Monday, September 26,

Banking & Insurance

Central European Weekly

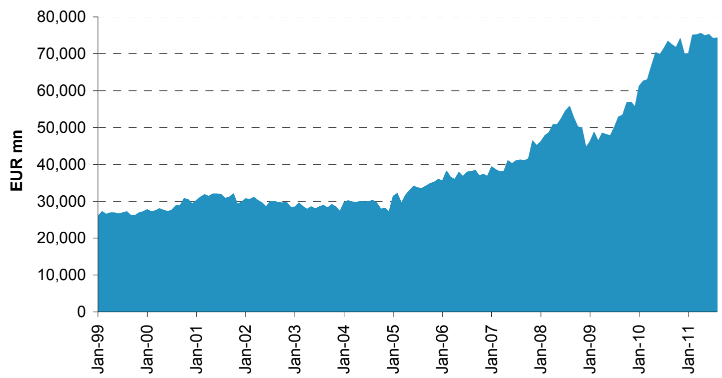
Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- Czech and Hungarian central banks downgrades economic outlook
- FX volatility now eyed by all regional central banks
- ….while, NBP explicitly joins zloty’s defence camp

Chart of the Week: Polish FX reserves in focus

NBP International Reserves



The coordinated action of Polish state owned bank BGK and NBP pushed the EUR/PLN back below 4.38 EUR/PLN (around 3% stronger). Polish authorities have enough reserves to defend the zloty in the upcoming months, although the strategy remains somewhat unclear.

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Market's editorial

Central banks downgrades economic outlook

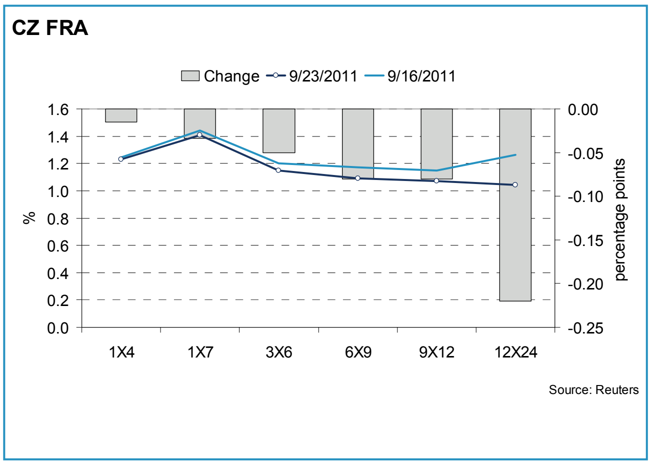
Not only the Fed and the ECB, but also Central European central banks are starting to significantly curb their optimism as to their outlooks for next year. The meetings of both the Czech National Bank and the National Bank of Hungary (MNB) were affected by increased pessimism. Both central banks uncommonly agreed on the fact that previous GDP forecasts had been overly optimistic, with the MNB having revised Hungary's growth quite significantly; however, this was the only similarity between the meetings of the MNB and the CNB, because the two banks find themselves in completely different positions: while the hawkish tenor disappeared from the CNB Board in September, the MNB Council even saw a proposal for an official rate hike.

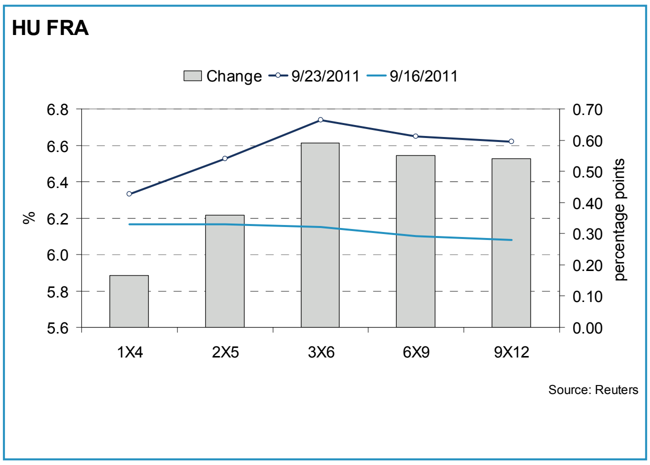
More focus on FX volatility

Nevertheless, what the policies of the Central European central banks have in common is their more careful monitoring of exchange rate developments. Obviously, given the debt crisis in the eurozone, the exchange rates of the forint, the zloty, and the Czech koruna are developing far less favourably than the respective central banks had expected. That said, the monetary conditions in the Central European economies are suddenly easing (through the respective exchange rates), and thus the policies of the Central European central banks may be stricter (at least in terms of the tenor of their statements) than they would have been under otherwise the same circumstances.

Random FX interventions will not alter the trend

The question is whether such a change in the central banks' attitudes may lead to a reversal on Central European forex markets. We do not consider this to be likely, because the reasons for the depreciation evidently lie outside the region. Likewise, the bearish trend will hardly be broken by the random interventions of the Polish state-owned bank BGK, or the Polish central bank. The trend will not change until at least (another) temporary solution to the debt crisis in the eurozone is presented.





	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.8	-0.12%	↗	↗
EUR/HUF	292	-0.03%	→	↗
EUR/PLN	4.43	-0.02%	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.1709	-1.81	↘	↗
10Y PLN	7.30	6.57	→	↗
10Y HUF	5.15	4.15	→	↗

Review of Economic Figures

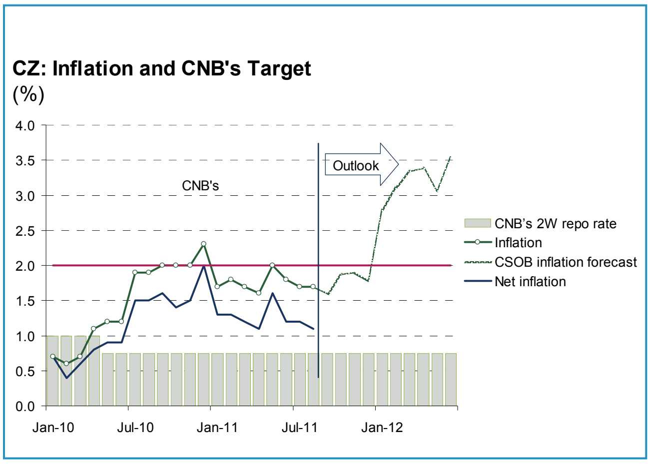
CNB

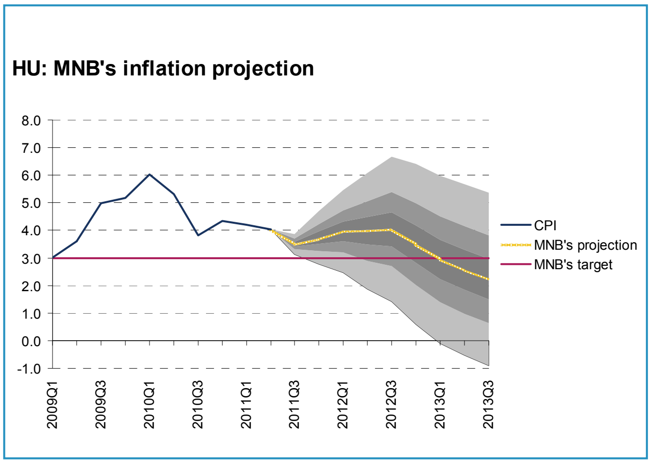
The Czech National Bank has again confirmed its conclusion that interest rates should go up in late 2011/early 2012, with the risks to the forecast being moderate in respect of lower inflation and strong in respect of lower foreign interest rates. While inflation will temporarily exceed the target in early 2012, this will be primarily due to the increase in the reduced VAT rate rather than because of inflationary pressures stemming from the market. In addition, increasingly evident signals of the deceleration of the European economy are coming from abroad, and this will also affect the new CNB forecast, which will be discussed in November. This will include not only anticipated growth deceleration in the eurozone, but also lower anticipated Euribors, lower commodity prices, and a weaker euro. At the moment, we can state that the latest CNB forecast appears to be optimistic, while external risks towards stagnation or even a recession are on the rise. Hence there is every indication of rate stability for a longer period of time than just until the end of the year. The only factor that may start to weigh against low rates could be the exchange rate of the koruna, because, in recent days, the Czech currency has diverged from the level anticipated by the central bank (EUR/CZK 24.2, as opposed to the current EUR/CZK 24.8), thus lagging well behind the levels anticipated by the central bank for the end of this year (EUR/CZK 23.7). Therefore the CNB has now included the exchange rate among the upside risks to inflation. Our opinion is that the latest CNB forecast is optimistic. This is why we believe that interest rates will not be raised at either the turn of the year or in the first half of next year. That said, we view the second half of next year as the nearest possible period for monetary tightening; however, everything will depend on how the euro area can recover from the ongoing debt crisis…, whether or not it will slip into stagnation or even a recession

MNB significantly reduces growth forecast

Hungary’s central bank stays on hold too, although the new inflation forecast is very mixed, with the MNB having rapidly reduced its growth forecast for this year and the next (by around one percentage point in both cases), and inflation forecasts have been increased. However, the MNB still believes that inflation will not leave the target inflation band in the end, and this would signal that the central bank will leave official interest rates unchanged.

Nevertheless, we still do not rule out a possibility of a surprise rate hike on worsening inflation outlook and deteriorating external environment. The government fiscal consolidation package contains VAT hike and several other tax increases, which deteriorate the inflation outlook, while the Greek tragedy creates a deteriorating external environment for the forint. Long-term forward spreads have been widening, thus higher risk premia could be a fundamental issue too.





Calendar

Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	09/28/2011	9:00	Unemployment rate	%	08/2011			10.8		10.8	
HU	09/29/2011	9:00	PPI	%	08/2011				0.2	0.3	-1
HU	09/2011	12:00	GB bond auction/floating rate	HUF B	09/2011 *A						
PL	09/29/2011	14:00	Current account	EUR M	2Q/2011			-2552		-3364	
HU	09/30/2011	8:30	Current account	HUF B	2Q/2011			750		787	
CZ	09/30/2011	11:00	Money supply M2	%	08/2011						3.1

Forex Technicals

EUR/CZK Daily Chart:

Above Downtrendline off May 2010 high, with rebound off year low having retested April 2010 low (25.0150) and reapproached the broken Uptrenline off low (see graph).
Support at 24.6500/ .6240 (break-up daily/ weekly modified Alpha Beta trend bottom): must sustain back below to indicate return of better fortunes for CZK.
Failure to hold would seen next levels at 24.5600/ .5490 (reaction low hourly/ break-up hourly), ahead of 24.5100 (weekly envelope bottom).
24.3800/ .3780 = Sept 16 low/ weekly Medium Term Moving Average↑: tough on 1st attempts.

Resistance at 24.8800/ .9020 (reaction high hourly + weekly modified Alpha Beta trend top/ weekly envelope top), where pause favored.
If unable to cap, next levels at 25.0150/ .0360 (current new year high + see above/ 76.4% Dec 2010 high to 23.9200), ahead of 25.0840 (weekly Starc top) and 25.1400/ .1600 (potential of daily Double Bottom off 24.5900: see graph): tough on 1st attempts.

EUR/HUF Daily Chart:

Rebound from new year sent the pair retesting the Uprendline off low and 285.00/ 292.10 (necklines long term Double Bottom: see graph).
Support at 287.77/ 287.60 (weekly envelope bottom/ 23.6% 261.90 to 295.55), with next levels at 284.90/ 284.49 (break-up hourly/ weekly Short Term Moving Average↑): needs to sustain below to call end of alert for HUF.
Failure to hold would see next levels at 282.82/ .69 (Sept 15 low/ 38.2% 261.90 to 295.55) and 280.80 (previous year high), where pause favored.

Resistance at 293.37(weekly Starc top), ahead of 294.81 (weekly envelope top) and 295.55/ 295 .85 (current new year high/ 61.8% 317.45 to 260.93): tough on 1st attempts.

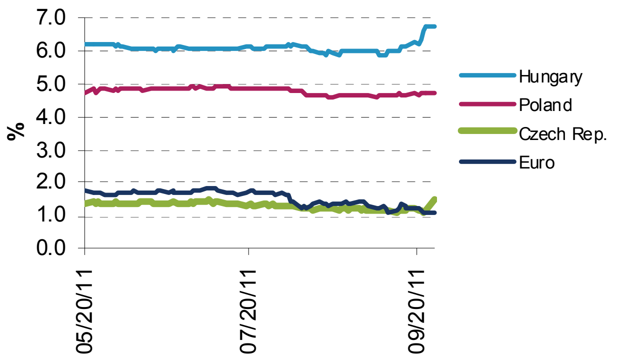
EUR/PLN Daily Chart:

New year high scored on move above the neckline of a long term Head And Shoulders bottom (4.2400: see graph) and currently back above the Uptrendline off low.
Support at 4.3660 (current reaction low off 4.5370), ahead of 4.3337/ .3205 (weekly envelope bottom/ break-up hourly) and 4.3147 (weekly Short Term Moving Average↑): must sustain back below to indicate better fortunes for Zloty.
Failure to hold would see next levels at 4.2815 (Sept 16 low); ahead of 4.2665 (38.2% 3.8290 to 45370 (tough on 1st attempts.

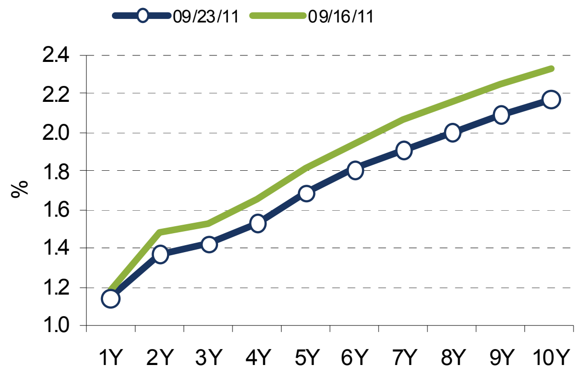
Resistance at 4.4469(weekly modified Alpha Beta trend top), ahead of 4.4638/ .4735 (weekly envelope top/ weekly Starc top), where pause favored.
Failure to cap would see next levels at 4.5020 (breakdown hourly), ahead of 4.5370/ .5467 (current new year high/ 2nd target of hourly channel break off 3.9261): suspect tough to sustain through on 1st attempts.

Fixed-income in Charts

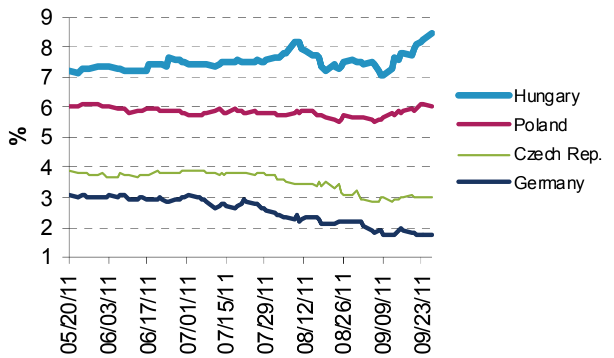
FRA 3x6



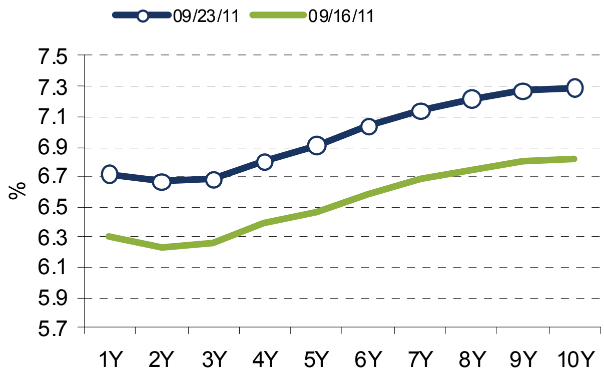
CZ IRS



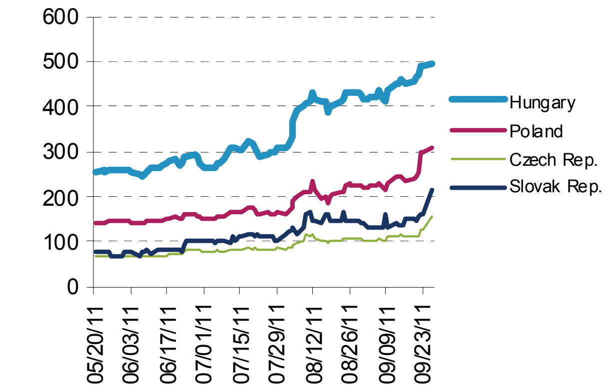
10Y GB Yields



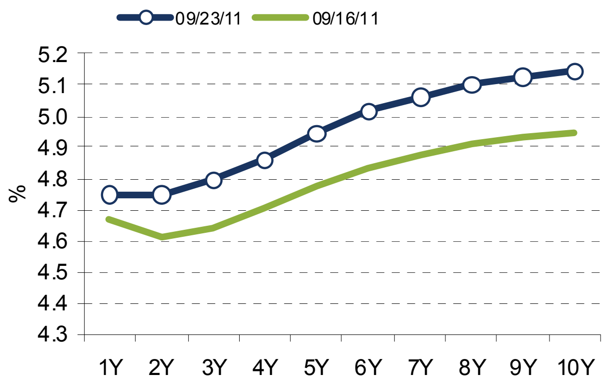
HU IRS



CDS 5Y



PL IRS



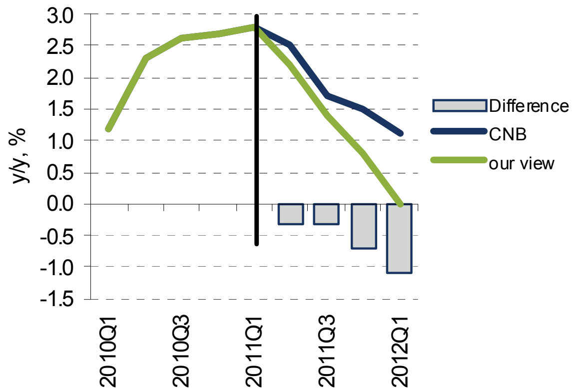
Source: Reuters

Medium-term Views & Issues

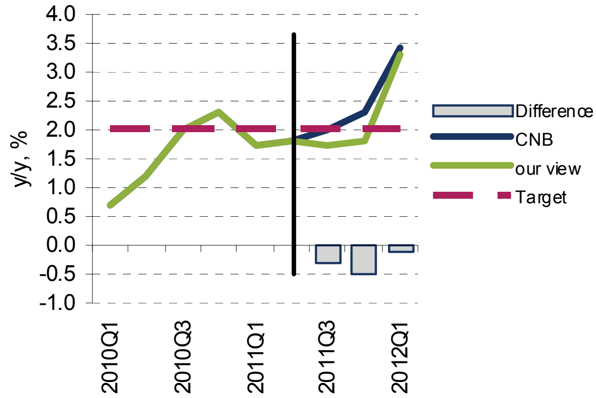
	The Czech Republic	Hungary	Poland
Growth & key issues	Although the situation in the governing coalition after some turmoil has stabilized again, tensions in the government coalition might return during discussions of the 2012 budget. The government intends to change the system of direct taxes radically and to unify gradually the VAT rate in order to push the deficit below 3 percent of GDP by 2013. Despite the positive outlook of the public budgets, the government does not intend to set a target date for the euro adoption in the Czech Republic.	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.	We believe that factors that kept the Polish economy growing during the World Financial Crisis will gradually step aside and we estimate that the economy will grow at a slower pace next year. More specifically, a room for relatively loose fiscal policy seems to have diminished as the debt-to-GDP ratio almost reached the constitutional threshold of 55 % in 2010. As regards monetary conditions, higher interest rates should, in our view, contribute to a slowdown in both households' consumption as well as private and public investment during the next year.
Outlook for official & market rates	Inflation declined below the central bank's target in spite of higher fuel and foodstuffs' prices and inflation boosting administrative measures. Fuel prices as well as prices of agricultural commodities continue to pose a risk for future inflation. On the other hand, weak domestic demand should counter a rise in inflation. We expect the CNB to maintain its wait-and-see policy at least until next autumn. The first rate hike delivered by the Czech central bank is probable in Q3 2012 (in contrast to the current prognosis implying it in 4^{th} 2011).	Inflation rose temporary 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 third time this year by 25 bps to 4.50%. Although the rate of inflation should stay above the target in the rest of 2011, the inflation expectations have stabilized and employment growth remains sluggish. Furthermore global risk has somewhat intensified recently. Hence we believe the NBP should stay on hold for some time, at least through 1st quarter 2012.
Forex Outlook	For the next few months, the Czech koruna should remain under pressure because of the escalating tension surrounding Greece and more dovish stance of CNB. Nevertheless, after the Greek issue is resolved, the koruna has potential to appreciate. The accelerating inflow of money from EU Funds, in addition to the slow continuation of real convergence, should remain a positive long-term factor for the Czech currency. We continue to see the koruna stronger in 12-month horizon at 23.40 EUR/CZK.	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. 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.	The Polish zloty remains under pressure. The coordinated action of Polish state owned bank BGK and Polish central bank (NBP) provided certain relief to the Polish currency. Nevertheless it is questionable whether the weakness of the Polish zloty is over. It is not very clear whether the NBP or the Ministry of Finance have any strategy how to defend the currency. The markets were used to the fact that Polish authorities were comfortable with the range 3.8-4.25 EUR/PLN, where the pair stayed for nearly two years. Nevertheless this time the authorities did not mind much weaker zloty before stepping in.

CB's Projections vs. Our Forecasts

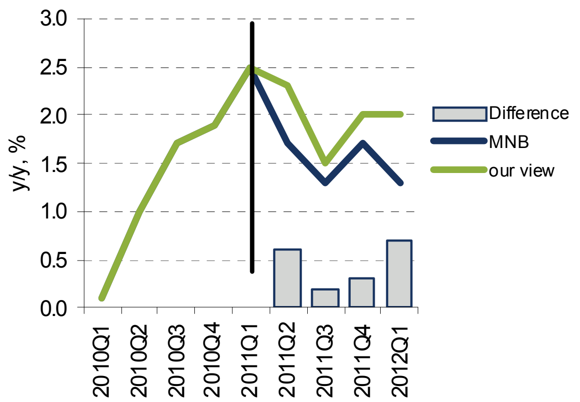
CZ: GDP Outlook



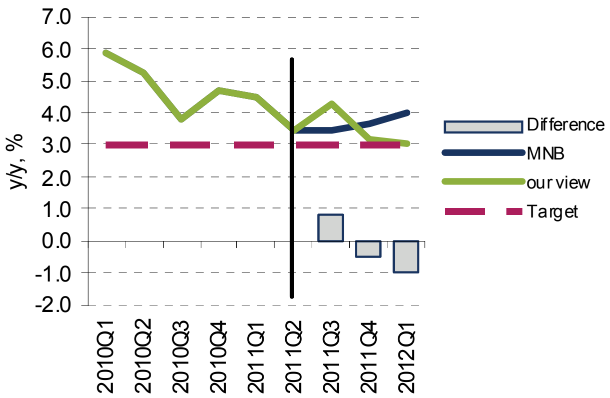
CZ: Inflation outlook



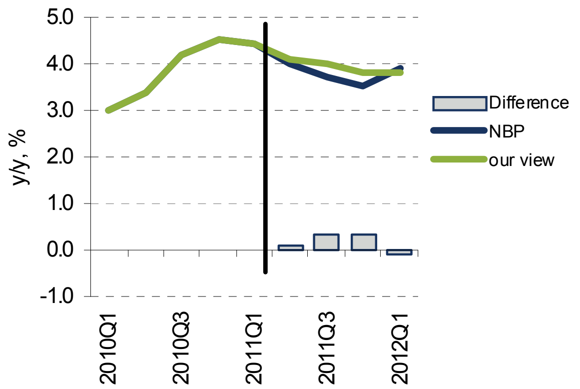
HU: GDP Outlook



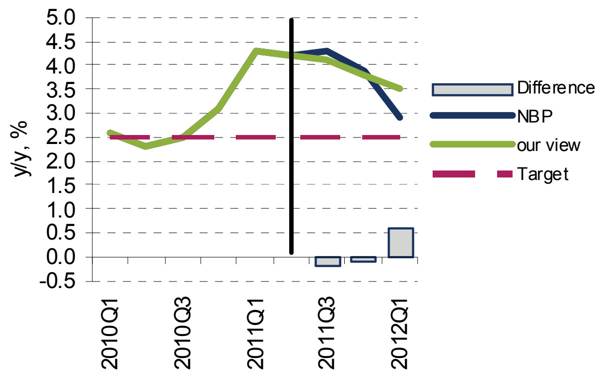
HU: Inflation outlook



PL: GDP Outlook



PL: Inflation outlook



Source: CNB, NBP, MNB, CSOB

Summary of Our Forecast

Official interest rates (end of the period)

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	Last change	
Czech Rep.	2W repo rate	*0.75*	0.75	0.75	0.75	0.75	1.00	-25 bps	5/7/2010
Hungary	2W deposit r.	*6.00*	6.00	6.00	6.00	6.00	6.00	25 bps	1/24/2011
Poland	2W inter. rate	*4.50*	4.50	4.50	4.50	4.75	4.75	25 bps	6/9/2011

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

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	PRIBOR	*1.17*	1.17	1.19	1.22	1.25	1.42
Hungary	BUBOR	*6.10*	6.00	6.00	6.00	6.00	6.00
Poland	WIBOR	*4.76*	4.60	4.60	4.60	4.75	4.80

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

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	CZ10Y	*2.1709*	2.05	2.10	2.40	2.70	3.05
Hungary	HU10Y	*7.30*	7.50	7.50	7.50	7.25	7.00
Poland	PL10Y	*5.15*	4.80	5.00	5.00	5.10	5.20

Exchange rates (end of the period)

		Current	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	EUR/CZK	*24.8*	25.0	24.4	24.0	23.8	23.8
Hungary	EUR/HUF	*292*	295	280	270	270	268
Poland	EUR/PLN	*4.43*	4.35	4.10	3.95	3.90	3.90

GDP (y/y)

	2011Q1	2011Q2	2011Q3	2011Q3	2012Q1	2012Q2	2012Q3
Czech Rep.	*2.8*	2.2	1.4	1.4	0.0	0.4	1.4
Hungary	*2.5*	1.5	1.5	1.5	2.0	1.8	1.8
Poland	*4.4*	4.3	4.0	4.0	3.8	3.7	3.5

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

	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Czech Rep.	*1.8*	1.7	1.8	3.3	3.5	3.4	3.2
Hungary	*3.5*	4.3	3.2	3.0	2.8	2.8	2.8
Poland	*4.2*	*4.1*	3.8	3.5	3.0	2.8	2.5

Current Account

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

Public finance balance as % of GDP

	2010	2011
Czech Rep.	-4.7	-4.3
Hungary	-3.8	-2.9
Poland	-7.1	-6.9

Source: CSOB, Bloomberg

Brussels Research (KBC)		Global Sales Force	
Piet Lammens	+32 2 417 59 41	Brussels	
Peter Wuyts	+32 2 417 32 35	Corporate Desk	+32 2 417 45 82
Didier Hanesse	+32 2 417 59 43	Commercial Desk	+32 2 417 53 23
Joke Mertens	+32 2 417 30 59	Institutional Desk	+32 2 417 46 25
Mathias Van der Jeugt	+32 2 417 51 94		
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Austin Hughes	+353 1 6646892	Paris	+33 153 89 83 15
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Prague Research (CSOB)		Singapore	+65 533 34 10
Jan Cermak	+420 2 6135 3578		
Jan Bures	+420 2 6135 3574	Prague	+420 2 6135 3535
Petr Baca	+420 2 6135 3570	Bratislava	+421 2 5966 8436
		Budapest	+36 1 328 99 63
Bratislava Research		Warsaw	+48 22 634 5210
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