CEE Research

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Fixed Income and Foreign Exchange

CEE Insights

- **Czech Republic:** CPI expected to have risen in January
- **Hungary:** Wait and see mood continues, US market development in focus
- **Poland:** Central bank's statement leaves door open for additional hikes
- **Romania:** Fitch changed Romania's outlook to negative
- **Slovakia:** FinMin: 2008 fiscal shortfall could be below plan

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Overview

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Czech Republic:

- CNB to hold first meeting of year next week
- CPI expected to have risen in January
- CZK likely to remain around CZK 26 per euro

Hungary:

- Wait and see mood continues, US market development in focus

Poland:

- Central bank's statement leaves door open for additional hikes…
- …but MPC members' rhetoric softens visibly
- We still see further monetary policy tightening as more likely scenario
- Poland to eye major markets in coming week

Romania:

- Fitch changed Romania's outlook
- Central bank representative declared that EUR/RON will not reach 4.0 zone
- Interbank interest rate reflects another hike of policy rate on January 4

Slovakia:

- EC recommended more ambitious fiscal tightening
- FinMin: 2008 fiscal shortfall could be below plan
- CB upped inflation forecasts as did MinFin
- Koruna highly volatile

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Thursday's close		Current	w/w	m/m	ytd	Spreads vs. Euroland		
						current	- 1m	02/01/2008
Czech Republic	EUR/CZK	25.93	-0.1%	1.6%	2.4%			
	3Y (yield bp)	4.02	-2	0	-29	55	31	41
	10Y (yield bp)	4.56	-1	-23	-18	63	48	53
Croatia	EUR/HRK	7.23	0.4%	1.5%	1.0%			
	3Y (yield bp)	5.92	14	80	61	254	112	140
	10Y (yield bp)	5.95	12	42	42	207	123	135
Hungary	EUR/HUF	257.45	0.1%	-1.5%	-1.7%			
	3Y (yield bp)	7.47	-2	-8	-8	400	351	365
	10Y (yield bp)	7.20	-5	9	9	327	281	290
Poland	EUR/PLN	3.59	0.6%	0.5%	0.2%			
	3Y (yield bp)	5.75	-10	-40	-44	228	211	229
	10Y (yield bp)	5.69	-10	9	-28	176	161	176
Romania	EUR/RON	3.67	3.2%	-2.7%	-2.6%			
Slovakia	EUR/SKK	33.35	0.5%	0.9%	0.6%			
	3Y (yield bp)	4.31	3	-28	-28	78	57	52
	11Y (yield bp)	4.62	2	-20	-20	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 HU GB 6,25	97.42	97.07	0.63%			98.95		
17	CZK 6M	05/12/2007	6M Pribor	4.04			3.12%	0.2%	4	5.1%	10.10%
	CZK/HUF			9.63	9.93	0.03			9.41		
		31/12/07	Euribor/ROBID	4.49 / 7.56	-	-2.05%	-1.79%	-20.1%	3.53	2.50%	15.80%
18	short EURRON		EURRON	3.60	3.68						
		21/01/08	US-Libor/Pribor	3,7/3,99		-2.95%	-2.96%	-96.9%	19.50	8.80%	17.8%
19	Long USDCZK		USDCZK	17.925	17.40						
		22/01/08	4m Bribid/Euribor	4,08/4,38		1.72%	1.71%	61.5%	33.00	2.80%	8.5%
20	short EURSKK		EURSKK	33.96	33.39						

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.

19) We see the US narrowly avoiding the recession (albeit with massive assistance from Fed) and the economy will start to pick up on real estate market being through its trough. Later phase of the business cycle will then appear in Europe. CZK got off the fundamentally justified level over last couple of months, becoming one of the fastest appreciating currencies in the world. Based on the fundamentals and seasonality, we expect weakening of CZK towards 27.00 against EUR in first half 2008.

20) The recent negative mood on the regional markets brought the koruna closer to 34 EUR/SKK. While there is a possibility of a further short-term weakening, we see current levels as attractive to open long koruna positions, as we expect the euro conversion rate to be set within 32.5-33.0 SKK/EUR. Taking a more conservative approach, our target is 33.0 EUR/SKK with a recommended 4M time horizon.

Trading Ideas

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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%

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

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	26.0		7.23		258		3.60		3.77		33.5		3.50	4.13	7.50	5.25	8.00	4.25
Mar-08	26.8	26.0	7.25	7.25	255	259	3.55	3.60	3.68	3.73	32.6	33.5	3.75	4.00	7.50	5.50	9.00	4.25
Jun-08	27.1	26.0	7.20	7.20	255	261	3.60	3.62	3.65	3.78	32.5	33.5	3.75	4.00	7.25	5.75	9.50	4.00
Sep-08	26.5	26.0	7.25	7.25	256	263	3.55	3.63	3.55	3.82	32.5	33.5	3.75	4.00	7.00	5.75	9.50	4.00
Dec-08	26.4	26.0	7.30	7.30	256	265	3.51	3.65	3.50	3.87	32.5	33.5	3.75	4.00	6.75	5.75	9.00	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	3.92		7.50		5.65		9.31		4.30		4.56	5.95	7.20	5.69	4.62	9.40
Mar-08	3.95	4.05	7.45	7.50	5.70	5.74	9.30	9.98	4.30	4.40	4.71	5.80	6.90	5.70	4.65	8.90
Jun-08	3.97	4.05	7.20	7.35	5.95	5.79	9.80	8.91	4.15	4.24	4.65	5.60	6.70	5.80	4.70	9.30
Sep-08	4.10	4.07	6.90	7.22	5.95	5.77	9.60	7.31	4.15	4.10	4.65	5.40	6.40	5.75	4.75	9.10
Dec-08	4.10	3.62	6.75	7.07	5.95	5.45	9.10	7.08	4.15	4.43	4.64	5.30	6.10	5.70	4.80	8.70

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	6.5	5.5	5.7
Romania	7.7	5.7	6.1	6.0
Slovakia	8.5	9.0	7.2	5.3

CPI (%), eoy	2006	2007e	2008f	2009f
Czech Republic	2.5	5.4	5.4	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

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	-14.1	-14.7	-14.7
Slovakia	-7.2	-4.2	-3.6	-3.3

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	-2.8	-3.4	-3.0
Romania	-1.6	-2.4	-2.7	-2.7
Slovakia	-3.7	-2.5	-2.4	-2.6

Diaries

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Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	01-Feb-08	Trade Balance (Dec, bn. CZK)	-3.30	
	07-Feb-08	Central Bank rate-setting meeting	+25bp (to 3.75%)	+25bp (to 3.75%)
	08-Feb-08	CPI (January)	0.5% m/m, 5.9% y/y	
	08-Feb-08	Unemployment (January)	6.20%	
Croatia	6-Feb	Retail trade	2.0% y/y	
	8-Feb	PPI	5.3% y/y	
Hungary	Feb-07	December Industrial output	6.2% y/y	6% y/y
	Feb-07	January Budget balance	HUF-28bn	-
	Feb-08	December Trade balance	EUR 50mn	EUR-48mn
Poland	No data releases scheduled			
Romania		Industrial production Dec 2007 - Dec./Dec.	5.0%	-
		Key interest rate	8.50%	8.50%
Slovakia	Feb-08	December industrial production	15.8% y/y	-

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		No auction scheduled					
Hungary		Feb-05	Feb-13	May-14-2008	-	HUF 20bn	7.45%
		Feb-06	Feb-13	July-30-2008	-	HUF 20bn	7.40%
		Feb-07	Feb-13	Jan-28-2009	-	HUF 30bn	7.40%
Poland		Feb-06	Feb-08	2013-Apr-25	5.25%	PLN 2.0-3.0bn	
Romania		07-Feb-08	11-Feb-08	N/A	N/A	RON 100mn	-
Slovakia		No auction scheduled					

Major markets

ECB on hold

The ECB Council is widely expected to keep rates on hold next Thursday. The question is whether the statement by President Trichet will be less hawkish than in January. The latest data for Euroland was mixed, with disappointing retail sales for Germany and a further worsening in consumer sentiment on the one hand and an improvement in manufacturing purchasing manager indices and the Ifo Index on the other hand. However, the combination of a very aggressive Fed and fears of further pressure on the ratings of monoliners and banks, as well as the rise in EURUSD, will keep hopes for a cut of Euro key rates alive. The short end of the curve should therefore stay supported. Next week's data will comprise factory orders, the trade balance and industrial production for Germany. New orders rose strongly in November. Therefore, a decline is expected in the volatile series for December. However, this would still leave the yearly change in double-digit figures.

FOMC Board met expectations

The FOMC Board met expectations of a 50bp cut of the Federal Fund Target Rate this week. Moreover, the outlook left the door wide open for a further decrease in key rates. We expect another cut in March by 50bp to 2.5%. Then, the interest rates should be kept steady for the rest of the year. The economic data was more mixed lately, including a surprising rebound in durable goods orders on the one hand and another weakening of the housing market on the other. The most important figures for next week will be released today - labor market data and the manufacturing ISM. The labor market data is expected to show an increase in non-farm payrolls of 70 thousand and a stable unemployment rate of 5%. As the ADP report on Wednesday came out above expectations, a positive surprise seems possible. However, as the ISM Index should remain at a low level, Treasuries should be able to stay at high levels - especially as the market is still highly nervous on the topic of possible downgrades of one of the big monoliners.

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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	3.00	4.37		3.10		3.95	3.64	1.489	
Mar-08	4.00	2.50	4.35	4.40	2.50	2.92	4.00	3.60	1.48	1.486
Jun-08	4.00	2.50	4.15	4.24	2.60	2.70	4.20	3.80	1.45	1.482
Sep-08	4.00	2.50	4.15	4.19	2.70	2.55	4.40	4.20	1.40	1.476
Dec-08	4.00	2.50	4.15	3.71	2.80	2.71	4.60	4.40	1.35	1.472

Czech Republic

CNB to hold first meeting of year next week

Next week, a host of data is to be released. The most important event will be the CNB's first meeting (of the eight scheduled) of the year on Thursday. The situation is anything but clear. On one hand, we think that the high headline and inflation expectations, new target looming on the horizon, new prognosis and departure of a known hiker (Mr. Niedermayer) from the board make it look more likely that a hike will be delivered. However, the strong koruna, uncertain outlook abroad, slowdown of domestic consumption and equivocal remarks from the bankers (of the "I have not made up my mind yet" variety) seem to indicate no rate movement. Voting last December was 5/2 (Niedermayer and someone else, perhaps Singer) and this one will be tight as well. Personally, I see the probability of a hike vs. no change as even, especially since three bankers (Tuma, Tomsik, Hampl) gave rather vague statements. Our baseline, however, remains a hike in February, accompanied by rather dovish statement hinting at stability for some time to come. In any case, even if there is not a hike this February, we think that the CZK weakening we anticipate in 1H will prompt a hike.

CPI expected to have risen in January

As for the other data, unemployment (January), the trade balance (December) and CPI for January will all be released next week, with the most important figure (CPI) out only after the CNB board meeting. The CPI is projected to rise further, by some 0.5 m/m, as indicated by the weekly surveys of food prices (these are not very reliable, but are as good as it gets). Add in oil prices (the increases of which even the CZK could not offset) and y/y inflation might be at 5.9%. This could be a powerful argument for raising rates, as expectations might be seen as threatened. Unemployment and the trade balance will not move the markets whatsoever, as seasonality will influence both figures.

CZK likely to remain around CZK 26 per euro

The CZK will in all likelihood remain at or slightly below 26.00. One factor that could change this would be if the CNB fails to meet the market's expectations of a hike. If that were to happen, we could see some weakening. However, with the dollar likely to remain under pressure, the CZK should get some support from the other side. All in all, the CZK around 26.00 is the most likely outcome next week.

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Hungary

Wait and see mood continues, US market development in focus

Next week, only second-tier macro figures will be released, among which the preliminary January budget balance should receive the most attention. In the middle of January, the Finance Ministry projected a deficit of just HUF 27.5bn for the first month of the year, while they also indicated that the deficit would reach half of the full-year cash flow-based target by the end of the first quarter. Thus, the budget is anticipated to show its usual seasonality in 2008, based on some one-off items (half of an extra month's salary paid to public sector employees, energy bill compensation payments and agricultural subsidies) due in the first months of the year. However, one should keep in mind that, until the publication of the January CPI and 4Q07 GDP figures (both scheduled for February 14), domestic markets should continue to concentrate on US events and figures (among which labor market data, due this afternoon, could be especially important in assessing the growth outlook in the US). The 50bp Fed rate reduction announced on Wednesday was in line with earlier expectations and thus did not cause a significant reaction on the domestic FX and forint markets. The new 10Y bond auctions attracted relatively low demand on Thursday. The markets have been in a wait and see mood, which is not expected to change in the near future.

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Poland

Central bank's statement leaves door open for additional hikes…

The Polish central bank hiked the key interest rate by 25bp, pulling it to the level of 5.25%. The after-meeting statement was negligibly changed compared to December and is still tilted to the hawkish side. The MPC still thinks that the growth will surpass potential in the coming quarters. A substantial slowdown in the world economy and higher financial market volatility were labeled as potential risks, but at the same time the statement reads that the impact on the Polish economy is difficult to assess. Moreover, the central bankers anticipate that inflation will remain above the tolerance band (1.5-3.5%) in the near future (which is not hard to agree with). Among pro-inflation factors, regulated items, food and higher oil prices (than assumed in the projection), as well as pro-cyclical fiscal policy are named. Importantly, the Council also perceives a further build-up in wage pressure as 'quite probable'.

…but MPC members' rhetoric softens visibly

However, interviews with Council members emerging after the rate setting meeting signal that the 'swing voter' wing of the Council is slowly starting to diverge from the hawkish camp and that some of the central bankers might prefer to take a longer pause before hiking (if at all). MPC member Jan Czekaj argued that if the January data shows a slowdown in GDP, then a hike would probably not be necessary at all. He also expressed his expectation that inflation should start to decline after peaking in March. Moreover, he drew attention to another factor, the interest rate differential. Czekaj said that if other central banks (especially the ECB) cut rates, the growing interest rate disparity between Poland and majors could put the zloty in an undesirable appreciation trend. Please recall that the other swing voter, Mr. Slawinski, cautioned recently against the zloty becoming a carry trade currency. It seems that a still-growing part of the Council is starting to pay attention to this factor and treat it as a potential impediment to further hikes.

We still see further monetary policy tightening as more likely scenario

Nevertheless, we have not changed our interest rate outlook so far, arguing that the data released in January will be of crucial importance. We expect inflation to creep further upwards in the first quarter of this year, hitting 4.5%, on the back of base effects, food, regulated prices and, last but not least, strong domestic demand making it into higher core inflation readings. Also, wages should accelerate again in January. There are some distressing signals coming from the public sphere. After calls for salary increases from customs officials and teachers, the unions have threatened a nationwide strike, demanding hikes in salaries of all state controlled industries (including mining and the railway sector). If satisfied, pay increases in the public sphere could ignite a wage spiral in the private sector. We believe that, in order to keep inflation expectations under control in this environment, the central bank will be forced to increase the base rates by a further 50 basis points this year (thus, the reference rate will stand at 5.75% at year-end). The risks are obviously tilted downwards.

Poland to eye major markets in coming week

Core market events will remain the predominant factor influencing Polish markets next week. Today's non-farm payrolls in the US and the ECB meeting next week should set the tone for trading. The macro release calendar is empty. Hence, there are no predictable local factors that could move the markets. The cut in the US did not have a strong impact on the Polish market. The zloty is currently range-trading, while a mild tendency to appreciate is traceable at the end of the week. Full-year GDP data did not bring an impulse to the trading. The data showed that the economy expanded by a respectable 6.5% y/y last year, on the back of robust domestic demand. Figures for 4Q are not yet available. It can only be guessed that (assuming no revisions in the numbers for the first three quarters) the growth is in the range of 5.8-6.2%. We still see the upper edge of this range as probable.

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Romania

Fitch changed Romania's outlook

Fitch revised Romania's outlook to negative from stable for long-term foreign and local currency issuer default ratings (IDRs). Romania's current account deficit (estimated at 14% of GDP in 2007), external financing requirements and rapid credit growth were among the principal weaknesses highlighted by Fitch. The decision was widely anticipated, given the turbulence on international financial markets and the significant growth of the C/A deficit as a percentage of GDP (from 10.3% in 2006 to around 14% in 2007). However, 2008 might bring a different picture, beginning with 2H. We anticipate a substantial slowdown of the trade balance deficit, following important FDIs in the manufacturing industry during the previous years. An average FX rate of around 3.6 should be more supportive for exports compared to the 3.33 seen in 2007. More companies from the EU might relocate their businesses in more attractive locations in Europe in their attempts to avoid losing ground to US investors from the productivity gains standpoint. Private transfers are expected to increase in nominal terms in 2008, mitigating the external imbalance, while FDIs will remain significant at around EUR 7bn. We forecast a C/A deficit of about 15% of GDP at the end of 2008. A steady disinflation process might begin in the second part of 2008, with key roles played by the FX rate, the results of the domestic agricultural sector and the evolution of international oil prices. The RON depreciated by 0.5% shortly after the press release.

Central bank representative declared that EUR/RON will not reach 4.0 zone

The RON saw a slight recovery this week, as Romanian central bankers threw a lifeline to the leu by intensifying open-market operations. Also, NBR representatives repeatedly underlined that the RON's recent depreciation was an overshoot. The governor suggested that the NBR has already made use of its instruments to curb the sudden depreciation of the local currency, pointing out that the RON started to recover. On Thursday, the domestic currency tested the 3.70 support level, which held on, as euro selling pressure was not strong enough. The exchange rate reversed its move to the upside until reaching the 3.73 zone, after Fitch revised Romania's outlook. The downgrading had a limited impact on the market, as it was already priced in, and the RON returned to the 3.70 zone on Friday. We believe that the RON might strengthen further next week and break the 3.70 support zone, especially if the central bank hikes the rate to above the market consensus estimate (8.5%).

Interbank interest rate reflects another hike of policy rate on January 4

Market participants expect the NBR to hike the monetary policy rate by at least 50bp to 8.5% on January 4. Our base scenario is that the central bank will raise the monetary policy rate by 50bp to 8.5%, but we do not rule out a hike of 75bp. The increase in the market's inflationary expectations and the sharp depreciation of the local currency might trigger a stronger policy response from the NBR on Monday, particularly as the sentiment among foreign investors towards Romania has worsened in the last few months. We do not rule out that the NBR could undertake administrative measures or even change the ratios of the mandatory reserves in order to reduce the growth dynamic of lending (especially FX loans), which rose by 54% in 2006 and even surpassed 60% in 2007.

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Slovakia

EC recommended more ambitious fiscal tightening

In its opinion on the Slovak convergence program, the European Commission called on the Slovak government to adopt more ambitious fiscal deficit cuts (in order to contain elevated inflation pressures once the exchange rate is fixed) and implement measures to enhance labor market performance. Since Slovakia will lose control of monetary policy after euro adoption, fiscal prudence and a flexible labor market will be decisive to absorb any possible inflation or demand shocks.

FinMin: 2008 fiscal shortfall could be below plan

In response, FinMin Jan Pociatek said that he saw fiscal consolidation as good enough to contain inflation pressures. He added that the 2008 general government shortfall could also be better than budgeted (2.3% of GDP), as was the case last year. While the final 2007 data is not known yet, Pociatek said the shortfall was likely around 2.3% of GDP (compared to the initial projection of 2.9% of GDP). He added that he saw some space for a quicker deficit reduction. Our view is that this year's general deficit shortfall could indeed be below forecasts in 2008 (as it was prepared before last year's better than expected outcome was known). However, the government has yet to prove it is able to cut the fiscal gap even without a euro anchor. That is, we see a significant risk that the fiscal consolidation will not be as ambitious as planned (a reduction of the fiscal shortfall to 0.8% of GDP by 2010) after EMU entry in 2009-10, particularly as the election date will be nearing.

CB upped inflation forecasts...

The Slovak central bank left key interest rates on hold, keeping the 2W repo rate at 4.25% and satisfying the market consensus. No proposal to change rates was raised. The CB also approved the new quarterly prognosis, which foresees higher inflation compared to the previous forecast. The increase of the end-08 HICP estimate from 2.3% y/y to 2.8% y/y mainly reflected the higher food and oil price growth. The CB also slightly lifted its end-09 HICP inflation estimate from 2.8% y/y to 2.9% y/y (our forecasts stand at 3.0% y/y for 2008 and 3.3% y/y for 2009). CB Governor Ivan Sramko mentioned a long list of inflation risks: food, fuels, wages and the labor market. Meeting of the nominal Maastricht criterion in spring 2008 is not endangered, but assessment of price performance sustainability remains an open issue. However, we do not think that the recent forecast update would make the discussion about sustainability more difficult (prices of food are a global phenomenon and the Maastricht limit could well exceed 3% during 2008). We expect the official Slovak interest rates to stay flat in the coming months and the CB to harmonize them with the Eurozone after Slovakia gets the European nod to adopt the euro in 2009. If our scenario of flat ECB rates throughout 2008 materializes, this would imply a 25bp rate cut by the NBS in May or June.

...as did MinFin

The Ministry of Finance also presented new forecasts, upping the expected real GDP growth in the next three years to 7.5% in 2008 (we expect 7.2%) and to 6.4% and 5.9% for 2009 and 2010, respectively. The ministry hence expects a slower pace of economic slowdown from the peak in 2007 than it did before, reflecting higher investment activity (especially in the electronics industry) and a greater positive impulse from euro adoption. Similarly to the CB, the ministry revised up its inflation forecasts, now anticipating the HICP average at 3.1% in 2008 and 3.0% in 2009.

Koruna highly volatile

The koruna was highly volatile in recent days, in general moving alongside other Central European currencies. Late appreciation brought it near 33.5 EUR/SKK on Friday, which was slightly stronger compared to the beginning of the week. There is a good deal of short-term uncertainty, but, in the horizon of several weeks, we expect further koruna appreciation. This week, no domestic market-moving events are scheduled. On Friday, December industrial production is due to be released. We expect the figure to confirm the strong growth seen in the previous months (our estimate is 15.8% y/y).

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Appendix Charts

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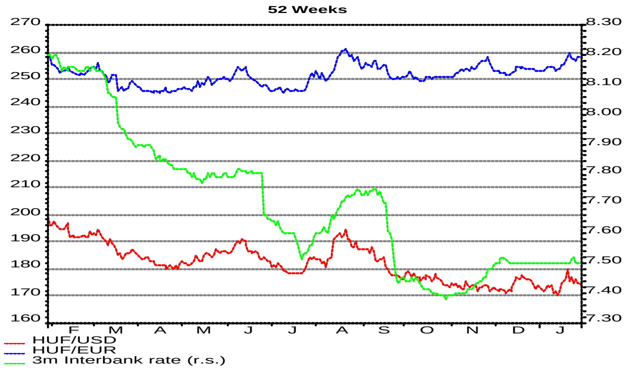
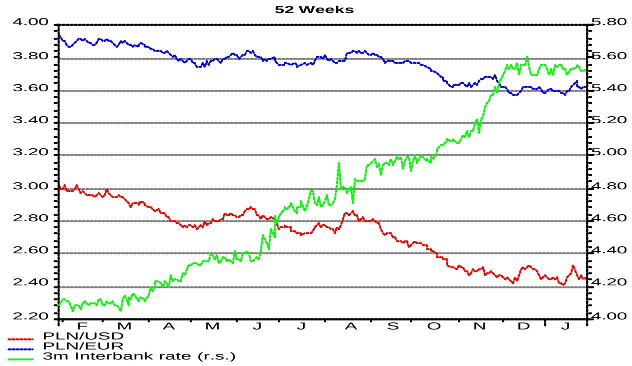
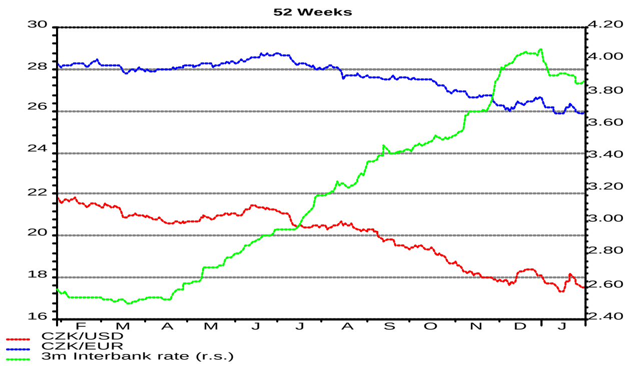
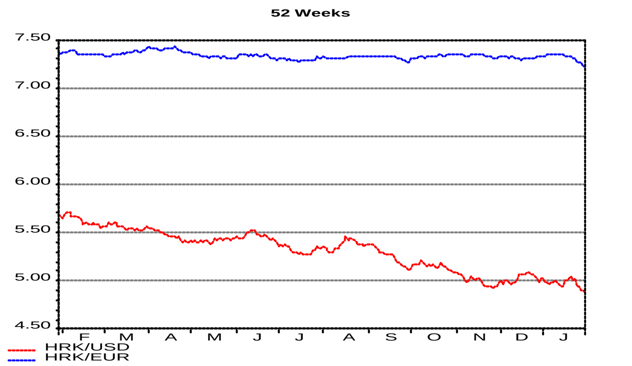
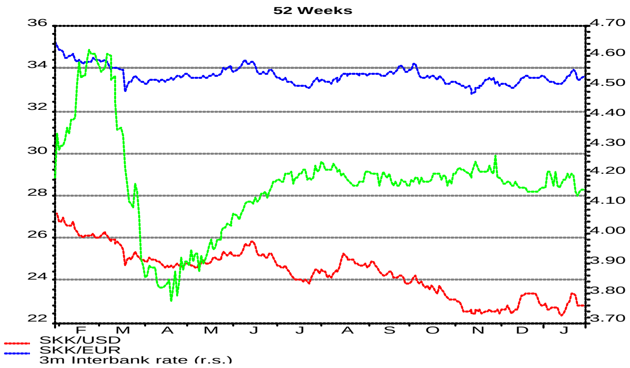
Exchange rates and interest rates (52 weeks)

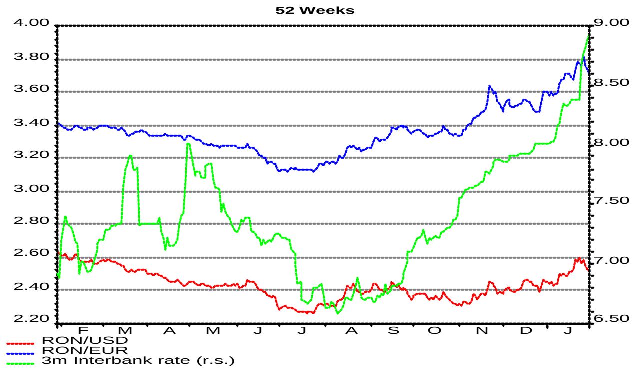








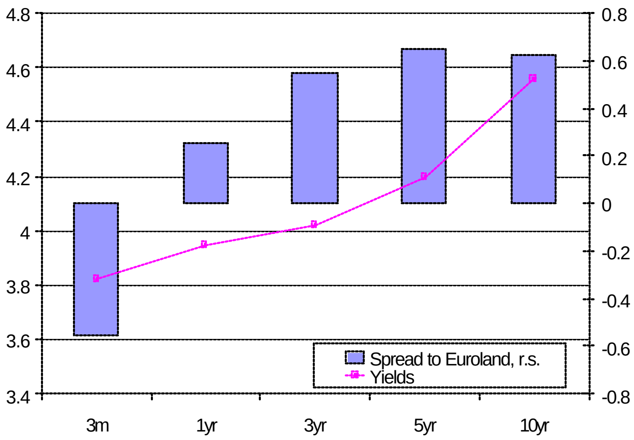




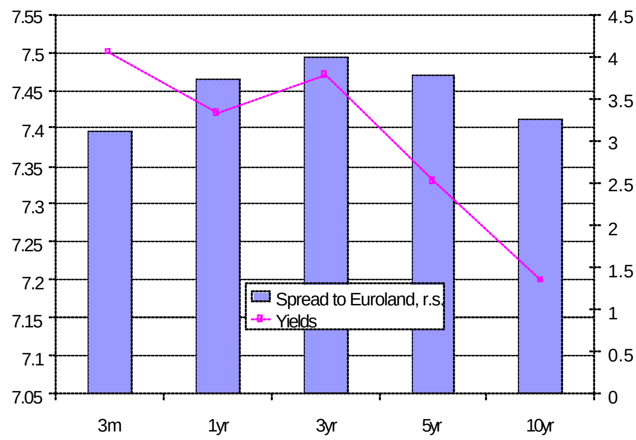
Source: Datastream

Benchmarks

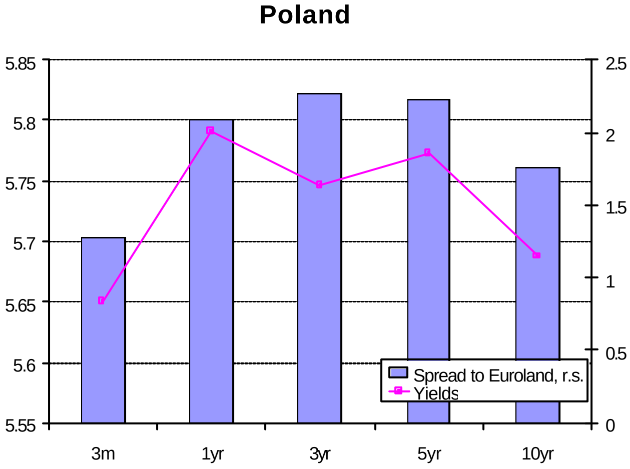
Czech Republic

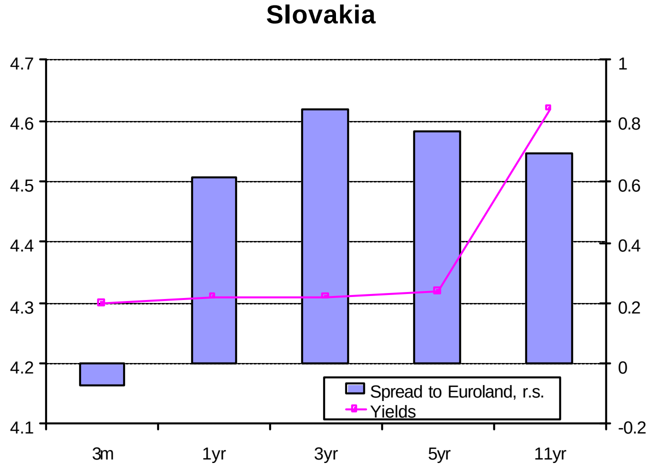


Hungary



Appendix Forwards





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