



Central European Weekly

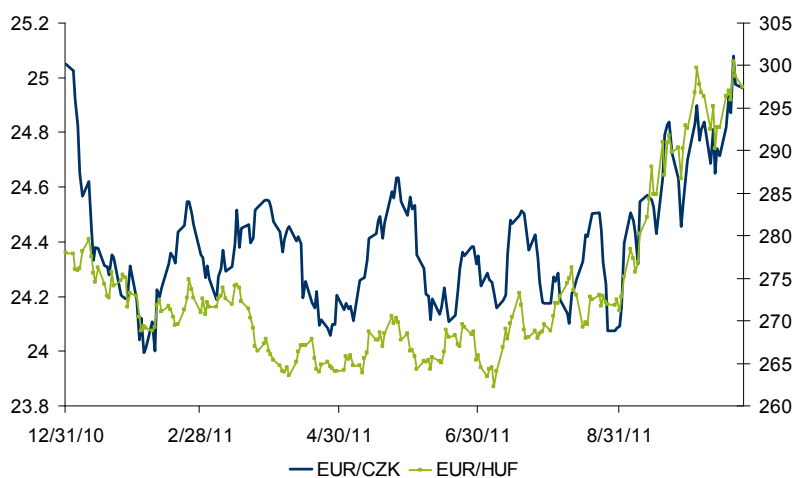
Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- Forint hits two-year lows, koruna slips to this year's minimum
- Weak zloty brings the Polish public debt into focus again
- MNB is expected to keep the base rate unchanged despite the record weak currency

Chart of the Week: Forint and koruna fell the heat coming from the EMU

EUR/CZK and EUR/HUF in 2011



Both the EUR/CZK and the EUR/HUF reached this year's highs during the past week. The koruna breached 25 EUR/CZK and the forint was trading above 300 EUR/HUF.

Table of Contents:

| | |
|---------------------------------------|---|
| Market's editorial..... | 2 |
| Weekly Preview | 3 |
| Calendar | 4 |
| Forex Technicals | 5 |
| Fixed-income in Charts | 6 |
| Medium-term Views & Issues | 7 |
| CB's Projections vs. Our Forecasts .. | 8 |
| Summary of Our Forecast | 9 |

Market's editorial

Koruna at this year lows, EUR/HUF at 300

Central European currencies are under pressure. The koruna appeared at its lowest levels of the year, while the forint has even hit two-year lows. Remarkably, the Central European currencies are depreciating despite the global sentiment on risk markets not being that bad, given the favourably developing earnings season and the fairly good macroeconomic data from the United States. Naturally, the debt crisis in the eurozone is responsible for the weakened Central European currencies, as the regional currencies seem to be much more affected by events on Europe's government bond markets than, for example, by developments in global stock markets.

A fairly positive feature of the current developments in Central European markets is that this is no panic sale, and the affected currencies are weakening only gradually; nevertheless, even though the depreciation of the currencies is in no way rapid, the mere fact that the forint or the zloty is weak may involve certain problems.

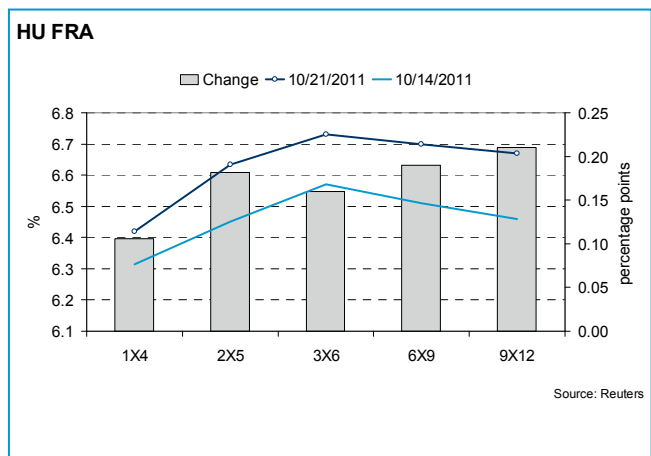
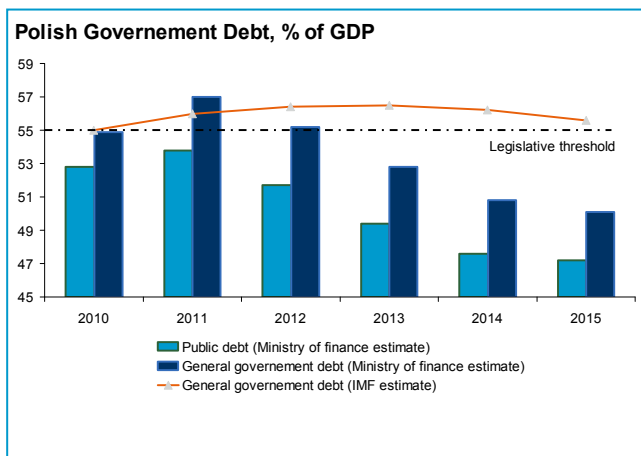
Weak zloty highlights the level of Polish debt

As far as Poland is concerned, it is the old, familiar problem concerning the volume of its public debt, which should not exceed the legal limit of 55% of GDP. Poland's public debt is very close to that level (though the general government is already above it) and, with a significant portion of the debt being de-

nominated in foreign currencies, the debt may exceed the legislative threshold. Of course, this may cause problems for the re-elected government (it would need to tighten its fiscal policy to prevent an increase in the debt as a share of GDP next year). This is also why it is expected that Polish authorities (notably the state-owned bank BGK) will continue to intervene in favour of the zloty if the currency continues to depreciate.

MNB meeting closely watched

It seems that the Hungarian government is even more nervous about the depreciation of its currency, for in response to the development of the forint, it is preparing more measures to help households whose debts are denominated in foreign currencies. Thus far, however, the government's attempts at curbing foreign-currency debts have had no effect, and the losses incurred by debtors (and now also by banks) are mounting, hand in hand with the depreciating forint. In this respect it will be worth watching the upcoming MNB meeting. The Hungarian central bank is expected to keep the base rate unchanged on Tuesday despite the fact that the money market is pricing in about 50bps rate hike for the next 3-6 months. Although the Council will weigh the record weak currency and financial stability risks in case the eurozone crisis takes a rougher path, the MNB will probably stay on hold again..



| | Last | Change 1W | Outlook 1W ahead | Outlook 1M ahead |
|---------|------|-----------|------------------|------------------|
| EUR/CZK | 25.0 | 0.06% | ↗ | ↘ |
| EUR/HUF | 298 | 0.12% | ↗ | ↘ |
| EUR/PLN | 4.39 | 0.69% | ↗ | ↘ |

| | Last | Change 1W | Outlook 1W ahead | Outlook 1M ahead |
|---------|------|-----------|------------------|------------------|
| 10Y CZK | 2.30 | -1.54 | → | ↗ |
| 10Y PLN | 7.22 | 1.26 | ↗ | ↗ |
| 10Y HUF | 5.07 | 1.81 | ↗ | ↘ |

Weekly Preview

| TUE 14:00 MNB base rate | | |
|-------------------------|--------------|-------------|
| | This meeting | Last change |
| rate level (in %) | 6.00 | 1/2011 |
| change in bps | 0 | 25 |

HU: MNB on hold despite very weak currency

The Hungarian central bank is expected to keep the base rate unchanged on Tuesday despite the record weak currency. Domestic demand is still depressed at the 2009 bottom, which keeps inflationary pressures low and may allow the central bank to tolerate the weak currency for some time. The latest inflation data from September was broadly ok at 3.6% Y/Y as core inflation was exactly at the target rate of 3.0% Y/Y due to low service and tradable prices. The Council thus could keep on focusing core inflation development and weigh financial stability risks in case the eurozone crisis takes a rougher path. Currently, the money market is pricing in about 50bps rate hike for the next 3-6 months and they react quickly to the swings of the currency, which is then depending on the news from abroad..



Calendar

| Country | Date | Time | Indicator | | Period | Forecast | | Consensus | | Previous | |
|---------|------------|-------|-------------------------------|-------|---------|----------|-----|-----------|-----|----------|------|
| | | | | | | m/m | y/y | m/m | y/y | m/m | y/y |
| PL | 10/25/2011 | 10:00 | Retail sales | % | 09/2011 | | | 0 | 9.9 | 1.1 | 11.3 |
| PL | 10/25/2011 | 10:00 | Unemployment rate | % | 09/2011 | | | 11.7 | | 11.6 | |
| HU | 10/2011 | 14:00 | NBH meeting | % | 10/2011 | 6 | | 6 | | 6 | |
| HU | 10/27/2011 | 12:00 | GB bond auction/floating rate | HUF B | 10/2011 | | | | | | |
| HU | 10/28/2011 | 9:00 | Unemployment rate | % | 09/2011 | | | 10.7 | | 10.8 | |

Forex Technicals

EUR/CZK Daily Chart:



Currently above Downtrendline off May 2010 high, with rebound off year low trying to regain the broken Uptrendline off low (see graph).

Support at 24.8220 (reaction low hourly + weekly Medium Term Moving Average↑), with next levels at 24.7800 (weekly envelope bottom), ahead of 24.6450/ .6300 (Oct 17/ 10 lows).

24.4770/ .4540 = 50 Week Moving Average↑/ weekly Bollinger midline: needs to sustain below to signal return of better fortunes for CZK.

Next levels would come in at 24.4000/ .3800 (Sept 27/ 16 lows + monthly envelope bottom), ahead of 24.2700 (Sept 09 low): tough on 1st attempts.

Resistance at 25.0700 (weekly modified Alpha Beta trend top), ahead of 25.1000 (new year high), where pause favored.

Failure to cap would see next levels at 25.1400 (1st target off daily Double Bottom off 24.5900: see graph), ahead of 25.1770 (weekly envelope top) and 25.2600/ .2820 (2nd target off 24.5900/ 23.6% 29.6900 to 23.9200): tough on 1st attempts.

EUR/HUF Daily Chart:



New year high has been scored: pair currently back above 292.10 (neckline long term Double Bottom: see graph).

Support at 294.50/ .24 (reaction low hourly + weekly envelope bottom/ break-up hourly), with next level at 293.34 (break-up daily), where pause favored.

Failure to hold would see next levels at 292.46 (23.6% 261.90 to 301.90), ahead of 288.65/ 287.65 (Oct 12 low/ weekly Stop And Reverse): needs to sustain below to call end of alert for HUF.

Resistance at 301.90/ 301.93 (new year high/ weekly Bollinger top), where pause favored.

Failure to cap would see next levels at 302.29 (weekly modified Alpha Beta trend top), ahead of 303.48/ 303.59 (1st Irregular B off 288.65/ weekly envelope top) and 305.23 (2nd Irregular B): tough on 1st attempts.

EUR/PLN Daily Chart:



Failed to regain the Uptrendline off low (see graph) but still above 4.2400 (neckline of a long term Head And Shoulders bottom).

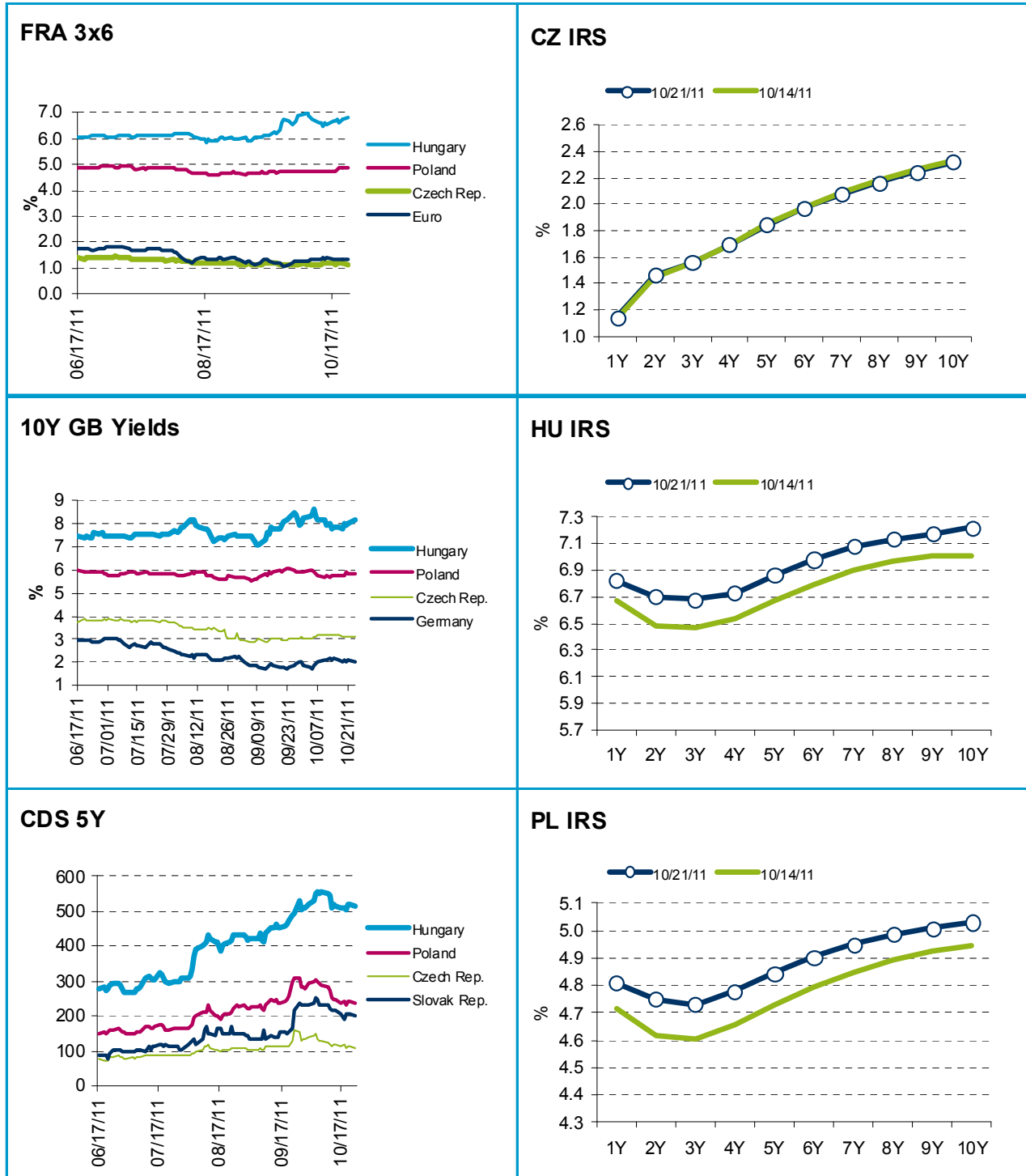
Support at 4.3270/ .3257 (break-up hourly/ weekly modified Alpha Beta trend bottom), with next levels at 4.3150/ .3089 (break-up daily/ weekly envelope bottom): needs to sustain back below to signal return of better fortune for Zloty.

Next Support levels would come in at 4.2980 (break-up hourly), ahead of 4.2756 (weekly Medium Term Moving Average↑) and 4.2665/ .2640 (Oct 17 low/ break-up daily + 38.2% 3.8225 to 4.5370), where pause favored.

Resistance at 4.4250 (current reaction high off 4.2665), with next level at 4.4312/ .4336 (weekly modified Alpha Beta trend top/ 61.8% 4.5370 to 4.2665), where pause favored.

Failure to cap would see next level at ahead of 4.4432 (weekly envelope top), ahead of 4.5092 (weekly Bollinger top): suspect tough to sustain through on 1st attempts.

Fixed-income in Charts

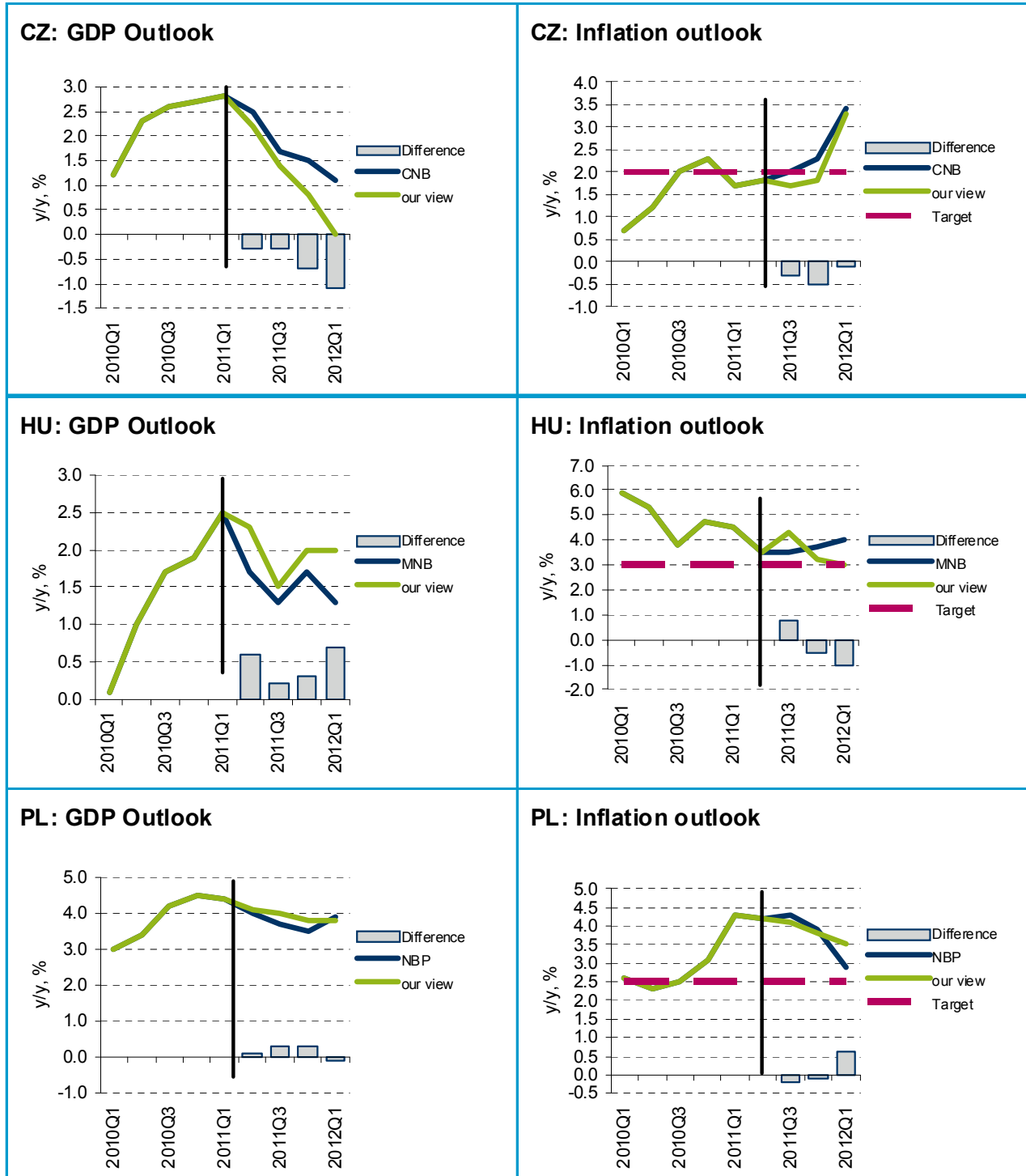


Source: Reuters

Medium-term Views & Issues

| | The Czech Republic | Hungary | Poland |
|-------------------------------------|--|--|---|
| Growth & key issues | <p>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.</p> | <p>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.</p> | <p>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.</p> |
| Outlook for official & market rates | <p>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 Q32012 (in contrast to the current prognosis implying it in 4th 2011).</p> | <p>We highlight the 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.</p> | <p>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.</p> |
| Forex Outlook | <p>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.</p> | <p>Negative sentiment on global markets continued to weigh on the forint, which slid to as EURHUF reached a new record high 300. The stabilisation in 5y5y forward spread over the euro is a necessary condition for the forex market has become more optimistic about the long-term outlook.</p> | <p>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.</p> |

CB's Projections vs. Our Forecasts



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 | 1.16 | 1.17 | 1.19 | 1.22 | 1.25 | 1.42 |
| Hungary | BUBOR | 6.12 | 6.00 | 6.00 | 6.00 | 6.00 | 6.00 |
| Poland | WIBOR | 4.87 | 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 | 2.3 | 2.05 | 2.10 | 2.40 | 2.70 | 3.05 |
| Hungary | HU10Y | 7.22 | 7.50 | 7.50 | 7.50 | 7.25 | 7.00 |
| Poland | PL10Y | 5.07 | 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 | 25.0 | 25.0 | 24.4 | 24.0 | 23.8 | 23.8 |
| Hungary | EUR/HUF | 298 | 295 | 280 | 270 | 270 | 268 |
| Poland | EUR/PLN | 4.39 | 4.35 | 4.10 | 3.95 | 3.90 | 3.90 |

GDP (y/y)

| | 2011Q1 | 2011Q2 | 2011Q3 | 2011Q4 | 2012Q1 | 2012Q2 | 2012Q3 |
|------------|--------|--------|--------|--------|--------|--------|--------|
| Czech Rep. | 2.8 | 2.2 | 1.4 | 0.8 | 0.0 | 0.4 | 1.4 |
| Hungary | 2.5 | 1.5 | 1.5 | 2.0 | 2.0 | 1.8 | 1.8 |
| Poland | 4.4 | 4.3 | 4.0 | 3.8 | 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 | -5.0 |

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 | |
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