CEE Research

November 2, 2007

Fixed Income and Foreign Exchange

CEE Insights

- **Croatia:** Regular CNB reverse REPO auctions have become irregular
- **Czech Republic:** CZK should weaken toward year-end or beginning of 2008
- **Hungary:** Central Bank kept base rate on hold
- **Poland:** CB left key rates flat, but fresh inflation report supports case for hikes in future
- **Romania:** RON rallied to 6-week high after NBR hiked key rate
- **Slovakia:** Central bank kept rates unchanged alongside increased inflation forecasts

ERSTE BANK

Overview

http://global.treasury.erstebank.com

Croatia:

- Some comments on foreign debt
- Regular CNB reverse REPO auctions have become irregular

Czech Republic:

- CPI due next week
- CZK should weaken toward year-end or beginning of 2008

Hungary:

- Central Bank kept base rate on hold
- Calm trading on markets

Poland:

- CB left key rates flat, but fresh inflation report supports case for hikes in future
- Markets slightly correct gains from recent rally

Romania:

- RON rallied to 6-week high after NBR hiked key rate
- Short-term interest rates slightly higher, but below magnitude of key rate increase
- MinFin still rejecting bids at its debt issues

Slovakia:

- Central bank kept rates unchanged...
- ...alongside increased inflation forecasts

Rainer Singer
(Co-Head CEE FI Research)
rainer.singer@erstebank.at
Juraj Kotian
(Co-Head CEE FI Research)
juraj.kotian@erstebank.at

Thursday's close		Current	w/w	m/m	ytd	Spreads vs. Euroland current	- 1m	02/01/2007
Czech Republic	EUR/CZK	26.97	0.4%	2.2%	2.4%			
	3Y (yield bp)	3.89	1	0	68	-23	-15	-66
	10Y (yield bp)	4.52	1	-7	81	28	27	-23
Croatia	EUR/HRK	7.33	0.1%	-0.3%	0.2%			
	3Y (yield bp)	4.74	21	15	20	60	48	66
	10Y (yield bp)	5.19	2	-12	n/a	95	97	n/a
Hungary	EUR/HUF	252.04	-0.4%	-0.1%	-0.2%			
	3Y (yield bp)	6.93	7	-8	-62	281	292	368
	10Y (yield bp)	6.56	4	-7	23	232	231	276
Poland	EUR/PLN	3.65	-0.6%	3.2%	5.0%			
	3Y (yield bp)	5.57	8	11	93	146	138	78
	10Y (yield bp)	5.51	0	-7	34	128	138	124
Romania	EUR/RON	3.34	0.2%	0.6%	1.3%			
Slovakia	EUR/SKK	33.31	0.0%	2.4%	3.5%			
	3Y (yield bp)	4.53	0	1	15	46	40	50
	12Y (yield bp)	4.84	1	1	53	63	48	38

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

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	33.35	1.72%	1.6%	3.8%	32.8	3.2%	6.4%
15	short EUR/RON	23/10/07	2m Bubid/ 6m Euribor EUR/SKK	6.8/ 4.33% 3.37	3.34	0.87%	0.9%	31.7%	3.3	2.5%	15.9%

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.

15) Recently, the Romanian Leu weakened against euro suffering from the knock-on effects of investor worries about economic prospects in countries with large external imbalances. We considered EUR/RON exchange rate of 3. 37 as a good level to sell. We expect it to trade around 3.3 at the year-end 2007 because bias towards monetary tightening and gradual increase of the remittances from Romanians who work abroad.

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%

To be included in the trading ideas mailing list, please, mail to rainer.singer@erstebank.at, subject: trading ideas

Forecasts

http://global.treasury.erstebank.com

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	27.0		7.35		251		3.65		3.34		33.3		3.25	3.50	7.50	4.75	7.50	4.25
Dec-07	27.3	27.0	7.40	7.40	253	253	3.60	3.65	3.30	3.33	32.5	33.3	3.25	3.50	7.25	5.00	7.50	4.25
Mar-08	27.2	27.0	7.30	7.30	255	254	3.55	3.66	3.25	3.36	32.4	33.3	3.50	3.50	7.00	5.25	8.00	4.25
Jun-08	27.1	26.9	7.25	7.25	255	256	3.60	3.67	3.21	3.39	32.5	33.3	3.50	3.50	6.75	5.25	8.00	4.25
Sep-08	26.8	26.9	7.25	7.25	256	257	3.55	3.68	3.22	3.41	32.5	33.3	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	3.59		7.43		5.21		7.88		4.34		4.54	5.17	6.56	5.50	4.72	7.60
Dec-07	3.30	3.66	7.20	7.22	5.25	5.29	7.60	8.49	4.30	4.41	4.55	5.20	6.35	5.40	4.70	7.40
Mar-08	3.40	3.74	6.95	6.89	5.30	5.44	8.20	7.93	4.30	4.42	4.80	5.10	6.10	5.38	4.80	7.50
Jun-08	3.55	3.89	6.70	6.64	5.40	5.50	8.20	6.05	4.35	4.43	4.90	5.10	5.90	5.35	4.80	7.50
Sep-08	3.60	3.97	6.50	6.58	5.40	5.39	7.70	7.19	4.35	4.57	4.80	5.20	5.80	5.33	4.80	7.40

Long-term forecasts

GDP growth (%)	2006	2007e	2008f	2009f
Czech Republic	6.4	5.4	4.1	4.8
Croatia	4.8	5.9	4.7	4.9
Hungary	3.9	2.2	3.0	3.9
Poland	6.2	6.5	5.5	6.0
Romania	7.7	6.0	6.1	6.0
Slovakia	8.3	8.9	7.2	5.3

C/A (%GDP)	2006	2007e	2008f	2009f
Czech Republic	-3.0	-3.5	-3.7	-2.8
Croatia	-7.8	-8.1	-8.0	-8.3
Hungary	-6.5	-5.0	-4.4	-3.9
Poland	-3.2	-4.1	-4.5	-4.9
Romania	-10.3	-13.7	-14.7	-14.7
Slovakia	-7.3	-3.4	-2.4	-1.9

CPI (%), eoy	2006	2007e	2008f	2009f
Czech Republic	2.5	3.9	4.9	3.2
Croatia	2.0	4.0	3.0	3.0
Hungary	6.5	6.2	3.6	2.3
Poland	1.4	2.7	2.9	2.7
Romania	4.9	5.7	4.1	3.9
Slovakia	4.2	3.0	3.5	3.5

Budget Balance (%GDP)	2006	2007e	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	-3.4	-3.1
Romania	-1.6	-2.7	-2.7	-2.7
Slovakia	-3.4	-2.9	-2.4	-2.6

Diaries

http://global.treasury.erstebank.com

Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	Nov-08	CPI(y/y)	3.8%	3.8%
	Nov-08	Sept Industrial output	7.0%	7.0%
		Unemployment	5.9%	5.9%
Croatia	Nov-06	Retail Trade	9.8% y/y	-
	Nov-07	PPI	4.9% y/y	-
Hungary	Nov-07	October Budget balance	HUF-28bn	-
	Nov-08	Sept Industrial output	9.2% y/y	-
	Nov-09	Sept Trade balance	EUR -80mn	-
Poland	No important data releases scheduled			
Romania	Nov-09	Sept Trade balance	EUR -1.68mn	-
Slovakia	Nov-08	Sept Industrial output	12.8% y/y	-
	Nov-09	Sept Trade balance	SKK -1.7bn	SKK -2.8bn

**Sources: Bloomberg, Reuters*

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		Nov-7	Nov-12	2017-Apr-11	4.00%	CZK 7 bn	
Hungary		Nov-06	Nov-14	2008-Feb-13	-	HUF 30bn	7.25%
		Nov-08	Nov-14	2010-Aug-24	6.25%	HUF 75bn	6.90%
Poland		Nov-5	Nov-7	2008-Nov-05	-	PLN 1bn	
		Nov-7	Nov-9	2009-Jul-25	0.00%	PLN 1.5-2.0bn	
Romania		Nov-7	Nov-9	1Y	-	RON 5.1bn	7.50%
Slovakia		No auction scheduled					

Major Markets

http://global.treasury.erstebank.com

Major markets

ECB Council to leave interest rates unchanged

Fundamental data for euro government bonds remained mixed over the week, with lower than expected readings in the sentiment indicators and higher than expected inflation figures. Next week's ECB Council meeting and press conference will have to deal with rising inflation expectations on one side and a still unsettled money market and a new high in the EUR/USD rate on the other side. We expect Mr. Trichet to stress the upside risks to inflation more vehemently in the press conference and paint a generally positive picture regarding growth. However, the still high money market rates and EUR/USD point to a further deferral of the envisaged hike to the first quarter. Releases of economic indicators next week include factory orders and the trade balance for Germany, as well as the service PMIs for Euroland. We expect factory orders to show a small gain compared to September and the service PMIs to recover after the plunge in September. The market seems to offer little value at current levels. With the outlook on a further rate hike next year and rising inflation rates, higher long- and short-term yields should be expected.

US labor market data and Bernanke testimony

This eventful week will come to a close with today's labor market report. After the wording of the recent FOMC press release, non-farm payrolls would have to be considerably below the market consensus to spark additional interest rate cut speculation. The central bank cut the key rate to 4.5% on Wednesday, but the assessment of balanced risks points at least to a pause in the cutting cycle. Fed Chairman Bernanke will have the opportunity to lay out his assessment of the economy in more detail before the economic committee of the US Congress on Thursday, which will be the most important event of next week. Bernanke's comments will of course include a warning about the negative impact from the housing market, but he should also mention inflationary risks. How the exact wording will be is of course anybody's guess, but the recent FOMC statement has given a guideline that he cannot deviate from too strongly. So, we think that Thursday's testimony should not give the market any strong impetus. Assuming that today's labor market data is not a complete disappointment, we see potential for a correction on the bond market, as the recent gains were only due to the stock market plunge. The EUR/USD, on the other hand, has so far hardly reacted to the decreased likelihood of an interest rate cut in December. Thus, the EUR/USD looks vulnerable to a downward movement.

Veronika Lammer, veronika.lammer@erstebank.at
Rainer Singer, rainer.singer@erstebank.at

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	4.60		4.88		4.20	4.35	1.448	
Dec-07	4.25	4.83	4.35	4.65	4.60	4.87	4.40	4.60	1.40	1.449
Mar-08	4.25	4.64	4.30	4.52	4.30	4.39	4.70	4.60	1.36	1.449
Jun-08	4.25	4.49	4.30	4.47	4.30	4.22	4.70	4.70	1.33	1.449
Sep-08	4.25	4.34	4.30	4.30	4.20	4.21	4.70	4.70	1.33	1.449

Croatia

Some comments on foreign debt

A recent IMF working paper addressing regional external imbalances drew significant public attention to the question of foreign debt, rising external imbalances and related risks. Debates on such issues are more than welcome, as the accumulation of foreign debt over the last decade was strong and the present level of foreign debt calls for caution. Hence, we will go into a little greater detail and try to give a more comprehensive outlook on Croatia's external position. The high level of foreign debt and high C/A deficits are more or less well known characteristics of the Croatian economy. Has the situation been worsening recently? In fact, it has not, as foreign indebtedness indicators are expected to stabilize in the range of 85-90% of GDP in the coming years, while foreign debt in relation to total exports should stabilize in the 170-180% range. Also, monetary measures aimed at curbing foreign debt and credit growth (the oft-mentioned marginal reserve requirement and limits on credit growth) are finally producing the desired results, as banks have accelerated their repayment of foreign debt and were forced to slow down credit growth, which should eventually lead to the convergence of y/y rates towards 12%. Thus, the corporate sector remains the dominant foreign debt growth driver and there is little the monetary authority can do about it. The factors that are changing are the global risk appetite and the fact that, due to recent turbulence on the global financial scene, emerging market economies (including Croatia) are likely to see their borrowing become more expensive. While this will undoubtedly negatively influence foreign debt servicing and burden growth potential, it is not so easy to argue that Croatia will fail to fulfill its debt obligations. First of all, the structure of foreign debt is roughly positive, meaning that the proportion of short-term foreign debt is close to 15% of total debt and roughly 75% of it is banking sector debt, which, given the banks' ownership structure, does not imply significant refinancing risks. On the other hand, only 10% of corporate sector debt is short-term. Also, foreign exchange reserves are adequately high, as we saw earlier. Therefore, from the current point of view, the strong skepticism and worrisome headlines seem somewhat exaggerated. A continuation of tight monetary policy and further fiscal consolidation should be pursued to alleviate existing pressures and improve the external position.

Regular CNB reverse REPO auctions have become irregular

The money market again attracted interest in the last two weeks, as the CNB decided not to hold a reverse REPO auction on the last two Wednesdays, thereby removing liquidity worth roughly HRK 3.5bn from the system and increasing uncertainties. As expected, MM rates again went up, thus prolonging the turbulent period for the domestic MM. In the absence of communication from the CNB, we only can guess that, at this moment, the CNB sees MM rates at present levels (close to 10%) as acceptable. Hence, the current outlook remains dim and subject to the influence of CNB moves. MM rates should gradually decline, although remaining at higher levels than they were prior to the summer months. Exchange rate developments offered little movement, as the exchange rate remained stable at around 7.35. We see it gradually depreciating towards 7.40 at the year-end.

Alen Kovac, akovac2@erstebank.com

Czech Republic

CPI due next week

Last week saw no macro data releases in the Czech Republic. As for next week, there is going to be a host of data releases, the most important of which will be CPI. CPI should quicken considerably on a y/y basis (to 3.8%, from 2.8% a month earlier), due largely to the base effects from last year (when the lower food prices kept the price level low) and higher oil prices. The monthly pickup in inflation is expected to be much more benign at 0.2%. The only risk from the jump in the y/y headline inflation that we see is that it might present the CNB (even though it is aware of this being in the pipeline) with a good opportunity to hike the rates this year (we still forecast this for January). This is especially the case, considering next year's headline likely rising to 5% and the potential for the koruna to weaken to around 27.30 and thus be in line with the assumptions of the CNB's latest prognosis. More importantly, the CNB also sees the pickup in the monetary policy-relevant inflation to around 2.7% y/y, which, if it does not materialize, would be another anti-inflationary factor for the CNB's relatively moderate prognosis.

As for other data, unemployment should fall to 5.9%, giving further evidence of the economy draining its reservoir of available workforce. Industrial production will remain healthy at 7%. This data will not have any impact on markets.

CZK should weaken toward year-end or beginning of 2008

The koruna is trading at around 27.00. We see it as being driven mainly by the global sentiment in general and the dollar in particular. We expect a slight weakening towards the end of the year or the beginning of next year. The seasonality effect around the end of the year that we saw in 2000-05 (with the CZK normally strengthening at the end of the year) has probably shifted earlier. With the situation expected to calm down in the US, the dislike for the dollar should cease and should help (in the coming months) direct money away from the CZK until fundamentals again prevail.

Martin Lobotka, mlobotka@csas.cz

Hungary

Central Bank kept base rate on hold

On Monday, the Monetary Council kept the base rate on hold (7.50%). Regarding the outcome of the meeting, opinions on the market had been extremely divided between keeping the base rate on hold and a 25bp rate reduction. This split also appeared in the Council; Governor Simor said at the press conference that, after long debates, the voting had been very tight. However, the "hold" outcome of the October meeting basically reflects the Council's cautious stance: "The current macroeconomic and money market environment can make a base rate cut possible. However, due to inflationary risks and uncertainties around the global market environment, the Monetary Council will remain cautious in its interest rate policy." There were some arguments, however, in the Council's statement that suggested that they had only postponed the rate reduction. These arguments are as follows. (1) Hungary is likely to be able to meet the 3% inflation goal by 2009, in which the negative output gap would also play a role. (2). Volatile and noisy y/y wage figures can be expected for the remainder of the year. However, excluding the effects of regulatory changes and bonus payments, there has been a gradual slowdown in wage dynamics. (3) Apart from (processed) food prices, other items of the core inflation do not indicate strong price pressure. To summarize these points, my view is that the tone of the statement was rather dovish, especially in light of the "hold" outcome of the meeting.

As for future rate prospects, the Quarterly Report on Inflation (with the new macro prognosis) is due in November, which should provide more detailed information for the Council. If the Inflation Report outlines a positive mid-term inflation outlook, I see room for a November rate reduction. However, based on the overall cautious stance of the Council, I have revised my year-end base rate forecast upwards to 7.25%.

Calm trading on markets

This week, the forint remained in a tight range. The effect of the Monday rate decision proved to be neutral, while the regional FX tendencies have been less decisive than usual. Some macro figures will be published next week, but they are of lower importance. Tendencies on global markets (especially related to sub-prime), as well as the rate outlook on major markets, could remain important drivers. Should markets remain calm in the coming weeks, the forint could also remain stable. In addition, the cautious stance of the Monetary Council, which suggested that the monetary easing cycle will likely drag on for a longer period, should also provide some support for the local currency.

Orsolya.Nyeste, orsolya.nyeste@erstebank.hu

Poland

CB left key rates flat, but fresh inflation report supports case for hikes in future

Poland's central bankers opted to leave the rate setting unaltered at its meeting in October. They thus confirmed our expectation that the central bank would decide to stretch the pause between the hikes (the rhythm of hiking had equaled two months so far this year). Such an outcome was in line with the majority market opinion, although a couple of analysts predicted a rate rise. The central bank's research team finished its work on the new inflation prognosis, which is done under the assumption of constant interest rates. The inflation trajectory until the middle of next year has been pushed downwards in comparison to the July version. However, we suspect that it does not contain data released over the course of October (this is a usual practice) and hence does not take into account the last inflation reading, which was visibly higher than expected. The second part of the inflation trajectory (since the middle of 2008 onwards) was, on the contrary, nudged upwards. In 2009, the central trajectory even overshoots not only the inflation target (2.5%), but also the upper end of the tolerance band (3.5%). We read this as a strong signal that further rate hikes are in the pipeline. The accompanying statement retains its hawkish tone. The MPC thinks that the economy will most likely continue to gallop above its potential in the coming quarters. The statement mentions deterioration in the relationship between wages and productivity and its potential adverse impact on the price development. For the first time, the global rising trend of food prices is also mentioned. The statement also mentions the need for further data to analyze the inflation risks more properly. We think this was the main reason why the monetary policy was not tightened already in October. The MPC is probably waiting primarily for the quarterly statistics of aggregate wages in the whole economy (monthly releases only include the corporate sector), which will be at hand in November. They will confirm the growth of ULC, in our view, and hence support the case for a rate hike in November (+25bp). Moreover, inflation figures will show that annual price growth keeps accelerating. We doubt that the hiking cycle will end this year, although the zloty rally should decrease the scale of hikes necessary in 2008 (to only one move, to 5.25% from 5.50%, which was our previous baseline).

Markets slightly correct gains from recent rally

Polish bonds and the PLN slightly corrected their earlier gains (made during the post-election rally). After nearing the 3.60 EUR/PLN threshold, the zloty bounced back and peeped above 3.65 in the second part of the week. The general sentiment on Polish assets remains positive - the markets appreciate the positive outcome of the elections and the prospects for a more fiscally responsible and euro-friendly government. This week's retreat of the zloty could be ascribed to a coincidence of several factors. The recent rally has been relatively deep and we already warned last week that the zloty is ripe for a correction from the technical viewpoint. Moreover, Thursday was a public holiday and many traders might have opted for an extended weekend, which limits the liquidity. Fundamentally, jitters on global markets in the second half of the week and the rise in risk aversion were the trigger for the move north.

Next week will not feature any important macro data and global sentiment will be the most important factor shaping Polish market developments. Parliament starts its session on Monday. Prime Minister Kaczynski is expected to step down and we might hear about a concrete lineup for the new cabinet. PO officials said that the most certain nomination is for the post of finance minister, which should be taken by Jacek Rostowski. We think that he would be warmly welcomed by the markets, thanks to his solid economic background. Moreover, Rostowski is a big and clear fan of the euro.

Maria Hermanová (Fehérová), mhermanova@csas.cz

Romania

RON rallied to 6-week high after NBR hiked key rate

The domestic currency started the week flat compared to Friday, as off-shore players refrained from taking positions ahead of the monetary policy meeting of the central bank. The RON thus stabilized in the 3.34 zone in the first part of the week, amid modest transacted volumes, based mainly on commercial purposes. However, starting Wednesday, some venture funds began to open new RON positions, pricing in a hike of the key rate and pushing the exchange rate down to the 3.33 zone ahead of the outcome of the monetary policy meeting. As we expected, the NBR decided to raise the monetary policy rate by 50 basis points to 7.50%, due to the rebound of the inflationary pressures in 3Q. Immediately after the rate hike announcement, several big off-shore players stepped into the market, placing substantial euro sell orders, which pushed the RON to the 3.31 zone within a couple of minutes. The next day, the RON hit a 6-week high against the euro, testing the 3.30 threshold. However, 3.30 proved a strong support zone, as the RON could not keep the gains and reversed its upside move. The central bank governor's comments at an economic seminar on Thursday made a substantial contribution to this reversal, as the governor warned the financial markets about the risks of an unsustainable appreciation of the local currency to the economy. The governor admitted that the central bank has limited instruments to ensure the stability of the Romanian economy, as it has exhausted almost all monetary levers already and has asked for the support of the government in maintaining fiscal tightening. Therefore, financial investors switched their attention to economic fundamentals and some off-shore players decided to cash in their profits, pushing the EUR/RON back to the 3.34 zone. We believe that the RON will remain range-bound in the 3.30-3.35 zone, depending mainly on the NBR's open market operation on Monday and the MinFin's auction due on Wednesday.

Short-term interest rates slightly higher, but below magnitude of key rate increase

Short tender interest rates recovered at the beginning of the week alongside the key rate, quoted for 7.1/7.7% bids/asks on the interbank market, as a new reserve period started. At its last monetary policy meeting for 2007, the central bank exceeded the market expectations and raised the key rate by 50bps (consensus: +25bps). However, the NBR changed the wording compared to its last monetary policy statement and committed itself to pursuing "prudent" (instead of "firm") control of market liquidity. This could indicate that the NBR might resort to variable rate deposit auctions or partial sterilization operations. "Prudent management" might signal less tightness than earlier, when the NBR resorted to complete sterilization at the level of the key rate. Therefore, we think that the effective sterilization rate will increase only slightly, probably by 20-25bps, but will stay below the present monetary policy rate of 7.50%. We expect short-term interbank interest rates to remain around 7.3/7.8%, with risks on the upside, if the NBR pursues firm control of the money market via its open market operations.

MinFin still rejecting bids at its debt issues

The Ministry of the Economy and Finance continues to refuse all bids at its debt auctions and did just that on November 1. The MinFin held an auction to sell benchmark bonds at 3-year maturity for an indicative amount of RON 300mn. The primary dealers had a modest offer of RON 434mn. The limited interest shown for the last state securities auctions reveals investors' unwillingness to place their liquidities for yields below 7.0%, the more so as inflation has sparked of late, reaching 6.0% in September (while the NBR has raised the monetary policy rate to 7.50%). We believe that the MinFin will begin to attract liquidity from the domestic market starting in November, as it will need money to finance the increased expenditures specific for the year-end.

Melania Hancila melania.hancila@bcr.ro

Slovakia

Central bank kept rates unchanged...

The central bank has left interest rates unchanged, meeting market expectations (the 2W repo rate remains at 4.25%). No proposal to change the rates was made. The koruna's appreciation is still tightening monetary conditions, offsetting the slightly higher than expected September inflation. The NBS is likely to maintain its cautious approach and leave interest rates unchanged until at least the second quarter of 2008, with the further outlook dependent on the ECB. A hike by the ECB would mean stable Slovak rates; if there are no further changes of policy interest rates in the Eurozone, we expect the NBS to deliver a 25bp cut, most likely in 2Q08.

...alongside increased inflation forecasts

In the new medium-term prognosis, the central bank upped its inflation forecasts. For end-2007, it increased the HICP inflation estimate from 1.5% to 1.6% y/y, due to food prices. Forecasts for 2008 and 2009 were revised up more significantly. The NBS sees harmonized inflation at 2.3% at end-2008 (up from 2.0%) and at 2.8% at end-2009 (up from 2.5%). Annual averages for 2008 and 2009 were raised to 2.3% and 2.7%, respectively. The revisions incorporate expectations of higher prices of food, fuels and cigarettes (the latter due to an excise tax hike). However, meeting of the Maastricht inflation criterion is not endangered (we expect average 12M inflation at 1.7-1.8%, below the inflation criterion estimated within 2.5-2.9%). The central bank did not change its view on GDP growth (8.9% and 7.5% for 2007 and 2008, respectively, close to our expectations).

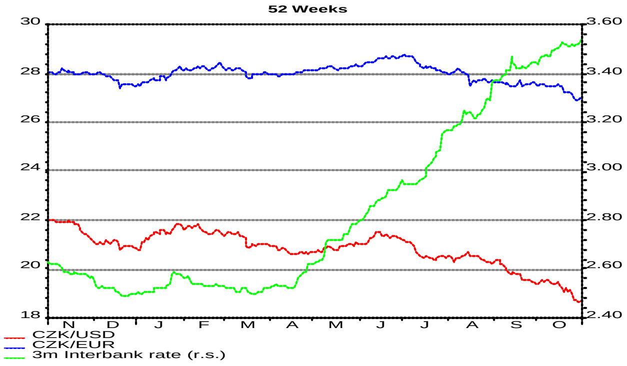
The new prognosis does not significantly affect the interest rate outlook, as the factors leading to the revision were more cost-related than demand-driven. Demand inflation pressures seem muted so far, with wage growth still significantly lagging behind productivity growth. Wage growth remains a risk factor for the NBS prognosis.

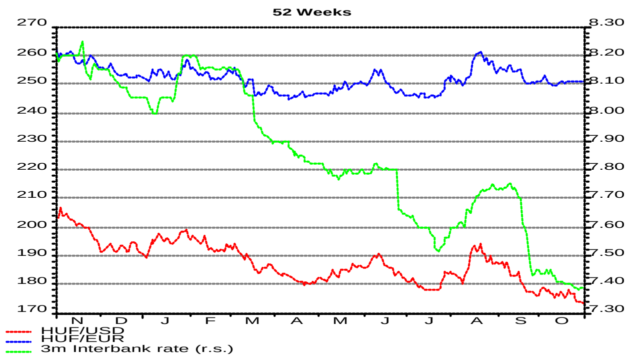
Michal Mušák, musak.michal@slsp.sk
Mária Valachyová, valachyova.maria@slsp.sk

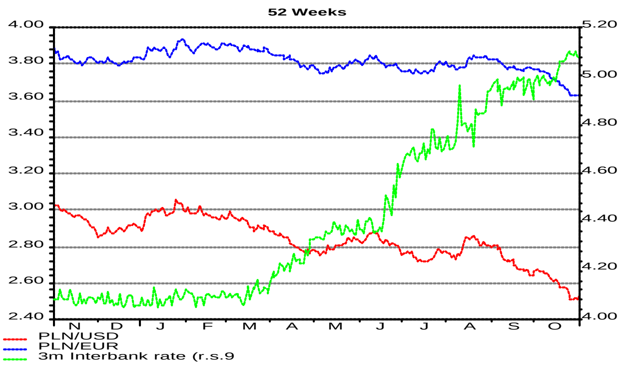
Appendix Charts

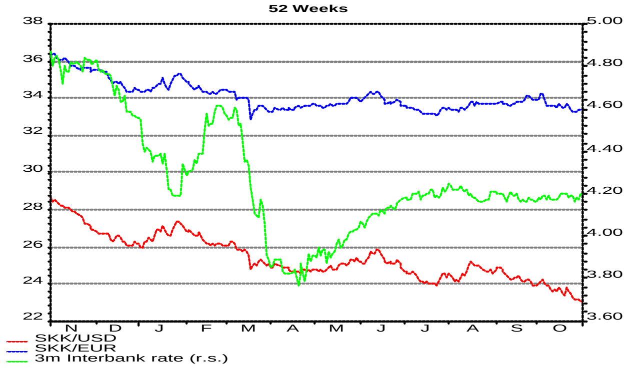
http://global.treasury.erstebank.com

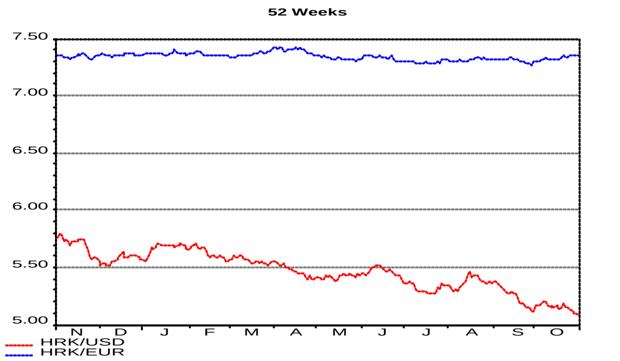
Exchange rates and interest rates (52 weeks)

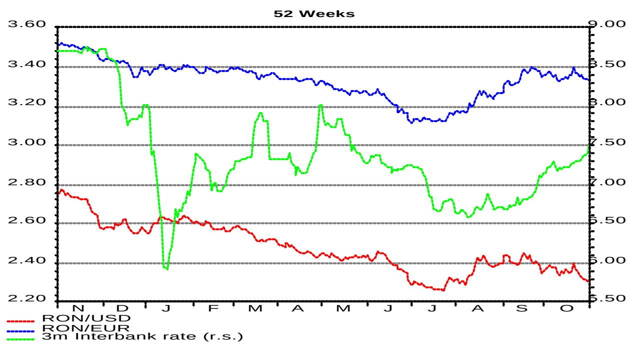








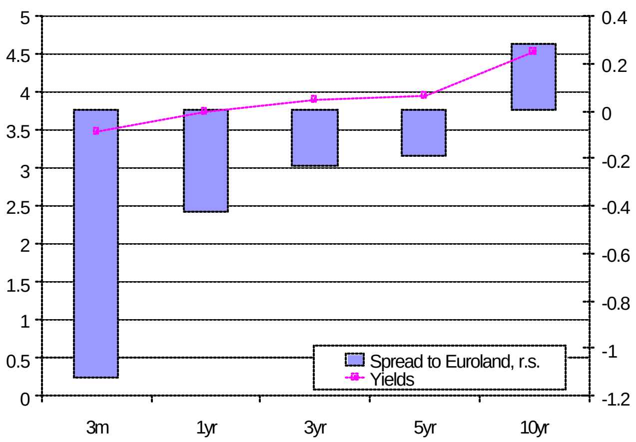




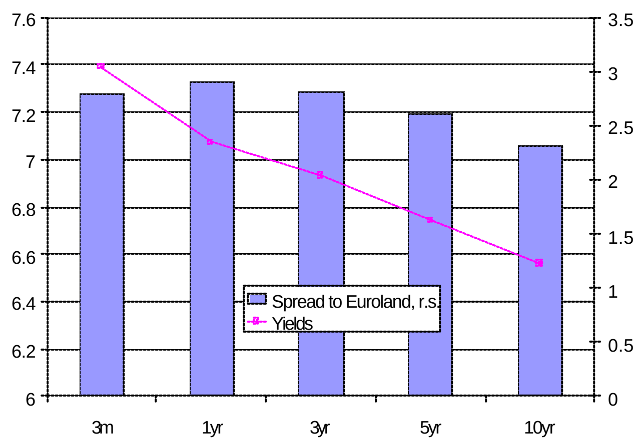
Source: Datastream

Benchmarks

Czech Republic

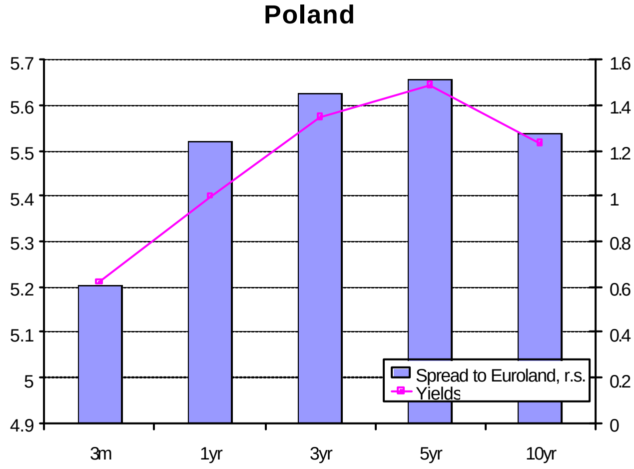


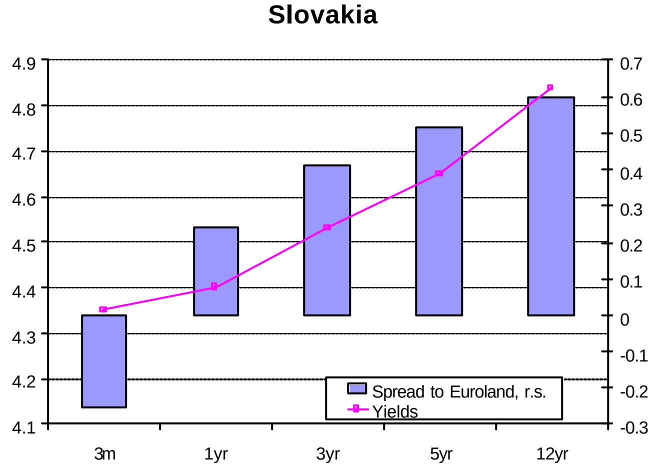
Hungary



Appendix Forwards

http://global.treasury.erstebank.com





Published by Erste Bank der oesterreichischen Sparkassen AG Börsegasse 14, OE 543 A-1010 Vienna, Austria. Tel. +43 (0)50100-ext.

Erste Bank Homepage: www.erstebank.at On Bloomberg please type: ERBK <GO>.

Contacts

http://global.treasury.erstebank.com

Group Research

Head of Group Research	
Friedrich Mostböck, CEFA	+43 (0)50 100-11902
CEE Equity Research	
Co-Head: Günther Artner, CFA	+43 (0)50 100-11523
Co-Head: Henning Eßkuchen	+43 (0)50 100-19634
Günter Hohberger *(Banks)*	+43 (0)50 100-17354
Franz Hörl, CFA *(Steel, Construction)*	+43 (0)50 100-18506
Gernot Jany *(Banks, Real Estate)*	+43 (0)50 100-11903
Daniel Lion *(IT)*	+43 (0)50 100-17420
Martina Valenta, MBA *(Transp., Paper)*	+43 (0)50 100-11913
Christoph Schultes *(Insurance, Utilities)*	+43 (0)50 100-16314
Vera Sutedja, CFA *(Telecom)*	+43 (0)50 100-11905
Vladimira Urbankova *(Pharma)*	+4202 24 995 940
Gerald Walek, CFA *(Machinery)*	+43 (0)50 100-16360
International Equities	
Hans Engel *(Market strategist)*	+43 (0)50 100-19835
Ronald Stöferle *(Asia)*	+43 (0)50 100-11723
Jürgen Rene Ulamec, CEFA *(Europe)*	+43 (0)50 100-16574
Macro/Fixed Income Research	
Head: Veronika Lammer *(Euroland,SW)*	+43 (0)50 100-11909
Alihan Karadagoglu *(Corporates)*	+43 (0)50 100-19633
Rainer Singer *(US, Japan)*	+43 (0)50 100-11185
Elena Statelov, CIIA *(Corporates)*	+43 (0)50 100-19641
Macro/Fixed Income Research CEE	
Co-Head CEE: Juraj Kotian *(Macro/FI)*	+43 (0)50 100-17357
Co-Head CEE: Rainer Singer *(Macro/FI)*	+43 (0)50 100-11185
Editor Research CEE	
Brett Aarons	+420 224 995 904
Research, Croatia/Serbia	
Head:Mladen Dodig	+381 11 22 00 866
Damir Cukman *(Equity)*	+385 62 37 28 12
Alen Kovac *(Fixed income)*	+385 62 37 13 83
Davor Spoljar *(Equity)*	+385 (62) 372 825
Research, Czech Republic	
Head: Viktor Kotlan *(Fixed income)*	+420 224 995-217
Petr Bartek *(Equity)*	+420 224 995 227
Maria Feherova *(Fixed income)*	+420 224 995 232
Jan Hajek, CFA *(Equity)*	+420 224 995 324
Radim Kramule *(Equity)*	+420 224 995 213
Martin Lobotka *(Fixed income)*	+420 224 995 192
Lubos Mokras *(Fixed income)*	+420 224 995 456
David Navratil *(Fixed income)*	+420 224 995 439
Jakub Zidon *(Equity)*	+420 224 995 340
Research, Hungary	
Head: József Miró *(Equity)*	+361 235-5131
György Zalányi *(Equity)*	+361-235-5135
Orsolya Nyeste *(Fixed income)*	+361 373-2830
Research, Poland	
Head: Artur Iwanski *(Equity)*	+48 22 3306253
Magda Jagodzinska *(Equity)*	+48 22 3306250
Marcelina Hawryluk *(Equity)*	+48 22 3306255
Tomasz Kasowicz *(Equity)*	+48 22 3306251
Piotr Lopaciuk *(Equity)*	+48 22 3306252
Marek Czachor *(Equity)*	+48 22 3306254
Research, Romania	
Head: Lucian Claudiu Anghel	+4021 312 6773
Mihai Caruntu *(Equity)*	+4021 311 27 54
Dumitru Dulgheru *(Fixed income)*	+4021 312 6773 1028
Cristian Mladin *(Fixed income)*	+4021 312 6773 1028
Loredana Oancea *(Equity)*	+4021 311 27 54
Research, Slovakia	
Head: Juraj Barta *(Fixed income)*	+421 2 59 57 4166
Michal Musak *(Fixed income)*	+421 2 59 57 4512
Maria Valachyova *(Fixed income)*	+421 2 59 57 4185

Institutional Sales

Head of Sales Equities & Derivatives	
Michal Rizek	+4420 7623-4154
Brigitte Zeitlberger-Schmid	+43 (0)50 100-83123
Equity Sales Vienna XETRA & CEE	
Hind Al Jassani	+43 (0)50 100-83111
Werner Fuerst	+43 (0)50 100-83114
Josef Kerekes	+43 (0)50 100-83125
Ana Milatovic	+43 (0)50 100-83131
Stefan Raidl	+43 (0)50 100-83113
Simone Rentschler	+43 (0)50 100-83124
Sales Derivatives	
Christian Luig	+43 (0)50 100-83181
Manuel Kessler	+43 (0)50 100-83182
Sabine Kircher	+43 (0)50 100-83161
Christian Klikovich	+43 (0)50 100-83162
Armin Pfingstl	+43 (0)50 100-83171
Roman Rafeiner	+43 (0)50 100-83172
Equity Sales, London	
Dieter Benesch	+4420 7623-4154
Tatyana Dachyshyn	+4420 7623 4154
Jarek Dudko, CFA	+4420 7623 4154
Federica Gessi-Castelli	+4420 7623-4154
Declan Wooloughan	+4420 7623-4154
Sales, Croatia	
Zeljka Kajkut *(Equity)*	+385 62 37 28 11
Damir Eror *(Equity)*	+385 62 37 28 13
Sales, Czech Republic	
Michal Brezna *(Equity)*	+420 224 995-523
Ondrej Cech *(Fixed income)*	+420 224 995-577
Michal Rizek	+420 2 2499 5537
Jiri Smehlik *(Equity)*	+420 224 995-510
Pavel Zdichynec *(Fixed income)*	+420 224 995-590
Sales, Hungary	
Róbert Barlai *(Fixed income)*	+361 235-5844
Gregor Glatzer *(Equity)*	+361 235-5144
Krisztián Kandik *(Equity)*	+361 235-5140
Zoltán Szabó *(Fixed income)*	+361 235-5144
Sales, Poland	
Head: Andrzej Tabor	+4822 330 62 03
Pawel Czuprynski *(Equity)*	+4822 330 62 12
Lukasz Mitan *(Equity)*	+4822 330 62 13
Jacek Krysinski *(Equity)*	+4822 330 62 18
Sales, Slovakia	
Head: Dusan Svitek	+421 2 5050-5620
Rado Stopiak *(Derivatives)*	+421 2 5050-5601
Andrea Slesarova *(Client sales)*	+421 2 5050-5629

Treasury - Erste Bank Vienna

Sales Retail & Sparkassen	
Head: Manfred Neuwirth	+43 (0)50100-84250
Equity Retail Sales	
Head: Kurt Gerhold	+43 (0)50100-84232
Domestic Sales Fixed Income	
Head: Thomas Schaufler	+43 (0)50100-84225
Treasury Domestic Sales	
Head: Gottfried Huscava	+43 (0)50100-84130
Corporate Desk	
Head: Leopold Sokolicek	+43 (0)50100-84601
Alexandra Blach	+43 (0)50100-84141
Roman Friesacher	+43 (0)50100-84143
Helmut Kirchner	+43 (0)50100-84144
Christian Skopek	+43 (0)50100-84146
Fixed Income Institutional Desk	
Head: Thomas Almen	+43 (0)50100-84323
Martina Fux	+43 (0)50100-84113
Michael Konczer	+43 (0)50100-84121
Ingo Lusch	+43 (0)50100-84111
Ulrich Inhofner	+43 (0)50100-84324
Karin Rauscher	+43 (0)50100-84112
Michael Schmotz	+43 (0)50100-84114