Monday, October 03,

Central European Weekly

Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- While Poland revises again its C/A figures, authorities continue to defend zloty
- Czech and Polish PMIs deteriorate further
- In focus: Uncertainty high ahead of Polish elections
- NBP should stay on hold, its comment to zloty's developments could be interesting

Chart of the Week: Regional C/A balances

Current account balance as % of GDP

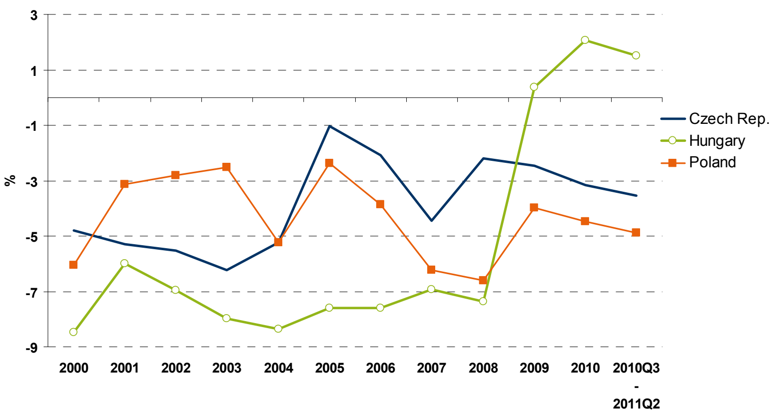


Table of Contents:

Market's editorial & Review of economic figures

Poland in focus again

Poland - the largest Central European market - grabs attention for several reasons now.
Firstly, doubts about the quality of Poland's balance of payments statistics are again starting to increase, because the central bank made another significant current account revision. The deficit was approximately € 1 bn greater than originally suggested by monthly forecasts. This is not good news in a situation when Poland still faces a quite high twin-deficit.

Defence of the zloty continues

Secondly, the weak zloty continues to attract official authorities' attention as they quite actively intervene in favour of the domestic currency. In supporting the Polish currency, the central bank, which does not like the weak zloty for monetary-policy reasons, has joined with the state-owned bank BGK, which is supplying the market with euros and US dollar. This is also why it will be interesting to monitor the outcomes of the upcoming meeting of the NBP. The outcomes should indicate how much the NBP is prepared to get involved in the protection of the zloty.

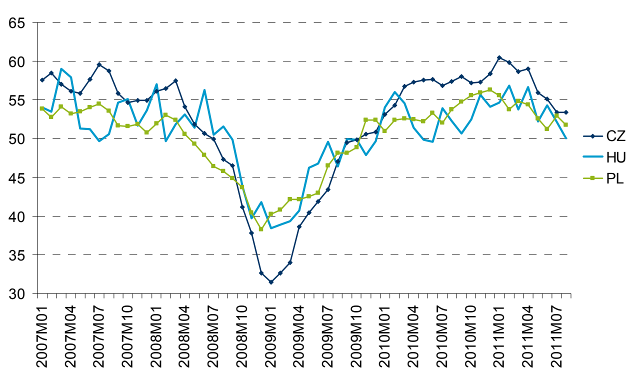
Surprising outcome from Polish elections?

Thirdly and finally, Polish markets will catch the eye because of the approaching general election (to be held next weekend). While the market is basically relying on the continuity of the current liberal government, led by the Civic Platform of Prime Minister Tusk, the latest opinion polls conducted before the election have signalled that the wait for the results will be more exciting than we anticipated some time ago. While the current coalition, led by the Civic Platform, still leads in the opinion polls, its lead is far from being as vast as it was at the beginning of the year, because Law and Justice, a conservative and social party led by Jaroslav Kaczinski, has been gaining ground among voters recently. Should the current coalition of the Civic Platform and the People's Party lose its parliamentary majority in favour of Law and Justice, it would not be good news for markets, because such developments could not guarantee that the austerity efforts to return the public budget deficit to reasonable limits (3% of GDP in 2013) will persist.

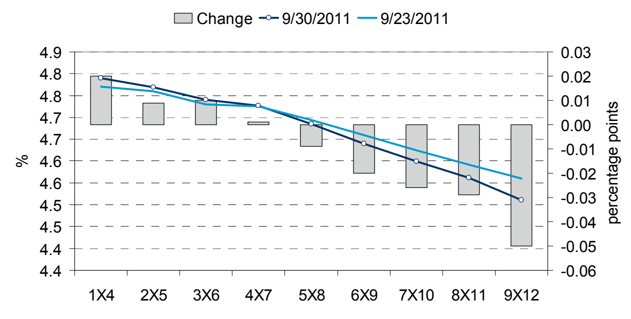
Czech and Polish PMIs deteriorate

Meanwhile Czech and Polish PMIs further weakened, with Czech new orders sub-component at lowest levels since August 2009. The Hungarian PMI was slightly higher, but at the 50.8 level it is still pretty near the contraction levels.

CE: PMI



PL FRA



Source: Reuters

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.8	1.29%	↗	↘
EUR/HUF	294	2.15%	↗	↘
EUR/PLN	4.43	0.76%	↗	↘

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.20	-1.83	↘	↗
10Y PLN	7.45	5.52	→	↗
10Y HUF	5.04	1.50	→	↗

In focus: Uncertainty high ahead of Polish elections

The Poles will again head to the polling booth in 14days. The current coalition, led by the Civic Platform(PO), continues to lead opinion polls; however, its lead is far from being as strong as it was at the beginning of the year. Should the opposition, led by conservative populists Law and Justice (PiS), continue to gain ground, foreign investors might not be pleased at all. At the moment, likely the worst conceivable scenario would be a victory for the PiS and a significantly weakened position for the People's Party (PSL), as this would again enable the post-communists from the SLD to get involved in coalition talks.

Polish Prime Minister Donald Tusk (Civic Platform – PO) is experiencing déjà vu. For a long time before the 2005 election, he held a strong lead in opinion polls, but in the end his lead was completely eliminated in the final month, to the benefit of the conservative populists of Jaroslav Kaczinski (Law and Justice – PiS). History is unpleasantly repeating itself. As recently as in late 2010, some opinion polls indicated that Tusk enjoyed the support of almost 50% of voters, approximately double the support for the PiS. However, the latest surveys seem to indicate that the active campaign by the PiS, rejuvenated by beautiful girls and highlighting conservative values and the welfare state, appeals to Poles. The PO's lead has shrunk to less than 5%, which, in Poland, may be within the margin of statistical error.

And what are markets hoping to see? They are basically calling for any continuation of Donald Tusk's rule, whether with the PO ruling alone or in the current coalition with the People's Party. This would be a guarantee for markets that the government would stick to its austerity programmes (albeit with numerous disputable measures), which may cut the government deficit to less than 3% of GDP by 2013.

By contrast, a victory of the PiS and the possible return of the conservatives to power would certainly be viewed negatively. In the past, a coalition led by the PiS significantly worsened Poland's relations with both Russia and the EU. The party's attachment to anti-Semitism, its campaigning against homosexuals, censorship of goodnight fairy-tales, or the rewriting of school curricula (the deleted items also included Dostoyevsky and Kafka) did not engender confidence either. However, this scenario is unlikely to happen; the coalition partners of the PiS at that time have negligible roles in today's political scene – the ultra-catholic League of Polish Families has disappeared from the scene, while Andrej Leper, the head of the extremists from the Self-defence, committed suicide last year. That said, the PiS would hardly find a coalition partner among the other parties even if it won the election. The postcommunists (SLD) and the ultra-liberal spinoff of the Civic Platform (the Palikot Movement) also stand realistic chances of entering the Parliament, in addition to the People's Party (today's coalition partner of the PO). Both the SLD and the Palikot actively oppose the Catholic Church and advocates homosexual rights. Thus we can scarcely expect them to find common ground with the conservative PiS.

As usually, voter turnout may be crucial for the Civic Platform's final success in the end. As we know, the conservative voters of the PiS are much more disciplined, and if the PO attracts well below 50% of voters to polling stations, the scenario of 2005 may easily repeat itself. By and large, the worst scenario for markets would likely be if Civic Platform had a weak victory or were to lose by a narrow margin, in combination with a poor result by its coalition partner PSL. If the PO had to negotiate with the postcommunists, the current rate of budget tightening could scarcely be maintained, and hardly anyone would believe that the deficit would be cut to less than 3% of GDP by 2013.

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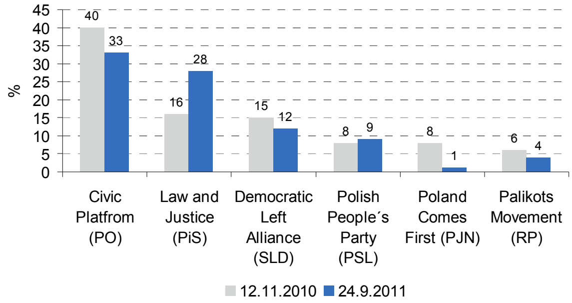
Pre-election polls, 2011 Elections



Weekly Preview

PL: NBP on hold

WED 14:00 — **NBP rate (in %)**

	This	Last change
rate level	**4.50**	5/2011
change in bps	**25**	25

The latest European debt crisis developments, which have made the zloty depreciate significantly, have not been overlooked by Poland's central bankers. By contrast, the period of increased uncertainty about the growth of European economies and the monetary tightening in the first half of the year (rates were up by 100 bps) should curb rate change desires, if any, as should the falling inflation expectations of Polish households. In addition, we believe that this year's inflation has already peaked and should slowly head towards the upper threshold of the tolerance band of the NBP (3.5%). This is why we believe that the NBP will not change rates until the end of the year, and will keep them at their current level of 4.5%.

CZ: Retail sales in the red again

THU 9:00 — **CZ Retail sales (y/y change ir**

	Aug-11	Jul-11	Aug-10
Monhtly	**-0.8**	-1.7	3.3
cummulative (YTD)	**1.8**	2.2	1.0

Just like in the previous two months, year-on-year retail sales likely fell again in August. As indicated new car registrations, the automotive segment continued to perform well in that month, while retail sales excluding cars likely maintained their falling tendency. By and large, consumer demand still proves to be subdued, with minimum latitude for demand-pull inflation pressures.

CZ: Industry still in the black

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

	Aug-11	Jul-11	Aug-10
Monhtly	**5.6**	4.4	13.7
cummulative (YTD)	**9.3**	9.8	9.4

Industry continued to go up, albeit even this sector is showing a decelerating trend. One more business day in August also contributed to the figure. A reasonable increase in output can be primarily expected in the engineering and mining industries. By contrast, PC manufacturing, the food industry, and the energy sector are likely to go down again on the year-on-year basis. However, data about contracts, which will signal the development of industry in the months to come, should be more important than the August increase in output.

CZ: Foreign trade shows a greater surplus

FRI 9:00 — **CZ Foreign trade (CZK bn)**

	Aug-11	Jul-11	Aug-10
Balance	**5.0**	14.0	0.7
cummulative (YTD)	**118.6**	113.5	87.0
Exports (y/y in %)	**8.0**	9.3	23.9
Imports (y/y in %)	**5.8**	4.0	31.0

The rise in exports likely continued to outpace imports in August. Although the month-on-month surplus is low at first glance, the August figures are usually some of the worst. The primary factors will again include the exports of machinery and means of transport, on the one hand, and increased commodity prices on the other. By contrast, poor domestic demand should lead to just a moderate increase in imports to the CR. The overall foreign trade developments remain positive this year and, as a matter of fact, foreign trade is continuing to be the primary driver of the Czech growth.

CZ: Inflation still below the target

MON 9:00 — **CZ Inflation (change in %)**

	Sep-11	Aug-11	Sep-10
CPI m/m	**-0.3**	-0.3	-0.3
Food m/m	**-0.1**	-1.4	0.1
Housing, energy	**0.0**	0.0	0.0
Transportation	**0.0**	0.2	-0.5

September's inflation was primarily influenced by the seasonal reductions in package tour prices. In addition, food prices also went down. On the other hand, seasonal clothing sellers raised their prices this time. Year-on-year inflation still remains below the CNB's target, where it will be until the end of the year. Inflation will only soar to more than 3% after the increase in the reduced VAT rate at the beginning of next year; however, poor consumer demand should eliminate the secondary impacts of that tax change. Hence the CNB may stick to its wait-and-see attitude.

CZ: Unemployment closely above 8%

MON 9:00 — **CZ Unemployment Rate (in %)**

	Sep-11	Aug-11	Sep-10
Rate	**8.1**	8.2	8.5

The unemployment rate likely fell by 0.1% in September. The decline is primarily due to seasonal factors and also to improved demand for early retirements, triggered by a change in the calculation of those pensions. By contrast, the increased influx of school-leavers will be evident on the labour market. While unemployment has been falling thus far, it is likely to go up again to as high as 8.5% in the last months of the year.

Calendar

Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	10/03/2011	9:00	Trade balance	EUR M	07/2011 *F					373.8	
HU	10/03/2011	9:00	PMI manufacturing		09/2011					50.1	
PL	10/2011	9:00	PMI manufacturing		09/2011						
CZ	10/03/2011	9:30	PMI manufacturing		09/2011						
CZ	10/03/2011	14:00	Budget balance	CZK B	09/2011					-87.3	
PL	10/05/2011	14:00	NBP meeting	%	10/2011					4.5	
HU	10/06/2011	9:00	Industrial output	%	08/2011 *P				1.3	0.8	2.7
CZ	10/06/2011	9:00	Retail sales	%	08/2011		-0.8				-1.7
HU	10/06/2011	12:00	GB bond auction/fixed rate	HUF B	10/2011						
CZ	10/07/2011	9:00	Trade balance	CZK B	08/2011	5				14	
CZ	10/07/2011	9:00	Industrial output	%	08/2011		5.6				4.4
CZ	10/07/2011	9:00	Construction output	%	08/2011						-11.1
HU	10/07/2011	17:00	Budget balance	HUF B	09/2011					-1544.6	

Forex Technicals

EUR/CZK Daily Chart:

Currently back below 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 24.5220 (weekly envelope bottom), with next levels at 24.4580 (50 Week Moving Average↑), ahead of 24.4160 (weekly Medium Term Moving Average↑) and 24.4000/ .3800 (Sept 27/ 16 lows), where pause favored.
Failure to hold would see next levels at 24.3380 (61.8% 23.9200 to 25.0150), ahead of 24.2700 (Sept 09 low) and 24.1900/ .1630 (break-up daily/ hourly): tough on 1st attempts.

Resistance at 24.8800 (reaction high hourly), ahead of 24.9040 (weekly envelope top) and 25.0150 (current year high + see above), where pause favored.
If unable to cap, next levels at 25.0360 (76.4% Dec 2010 high to 23.9200), ahead of 25.1400 (1st target off daily Double Bottom off 24.5900: see graph/ weekly Starc top): tough on 1st attempts.

EUR/HUF Daily Chart:

Rebound from year low: pair currently back above the Uprendline off low and 292.10 (neckline long term Double Bottom: see graph).
Support at 291.49 (weekly envelope bottom), with next levels at 288.60/ .41 (weekly Short Term Moving Average↑/ reaction low hourly) and 285.35 (current reaction low off 295.55): 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 295.55/ 295.85 (current new year high/ 61.8% 317.45 to 260.93), with next levels at 297.28/ 297.53 (weekly Starc top/ weekly modified Alpha Beta trend top): tough on 1st attempts.

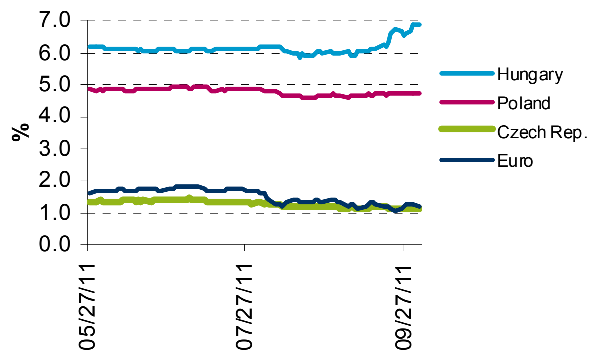
EUR/PLN Daily Chart:

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 4.4036 (weekly envelope bottom), with next levels at 3.3935/ .3882 (reaction lows hourly), ahead of 4.3646/ .3600 (weekly Short Term Moving Average↑/ current reaction low off 4.5370): must sustain back below to indicate better fortunes for Zloty.
Failure to hold would see next levels at ahead of 4.3322/ .3205 (breaks-up hourly), ahead of 4.2815 (Sept 16 low) and 4.2665 (38.2% 3.8290 to 45370): tough on 1st attempts.

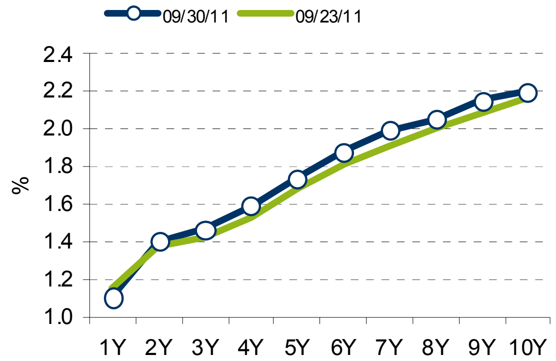
Resistance at 4.4495 (weekly Bollinger top), ahead of 4.4882/ .5020 (weekly modified Alpha Beta trend top/ breakdown hourly), where pause favored.
Failure to cap would see next levels at4.5208 (weekly Starc top), ahead of 4.5370/ .5467 (current new year high/ 2nd target of hourly channel break off 3.9261): suspect tough to sustain through on 1st attempts.

Fixed-income in Charts

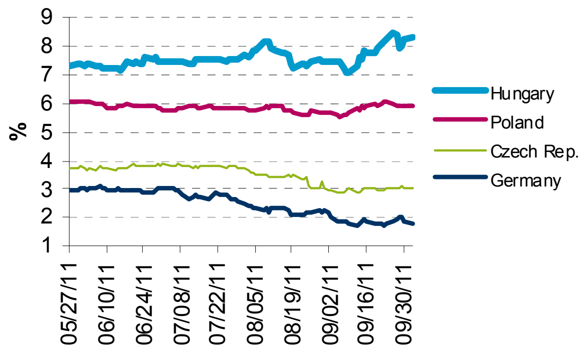
FRA 3x6



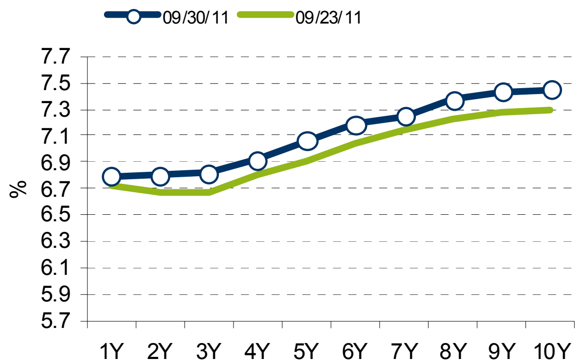
CZ IRS



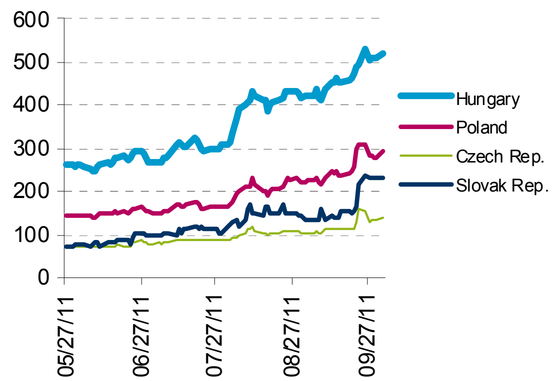
10Y GB Yields



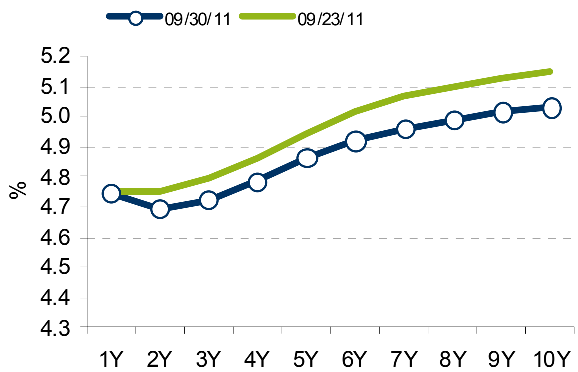
HU IRS



CDS 5Y



PL IRS



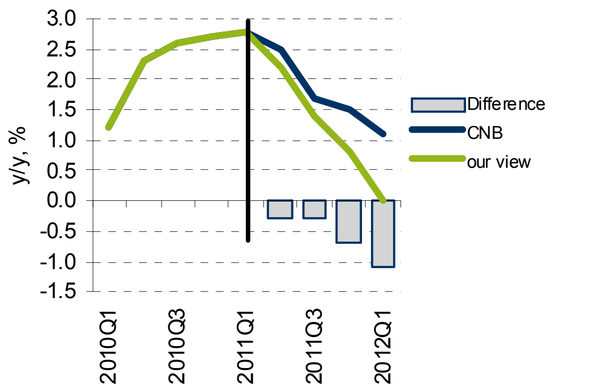
Source: Reuters

Medium-term Views & Issues

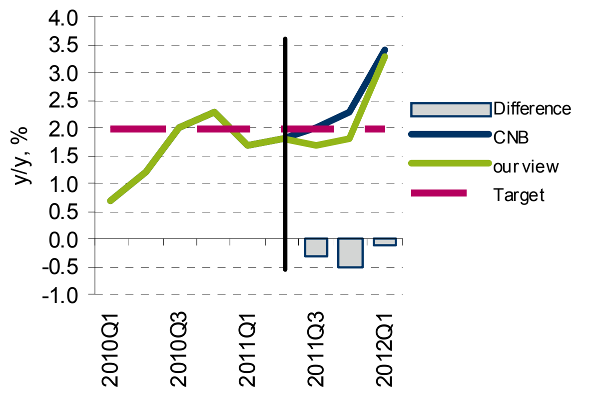
	The Czech Republic	Hungary	Poland
Growth & key issues	Although the situation in the governing coalition after some turmoil has stabilized again, tensions in the government coalition might return during discussions of the 2012 budget. The government intends to change the system of direct taxes radically 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 4th 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

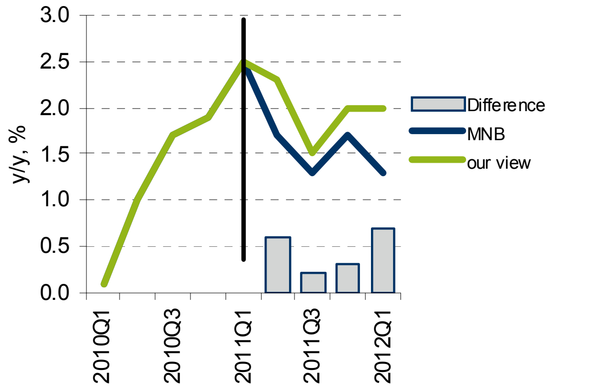
CZ: GDP Outlook



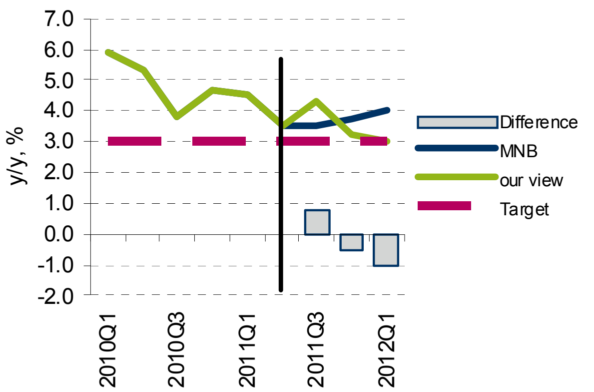
CZ: Inflation outlook



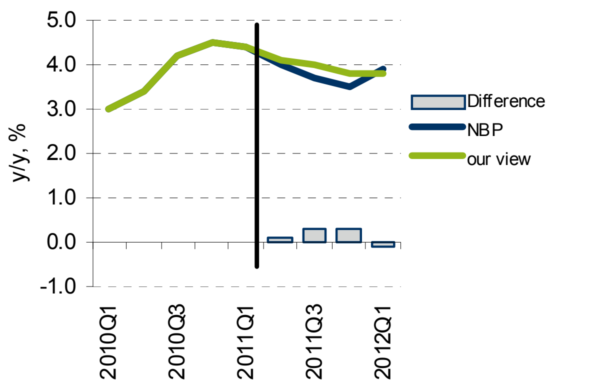
HU: GDP Outlook



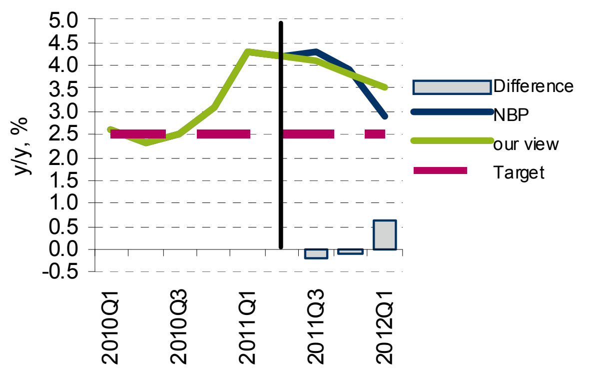
HU: Inflation outlook



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	*1.18*	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	*2.2*	2.05	2.10	2.40	2.70	3.05
Hungary	HU10Y	*7.45*	7.50	7.50	7.50	7.25	7.00
Poland	PL10Y	*5.04*	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	*294*	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)	
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	
Austin Hughes	+353 1 6646892
Prague Research (CSOB)	
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Jan Bures	+420 2 6135 3574
Petr Baca	+420 2 6135 3570
Bratislava Research	
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Warsaw Research	
Budapest Research (K&H)	
Gyorgy Barcza	+36 1 328 99 89

Global Sales Force	
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