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Fixed Income and Foreign Exchange

CEE Insights

- **Croatia:** Real economy continues to grow briskly
- **Czech Republic:** Calming markets could mean weaker CZK
- **Hungary:** September budget deficit and CPI figures due next week
- **Poland:** Calendar again empty next week, looming elections might keep markets cautious
- **Romania:** MinFin continued to reject bids at auctions of state securities
- **Slovakia:** PM reiterated that Slovakia will meet fiscal criterion

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Overview

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Croatia:

- Real economy continues to grow briskly
- 1H07 C/A deficit reached EUR 3.4bn
- Financial markets: Exciting week behind us

Czech Republic:

- Calming markets could mean weaker CZK
- September CPI could surprise

Hungary:

- September budget deficit and CPI figures due next week
- Forint stuck in range

Poland:

- Calendar again empty next week, looming elections might keep markets cautious

Romania:

- RON mirrored jitters on political scene
- Central bank's firm control of liquidity brought stability to Romanian money market
- MinFin continued to reject bids at auctions of state securities

Slovakia:

- PM reiterated that Slovakia will meet fiscal criterion
- Inflation to dominate next week's data

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Thursday's close		Current	w/w	m/m	ytd	Spreads vs. Euroland current	Spreads vs. Euroland - 1m	Spreads vs. Euroland 02/01/2007
Czech Republic	EUR/CZK	27.56	0.1%	0.4%	0.2%			
	3Y (yield bp)	3.94	-1	0	73	-11	-14	-66
	10Y (yield bp)	4.57	-3	-6	86	28	35	-23
Croatia	EUR/HRK	7.30	-0.3%	0.3%	0.7%			
	3Y (yield bp)	4.67	11	12	13	61	42	66
	10Y (yield bp)	5.33	1	4	n/a	104	103	n/a
Hungary	EUR/HUF	252.14	-0.5%	1.2%	-0.3%			
	3Y (yield bp)	7.10	16	-9	-45	305	312	368
	10Y (yield bp)	6.71	10	-6	40	242	250	276
Poland	EUR/PLN	3.77	0.4%	1.5%	1.8%			
	3Y (yield bp)	5.46	7	0	81	141	139	78
	10Y (yield bp)	5.72	2	-6	55	144	151	124
Romania	EUR/RON	3.37	0.1%	-1.8%	0.4%			
Slovakia	EUR/SKK	34.19	-0.9%	-1.3%	0.8%			
	3Y (yield bp)	4.55	1	6	17	48	40	50
	12Y (yield bp)	4.85	1	7	54	56	52	38

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

Trading Ideas

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	3,9/ 4,28%			-0.8%	-2.4%	32.8	3.2%	6.4%
			EUR/SKK	33.92	34.16	-0.69%					

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.

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%
14	long SKKFRA 9x12, short EURF	16/07/2007	13/08/2007	30 bp
13	short EUR/CZK	07/06/2007	14/09/2007	3.0%

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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	27.6		7.31		251		3.77		3.37		34.1		3.25	3.50	7.75	4.75	7.00	4.25
Dec-07	27.6	27.5	7.40	7.40	253	253	3.72	3.77	3.30	3.40	32.5	34.1	3.25	3.50	7.00	5.00	7.25	4.25
Mar-08	27.3	27.5	7.30	7.30	255	255	3.70	3.78	3.28	3.42	32.4	34.1	3.25	3.50	6.75	5.00	7.50	4.25
Jun-08	27.1	27.4	7.25	7.25	255	256	3.70	3.78	3.20	3.44	32.5	34.0	3.50	3.50	6.75	5.25	7.50	4.25
Sep-08	26.8	27.4	7.25	7.25	256	258	3.67	3.79	3.24	3.47	32.5	34.0	3.50	3.50	6.50	5.25	7.50	4.25

	3m Money Market Rate										10y Govt. Yield					5y Yield
	CZ	Forward	HU	Forward	PL	Forward	RO	Forward	SK	Forward	CZ	HR	HU	PL	SK	RO
Spot	3.52		7.43		5.09		7.69		4.33		4.57	5.33	6.70	5.72	4.77	7.00
Dec-07	3.30	3.56	7.00	7.21	5.20	5.19	7.60	7.17	4.30	4.41	4.55	5.20	6.20	5.65	4.70	7.25
Mar-08	3.40	3.66	6.80	6.88	5.30	5.32	7.45	7.90	4.30	4.50	4.80	5.10	6.00	5.70	4.80	7.25
Jun-08	3.55	3.76	6.70	6.72	5.40	5.38	7.70	7.28	4.30	4.55	4.90	5.10	5.90	5.76	4.80	7.25
Sep-08	3.60	3.80	6.60	6.65	5.57	5.37	7.70	7.15	4.30	4.64	4.80	5.20	5.80	5.85	4.80	7.30

Long-term forecasts

GDP growth (%)	2006	2007f	2008f	2009f
Czech Republic	6.4	5.4	4.1	4.8
Croatia	4.8	5.4	4.7	4.9
Hungary	3.9	2.2	3.0	3.9
Poland	6.1	6.3	5.7	6.1
Romania	7.7	6.0	6.1	6.0
Slovakia	8.3	8.9	7.2	5.3

C/A (%GDP)	2006	2007f	2008f	2009f
Czech Republic	-3.0	-3.5	-3.7	-2.8
Croatia	-7.8	-8.2	-7.9	-8.3
Hungary	-6.5	-4.4	-4.2	-3.9
Poland	-2.3	-3.1	-3.3	-4.3
Romania	-10.3	-13.7	-14.7	-14.7
Slovakia	-8.4	-3.8	-2.4	-1.9

CPI (%), eoy	2006	2007f	2008f	2009f
Czech Republic	2.5	3.9	4.9	3.2
Croatia	2.0	3.4	3.0	3.0
Hungary	6.5	6.0	3.4	2.3
Poland	1.4	2.7	2.9	2.7
Romania	4.9	4.6	4.1	3.9
Slovakia	4.2	2.8	3.3	3.5

Budget Balance (%GDP)	2006	2007f	2008f	2009f
Czech Republic	-3.3	-4.0	-3.3	-2.8
Croatia	-3.0	-2.6	-3.0	-3.0
Hungary	-9.2	-6.0	-4.2	-4.1
Poland	-3.9	-3.2	-3.5	-3.4
Romania	-1.6	-2.7	-2.7	-2.7
Slovakia	-3.4	-2.9	-2.4	-2.6

Diaries

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Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic		CPI (m/m,%)	-0.4	-0.4
		CPI (y/y, %)	2.9	2.8
		Trade Balance (bn. CZK)	1.1	1.1
		Unemployment rate (%)	6.3	6.3
Croatia	No data releases scheduled			
Hungary	Oct-08	September budget balance	HUF -190bn	-
	Oct-09	August Industrial output	10.9% y/y	10.0% y/y
	Oct-09	August Trade balance	EUR -110mn	EUR -167mn
	Oct-11	September CPI inflation	6.3% y/y	6.3% y/y
	Oct-12	Minutes of Sep 24 monetary meeting	-	-
Poland	No data releases scheduled			
Romania	October 10	Inflation rate - September yoy	5.3	5.3
	October 10	Trade deficit - August (FOB-CIF) - EUR mn	1,650	-
Slovakia	Oct-08	August industrial output	10.0% y/y	10.4% y/y
	Oct-11	September inflation	0.2% m/m, 2.8% y/y	2.7% y/y
	Oct-11	September core inflation	0.3% m/m, 3.1% y/y	2.9% y/y
	Oct-12	August foreign trade	SKK -2.4bn	SKK -3.2bn

**Sources: Bloomberg, Reuters*

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		No auction scheduled					
Hungary		Oct-08	Oct-10	Nov-14-2007	-	HUF 40bn	7.45%
		Oct-09	Oct-17	Jan-16-2008	-	HUF 30bn	7.40%
		Oct-11	Oct-17	Aug-24-2010	6.25%	HUF 75bn	7.05%
		Oct-11	Oct-17	Nov-24-2023	6.00%	HUF 20bn	6.55%
Poland		Oct-08	Oct-10	2008-Oct-08	-	PLN 0.5-1.0bn	-
		Oct-10	Oct-25	2017-Oct-25	5%	PLN 1.5-2.5bn	-
Romania		10-Oct-07	12-Oct-07	12M		RON 100 million	7.00%
Slovakia		No auction scheduled					

Major Markets

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Major markets

ECB confirmed wait and see stance

After this week's ECB rate decision, by which the central bank extended its wait and see stance, the calendar for next week contains several releases, albeit with a likely limited impact on markets. Generally, markets do not expect any considerable impact form the turmoil on financial markets on the real economy in August. Monday's factory orders for Germany should show a recovery after the slump in July. In line with this expectation is accelerated growth of industrial production in the same month. Industrial production for France (the following day) will show an opposite development - weaker growth, after a good development in July. Bond markets should likely trade within ranges, with only the US data having the potential to change this.

Disappointing US labor market data would trigger strong market reaction

Today's labor market data will be decisive for markets for most of next week. We are in accordance with the market in thinking that non-farm payrolls should have recovered after the slump in August. Zero employment growth does no represent the true state of the US economy, but was rather due to the turmoil in August. Should this employment recovery not occur, the outlook for the US economy would dim. Bonds would gain and the dollar would weaken, as a further rate cut by the Fed already at the end of October would become very likely. A better than expected employment number would affect the dollar the most, triggering a technical correction of the EUR/USD, in our view. Bond losses should be limited in such a scenario, as worries about the US economy would only be eased, but would not disappear. The continued sluggishness of the US economy is likely to be confirmed a week later, when retail sales for September will be released. Growth should be posted at a low level, and it will be interesting to see the extent to which higher gasoline prices contributed. The same day, the Univ. of Michigan Index is expected by markets to show stable - moderate - consumer sentiment. Here, we see a risk for a deterioration.

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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	4.75	4.77		5.24		4.30	4.53	1.411	
Dec-07	4.25	4.50	4.35	4.70	4.60	5.09	4.40	4.60	1.40	1.413
Mar-08	4.25	4.25	4.30	4.54	4.30	4.76	4.70	4.60	1.36	1.415
Jun-08	4.25	4.00	4.30	4.49	4.30	4.61	4.70	4.70	1.33	1.415
Sep-08	4.25	4.00	4.30	4.06	4.20	4.53	4.70	4.70	1.33	1.417

Croatia

Real economy continues to grow briskly

GDP performance remained robust in 2Q07, exceeding our expectations (set slightly below 6% y/y) and posting 6.6% y/y in real terms. As expected, private consumption was the dominant growth driver (as in 1Q07), posting strong 6.5% y/y growth. On the other hand, fixed capital formation growth moderated from 11.2% y/y in the preceding quarter to 5.8% y/y growth. Overall, the slowdown of construction activity in 2Q07 translated into lower investment activity, in line with our more conservative forecast for 2H07. On the other hand, private consumption growth was stronger than we anticipated, although short-term indicators supported a continuation of strong consumption momentum. Public consumption again confirmed its upward trend, rising 2.7% y/y, but still grew considerably more slowly than overall GDP. As could have been expected from the trade balance figures, exports performed better than in 2Q07, posting solid 8.9% y/y growth. Imports also accelerated to 6.4% y/y, which, given the strong growth momentum and export performance, came as no surprise. Regarding 2H07, we expect growth rates to moderate to some extent, as domestic demand (the main growth driver) should be negatively influenced by tight monetary conditions and shrinking credit. Therefore, we anticipate that FY07 GDP growth should come in at around 5.5%.

1H07 C/A deficit reached EUR 3.4bn

The 2Q current account deficit figure release showed the C/A deficit widening to EUR 1,350mn (+3.9% y/y). As expected, the merchandise account saw a further deterioration, as the deficit increased by 8.2% y/y (EUR 2,535mn). Exports outpaced imports (16.1% vs. 11.8%), thus performing better than in 1Q07. Nevertheless, the deficit increased, due to the large difference in absolute terms. The service account managed to cover the merchandise account deficit increase in 2Q, as the surplus on the service account increased by 17.2% (EUR 1,520mn). Service export growth remained solid, as exports grew by 8.8% y/y, while service imports were down 6.2% y/y (compared to 2Q06). The deficit on the income account (EUR 598mn) was 8.9% higher y/y. However, inflows on the income account continued to record a solid growth rate (+62.3%). Thus, the offsetting pressure came from outflows, which was especially evident in 1H07, as the deficit on the income account decreased by 9% y/y. Finally, current transfers once again confirmed their moderating trend, as the surplus in 2Q07 declined 11.5% y/y. On the financing side, FDI inflows remained solid (although FDI details were not yet published, it is likely that a large proportion of FDI inflows were related to the financial sector's reinvested profits), standing at EUR 836mn (+2.6% y/y). The 1H07 C/A deficit increased by 3.6% y/y, reaching EUR 3.4bn. Roughly 60% of this deficit was financed through FDI; over the last four quarters, that percentage has stood at close to 120%. The service account surplus managed to cover 75% of the merchandise account deficit increase, which is a favorable development. Nevertheless, we continue to see the 2007 C/A deficit coming in above the 2006 deficit, arriving close to 8% of GDP this year.

Financial markets: Exciting week behind us

The finalization of the telecom IPO process last Thursday and actual payment of HRK 13bn further boosted pressures on the MM and FX market. Large amounts of liquidity were reshuffled among banks, triggering some system inefficiencies, and hence significantly reducing liquidity. After MM rates headed well above 10% and the exchange rate further appreciated towards 7.26, the CNB had to intervene on the FX market by purchasing EUR 355.2mn. Afterwards, the exchange rate moved around 7.30, while MM rates, in combination with the record-high CNB reverse REPO auction (HRK 6.5bn), moderated somewhat, but still remained high at around 10%. In the coming weeks, pressure is likely to remain pronounced, with MM rates under pressure. Also, more details about the postponed new government bond issue should be known soon. At the moment, it is known that it will be a kuna issue, while total issuance and maturity are unknown. Pure kuna bonds have so far put in stable performances, showing little correlation with the MM developments, indicating that investors perceive the current situation as having a transitory nature.

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Czech Republic

Calming markets could mean weaker CZK

There were no data releases scheduled this past week. The koruna traded pretty uneventfully around 27.50. As for the outlook, the situation on the major markets seems to be calming down somewhat. If that continues, we believe that we might be in for some slight weakening of the CZK, although nothing on the scale witnessed in the first half of this year (the CZK has already weakened somewhat from the highs seen in the first week of September against the NZD and AUD, both currencies with large interest rates differentials vs. the CZK). However, the longer-term outlook remains bullish (26.80 per EUR a year from now).

September CPI could surprise

As for the next week, data on CPI, unemployment and the trade balance will be released. CPI for September will be watched for whether it defies the CNB forecast (as in August). However, one needs to take into account that the July prognosis was based on a dramatically different set of assumptions (for example, the CZK). Thus, surprises are entirely possible. Minutes from the last CNB meeting also acknowledged that the situation has changed considerably from July (global financial uneasiness and reform package) and indicated that the new prognosis (to be released later this month) will prove to be of greater importance for monetary policy. As for the CPI proper, we expect a y/y rise to 2.9 % (m/m fall of 0.4%).

The unemployment release will not have the potential to change the macro picture. It is a well known fact that the economy is in full swing, even pushing unemployment against its structural limits (some industries already report a lack of qualified workers). We expect a slight decrease to 6.3% (from 6.4%). Minutes also identified the labor market as a potential source of inflationary pressures, even though the growth of unit labor costs is mild for now (under 3%).

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Hungary

September budget deficit and CPI figures due next week

Next week will be full of macro releases, among which the September budget deficit and CPI figures should be the most watched. The budget deficit figures will be released on Monday, late afternoon. As in the middle of September, the Finance Ministry revised downwards their CF-based budget deficit forecast for the 2007 January-September period to a deficit of HUF 1,182.4bn. This downward revision should mean an HUF 200.1bn monthly deficit for September. The actual 1-3Q balance figures should again suggest that Hungary will finally meet its deficit targets in 2006. However, attention is expected to slowly turn to the 2008 budget law. The September CPI inflation figure is due Thursday morning. A significant slowdown in the 12-month index may have taken place in the ninth month of the year - in my estimation, to 6.3% y/y, after the 8.3% published for August. However, assessing the figure is difficult. Earlier, I had expected the 12-month CPI to drop to well below 6% in September 2007. The difference between the original and the current estimate can basically be explained by the sharp food price increases, which could make monetary policy decisions even harder in the coming period. Thus, the minutes of the September 24 monetary meeting (due next Friday), with arguments from the council's members, should be more interesting than usual for market participants.

Forint stuck in range

The forint continued to move in a relatively tight range. The ECB rate decision and the press conference on Thursday had a minor impact, causing a little strengthening in the forint exchange rate, due to the so far unchanged interest rate differential. Before the data harvest next week, the key event for domestic markets should be US labor market data (this afternoon), as it is expected to provide further information regarding the shape of the US economy and the FED monetary policy. The expected further FED rate reductions should provide some support for the forint and make more rate cuts possible for the central bank, despite the current uncertainties around the mid-term inflation prospects.

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Poland

Calendar again empty next week, looming elections might keep markets cautious

There were no important macroeconomic data releases on the Polish schedule in the last five days, and the calendar will remain covered in cobwebs during next week as well. The zloty stayed in strong territory and, as we assumed, failed to escape from the trading range of 3.75-3.78 EUR/PLN. There was one potential zloty-negative piece of news, but the market failed to react to it. The Statistical Office revised the published current account data, as a result of which the deficit for 2006 went up by a sizeable 0.9pp to 3.2% of GDP. Spreads on government bonds (against the Eurozone) widened by 5-10 basis points (for 1-year papers, even 30 points). Such a move might have been motivated by the slight strengthening of expectations that there are further rate hikes in the pipeline. Also, the moderate rise of FRA pricing supports this hypothesis. The impulse came from the Finance Ministry, which said that it forecasted inflation reaching 2.0% y/y in September, which means a relatively significant increase from the 1.5% notched in August. This only confirms what we suggested before - that the unexpected dip in price growth in August was of a temporary nature and that inflation will be back above the target by year-end. The rhetoric of central bankers remains soft, however, and suggests that the MPC is inclined to increase the break between the rate hikes from two months to at least three months (in line with our forecast of the next hike coming in November). Due to the data vacuum, the markets will again primarily eye majors in the coming week. However, given the approaching elections (October 21), we do not see much space for significant zloty appreciation in the next two weeks. Rather, it should be trying to break the upper end of the trading range of 3.75-3.78 EUR/PLN.

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Romania

RON mirrored jitters on political scene

The local currency started the week in the 3.34 zone, sustained by high interbank interest rates. On Wednesday (the day of the no-confidence vote), the RON weakened slightly to 3.37, amid extremely thin forex trading, as investors refrained from taking positions ahead of the censure motion. The no-confidence motion against the government, tabled by the main opposition party (the Social Democrats, PSD), failed to pass, so the government remains in place. After the failure of the censure motion, the mood among investors turned rather dovish regarding the prospects for future economic policies in Romania. The change in mood was fueled by some news agencies, which introduced the idea that a new cabinet could have revived the stalling reforms that the minority government was not able to implement in the last three years. Afterwards, the RON started to lose ground to the euro, hovering around the 3.3850 level on Thursday. We expect the RON to remain range-bound in the 3.36-3.41 zone next week, with risks on the upside, arising from political uncertainties and higher inflation. The consumer price index for September will be released on October 10 and is likely to push headline inflation above the upper band of the NBR's inflation target of 4.0% ±1%. We expect the monthly inflation at around 0.4%. This would push headline inflation to 5.3%, on the back of food price increases (driven by the prolonged drought), which could not be offset by the evolution of the local currency.

Central bank's firm control of liquidity brought stability to Romanian money market

Short-term interest rates were quoted slightly lower at the beginning of the week (in the 6.8/7.7% zone), as commercial banks preferred to keep liquidity at their disposal or place it on shorter terms (ON, TN) than the NBR's open market operations. Therefore, participation at the NBR's regular 2-week depo auction was quite limited. The overall offer reached RON 1.7bn, although RON 3.5bn matured the same day. Moreover, banks kept liquidity for their clients' needs, as Monday was the last day to pay local taxes. Only nine commercial banks took part in the open market operation held by the NBR at the 7.0% fixed sterilization rate. Overnight interest rates increased gradually during the week, rising to 7/8% bids/asks on Friday, as the extra liquidity on the interbank money market was restrained. Given the scarce liquidity conditions on the Romanian interbank money market, we expect the short-term tenors to be transacted at 7/8% bids/asks next week.

MinFin continued to reject bids at auctions of state securities

The Ministry of the Economy and Finance released the debt calendar for the last quarter of 2007. The MinFin plans to issue treasury bills worth RON 1.9bn and benchmark bonds worth RON 2.3bn, totaling RON 4.2bn. At the beginning of the year, the Ministry of the Economy and Finance announced its willingness to attract RON 12bn from the Romanian primary market. By now, the MinFin has attracted state securities worth RON 9.5bn; adding the sum projected for the last quarter, it will have accrued RON 13.7bn. However, this calculation collapsed shortly after the first auction in the debt calendar. On October 4, the MinFin reopened a 10-year benchmark bond auction for the indicative amount of RON 500mn. The offer of the primary dealers totaled RON 744mn, but the MinFin rejected all bids, as the participants are likely to have demanded higher yields than the ministry was willing to pay. The last 10Y benchmark bonds issued on the Romanian primary market were sold for an average yield of 6.70%.

We expect the MinFin to continue rejecting bids that exceed the actual level of the policy rate again this month, as it recorded a budgetary surplus of 0.32% of GDP in the first eight months of 2007. As the year-end and the elections for the European Parliament approach, the MinFin will start draining liquidity at higher yields, as the consolidated budget will begin to record a deficit.

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Slovakia

PM reiterated that Slovakia will meet fiscal criterion

Our assumption that Monday would bring Eurostat's verdict about the revision of fiscal data (as was indicated by the PM) turned out to be a bit premature. It emerged that Eurostat was only to have delivered its stance to the Slovak authorities, which have two weeks for possible objections and consultations (the ruling should be known on October 22, at the latest). As a reminder, Eurostat has requested that Slovakia include some items in the fiscal balance that would deepen the general government deficit, which poses a risk to Slovakia's euro adoption in 2009. To calm the fears that the country could miss the target date, PM Robert Fico reiterated that the government is ready to cut spending if necessary. He also added that, in the worst case, Slovakia's fiscal deficit would reach 2.87% of GDP in 2007 (the precision of the figure might suggest that the PM is already aware of Eurostat's final stance). After his assurances, the koruna reversed the negative trend seen earlier in the week. Still, markets, which have bet heavily on 2009 EMU entry, will probably stay wary until more positive news comes out and confidence in Slovakia's euro adoption is restored to the previous extent. Once Eurostat's ruling is known and perceived to be non-threatening to the 2009 adoption, we expect the koruna to again strengthen. Thus far, we keep our end-year forecast at 32.5 EUR/SKK (although the risks are skewed to the weaker side).

Inflation to dominate next week's data

Next week will bring the traditional beginning of the month data stream. September inflation is likely to be the most watched figure. Recently, there were suggestions by the media and the central bank that it could be negatively affected by higher prices of food (diary and possibly cereals). Hence, among other things, we will watch this impact to gauge potential inflation risks. We expect inflation at +0.2% m/m and +2.8% y/y, while the market consensus is a notch lower. CPI inflation reached 2.3% a month ago, but the acceleration is due mainly to the base effect. Foreign trade and industrial output for August are also due out, but the figures should have little impact on markets or monetary policy.

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Appendix Charts

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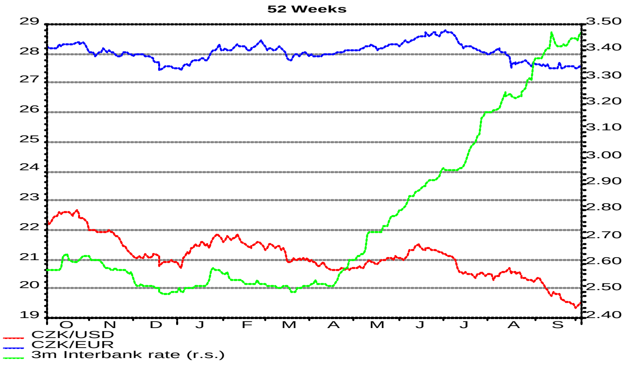
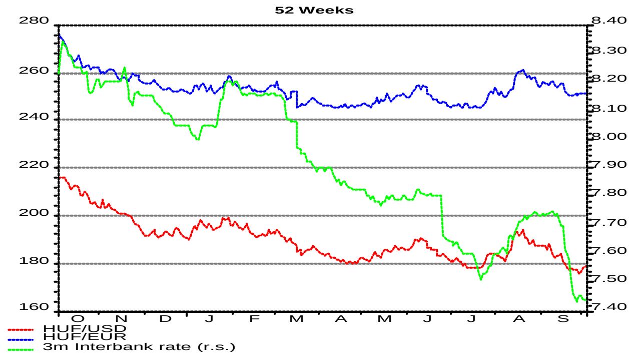
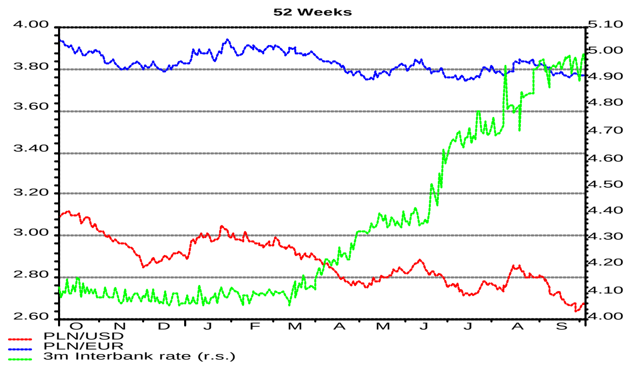
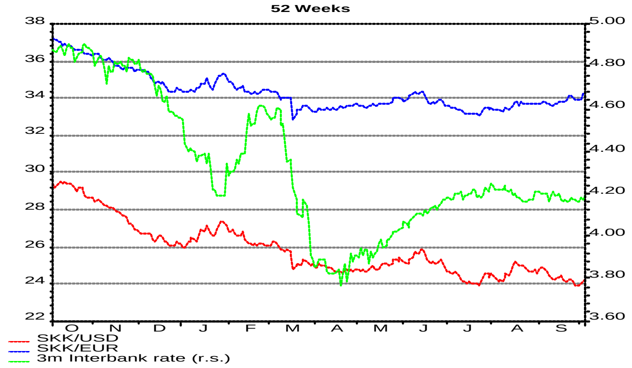
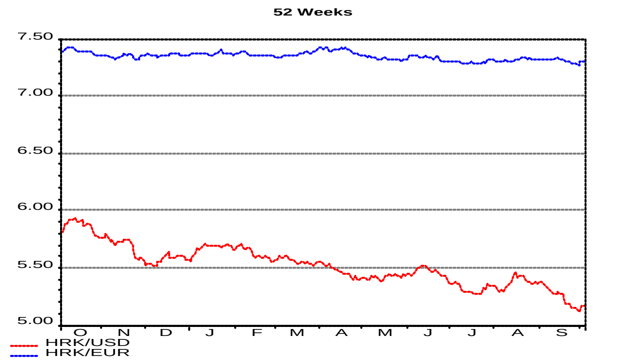
Exchange rates and interest rates (52 weeks)

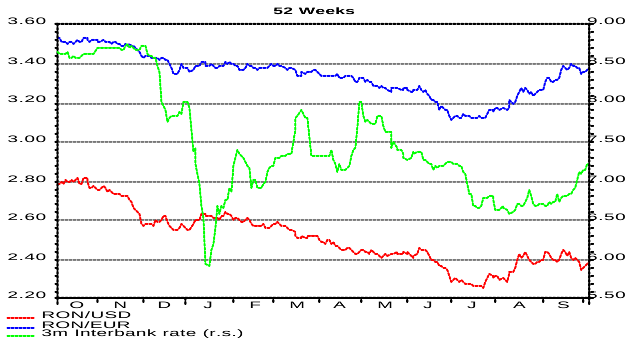








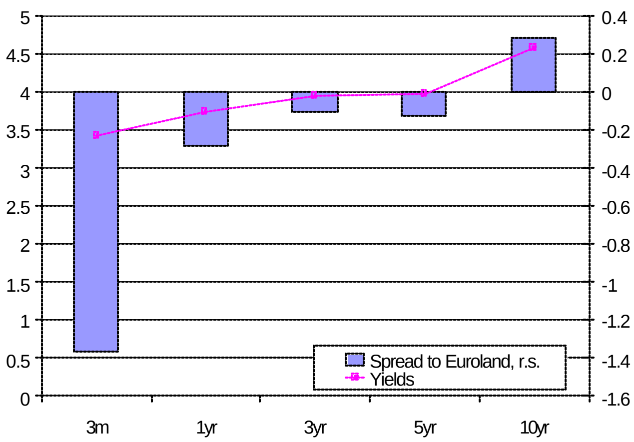




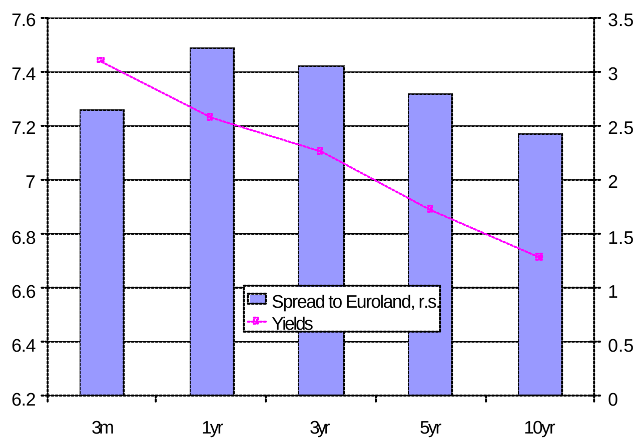
Source: Datastream

Benchmarks

Czech Republic



Hungary



Appendix Forwards

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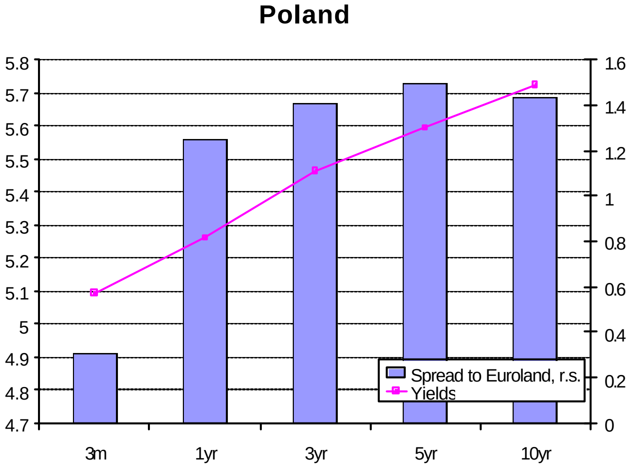

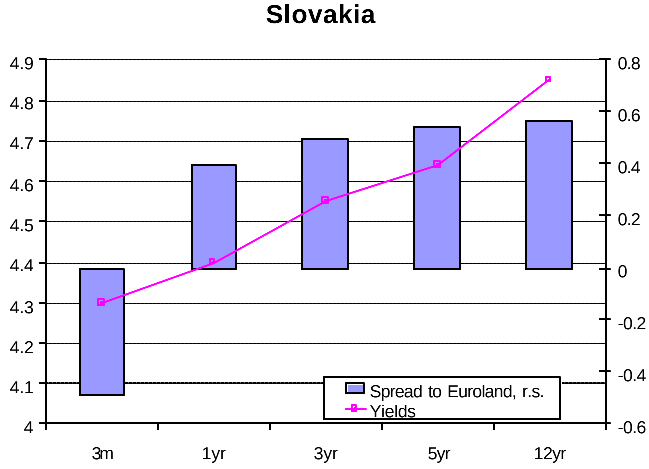

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