Central European Weekly

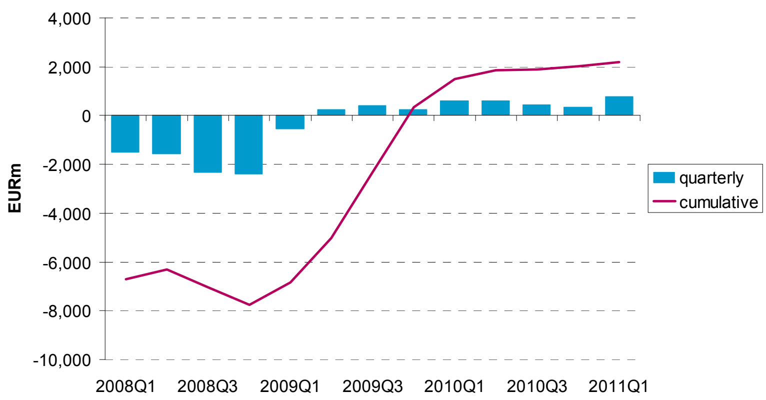
Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- The forint and the zloty reacted positively on the balance of payments statistics
- In Focus: Poland's current account deficit brings relief…

Chart of the Week: …

HU: Current account of the balance of payments



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Market's Editorial

The forint and the zloty reacted positively on the balance of payments statistics

Just as did numerous markets at the global level, those in Central Europe fetched a sigh of relief after the Greek Parliament approved the controversial package of austerity measures; however, the reaction was not quite unanimous, in terms of both direction and strength.

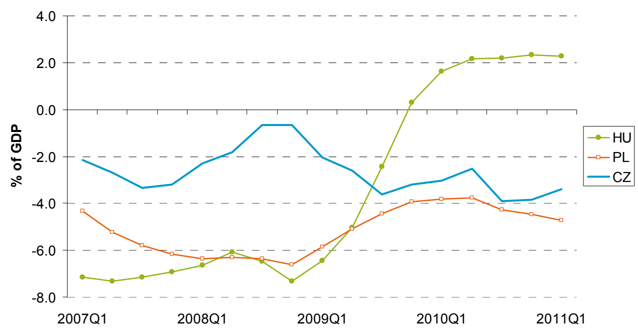
For example, regarding government bond prices: while Hungarian and Polish bond prices went up, Czech bonds, which tend to follow on the heels of German Bunds, were under moderate selling pressure.

A similar divergence was also evident on forex markets, with the Czech koruna, on the one hand, only strengthening slightly after the vote in Greece. The forint and the zloty on the other hand, obviously appreciated. Specific (domestic) factors were, of course, also relevant in these two cases.

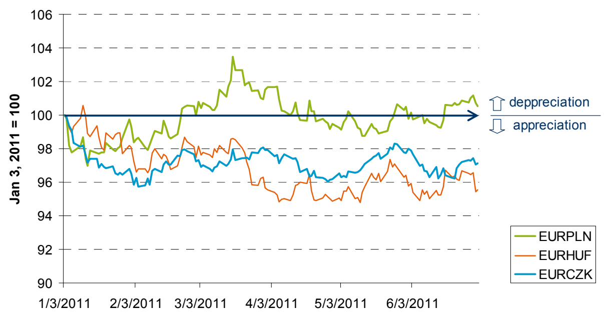
As far as the Polish zloty is concerned, it is important that the revision of Poland's balance of payments (for the worse) was in the end not that dramatic as markets had anticipated. In addition, the revision was also positively received because consumption increased hand in hand with the increase in imports, and thus Polish GDP has remained unchanged. For investors, the Polish revision is also positive, because future balance of payments statistics may be considered as being more trustworthy, that is to say more accurate.

Perhaps, the appreciation of the forint was also influenced by the balance of payments statistics, which, by contrast, were excellent in Hungary in the first quarter of the year. That said, the economy has continuously shown high current account surpluses for two years, and these surpluses are rising. If we consider that the capital account of the balance of payments is also well in a surplus, owing to high transfers from EU funds, it becomes evident that there is no reason for any depreciation of the forint in fundamental terms.

Current account



Index of the exchange rates in CE



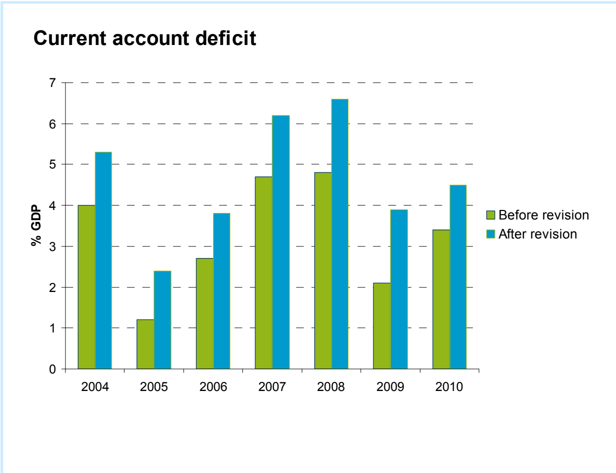
	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.23	-0.52%	↗	↘
EUR/PLN	3.953	-0.90%	↗	↗
EUR/HUF	264.5	-1.72%	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	3.81	0.11	→	→
10Y PLN	5.72	-0.14	→	↗
10Y HUF	7.16	-0.09	→	↗

In Focus: Poland's current account deficit brings relief…

Everything began with a simple remark by Miroslaw Gronicki, ex-Minister of Finance and current advisor of Marek Belka, Governor of the National Bank of Poland. He said that Poland's statistics had shown a 2010 trade balance surplus of €2.1bn with Germany, while Germany said the contrary was true – i.e., that Germany had posted a surplus of as high as €12bn. Who published wrong figures? The doubts drew attention to deeper inconsistencies in Poland's balance of payments, because the negative effect of the 'errors and omissions' item soared to a huge 4% of GDP over the last two years. Now, the National Bank of Poland has released the long-expected current account revision for 2004-2010, which was close to the original forecasts of the NBP. In addition, the central bank confirms that the revision will not trigger changes in GDP levels. Both of these messages are good news for Polish assets.

Investors feared the scenario in which the current account deficit would be due to significantly more undervalued imports which would have resulted in reduced GDP figures. This would have worsened all ratio indicators vis-à-vis the GDP. As a consequence, for example, the amount of Poland's public debt might have exceeded the constitutional limit of 55% of GDP, as early as the end of 2010. However, the released revision has calmed things down for the moment. The current account deficit was revised from 3.4% to 4.5% of GDP for 2010 (as opposed to the market expectations of 4.7% of GDP). Although the undervalued imports (with an effect of 0.8% of GDP) were crucial in terms of structure, this was not the only error found by Polish statisticians. Errors also occurred in the accounts of cross-border pension and wage flows. In the wake of the 2010 revision, Poland has the fourth worst current account deficit (after Greece, Portugal and Spain), but the structure of the deficit financing is, unlike the above countries, stable at the moment. As concerns the zloty and Polish assets in general, more importantly, both the National Bank of Poland and the Statistical Office insist that the balance of payments revision will not lead to a revision of the GDP level, and will only involve a change in structure; the increased imports (lower net export contribution) will be simply counterbalanced by increased domestic consumption. That said, as far as structure is concerned, the already strong domestic demand, funded by current account deficits, will become even more relevant. Unless something changes in Poland, this may start to cause troubles when the inflow of EU funding, which currently helps to finance current account deficits, starts to wane.



CE Weekly Preview

THU 9:00	CZ Foreign trade (CZK bn)		
	May-11	Apr-11	May-10
Balance	**9.5**	12.6	11.2
cummulative (YTD)	**75.0**	65.5	72.6
Exports (y/y in %)	**11.0**	14.8	23.8
Imports (y/y in %)	**12.5**	16.8	26.2

CZ: Foreign trade still fuelled by cars

Compared to previous months, the rate of foreign trade is likely easing. While exports were helped by a larger number of business days, the double-digit increases will slowly turn into single-digit ones. Exports are primarily driven by carmakers, which are faring well on European as well as Asian markets. Imports are still encumbered by costly raw materials, which are also reducing year-on-year trade balance figures.

WED 14:00	NBP rate (in %)	
	This	Last change
rate level	**4.50**	5/2011
change in bps	**25**	25

PL: NBP will leave rates unchanged

The National Bank of Poland should take a summer breather in July and August, and wait to see what the effect of the existing monetary tightening will be and how the demand from main trading partners will develop. Governor Belka's comment was also in line with this. While inflation again surprised with a higher value (5% y/y), inflation expectations have already declined slightly over the last month. Also, the mood in Poland's industry has worsened quite significantly for a third consecutive month.

FRI 9:00	CZ Industry (y/y change in %)		
	May-11	Apr-11	May-10
Monhtly	**7.6**	4.7	15.8
cummulative (YTD)	**10.0**	10.6	9.4

CZ: Industry still primarily driven by carmakers

May's industry was bolstered by a greater number of business days and the persisting highly favourable development of foreign contracts. Carmakers were again the primary contributors to the rise in output. In addition to carmakers, industrial output was also fuelled by metal production, engineering and clothing industries. By contrast, the energy sector, food, chemical and electrical industries are likely to show worse figures. This time, the main attention will again be primarily attracted by new contracts, which will signal the direction of the Czech industry in the months to come.

Weekly Calendar

	Date	Time	Indicator	Period	Forecast		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y
CZ	4.7.2011	09:00	Retail sales (%)	05/2011		3.2		3.7		2.7
PL	**6.7.2011**	**14:00**	**NBP meeting (%)**	**07/2011**			**4.50**		**4.50**	
HU	7.7.2011	09:00	Industrial output (%)	05/2011 *P					0.7	9.7
CZ	**7.7.2011**	**09:00**	**Trade balance (CZK B)**	**05/2011**	**9.5**		**11.0**		**12.56**	
HU	7.7.2011	12:00	GB bond auction/floating rate (HUF B)	07/2011						
HU	7.7.2011	17:00	Budget balance (HUF B)	06/2011					-724.2	
CZ	8.7.2011	09:00	Construction output (%)	05/2011						-6.0
CZ	8.7.2011	09:00	Industrial output (%)	05/2011		7.6		7.8		4.7
HU	8.7.2011	09:00	Trade balance (EUR M)	05/2011 *P					479.3	

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:

Back below 24.5900/ .5650 (March high/ see graph: neckline medium term Double Bottom).
Support at 24.1730/ .1520 (monthly modified Alpha Beta trend bottom/ break-up daily), where pause favored.
If unable to hold, next levels at 24.0950 (weekly Bollinger bottom + monthly envelope bottom), ahead of 24.0700/ 0450 (June 14 low/ April 27 low).
23.9200/ .9090 = current year low/ broken monthly channel top off 1999 (synthetic charts): tough on 1st attempts.

Resistance at 24.4830/ .5000 (weekly Long Term Moving Average→ + monthly modified Alpha Beta trend top/ current reaction high off 24.0700), where pause favored.
If unable to cap, next levels at 24.6090/ .6220 (weekly Bollinger top/ monthly envelope top), ahead of 24.6650/ .7340 (May 26 high/ monthly channel top off March 2009): tough on 1st attempts.

EUR/HUF Daily Chart:

Rebound off year low failed to extend above Downtrendline off 289.55 (see graph).
Support at 263.70 (June 03 low), ahead of 263.10/ .01 (June 10 low + see graph: neckline Double Top/ year low), where pause favored.
If unable to hold, next levels at 261.75/ .60 (monthly envelope bottom/ monthly modified Alpha Beta trend bottom) and 260.93 (2010 low + neckline long term Double Top): tough on 1st attempts.

Resistance at 267.15/ 268.10 (breakdown hourly/ daily): ideal area to stay below to keep current short term mood on HUF.
If unable to cap, next levels at 269.47/ .90 (monthly channel top off historic high/ June 28 high), ahead of 270.60/ 271.15 (weekly Long Term Moving Average↓/ May 23 high + see graph): tough on 1st attempts.

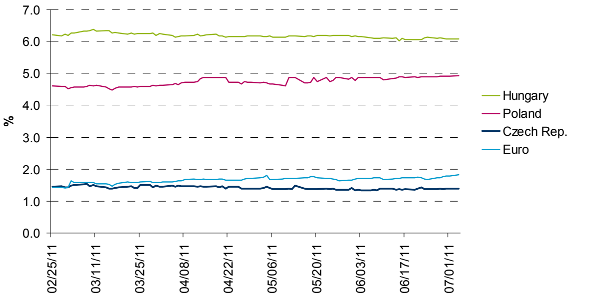
EUR/PLN Daily Chart:

In Triangle pattern (see graph).
Support at 3.9530/ .9493 (break-up daily/ broken weekly Medium Term Moving Average↓).
Failure to hold would see next levels at 3.9235/ .9125 (June 14 low/ May 18 low), where pause favored to set in.
If wrong, next levels at 3.9016/ .9010 (monthly envelope bottom/ weekly Bollinger bottom), ahead of 3.8888 (current reaction low off year high): tough on 1st attempts.

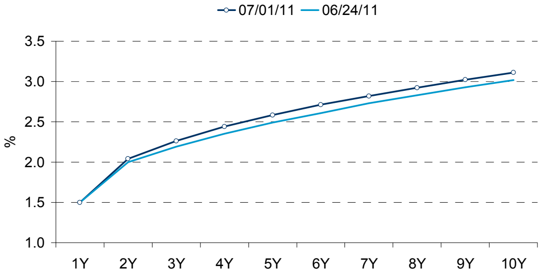
Resistance at 3.9942 (breakdown hourly + weekly modified Alpha Beta trend top), where pause favored.
If unable to cap, next levels at 4.0190 (June 23 high), ahead of 4.0319/ 4.0332 (monthly envelope top/ 61.8% 4.1225 to 3.8888) and 4.0414 (weekly Bollinger top): tough on 1st attempts.

CE Fixed-income in Charts

FRA 3x6

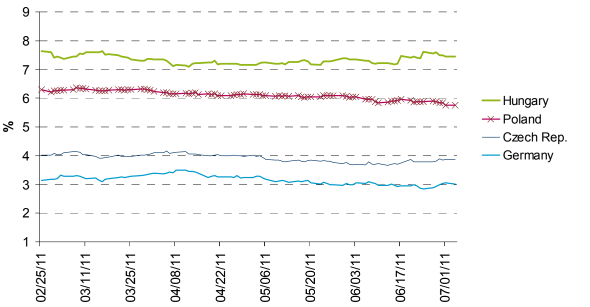


CZ IRS

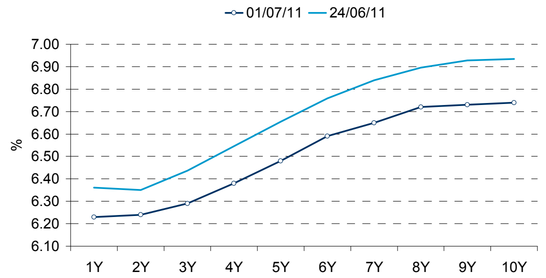


Source: Reuters

10Y GB Yields

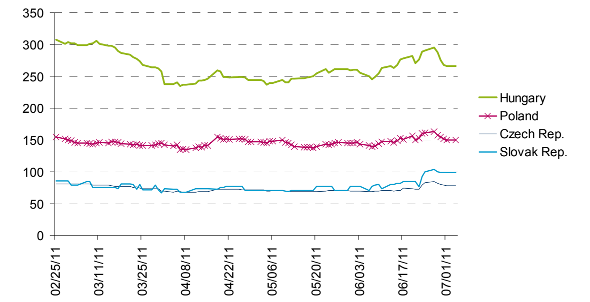


HU IRS

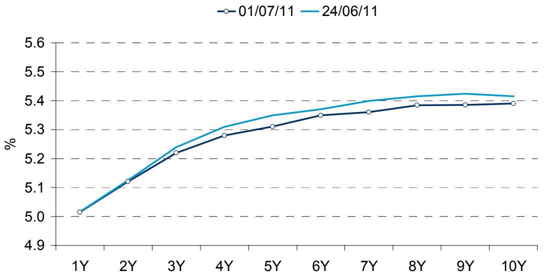


Source: Reuters

CDS 5Y



PL IRS

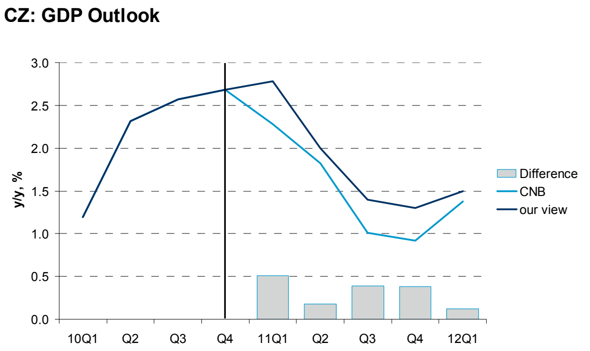


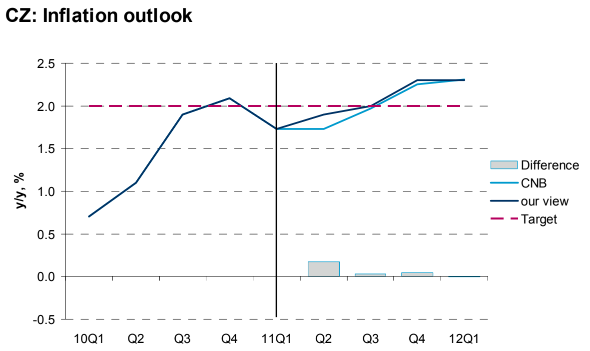
Source: Reuters

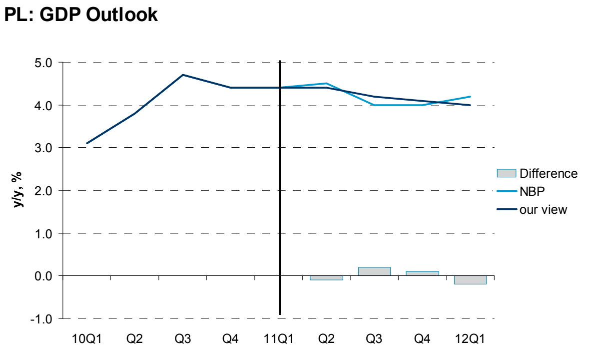
Medium-term Views & Issues

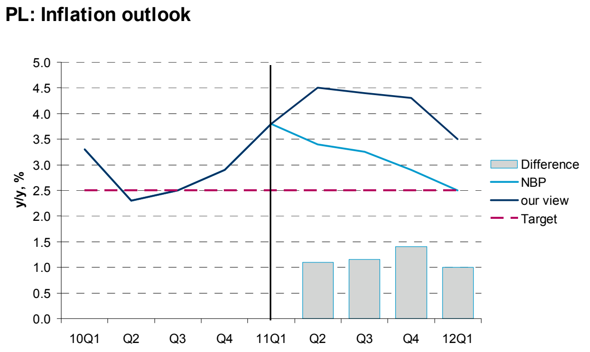
	The Czech Republic	Hungary	Poland
Growth & key issues	The situation in the governing coalition after some turmoil again stabilized. The government can continue to prepare the reforms needed to reduce the deficit of public finances. The general government deficit even felt to 4.7% of GDP in 2010. The government intends to cut the deficit below 3% by 2013. The fundamental precondition for hitting the budget targets is the launch of reforms, notably of the social security and pension system. Despite the positive outlook of the public budgets, the government still does not intend to set date for euro adoption in the country.	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 declined below the central bank's target in spite of 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 (though it may change after the new proposal).	Fears of inflation remaining above the target in medium term led to the further round of monetary tightening in Poland. The National Bank of Poland increased the reference rate already for the fourth time this year by 25 bps to 4.50%. 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 believe that the NBP might deliver this year's last hike as soon as at its September monetary policy meeting.
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 gains from the beginning of the year were too aggressive and calls for certain correction. On the other hand probably not substantial as the Czech koruna may start to feel support from the approaching start of interest rate hiking cycle (August 2011).	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. Commodity correction and renewed fears about Greece caused the forint to dip. Overall, in a short run risks for the forint seem balanced. In a longer run, should investors' confidence strengthen in the government policies, inflows into the domestic bond market may appreciate the currency further.	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 despite higher than expected inflation we believe that market has already priced in our interest rate outlook. 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. On the other hand in case of more severe selling pressure the Ministry of finance can sell the euros from structural funds and NBP would probably consider more aggressive monetary policy.

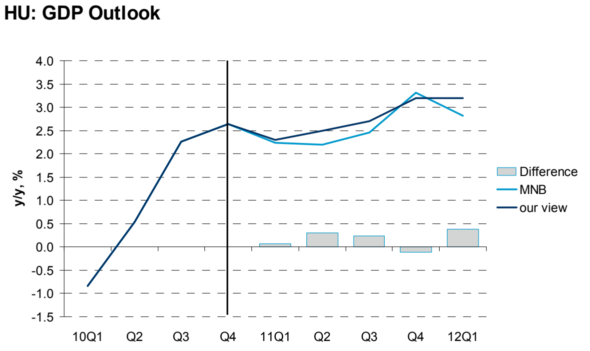
Central Bank's Projections versus Our Macro Forecasts

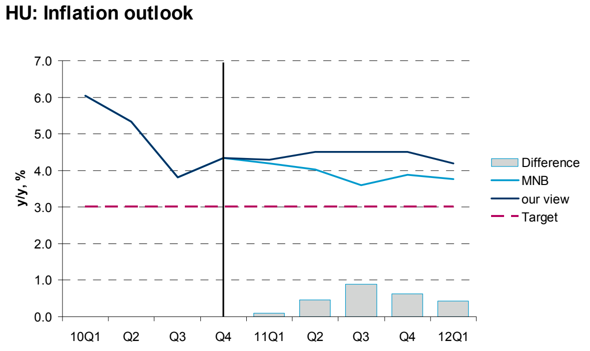












Summary of Our Forecast

Official interest rates (end of the period)

		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	*4.25*	4.50	4.75	4.75	4.75	4.75	25 bps	5/11/2011

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

		Current	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Czech Rep.	PRIBOR	*1.17*	1.20	1.45	1.60	1.65	1.85
Hungary	BUBOR	*6.10*	6.00	6.00	6.25	6.25	6.30
Poland	WIBOR	*4.7*	4.60	5.00	5.10	5.15	5.15

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

		Current	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Czech Rep.		*3.05*	3.10	3.30	3.45	3.55	3.65
Hungary		*6.74*	7.50	7.25	7.00	7.00	6.90
Poland		*5.40*	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*	24.5	24.6	24.4	24.0	23.7
Hungary	EUR/HUF	*265*	280	275	270	267	265
Poland	EUR/PLN	*3.95*	4.00	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	1.4	1.1	1.3	2.6	3.5
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.		2.2	2.3	2.5	2.4	2.2	2.1
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	-6.9

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