CEE Research

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Fixed Income and Foreign Exchange

CEE Insights

- **Czech Republic:** Markets taking cues from abroad
- **Hungary:** Markets remained nervous
- **Poland:** PLN and bonds enjoy (fragile) stabilization, offshore factors still determine short-term outlook
- **Romania:** Short-term interbank interest rates tumbled further
- **Slovakia:** Central bank kept rates on hold and maintained positive outlook

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Overview

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Czech Republic:

- **Markets taking cues from abroad**
- **CPI for July due next week**

Hungary:

- **Budget deficit and industrial output figures due next week**
- **Markets remained nervous**

Poland:

- **PLN and bonds enjoy (fragile) stabilization, offshore factors still determine short-term outlook**

Romania:

- **Retail sales growth slowed to 9.6% in 1H07**
- **Downward yield trend toward benchmark bonds continued**
- **RON suffered slight correction, due to bearish regional mood**
- **Short-term interbank interest rates tumbled further**

Slovakia:

- **Central bank kept rates on hold…**
- **…and maintained positive outlook**
- **MinFin expects lower fiscal deficit, better inflation**
- **Next week rich in data**

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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**	28.02	0.0%	2.6%	-1.4%			
	3Y (yield bp)	3.98	-3	0	77	-38	-47	-66
	10Y (yield bp)	4.59	-2	-8	89	22	11	-23
Croatia	**EUR/HRK**	7.31	-0.3%	0.0%	0.6%			
	3Y (yield bp)	4.45	-12	2	3	6	-5	66
	10Y (yield bp)	5.34	-22	-11	n/a	98	90	n/a
Hungary	**EUR/HUF**	250.96	0.0%	-1.7%	0.2%			
	3Y (yield bp)	7.05	20	22	-50	269	235	368
	10Y (yield bp)	6.71	9	10	35	234	205	276
Poland	**EUR/PLN**	3.79	0.7%	-0.6%	1.2%			
	3Y (yield bp)	5.33	1	-2	68	97	87	78
	10Y (yield bp)	5.59	-1	10	42	122	109	124
Romania	**EUR/RON**	3.17	-0.5%	-1.4%	6.8%			
Slovakia	**EUR/SKK**	33.38	0.1%	0.7%	3.3%			
	3Y (yield bp)	4.60	2	5	22	22	9	50
	12Y (yield bp)	4.82	0	-4	51	45	34	38

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

Trading Ideas

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Positions

#	Position	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. (%)
12	short EUR/SKK	04/06/07	6m Bribid/ 6m Euribor EUR/SKK	3,9/ 4,28% 33.92	33.37	1.65%	1.6%	9.7%	32.8	3.2%	6.4%
13	short EUR/CZK	07/06/07	12m Pribid/ 12m Euribor EUR/CZK	3,21/4,47% 28.39	28.04	1.24%	1.0%	6.6%	26.8	4.7%	4.7%
14	buy SKKFRA 9*12 sell EURFRA 9*12	16/07/07	SKKFRA 9*12 EURFRA 9*12	Spread 30bp	Spread 15bp	15bp	15bp	-	Spread 0	30bp	-

Rationale at inception

12) The Slovak koruna might soon become an attractive buy. While we do not rule out short-term weakening, we see these eventual dips into the 34.0-34.2 EUR/SKK range as a good opportunity to buy the Slovak currency, as we expect it to strengthen in the euro run-up. We advise profit taking at 32.8 EUR/SKK, as the previous ERM-2 band at 32.69 EUR/SKK could be defended by the central bank. The expected time horizon is six months.

13) EUR/CZK is currently by roughly 0.30 CZK weaker that we estimate its fundamental level should be. Even though we expect milder appreciation this year than what we have seen over previous years, we still see Koruna strengthening owing to the convergence of Czech economy and real and monetary flows. Our prognosis for July 2008 sees CZK at 26.80 and hence we recommend entering long positions in CZK against EUR.

14) We bet on a narrowing of the spread between Slovak and European interest rates on a 9M horizon. Currently, SKKFRA 9x12 is traded 30bp below EURFRA 9x12, while Slovakia's expected euro entry in 2009 should ensure advance convergence of money market rates. Even in the case of Slovakia missing euro adoption in 2009, this should result in growth of domestic interest rates, making such a scenario profitable as well.

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%
11	short CZGB/ long PLGB	07/03/2007	10/05/2007	5.5%

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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		7.28		251		3.78		3.18		33.3		3.00	3.50	7.75	4.50	7.00	4.25
Sep-07	28.2	28.0	7.40	7.40	251	252	3.80	3.78	3.18	3.18	33.1	33.3	3.00	3.50	7.50	4.75	7.00	4.25
Dec-07	27.4	28.0	7.40	7.40	253	254	3.72	3.79	3.15	3.19	32.5	33.3	3.00	3.50	6.75	5.00	6.75	4.25
Mar-08	27.2	27.9	7.40	7.40	255	256	3.70	3.79	3.18	3.20	32.4	33.3	3.25	3.50	6.50	5.00	6.75	4.25
Jun-08	26.9	27.8	7.25	7.25	255	257	3.69	3.80	3.15	3.22	32.5	33.3	3.25	3.50	6.50	5.25	6.50	4.25

	3m Money Market Rate										10y Govt. Yield				
	CZ	Forward	HU	Forward	PL	Forward	RO	Forward	SK	Forward	CZ	HR	HU	PL	SK
Spot	3.22		7.50		4.81		6.62		4.37		4.59	5.34	6.70	5.60	4.75
Sep-07	3.05	3.33	7.40	7.35	5.00	4.97	6.85	6.87	4.30	4.41	4.50	5.10	6.40	5.50	4.70
Dec-07	3.13	3.69	6.80	6.96	5.15	5.19	6.55	6.65	4.30	4.45	4.60	5.10	6.10	5.45	4.70
Mar-08	3.30	3.96	6.50	6.69	5.30	5.41	6.45	6.57	4.30	4.51	4.70	5.00	6.00	5.55	4.80
Jun-08	3.38	4.03	6.40	6.63	5.40	5.43	6.35	6.38	4.30	4.35	4.70	4.90	5.90	5.65	4.80

Long-term forecasts

GDP growth (%)	2005	2006	2007f	2008f
Czech Republic	6.5	6.4	5.6	3.9
Croatia	4.3	4.8	5.4	4.7
Hungary	4.2	3.9	2.5	3.2
Poland	3.6	6.1	6.3	5.7
Romania	4.4	7.7	6.5	6.3
Slovakia	6.0	8.3	8.9	7.1

CPI (%), eoy	2005	2006	2007f	2008f
Czech Republic	2.2	1.7	3.7	4.5
Croatia	3.6	2.0	3.4	3.0
Hungary	3.3	6.5	5.2	3.4
Poland	0.7	1.4	2.5	2.6
Romania	8.6	4.9	3.7	4.2
Slovakia	3.7	4.2	2.8	3.3

C/A (%GDP)	2005	2006	2007f	2008f
Czech Republic	-2.5	-4.0	-3.3	-2.6
Croatia	-6.4	-7.8	-8.2	-7.9
Hungary	-6.9	-5.8	-4.5	-4.1
Poland	-1.7	-2.3	-2.6	-3.2
Romania	-8.7	-10.3	-11.4	-11.4
Slovakia	-8.5	-8.4	-3.6	-2.4

Budget Balance (%GDP)	2005	2006	2007f	2008f
Czech Republic	-2.2	-3.3	-4.0	-3.3
Croatia	-4.2	-3.0	-2.6	-3.0
Hungary	-7.8	-9.2	-6.5	-5.0
Poland	-4.3	-3.9	-3.4	-3.7
Romania	-0.8	-1.6	-2.8	-2.7
Slovakia	-2.8	-3.4	-2.9	-2.9

Diaries

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Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	Aug-07	Trade Balance (June, CZK bn.)	9.4 bn	9.4 bn
	Aug-08	CPI (July, m/m)	0.5%	0.6%
	Aug-08	Unemployment	6.3%	6.5%
Croatia	6-Aug	Retail trade	5.8% y/y	-
	7-Aug	PPI	3.0% y/y	
Hungary	Aug-07	July Budget balance	HUF +90bn	-
	Aug-07	June Industrial output	2.8% y/y	-
	Aug-08	June Trade balance	EUR-50mn	-
	Aug-10	Minutes of the CB meeting	-	-
Poland	Aug-09	Average monthly wages 2Q	-	-
Romania	Aug 9	Trade balance - June (FOB-FOB) - EU	1.577	
	Aug 10	CPI - July (yoy) - %	4.1	
Slovakia	Aug-08	June industrial production	15.6% y/y	-
	Aug-10	July CPI inflation	0.0% m/m, 2.4% y/y	2.4% y/y
	Aug-10	July core inflation	0.1% m/m, 2.5% y/y	2.5% y/y
	Aug-10	June foreign trade	SKK -1.0bn	SKK -0.4bn

**Sources: Bloomberg, Reuters*

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		Aug-09	Aug-10	2008-Aug-10		CZK 5 bn	
Hungary		Aug-07	Aug-15	Nov-14-2007	-	HUF 25bn	7.35%
		Aug-08	Aug-15	Feb-13-2008	-	HUF 25bn	7.25%
		Aug-09	Aug-15	July-02-2008	-	HUF 35bn	7.15%
Poland		Aug-06	Aug-08	2008-Aug-06	-	PLN 0.5-1.0bn	-
		Aug-08	Aug-10	2018-Jan-25	5%	PLN 1.5-3.0bn	-
		Aug-08	Aug-24	2016-Aug-24	3%	PLN 0.5-1.0bn	-
Romania		8.08.2007	10.08.2007	6M		RON 100 mill.	6.75
Slovakia		Aug-06	Aug-08	May-04-12	-	-	4.6%

Major markets

ECB rate hike in September

The ECB Council left key interest rates unchanged yesterday, but indicated an interest rate hike in September. It seems astonishing that the Council members made up their minds to indicate an interest rate hike in September, given the background of rising market volatility, after they hesitated to prepare this hike in July, when the markets were still calm. The ECB Council is '…calling for an orderly and smooth re-appreciation of risks…' So, a more supportive stance is only to be expected in the case of a disorderly movement. The fact that the next hike will come as early as September raises the probability of a further hike in December, although our core scenario is still a 4.25% repo rate in December. Next week, industrial production and factory orders for June will be released for Germany. As factory orders rose strongly in May, a decrease should be expected, but industrial production should rise somewhat in a monthly comparison. Government bond markets remained well supported this week. As the panic in the credit markets seems to be subsiding, we expect normalization on government bonds, taking the 10-year German Bund yields back to 4.5% over the coming weeks. As the economic situation is far better in Euroland than in the US, we expect the 10-year yield spread to close further.

FOMC statement slightly more dovish?

The Fed also does not seem to be concerned about the turmoil on the credit markets. The FOMC meeting on Tuesday will result in unchanged interest rates. With a background of a general worsening of economic indicators and still low inflation, the wording of the statement could be slightly more dovish this time. The widening of the crisis in the housing market raises public concern about a general downturn in the economy. At the same time, core inflation has decelerated to only 2.2% in the last two months. However, as is often the case in the US, the decisive factor will be the labor market. Today's labor market report will therefore again be in focus. As the summer months are used by car producers to retool their assembly lines, the unemployment rate could increase slightly. Next week, the ISM non-manufacturing index and productivity data will be released. Similarly to the ISM manufacturing, we expect a slowdown in the non-manufacturing, after a surprisingly high reading in June.

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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	4.00	5.25	4.28		5.36		4.36	4.77	1.370	
Sep-07	4.25	5.25	4.35	4.42	5.20	5.29	4.50	4.80	1.40	1.372
Dec-07	4.25	5.00	4.35	4.56	4.90	5.10	4.60	4.70	1.37	1.375
Mar-08	4.25	4.75	4.30	4.64	4.70	4.96	4.70	4.70	1.33	1.377
Jun-08	4.25	4.50	4.30	4.57	4.40	4.94	4.70	4.70	1.33	1.378

Czech Republic

Markets taking cues from abroad

This past week has been quite peaceful; no data releases were scheduled, so most of the impulses for the market movements came from abroad. Sub-prime problems on the other side of the Atlantic (leveraged hedge funds facing sub-prime contagion) reverberated across the financial community, driving stocks down across the board and pushing yields up. The Czech koruna briefly hit a 3M high against the euro as carry trades were (presumably) unwound; the CZK now trades in a range above 28.00. This is also going to be the main driving force over the course of the next few weeks, with the risk aversion evolution, heightened concern about sub-prime problems and tightening credit all potential market-movers.

CPI for July due next week

As for next week, the trade balance, CPI and unemployment data are all on the release schedule. We expect the trade balance to reach a surplus of CZK 9.4bn, thus confirming strong demand from abroad (as well as rapid growth of imports). The most closely watched release will be CPI for July; we expect a m/m rise of 0.5%, mainly on the back of vacation packages, and y/y growth of 2.6%, due primarily to food prices. Monetary-relevant inflation is heading upwards and it is a unanimous expectation that the CNB is far from done with hiking (our expectation is one more hike towards the end of the year, a scenario that relies on koruna strengthening). The CNB expects core inflation (monetary-policy relevant) to hit 2.6-4.0% in June 2008 (roughly 50 basis points different from what it forecasted in April) and some 3.0-4.4% six months thereafter, mainly because of the accelerating household demand. Unemployment will remain low at 6.5%, a slight uptick from a month earlier, largely due to seasonal variations.

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Hungary

Budget deficit and industrial output figures due next week

The Finance Ministry is scheduled to release July budget balance figures on Tuesday afternoon. After the deficit of HUF 1,003.7bn published for the first half of the year, the ministry expects a surplus amounting to HUF 95bn for July. Due to seasonal reasons, the budget balance usually shows a surplus in the seventh month of the year. However, the above-mentioned surplus should be much higher than those seen in previous years. This can basically be explained by the strong revenue side (especially from VAT) of the balance, which is not expected to change in the near period.

June industrial output and trade balance figures are due on Tuesday and Wednesday, respectively. The yearly growth rate of industrial performance may have again been relatively mild in June, due to the unfavorable base effects.

The minutes of the central bank monetary meeting held on July 23 will be published on Friday. As the governor said nothing on how the council members voted at the press conference following the meeting, the minutes should attract more interest than usual.

Markets remained nervous

Domestic markets have continued to be under the influence of the jittery international market environment, due to ongoing uncertainties around the US sub-prime market and the possible unfavorable impacts of credit problems on economic growth. Thus, the forint has continued to show volatile movements, while bond yields have risen. It is positive, however, that Thursday's bond auctions attracted healthy demand for both the 5Y and 10Y papers, improving the overall market sentiment by the end of the week.

After this week's nearly empty macro calendar, next week's figures could drive investors' attention toward domestic fundamentals. However, the majority of the currency and yield movements should still stem from major and other emerging market events.

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Poland

PLN and bonds enjoy (fragile) stabilization, offshore factors still determine short-term outlook

Following the visible losses suffered during the final week of July, Polish markets managed to calm down somewhat. The zloty successfully marched into stronger territory, dipping back below the threshold of 3.80 EUR/PLN. Similarly, the bond market also stabilized. The risk premium against the Eurozone even declined slightly across the curve (by approximately 5bp). As the local macro calendar was empty, the direction for the Polish markets was totally driven by global patterns. The Statistical Office will publish 2Q wage development for the whole economy next week (the monthly data only concerns the corporate sector). This could be an interesting input for monetary policy makers and could move bonds. However, we sense that offshore developments (patterns seen on equity markets, credit spreads and consequent risk aversion) will remain the single most crucial factor for Poland in the week ahead. In the case of a further wave of risk aversion, both the zloty and bonds would again weaken.

The atmosphere of the local political scene remains tense and the threat of early elections keeps rising. Prime Minister Jaroslaw Kaczynski, from the ruling Law and Justice (PiS) party, angered the coalition partners by naming a PiS nominee to the post of farm minister. This post had been empty since Andrzej Lepper was sacked, and it was expected to be taken by a Self-Defense candidate. The president spoke openly about possible dates for snap polls: they could take place in September, November, or spring of next year. He prefers spring, arguing that if they took place this year, the next regular polls (in four years) would coincide with the period when Poland is scheduled to take over the rotating EU presidency (in the second half of 2011). We assume that the situation will remain unresolved, with no final conclusion on the fate of the government until at least the next parliamentary session on August 22, which will show whether the coalition still enjoys majority support and how real the early election threat is. The Polish political scene is never-endingly surprising, and it cannot be ruled out that there could still be enough deputies (from Lepper's Self-Defense and even the small opposition parties) willing to tolerate the coalition, due to fears that they would not make it back into Parliament.

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Romania

Retail sales growth slowed to 9.6% in 1H07

Retail sales (with the exception of motor vehicles and motorcycles) increased by 9.6% in 1H07, compared to 25.1% in 1H06, mainly driven by non-food products sales (+10.2%). At the same time, wholesale and retail trade, maintenance and repair of motor vehicles and motorcycles, and retail trade of motor vehicle fuels accelerated to 43.2% in the first six months of 2007, compared to the 16.5% increase seen in 1H06. Local car sales declined by 3.7% in 1H07, due to the unfavorable start in the first month of the year, but the introduction of a new model by Dacia in late January pushed up sales later on. Imported cars advanced by 53.3% in 1H07. According to our estimates, the strong increase in auto imports will drop off in 2008, once Ford starts to produce a family model on the local market. Following the increase in the number of motor vehicles registered, retail trade of fuels went up strongly (by 62.5%) in 1H07 (+11.6% in 1H06). We see the retail sales increase as healthy and sustainable, reducing the likelihood of the Romanian economy overheating. This is good news for the current account deficit, as many retail goods are imported, while fuels (which experienced significant growth) are produced in Romania.

Downward yield trend toward benchmark bonds continued

On August 2, the Minister of Finance held a benchmark bond auction for the three-year maturity, for an indicative amount of RON 100mn. The overall offer of the primary dealers exceeded the indicative amount by three times over. However, the FinMin drained only the initially intended sum. The average accepted yield stood at 7.04%, as we had anticipated, while the maximum accepted rate reached 7.10%. Considering the previous 3Y benchmark bond auction held in July, one can see the continuation of the downtrend in the yields demanded by the participants, as the average yield was 7.13%, while the maximum accepted rate reached 7.15%. Market participants have maintained their interest in this type of placement instrument, although the outturns do not fully compensate for their moderate liquidity and country risks (as evaluated by the international rating agencies). Most of the commercial banks have started to build substantial portfolios of debt instruments to guard against liquidity shortages. Commercial banks need eligible assets in their portfolios, so that they are able to access the credit facilities offered by the Central Bank (repos and Lombard credits), whenever interbank short-term financing becomes too expensive. Along with the commercial banks, the mutual and pension funds also need state debt instruments in their portfolios. It is likely that the demand for these debt instruments will gradually expand, as pension funds should be more active on the Romanian market next year. We expect that the yields demanded for the medium- and long-term debt instruments will arrive in proximity to the monetary policy rate, given the low level of the offer.

RON suffered slight correction, due to bearish regional mood

The RON was marginally affected by the bearish regional mood, losing 0.5% w/w, as investors reduced some of their exposure to emerging markets. The domestic currency started the week in the 3.16 zone and fell to a one-month low of 3.1820 on August 1, due to the intensifying risk aversion among off-shore investors. The Administration Board of the NBR held a policy meeting on July 31 and decided to keep the key rate flat at 7.0%, after four consecutive cuts this year. The decision was not reflected on the forex market. However, if the policy rate had been cut further, it is likely that the RON would have broken the 3.20 resistance area shortly thereafter. The NBR's main motivation for keeping the key rate unchanged - despite the further deceleration of CORE2 inflation - is the concern over the high inflationary pressures, which are due to the sharp rise in income, the impact of drought on food prices and growing government expenses. The RON recovered slightly in the second half of the week, moving to a narrow range of 3.15-3.17, as the commitment expressed by the NBR to fight inflationary pressures has further stirred the interest of off-shore players. It is likely that the recent correction suffered by the domestic currency will continue next week as well, as the low interbank interest rates and the bearish regional mood might put further pressure on the RON. Despite the upward bias, we expect that the 3.20 resistance area will hold, as it has proven to be quite a strong threshold. The support zone is seen at 3.15.

Short-term interbank interest rates tumbled further

Although the short-term deposits were quoted in the proximity of the key rate at the beginning of the week, the ON interbank interest rates gradually tumbled to 3.2/4.4% bids/asks on Thursday, due to the low allocation ratio by the NBR at its usual Monday deposit auction. The central bank decided to sterilize just RON 2bn, although a 1M deposit at the NBR worth RON 3bn expired the very same day. Although the overall offer of the commercial banks reached RON 6bn, the NBR chose to sterilize only 33%. We believe that the NBR will maintain the low allocation ratio in the coming weeks, as it seems to be using this channel to discourage inflows of hot money from abroad via carry trades. At the next deposit auction to be held on Monday, we expect the yields demanded by commercial banks to reposition lower, due to the high liquidity in the Romanian money market. Therefore, the average accepted interest rate might drop below the 6.57% level set at the previous depo auction.

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Slovakia

Central bank kept rates on hold…

The CB left rates on hold, meeting our and market expectations. The 2W repo rate stayed at 4.25% and O/N rates at 2.25/5.75%. No proposal to change rates was made. The most important factors included the koruna, inflation and the outlook for ECB rates. Firstly, the exchange rate was still more than 2% off its all time high (at 32.71 EUR/SKK). Hence, it did not force the CB to ease monetary conditions, even though it sees them as restrictive at present. Secondly, harmonized inflation stood at a record low 1.5% in May and June, but there are still risks regarding the 2008 inflation outlook (stemming from energy prices, wages, the looming tax hike on cigarettes as of next year; plus, inflation will get less help from the koruna). This advocates a cautious approach, especially regarding the sustainability of low inflation, which might be monitored during euro evaluation. Finally, an ECB hike is expected to bring the ECB base rate to 4.25% in autumn. Hence, no further action by the NBS is necessary in order to achieve rate harmonization (early convergence is preferred by the central bank). We continue to see Slovak interest rates as stable until the year-end. If the ECB opts to hike rates above 4.25% in late 2007 or early 2008, we expect the NBS to follow accordingly (possibly with some lag). Even if the koruna were to appreciate beyond the central bank's tolerance territory, we think that the bank would use interventions and repo under-acceptance as its primary tools to fight appreciation, rather than rate cuts.

…and maintained positive outlook

The CB also released a new medium-term prognosis. No significant changes appeared in the outlook. The NBS only revised up the forecast for end-year HICP inflation from 1.3% to 1.5%. The inflation outlook for the following years remained unchanged; the CB sees end-2008 inflation at 2.0% and 2.5% in 2009 (our estimates are higher, at 2.8% and 3.3%, respectively, as the channel of koruna appreciation will no longer curb inflation). The NBS sees GDP growth at 8.9% in 2007 and 7.5% in 2008.

MinFin expects lower fiscal deficit, better inflation

The Ministry of Finance revised the forecast for the 2007 general government deficit to 2.7% of GDP (from the 2.9% projected in the budget). The improvement comes on the back of cheaper debt service, better tax intake and higher dividends. The MinFin also revised its forecast for average inflation in the period April 2007-March 2008 (likely to be used for euro evaluation) from 1.8% to 1.6% (our view is similar). This should be well below the Maastricht criterion, which the MinFin sees at around 2.8%.

Next week rich in data

Next week will bring several data releases. Among them, inflation for July will probably be the most interesting (scheduled for Friday). Our forecast of 2.4% y/y (flat on a monthly basis) meets the market consensus, as we expect the decline of food prices to offset the slight growth of other items. Also, June industrial production is out on Wednesday and should again show a strong pace (our forecast is 15.6%). The June foreign trade balance (on Friday) is expected to come out close to even (our forecast is a deficit of SKK 1.0bn) and register yet another improvement compared to last year.

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Appendix Charts

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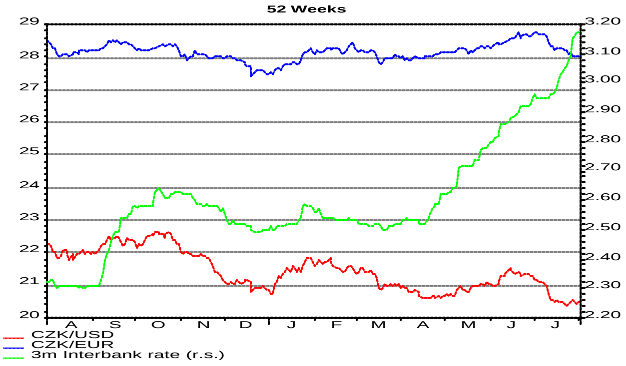
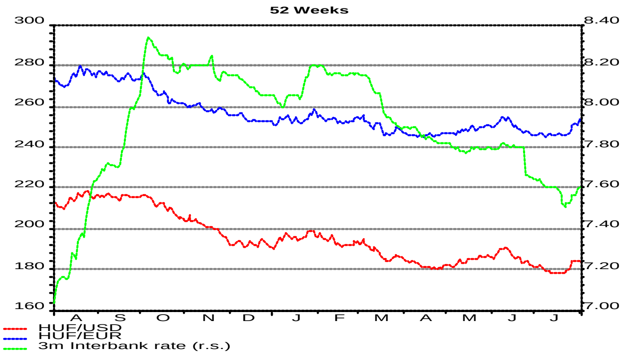
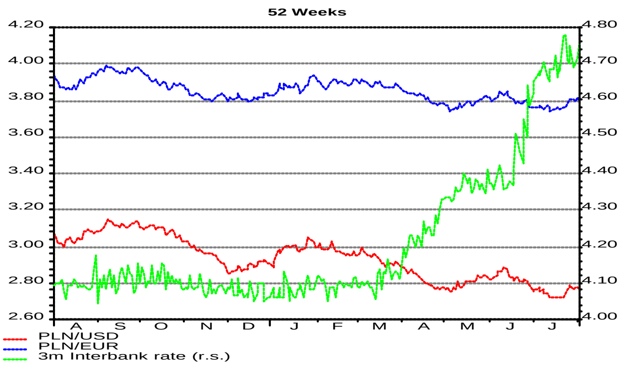
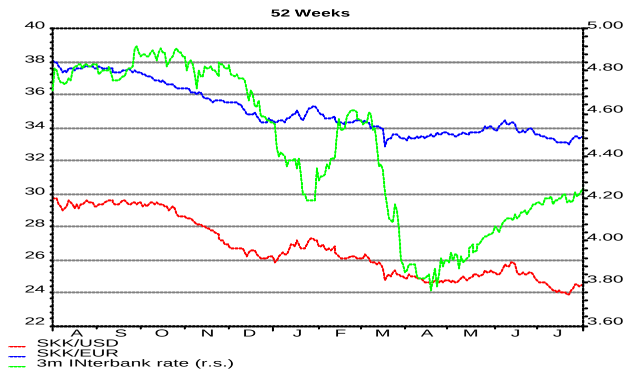
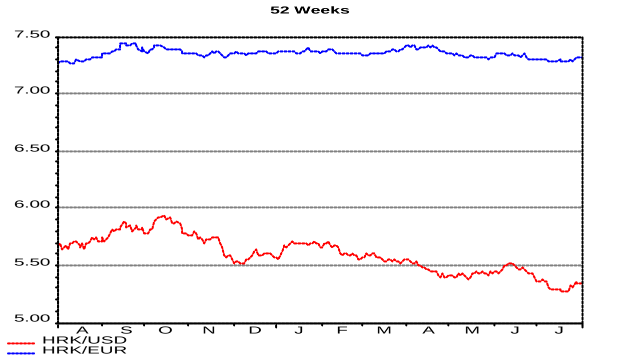
Exchange rates and interest rates (52 weeks)

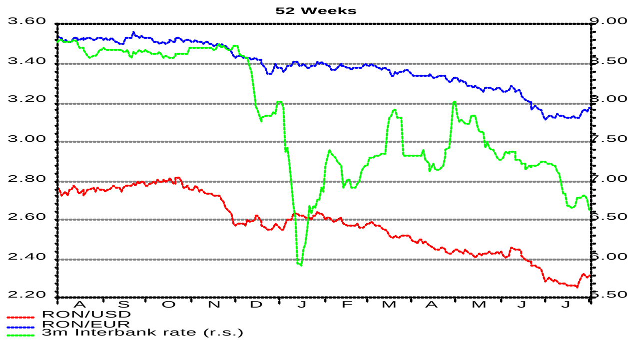








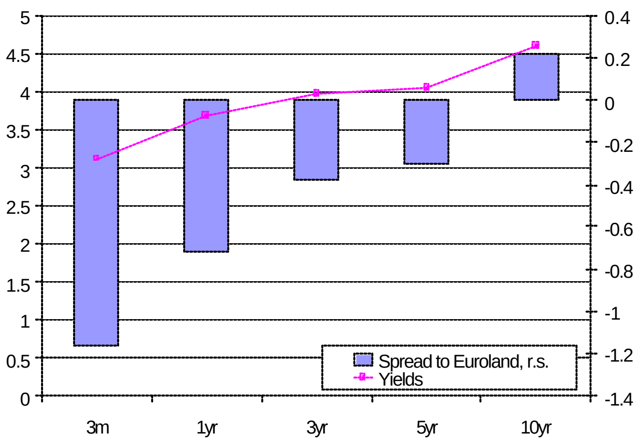




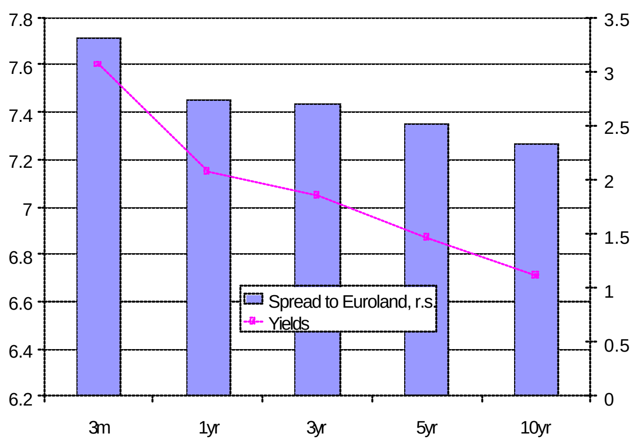
Source: Datastream

Benchmarks

Czech Republic



Hungary



Appendix Forwards

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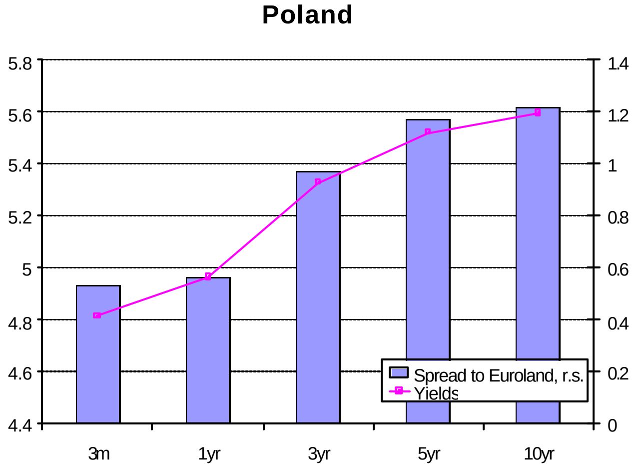

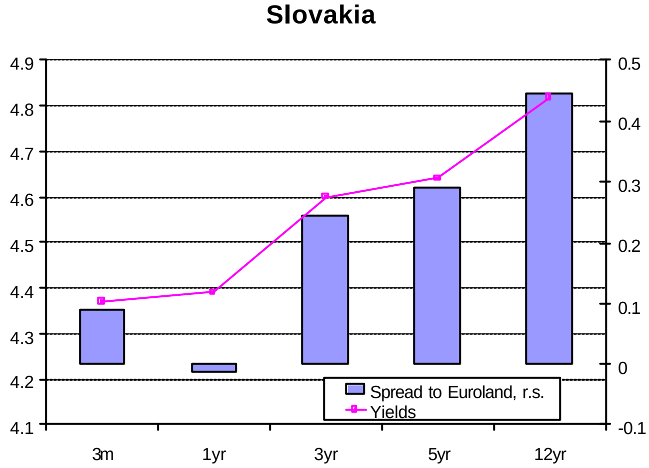

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