CEE Research

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Fixed Income and Foreign Exchange

CEE Insights

- **Czech Republic:** Room for one more preventative hike
- **Hungary:** No rate change expected on Monday
- **Poland:** Inflation bouncing further from CB tolerance band
- **Romania:** Central bankers consider RON depreciation an overshoot
- **Slovakia:** PM Fico does not expect further ERM-2 central parity revaluation

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Overview

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Czech Republic:

- At zenith of industrial expansion in Czech Republic?
- Room for one more preventative hike

Hungary:

- CPI inflation stood at 7.4% y/y in December 2007
- No rate change expected on Monday

Poland:

- Inflation bouncing further from CB tolerance band
- Wages grew notably more slowly than expected in December
- Expectation of January hike still firmly in place
- Zloty corrects on back of higher investor risk aversion

Romania:

- General consolidated state budget deficit around 2.7% of GDP in 2007
- Central bankers consider RON depreciation an overshoot
- Central bank drained all excess liquidity in money market
- Romania rejected all bids at reopening of 10-year bonds

Slovakia:

- PM Fico does not expect further ERM-2 central parity revaluation
- CB vice governor: Enough arguments to prove sustainability
- Negative sentiment weakened koruna
- Debt agency: Eurobonds likely to be delayed

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	02/01/2008
Czech Republic	EUR/CZK	26.16	-0.9%	-0.1%	1.5%			
	3Y (yield bp)	4.16	-1	0	-16	56	31	41
	10Y (yield bp)	4.59	-1	-20	-15	62	50	53
Croatia	EUR/HRK	7.34	0.1%	-0.5%	-0.5%			
	3Y (yield bp)	5.34	4	5	3	186	121	140
	10Y (yield bp)	5.58	4	17	5	168	110	135
Hungary	EUR/HUF	255.43	-0.8%	-0.4%	-0.9%			
	3Y (yield bp)	7.39	1	-11	-16	379	347	365
	10Y (yield bp)	7.04	5	3	-7	307	273	290
Poland	EUR/PLN	3.61	-0.7%	0.2%	-0.2%			
	3Y (yield bp)	5.94	-7	-23	-25	234	214	229
	10Y (yield bp)	5.84	0	3	-13	186	167	176
Romania	EUR/RON	3.68	-0.5%	-3.8%	-2.7%			
Slovakia	EUR/SKK	33.68	-1.1%	-0.2%	-0.3%			
	3Y (yield bp)	4.42	-9	-21	-17	81	61	52
	11Y (yield bp)	4.64	-8	-15	-18	68	50	48

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. (%)
	long HUGB 3Y		3Y HUGB 6,25	97.42	97.16	0.48%			98.95		
17	CZK 6M	05/12/2007	6M Pribor	4.04			1.83%	0.2%	4	5.1%	10.10%
	CZK/HUF			9.63	9.80	0.02			9.41		
	Euribor/ROBID	31/12/07	Euribor/ROBID	4.49 / 7.56	-	-2.84%	-2.70%	-53.9%	3.53	2.50%	15.80%
18	short EURRON		EURRON	3.60	3.71						

Rationale at inception

17) Due to the jitters around the sub-prime crisis, sentiment on international markets turned for the worse and risk premiums increased. As Hungary's exposure to changes in global risk appetite is still seen as high, the forint weakened, while long-term bond yields jumped significantly in November, based on the increase in global risk premiums. We think that Hungarian government bonds have become attractive at their current level. Thus, there is potential for bond investors to cautiously enter the market (even at the auction scheduled for today). The target for six months is 6.75% HUF GB 3Y.

18) We consider that a EUR/RON exchange rate of 3.6 is a good level to sell. We expect RON to trade around 3.53 in two months time and therefore we recommend closing the position by the end of February. We see RON appreciating slightly as compared to the level reported as the central bank is likely to tighten monetary policy in an attempt to mitigate pressures on inflation. So, the interest rate differential will widen, not only for the RON but also for some other regional currencies, stirring up the sentiment for the whole region.

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%
15	Short EUR/RON	23/10/2007	21/11/2007	-4.9%
12	Short EUR/SKK	04/06/2007	04/12/2007	1.6%
16	long USD/CZK	29/11/2007	14/01/2008	-3.10%

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Forecasts

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	26.2		7.34		257		3.62		3.69		33.7		3.50	3.50	7.50	5.00	8.00	4.25
Mar-08	27.0	26.2	7.30	7.30	255	258	3.55	3.62	3.62	3.72	32.6	33.7	3.75	3.50	7.50	5.50	8.50	4.25
Jun-08	27.1	26.2	7.20	7.20	255	260	3.60	3.64	3.56	3.76	32.5	33.7	3.75	3.50	7.25	5.75	8.50	4.00
Sep-08	26.5	26.1	7.25	7.25	256	262	3.55	3.65	3.55	3.80	32.5	33.7	3.75	3.50	7.00	5.75	8.50	4.00
Dec-08	26.4	26.2	7.30	7.30	256	264	3.51	3.67	3.47	3.84	32.5	33.7	3.75	3.50	6.75	5.75	8.00	4.00

	3m Money Market Rate										10y Govt. Yield					5y Govt. Yield
	CZ	Forward	HU	Forward	PL	Forward	RO	Forward	SK	Forward	CZ	HR	HU	PL	SK	RO
Spot	3.97		7.50		5.65		8.76		4.35		4.59	5.58	7.05	5.83	4.64	8.30
Mar-08	3.95	4.20	7.45	7.45	5.70	5.94	8.70	8.55	4.30	4.30	4.71	5.30	6.70	5.88	4.70	8.30
Jun-08	3.97	4.13	7.20	7.31	5.95	6.05	8.70	8.37	4.15	4.26	4.65	5.20	6.50	5.85	4.80	8.50
Sep-08	4.10	4.12	6.90	7.16	5.95	6.05	8.70	6.41	4.15	4.21	4.65	5.20	6.30	5.82	4.80	8.30
Dec-08	4.10	4.08	6.75	7.03	5.95	5.79	8.20	5.56	4.20	4.56	4.64	5.30	5.90	5.80	4.80	8.10

Long-term forecasts

GDP growth (%)	2006	2007e	2008f	2009f
Czech Republic	6.4	5.9	4.3	5.4
Croatia	4.8	6.1	4.9	4.9
Hungary	3.9	1.6	2.5	3.5
Poland	6.2	6.6	5.5	5.8
Romania	7.7	5.7	6.1	6.0
Slovakia	8.5	9.0	7.2	5.3

C/A (%GDP)	2006	2007e	2008f	2009f
Czech Republic	-3.0	-3.4	-4.0	-3.4
Croatia	-7.8	-8.2	-7.7	-7.8
Hungary	-6.5	-5.2	-4.6	-4.2
Poland	-3.2	-3.8	-4.5	-4.9
Romania	-10.3	-13.7	-14.7	-14.7
Slovakia	-7.2	-4.2	-3.6	-3.3

CPI (%), eoy	2006	2007e	2008f	2009f
Czech Republic	2.5	4.0	5.1	3.2
Croatia	2.0	4.0	3.3	3.5
Hungary	6.5	7.4	4.2	2.5
Poland	1.4	4.0	3.4	2.7
Romania	4.9	6.6	5.4	4.5
Slovakia	4.2	3.4	3.5	3.5

Budget Balance (%GDP)	2006	2007e	2008f	2009f
Czech Republic	-2.9	-1.9	-2.9	-2.7
Croatia	-3.0	-2.6	-3.0	-3.0
Hungary	-9.2	-5.7	-4.0	-3.9
Poland	-3.9	-3.0	-3.4	-3.1
Romania	-1.6	-2.4	-2.7	-2.7
Slovakia	-3.3	-2.5	-2.4	-2.6

Diaries

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Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	Jan-22	Retail Sales, November (YoY, %)		8.3%
Croatia	21-Jan	Unemployment rate	14.7%	
	22-Jan	Industrial production	3.0% y/y	
Hungary	Jan-21	NBHs rate setting meeting	no change (7.50%)	no change (7.50%)
	Jan-24	Nov Retail sales	-3.5% y/y	-3.6% y/y
Poland	Jan-22	Net core inflation (% y/y)	1.8%	-
	Jan-21-25	Retail sales (% y/y)	18.9%	20.3%
	Jan-21-25	Unemployment (%)	11.4%	11.4%
Romania	No data releases scheduled			
Slovakia	No data releases scheduled			

**Sources: Bloomberg, Reuters*

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		Jan-24	Jan-25	Oct-24-2008		CZK 5 bn.	
		Jan-23	Jan-28	April-04-2011	4.1%	CZK 6 bn.	
Hungary		Jan-22	Jan-30	April-30-2008	-	HUF 20bn	7.38%
		Jan-23	Jan-30	July-30-2008	-	HUF 20bn	7.40%
		Jan-24	Jan-30	Dec-17-2008	-	HUF 30bn	7.40%
Poland		No auction scheduled					
Romania		23-Jan-08	25-Jan-08	1Y		RON 1 billion	8.7%
Slovakia		No auction scheduled					

Major markets

Purchasing manager indices and Ifo Index near stabilization

Weak equity markets and growing doubts about the possible decoupling of the Eurozone economy from the US supported government bonds, driving yields lower. Additionally, the yield curve steepened, on the back of comments from ECB Council member Mr. Mersch. Although he tried to correct the impression later that the Council was prepared to change its mind, two-year yields declined further. Government bonds seem to be quite expensive over the whole curve now. Next week, we will see the release of preliminary data for the Purchasing Manager Indices. We expect only a small further slide in both indices. On Thursday, the Ifo Index will be released. The assessment of the current situation will go down, but the expectation index could show a sideways movement. Also, consumer and business confidence for France will gain some attention.

Annual results of US financial institutions in focus next week

The few upcoming data releases are unlikely to give the markets any new direction. The Univ. of Michigan Index today and existing home sales on Thursday will of course be watched and are very likely to confirm the negative expectations, but the course of monetary policy has been set by the Fed chairman quite clearly. In his testimony to the Budget Committee, he reiterated that "the FOMC stands ready to take substantive additional action as needed to support growth and to provide adequate insurance against downside risks." The string of interest rate cuts should start on January 30, for which we estimate a 50bp cut of the Fed Funds Rate. So, bond markets will probably get their most important impulse from equity markets, as more banks will report annual results next week. Overall, we expect yields and the EUR/USD to move sideways.

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

	Intervention Rate		3m Money Market Rate				10y Govt. Yield		FX	
	EUL	USA	EUL	Forwards	USA	Forwards	EUL	USA	EUR/USD	Forwards
Spot	4.00	4.25	4.44		3.93		3.96	3.65	1.462	
Mar-08	4.00	3.50	4.35	4.47	3.60	3.74	4.20	3.90	1.45	1.461
Jun-08	4.00	3.00	4.15	4.33	3.10	3.28	4.40	4.00	1.40	1.458
Sep-08	4.00	3.00	4.15	4.28	3.20	3.03	4.60	4.40	1.35	1.455
Dec-08	4.00	3.00	4.15	3.63	3.30	2.93	4.60	4.40	1.35	1.451

Czech Republic

At zenith of industrial expansion in Czech Republic?

Last week saw the release of data on industrial production and the current account. Industrial production posted its 63rd y/y increase in a row, having grown at 6.7% in November (adjusting for seasonal effects and the working-day difference, the growth was 5.6%). The growth was driven by vehicles, electrical and optical appliances and machinery, which have been the main drivers over the last few years. Certainly, there has been some slight downward revision of the trend component in the last 2-3 months, but a good part of this is ascribable to longer than expected shutdowns of refineries and related facilities (Unipetrol), which dragged the growth down (in September, refineries alone subtracted 2p.p. off the growth; in November, 1p.p.). All in all, for the moment, industry remains in a solid state, and if there is not any significant slowdown in the EU, it should remain more or less so next year. A lingering question, however, is whether the current strength of the CZK (one of the fastest appreciating currencies for the last six months) will not harm the mostly export-oriented industry. On the other hand, the last few years saw some of the largest movements in the CZK and industry seemed to cope relatively well, even though some big industrial projects took place in this period as well (notably, among carmakers), enhancing industrial capabilities. More on the visionary side of things, we would assert that, absent other investment projects and given the ongoing rise in wages, we might already be at or close to the zenith of industrial expansion in the Czech Republic.

Room for one more preventative hike

An interview with three members of the Board appeared in the media. Mr. Niedermayer (who is to attend his last meeting in February) argued for a hike in rates, given the high headline inflation. Mr. Singer did not give a clear indication of what he intends to do, except for a vague reassurance that the "CNB will do what it takes to ensure that the current spike in inflation remains an isolated incident and that the costs of so doing will be reasonable". Mr. Hampl said he is not afraid of inflation expectations getting out of control and that the rates might be at the peak or close to it. So, except for Mr. Niedermayer, there was no clear hint of what happens next. We think there is space for one more preventative hike, given the higher headline, but thereafter the rates should remain stagnant until the situation regarding the CZK and/or the US is clarified.

Next week, retail sales for November is the only data release due, but this will in all likelihood not be of any significance for the markets. Given the y/y fall of employment and rise in real wages, we expect growth of 8.5%. For the next year, the growth of retail sales will be lower, due to the cuts in mandatory spending and social programs, which will lower consumption.

David Navratil, dnavrati@csas.cz

Hungary

CPI inflation stood at 7.4% y/y in December 2007

Consumer prices rose 0.4% m/m in December 2007, while the 12-month inflation rate further accelerated to 7.4% (from the 7.1% published for November). The average inflation in 2007 was 8% y/y. The y/y figure proved to be somewhat higher than market expectations, fluctuating around 7.2-7.3%. The reasons behind the figure are the same as in the previous months: foodstuffs and fuels. Food prices rose 0.8% m/m. In this category, prices of cooking oil, cheese, bakery products, eggs and milk were the main drivers. Fuel prices rose 2% m/m, pushing the monthly increase in the category of "other goods and fuels" to 0.7%. Other items did not show significant changes on the monthly level. The seasonally-adjusted core inflation rose 0.6% m/m and the 12-month core CPI rate increased to 4.8%.

The 12-month inflation rates are expected to slowly decrease in the coming months, but they are unlikely to drop below 6% in the first half of the year. For 2008, we predict 5.6% y/y and 4.2% y/y for the average and year-end inflation rates, respectively.

No rate change expected on Monday

Next week, the most important event should be the central bank's rate setting meeting on Monday. As for the outcome of the meeting, the members of the council are unlikely to abandon their current cautious, "wait and see" stance. The main reasons are the same - there are still many uncertainties around the 2008 inflation prospects, while the currently very negative mood on global capital markets (based on the intensifying recession fears in the US) also does not support a rate reduction. On the other hand, there are some promising aspects around wage developments. Firstly, according to the latest figures from the statistical office, the highly monitored regular (ex bonus) annual wage growth in the private sector slowed to 8.5% y/y in November (from the 9.7% y/y seen in October). Secondly, according to the polls, private sector companies intend to provide 6% gross wage increases on average for their employees in 2008, which is in the tolerance range of the central bank. Both the expected moderate wage increases in the private sector and the rate path on major markets (faster rate reductions in the US) suggest that the next rate step from the NBH's side could also be a rate reduction, but such a step is not likely before 2Q08.

For the remainder of the coming week, the macro calendar is almost empty, with only retail sales figure due on Thursday. Their market impact should be limited, however. Instead, the approaching rate setting meeting of the FED at the end of the month should gain increasing attention among investors.

Orsolya.Nyeste, orsolya.nyeste@erstebank.hu

Poland

Inflation bouncing further from CB tolerance band

Consumer prices continued their upward march for the fourth month in a row. The increase by 0.3% m/m in the final month of last year translated into a pickup in the annual inflation rate to 4.0% y/y. This is already half a percentage point above the tolerance band of the central bank (1.5-3.5%). The structure is not very appealing from the viewpoint of monetary policy. The monthly pickup in prices was broad-based and concerned all major categories, except for footwear and clothing. Moreover, the annual dynamics of all categories (excluding clothes) quickened. The biggest contribution was provided by a category with an important weighting, food. Positively, the scale of the increase was not as severe as in the previous months (0.3% m/m, vs. above 1.5% m/m in September-November). However, it is still too early to assess this as a fading food price shock. On the other hand, prices of various services (most visible: healthcare and recreation & culture) went up in December, which might signal the origination of some demand-induced price pressures. All in all, net core inflation increased by more than we anticipated. We now think that it likely reached 1.8% y/y in December, up from November's 1.5%.The price dynamics are likely to accelerate further in the first quarter of this year. The main culprits will include food prices (where global pressures might be reinforced by the removal of a ban on Polish imports to Russia), regulated prices and adjustment of retailers' price lists at the beginning of the year (among others, the special promotion by an Internet operator might come to a halt). All in all, inflation should move further away from the central bank's target and might hit 4.5% in 1Q. We expect stabilization thereafter and a gradual decline in the second half of the year to 3.4% y/y in December.

Wages grew notably more slowly than expected in December

After the seven-year record of 12.0% y/y seen in November, wage dynamics in the corporate sphere moderated visibly at the end of the year to one-digit territory at 7.2% y/y. Putting together the pickup in wages and employment and adjusting for inflation, aggregate real wages increased by 8.2% y/y in December. This is also a notable deceleration from the 13.5% y/y registered a month ago. For the whole year, wages in the corporate sector ballooned by 9.2% y/y. Looking at the structure, the quickest growth rate was seen in the sector of construction (17.4% y/y), which fits nicely with ongoing complaints about a shortage of workforce in this segment. The sectors of trade & repair and electricity and gas supply follow in terms of those with the most robust wage dynamics.

Expectation of January hike still firmly in place

The macro data released over the past week has not changed our interest rate outlook. Inflation will keep the alarm bells switched on at the MPC, as not only did the headline inflation rate accelerate further, but the structure is also somewhat worse. Regarding wages, we think it is too early to make hasty conclusions about a relief of wage pressures based on just a one-month figure. It is well possible that only some enterprises decided to postpone the payout of extra Christmas wages to January, due to the decline in social contributions. Moreover, wage setting at the beginning of this year (which will take place amid briskly growing inflation) will be of greater importance for policy makers. Our expectation of a smaller hike (25bp) is still valid for this month. This move seems to already be a done deal. Even the dovish-leaning governor was quoted this week as saying that the MPC would take essential steps to curb inflation. However, the majority of the MPC does not seem to share the view of the hawks (who did not rule out a possibility of the key rate reaching 6.0%). For example, important swing voter Andrzej Slawinski cautioned against a growing interest rate differential and said it would not be good if the zloty joined a group of carry trade currencies. We think that the monetary policy tightening cycle will stop at 5.75% and hence are currently less hawkish than the market pricing.

Zloty corrects on back of higher investor risk aversion

Despite no unpropitious news coming from the domestic scene, the zloty rode on a correction wave this week. In our view, the main culprit behind the move is primarily the more nervous atmosphere on the world markets, as a result of the darker outlook for the US economy, which increased risk aversion among investors. The exchange rate cracked the 3.60 EUR/PLN psychological threshold and technicals suggest further short-term easing might be in the pipeline. Nevertheless, given the favorable domestic fundamentals and increasing interest rate differential, we still believe that the unit will firm to 3.50 EUR/PLN by the year-end. The first half of the year could still be shakier though, due to the jitters on majors and, later, due to the start of dividend season. Hence, we think that the majority of gains will be reached in the second half of the year. The data to be published next week will most likely leave the markets unaffected. Retail sales should have stayed robust in the Christmas month. On the other hand, as can be estimated on the basis of the inflation data breakdown, the net core inflation saw a relatively significant jump in December (by 0.3pp to 1.8%).

Mária Hermanová, mhermanova@csas.cz +420 224 995 232

Romania

General consolidated state budget deficit around 2.7% of GDP in 2007

The finance minister said earlier this week that the 2007 deficit of the consolidated state budget was 2.4% of GDP according to national standards and 2.6-2.7% of GDP according to EU standards. Although official data will only be released in February, we do not expect any major negative surprises. The state budget turned to a deficit in November (1.14% of GDP, according to national standards). Small monthly surpluses alternated with low deficits in the first ten months. Government spending was high in November and December (about EUR 3.1bn), a pattern also seen in 2006. As for 2008, we must consider the local and parliamentary elections (in May and November, respectively), which induce risks to budget execution. The government should spend consistent amounts throughout the entire year, focusing on infrastructure development. Revenues were about 35% of GDP, while spending reached 37.6% of GDP in 2007, according to the finance minister. Consolidated budget revenues are planned to increase to 39.3% of GDP and spending will reach 42% of GDP this year. This was rather good news for the markets, preventing the RON from falling further. At the beginning of this year, there were some press statements regarding a potential deficit of over 3% of GDP for 2007. We estimate a 2008 deficit of 2.7% of GDP according to national standards and up to 3% considering EU methodology. Some risks may arise from the economic growth, namely the strong correlation between domestic agriculture and weather conditions (our forecast for real GDP growth is 6.1% in 2008), and RON volatility throughout the year.

Central bankers consider RON depreciation an overshoot

The leu was one of the most affected emerging market currencies in the past few months, hit by the bearish international sentiment among financial investors and Romania's large current account shortfall. The domestic currency started the week in the 3.70 area and, shortly after the opening, the RON dropped to 3.7250, touching a 3-year low against the euro, on the back of speculative orders. In the next two days, demand for the euro remained high, coming from both local and foreign players, and the EUR/RON remained range-bound in the 3.69-3.72 area. However, the leu seems to have found some support in late trading on Wednesday from central bankers' comments at an economic seminar in Vienna. Firstly, Vice Governor Eugen Dijmarescu stated on Tuesday that, "the central bank will not spare any needed effort" when asked if the NBR is considering hiking the policy rate to halt the depreciation of the local currency and prevent it from impacting the inflation outlook even more. Also, Deputy Governor Cristian Popa declared (regarding the local currency) that it "is a bit of an overshoot" and that Romania needed tighter monetary policy to offset risks to the economy. Although the pair broke the 3.70 threshold this week, the NBR has refrained from intervening directly in the forex market. However, the NBR's chief economist reminded the market that "the central bank operates with the interest rate first of all, but the NBR is keeping the option to use other instruments, if needed, including direct interventions on the forex market, without announcing in advance". The exchange rate reacted to the strong rhetoric from central bank representatives and posted a slight recovery to the 3.66 zone on Thursday, also supported by the NBR's intensive sterilization operations. On Friday, the EUR/RON pair was trading in the 3.69-3.71 zone. We believe that the domestic currency will remain range-bound at recent levels, still carrying upside risks, unless there are other supportive reactions from the central bank.

Central bank drained all excess liquidity in money market

The NBR proved its commitment to firmly manage the money market liquidity, setting up open-market operations whenever domestic liquidity conditions have required it, even if the frequency of the deposit auctions became daily. However, the short-term interbank interest rates do not reflect the hike of the monetary policy rate by 50bps, despite the NBR's intensive sterilization, as the MoF injected substantial amounts in the market in late December, at the expense of the general consolidated budget. Short-term deposits were traded for 7.2-7.4%/7.7-7.9% bids/asks on the interbank money market this week.

Romania rejected all bids at reopening of 10-year bonds

As we had previously anticipated, the MoF has refrained from attracting liquidity on longer tenors, as they expect a decrease of the yields demanded by investors towards the end of the year. The MoF reopened 10-year benchmark bonds and held an auction on January 17 worth RON 1,000mn. The offer of primary dealers totaled RON 1,419mn, but the MoF decided to reject all bids.

Melania Hancila, melania.hancila@bcr.ro
Eugen Sinca, eugen.sinca@bcr.ro

Slovakia

PM Fico does not expect further ERM-2 central parity revaluation

PM Robert Fico suggested that he does not expect any more revaluation of the ERM-2 central parity. He did not elaborate more on the issue. While we see arguments for an adjustment (stabilizing the exchange rate), even if it does not happen, such a scenario does not mean that the final conversion rate will be at the current ERM-2 central parity of 35.44 EUR/SKK. Indeed, we expect it to be stronger, regardless of whether revaluation takes place or not (we predict the conversion rate at 32.5-33.0 EUR/SKK).

CB vice governor: Enough arguments to prove sustainability

Slovakia's harmonized inflation stayed within the Maastricht limit in December, as the 12M average reached 1.9%, well below the Maastricht criterion at 2.8%. In response, the CB said the figure was slightly above its forecast. We expect the Maastricht limit to stay near 3% in spring 2008, while Slovak average inflation should be around or slightly above 2% then. The nominal euro-related criterion should hence be fulfilled, with a substantial buffer, supporting the position of the CB in discussions about inflation sustainability. Indeed, CB Vice Governor Viliam Ostrozlik voiced confidence this week that Slovakia will have enough arguments to prove the sustainability of this price performance.

Negative sentiment weakened koruna

Facing meager interest among buyers, the Slovak currency significantly weakened (by more than 2%), from Monday's 33.2 EUR/SKK to 33.9 EUR/SKK on Friday morning. The main reason is the negative global market sentiment, which also led to a weakening of other Central European currencies. The PM's comments that he saw no further parity revaluation might also have contributed to the low interest in the koruna, as some investors might have become worried that the conversion rate will be weaker than the current exchange rate. The koruna, at close to 34 EUR/SKK, becomes more attractive for market participants expecting a stronger conversion rate (as we do), and the weakening trend might cease. However, it will likely remain sensitive to any short-term regional turbulence.

Debt agency: Eurobonds likely to be delayed

Also this week, a debt agency official said that the chances of a Eurobond issue in 1Q08 have decreased, due to the worsened market conditions. The agency still plans to issue 5Y or 10Y Eurobonds worth EUR 1bn, but the timing is unclear. The delay of Eurobond issuance might make the debt agency issue more koruna-denominated debt in the first part of 2008 (particularly as we expect long-term yields to pick up slightly by the year-end).

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

Appendix Charts

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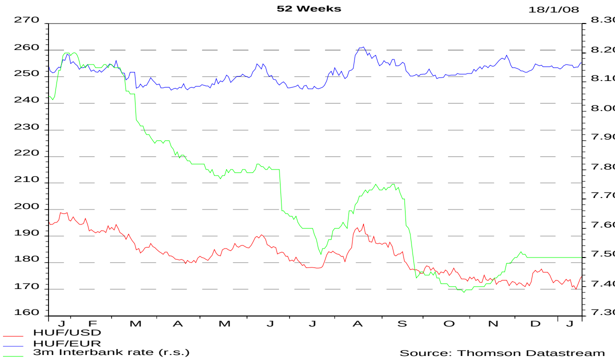
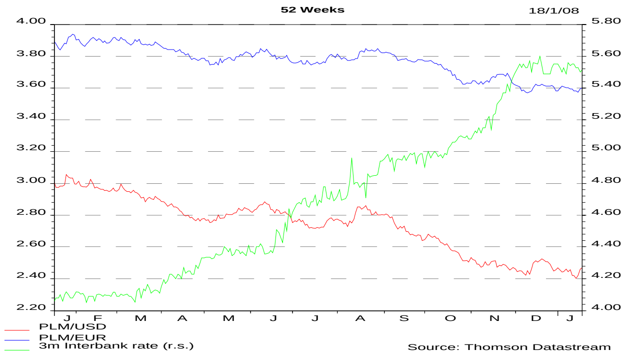
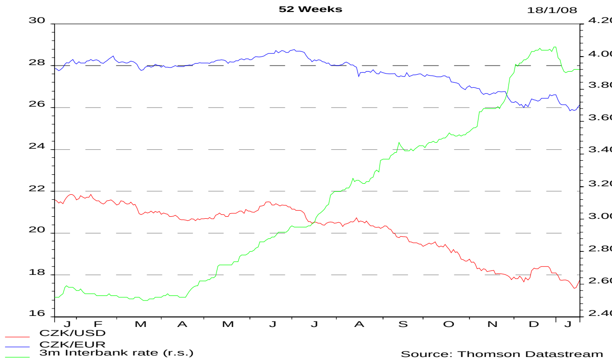
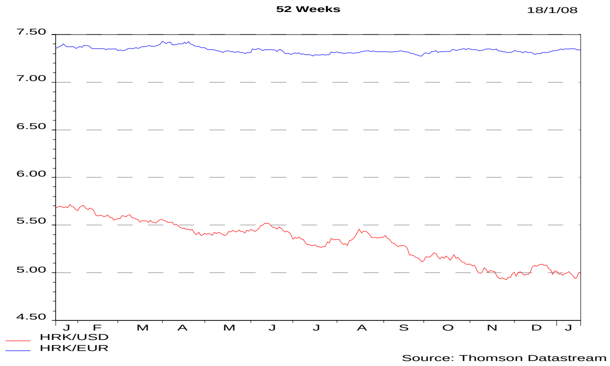
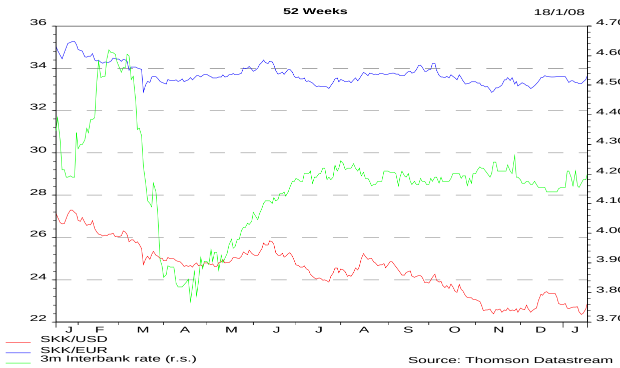
Exchange rates and interest rates (52 weeks)

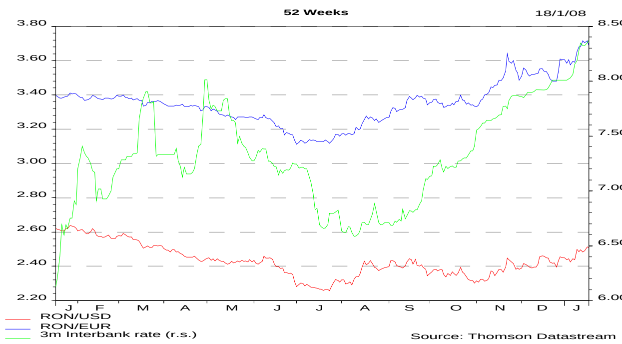








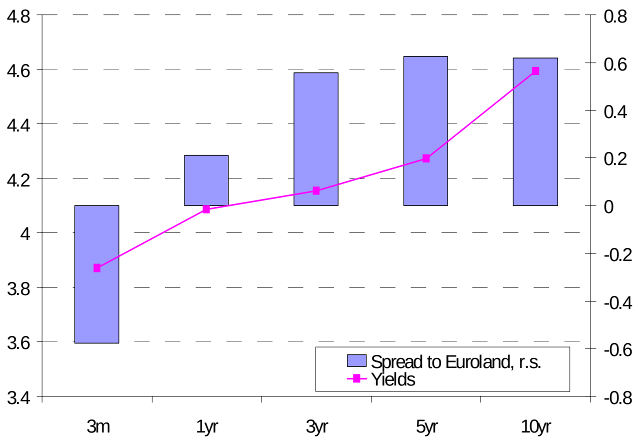




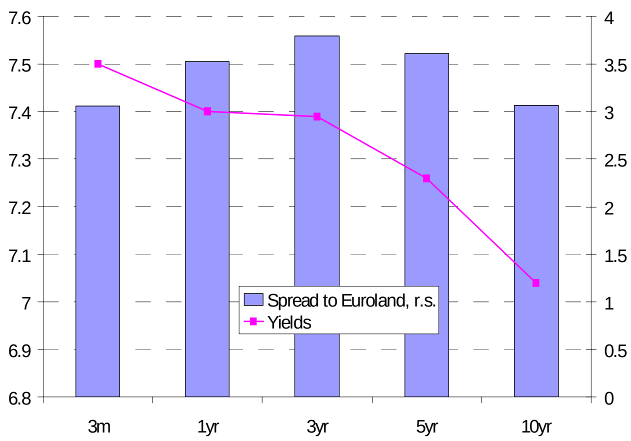
Source: Datastream

Benchmarks

Czech Republic



Hungary



Appendix Forwards

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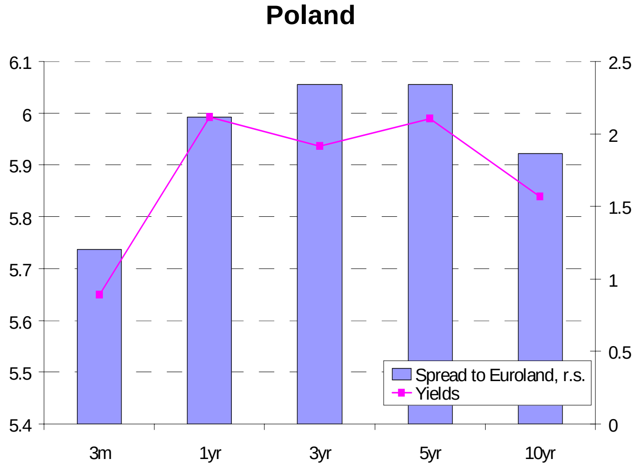

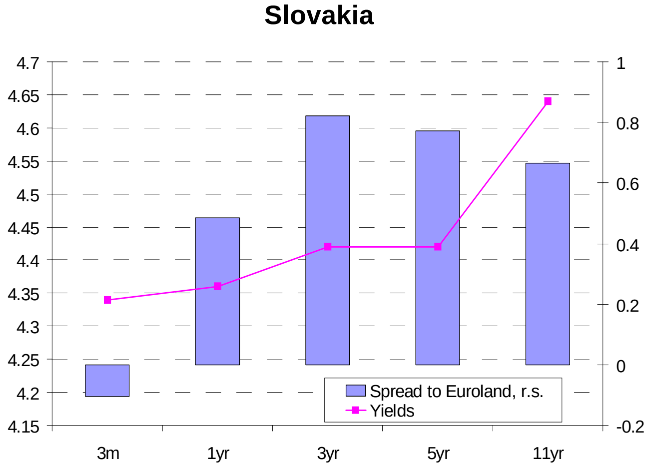

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Contacts

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
Ivan Gojnic *(Equity)*	+381 11 22 00 852
Alen Kovac *(Fixed income)*	+385 62 37 13 83
Uros Mladenovic *(Equity)*	+381 11 22 00 872
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 Hermanova *(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
Raluca Ungureanu *(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	
Gregor Glatzer *(Equity)*	+361 235-5144
Krisztián Kandik *(Equity)*	+361 235-5140
Istvan Kovacs *(Fixed income)*	+361 235-5846
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