



# Central European Weekly

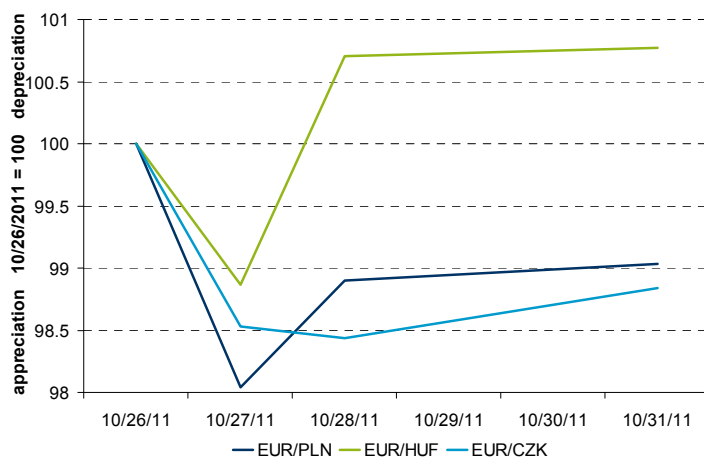
Written by CSOB Prague and K&H Budapest

## Weekly Highlights:

- CEE currencies set for relief after EU summit, at least short-term
- Hungarian forint threatened by rating cut rumours
- Czech koruna may lag behind in case of relief rally
- CNB should leave rates unchanged, while it may downgrade growth outlook

## Chart of the Week: Reaction of CE currencies to the Greek deal

CE currencies since EMU summit held last week



Unlike its peers, the Hungarian forint failed to gain support from the summit. The forint has remained under pressure due to worries regarding possible downgrade of Hungarian rating.

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# Market's editorial

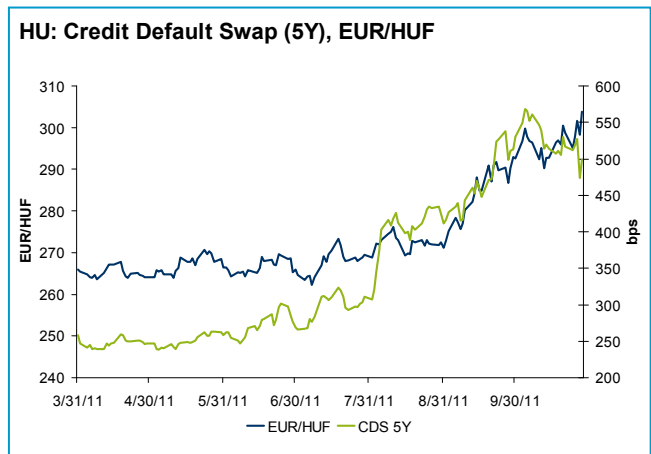
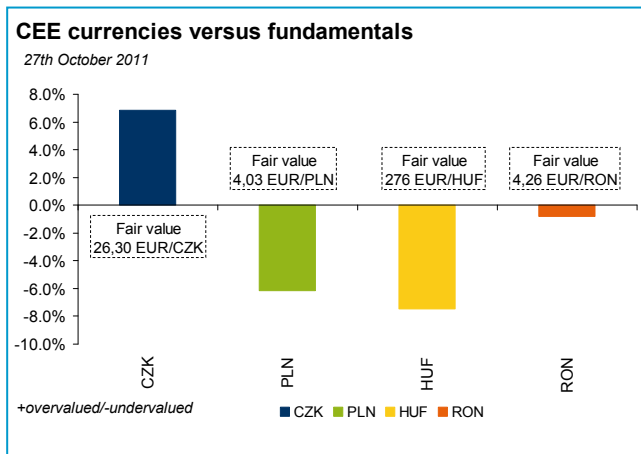
## CEE currencies set for relief, at least short-term

The European summit has, at least temporarily, put risky assets back on track. What does it mean for Central Europe? Naturally, weaker US dollar should benefit most Central European currencies. We believe that the Polish zloty, which has depreciated the most since the beginning of the year (almost 10%), may fare best. Also, the Polish economy is the most immune to the coming deceleration in the eurozone, and our fundamentals model indicates that the zloty, just like the forint, is currently undervalued quite significantly compared to its fundamentals (5-6%). Of course, both economies also involve significant risks in the long-term horizon. The risks in Hungary are primarily associated with the hardly predictable government measures, which could result in rating downgrade as Economy Minister Gyorgy Matolszy warned last week. In Poland the risks stem from the government's inability to speed up the fiscal consolidation and to prevent current account deficits from increasing. At the moment, however, especially the zloty stands good chances of benefiting from the

return of an appetite for risky assets on global markets.

## Czech koruna lagging behind...?

The Czech koruna finds itself in a completely different situation, as the tension at the peripheries of the eurozone has affected the currency to a lesser extent and, for this reason alone, its appreciation potential is fairly small. In addition, the Czech currency bears by far the lowest yield now, with the two-year Czech swap yielding only 1.4%, i.e., less than its German counterpart. By contrast, the yield of the two-year swap on the Hungarian market exceeds 6.5%, and the yield of the Polish swap is nearly 4.7%. That said, Czech assets are not suitable for speculative investments through low yield, and the koruna may again serve more as a safe currency to finance riskier positions in neighbouring currencies in the future. If this happens, the Czech currency may weaken significantly against both the forint and the zloty.



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	24.8	-0.64%	→	→
EUR/HUF	305	2.26%	→	→
EUR/PLN	4.34	-0.57%	→	→

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.33	-3.56	↗	↗
10Y PLN	7.21	0.84	↗	↗
10Y HUF	4.95	-1.11	↗	↗



## Weekly Preview

THU 13:00

CNB base rate

	This meeting	Last change
rate level (in %)	0.75	5/2010
change in bps	0	-25

### CZ: CNB leaves official rates unchanged again

The central bank's new forecast should not lead to a rate change in the Czech Republic soon. On the contrary, the forecast is likely to defer the announced rate hikes. While the latest forecast favoured a rate hike in late 2011/early 2012, the new forecast will be less optimistic.

The Czech National Bank is likely to revise its GDP growth outlook from the current 2.2% to a much lower figure, while the inflation forecast is unlikely to change significantly.

The weak European economy is going to curb the Czech Republic's economic growth in 2012, and this does not provide much latitude for rate hikes. Thus the earliest possible date for the first monetary tightening appears to be late 2012, when the economy may already be heading for better times.



## Calendar

Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
CZ	10/31/2011	11:00	Money supply M2	%	09/2011						3.1
CZ	11/01/2011	9:30	PMI manufacturing		10/2011						
CZ	11/2011	14:00	Budget balance	CZK B	10/2011						-105.1
PL	11/02/2011	9:00	PMI manufacturing		10/2011						
HU	11/02/2011	9:00	PMI manufacturing		10/2011						50.8
HU	11/02/2011	10:00	PPI	%	09/2011						-0.1
HU	11/03/2011	9:00	Trade balance	EUR M	08/2011 *F						492.4
HU	11/03/2011	12:00	GB bond auction/fixed rate	HUF B	11/2011						
CZ	11/03/2011	12:30	CNB meeting	%	11/2011	0.75		0.75			0.75

# Forex Technicals

EUR/CZK Daily Chart:



Rebound off year low tried to regain the broken Uptrendline off low (see graph).

**Support** at 24.6490/ .6300 (38.2% 23.9200 to 25.1000/ Oct 10 low), ahead of 24.5100 (50%) and 24.4650 (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), ahead of 24.2700 (Sept 09 low): tough on 1st attempts.

**Resistance** at 24.8950 (breakdown daily): ideal area to stay below to keep current better tone for CZK.

Failure to cap would see next levels at 24.9870 (weekly Bollinger top), ahead of 25.0750/ .1000 (Oct 26 high/ new year high). 25.2860 = 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 294.90/ 294.24 (Oct 24 low/ break-up hourly), with next level at 293.34 (break-up daily), where pause favored.

Failure to hold would see next levels at 290.65 (weekly Stop And Reverse), ahead of 288.65/ 287.61 (Oct 12 low/ weekly Medium Term Moving Average↑): needs to sustain below to call end of alert for HUF.

**Resistance** at 302.79 (current new year high?), ahead of 303.48 (1st Irregular B off 288.65), where pause favored.

Failure to cap would see next levels at 305.23 (2nd Irregular B), ahead of 306.53 (weekly Bollinger top): 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).

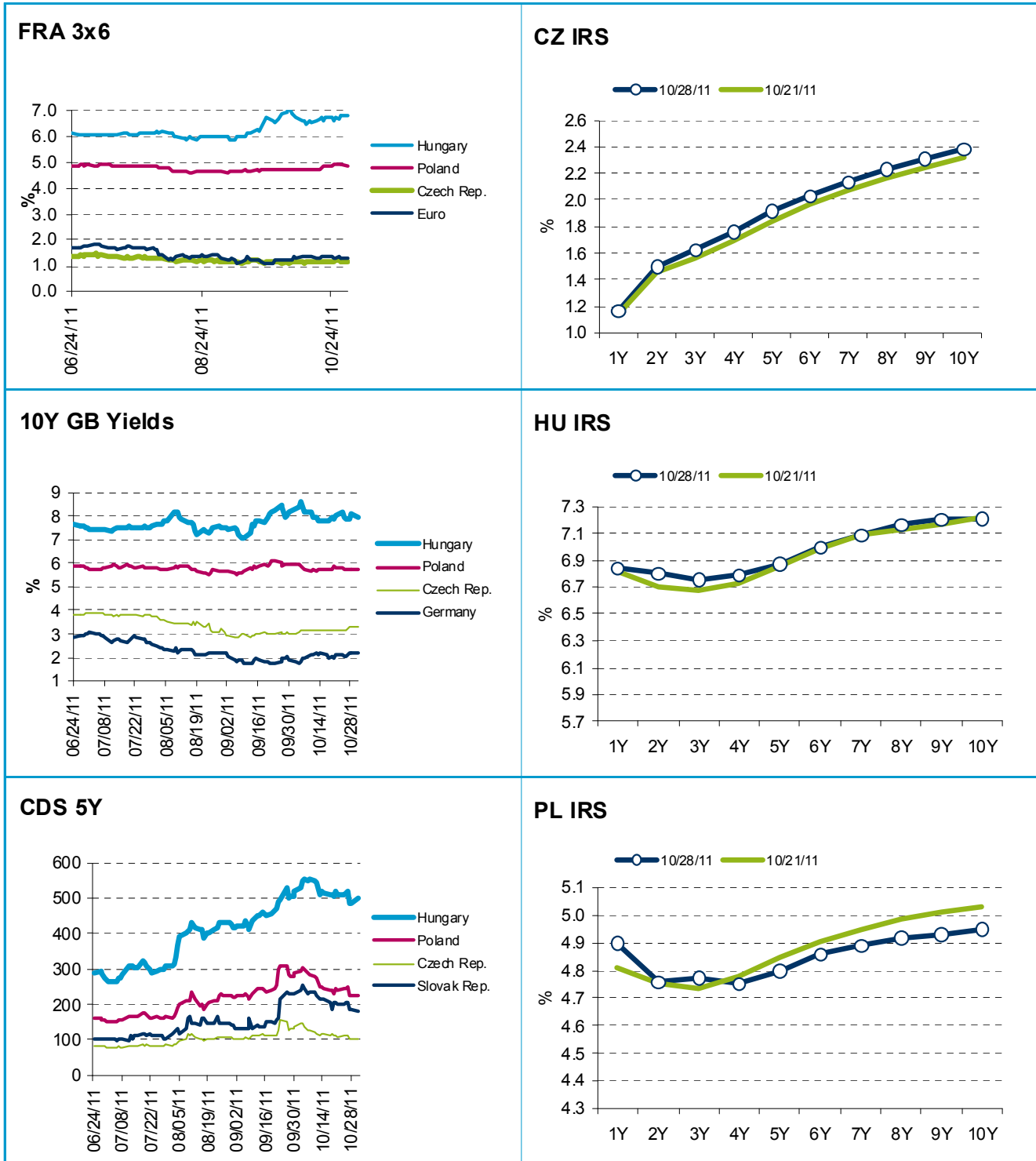
**Support** at 4.2815 (neckline of short term daily Triple Tops), with next levels at 4.2665/ .2640 (Oct 17 low/ break-up daily + 38.2% 3.8225 to 4.5370): needs to sustain back below to signal return of better fortune for Zloty.

Next Support levels would come in at 4.2000 (break-up weekly), ahead of 4.1830 (50% year low to 4.5370), where pause favored.

**Resistance** at 4.3550 (breakdown daily + weekly Short Term Moving Average↓): ideal area to stay below to keep current better tone for Zloty.

Failure to cap would see next levels at 4.3810/ .3980 (breakdown hourly/ Oct 26 high), ahead of 4.4250 (Oct 20 high): suspect tough to sustain through on 1st attempts.

# Fixed-income in Charts

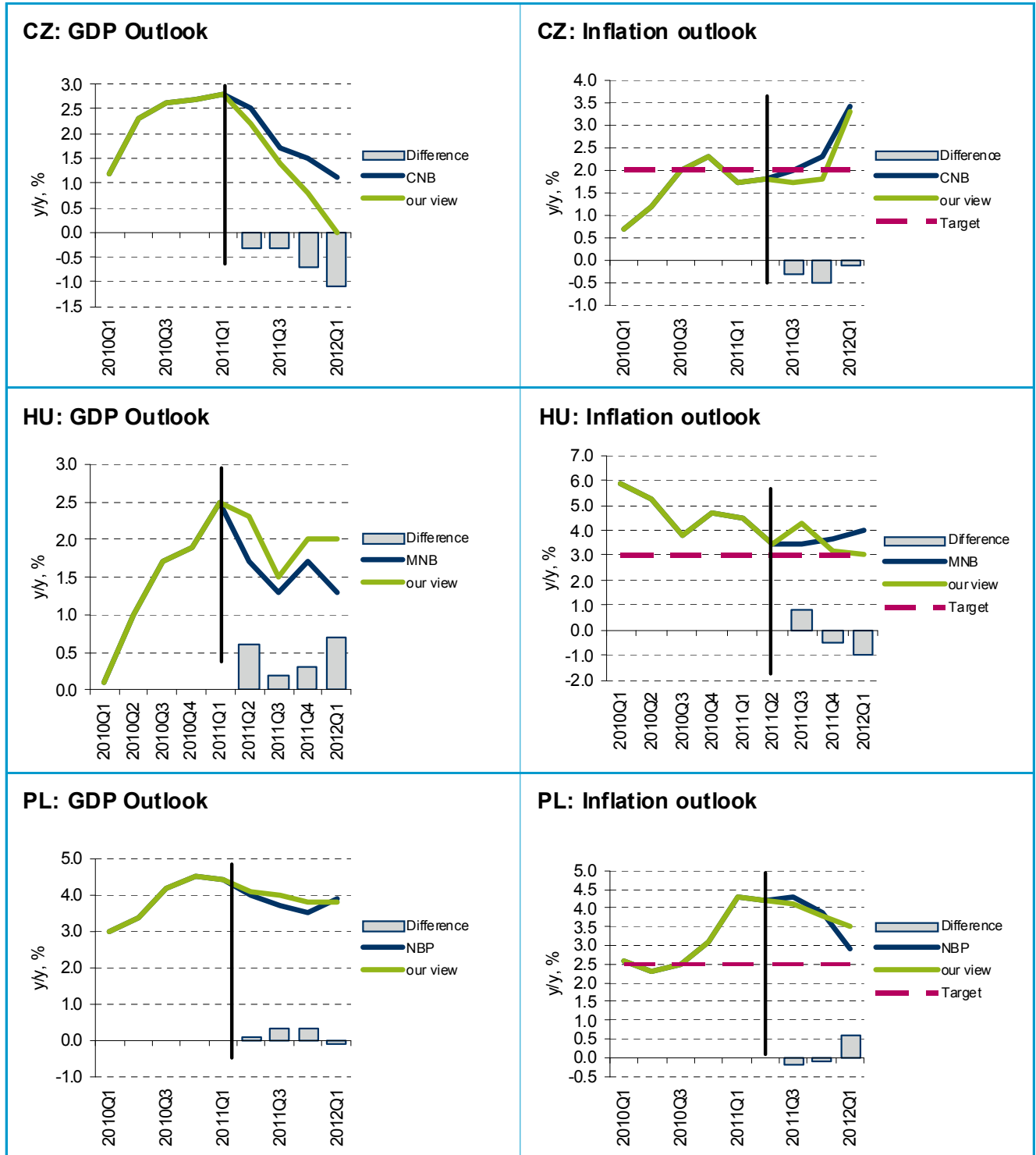


Source: Reuters

## 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	6.13	6.00	6.00	6.00	6.00	6.00
Poland	WIBOR	4.9	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	2.33	2.05	2.10	2.40	2.70	3.05
Hungary	HU10Y	7.21	7.50	7.50	7.50	7.25	7.00
Poland	PL10Y	4.95	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	305	295	280	270	270	268
Poland	EUR/PLN	4.34	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



## Central European Weekly

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