Central European Weekly

Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- While Hungary turns again to the IMF, the MNB signals that rate hikes might come
- Polish government introduces new austerity measures
- GDP growth surprisingly accelerates

Chart of the Week: GDP growth in Central Europe

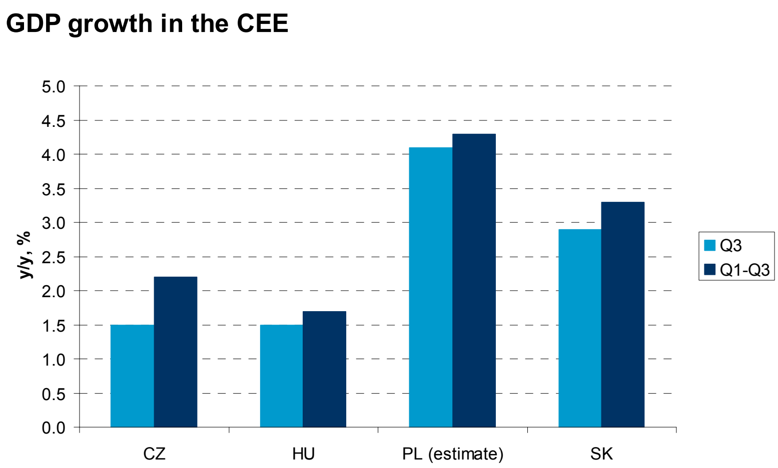


Table of Contents:

Market's editorial

Hungarian seeks new deal with the IMF

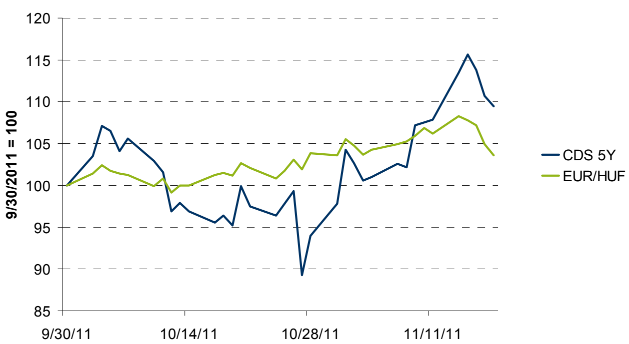
CEE strengthened by the end of the week on positive developments in Hungary and partly also in Poland. The Hungarian government submitted the letter to the IMF for a precautionary loan, which means a credit line and different from the stand-by loan we had in 2008. The government likely hopes that low budget deficit, declining public debt path and current account surplus give healthy macroeconomic background. We think most likely the government will go for the credit line (PCL), which may reach €6-12bn over the next 12-months. The IMF may accept the below 3% of GDP budget deficit for 2012, but may require additional measures to see it unchanged in 2013 and may also want an agreement with banks (speaking about them - the Banks submitted their proposal to save troubled borrowers to the government so a new agreement is likely to emerge over weeks ahead).

Overall, we think we think the government has good chance to get the loan (the agreement with IMF could be reached by the beginning of January). From market point of view it could be enough to lower the probability of a complete currency meltdown, so the forint may stabilize in the weeks ahead. Meanwhile, the central bank clearly established a tightening path, which may help the currency too.

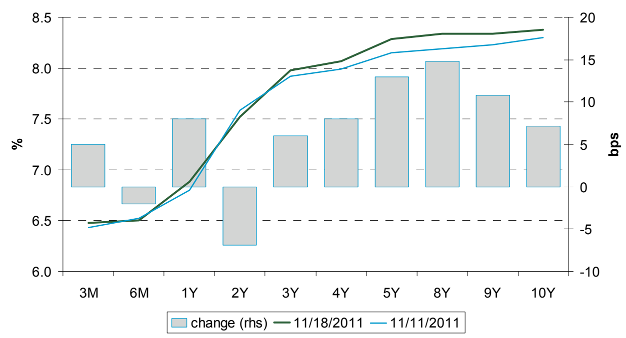
Polish government introduces austerity measures

In Poland, Prime Minister Donald Tusk has introduced new measures to curb the deficit. The retirement age should be increased (to 67 years). Beside that special pension arrangements for farmers, miners and other professions should be abolished as well as several tax breaks. Altogether with reductions in state bureaucracy it should bring the deficit down below 3% GDP for next year and to 1% GDP by 2015. In our view, this is positive from the point of view of Polish assets.

HU: CDS vs. EUR/HUF



HU: Yiedl curve



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	*25.5*	*-1.01%*	↗	↗
EUR/HUF	*307*	*-2.90%*	↗	↗
EUR/PLN	*4.44*	*-0.11%*	↗	↗

	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	*2.34*	*4.93*	↗	↗
10Y PLN	*7.26*	*-2.02*	↗	↗
10Y HUF	*5.04*	*-0.20*	↗	↗

Review of Economic Figures

The Czech economy comes to a halt

While large European economies reported mostly positive news on persisting economic growth last week, the first forecast of the Czech Republic's GDP unfortunately sprang no positive surprise. The economy, which grew by almost 1% (q/q) at the beginning of the year, virtually came to a halt in the third quarter. Although the Czech Republic's GDP still grew by 1.5% y/y, the quarter-on-quarter rate, which is zero at the moment, is more relevant in terms of the current growth rate of the economy. The GDP details are not yet available; nevertheless, the economy only seems to be driven by foreign trade, while domestic demand is still declining. In short, we can say that the Czech economy still stands on only a single foundation – car manufacturing, while the other sectors and industries, from construction to numerous services, are mostly subdued. The latest data from the economy failed to come up to the expectations of the central bank, whose latest forecast predicted 1.7% GDP growth. In addition, end-of-year economic growth is likely to fall to less than 1% y/y. For this year as a whole, the Czech economy may grow by 1.8%, which means deterioration compared to 2010, when the GDP grew by 2.3%; yet it will most likely be much more than next year's economic growth (0.5%).

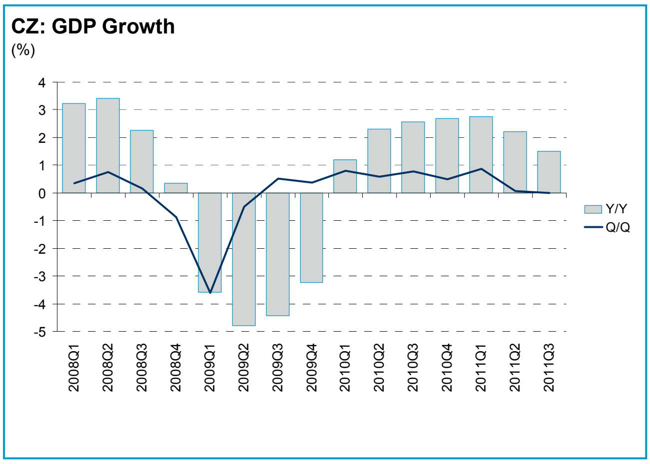
Hungary's growth surprisingly accelerates

In the end, the Hungarian economy performed decently in the third quarter of the year, having grown by 0.5% q/q, even slightly more than in the previous quarter. This fairly reasonable growth was likely fuelled not only by the decent growth of export-oriented industry but probably also by the very good crop, which led to increased agricultural production.

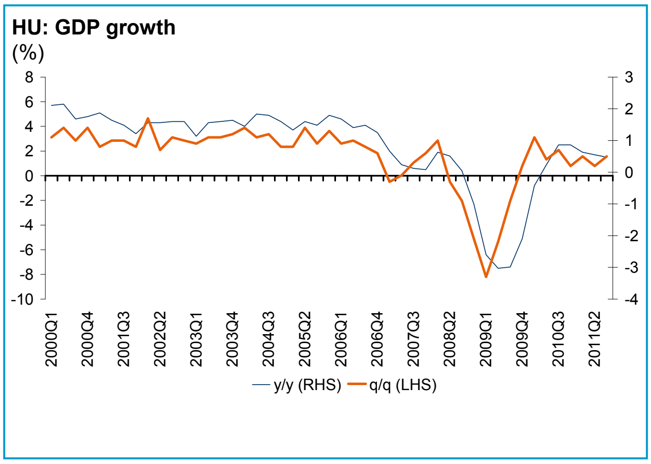
While year-on-year growth decelerated to 1.5%, the full-year figure should be faster than that, given the more rapid growth in the first half of the year. Nonetheless, not even the Hungarian economy will avoid an aggressive slowdown next year, associated with the (shallow) recession in the eurozone. In 2012, the Hungarian economy should grow at the same rate as the Czech economy, i.e., by 0.5%.

Strong growth of the Slovak economy continues

For the sake of completeness, we should add that, according to the first forecast by the Slovak Statistical Office, the Q3 growth of the Slovak economy was 0.7% compared to Q2 and 3.2% y/y. And just like in the Czech Republic, the positively developing foreign trade was likely responsible for that growth.



CZ: GDP Growth



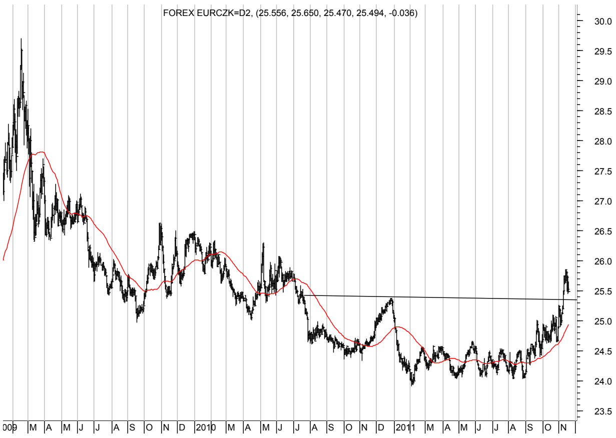
HU: GDP growth

Calendar

Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
PL	11/21/2011	14:00	PPI	%	10/2011			0.3	8.3	1.4	8.1
PL	11/21/2011	14:00	Industrial output	%	10/2011			-2	7	13	7.7
PL	11/2011	14:00	Core CPI	%	10/2011			0.2	2.6	0.2	2.6
HU	11/24/2011	9:00	Retail sales	%	09/2011				-0.1		0.4

Forex Technicals

EUR/CZK Daily Chart:



Pair currently above 25.3800 (Dec 2010 high + neckline Double Bottom: see graph).
Support at 25.4150 (current reaction low off 25.8500), with next levels at 25.3940/ .3800 (23.6% 23.9200 to 25.8500/ see above), ahead of 25.3100 (weekly envelope bottom), where pause favored.
Failure to hold would see next levels at 25.2680/ .2550 (weekly Short Term Moving Average↑/ break-up daily), ahead of 25.2000 (reaction low hourly) and 25.1120 (38.2% 23.9200 to 25.8500): tough on 1st attempts.

Resistance at 25.5690 (weekly Bollinger top), with next levels at 25.7500/ .7600 (reaction highs hourly) and 25.8380/ .8500 (weekly modified Alpha Beta trend top/ current new year high + weekly envelope top), where pause favored.
Failure to cap would see next levels at 25.9270 (weekly Starc top), ahead of 26.0800/ .1240 (June 2010 high/ 38.2% 29.6900 to 23.9200): tough on 1st attempts.

EUR/HUF Daily Chart:

Move above 292.10 (neckline long term Double Bottom: 1st target would be 322.75) sent the pair to a new historic high, but amid bearish reversal.
Support at 302.50 (current reaction low off 317.90 + weekly modified Alpha Beta trend bottom), with next level at 301.58 (monthly envelope bottom), ahead of 300.63 (weekly envelope bottom), where pause favored.
Failure to hold would see next levels at 299.82 (weekly modified Standard Error band bottom): needs to sustain back below to signal return of better fortune for HUF.

Resistance at 308.01 (breakdown hourly), ahead of 311.15/ 312.00 (weekly envelope top/ breakdown daily + (weekly modified Alpha Beta trend top), where pause favored.
Failure to cap would see next level at 315.72 (weekly Bollinger top), ahead of 317.90 (new year high): tough on 1st attempts.

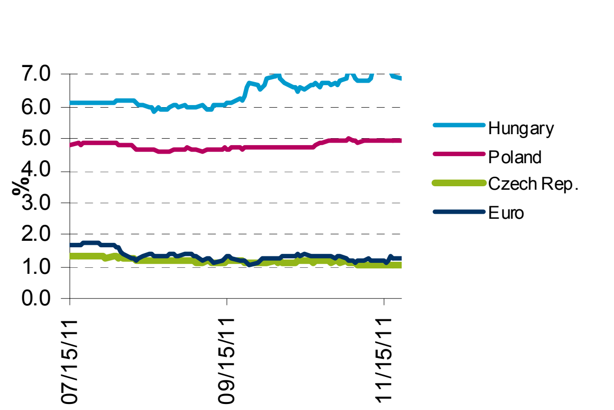
EUR/PLN Daily Chart:

Above 4.2400 (neckline of a long term Head And Shoulders bottom: see graph).
Support at 4.4050 (reaction low hourly), with next levels at 4.3883 (weekly Short Term Moving Average↑), ahead of 4.3703/ .3687 (weekly envelope bottom/ break-up daily) and 4.3538 (weekly Medium Term Moving Average↑), where pause favored.
Failure to hold would see next levels at 4.3300 (Nov 03 low), ahead of 4.3185 (reaction low hourly), ahead of 4.2995 (break-up hourly) and 4.2815 (Oct 27 low).
4.2665/ .2640 = neckline daily Double Top/ 38.2% 3.8225 to 4.5370: needs to sustain back below to signal return of better fortune for Zloty.

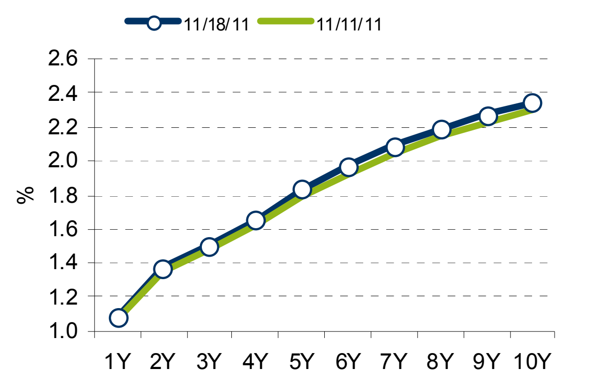
Resistance at 4.4590 (Nov 16 high + weekly modified Alpha Beta trend top), where pause favored.
4.4888/ .4938 = Nov 01 high/ weekly envelope top: suspect tough to sustain through on 1st attempts.

Fixed-income in Charts

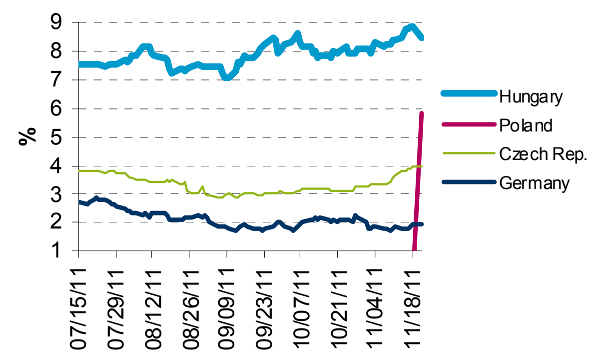
FRA 3x6



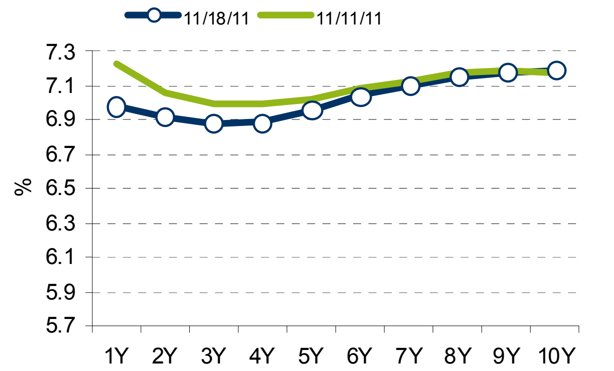
CZ IRS



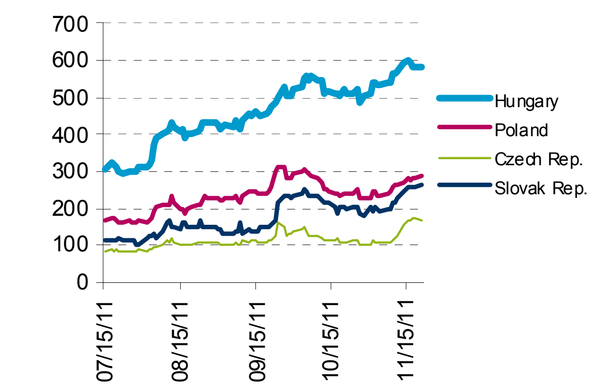
10Y GB Yields



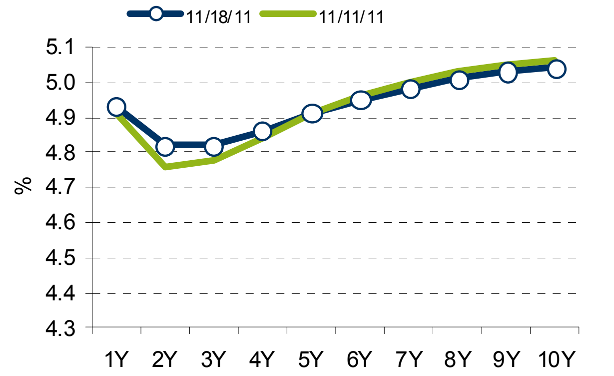
HU IRS



CDS 5Y



PL IRS



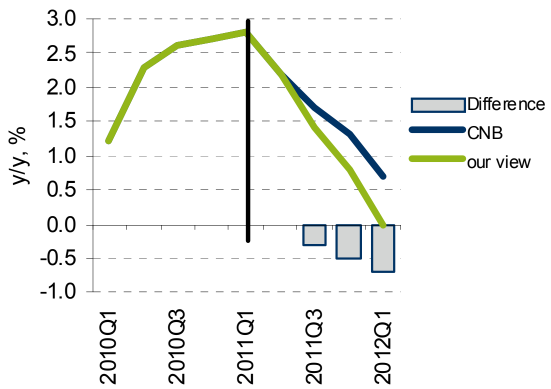
Source: Reuters

Medium-term Views & Issues

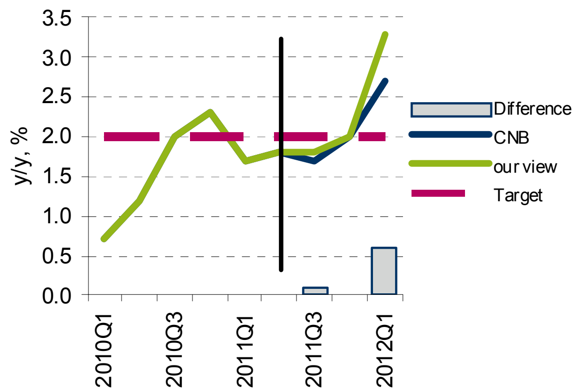
	The Czech Republic	Hungary	Poland
Growth & key issues	Although the situation in the governing coalition after some turmoil has stabilized again, tensions in the government coalition might return during discussions of the 2012 budget. The government intends to change the system of direct taxes radically 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 increased above the central bank's target in October driven by food and fuel prices. Fuel prices as well as prices of agricultural commodities continue to pose a risk for future inflation. In January the inflation will jump above the 3% as a result of V.A.T. increase. 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 the end of the next year. The first rate hike delivered by the Czech central bank is probable in 2013H1.	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.	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.	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.	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

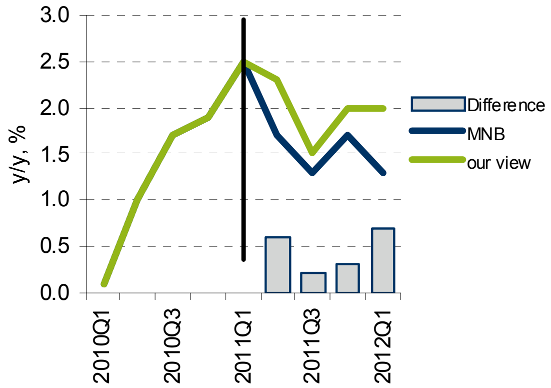
CZ: GDP Outlook



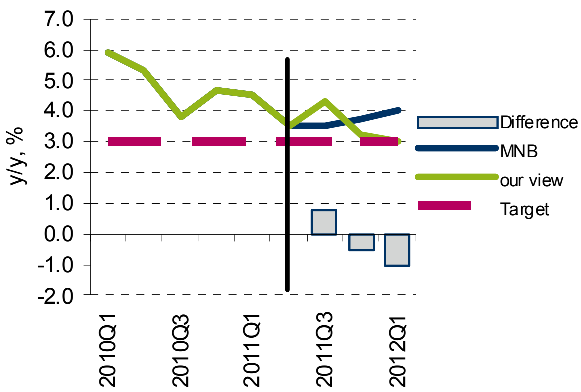
CZ: Inflation outlook



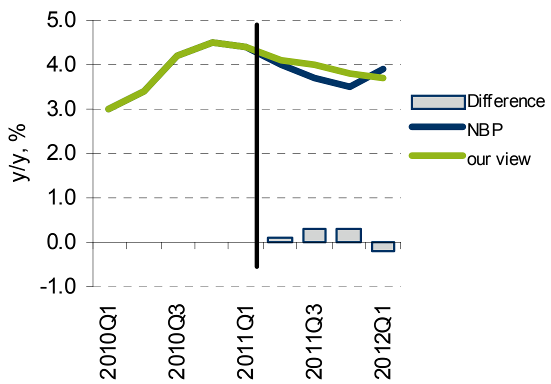
HU: GDP Outlook



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	0.75	-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	1.17	1.18	1.20	1.21
Hungary	BUBOR	*6.45*	6.00	6.50	7.00	7.00	7.00
Poland	WIBOR	*4.95*	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	*2.3409*	2.05	2.20	2.30	2.50	2.85
Hungary	HU10Y	*7.26*	7.50	7.50	7.50	7.50	7.50
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	*25.5*	25.0	26.0	25.3	25.0	24.7
Hungary	EUR/HUF	*307*	295	280	270	270	268
Poland	EUR/PLN	*4.44*	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	3.7	3.5	3.3

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

	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Czech Rep.	*1.8*	1.8	2.0	3.3	3.3	3.0	3.0
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

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