



Central European Weekly

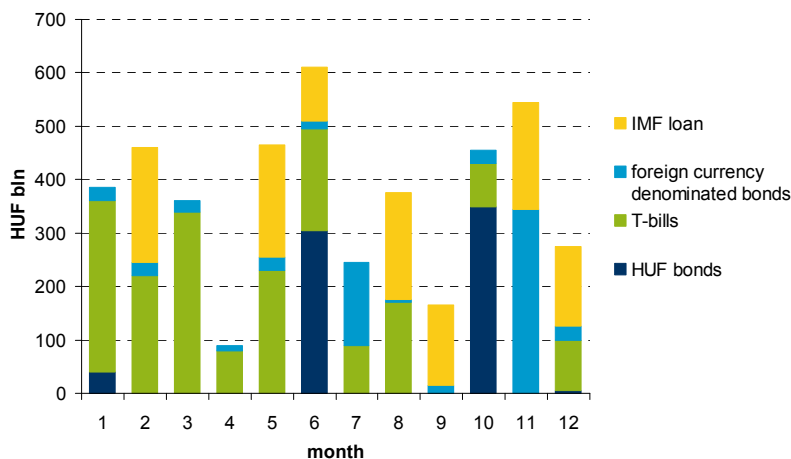
Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- CE currencies continue to recover
- Regional governments successfully issued their debts
- Hungarian government is ready to modify disputed legislation
- MNB is going to deliver third 50 bps rate hike in row

Chart of the Week: redemption calendar of Hungary's government

HU: Debt redemptions in 2012



The redemption calendar of the Hungarian government is quite heavy, so it has little room to manoeuvre in talks with the IMF about a new stand-be agreement.

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Market's editorial

Regional Forex and fixed-income markets rally

Both Central European currencies and Hungarian bonds recovered strongly last week. For instance the Polish zloty strengthened by 2.1% the Hungarian forint by 1.9%, while the Czech koruna, following on their heels, appreciated by 0.5%.

CE governments successfully issued their bonds

The main reason was the positive development at the peripheries of the eurozone. Markets quite reasonably withstood the series of rating downgrades of nine countries and the eurozone's bailout fund (EFSF). Later in the week, notwithstanding their rating downgrades, Spain and France held very successful auctions. Following their example, most auctions in Central Europe were also fairly successful. Poland's two-year auction attracted almost record-breaking demand, while the Hungarian, Slovak, and Czech bond markets also rallied, albeit the Czech 5Y variable-coupon auction lagged behind expectations.

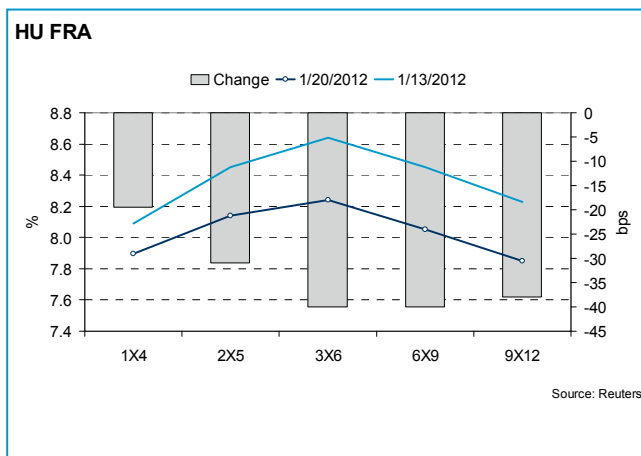
Hungary's government on more cooperative note

As concern Hungary and its road for a new stand-by loan the IMF said it would like to see Hungary agreeing with the EU before talks about a new loan could start. This may slow down the process and may force Hungary to give in a lot of concessions about fiscal

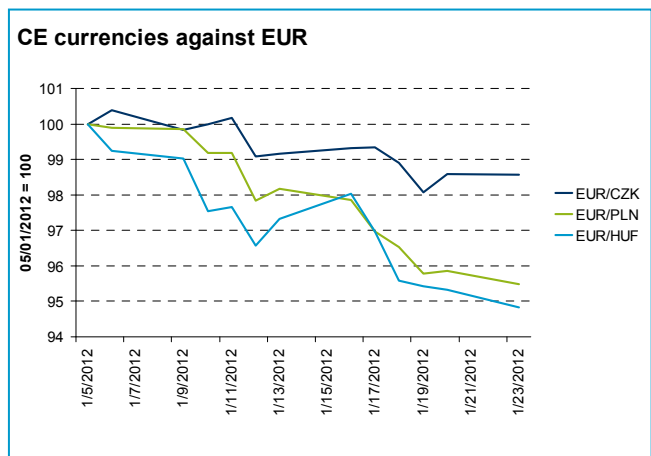
policy and other issues. The government on the other hand indicated this morning that it is ready to negotiate about any issues, even the flat-tax may be modified, which means that most likely talks will continue and sooner or later there will be an agreement. Markets have gone a bit too far in our view, when the forint appreciated to the EUR/HUF 302 level and we may see a correction from here to between EUR/HUF 305-310 levels. We expect the size of the loan to reach €15-20bn and cover external debt redemptions until 2015, which would be a safe position if achieved.

MNB will deliver another 50 bps rate hike

Hungary will remain in focus not only because of ongoing talks with the IMF, but because of its monetary policy. The Hungarian central bank is expected to hike the base rate by 50bps to 7.50%. The weak forint and unfinished talks with the IMF are warranting another hike, while faster negotiations may limit the end of the tightening cycle. The market is currently expecting to end at 8.25%, but we think it could be a bit below this at 8.00%. The December inflation data was broadly in line with expectations thus the weak forint has so far left prices broadly unaffected due to the weak demand. There is however the risk that this may change and the exchange rate may slowly pass through onto prices.



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
EUR/CZK	25.4	-0.76%	↗	↗
EUR/HUF	303	-2.04%	↗	↗
EUR/PLN	4.30	-1.54%	↗	↗



	Last	Change 1W	Outlook 1W ahead	Outlook 1M ahead
10Y CZK	2.27	1.80	→	↗
10Y PLN	7.74	-2.15	→	↗
10Y HUF	4.89	-2.00	↗	↗



Weekly Preview

TUE 14:00

MNB base rate

	This meeting	Last change
rate level (in %)	7.50	11/2011
change in bps	50	50

HU: NBH raises base rate by another 50 bps

The Hungarian central bank is expected to hike the base rate by 50bps to 7.50%. The weak forint and unfinished talks with the IMF are warranting another hike, while faster negotiations may limit the end of the tightening cycle. The market is currently expecting to end at 8.25%, but we think it could be a bit below this at 8.00%. The December inflation data was broadly in line with expectations thus the weak forint has so far left prices broadly unaffected due to the weak demand. There is however the risk that this may change and the exchange rate may slowly pass through onto prices.

PL: The economy grew by 4.1% in 2011

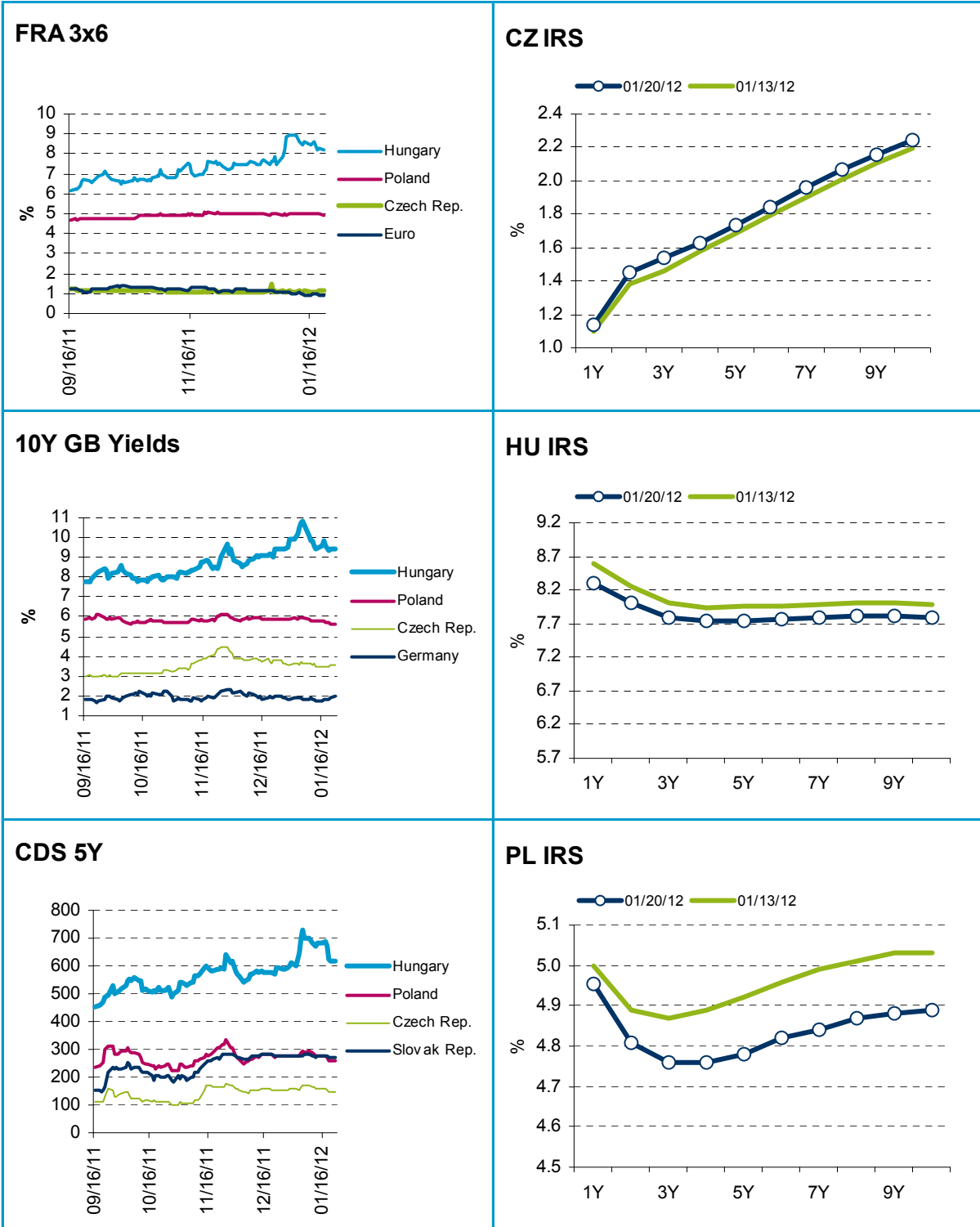
We expect that the Polish economy grew by as much as 4.1% Y/Y in 2011, mainly due to the very favourable figures for the first three quarters as we expect the GDP growth dipped below 4% Y/Y in the last quarter. Nevertheless, despite the slower growth in Q4/2011, the Polish economy by far outperformed its regional peers last year. However, we expect that factors that kept the Polish economy expanding rapidly in 2011 will gradually step aside and we estimate that the economy might grow at a slower pace (about 3 %) next year. More specifically, a room for relatively loose fiscal policy seems to have diminished and higher interest rates should, in our view, contribute to a slowdown in both households' consumption as well as private and public investment.



Calendar

Country	Date	Time	Indicator		Period	Forecast		Consensus		Previous	
						m/m	y/y	m/m	y/y	m/m	y/y
HU	01/24/2012	14:00	NBH meeting	%	01/2012	7.5		7.5		7	
HU	01/25/2012	9:00	Retail sales	%	11/2011					-0.2	0.6
PL	01/27/2012	10:00	Retail sales	%	12/2011			22.6	10	-5.5	12.6
PL	01/27/2012	10:00	GDP	%	4Q/2011*A			4.2		3.8	
PL	01/27/2012	10:00	Unemployment rate	%	12/2011			12.5		12.1	
PL	01/27/2012	14:00	CPI	%	01/2012 *P						4.8

Fixed-income in Charts

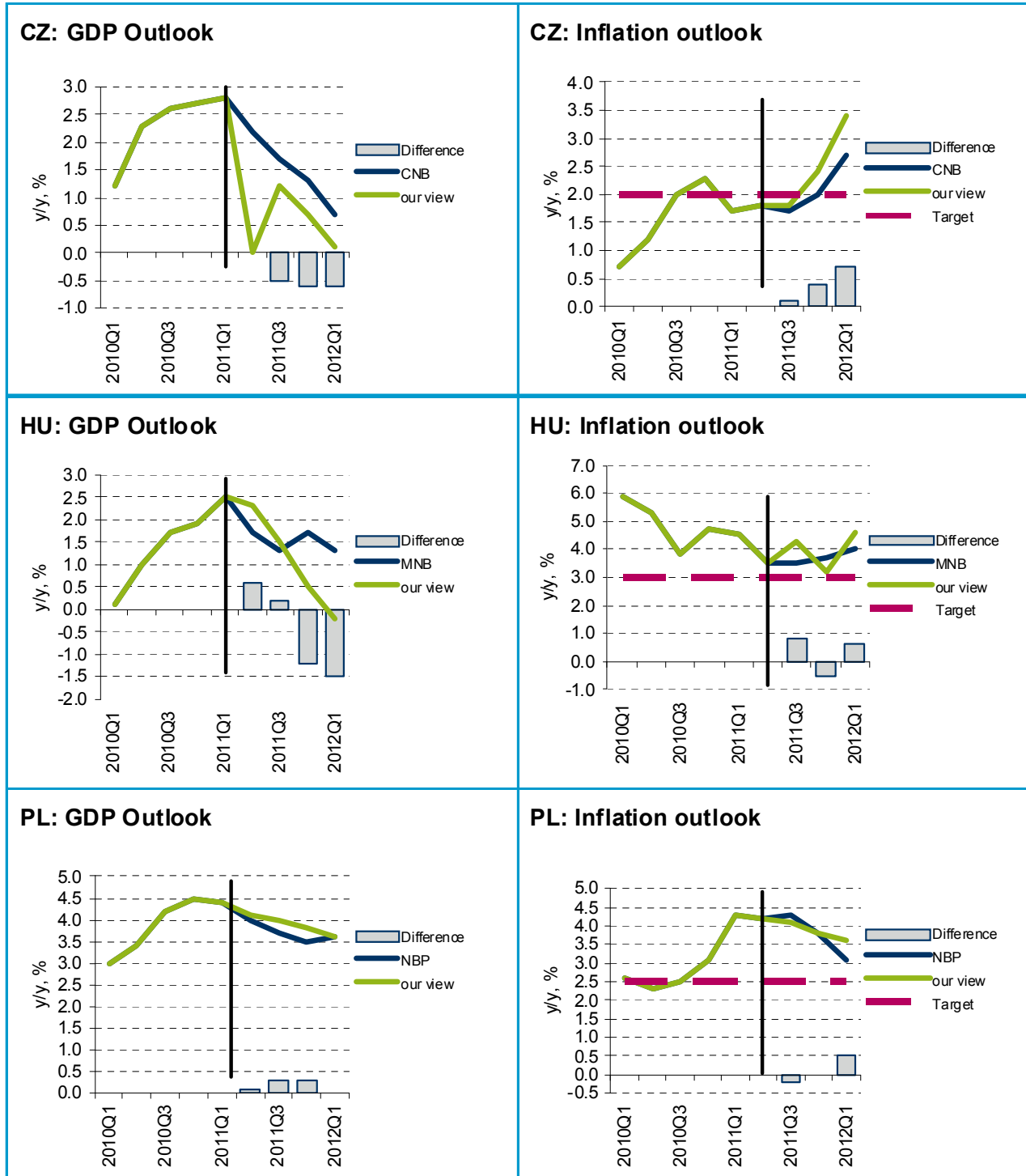


Source: Reuters

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>Most of the economists now expect a recession for Hungary in 2012 partly because some foreign banks will have to drastically improve their loan/deposit ratios. The growth forecast could be a point in the IMF talks. A weaker growth outlook may also require additional fiscal measures. The IMF would like to see 'tangible' steps from the government, but did not specify what tangible means here. The next step could be that the EU also replies to the government message and that we may see how negotiations could continue. As a base case, we think a deal could be reached till the end of February.</p>	<p>We believe that Poland's economic growth for may be 4.1% in 2011 (due to the very favourable figures for the first three quarters). Nevertheless, we expect 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 and higher interest rates should, in our view, contribute to a slowdown in both households' consumption as well as private and public investment.</p>
Outlook for official & market rates	<p>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.</p>	<p>The Hungarian central bank matched analysts' expectations and hiked the base rate by 100bps in aggregate by the end of 2011. We expect two more 50bps rate hikes, so the base rate should hit 8.00% in 2012.</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 1. quarter 2012.</p>
Forex Outlook	<p>The Czech koruna should remain under pressure because of the escalating tension surrounding euro-crisis management. Nevertheless, if the worst case scenario of eurozone meltdown is avoided, the koruna has potential to appreciate. However, after re-pricing of systemic risks, slow continuation of real convergence does not argue for dramatic gains of the Czech currency over 2012. Putting it together, after current correction with short term target around 26.6 EUR/CZK, we continue to see the koruna stronger in 12- month horizon at 24.50 EUR/CZK.</p>	<p>Talks between Hungary and the IMF/EU has been ongoing slowly, which means that on the positive side there is some advance, while negotiations will take time because both side are giving in concessions only marginally.. The FX market may react to incoming news over the short-term, which is probably a range between 308 and 315/€, while we expect the forint to appreciate after negotiations reach a key point and the main fundamentals of the agreement are formulated. We expect the currency to appreciate to 290/€ by the year-end.</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 the motivation to intervene in 2012 may be weaker due to changed methodology of debt/GDP calculation and lower sensitivity to FX volatility. Hence we are afraid escalating tensions on the eurozone markets can weigh heavily on the Polish markets and the zloty can easily move above 4.80 EUR/PLN in 3month horizon.</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	0.75	-25 bps	5/7/2010
Hungary	2W deposit r.	7.00	6.00	7.00	8.00	8.00	8.00	50 bps	12/20/2011
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	1.17	1.12	1.10	1.12
Hungary	BUBOR	7.64	6.00	6.50	8.00	8.00	8.00
Poland	WIBOR	4.97	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	2.2659	2.05	2.24	2.25	2.40	2.60
Hungary	HU10Y	7.74	7.50	7.50	9.25	9.25	9.00
Poland	PL10Y	4.89	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	25.4	25.0	26.0	26.2	25.0	24.7
Hungary	EUR/HUF	303	295	280	310	300	290
Poland	EUR/PLN	4.30	4.35	4.10	4.60	4.40	4.20

GDP (y/y)

	2011Q1	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3
Czech Rep.	2.8	2.0	1.2	0.7	0.1	-0.1	0.6
Hungary	2.5	1.5	1.4	0.5	-0.2	-0.5	-0.8
Poland	4.4	4.3	4.2	3.8	3.6	3.3	3.0

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

	2011Q2	2011Q3	2011Q4	2012Q1	2012Q2	2012Q3	2012Q4
Czech Rep.	1.8	1.8	2.4	3.4	3.3	3.2	3.1
Hungary	3.5	3.6	4.1	4.6	4.5	4.4	4.2
Poland	4.2	3.9	4.6	3.6	4.1	4.1	3.1

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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