CEE Research

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Fixed Income and Foreign Exchange

CEE Insights

- **Czech Republic:** 4Q GDP growth most important figure to be released next week
- **Hungary:** NBH left rates unchanged on Monday, but changed FX regime to free float
- **Poland:** MPC to stay in tightening gear; expect next hike soon
- **Romania:** RON hit by poor news from US
- **Slovakia:** Koruna at new highs, comments on conversion rate closely watched

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Overview

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Czech Republic:

- 4Q GDP growth most important figure to be released next week
- Trade balance should be closely monitored

Hungary:

- NBH left rates unchanged on Monday, but changed FX regime to free float
- Quo vadis forint and rates?
- 4Q07 GDP breakdown in focus next week

Poland:

- Hawkish post-meeting statement in line with decision to hike key rates by 25bp
- Inflation to hover above-target in 2010
- MPC to stay in tightening gear; expect next hike soon
- Zloty enjoyed another positive week

Romania:

- Good economic growth in 2007, despite difficult year
- RON hit by poor news from US
- Romania to issue state treasuries worth RON 1.6bn in March

Slovakia:

- Koruna at new highs, comments on conversion rate closely watched
- CB kept interest rates steady

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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	25.01	0.8%	3.6%	6.1%			
	3Y (yield bp)	4.01	1	0	-30	67	46	41
	10Y (yield bp)	4.63	0	9	-11	63	55	53
Croatia	EUR/HRK	7.28	0.2%	-0.2%	0.4%			
	3Y (yield bp)	5.89	-1	4	58	252	243	140
	10Y (yield bp)	5.77	1	-8	24	183	195	135
Hungary	EUR/HUF	257.62	3.2%	0.4%	-1.7%			
	3Y (yield bp)	8.19	-12	72	64	485	390	365
	10Y (yield bp)	7.70	-6	50	59	370	321	290
Poland	EUR/PLN	3.52	1.7%	3.0%	2.4%			
	3Y (yield bp)	6.22	13	43	3	288	222	229
	10Y (yield bp)	5.98	3	50	2	198	171	176
Romania	EUR/RON	3.64	0.3%	3.3%	-1.8%			
Slovakia	EUR/SKK	32.81	0.9%	2.6%	2.3%			
	3Y (yield bp)	4.21	0	-11	-38	86	77	52
	11Y (yield bp)	4.63	-1	2	-19	66	64	48

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

Trading Ideas

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Positions

Currently no open trading idea

Rationale at inception

Currently no open trading idea

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	6.0%
5	long: SKK/CZK	09/11/2005	20/01/2006	1.9%
3	short EUR/SKK	29/09/2005	07/02/2006	3.5%
4	EUR/PLN options	21/10/2005	28/07/2006	-2.7%
6	SKK/CZK long	23/03/2006	30/10/2006	2.2%
7	FRA 9*12 short	28/07/2006	08/11/2006	8bp
8	long HUGB 5y	13/10/2006	29/01/2006	5.7%
9	short CZGB/ long GDBR	09/01/2007	27/02/2007	1.8%
10	long CZK/EUR	27/02/2007	19/03/2007	2.3%
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	-3.1%
17	long 3y HUGB / 3m Pribor	05/12/2007	08/02/2008	-6.8%
20	short EUR/SKK	22/01/2008	13/02/2008	2.9%
19	long USD/CZK	21/01/2008	18/02/2008	-3.6%
18	short EURRON	31/12/2008	28/02/2008	-0.6%

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	25.2		7.28		263		3.53		3.65		32.5		3.75	4.76	7.50	5.50	9.00	4.25
Mar-08	26.0	25.2	7.25	7.25	261	264	3.55	3.53	3.68	3.67	32.6	32.5	3.75	4.50	7.50	5.50	9.50	4.25
Jun-08	26.8	25.2	7.20	7.20	260	266	3.60	3.55	3.65	3.73	32.5	32.5	4.00	4.50	7.50	5.75	9.50	3.75
Sep-08	26.3	25.2	7.25	7.25	256	269	3.55	3.57	3.60	3.78	32.5	32.5	4.00	4.00	7.25	5.75	9.50	3.50
Dec-08	25.9	25.2	7.30	7.30	256	272	3.51	3.59	3.55	3.84	32.5	32.5	4.00	4.00	7.00	5.75	9.00	3.50

	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		5.92		10.67		4.26		4.62	5.77	7.70	5.98	4.62	9.70
Mar-08	4.10	4.03	7.50	8.05	5.90	6.11	11.00	10.20	4.25	4.52	4.70	5.80	7.40	5.70	4.65	9.80
Jun-08	4.14	4.05	7.50	8.35	6.00	6.39	10.50	9.46	3.85	4.23	4.60	5.60	7.20	5.60	4.65	9.70
Sep-08	4.09	4.04	7.30	8.34	5.95	6.34	10.20	8.36	3.70	4.04	4.70	5.40	6.60	5.65	4.65	9.10
Dec-08	4.14	4.01	7.00	8.26	5.95	6.24	9.80	7.82	3.70	3.87	4.80	5.30	6.40	5.55	4.70	9.00

Long-term forecasts

GDP growth (%)	2006	2007e	2008f	2009f
Czech Republic	6.4	5.9	4.3	5.4
Croatia	4.8	5.7	4.6	4.8
Hungary	3.9	1.3	2.5	3.2
Poland	6.1	6.5	5.5	5.7
Romania	7.7	5.7	6.1	6.0
Serbia	5.7	7.3	6.3	6.8
Slovakia	8.5	10.3	6.7	5.0
Ukraine	7.1	7.3	6.6	6.0
CEE8 weighted average	**6.3**	**6.0**	**5.2**	**5.4**

CPI (%), eoy	2006	2007e	2008f	2009f
Czech Republic	2.5	5.4	5.4	3.2
Croatia	2.0	5.8	3.1	3.5
Hungary	6.5	7.4	4.5	2.7
Poland	1.4	4.0	3.4	2.7
Romania	4.9	6.6	5.4	4.5
Serbia	6.6	10.1	4.9	5.5
Slovakia	4.2	3.4	3.7	3.9
Ukraine	11.6	16.6	12.8	11.5
CEE8 weighted average	**4.1**	**6.6**	**5.2**	**4.2**

Unemployment (%)	2006	2007e	2008f	2009f
Czech Republic	8.1	6.7	6.3	6.1
Croatia	10.5	9.8	9.4	9.0
Hungary	7.5	7.7	7.6	7.5
Poland	14.9	11.4	9.3	8.0
Romania	5.2	4.1	4.0	3.9
Serbia	20.9	20.0	19.0	18.0
Slovakia	10.4	8.4	7.6	7.4
Ukraine	7.4	6.4	5.4	4.2
CEE8 weighted average	**10.6**	**8.8**	**7.7**	**7.0**

3M rates (average, %)	2006	2007e	2008f	2009f
Czech Republic	2.3	3.0	3.7	4.3
Croatia	4.5	5.6	7.0	5.5
Hungary	7.0	7.7	7.4	6.5
Poland	4.2	4.6	5.8	5.5
Romania	8.8	7.8	9.5	8.0
Serbia	22.1	11.3	11.2	10.0
Slovakia	4.3	4.3	4.0	4.2
Ukraine	13.5	9.8	10.9	10.0
CEE8 weighted average	**6.5**	**6.0**	**6.9**	**6.4**

C/A (%GDP)	2006	2007e	2008f	2009f
Czech Republic	-3.0	-3.4	-4.0	-3.4
Croatia	-7.8	-8.3	-8.1	-7.9
Hungary	-6.5	-5.2	-4.7	-4.3
Poland	-3.2	-3.7	-5.0	-5.6
Romania	-10.3	-14.3	-15.0	-15.0
Serbia	-11.7	-16.8	-16.0	-16.2
Slovakia	-7.2	-4.8	-3.9	-3.6
Ukraine	-2.9	-4.1	-3.7	-4.2
CEE8 weighted average	**-5.2**	**-6.0**	**-6.5**	**-6.6**

Budget Balance (%GDP)	2006	2007e	2008f	2009f
Czech Republic	-2.9	-1.9	-2.9	-2.7
Croatia	-3.0	-2.3	-2.8	-3.0
Hungary	-9.2	-5.7	-4.0	-3.9
Poland	-3.9	-2.6	-3.2	-2.9
Romania	-1.6	-2.4	-2.7	-2.7
Serbia	0.2	-1.0	-0.5	-0.5
Slovakia	-3.7	-2.5	-2.4	-2.6
Ukraine	-0.7	-2.8	-2.7	-3.0
CEE8 weighted average	**-3.5**	**-2.8**	**-3.0**	**-2.9**

Diaries

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Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	Mar-06	Trade balance (CZK bn)	-	-
	Mar-07	GDP 4Q final (% y/y)	-	-
Croatia	No data releases scheduled			
Hungary	Mar-07	January Industrial output	5.5% y/y	-
	Mar-07	January Trade balace	EUR-90mn	-
	Mar-07	4Q07 GDP breakdown	-	-
	Mar-09	Referendum on co-payments in the healthcare and univ. tuition fees		
Poland	No data releases scheduled			
Romania		GDP growth - y/y	5.7%	5.9%
Slovakia	Mar-04	4Q GDP	14.1% y/y	14.1%
	Mar-07	January industrial production	5.6% y/y	n.a.

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		Mar-05	Mar-10	2017-Apr-11	4.00%	CZK 7bn	-
		Mar-06	Mar-07	2008-Jun-06	-	CZK 5bn	-
Hungary		Mar-03	Mar-05	April-23-2008	-	HUF 40bn	7.90%
		Mar-04	Mar-12	June-11-2008	-	HUF 35bn	7.90%
		Mar-05	Mar-12	Sept-24-2008	-	HUF 20bn	8.00%
		Mar-06	Mar-12	Jan-28-2009	-	HUF 35bn	8.00%
Poland		Mar-05	Mar-07	2017-Oct-25	5.25%	-	-
Romania		06-Mar-08	10-Mar-08	3Y	8.00%	RON 500 mn	9.30%
Slovakia		No auction scheduled					

Major Markets

Major markets

New ECB staff projections

Next week's ECB meeting will bring no change in interest rates and the neutral bias implemented in February will be kept unchanged. In the press conference, President Trichet will present the new economic projections of the ECB staff. A downward revision to the growth forecasts and an upward revision to inflation forecasts must be expected. We expect the forecasts to be brought near to our expectations of a growth rate of 1.8% for 2008. The inflation forecast for 2008 will be revised significantly up, but will likely remain below our estimate of 2.8%. The general tone of the statement will be more hawkish than in February, as council members were keen to weaken the impression of the market after the last meeting that interest rate cuts were imminent. We expect the ECB to cut interest rates in 2Q and 3Q by 50bp in total to support the banking sector. Next weeks data releases will contain the final figures for the purchasing manager indices and January factory orders and industrial production for Germany. The flash estimate of purchasing manager indices came in above expectations and these positive numbers should be confirmed by the final figures. Factory orders and industrial production should both show a more or less unchanged reading, with a small increase in production and a small decline in orders.

Already poor sentiment after Bernanke comments to decline further, albeit only moderately

Next week will bring important economic data for the US. Good news is very unlikely, although it remains to be seen if sentiment can deteriorate further. Fed Chairman Bernanke confirmed the deterioration of the economy and inflationary risks, but this was more or less known. However, market sentiment was pushed over a cliff, as Bernanke said that the current situation was worse than before the 2001 recession. Whether this was intended or not, this was of course a boost to recession expectations. Next week will start off with the ISM index. After a slight improvement in the previous month, the index likely worsened in February. The numbers should indicate a moderate decline in output and a bleak outlook. The ISM index for the non-manufacturing industries released on Wednesday should hardly have any market impact, at best amplifying any intraday trends at that time. The week will close with the all-important labor market report. Weekly initial jobless claims point to a stronger contraction of the labor market in February than in January, in our view. So, we think that the market's estimate of a reduction of non-farm payrolls by the same amount is too optimistic. As usual, one must also consider the high risk for considerable revisions of historical data. Overall, next week's data will definitely not improve the outlook for the US economy. However, given the current levels of yields and the dollar, we think that there is only moderate potential for further declines.

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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	4.39		3.08		3.95	3.64	1.520	
Mar-08	4.00	2.50	4.20	4.42	2.50	3.01	4.00	3.60	1.48	1.519
Jun-08	3.75	2.50	4.00	4.32	2.60	2.76	4.00	3.80	1.45	1.514
Sep-08	3.50	2.50	3.75	4.27	2.70	2.52	4.30	4.20	1.40	1.508
Dec-08	3.50	2.50	3.70	3.92	2.80	2.52	4.50	4.40	1.35	1.503

Czech Republic

4Q GDP growth most important figure to be released next week

Data releases will be scarce next week. The most important is the final data on GDP growth for 4Q. While we already had the preliminary data on GDP, we did not see the structure. Preliminary data showed the growth surging to 6.9% in 4Q, of which 0.5pp is estimated to have been added by health insurers alone (probably due to the frontloading of medical supply purchases ahead of the January VAT increase and the introduction of health fees). Nevertheless, even abstracting from this one-off change would keep the GDP above 6%. The structure will show consumption as the main driver of GDP. Net exports will also make a positive contribution, albeit not as substantial as in previous years, since the growth of exports was almost compensated for by the growth of imports.

Trade balance should be closely monitored

Other data next week will include the average real wage for 4Q (also a backward-looking indicator) and the trade balance for January (our expectation: CZK +6.8bn). However, this data should not have much of an impact on the immediate trading. Nonetheless, the trade balance and industrial production need to be monitored closely, in order to discover signs of negative effects from the combination of the stronger CZK and the slowdown in the EU.

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Hungary

NBH left rates unchanged on Monday, but changed FX regime to free float

At its Monday monetary meeting, the central bank opted to keep the base rate on hold (7.50%), but chose something else to improve the credibility of the monetary policy. Instead of hiking the base rate - as a reply to the forint weakening and poorer inflation outlook - the monetary council announced the abolishment of the forint exchange rate band. From Tuesday, the bandwidth (HUF/EUR 240-324.7) was abandoned and the exchange rate regime was changed to free float. The decision came as a big surprise, as the government had so far rejected this step, despite the central bank's endorsement. Please note that the last time the topic of the Hungarian FX regime was strongly in focus was just one year ago. In our CEE Insights (published on March 23, 2007), we also wrote about problems related to the previous regime - mainly the band's unrealistic position and its inconsistency with the inflation targeting system, which led to lower credibility of the monetary policy.

We believe that the central bank has managed to persuade the government just in time. No one expected the step to be taken recently, so the exchange rate was comfortably far from the edges of the band. In addition, as inflation has been suffering from different shocks and the mid-term inflation outlook worsened, the change in the FX regime could help the monetary policy to anchor inflationary expectations, which now seem to be a key factor for reaching the inflation goal in a foreseeable period. Overall, by eliminating the possible contradictions between the existence of the band and the inflation targeting system, the step should lead to higher credibility of the monetary and economic policy. And, last but not least, the decision can also be seen as a commitment to the EMU. Freeing the exchange could create a basis for a market-determined ERM II entry rate, as a preliminary stage for EMU entry.

In the mid and longer run, due to the new FX regime, we could expect lower risk premia on Hungarian assets (lower base rates). In addition, as the new regime allows for appreciation beyond the EUR/HUF level of 240, we see more room for the real price convergence to be driven rather by the forint's nominal appreciation than by higher inflation (similarly to the Czech Republic, Slovakia and Poland).

Quo vadis forint and rates?

As the sentiment on the market had pointed to base rate hikes last week, we also indicated that we might have to change our base rate forecasts. After Monday's surprising event, however, we leave our original forecasts unchanged (hold in 1H and cautious rate reductions in 2H) for the time being. We should add, however, that the possibility for rate hikes within a relatively short amount of time cannot be ruled out. According to the February Inflation Report, the inflation forecast of the bank's staff for 2009 was raised to 3.6% y/y (from just 3% y/y in November). Thus, the 3% goal is not seen to be reached by 2009 with the current monetary conditions. The rate policy in the near future will strongly depend on the incoming inflation and wage figures, as well as forint market developments.

As for the exchange rate, first of all, we should mention that we do not think that abandoning the band means an increasing risk of forint weakening. The market immediately replied to the decision with a stronger forint. However, by the end of the week, the forint again weakened, due to increasing recession fears in the US. All in all, although we expect nominal currency appreciation in the mid run, the short-term development of the exchange rate remains highly uncertain, mainly because of the current uncertain global environment. The key factor should again become the formation of global risk appetite, which is not expected to significantly improve before 2H.

4Q07 GDP breakdown in focus next week

Next week, the most watched event should be the release of the breakdown of the 4Q07 GDP figures on Friday. However, the CSO already published the 4Q investment figures this morning, which surprised us on the upside. Investments rose 2.4% y/y in 4Q07 (after the 2.5% drop in 3Q), finally pushing the FY07 figure into slightly positive territory (+0.3% y/y). Public investments continued to drop. However, it is positive for future growth prospects that investments carried out in the private sector showed some revival in the last quarter of 2007 (especially in the fields of processing industry and transport).

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Poland

Hawkish post-meeting statement in line with decision to hike key rates by 25bp

The central bank opted to increase the reference rate by 25bp at the February meeting, bringing it to the level of 5.5%. As such, this did not represent a big surprise to the market. While analysts were unanimous in not expecting a move in polls conducted at the beginning of the month, the opinions started to change following macro data releases that pointed to higher spot inflation, its deteriorating structure and intensifying inflation risks (mainly in the area of wages). Hence, the market became almost evenly split between the 'no hike' and '+25bp' options in the end. We were betting on a hike one month later (in March), but acknowledged the high probability of an earlier move. A hawkish tone reigned in the accompanying statement, which is not a surprise, taking into account the outcome of the meeting. The council seems to be worried by the uptick in the spot inflation rate. Though seen as temporary, it creates a risk of inflation expectations getting stuck at higher levels and the emergence of undesirable second-round effects (this is a new point in the statement). The statement also lists several inflation risks. The economy is expected to gallop above the potential pace of growth in the coming quarters. Moreover, attention is paid to a further deterioration in the gap between wages and productivity. Last but not least, the state budget should end this year with a higher deficit than a year ago. There were also some dovish points mentioned, but these are not seen as strong enough to offset the inflation risks (e.g. globalization, the good financial standing of companies, the zloty and the slowdown in the global economy).

Inflation to hover above-target in 2010

Within the fresh inflation prognosis, the central bank's research team revised the expected GDP growth downwards for the coming two years. This year's growth is seen with a probability of 50% in the range of 4.4-5.8%. At the same time, though, the inflation path has been significantly nudged upwards in comparison to the October report. The projected inflation trajectory approaches the previous prognosis only in the second half of 2009. An important point is that inflation is seen hovering above the target (2.5%) in 2010, as well (a horizon that was not included in the previous projections).

MPC to stay in tightening gear; expect next hike soon

Even the fresh update of the Inflation Report, which was accused of being too dovish on previous occasions by MPC members, foresees inflation hovering above the target of 2.5% in the medium term. This clearly hints that the rate tightening cycle has not ended in Poland. Inflation should creep yet higher in the coming months, on the back of regulated price increases, while the core component will also be pulled upwards by the robust domestic demand. However, we think that the rate cuts by central banks in major markets (increasing the interest rate differential), stronger zloty, slower economic growth and the impact of previous monetary tightening should gradually start to bite into the hiking appetite of central bankers. The acceleration of the hiking pace (two hikes in a row) does not necessarily mean more pronounced tightening (than we expected earlier). We think that the council might have been motivated by two factors to hike already in February. The first was the desire to strengthen its credibility. The hike was a signal that the central bank stays strongly committed to controlling inflation (in the environment of rising headline inflation). Such a signal is especially important to be sent out at the beginning of the year, when many wage agreements are adjusted. Secondly, we think that the MPC wants to avoid hiking the rates significantly at the time when the ECB starts to ease its monetary policy. This could exert excessive psychological pressure on the appreciation of the zloty. Our long-held core scenario assumes the tightening cycle peaking at 5.75% (vs. the market estimate of 5.5% in the poll at the beginning of this month). Risks are currently skewed towards more pronounced tightening (to 6.0-6.25%).

Zloty enjoyed another positive week

The zloty traded on a strong footing this week, notching further gains against the euro. On the domestic scene, Wednesday's hike brought upward adjustments to the expected scale of future tightening to the market, which helped the zloty. However, from a technical viewpoint, the risk of a short-term correction is rising. The head of the central bank said this week that the turn of years 2009 and 2010 may be the time of Poland's entry to ERM II. This would imply earliest possible euro adoption in 2012-13. The latter date is our baseline scenario.

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Romania

Good economic growth in 2007, despite difficult year

The Romanian National Institute of Statistics will release the GDP growth figures for 2007 next week. According to our estimation, the economic growth for 2007 was around 5.7%. The main driver of the economic growth was the strong investments in construction (+30% y/y), with a balanced distribution among residential buildings, non-residential buildings and civil engineering work. The contribution of industry to the economic growth was rather modest in 2007, following a fall-off in the energy and mining sectors. However, manufacturing performed well, offsetting the slight decreases in the two other main industrial sectors. We expect a better development of industry beginning with 2008-09, following higher output of international companies in the automotive and electronics industry. Agriculture had a strongly negative contribution to economic growth in 2007, as the severe summer drought affected the production of small farms. Agriculture relies heavily on weather conditions and significant investments are required in the coming period. Considering the traditional potential of Romanian agriculture, we expect important FDIs in the coming period, with an important focus on European funds. Economic growth for the next few years will be closer to potential GDP (around 6%), thus preserving the significant growth differential relative to the Eurozone average. Economic growth should not generate additional pressures on the inflation rate, and the central bank seems determined to pursue a tight monetary policy, in order to reduce the inflation rate in a consistent way. Aggregate consumption has already shown clear signs of deceleration (+7.8% y/y in 3Q07, compared to +11.2% y/y in 1Q07), while net exports should improve their performance, following important FDIs in previous years.

RON hit by poor news from US

Starting Thursday, the RON positioned on a weakening path, although the interbank interest rates remained high. The worsening of investors' sentiment was triggered by the poor news from the US, as the market prices in chances of contagion from the US in countries with high external imbalances. The RON dropped to 3.72 in early Friday trading, where it found some resistance; the EUR/RON quotes repositioned lower to 3.70 within less than one hour. The central bank maintained its restrictive monetary policy, wiping out all of the liquidity in the local money market. We believe that the Romanian forex market will remain highly volatile next week, with the exchange rate ranging in the 3.65-3.72 zone.

Romania to issue state treasuries worth RON 1.6bn in March

At the beginning of the year, Romania needed money to finance its contribution to the EU budget and decided to borrow money from the domestic financial market, despite the high yields requested by investors (which even surpassed the monetary policy rate). In the first two months of 2008, the MinFin issued state debt instruments amounting to RON 2.55bn, while Romania initially planned to sell RON 3.7bn. The yields paid to investors by the MinFin ranged from 9.0% to 9.5%, differentiating on the maturity of the debt instrument. The Romanian bond market has a descending yield curve, as market expectations point towards a decrease of yields in the medium term, as inflationary pressures ease. The MinFin released the calendar for state debt instruments for March. It intends to borrow RON 1.6bn from the local market through 6M and 1Y T-bills and 3Y and 5Y benchmark bonds. The next auction will take place on March 6. Romania will be selling 3-year benchmark bonds for an indicative amount of RON 500mn. The coupon rate stands at 8.0%, but we do not expect the cut-off rate to exceed 9.5%.

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Slovakia

Koruna at new highs, comments on conversion rate closely watched

The koruna reached new all-time highs this week (at 32.44 EUR/SKK), as the markets showed great sensitivity to comments from Slovak and European officials on the possible euro conversion rate during the past week. CB Vice Governor Martin Barto propelled the koruna last Friday, saying that the Slovak conversion rate should reflect the future development of the economy, suggesting a preference for a stronger conversion rate. He also added that it would be beneficial if the exchange rate worked against inflation pressures after euro adoption. Another positive impulse was delivered this week by PM Robert Fico, who said that the exchange rate should be negotiated at a level that would not boost inflationary pressures. On Thursday, the koruna advanced further, after the comments from Finance Minister Jan Pociatek, who said that the possibility of (ERM-2 central parity) revaluation cannot be ruled out. In addition, Eurogroup Chairman Jean-Claude Juncker voiced his optimism that Slovakia would fulfill all of the convergence criteria. The market is obviously skewed to one side at the moment and responds vigorously to vague comments (like that of Finance Minister Pociatek), in line with our long-held view that foreign investors are interested in as strong an exchange rate as possible. The most critical question mark remains the stance of the central bank (as to what levels would still be acceptable). We expect the conversion rate to be set at a level close to the one prevailing on the market at the time of setting the conversion rate or the revaluation of the ERM-2 central parity. Currently, the market is close to where we expect the conversion rate (32.5-33.0 EUR/SKK, which is also where the CB will - in our view - see the equilibrium rate in mid-2008).

CB kept interest rates steady

The central bank left official interest rates unchanged at this week's meeting, matching broad market expectations (the key 2W repo rate stays at 4.25%). No proposal to change interest rates was raised at the Bank Board meeting. According to Vice Governor Ostrožlík, the economy did not feature demand-driven inflation pressures. We expect official interest rates to stay flat at least until May, when Slovakia gets approval to adopt the euro in 2009. The key interest rate, currently 25bp above the ECB level, should in May or June be harmonized with the ECB level. Afterwards, we expect the NBS to follow the steps of the ECB.

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Appendix Charts

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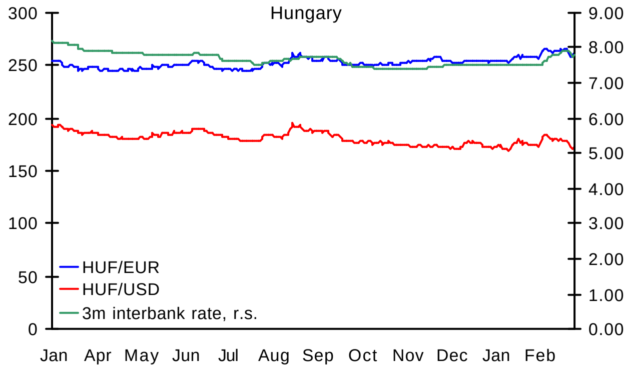
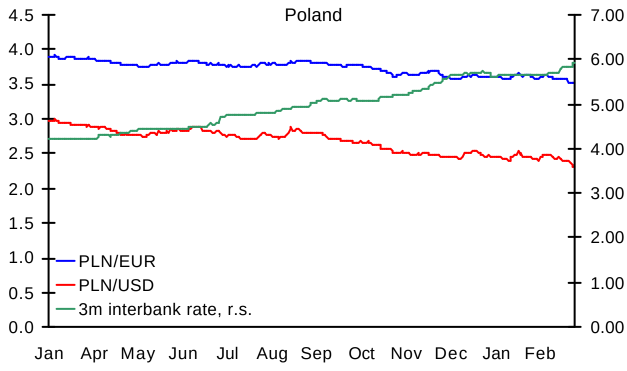
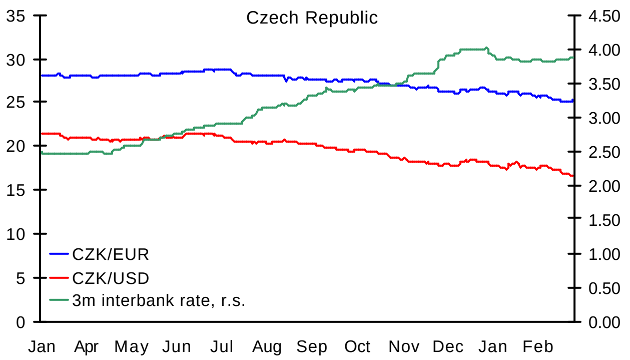
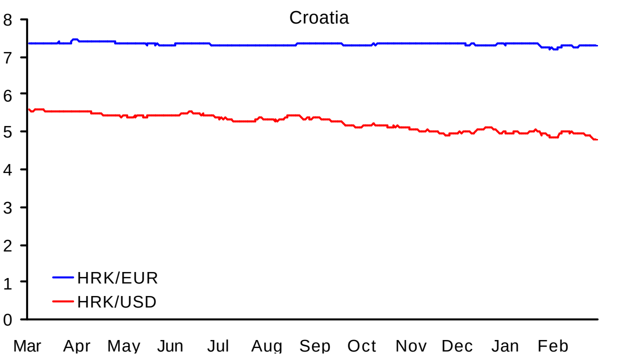
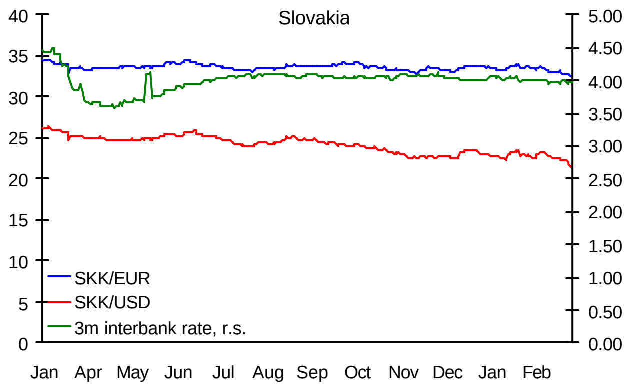
Exchange rates and interest rates (52 weeks)

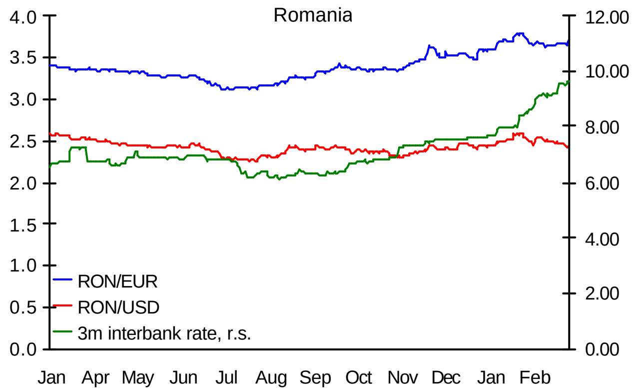








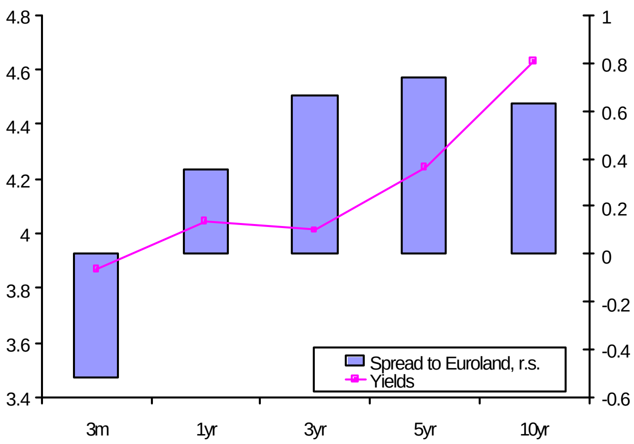




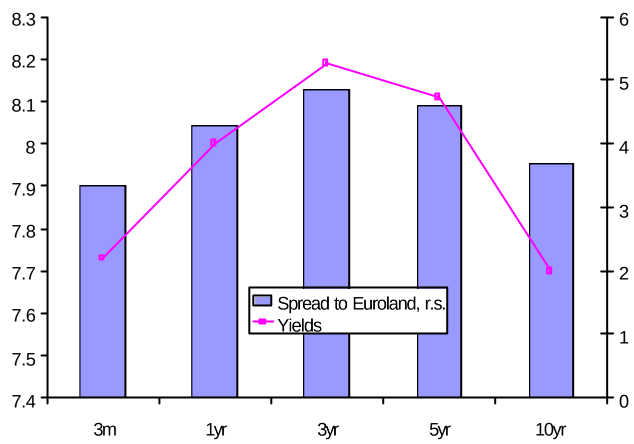
Source: Bloomberg

Benchmarks

Czech Republic



Hungary



Appendix Forwards

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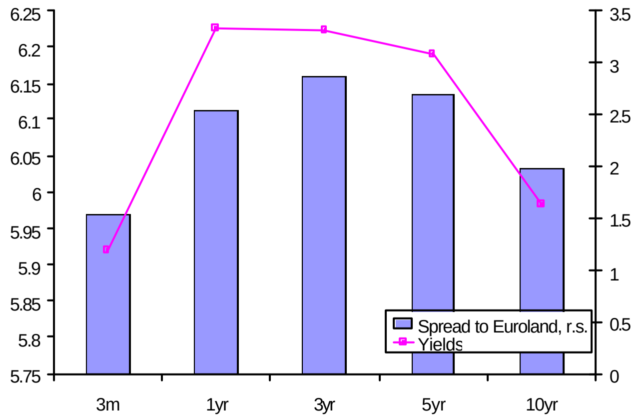
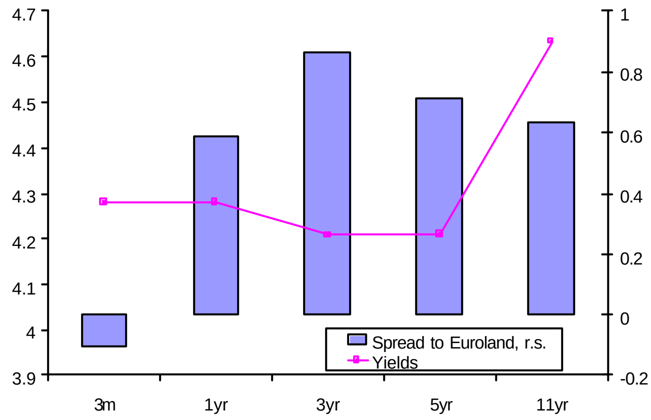
Poland



Slovakia



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