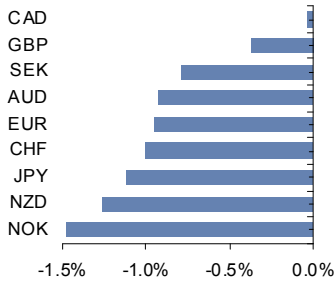


FX
11 February 2011

Daily FX Strategy

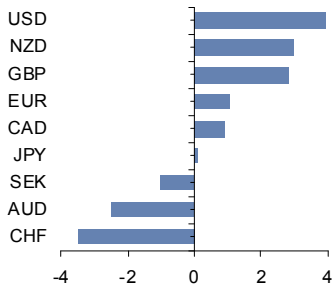
PLN: Hikes insufficient to reverse under-performance ...page 2

%ch vs USD past 24 hrs



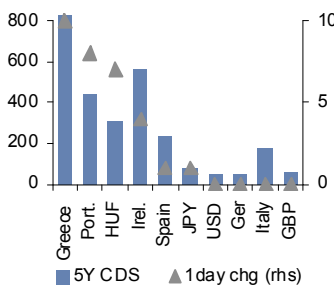
Source: Thomson Reuters

10yr yield ch past 24 hrs (bp)



Source: Thomson Reuters

Sovereign 5yr CDS (bp)



Source: Markit

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Currency view

USD: The global environment remains mixed. Activity remains reasonably strong world-wide, including evidence of a broadening recovery in the US, but higher headline inflation and fears of tightening are providing a headwind to risk trades. Today sees the first read of US consumer confidence for February. A small increase should support the recent rise in bond yields and provide a little support to the dollar in the absence of any other drivers. Looking around the world, investors still seem in a mood to take risk off the table and with Asia so far disappointing in the amount of FX appreciation on offer (PBOC fixed USD/CNY at 6.5952 versus 6.5849) - another channel of potential USD weakness has been temporarily shut. USD Index to edge up to 78.50/79.00.



EUR: EUR/USD finally succumbed to the weaker risk environment yesterday. So far, however, the market seems to be providing Eurozone debt with the benefit of the doubt with the key swing sovereign, Spain, still seeing subdued CDS spreads. Today sees a Franco-German summit where both finance ministers and central bank governors speak. Expect the politicians to push their competitiveness pact and the CB governors to focus on price stability. EUR/USD may retest 1.3500 again, but we prefer to be buyers on dips. GBP/USD held up reasonably well after unchanged BoE rates yesterday, with the money market hardly moving. Again, we believe 1.60 is a buy.



JPY: Technically USD/JPY looks to have broken higher, with 82.60 now support. If the USD is to rally against any currency based on higher US yields, it should be against the JPY. 84.50 looks the target even though some large USD selling should be seen ahead of next week's US Treasury coupon payments. USD/KRW saw a short squeeze on unchanged BoK rates, yet the hawkish statement suggests rates should be going higher next month. We still prefer to sell these corrective rallies in Asia ex Japan.



CZK: EUR/CZK has corrected higher in the wake of softer than expected January CPI, seemingly reducing the need for an early rate hike from the CNB. However, strong trade trends, i.e. strong exports and weak domestic demand has been a key factor driving CZK strength and one we expect to continue. For those corporates short CZK, this EUR/CZK bounce to 24.30 looks a good opportunity to acquire CZK ahead of a move to 23.50 and even 23.00 this year.

Key data releases and events

Country	GMT	Data/event	ING forecast	Consensus	Prior
United States	1330	Dec Trade Balance (\$bn)	-39.2	-40.7	-38.309
	1455	Feb University of Mich Confidence	75	75	74.2
UK	0930	Jan PPI Input (MoM%)	-	-	3.4
Canada	1330	Dec Int'l Merch. Trade Bal (C\$bn)	0.3	-	-0.08
Poland	1300	Dec Current Account (€)	-2128	-1235	-2286
	1300	Dec Trade Balance (€)	-1738	-13.2	-1254
Czech Republic	0900	Dec Current Account (CZK bn)	-	-	-1.98
Mexico	1400	Dec Industrial Production (YoY%)	3.2	-	5.33

Source: ING

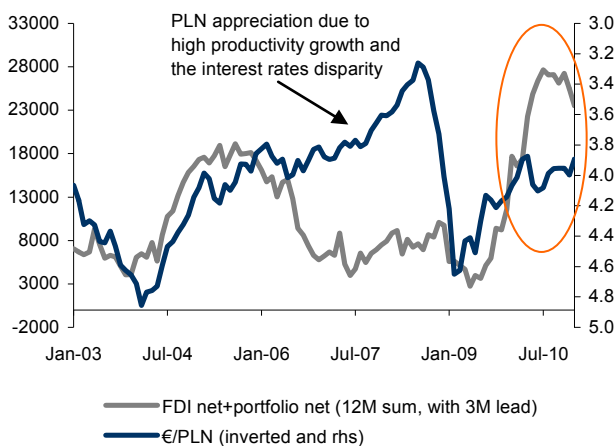
PLN: Hikes insufficient to revert underperformance

Despite large PLN buying from BGK and speculators, PLN appreciation proved limited

The spike of the C/A deficit (exaggerated by one-offs and transitory factors), the change of FDI and portfolio flows and switching to HUF are responsible for PLN underperformance in Jan-11

PLN has undergone at least two tests which showed that its appreciation potential is limited. In December BGK sold about €1-2bn from MinFin's FX deposit and bought PLN. The PLN barely appreciated to 3.96/€. In the first half of Jan-11 we also saw massive PLN buying by speculative accounts, positioning for Polish tightening. The PLN gains seen during these two episodes were rather limited and PLN actually underperformed CEE FX. Some investors decided to close PLN positions, while others switched to vastly underweighted HUF. We see at least two reasons behind the limited PLN appreciation. The first is the spike of the C/A and trade deficits in November (respectively to €2.3bn – 10-year high, and €1.3bn). One-offs are partially responsible for this, including payment of contribution to the EU budget and a rare shipyard deal). The high trade gap is also a result of the transitory acceleration of consumption in 4Q10 caused by expiry of tax relief for business cars and the expected VAT hike. Thus, 1Q11 should see an unwinding of this trend. Subsequently, the trade gap should widen. But export orders in the PMI look very robust and we expect the 2011 C/A deficit to reach 3.7-4.0% of GDP vs. 3.5% in 2010. The second reason behind the limited PLN appreciation is substantial change of the portfolio and FDI flows in 4Q10 (Fig 1). The slowdown of FDI is temporary in nature (accounting issues according to NBP statistics office). More concerning, in our view, are the lower portfolio inflows and drop of fresh money into the FI market. This trend should be sustained due to the high fiscal deficit (ESA95 at about 8% GDP in 2010 and 6.5% in 2011) and the government's aversion to deeper fiscal cuts in an election year.

Fig 1 In 2010 PLN undervalued despite huge FI flows



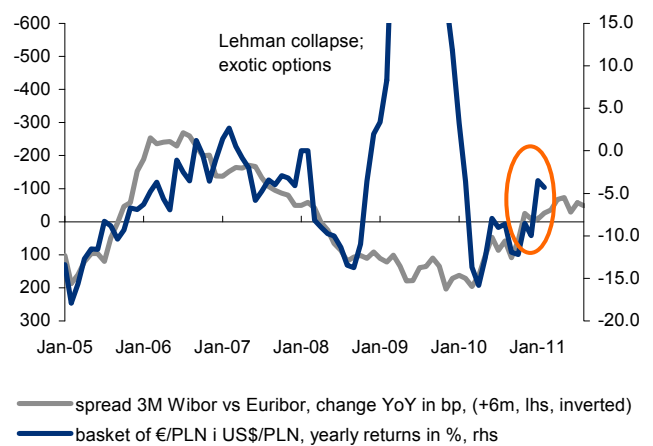
Source: MinFin, ING

Cross country comparisons suggest PLN may be vulnerable to the likely slowdown of portfolio flows into EM in 2011

In 2010, PLN remained undervalued despite significant FI flows

Any withdrawal of portfolio capital should not impact the PLN, since the original inflows mainly went through the money market

Fig 2 PLN slightly below value implied by % spread



Source: MinFin, ING

Periods of the PLN underperforming within EM and lagging CEE FX may be repeated. After a year of massive inflows into EM markets and their expected slowdown in 2011, the PLN looks vulnerable - particularly due to the record-high positioning of foreign investors on the FI market and the uncertain outlook for fiscal reform in election year 2011. On the flip side, we are far from total pessimism. PLN already underperforms its fair value estimated with VAR model based on rates differential. In 2010 the massive portfolio flows into FI market did not cause respective PLN appreciation (Fig 2). The majority of portfolio money went through the MM and not FX markets (via Basis and FX swaps). Thus the withdrawal from the bond market should have less significant consequences for FX. And NBP widely flags that PLN is an important policy tool and that the magnitude of tightening depends on PLN performance. 3.85/€ proved to be strong resistance, we prefer playing range with 3.95/€ and 4.05/€ on the upper side. 4.4% GDP growth, a PLN15bn privatisation pipeline, strong export orders in PMI as well as productivity growth point to stronger a PLN over the medium term – (we target 3.60/EUR this summer) - unless post election reforms fail to provide the fiscal consolidation necessary to sustain unchanged ratings

Disclosures Appendix

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