

# Fortis Global Markets – Strategy & Technical Analysis

## CZK FX Update

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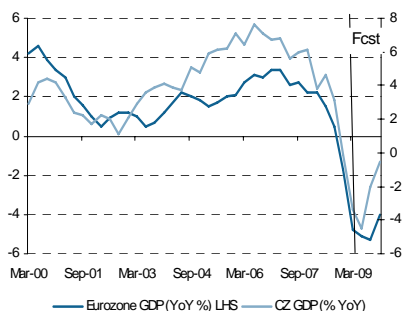


# Czech Republic Economic Summary

## Further economic contraction on the cards

## Official interest rate likely to be lowered to 1% by Q3 09

EZ and CZ GDP Growth



CPI and Key Policy Rate



- The Czech economy is suffering from the collapse in export and internal demand. Exports account for 85% of GDP and with the main trading partners all in recession, this is weighing heavily on the Czech economy, with industrial output dropping by an estimated 23.2% (YoY) in April and unemployment rising to 7.9% in May from 5% last year at the same period. Weak employment, stalling wage growth will keep consumption demand fragile.
- While business and consumer confidence indicators have somewhat improved over the last months, they are still very close of their lowest levels. Recovery is therefore not expected before the end of this year, with Czech GDP likely to fall by around 3% (YoY) in 2009. Indeed, the GDP growth already slumped by 3.4% (YoY) in Q1 09. Furthermore, advanced indicators, such as PMI, suggest that the economic activity will continue to contract in the coming months.
- Although the recession hits the country, fundamental imbalances remain low, with the current account deficit like to stay above 3% of GDP and no strong debt overhang for the government. As the country is a small and open economy and given its relatively sound macroeconomic situation, we think that the Czech economy is likely to recover faster than other in its region, should the global economy shows signs of recovery by the end of this year.
- The Czech National Bank (CNB) cut again its main interest rate by 25bp to 1.50% at its last meeting in May amid declining inflation outlook and deterioration of the economic conditions. Whilst currency weakness refrained the central bank from cutting interest rate at the beginning of this year, lower inflation over the last two months gave more room to the CNB to cut official rate.
- As economy is likely to slow further and given the expected easing in inflation, the central bank may cut further its official rate this year. We estimate that the CNB could lower the rate to as low as 1% by the Q3 09. The rate could be decreased even more, should the macroeconomic situation deteriorates more than currently expected. Indeed, the PPI, which is an advanced indicator of the future inflation, suggest that inflation may record a negative growth in the second part of this year.

## EUR/CZK Outlook Summary

EUR/CZK 6M history



EUR/CZK 5Y history



### The Koruna is likely to remain weak against the Euro in the coming 3 months

- While the negative impact of falling external demand on the CZK has been mitigated by the fact that Koruna has been perceived as a less risky currency than its Eastern European counterparts, (given the lack of macroeconomic imbalances), we think lower interest rates (see previous page) combined with the deepening of the economic downturn are likely to weigh on the Koruna in the coming 3 months.
- Nevertheless, the situation may change by the end of the year, should the global economic prospects improve, as currently expected. Indeed, the improvement of the global macroeconomic conditions are likely to be beneficial for the Czech economy and the koruna, as Czech Republic is an export-oriented economy.

#### Fortis Bank EUR/CZK Forecasts

	Q3 09	Q4 09	Q1 10	Q2 10
EUR/CZK	27.50	26.50	26.00	25.50

#### Bloomberg EUR/CZK Forecasts

	Q3 09	Q4 09	Q1 10	Q2 10
Median	27.00	26.50	26.00	25.70
Mean	27.20	26.60	26.20	26.10
Low	25.00	24.00	23.50	24.60
High	29.50	30.00	29.50	29.00
Forward	26.90	26.90	27.00	27.00

## Disclaimer

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