the next few weeks was based. That said, the scenario may need to be adjusted slightly.

Above all, a less aggressive ECB may offer some relief to the Central European currencies. If CE currencies would profit from this less aggressive ECB stance, the stronger currencies may also influence the thinking of Central European central banks, because small open economies would be confronted with tighter monetary conditions.

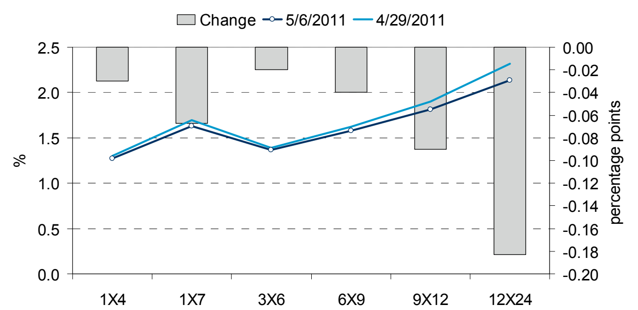
Strong(er) zloty eases pressure on NBP

The first central bank in the region that may be confronted with such a situation could be the National Bank of Poland (NBP), as early as this Wednesday. The Polish central bankers bet on a strong zloty to help to curb accelerating inflation. And as we will see from the inflation data (also to be released this week), inflation in Poland is still rising. This is also why the Polish monetary policy will need to remain restrictive. Thus, even as we expect the NBP to leave rates unchanged this week, it should proceed to another 25 bps rate hike as early as next month.

Czech and Hungary's GDP data might grab some attention

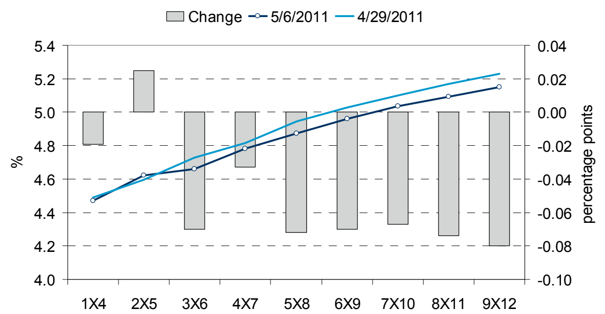
Otherwise, for the first time in a long while, the macroeconomic statistics from the individual countries may also be of interest to Central European markets now. In addition to inflation data, which is always useful, the preliminary growth figures for the first quarter of the year will be unveiled in the Czech Republic and in Hungary. We expect both economies (measured by quarter-on-quarter growth) having sped up their growth, compared to the end of last year. This, along with a less tight approach by the ECB, may be fairly good news for the koruna and the forint.

CZ FRA



Source: Reuters

PL FRA



Source: Reuters

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.07	-0.42%	↘	→
EUR/PLN	3.940	0.29%	↘	→
EUR/HUF	263.5	-0.26%	↘	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	3.87	-0.05	↘	↗
10Y PLN	6.04	-0.07	↗	↗
10Y HUF	6.90	0.05	→	→

Review of Economic Figures

CNB again leaves rates unchanged again

The CNB Board did not change rates at its third meeting of this year. The latest inflation forecast, this year's second, was available to the central bank, but differed only slightly from the previous one. While the external assumptions of the forecast have changed substantially, now being on the upside with respect to inflation, the view of the domestic economy has worsened slightly. First, let us look at foreign assumptions, which the CNB adopts from the Consensus Forecast survey. Foreign institutions' view of the development of the euro area has changed significantly over the last three months. Inflation expectations (for both the CPI and the PPI) have increased for this year, as have the economic growth and Euribor forecasts. By contrast, the view of 2012 has not changed very much, except for the anticipated price of Brent Oil and Euribor. As far as the Czech economy is concerned, the CNB only changed its expectations slightly. It increased its one-year inflation forecast very moderately, and lowered its GDP growth forecast for both this year and the next. Nevertheless, the CNB is currently much more optimistic about the koruna, expecting the appreciation of the currency to reach CZK 23.20 per EUR at the end of next year. As concerns rates, there is even no change. The only thing to have changed is the timing of the anticipated first rate hike, although further rate hikes should be slightly slower. The overall tenor of the forecast is as follows: "Consistent with the forecast is the stability of market interest rates in the immediate future and their gradual rise starting from the fourth quarter of 2011". The CNB had previously cited the end of 2011 in its timing of this development.

Risks seem to be balanced

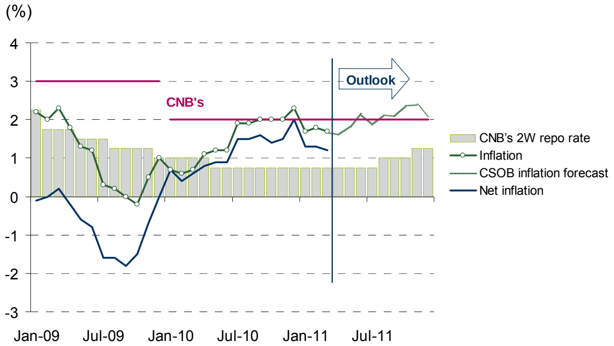
The central bank considers the risks to the inflation forecast to be balanced. Given the tenor of the forecast and our expectations for the Czech economy, we still believe that the CNB will not proceed to a rate hike at the next CNB Board meeting either, and will raise rates in August, when it discusses its third forecast of this year. This will be only slightly sooner than cited in the current forecast. The CNB, unlike the ECB, need not hasten to raise rates at all. Inflation in the Czech Republic continues to be well below that of the eurozone, in spite of record-breaking fuel prices and deregulation. The anticipated exceeding of the target inflation level at the end of the year will be very temporary, and thus shouldn't be overestimated at the moment. Likewise, we continue to stick to our forecast that the CNB will proceed to one more rate hike by the end of the year.

Should there be an increase in the lower VAT rate, the CNB has already prepared an alternative economic outlook, according to which inflation would rise by 1.1% next year while the GDP would decelerate by 0.4%. The CNB would most likely not react to the impacts of that tax change, because it anticipates no major secondary impacts of that move.

.

CNB's prognosis		new	previous	change
GDP	2011	1.5	1.6	↓
GDP	2012	2.8	3.0	↓
Inflation	2012Q2	2.2	2.1	↑
Monetary-relevant inflation	2012Q2	2.1	2.1	→
PRIBOR 3M	2012Q2	1.9	1.9	→
EUR/CZK	2012Q2	23.5	23.8	↓
External assumptions		**new**	**previous**	**change**
GDP-EMU	2011	2.4	2.2	↑
Inflation-EMU	2011	2.4	1.9	↑
EURIBOR 3M	2011	1.6	1.2	↑
Brent	2011	115.9	95.4	↑
USD/EUR	2011	1.38	1.32	↑

CZ: Inflation and CNB's Target



CE Weekly Preview

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

	Apr-11	Mar-11	Apr-10
CPI m/m	**0.3**	0.1	0.3
Food m/m	**0.6**	0.3	0.4
Housing, energy	**0.1**	0.1	0.3
Transportation	**0.7**	0.8	1.0

CZ: Inflation still below the CNB target

April's inflation was primarily affected by costlier food and record-breaking fuel prices. Even this time, consumers had to pay more for dairy products, bread, and certain fruit and vegetables. By contrast, package tour prices went down. Year-on-year inflation did not change significantly, and remains below the CNB target, in spite of the historically high petrol prices and deregulation. Thus inflation in the Czech Republic remains far below that of the eurozone, mainly because of the strong koruna and poor consumer demand. The months to come will see a gradual rise of inflation towards the central bank target. While June's increase in natural gas prices will push inflation upwards by 0.2%, inflation risks will continue to be balanced.

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

	Mar-11	Feb-11	Mar-10
Balance	**15.0**	13.7	17.3
cummulative (YTD)	**46.2**	31.2	47.3
Exports (y/y in %)	**18.0**	18.4	12.5
Imports (y/y in %)	**20.7**	20.5	16.0

CZ: The export expansion continues

Foreign trade continued to be primarily at the mercy of strong car exports and expensive commodity imports in March. While the trade balance surplus likely shrank somewhat on the year-on-year basis, the main reason is the commodities, which encumbered the trade balance with an additional approximately CZK 5bn due to the high prices of energy and raw materials. After all, this is also the main reason for imports still being ahead of exports. Nevertheless, no other strong pressure on imports is evident at the moment, due in particular to poor domestic demand. We still consider the trade balance developments to be favourable, primarily owing to the persisting strong rise in exports.

WED 9:00 **HU Inflation (change in %)**

	Apr-11	Mar-11	Apr-10
CPI y/y	**4.6**	4.5	5.7

HU: Inflation up again due fuel prices

Year-on-year inflation should be again modestly higher in April due to higher fuel prices.

WED 14:00 **NBP rate (in %)**

	This	Last change
rate level	**4.00**	4/2011
change in bps	**0**	25

PL: NBP will wait with a rate hike till June

In spite of surprisingly high inflation for March, which will even continue to rise in April (to 4.5% y/y, according to our forecast), we believe that the central bank, led by the moderate median voter and concurrently NBP President Marek Belka, will not raise rates. Belka has said before that the MPC's decisions are not based solely on monthly data and that every supply shock only has a temporary effect. In addition, the state-owned bank BGK has launched the pre-announced exchange of money from EU funding into zlotys, owing to which the zloty is trading below PLN 3.95 per EUR for the first time in more than two months. We expect that Poland's rates will not go up until June (June 8, 2011).

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

	Q1-11	Q4-10	Q1-10
GDP (y/y)	**2.5**	2.6	1.1
GDP (q/q)	**0.5**	0.3	0.7

CZ: The economy is maintaining a stable growth rate

The preliminary GDP forecast should not be at variance with the previous trends of the Czech economy. Although more detailed data will not be available, it seems likely that the manufacturing industry (carmakers in particular) is continuing to drive the economy, while the performance of construction and services will tend to be negative. Regarding demand, we do not anticipate any significant reversals either. Consumer demand remains weak while investment demand is still deteriorating. That said, foreign trade and, to a lesser extent, also inventories are continuing to be primary in

terms of growth. We still keep our GDP growth forecast for this year as a whole unchanged (at 1.8%).

FRI 9:00 **HU GDP (change in %)**

	2010Q4	2010Q1	2010Q4
GDP (y/y)	**2.2**	1.9	0.1
GDP (q/q)	**0.3**	0.2	1.4

HU: GDP growth accelerates modestely

The economy should accelerate driven by strong performance of exports.

FRI 14:00 **PL Inflation (change in %)**

	Apr-11	Mar-11	Apr-10
CPI y/y	**4.5**	4.3	2.4
Food (ex Alc.) y/y	**7.6**	6.8	0.7
Transport (including fuel)	**7.0**	7.3	8.4

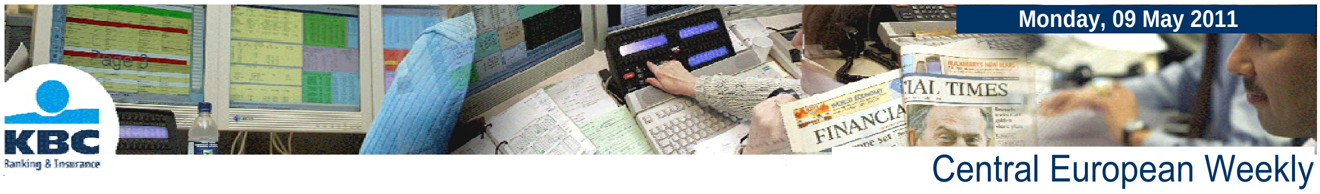
PL: Inflation will continue to rise

After Poland's inflation for February, which surprised markets on the downside, March's inflation also surprised markets, by soaring to 4.3% y/y. That said, prices in Poland are currently rising much faster than the central bank target (2.5%). April's consumer price index was up by 4.5% y/y in Poland, according to our forecasts. The main contributors to April's inflation rise (with the effect of the comparative baseline included) should be food prices.

Weekly Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
CZ	9.5.2011	09:00	Construction output (%)	03/2011		-1.5				5.6
CZ	9.5.2011	09:00	Industrial output (%)	03/2011		12.0		12.0		13.0
CZ	9.5.2011	09:00	Unemployment rate (%)	04/2011	8.7		8.7		9.2	
HU	10.5.2011	09:00	Trade balance (EUR M)	03/2011 *P					831	
CZ	**10.5.2011**	**09:00**	**CPI (%)**	**04/2011**	**0.3**	**1.6**	**0.3**	**1.6**	**0.1**	**1.7**
CZ	**10.5.2011**	**09:00**	**Trade balance (CZK B)**	**03/2011**	**15.0**		**15.5**		**13.75**	
HU	**11.5.2011**	**09:00**	**CPI (%)**	**04/2011**		**4.6**		**4.6**	**1.1**	**4.5**
CZ	11.5.2011	12:00	CZ bond auction 3.85%/2021 (CZK B)	05/2011			6			
PL	**11.5.2011**	**14:00**	**NBP meeting (%)**	**05/2011**	**4.00**		**4.00**		**4.00**	
HU	13.5.2011	09:00	Industrial output (%)	03/2011 *F					-3.6	9.2
CZ	**13.5.2011**	**09:00**	**GDP (%)**	**1Q/2011 *P**	**0.5**	**2.5**	**0.5**	**2.7**	**0.3**	**2.6**
HU	**13.5.2011**	**09:00**	**GDP (%)**	**1Q/2011 *P**	**0.3**	**2.2**	**0.2**	**1.9**	**0.2**	**1.9**
PL	**13.5.2011**	**14:00**	**CPI (%)**	**04/2011**	**4.5**	**0.6**	**0.6**	**4.4**	**0.9**	**4.3**
PL	13.5.2011	14:00	Money supply M3 (%)	04/2011			-1.6		3.1	

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



CE Forex Technicals

EUR/CZK Daily Chart:

Currently back below neckline of Double Top (24.1800: see graph), with 2nd target off 24.3160 (neckline short term Double Top: see graph) at 24.0420 having been approached.
Support at 24.0450/ .0420 (current reaction low off 24.5900/ see above), ahead of 24.0150 (weekly modified Alpha Beta trend bottom), where pause favored.
If unable to hold, next level at 23.9610 (monthly modified Alpha Beta trend bottom), ahead of 23.9200 (year low).
In case of move to new medium term lows, next levels at 23.8400/ .8180 (weekly Bollinger bottom/ monthly envelope bottom), ahead of 23.7700/ .7610 (1st target off 24.1800/ 1st Irregular B off 24.5900) and 23.7300 (1st target of long term daily Double Top off 25.0150): tough on 1st attempts.

Resistance at 24.2600 (May 05 high): ideal area to stay below to keep current better tone on CZK.
Failure to cap, would see risk towards 24.3400 (broken weekly Medium Term Moving Average↑ + breakdown daily), ahead of 24.4180 (monthly envelope top), where pause favored.

EUR/HUF Daily Chart:

Drop from 268.85 (April 18 high) sent the pair back towards new year low (263.01).
Support at 263.01 (see above + weekly modified Alpha Beta trend bottom), where pause favored.
If unable to hold, next levels at 261.63 (1st Irregular B off 268.85), ahead of 260.93/ .77 (2010 low/ 2nd Irregular B) and 260.29 (monthly Bollinger bottom): tough on 1st attempts.

Resistance at 266.60/ .65 (breakdown daily/ May 05 high): ideal area to stay below to keep current positive tone on HUF.
If unable to cap, next levels at 267.90 (weekly Medium Term Moving Average↓), ahead of 268.85 (see above): sustained trade above would indicate end of current love affair with HUF.

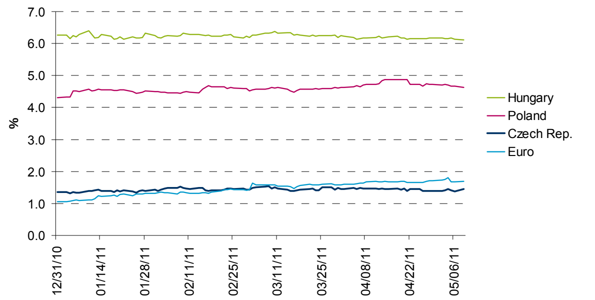
EUR/PLN Daily Chart:

Below 3.9820 (neckline short term Double Top: see graph), with Feb 18 break-up area 3.9240 having been retested.
Support at 3.9340 (break-up hourly), with next levels at 3.9205/ .9176 (current reaction low off 4.1225/ 1st target off 3.9820), ahead of 3.9126 (50 Month Moving Average↑) and 3.9010 (weekly modified Alpha Beta trend bottom).
3.8982/ .8970 = 76.4% 3.8290 to 4.1225/ Feb 17 low: tough on 1st attempts.

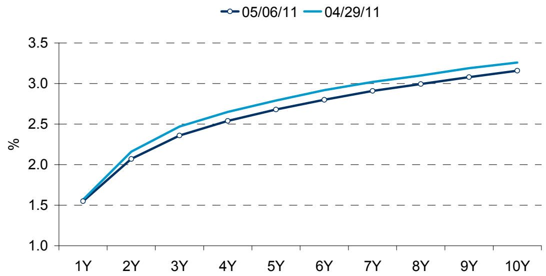
Resistance at 3.9785/ .9820 (breakdown hourly/ see above): Zloty on better footing while below this area.
If unable to cap, next levels 3.9966 (monthly modified Alpha Beta trend top + broken Monthly Medium Term Moving Average→), ahead of 4.0002 (April 18 high): tough on 1st attempts.

CE Fixed-income in Charts

FRA 3x6

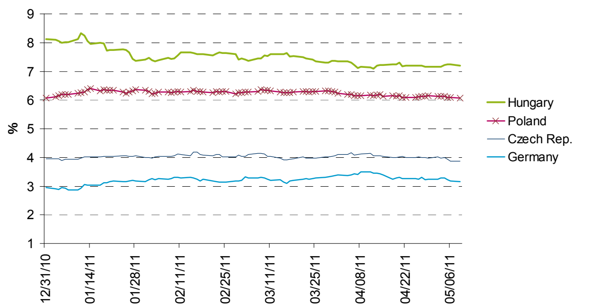


CZ IRS

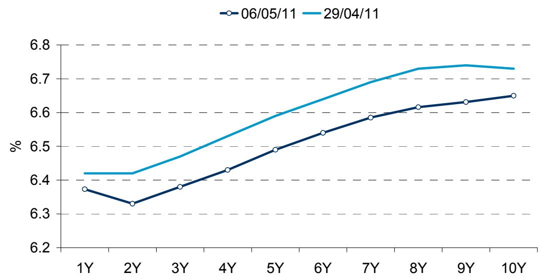


Source: Reuters

10Y GB Yields

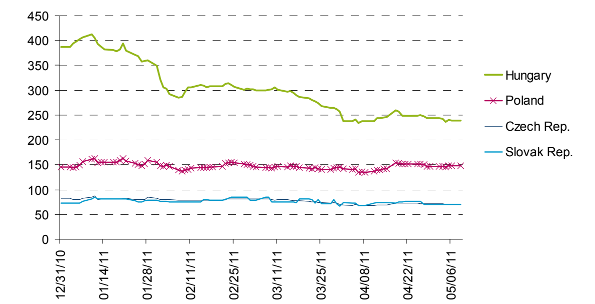


HU IRS

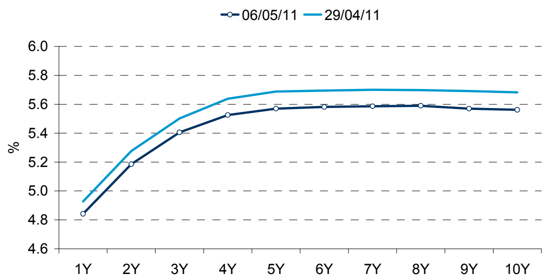


Source: Reuters

CDS 5Y



PL IRS



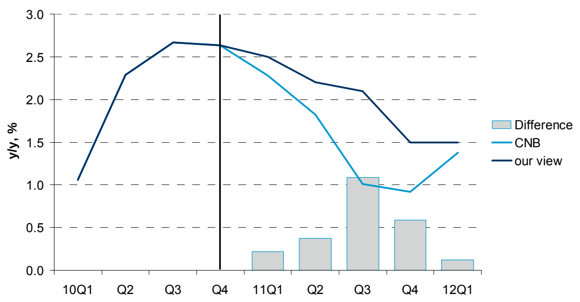
Source: Reuters

Medium-term Views & Issues

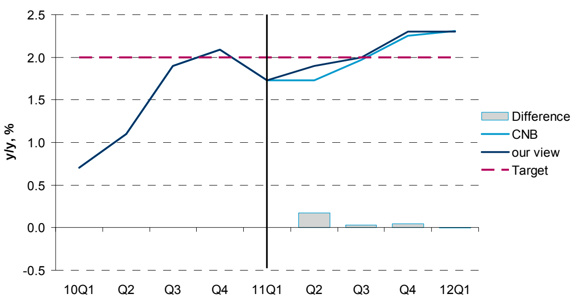
	The Czech Republic	Hungary	Poland
Growth & key issues	The June general election resulted in the victory of the centre-right parties, whose policies are austerity-minded. The new Cabinet has set a realistic target of cutting the deficit to less than 3% by 2013. The reduction by less than a percentage point per year is reasonable and doesn't pose a huge risk to the ongoing economic recovery. Already last year's budget ended with a lower than planned deficit. The general government deficit even felt below 5% of GDP in 2010. The fundamental precondition for hitting the budget targets is the launch of reforms, notably of the social security and pension system.	Hungary's government decided on an ambitious fiscal consolidation program (Szell Kalman Plan) that sees 3% of GDP deficit reduction measures by 2013. The Convergence Program detailed this further and most importantly targeted the 2012 budget deficit below 3% of GDP without one-off revenues. This is an important step as previous plans saw some 1% of GDP revenues from the asset sale of second pillar pension funds, which were cancelled. Accelerating growth and fiscal policy constitute a positive outlook for Hungary.	According to our estimates, the Polish economy grew in Q1/2011 at more or less the same pace as in the last quarter of the previous year. Given the recent set of data, we revise the expected growth up to 4.4% in 2011. Mainly domestic consumption and investment should drive the growth with government and external sector having more or less neutral impact. However, one should bear in mind that there is risk of revisions of previous figures due to due to huge errors and omissions line of the balance of payments (around 4% of GDP).
Outlook for official & market rates	Inflation climbed above the central bank's target due to higher fuel and foodstuffs' prices and to administrative measures. Fuel prices continue to pose a risk to inflation. On the other hand, weak demand and the strong koruna should counteract the rise in inflation. We still think that the CNB will hike its rates sooner than its new prognosis announced (2011 Q4). We believe that rates may be raised as early as in the third quarter of this year. The CNB's repo rate should reach 1.25% by the end of 2011.	Inflation rose to well above the central bank's 3% target on higher food and fuel prices, but underlying inflation trend remained favourable. Demand side inflationary pressures are low in the economy and hence the central bank expects inflation to return to the target level by end-2012. We generally agree with this view, while acceleration of the economy may challenge this if domestic demand also revives. Currently it is depressed by the strong Swiss franc rate that costs much to foreign currency debtors.	A sharp increase in inflation expectations led to the further round of monetary tightening in Poland. In line with our expectations, the National Bank of Poland increased the reference rate by 25 bps to 4%. Given the fact that the rate of inflation should stay above the target in the rest of 2011, we expect that interest rates in Poland should rise even further. We think that two more hikes hang in the air. Our scenario bets on the first hike as early as at July's Monetary Policy Council's meeting. The second hike could take place during Q4/2011.
Forex Outlook	Although fundamentals behind the Czech currency continue to be strong (the Czech economy should outperform euro-zone and the external balance should remain at reasonable levels), our long term model suggests that recent gains were too aggressive. Nevertheless the Czech koruna may continue to profit from approaching start of interest rate hiking cycle in short term (3-6 month). It may move into the defensive at the end of 2011. The profit taking could be triggered by the Polish elections and the related weakening of the Polish zloty.	The forint has outperformed peers in 2011 Spring as fiscal consolidation plans allowed the government to refinance its large, €4bn redemption of bonds and loans, including the first tranche of the IMF loan. Should investors' confidence strengthen in the government policies, inflows into the bond market may appreciate the currency further. At levels stronger than the key 260/€ level, we believe the issue of rate cuts could come to the fore.	Tighter monetary policy has not helped the zloty very much so far and we believe even further monetary tightening has only limited potential to boost the Polish currency. First of all because market has already priced in our interest rate outlook. The effect of domestic tightening may also be somewhat offset by interest rate hikes in eurozone. Further more we are afraid of negative effect of errors in Polish balance of payments on Polish GDP and especially on highly important debt/GDP ratio. Given that uncertainty ahead of Parliamentary elections, we remain more or less neutral on Polish currency at levels around 4.00 EUR/PLN.

Central Bank's Projections versus Our Macro Forecasts

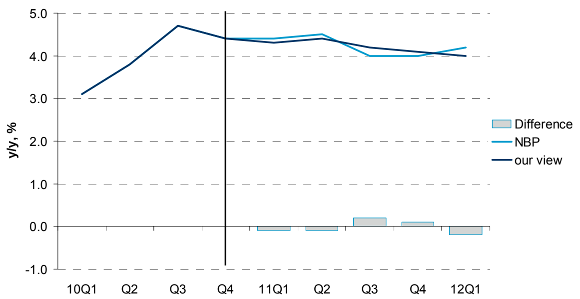
CZ: GDP Outlook



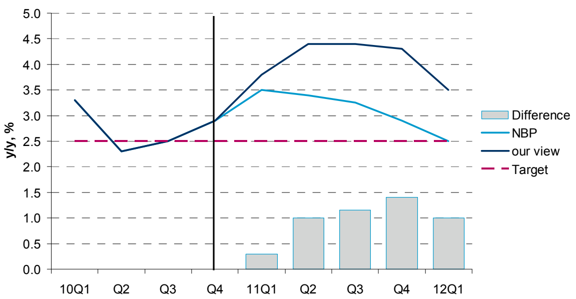
CZ: Inflation outlook



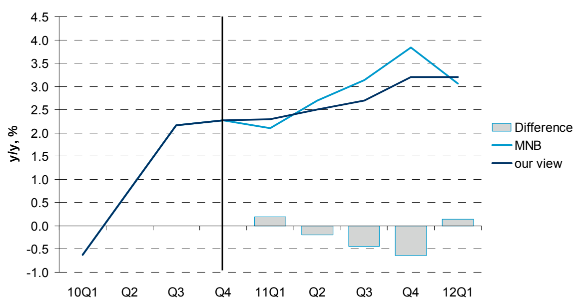
PL: GDP Outlook



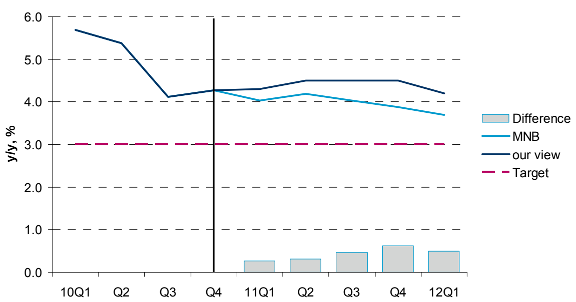
PL: Inflation outlook



HU: GDP Outlook



HU: Inflation outlook



Summary of Our Forecast

		Current	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Last change	
Czech Rep.	2W repo rate	*0.75*	0.75	1.00	1.25	1.25	1.50	-25 bps	5/6/2010
Hungary	2W deposite r.	*6.00*	6.00	6.00	6.25	6.25	6.25	25 bps	1/24/2011
Poland	2W inter. rate	*4.00*	4.25	4.25	4.50	4.75	4.75	25 bps	4/6/2011

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

		Current	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Czech Rep.	PRIBOR	*1.21*	1.35	1.45	1.60	1.65	1.90
Hungary	BUBOR	*6.10*	6.00	6.00	6.25	6.25	6.30
Poland	WIBOR	*4.31*	4.30	4.45	4.60	4.65	4.70

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

	Current	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Czech Rep.	*3.13*	3.40	3.50	3.60	3.70	3.85
Hungary	*6.62*	7.50	7.25	7.00	7.00	6.90
Poland	*5.543*	5.95	6.00	6.10	6.15	6.20

Exchange rates (end of the period)

		Current	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Czech Rep.	EUR/CZK	*24.2*	24.2	24.6	24.4	24.0	25.5
Hungary	EUR/HUF	*264*	280	275	270	270	270
Poland	EUR/PLN	*3.93*	3.90	4.00	3.70	3.70	3.60

GDP (y/y)

	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012
Czech Rep.	2.2	2.1	1.5	1.5	2.5	3.0
Hungary	2.5	2.7	3.2	3.2	3.2	3.2
Poland	*4.4*	4.6	4.2	4.6	4.9	4.7

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

	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
Czech Rep.	2.1	2.1	2.2	2.2	2.3	2.0
Hungary	4.5	4.5	4.2	4.0	3.5	3.0
Poland	4.4	4.2	3.3	3.5	3.3	3.0

Current Account as % of GDP

	2010	2011
Czech Rep.	-3.8	-3.6
Hungary	0.5	1.0
Poland	-2.1	-2.9

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

	2010	2011
Czech Rep.	-4.7	-4.3
Hungary	-3.8	-2.9
Poland	7.1	-7.9

Brussels Research (KBC)	
Piet Lammens	+32 2 417 59 41
Peter Wuyts	+32 2 417 32 35
Didier Hanesse	+32 2 417 59 43
Joke Mertens	+32 2 417 30 59
Mathias Van der Jeugt	+32 2 417 51 94
Dublin Research (KBC Bank Ireland)	
Austin Hughes	+353 1 6646892
Prague Research (CSOB)	
Jan Cermak	+420 2 6135 3578
Jan Bures	+420 2 6135 3574
Bratislava Research (CSOB)	
Marek Gabris	+421 2 5966 8809
Budapest Research (K&H)	
Gyorgy Barcza	+36 1 328 99 89

Global Sales Force	
Brussels	
Corporate Desk	+32 2 417 45 82
Commercial Desk	+32 2 417 53 23
Institutional Desk	+32 2 417 46 25
London	+44 207 256 4848
Frankfurt	+49 69 756 19372
Paris	+33 153 89 83 15
New York	+1 212 541 06 97
Singapore	+65 533 34 10
Prague	+420 2 6135 3535
Bratislava	+421 2 5966 8436
Budapest	+36 1 328 99 63
Warsaw	+48 22 634 5210
Moscow	+7 495 228 69 61

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