CEE Research

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Fixed Income and Foreign Exchange

CEE Insights

- **Croatia:** FX market stabilized around 7.40
- **Czech Republic:** No rate change expected next week
- **Hungary:** Central bank rate setting meeting in focus next week
- **Poland:** Markets to monitor MPC meeting and new inflation report next week
- **Slovakia:** CB could cut rates on Tuesday

Overview

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Croatia:

- CPI accelerated to 1.8% y/y in March
- FX market stabilized around 7.40
- Pure kuna bond yields increased

Czech Republic:

- No rate change expected next week
- CNB board keeping an eye on wage growth
- Retail sales jumped in February

Hungary:

- Central bank rate setting meeting in focus next week
- Updated convergence plan seems to have been approved

Poland:

- Dynamics of consumer prices gained further momentum in March
- Wage and inflation data support case for preventive hike
- Ruling Law and Justice party divided over abortion law
- Poland to co-host soccer championship in 2012
- Markets to monitor MPC meeting and new inflation report next week

Slovakia:

- CB could cut rates on Tuesday
- Markets still in wait-and-see mood

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Thursday's close		Current	w/w	m/m	ytd	Spreads vs. Euroland		
						current	- 1m	02/01/2007
Czech Republic	EUR/CZK	27.98	-0.1%	-0.5%	-1.3%			
	3Y (yield bp)	3.31	4	0	10	-83	-82	-66
	10Y (yield bp)	4.12	-1	12	42	-7	10	-23
Croatia	EUR/HRK	7.42	-0.4%	-0.4%	-0.9%			
	3Y (yield bp)	4.14	-32	29	-27	10	1	66
	10Y (yield bp)	4.92	1	24	n/a	76	80	n/a
Hungary	EUR/HUF	246.11	-0.3%	0.3%	2.2%			
	3Y (yield bp)	7.08	3	-29	-47	294	346	368
	10Y (yield bp)	6.63	1	-3	38	243	275	276
Poland	EUR/PLN	3.81	0.7%	1.8%	0.7%			
	3Y (yield bp)	4.92	5	26	27	78	75	78
	10Y (yield bp)	5.33	5	-3	16	114	128	124
Romania	EUR/RON	3.34	0.2%	0.1%	1.4%			
Slovakia	EUR/SKK	33.50	-0.2%	-0.3%	2.9%			
	3Y (yield bp)	4.13	0	-11	-25	-2	31	50
	12Y (yield bp)	4.41	4	9	10	21	39	38

Source: Reuters, Bloomberg (+ means strengthening / - means easing of the exchange rate)

Positions

#	Recommendation	Date of opening	Instruments	Entry values	Today's values	flat P/L (%)	flat P/L inc. carry (%)	P/L p.a. inc. carry (%)	Target values	Target P/L flat inc. carry (%)	Target P/L p.a. (%)
11	short CZ GB10Y, long PL GB10Y	07/03/07	CZGB 3,8 04/15	100.59	99.17	1.43	2.8%	23.6%	97.63	4.10	8.18
			PL GB10Y 5,25 10/17	100.22	99.25	1.22			101.18		

Rationale at inception

11) We still see space for growth of the long end of the Czech yield curve and gradual closing of the negative spread against the EMU bonds. At the same time, risk spread on Polish debt should decrease trend-wise. We recommend to play this via taking short position in the short CZGB and long position in POLGB. The exchange rate risk is reduced thanks to the correlation of regional currencies.

Closed positions

#	Recommendation	opened	closed	P/L inc.carry
1	long: PLGB10y / 4m Euribor	16/09/2005	27/10/2005	-3%
2	short: CZGB15y / 6m PRIBID	16/09/2005	21/11/2005	5.97%
5	long: SKK/CZK	09/11/2005	20/01/2006	1.90%
3	short EUR/SKK	29/09/2005	07/02/2006	3.45%
4	EUR/PLN options	21/10/2005	28/07/2006	-2.69%
6	SKK/CZK long	23/03/2006	30/10/2006	2.16%
7	FRA 9*12 short	28/07/2006	08/11/2006	8bp
8	long HUGB 5y	13/10/2006	29/01/2006	5.70%
9	short CZGB/ long GDBR	09/01/2007	27/02/2007	1.80%
10	long CZK/EUR	27/02/2007	19/03/2007	2.30%

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Forecasts

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Capital markets forecasts

	Exchange Rate vs EUR												Intervention Rate					
	CZK	Forward	HRK	Forward	HUF	Forward	PLN	Forward	RON	Forward	SKK	Forward	CZ	HR	HU	PL	RO	SK
Spot	28.0		7.40		246		3.81		3.34		33.4		2.50	3.50	8.00	4.00	7.50	4.50
Jun-07	27.7	27.9	7.25	7.25	248	248	3.90	3.81	3.37	3.36	33.5	33.4	2.50	3.50	7.75	4.25	7.50	4.25
Sep-07	27.6	27.9	7.40	7.40	251	250	3.80	3.82	3.39	3.39	32.4	33.4	2.75	3.50	7.00	4.25	7.50	4.00
Dec-07	27.2	27.8	7.40	7.40	252	253	3.75	3.81	3.30	3.41	31.9	33.4	3.00	3.50	6.75	4.25	7.25	4.00
Mar-08	26.9	27.7	7.30	7.30	252	253	3.73	3.82	3.35	3.43	32.2	33.3	3.25	3.50	6.50	4.50	7.00	4.00

	3m Money Market Rate										10y Govt. Yield				
	CZ	Forward	HU	Forward	PL	Forward	RO	Forward	SK	Forward	CZ	HR	HU	PL	SK
Spot	2.59		7.82		4.35		7.15		3.97		4.12	4.92	6.63	5.33	3.97
Jun-07	2.63	2.74	7.65	7.45	4.35	4.54	7.55	7.18	4.10	3.96	4.15	4.90	6.50	5.25	4.40
Sep-07	2.88	3.00	7.15	7.03	4.35	4.75	7.10	6.84	4.05	4.12	4.50	4.85	6.30	5.10	4.45
Dec-07	3.13	3.12	6.70	6.78	4.55	4.86	6.80	6.81	4.05	4.15	4.50	4.95	6.10	4.90	4.50
Mar-08	3.30	3.17	6.50	6.70	4.70	4.89	6.70	6.69	4.05	4.23	4.75	4.80	5.90	4.85	4.50

Long-term forecasts

GDP growth (%)	2005	2006e	2007f	2008f
Czech Republic	6.1	6.1	4.2	4.5
Croatia	4.3	4.8	4.5	4.6
Hungary	4.2	3.9	2.3	3.2
Poland	3.5	5.8	5.7	5.6
Romania	4.4	7.7	6.5	6.3
Slovakia	6.0	8.3	8.9	6.5

C/A (%GDP)	2005	2006e	2007f	2008f
Czech Republic	-2.0	-4.6	-4.1	-4.1
Croatia	-6.4	-8.0	-8.7	-9.8
Hungary	-6.9	-5.8	-5.1	-5.1
Poland	-1.4	-2.1	-2.6	-3.0
Romania	-8.7	-10.3	-10.9	-9.1
Slovakia	-8.6	-8.3	-3.7	-2.4

CPI (%), eoy	2005	2006e	2007f	2008f
Czech Republic	2.2	1.7	3.3	3.4
Croatia	3.6	2.0	3.0	3.0
Hungary	3.3	6.5	5.2	3.5
Poland	0.7	1.4	2.3	2.3
Romania	8.6	4.9	4.5	3.5
Slovakia	3.7	4.2	2.8	3.3

Budget Balance (%GDP)	2005	2006e	2007f	2008f
Czech Republic	-2.2	-3.3	-4.1	-3.8
Croatia	-4.2	-3.0	-2.8	-3.0
Hungary	-7.8	-9.8	-6.5	-5.0
Poland	-4.2	-3.5	-3.4	-3.2
Romania	-0.8	-1.6	-2.8	-2.7
Slovakia	-3.1	-2.5	-1.7	-1.7

Diaries

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Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	Apr-26	Monetary policy meeting of CNB	no change {2.50%)	no change(2.50%)
Croatia	No data releases scheduled			-
Hungary	Apr-23	NBH monetary meeting	no change (8%)	no change (8%)
	Apr-23	Feb Retail sales	1.4% y/y	
	Apr-27	March Industrial PPI	2.5% y/y	
Poland	Apr-25	Retail sales (03/2007)	15.1% y/y	16.8% y/y
	Apr-25	Monetary policy meeting of CB	hike by 25bp to 4.25%	hike by 25bp to 4.25%
Romania	No data releases scheduled			
Slovakia	Apr-24	NBS monetary meeting	-25bp to 4.25%	-25bp to 4.25%
	Apr-24	February C/A deficit	SKK 0.1bn	n.a.
	Apr-27	March PPI	3.3% y/y	3.5% y/y

**Sources: Bloomberg, Reuters*

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		Apr-25	Apr-30	2017-Apr-11	-	CZK 8bn	-
		Apr-26	Apr-27	2008-Jan-25		CZK 5bn	
Hungary		Apr-24	May-02	Aug-01-2007	-	HUF 30bn	7.70%
		Apr-26	May-02	Apr-12-2010	6.75%	HUF 75bn	7.00%
		Apr-26	May-02	Nov-24-2023	6.00%	HUF 20bn	6.45%
Poland		Apr-23	Apr-25	52 weeks	-	PLN 0.9-1.0bn	4.45%
Romania		25-Apr.07	27-Apr.07	1 Y	-	100,000,000	7.25%
Slovakia		No auction scheduled					

Major markets

Ifo Index to remain at high level

Euroland bond markets went on a roller coaster ride this week. The better then expected numbers for the ZEW survey did not weigh on bonds. Instead, yields followed their US peers downwards during the following days, as lower US CPI numbers and a re-emergence of global risk reduction increased the demand for bonds. The latter lasted only briefly and yields increased once again. Next week's main release will be the German Ifo Index on Wednesday. As all indicators point to a continued upswing of the economy, this should be mirrored in another strong reading. The only risk for this outcome is the recent appreciation of the euro and how it is assessed by survey participants. In total, however, we see the risks for bond yields as tilted to the upside next week.

GDP data on Friday to confirm sluggish US growth

Lower than expected CPI data and a short-term risk reduction on global markets led in total to a positive performance of the US bond market in the course of this week. Next week will bring releases of housing market data on Tuesday and Wednesday. Existing home sales recovered in the previous month, while new home remained low. Overall, we remain skeptical on the outlook for the US housing market and see more consolidation potential. The outcome of next week's data is especially uncertain, as the effects of the announced tighter credit standards (due to increasing delinquency rates in the subprime segment) might be felt. Durable goods orders on Wednesday will be watched, as the weakness in this segment is puzzling the Fed. The first estimate of 1Q GDP on Friday should provide some clarification about the status of investment spending. While we also expect only moderate economic growth for this period, the average market expectation is at the lower end of the possible outcomes, in our view. In any case, the sluggish growth of the US economy should be confirmed, which should be in line with other released indicators and give support to bond markets. The EUR/USD is expected to test its all-time high of around 1.366.

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Forecasts

	Intervention Rate		3m Money Market Rate				10y Govt. Yield		FX	
	EUL	USA	EUL	Forwards	USA	Forwards	EUL	USA	EUR/USD	Forwards
Spot	3.75	5.25	3.99		5.36		4.19	4.66	1.361	
Jun-07	4.00	5.00	4.15	4.17	4.90	5.30	4.30	4.50	1.350	1.364
Sep-07	4.00	4.75	4.10	4.27	4.60	5.16	4.30	4.50	1.330	1.368
Dec-07	4.00	4.50	4.10	4.35	4.40	4.93	4.40	4.60	1.330	1.371
Mar-08	4.00	4.25	4.10	4.27	4.30	4.85	4.40	4.70	1.300	1.373

Croatia

CPI accelerated to 1.8% y/y in March

After reaching a low 1.2% y/y in February, CPI inflation picked up to 1.8% y/y, for a 0.6% m/m increase. The main driver behind the higher inflation rate was the increase in clothing and footwear prices (+4.3% m/m), transport prices (+1.1% m/m; due in turn to the oil price increase of 2.7% m/m) and food and non-alcoholic beverages (+0.4% m/m). The inflation outlook remains unchanged in the coming months. We continue to see inflation pressures as subdued and CPI rates around 2%, mainly due to the high base effect from 2006. In 2H07, we anticipate a mild upward trend and rates closer to 3%.

FX market stabilized around 7.40

After the end of March brought depreciation pressures on the kuna, the exchange rate stabilized around 7.40 in the last two weeks. Current developments on the market indicate that appreciation pressures are not as strong this year as in the same period last year. In the year-earlier period, the exchange rate was below 7.30 and the CNB had to use FX interventions rather heavily to prevent appreciation. For the coming weeks, we expect the exchange rate in the 7.35-7.45 range. The solid demand for FX among corporates and banks is stabilizing the exchange rate at present levels.

Pure kuna bond yields increased

In the last two weeks, the pure kuna bond market has undergone a slight correction, as 10Y yields increased by approximately 20bps. One of the reasons was the announcement of a new bond issue in June, which, as usual, triggered some correction. This was due to the fact that pricing of the bond will be done in line with the market yields, while the market is going for more favorable pricing. Also, market liquidity in the past weeks was somewhat tight, which, along with the slightly higher exchange rate, also supported a yield increase. However, a recovery came in the last few days. We expect the market to stabilize in the coming weeks.

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Czech Republic

No rate change expected next week

The main event next week will be the CNB's rate setting meeting. We expect no change in the key rate, which will in all probability be left at 2.50 for the seventh month in a row. Nonetheless, the time may be nearing when the central bank will contemplate raising the rates, even though it still appears to be in wait-and-see mode. Last week's release of retail sales data (see below), coupled with the agreement on a 12.7% salary increase at Skoda a.s. as of April this year, may have raised some red flags on the banking board. However, to expect any kind of immediate response from the board would be a bit premature. Inflation did creep up to 1.9% in March, but two reservations against interpreting this as a reason for the CNB to hike quickly stand out. First, the lifted inflation figure was to a non-negligible extent due to cigarettes (tax), a one-off effect that will die out in a year. Secondly, inflation is still well below the target of 3%. The CNB will therefore probably wait until it sees more hard evidence (from the real economy) that hiking is indeed necessary.

CNB board keeping an eye on wage growth

The previous two weeks saw interviews with two central bank board members, Governor Tuma and Robert Holman. On April 12, Holman said that he sees the economy growing more quickly than the CNB forecasted, but added that he sees the growth as non-inflationary and with no signs of overheating. He identifies the nominal wage growth rate as potentially dangerous, but expects no dramatic impact for now. Tuma spoke roughly a week later and was considerably more hawkish in commenting on the recent developments, saying that the latest data was slightly pro-inflationary and that the 'next move will be rather upwards'. It appears that at least some of the members of the CNB banking board are trying to break the lull and are prepping the market for the eventual rise in rates.

Retail sales jumped in February

These comments may have been at least in part provoked by the retail sales data for February released last week, showing a 9.5% y/y surge. Two main phenomena were probably behind this development. One of them is weather that - in all likelihood - was behind the growth of sales of building materials and furniture. Also, seasonal clearance sales, this time lasting longer and starting earlier, are also likely to have played a role (especially in clothing and footwear). The other factor is of a more systemic nature - the drop in unemployment brought about by the fast GDP growth necessarily leads to higher retail sales growth across the board. After all, this was one of the concerns expressed in the Minutes from last month's CNB policy meeting, when policymakers acknowledged the risk that the economy 'was drying up the pool of available workers and could push up wages even though no signs of wage-induced inflation had yet been detected in data.

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Hungary

Central bank rate setting meeting in focus next week

Without doubt, the most important event next week will be the central bank's rate setting meeting on Monday, at which the monetary council is not expected to change the base rate. Thus, the base rate should remain at 8%. However, our view is that the council will discuss the option of a 25bp rate cut. Furthermore, we have changed our expectation on the timing of the first rate reduction. We think that the central bank is likely to start the rate cutting process in May or June, instead of some time in the second half of the year (as expected earlier). The arguments for earlier rate reductions are as follows. A hawkish member of the council, Péter Adamecz, gave an interview to Reuters this week, saying that although the fact that inflation prospects were still uncertain, a fall in the risk premium demanded by investors for holding Hungarian assets might allow the central bank to cut rates. This could be seen as a broad hint; due to the improving mid-term prospects and the presently high global risk appetite, the risk premium had decreased and markets had earlier priced in rate cuts. Furthermore, the February wage data was surprisingly calming (from the point of view of inflation). In February, the gross average wage growth in the economy slowed to 5.7% y/y (from 7.1% y/y in January), within which the gross average wage in the private sector increased by 8% y/y. Net wages decreased by 0.1% y/y in February, which means an 8.2% y/y drop in real wages in the overall economy, taking the 8.8% February 12-month inflation rate into consideration. Obviously, this sharp drop in real wages does not suggest demand-pull inflation. Apart from the drop in real wages, regular (ex bonuses) private sector gross wage growth slowed down to 10.6% y/y, from 12.3% y/y in January. This still seems high, but this was due to the fact that the yearly regular wage increases were significant in the lower-paid, manual worker category. Based on this, one could assume that the strong gross wage figures in these sectors may have been due to some "legitimization" of already existing employment within the economy (in line with the stricter administrative measures), rather than indicating increasing inflationary expectations. The construction industry could be a good example - the CSO measured close to 20% y/y regular gross wage increases both in January and February, despite the fact that the sector is currently suffering a recession.

All in all, the central bank's rate cutting process may start earlier than we anticipated. However, we are not changing our year-end base rate forecast (6.75%). One should keep in mind that the ECB rate hiking process has not come to an end yet. Apart from the expected further 25bp rate increase in June, the bank's monetary policy for the second half of the year remains an open issue after the last ECB meeting. This should have some impact on the NBH's monetary policy as well.

Updated convergence plan seems to have been approved

As the EU checks Hungary's convergence program every six months (with the April 2007 check looming), before submitting it to the EU, the government presented the updated version this week. Compared to December 2006, the following changes took place. On the one hand, the government raised its prognosis for the 2007 average inflation rate from 6.2% to 7%. However, they trust that the inflation increase is transitory, and they expect 4-4.5% 12-month inflation for December 2007. The finance minister said that the ESA deficit figure for 2006 might have been 9.2% of GDP (the official Eurostat figure has still not been published). As for 2007, the government cut its budget deficit forecast to 6.6% (from 6.8% in December 2006). The government considered raising its 2007 GDP forecast of 2.2% y/y somewhat, but finally decided to wait until the 1Q07 figures are published.

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Poland

Dynamics of consumer prices gained further momentum in March

Macroeconomic releases over the past week reinforced the expectations that the first move in key interest rates by the Polish central bank (after thirteen months of stability) will be a hike in April. Inflation surprised mildly on the upside. Consumer prices leaped upwards by 0.5% m/m in March, compared to the market consensus of +0.4% (and our +0.3% estimate). This translated into the headline yearly inflation rate accelerating for the third month in a row and hitting the central bank's target of 2.5% y/y. Almost the entire increase in the price level can be ascribed to two categories: food and transport, which together explain more than 80% of the monthly rise in consumer prices. The former reflects the jump in the prices of poultry, fruit and vegetables and flour. The latter mirrors the visible rise of oil prices witnessed on world markets in March, which was only partially offset by the appreciation of the zloty against the US dollar. Most of the other categories saw rather mild increases or even stagnation (perhaps with the exception of healthcare). We regard the current inflation jump as temporary and expect that it will slow down in the third quarter (at the latest), due to base effects, before going up again in the final quarter of 2007. We see inflation at 2.3% y/y at year-end.

Wage and inflation data support case for preventive hike

The upturn in the inflation rate seen in March is attributable chiefly to external factors that are beyond the reach of monetary policy, while demand pressures on prices are still relatively mild. However, the central bankers might be afraid that the trend-wise growth of headline inflation over the last few months will spark undesirable growth of inflation expectations. Moreover, wages in the corporate sphere saw unexpected acceleration as far as 9.1% y/y in nominal terms in March (from 6.4% y/y in February). Taking into account the 4.5% y/y growth in employment, this translates into an impressive 11.2% increase in the real wage bill, which was most likely above the productivity growth in this segment. Although wages are a volatile piece of data and it is not clear that the jump was not a one-off (the breakdown is not yet known), this data completes the mosaic of potential inflation threats painted over the last couple of months. Therefore, we believe that the sufficient number of 'moderate' voters on the MPC will be gathered to raise their hands for a signaling rate hike of 25bp this month, which has been our long-held scenario. We still expect rate stability thereafter and two hikes of 25bp (50bp in total) next year.

Ruling Law and Justice party divided over abortion law

With the weather getting warmer, the Polish political climate is also heating up. The newest political jitters emerged within the senior ruling party (Law and Justice, PiS) itself. The vote on abortion law served as a detonator. While the junior coalition party League of Polish Families and a minority of PiS members called for a stricter law and a total ban on abortions, the majority of PiS MPs wished to preserve the current state and anchor it in the constitution, so as to make any potential reversal tougher. Parliament failed to support either proposal in the end, and parliamentary speaker Marek Jurek opted to quit the PiS party in response, announcing that he would establish his own parliamentary group (and party) a couple of days later. It is still not clear how many deputies from PiS will follow him, but there is a real chance that the government will be deprived of a majority. This again raises the possibility of early elections. However, we think that such a scenario is not the most likely outcome. First of all, Jurek promised that he and his new party would continue to support the government. Second, given the standing in opinion surveys, snap polls would possibly bring less power to the ruling parties (some of them would not even make it into Parliament). Also, the newly established party around Jurek does not have enough time to profile itself and gather voter support. Moreover, it might be tough politically for the government to lose power in a period when the economy is enjoying a boom.

Poland to co-host soccer championship in 2012

Poland won the possibility to co-host (together with Ukraine) the European soccer championship in 2012. This news triggered an immediate positive reaction on the stock market, while the impact on FX was muted. What does this mean for the economy? It is likely that higher investment, especially in infrastructure and buildings, will provide a positive boost to Poland's economic growth. Tourism should also be supported. According to preliminary official estimates, infrastructure alone will in total require about EUR 19bn in investments (some of which would have been carried out anyway, but probably over a longer time horizon). On the other hand, this support comes at a time when the Polish economy is enjoying a visible economic boom. According to the fresh quarterly survey of the central bank, overall capacity utilization is at historical highs. Moreover, even though unemployment is still relatively high (above 14%), there are structural problems and some of the sectors have already signaled problems in finding employees (especially in construction, which will be even more strained due to the championship). Hence, it is possible that the need for further investments and construction will also open the door to higher wage pressures and lead to an increase in inflation.

Markets to monitor MPC meeting and new inflation report next week

The zloty enjoyed another relatively favorable week, thanks to the persisting conducive sentiment toward emerging markets and domestic data, which cemented the April rate hike expectation. The region of 3.78-3.80 might be a strong barrier for the zloty in its move south. On the weaker side, 3.83-3.85 should be a cap for any possible weakening. Domestically, the MPC rate setting meeting will be the most closely watched event, while politics will stay in traders' peripheral vision. The actual decision of the central bank will affect the market only in the case of an unexpected outcome (i.e. a hike of 50bp or 'no change'), as tightening by 25bp is already priced in. Some impulses might also come from the release of the fresh quarterly update of the central bank's inflation report. We think that there will still be a threat of an inflation target overshoot in 2008 and 2009, but the inflation trajectory could actually be shifted slightly downwards in comparison to the January update, which should calm nerves and fears of further, more pronounced monetary policy tightening.

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Slovakia

CB could cut rates on Tuesday

The central bank monetary meeting scheduled for Tuesday will be the most important event of the next week. In line with the majority of the market, we expect the CB to deliver a 25bp interest rate cut. The main reason is still the strong koruna, which is seen as overvalued by the central bank (currently 6% stronger than the central parity), and the positive inflation outlook allows monetary easing (the released March HICP at 2.1% y/y was slightly below the central bank's expectations). Despite the fact that the CB lowered interest rates by 25bp at the end of March, it had to intervene against the koruna in the beginning of the month to halt the currency's firming. It will be interesting to see whether the central bank also lowers the sterilization O/N rate, which was cut by 75bp last month, adding to the distortion on the money market (the CB continued to under-accept liquidity in repo tenders and the bigger gap between the sterilization and repo rates led to lower market rates than the official ones). The central bank will also present a new quarterly prognosis on Tuesday, in which it might move the equilibrium real exchange rate to a stronger level. However, the current exchange rate will remain stronger than the equilibrium rate, suggesting a tightening of real monetary conditions.

Markets still in wait-and-see mood

The past week was rather calm market-wise. On the money market, the central bank continued to partially reject liquidity in repo tenders (it accepted SKK 180bn out of total demand of SKK 222.5bn), while both average and maximum accepted yields remained well below the official repo rate (avg. 3.78%, max. 3.99%, while repo rate is 4.5%). The bond market took Monday's second auction of 3Y zerobonds well, with the auction attracting heavy demand of SKK 31bn, similar to the initial auction. Out of this, the debt agency accepted SKK 16.0bn (most of the volume went to foreign investors) at an average yield of 3.89%. With SKK 60bn of YTD issuance, we believe most of this year's koruna-denominated issuance has already been raised (Eurobonds worth EUR 1bn are planned for 2Q07). Finally, the koruna was moving within a thin range of 33.33-33.60 EUR/SKK for the whole week, basically mirroring the regional sentiment and major markets. The next impetus for the markets will be Tuesday's central bank meeting. Should interest rates remain on hold, it could be a positive impulse for the koruna.

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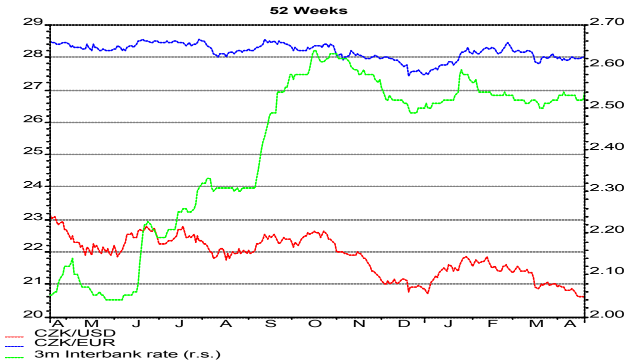
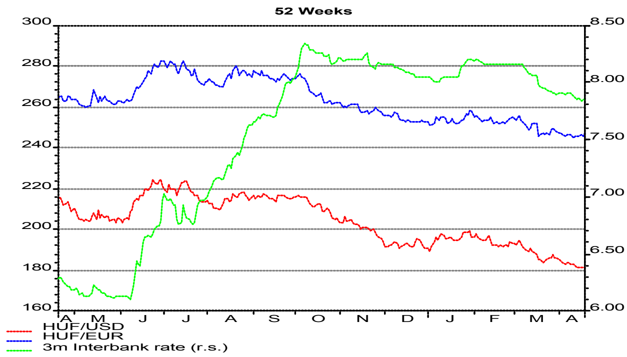
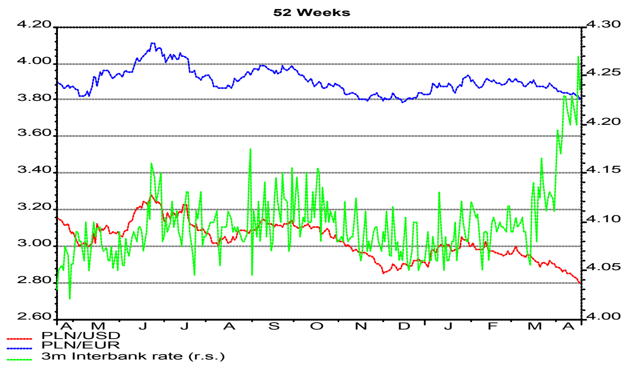
Appendix Charts

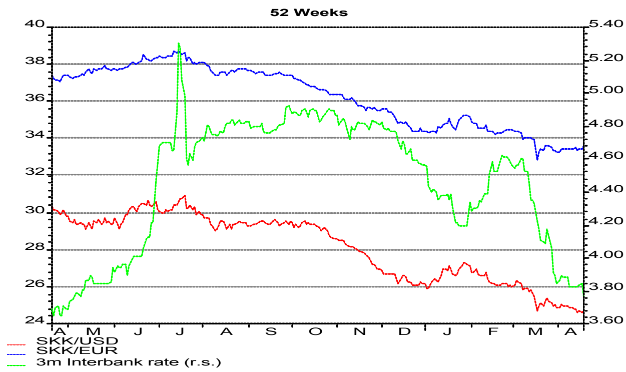
http://global.treasury.erstebank.com

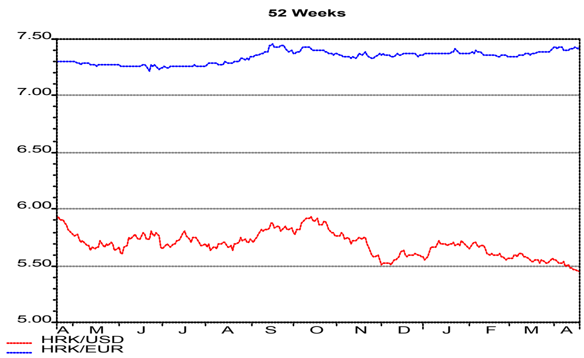
Exchange rates and interest rates (52 weeks)

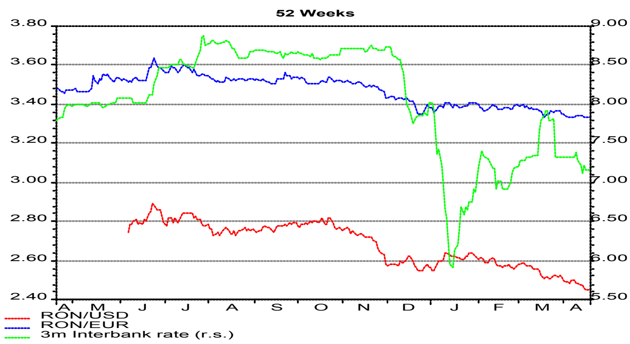






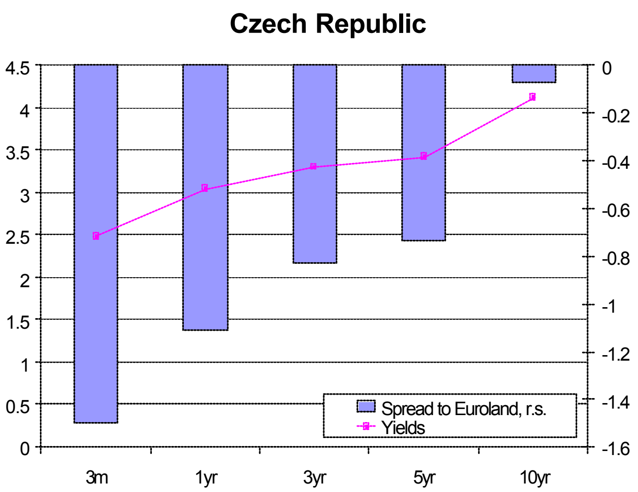


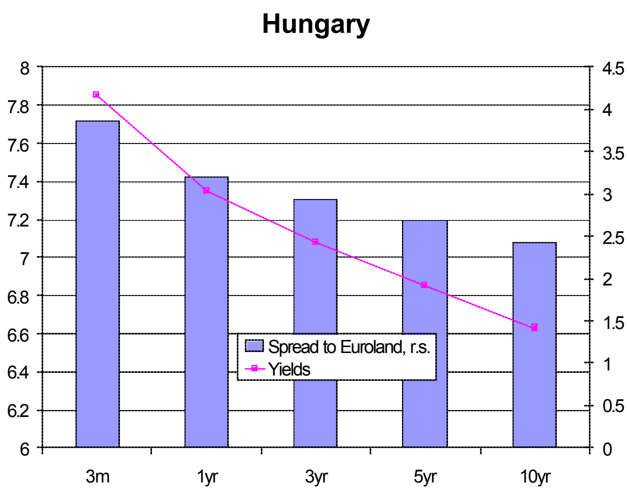




Source: Datastream

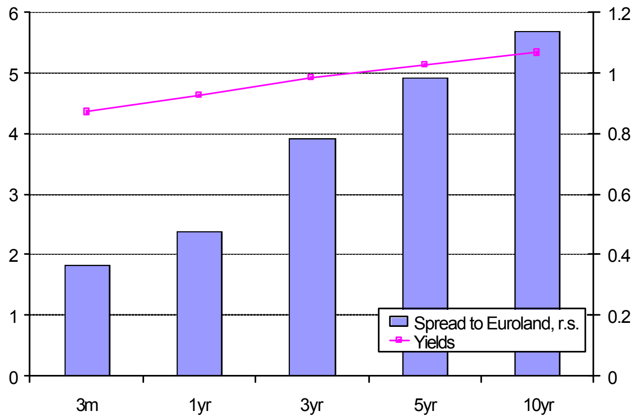
Benchmarks



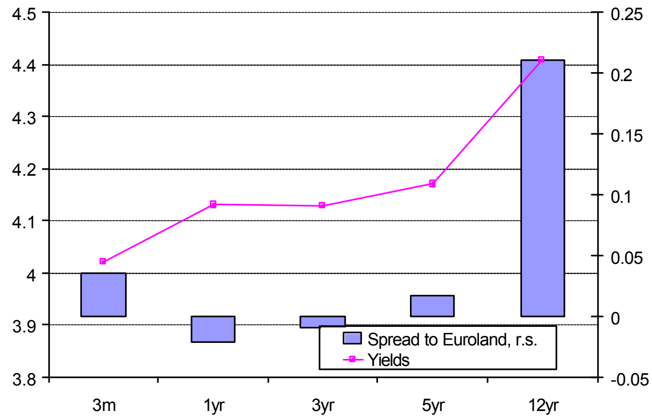


Appendix Forwards

Poland



Slovakia



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