CEE Research

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Fixed Income and Foreign Exchange

CEE Insights

- **Croatia:** Short-term indicators bring some optimism
- **Czech Republic:** Looking for ways to limit CZK appreciation
- **Hungary:** We have changed our base rate forecasts for 2008
- **Poland:** CB to hike key rates by 25bp next week
- **Romania:** Central bank to hike key rate next week
- **Slovakia:** CB to keep interest rates stable next week

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Overview

Croatia:

- CPI figures moderated in February
- Short-term indicators bring some optimism
- Markets offering low volatility

Czech Republic:

- Looking for ways to limit CZK appreciation
- Retail sales figures reported
- No change in rates expected next week

Hungary:

- More comments from rate setters
- We have changed our base rate forecasts for 2008
- Government changed its macro forecast
- Market consolidation continued

Poland:

- Wages galloping briskly ahead
- Industry shows strong reading, mitigating fears of economic slowdown
- CB to hike key rates by 25bp next week

Romania:

- Central bank to hike key rate next week
- Low RON volatility, despite unfavorable international environment
- Labor productivity above salary growth during last few years
- Ford officially becomes owner of car plant today

Slovakia:

- CB to keep interest rates stable next week

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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	25.53	-1.9%	-0.7%	4.0%			
	3Y (yield bp)	4.25	6	0	-6	86	57	41
	10Y (yield bp)	4.75	10	17	1	99	58	53
Croatia	EUR/HRK	7.26	0.0%	0.3%	0.6%			
	3Y (yield bp)	5.81	1	-9	50	249	246	140
	10Y (yield bp)	5.83	3	5	30	210	180	135
Hungary	EUR/HUF	258.14	0.2%	2.6%	-1.9%			
	3Y (yield bp)	9.11	-7	80	156	572	497	365
	10Y (yield bp)	8.08	-49	32	97	433	377	290
Poland	EUR/PLN	3.54	0.1%	1.1%	1.8%			
	3Y (yield bp)	6.28	-5	23	9	289	271	229
	10Y (yield bp)	5.99	0	32	2	224	191	176
Romania	EUR/RON	3.73	-0.5%	-2.4%	-4.1%			
Slovakia	EUR/SKK	32.65	-1.0%	1.3%	2.8%			
	3Y (yield bp)	4.20	2	0	-39	71	83	52
	11Y (yield bp)	4.59	0	-4	-23	85	62	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	25.5		7.26		258		3.54		3.72		32.7		3.75	5.04	7.50	5.50	9.00	4.25
Mar-08	25.1		7.25	7.25	260	258	3.55		3.68	3.73	32.5	32.7	3.75	4.50	8.00	5.75	9.50	4.25
Jun-08	26.1	25.5	7.20	7.20	260	260	3.60	3.55	3.65	3.79	32.5	32.7	4.00	4.50	8.00	5.75	9.50	3.75
Sep-08	26.4	25.5	7.25	7.25	256	263	3.55	3.57	3.60	3.85	32.5	32.6	4.00	4.00	7.75	5.75	9.50	3.50
Dec-08	25.9	25.5	7.30	7.30	256	266	3.51	3.59	3.50	3.91	32.5	32.6	4.00	4.00	7.50	5.75	9.00	3.50

	3m Money Market Rate										10y Govt. Yield					5y Yield
	CZ	Forward	HU	Forward	PL	Forward	RO	Forward	SK	Forward	CZ	HR	HU	PL	SK	RO
Spot	4.09		8.16		6.04		10.94		4.27		4.75	5.83	8.15	5.98	4.58	10.00
Mar-08	4.03	4.12	8.20	8.24	6.00	6.07	11.00	10.40	4.25	4.35	4.70	5.80	8.10	5.95	4.65	10.30
Jun-08	4.06	4.05	7.90	8.47	5.95	6.29	10.50	9.38	3.85	4.35	4.60	5.60	7.60	5.80	4.65	10.10
Sep-08	4.09	4.17	7.70	8.46	5.95	6.30	10.10	7.81	3.70	4.27	4.70	5.40	7.00	5.80	4.65	9.60
Dec-08	4.14	4.30	7.40	8.37	5.90	5.80	9.50	6.89	3.70	3.99	4.80	5.30	6.70	5.55	4.70	9.30

Long-term forecasts

GDP growth (%)	**2006**	**2007e**	**2008f**	**2009f**
Czech Republic	6.4	6.6	4.3	5.4
Croatia	4.8	5.7	4.6	4.8
Hungary	3.9	1.3	2.2	3.2
Poland	6.1	6.5	5.5	5.7
Romania	7.9	6.0	6.1	6.0
Serbia	5.7	7.3	6.3	6.8
Slovakia	8.5	10.4	6.7	5.0
Ukraine	7.1	7.3	6.6	6.0
CEE8 weighted average	**6.3**	**6.2**	**5.2**	**5.4**

Unemployment (%)	**2006**	**2007e**	**2008f**	**2009f**
Czech Republic	8.1	6.6	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**	**8.7**	**7.7**	**7.0**

C/A (%GDP)	**2006**	**2007e**	**2008f**	**2009f**
Czech Republic	-3.0	-3.2	-3.6	-2.2
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	-10.4	-13.9	-15.0	-15.0
Serbia	-11.7	-16.8	-16.0	-16.2
Slovakia	-7.2	-5.3	-4.5	-4.1
Ukraine	-2.9	-4.1	-3.7	-4.2
CEE8 weighted average	**-5.2**	**-6.0**	**-6.5**	**-6.5**

CPI (%), eoy	**2006**	**2007e**	**2008f**	**2009f**
Czech Republic	2.5	4.9	5.1	4.2
Croatia	2.0	5.8	3.1	3.5
Hungary	6.5	7.4	4.6	3.1
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**	**6.5**	**5.2**	**4.4**

3M rates (average, %)	**2006**	**2007e**	**2008f**	**2009f**
Czech Republic	2.3	3.1	4.1	4.4
Croatia	4.5	5.6	7.0	5.5
Hungary	7.0	7.7	7.6	6.5
Poland	4.2	4.6	5.8	5.5
Romania	8.8	7.8	10.3	7.8
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**	**7.1**	**6.3**

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	-2.3	-2.7	-2.7
Serbia	0.2	-1.0	-0.5	-0.5
Slovakia	-3.7	-2.2	-2.1	-2.4
Ukraine	-0.7	-2.8	-2.7	-3.0
CEE8 weighted average	**-3.5**	**-2.7**	**-3.0**	**-2.9**

Diaries

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Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	Mar-26	CB rate-setting meeting	no change (3.75%)	no change (3.75%)
Croatia	Mar-28	4Q GDP	4.1% y/y	
Hungary	Mar-21	Minutes from CB meeting (02/2008)		
Poland	Mar-26	Retail sales (% y/y)	17.7%	19.4%
	Mar-26	CB rate-setting meeting	+25bp (5.75%)	+25bp (5.75%)
Romania	26 March 2008	Monetary Policy Interest rate - %	9.5	9.5
Slovakia	Mar-25	CB policy rate	no change (4.25%)	no change
	Mar-28	February PPI	3.2% y/y	3.2% y/y

**Sources: Bloomberg, Reuters*

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		Mar-27	Mar-28	2008-Sept-26	-	CZK 5bn	-
Hungary		Mar-25	Apr-02	July-02-2008	-	HUF 40bn	8.40%
		Mar-27	Apr-02	April-22-2011	6.75%	HUF 70bn	9.00%
Poland		No auction scheduled					
Romania		26-Mar-08	28-Mar-08	1Y	-	RON 100 mn	9.50%
Slovakia		No auction scheduled					

Major Markets

Major markets

Leading indicators expected to show diverging trends

The round of leading indicators for March started already with the release of the ZEW Survey last week and the flash estimates of purchasing manager indices this week. The purchasing manager indices showed a mixed picture, with a better reading for Germany and a drop for France. It seems that Germany's companies are still able to withstand the strong pressure. If the latest trends are prolonged, the Ifo Index could even show an increase, but the sentiment indicators for France and Italy should decrease. Preliminary March inflation data for Germany is expected to increase by 0.3% m/m, on the back of still higher raw material prices and price increases linked to the early Easter holidays. Should the actual correction in the commodity sector persist, the chance for more stable consumer prices arises on the horizon. This would take pressure from the ECB council to hold interest rates unchanged at 4% and would support the USD exchange rate. Furthermore, lower commodity prices and a higher USD would bode well for the Euroland economy. However, up to now, only the most recent increases in the oil price have been eroded.

Markets calmed after recent Fed actions

After the last week ended turbulently, it seems as if this week will close on a high note. Opening the discount window to primary dealers, together with a 75bp rate cut only two days later, triggered a relaxation on at least some markets. Spreads narrowed and the dollar gained. Looking into next week, any news from the financial sector will remain the crucial factor for markets. Several macro releases are scheduled, but will at best show a stable development at a low level. This is especially true for consumer confidence, scheduled for Tuesday. On one hand, the drop has already been significant (the level was only lower right before the Iraq war in 2003). On the other hand, the last few weeks certainly did not give any reason for an improvement. Data from the housing market is scheduled for Monday and Wednesday and stable sales numbers are expected, but a moderate further deterioration should not be ruled out. Also, on Wednesday, durable goods orders should show some gains after the slump in the previous month. Final 4Q GDP data should hardly get any attention and the final number of the Univ. Michigan Index for March only a bit more. If - and that is a big if - no news about another financial institution getting into difficulties pops up, we think yields should move up moderately and the dollar should gain further next week.

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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	2.25	4.68		2.61		3.75	3.33	1.543	
Mar-08	4.00	2.25	4.50	n.a	2.40	2.59	3.90	3.50	1.55	1.543
Jun-08	3.75	1.75	4.00	n.a	2.00	2.45	4.00	3.80	1.52	1.535
Sep-08	3.50	1.75	3.75	n.a	2.10	2.19	4.30	4.20	1.47	1.527
Dec-08	3.50	1.75	3.70	n.a	2.20	2.24	4.50	4.40	1.40	1.521

Croatia

CPI figures moderated in February

February finally brought some moderation of inflation pressures. On a monthly basis, consumer prices declined by 0.1% (for the first time since July 2007), hence also positively affecting the y/y figure, which declined from 6.2% to 5.8%, despite the strong negative base effect from 2007. Prices of food and non-alcoholic beverages declined by 0.9%, due to the government agreement with large retailers to correct the prices of some basic food products. In the opposite direction, only housing, water, electricity, gas and other fuels had a stronger impact (+0.6% m/m). We see February more as a time-out, while, in the coming months, pressures should again mount, due to ongoing pressure on the supply side (food and oil prices), keeping rates at higher levels. Thus, the outlook remains unchanged and average inflation is expected at above 5% in 2008.

Short-term indicators bring some optimism

Monthly frequency indicators brought a positive surprise at the beginning of 2008. Industrial production in February confirmed the upward momentum from January and the acceleration from the mediocre 4Q07. January retail trade figures also showed a recovery, which could have been affected by the sales season. Retail trade turnover accelerated in nominal terms to 9.7% y/y (6.7% y/y in December). In real terms, after -0.2% in December, turnover increased by 2.2% y/y. In combination with the favorable labor market trends and the declining unemployment rate in February (dropping from 15.1% to 14.7%), some optimism regarding the 1Q economic performance has arisen. The upcoming monthly observations should reveal more about the course of economic activity in 1H08.

Markets offering low volatility

Markets have been stuck in sleep mode in the past two weeks. Thus, the exchange rate continued to hover in a stable band of 7.25-7.28, changing direction from time to time, but exhibiting little volatility overall. The bond market also offered low turnover and only marginal yield movement, confirming that the bond market is not in investors' focus right now. Money market rates also continued to stabilize and short-term MM rates continued to move around 5%, indicating satisfactory liquidity in the system at the moment. The coming weeks could bring slightly stronger appreciation pressures, due to the Easter holiday (higher demand for cash and some tourist related FX inflows). Getting closer to the tourist season, we anticipate pressures on kuna liquidity mounting and stronger appreciation pressures related to intensified FX inflows.

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Czech Republic

Looking for ways to limit CZK appreciation

In the last week, retail sales were reported and the CZK weakened, but the latter was not caused by the former. The CZK weakened on news that the CNB and the Ministry of Finance are in talks to devise measures to limit the extent to which planned government operations might further strengthen the currency. These operations include postponing or limiting a possible EUROBOND issue or freezing privatization revenues (for example, from the Prague Airport); the preparations for privatization were hypothesized by one board member to have been one reason for the recent strengthening of the CZK. Whether this is already the beginning of a correction is hard to forecast, but should the CZK break through 25.50, technically, it looks like it could go to 25.80 in a relatively short time.

Retail sales figures reported

Seasonally-adjusted real retail sales (excluding the automotive segment) rose by 0.4% m/m and 4.9% y/y. Including the automotive segment, seasonally-adjusted retail sales decreased by 0.1% m/m, while posting growth of 5.1% y/y. The m/m decrease of overall retail sales is thus due to the decrease (by one percent) of retail sales in the automotive segment, which we think is largely a seasonal effect (after strong December growth of over 5% m/m). Seasonally-unadjusted sales posted y/y growth of 4.1%, which was in line with the market expectation (4%) and below ours (5%). The highest contribution to the growth came from electronics, furniture and household goods; in particular, electronics is driven by falling prices (strong CZK), which stimulate demand. Frontloading of drug purchases (which was one of the reasons behind the stronger than expected GDP growth in 4Q) in December 2007 was probably behind the drop of 7.1% in sales of pharmaceutical goods in January. This will also have an impact on growth in 1Q08. We expect the growth to be around 4% this year, due to tax reform, higher inflation vis-à-vis nominal wage growth and cuts in social expenditures.

No change in rates expected next week

Next week, the major event is the second rate setting meeting this year (out of eight scheduled for 2008). Despite the fact that inflation is at a 10Y high, we do not expect any change in rates. Why? The stronger koruna is one powerful reason. Even though it weakened somewhat last week, it is still stronger than the CNB assumed in its latest forecast, and thus somewhat offsets the higher headline. We still expect the next move to be a hike (higher headline, inflation expectations at stake, lower target at the monetary policy horizon, tactical reasons, expected weakening of CZK), but postponed until the end of the second or third quarter.

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Hungary

More comments from rate setters

This week, hawkish comments arrived from the monetary council's rate setters. According to Péter Bihari, the central bank has to act to meet the inflation target and it is already not enough to express commitment to the target verbally. He added that the electricity price hike is an exogenous shock that monetary policy cannot ignore, as it has impacts on wider parts of the consumer basket. Finally, he mentioned the large difference between the base rate and market yields, which - according to him - could jeopardize the role of the base rate in providing guidance. On Thursday, Csaba Csáki cited the higher risk premium, as well, stating that the central bank is now more likely to raise interest rates, due to rising bond market premiums. Last but not least, Ferenc Karvalist mentioned a positive phenomenon in the inflation development (wage dynamics of the past quarter, formation of non-tradable prices in the past few months), but he also did not exclude the possibility of a rate rise.

We have changed our base rate forecasts for 2008

Based on the previous weeks' events on capital markets and the messages coming from the central bank, the majority of the council members now seem to have started to think that they cannot avoid an "emergency" hike in the base rate. In addition, higher than expected wage outflow seen in the private sector in January (see our short note published on Wednesday) could also push the monetary council towards a more hawkish stance. Thus, we expect a 50bp rate hike (to 8%) at the next monetary meeting (March 31), but we do not think that this expected final decision will be unanimous. However, we still believe that cautious rate cuts could start in the second half of the year, assuming the consolidation of global capital markets and a slowdown in the 12-month inflation rate in the coming months.

Government changed its macro forecast

This week, Finance Minister Janos Veres announced some changes to the government's macro forecasts. They cut the GDP growth forecast for 2008 to 2.4% (from the earlier 2.8%) and increased the forecast for 2008 average inflation to 5.9% (from 4.8%). The government's budget deficit forecast for 2008 remained unchanged (4% of GDP). The new figures are closer to the current market consensus estimations.

Market consolidation continued

Further liquidity measures announced by the FED last Sunday and the 75bp rate reduction on Tuesday have provided further support for markets. The domestic FI market now seems to have calmed down somewhat and demand for government papers has returned. Bond yields have continued the normalization process, while the forint exchange rate has managed to preserve its strength below 260 EUR/HUF. Next week, the macro calendar is empty. Thus, the auction of the 3Y bond could be in focus for market participants. In addition, the minutes of the February monetary meeting (due this afternoon) deserve a short look, as the change in the exchange rate regime was announced after this meeting.

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Poland

Wages galloping briskly ahead

Wage development in the corporate sphere surpassed analysts' expectations in February. While the consensus foresaw a slight deceleration in the annual dynamics, the actual figure moved in the opposite direction. Corporate wages increased by 12.8% y/y in February, which represents the fastest growth rate in almost eight years. Employment dynamics remained solid, notching 5.9% y/y growth. Putting together the employment gains with wage hikes and adjusting the figure for inflation, the aggregate real wages were 14.7% higher in February when compared to the same period of the previous year. As such, this suggests that households' wallets are still enjoying solid support from the labor market. Hence, the risk of demand-driven pressures on inflation lingers.

Industry shows strong reading, mitigating fears of economic slowdown

Activity in industry revived further in February, with output increasing by 14.9% y/y. The favorable working day effect was helpful. However, even after eliminating seasonal influences, the output quickened. Manufacturing and mining were the drivers behind this development. The solid performance of the former bodes well for the export side of the trade balance. Construction saw a remarkable revival in February, jumping by 20.7% y/y. The overall message is that the slowdown of the economy will probably be milder than previously expected and we might see GDP growth close to 6.0% y/y in the first quarter. The industrial data alleviates the concerns about the strength of the Polish economy amid the global slowdown and, as such, keeps the possibility of monetary policy tightening open.

CB to hike key rates by 25bp next week

The central bank will hold its regular rate setting meeting next week. While the analysts' opinions were split in polls conducted at the beginning of the month, now they almost unanimously expect the MPC to deliver a 25bp hike for the third month in a row. We stick to our earlier forecast and agree that policy tightening is indeed the most likely option. The decision-making of the MPC has become quite data-dependent recently. Macro releases over the past month reinforce (rather than alleviate) concerns about the inflation outlook. Although headline inflation was lower than expected, the main reason was of a technical nature - revision in the weighting scheme. However, the structure of inflation showed further deterioration (pickup in the prices of services), which might spark concerns that second-round effects are slowly starting to emerge. As for inflation risks, wage development has been at the center of the central bank's worries. The figure released this month will by no means help to ease them. We think that the MPC would like to anchor inflation expectations at the beginning of the year when wages are being negotiated. The desire to prevent a situation in which Poland is in a tightening mode and the ECB starts cutting rates is another argument for an early hike. Our long-held core scenario assumes that 5.75% (to be reached next week) should be the peak for rates. Nevertheless, the risks are clearly tilted towards the possibility of one or two additional hikes this year.

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Romania

Central bank to hike key rate next week

Our base scenario for the central bank's monetary policy decision on March 26 is an increase of the key rate by 50 basis points to 9.5%. The market consensus is also 9.5%. However, we do not rule out an increase to above 9.5%, given the strong inflationary pressures in March. According to the central bank's forecast, the annual inflation rate will reach 8.3% at the end of March. Our estimate points to an even higher level, following the increases in administered rents, fuels and the RON's monthly depreciation. This is the last monetary policy decision before the orthodox Easter holiday at the end of April and the central bank might want to further decelerate RON-denominated loans, which usually spike during this time of the year. The central bank restricted monetary conditions beginning in 4Q07 by raising the key rate three times in a row by a total of 200 basis points, imposing additional restrictions for unhedged borrowers exposed to FX risk and increasing the control over money market liquidity. Aggregate demand remained strong, as January statistical data shows an increase in retail trade of 16.6% y/y, supported by the growth of real salaries (+21.9% y/y). Considering the important lags in the transmission mechanism of monetary policy, we expect the first results of the tighter monetary policy to be seen beginning with 2Q08.

Low RON volatility, despite unfavorable international environment

The RON was traded between 3.71 and 3.76 last week, remaining more stable compared to the previous weeks. The international turmoil had little impact, while domestic developments were insignificant, as no important macro data was released. The central bank drained the liquidity surplus from the money market, providing significant support for the RON. The NBR organized three deposit auctions, withdrawing a total of RON 7.1bn (EUR 1.9bn) from the money market. ON interest rates reacted quickly and reverted to levels above the key rate (9%). The RON might appreciate before the central bank's monetary policy decision to around 3.7. The developments after the announcement of the decision are rather difficult to anticipate, as foreign players expect an increase of the key rate to considerably above 9.5%.

Labor productivity above salary growth during last few years

The Romanian National Institute of Statistics released for the first time information about labor productivity for the entire economy. Until now, we had only monthly data for industry labor productivity. During the last five years, labor productivity went up by 175%, compared to an increase of 164% for nominal gross salaries, thus preserving the important competitive advantage for the Romanian economy. The labor productivity increase ranged from 30.5% in 2003 to 17.8% in 2007, strongly backed by favorable developments in construction and services (for example, labor productivity in industry went up by 9.9% y/y in 2007). However, the trend reversed in 2007 and the labor productivity rise was slower than the increase in the average nominal salary. Many European companies decided to relocate some activities to Romania, considering the attractive ratio between labor productivity and unit labor costs. Textile industry output decreased constantly, but high value added industrial sectors (automotive, IT&C) gained speed in the middle of an important restructuring process for Romanian industry. The highly skilled labor force, strategic location (allowing easy access to both emerging and developed markets) and profitable fiscal environment are strong incentives for long-term investors. Total dividend outflows reached EUR 4.6bn in 2007 (+40% y/y), compared to just EUR 0.79bn in 2003.

Ford officially becomes owner of car plant today

The transaction between the Romanian government and Ford is to be concluded today, as the American car maker has already paid EUR 57mn for a 72.4% stake in the former Daewoo car factory. Ford intends to build at least 200,000 cars and gear boxes per year, increase the number of workers and make significant investments. The production of a new car model will begin in 2009, boosting the domestic production of cars. Exports of passenger cars went up by 53.5% y/y in the first two months of 2008.

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Slovakia

CB to keep interest rates stable next week

Although the koruna withstood the global market turmoil well at the beginning of the week, trading at 32.4 EUR/SKK Wednesday and Thursday brought a weakening of the unit by more than 1%. As there was no new data or comments released in Slovakia and the rest of the region was rather stable, we would ascribe the koruna move to some individual client orders. The next event with market-moving potential will be the CB monetary meeting next Tuesday, at which interest rates are unanimously expected to remain unchanged. Comments are likely to remain slightly hawkish, as February inflation was again slightly above the NBS and market forecasts. We maintain our outlook for Slovak interest rates. As the country will be allowed to join the Eurozone in 2009 (which will be known for sure in May), independent monetary policy will be largely ineffective; thereafter, we expect the NBS to follow ECB moves. We anticipate interest rates at 3.5% by year-end.

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Appendix Charts

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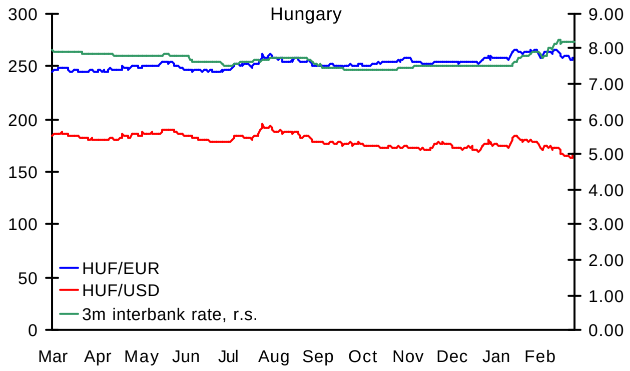
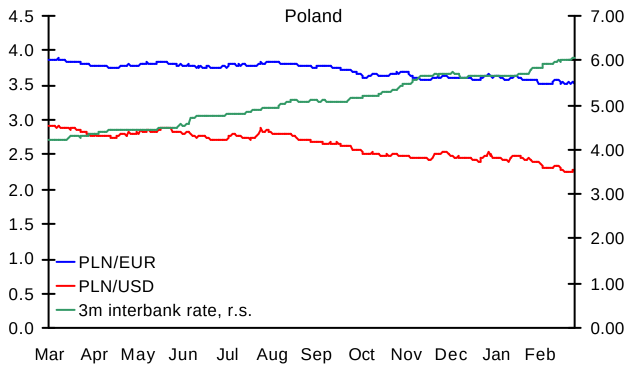
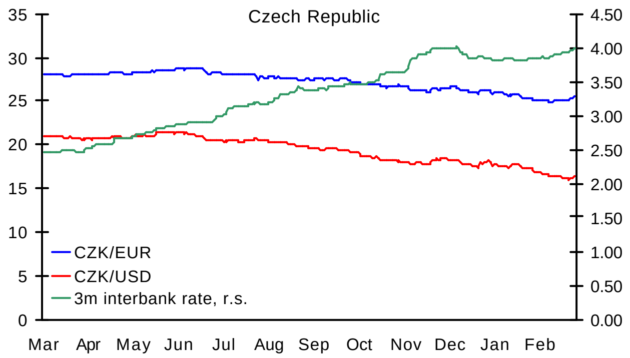
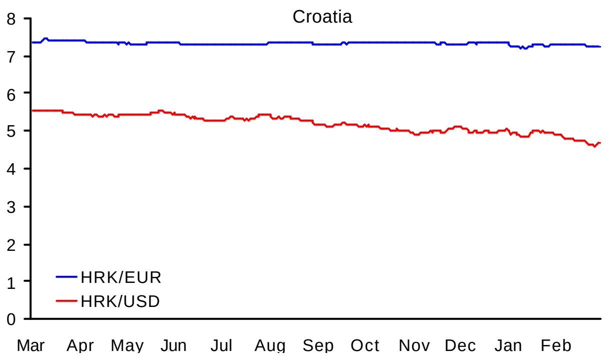
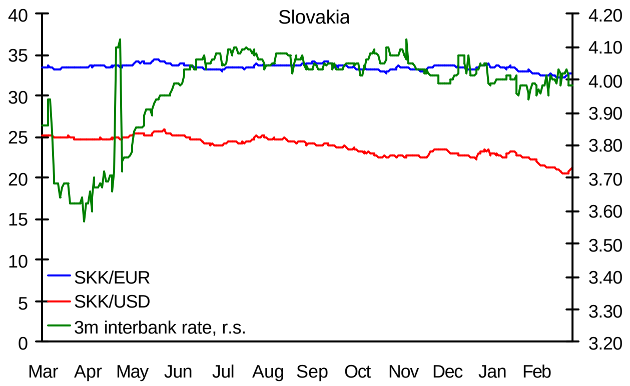
Exchange rates and interest rates (52 weeks)

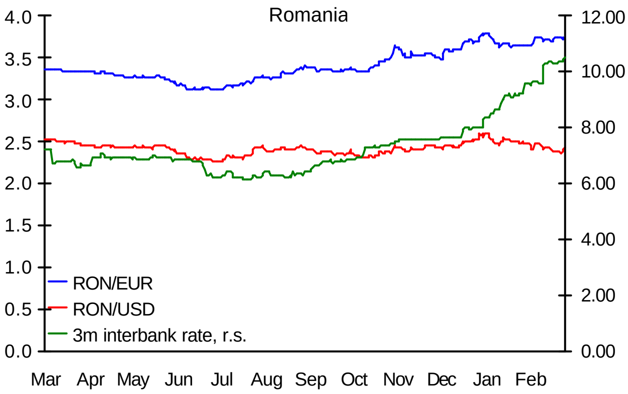








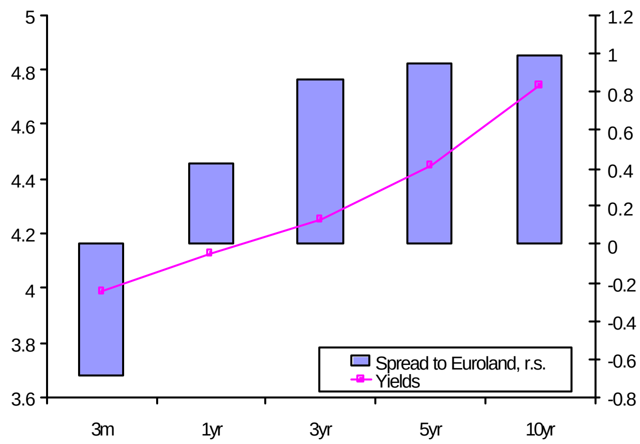




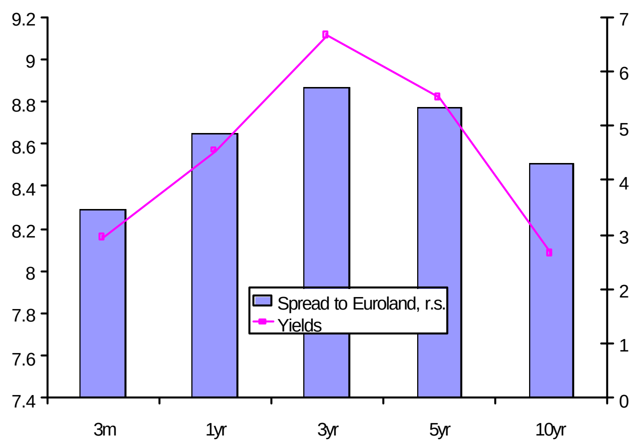
Source: Bloomberg

Benchmarks

Czech Republic



Hungary



Appendix Forwards

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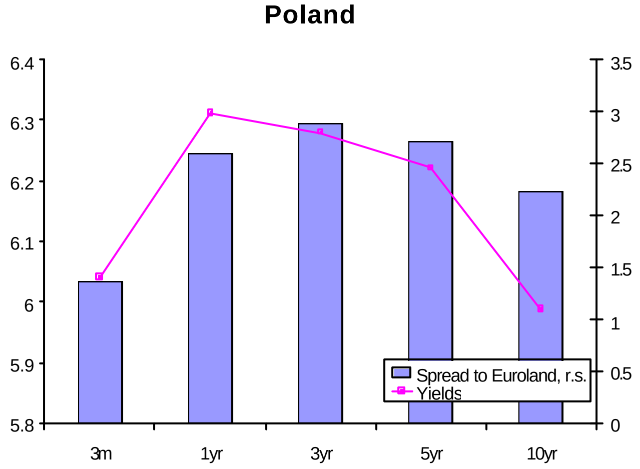

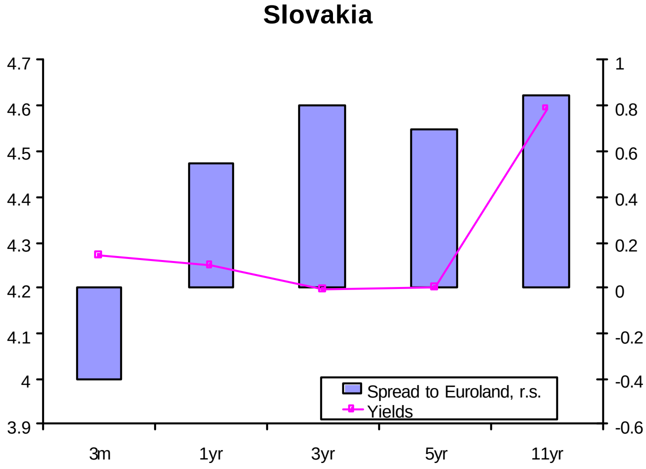

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