CEE Research

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Fixed Income and Foreign Exchange

CEE Insights

- **Czech Republic:** EUR/USD correction could be a trigger for CZK/EUR correction
- **Hungary:** A question mark remains over the outcome of Monday's monetary meeting
- **Poland:** There is slightly more likelihood for a rate hike next week
- **Romania:** The correction on Romanian Leu
- **Slovakia:** EC inflation forecasts to be published on Monday
- **Ukraine:** National Bank has postponed official currency band changes

Overview

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Czech Republic:

- We expect stable rates in May
- EUR/USD correction could be a trigger for CZK/EUR correction

Hungary:

- A question mark remains over the outcome of Monday's monetary meeting
- Government revises down its GDP forecast for 2009
- No major changes expected in a 3-day week

Poland:

- There is slightly more likelihood for a rate hike next week
- Strong growth of retail sales supports further tightening

Romania:

- The correction on Romanian Leu
- Romania issued 1Y T-bills for 10.22% yield
- Romania might attract total FDIs of EUR 7.8bn in 2008
- Favourable expectations in construction in April, according to Central Bank poll

Slovakia:

- Media: draft ECB report concerned about inflation, but could be softened
- EC inflation forecasts to be published on Monday
- April should be the last month of stable CB rates
- We see risks for move to stronger side of our 32.5 SKK/EUR conversion rate forecast

Ukraine:

- National Bank has postponed official currency band changes
- Recent NBU monetary policy has drained too much liquidity

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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	25.13	-0.4%	1.3%	5.6%			
	3Y (yield bp)	4.28	11	0	-3	39	75	41
	10Y (yield bp)	4.75	3	-7	1	56	93	53
Croatia	EUR/HRK	7.263	-0.1%	-0.1%	0.5%			
	3Y (yield bp)	5.65	-1	-16	34	180	234	140
	10Y (yield bp)	5.78	1	-5	25	163	197	135
Hungary	EUR/HUF	252.1	0.6%	1.7%	0.4%			
	3Y (yield bp)	9.09	1	-23	154	520	576	365
	10Y (yield bp)	8.02	5	-13	91	384	427	290
Poland	EUR/PLN	3.433	-0.2%	2.6%	4.9%			
	3Y (yield bp)	6.18	-4	-1	-1	229	263	229
	10Y (yield bp)	5.98	-3	-13	2	180	205	176
Romania	EUR/RON	3.586	0.7%	3.7%	-0.2%			
Slovakia	EUR/SKK	32.39	0.1%	0.6%	3.6%			
	3Y (yield bp)	4.43	5	19	-16	39	73	52
	11Y (yield bp)	4.74	6	16	-8	51	75	48
Ukraine	EUR/UAH	7.56	4.8%	3.2%	-2.5%			
	3Y (yield bp)	8.91	0	8	-11	388	480	609

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

Trading Ideas

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Positions

Currently, no open trading ideas.

Rationale at inception

Currently, no open trading ideas.

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%
21	Short USD/RON	02/04/2008	10/04/2008	3.90%
22	Buy EURFRA, sell SKKFRA	04/04/2008	18/04/2008	26bp

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													
	CZK	Forward	HRK	Forward	HUF	Forward	PLN	Forward	RON	Forward	SKK	Forward	UAH	Forward
Spot	25.2		7.26		253		3.43		3.62		32.4		7.6	
Jun-08	25.8	25.2	7.20	7.20	255	255	3.60	3.44	3.65	3.63	32.5	32.4	7.4	7.7
Sep-08	26.4	25.2	7.25	7.25	256	257	3.51	3.45	3.58	3.69	32.5	32.3	7.1	8.1
Dec-08	25.9	25.1	7.30	7.30	256	260	3.45	3.46	3.50	3.75	32.5	32.3	6.7	8.3
Mar-09	25.9	25.1	7.25	7.25	255	262	3.40	3.47	3.50	3.81	-	32.2	6.6	8.5

	Intervention Rate							3m Money Market Rate											
	CZ	HR	HU	PL	RO	SK	UA	CZ	Fwd	HU	Fwd	PL	Fwd	RO	Fwd	SK	Fwd	UA	Fwd
Spot	3.75	4.81	8.00	5.75	9.50	4.25	10.00	4.11		8.24		6.32		12.44		4.29			
Jun-08	3.75	4.50	8.00	6.25	9.50	3.75	12.00	4.03	4.17	8.20	8.83	6.45	6.39	10.04	9.72	3.85	4.62	19.00	-
Sep-08	4.00	4.25	8.00	6.25	9.50	3.50	12.00	4.06	4.05	7.80	8.91	6.45	6.52	9.96	7.03	3.70	4.47	18.00	-
Dec-08	4.00	4.00	7.75	6.25	9.00	3.50	12.00	4.09	4.04	7.60	8.85	6.45	6.22	9.00	6.69	3.70	4.48	16.00	-
Mar-09	4.00	4.00	7.50	6.25	8.25	-	12.00	4.14	4.05	7.50	8.60	6.35	6.24	8.50	5.14	-	3.86	14.00	-

	10y Govt. Yield					5y Govt. Yield	3y Govt. Yield
	CZ	HR	HU	PL	SK	RO	UA
Spot	4.75	5.78	8.10	5.99	4.73	10.20	7.8
Jun-08	4.70	5.60	7.60	5.90	4.65	10.10	9.8
Sep-08	4.60	5.40	7.00	5.90	4.65	9.60	10.4
Dec-08	4.70	5.30	6.70	5.55	4.65	9.30	9.4
Mar-09	4.80	5.20	6.60	5.45	4.70	8.55	8.2

Long-term forecasts

GDP growth (%)	2006	2007e	2008f	2009f
Czech Republic	6.4	6.6	4.3	5.4
Croatia	4.8	5.6	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	7.6	6.6	6.0
CEE8 weighted average	**6.3**	**6.2**	**5.2**	**5.4**

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	4.8	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	4.2	4.0
Ukraine	11.6	16.6	19.0	15.0
CEE8 weighted average	**4.2**	**6.6**	**6.0**	**4.9**

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	6.9	6.4	6.3
CEE8 weighted average	**10.6**	**8.8**	**7.8**	**7.2**

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	8.0	7.1
Poland	4.2	4.6	6.3	5.5
Romania	8.8	7.8	10.0	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	11.5	10.0
CEE8 weighted average	**6.6**	**6.0**	**7.3**	**6.4**

C/A (%GDP)	2006	2007e	2008f	2009f
Czech Republic	-3.0	-3.2	-3.6	-2.2
Croatia	-7.9	-8.6	-8.1	-7.9
Hungary	-6.1	-5.0	-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	-4.1	-3.8
Ukraine	-2.9	-4.2	-5.8	-6.3
CEE8 weighted average	**-5.2**	**-6.0**	**-6.7**	**-6.7**

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	-5.5	-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	-1.1	-2.0	-3.0
CEE8 weighted average	**-3.5**	**-2.5**	**-2.9**	**-2.9**

Diaries

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Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	No data releases scheduled			
Croatia	30-Apr	Trade blance	€ -950mn	
Hungary	Apr-28	NBH rate setting meeting	8% (no change)	8.25% (25bp hike)
	Apr-30	March PPI	6% y/y	-
Poland	Apr-30	CB Rate-setting meeting	6.00%	5.75%
Romania	No data releases scheduled			
Slovakia	Apr-29	NBS monetary meeting	4.25% (no change)	4.25% (no change)
Ukraine	No data releases scheduled			

**Sources: Bloomberg, Reuters*

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		Apr-30	May-05	Apr-11-2017	4.0%	7	
Hungary		Apr-29	May-07	Aug-06-2008	-	HUF 40bn	8.35%
		Apr-30	May-07	Nov-19-2008	-	HUF 25bn	8.50%
		Apr-30	May-07	April-08-2009	-	HUF 40bn	8.80%
Poland		No auction scheduled					
Romania		No auction scheduled					
Slovakia		Apr-28	Apr-30	Feb-08-10	-	-	4.35%
Ukraine		No auction scheduled					

Major Markets

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Major markets

ECB comments become more neutral

Market sentiment remained bearish last week although the economic outlook deteriorated on the back of a drop in the leading indicators. The Ifo Expectation Index followed the ZEW survey down on Thursday and the German government reduced its GDP growth outlook for 2009 to just 1.2%, after 1.7% for 2008. ECB comments became even more hawkish at the beginning of the week pointing in the direction of possible rate hikes. In the meantime, ECB vice president, Stark, made it clear that past rate increases are still working their way through the economy and will have a restrictive impact in the coming quarters and that the ECB expects that wage-setting "…will remain under control". ECB president, Trichet, said that the ECB is worried about the "sharp fluctuations" of the euro and that the Council assesses that the current level of interest rates "…will contribute to achieving our objective…" From the current level, these comments open the way for a slight steepening in the yield curve as interest rate hikes seem even more unlikely. Next week's data will contain the first inflation indications for April. After the massive rise in inflation in March, the April data could offer a slight decrease as part of the March increase was due to the early Easter Holiday and some base effects start to come in. After 3.6% in March, we expect 3.4% inflation rate for April. Sentiment indicators for Euroland are likely to remain quite depressed. The EU Commission will publish its new economic forecast on Monday.

Next week is packed with important data

In a week dense with important events, consumer confidence on Tuesday will be of minor interest, all the more so as in an environment of falling house and rising gasoline prices there is little scope for any improvement. The first estimate of 1Q GDP the following day could see the r-word disappear from the markets for the time being. We agree with the market in expecting economic growth to barely make it into positive territory, which would make two consecutive quarters of negative economic growth - the technical definition of a recession - unlikely. On the same day, markets will learn how the Fed evaluates the situation. Next to a cut of the Fed Fund rate by 50bp, we expect some mentioning of the recent stabilisation of financial markets and the economy. Still, due to the high degree of uncertainty the door should be left open for further interest rate cuts. On Thursday the ISM index is unlikely to change much versus the previous month indicating a stagnating to slightly contracting US manufacturing sector. Finally, on Friday another heavyweight - the labour market report - is scheduled for release. Markets expect jobs to have been shed at the same pace as in the previous month, but we think an improvement is more likely. While we believe bond markets have already run ahead of the upcoming data and do not see further yield increases as justified, the dollar has potential to gain further.

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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	4.83		2.91		4.22	3.90	1.561	
Jun-08	4.00	2.25	4.00	5.01	2.00	3.03	4.00	3.80	1.52	1.558
Sep-08	3.75	1.75	3.75	4.87	2.10	3.10	4.30	4.20	1.47	1.550
Dec-08	3.50	1.75	3.70	4.90	2.20	3.07	4.50	4.40	1.40	1.544
Mar-09	3.75	2.00	4.00	4.45	2.30	3.29	4.60	4.60	1.38	1.540

Czech Republic

As was the case last week there is no macro data this week. There was little news regarding the fiscal side of the economy - government spending plan for 2009-2011, proposal to lower social-security tax paid by employers by 2.5pp - but these are uncertain (at best) at the present time.

We expect stable rates in May

The CNB's newest board member pretty much reiterated what was at the core of the latest CNB statement in March - that the risks are in both directions and that she will be following pro-inflationary risks and potential secondary effects closely. The CZK is, in her view, "far from all fundaments" and she expects correction. What was new was that she is not in favour of too frequent - let alone counter - movements in rates. This would put her close to the Messrs. Rezabek-Holman duo as they also seem to be disinclined to use rates 'often'. As for the implications for the upcoming CNB meeting on May 7, this indicates the stability of rates: our view that it is the CZK that is preventing the CNB from one more hike this year and will determine when the hike will come thus still holds.

EUR/USD correction could be a trigger for CZK/EUR correction

The CZK weakened to close to 25.20 against the EUR by Friday on no domestic news; the fall of the EUR against USD in all likelihood played a role. If EUR/USD correction were to be sustained (data from the US is mixed at best and does not indicate any significant improvement in the economy), this might be the start of the CZK/EUR correction we've been expecting as well.

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Hungary

A question mark remains over the outcome of Monday's monetary meeting

The rate setting meeting of the central bank to be held on Monday will be the focus among market participants next week. After the 50bp rate raise carried out in March, the majority of market analysts expect a rate hike of 25bp for April although opinions are not unanimous. According to the latest Reuters poll, nine of the 25 participants say that the base rate would be left unchanged at 8%. Rate hiking expectations have intensified after the publication of the annual February "ex bonus" nominal wage figures for the private sector last week, which were again in double-digit territory. Although some interpretation problems around the figures still exist, high private sector wage figures may have a message that the CB has failed to anchor inflationary expectations, thus the battle against inflation could fail in the mid run. If the CB takes this stance and strictly concentrates just on wages on Monday, the rate hiking process could continue. Our view is, however, that taking the current strong position of the forint, the relatively favourable structure of the latest March CPI figures and the normalization of the interbank and government securities markets into the consideration, there seems to be no need for any immediate action. In addition, the next Quarterly Report on inflation will be due in May, which could provide additional information for the monetary council on the mid -term inflation outlook. Thus, the CB can take a wait and see stance now. If - according to the May report - the inflation outlook becomes worse and upside risks are increasing, the CB could still hike the base rate next month.

Government revises down its GDP forecast for 2009

Instead of once a year, the EU checks Hungary's economic progress every six months. Thus, the country's Convergence Report had to be updated again. The most important change is that the government revised down its GDP forecast for 2009 to 3.4% y/y from the previous 4% y/y. On the other hand, the 2009 CPI inflation forecast was modified to 3.6% from 3%, which is in line with the central bank's latest projection. The budget deficit projection remained unchanged at 3.2% of GDP. The new version of the programme will be sent to Brussels by the end of the month.

No major changes expected in a 3-day week

The forint has preserved its strength for the majority of the week, but finally did not manage to reach the 250 level against the euro. Range trading movements should prevail next week. Besides the rate decision of the NBH on Monday, the outcome of the US FED meeting should be in focus, too. As Thursday and Friday are market holidays in Hungary, some profit taking could take place before the long weekend, after the market consolidation process seen in recent weeks.

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Poland

There is slightly more likelihood for a rate hike next week

The meeting of the monetary council of the National Bank of Poland will be most important event next week. We expect that the hawks will vote for a hike while the doves will opt for unchanged rates. The central bank's minutes released on Thursday showed that the monetary council considered a 50bp hike at its last meeting. The reason for the tightening was the risk of second round effects coming from the current high level of inflation. In the end, the council voted for a 25bp hike in a ratio of 6:3. This shows that the hawks are really determined to tighten further, although it is not clear if they can manage to persuade neutral members of the council, namely J. Czekaj, who said on Tuesday that further data may be needed for confirmation, if further tightening of monetary policy is necessary. It was, nevertheless, an important message, which considerably increased the likelihood of unchanged interest rates at the April meeting. However, we still believe that there is slightly more likelihood for a rate hike, which should ensure the return of inflation to the central bank's target: hawks may want to ensure high enough interest rates before the central bank embarks on a wait-and-see stance. Such an approach was strongly supported by well known hawk D. Fillar, who wrote in Rzecpospolita that the rate hike cycle should continue even in April and also by comments from A. Slawinski in daily Gazeta Prawna, who said that macroeconomic indicators show that the Polish economy is still in a good state, which means that the need for monetary policy tightening cannot be ruled out. Further rate hikes are then likely only in the case of further rapid growth of wages or other signs of creation of a wage-inflation spiral. Analysts are split but with most of them expecting unchanged interest rates.

Strong growth of retail sales supports further tightening

Growth of retail sales in March slowed to 15.7% y/y. This means that household demand was slightly weaker than expected although its growth remains strong. Such strong growth supports the case for further tightening of monetary policy. The zloty tested the 3.40 support to the euro but it seems that it will bounce back. The monetary policy council's decision will be most important fundamental factor for the zloty. Unchanged rates may support a technical inclination towards weakening; also the stronger dollar could push zloty to weaker levels.

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Romania

The correction on Romanian Leu

The RON started the week on a strong footing in the 3.57 zone and rallied up to the 3.55 level, hitting this year's maximum level. However, the Romanian currency could not hold onto the recent gains and reversed its move to the upwards. The selling orders came mainly from foreign players who decided to take profits, as they considered that the RON does not have the strength to appreciate below the 3.55 level, despite the consistent yields paid by RON placements. We consider that the RON might weaken temporary further towards the 3.65 zone next week, amid dovish investor sentiment towards emerging markets.

Romania issued 1Y T-bills for 10.22% yield

The Ministry of Economy and Finance organized an auction for the sale of one-year treasury bills worth RON 600mn on April 23. The primary dealers submitted RON 872mn at the auction, but the MEF decided to accept only the bids that did not outpace 10.49% yield. The Ministry of Economy and Finance attracted just RON 200mn, paying an average yield of 10.22%. The yields paid by MEF at this auction were sensibly higher than at the last 1-year T-bill auction, when the average yield stood at 9.5%. The Ministry of Economy and Finance borrowed RON 1.5bn from the local market in the first 4 months of the year.

Romania might attract total FDIs of EUR 7.8bn in 2008

We have revised upward our forecast for FDI inflows in 2008 to EUR 7.8bn in light of the latest developments and the prospects for the rest of the year. Total FDIs stood at EUR 1.2bn in January-February, covering about 55.5% of the C/A deficit, up from last year. Considering the experience from previous years, FDI inflows could accelerate in 2H08. At the same time, Romanian government seems determined to complete the privatization of the last state companies in 2008 and foreign investors can choose between 60 companies. Among them are the only Romanian producers of military planes and helicopters, companies from pharmaceutical, chemical, food, machinery and equipment industries. Besides the potential sums to be raised from these privatizations, the future investments are the most important aspect as most of these companies activate in areas with huge potential for development.

Favourable expectations in construction in April, according to Central Bank poll

Construction could gain speed in April on a m/m basis against the background of improved weather conditions, according to the company managers polled by the Central Bank. Industrial output is expected to grow further as well as the volume of new orders. New orders for manufacturing industry will be supported by means of road transport and construction materials industrial sectors. The estimation is in line with our scenario regarding higher economic growth in 2008 following important investments in construction and industry. However, industry still requires some structural reforms as many managers indicated the low demand as the main drawback in industry. FDIs might provide an additional boost to industrial production in the coming years, together with a better orientation of production towards markets.

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Slovakia

Media: draft ECB report concerned about inflation, but could be softened

In a series of stories based on allegedly leaked information, press agencies first suggested that the soon-to-be-published ECB report will expose 'serious concerns' about the prospect of price performance sustainability. However, later news suggested that the wording might be softened after objections by EU central banks. The report is scheduled for release on May 7 and will be important for Slovakia's euro chances. We remind that inflation sustainability is probably the last unresolved issue that could prevent Slovakia's entry to the Eurozone after the country met all the nominal convergence criteria.

EC inflation forecasts to be published on Monday

As an input for discussion, the EC is about to publish its spring forecasts on Monday and the outlook for 2008 and 2009 will be watched closely. Our own expectation is that the Slovak average HICP inflation will reach 3.7% y/y in 2008, close to the Maastricht reference limit, which we expect to grow from the current 3.2% to 3.5-4.0% by the year-end. Next year, we think that fulfilling the criterion is less likely, as our forecast for next year's inflation is 3.6%, while the Maastricht threshold would probably decline more significantly (long term average stands at 2.6%). We expect Slovakia to be allowed to join the euro club.

April should be the last month of stable CB rates

Also next week, the CB holds its last policy meeting before Slovakia's euro fate is decided. In line with the general view, we expect the central bank to keep rates on hold but we see this as the last month of stable interest rates. In the likely scenario that the euro assessment is positive, we think the central bank will probably cut rates from the current 4.25% to the ECB's 4.0% as early as May, as the monetary policy will no longer be effective once Slovakia's Eurozone path is confirmed (setting the conversion rate will be the central bank's last chance to influence inflation; after that, any difference in rates would have no impact due to the possibility to draw loan in euros). On the other hand, the risk scenario (15% perceived chance) that Slovakia is ruled out of the Eurozone would be likely to bring significant koruna depreciation due to capital outflow and, in response, possibly an interest rate hike. The central bank's new macro prognosis will also be published after the meeting.

We see risks for move to stronger side of our 32.5 SKK/EUR conversion rate forecast

Regarding the conversion rate, we now see more risks to the stronger side of our point forecast 32.5 SKK/EUR (to a range of 32.0-32.5 SKK/EUR). Unless the ERM-2 central parity is revaluated beforehand, positive euro assessment might serve as one last trigger for currency appreciation, as foreign investors might try to influence the process of conversion rate setting in order to get more euros for their koruna assets. However, if the Slovak central bank felt confident enough that Slovakia will be admitted to the Eurozone, it could initiate the ERM-2 parity revaluation even before the assessment. In such a case, the new central parity would probably be close to current market levels (32.4 SKK/EUR on Friday) and would also later serve as the euro conversion rate.

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Ukraine

National Bank has postponed official currency band changes

On Thursday, 24 April, the National Bank of Ukraine had a meeting in which, according to previous statements from NBU head, Mr. Stelmakh, possible changes to the official hryvnia rate and widening of the currency band were expected. The result of the meeting was that NBU officials agreed that before they introduce any changes, they would like to see the new macroeconomic figures, which are currently being revised by the government. Financial markets were volatile on the day, following the previous comments from officials about a possible widening of the currency band to 4.90-5.30 UAH/USD. During the morning trading session, the exchange rate dropped from the 4.91 level to 4.79 UAH/USD, reflecting the expectations of market participants. The official exchange rate was changed from 5.30 to 5.05 last time in April 2005. Y. Tymoshenko's government had successfully used this measure as a tool to slow down inflation although it had a negative impact on the current account balance. The current official exchange rate is 5.05 UAH/USD. The currency band for 2008 is set at 4.95-5.25 UAH/USD. We expect that the exchange rate will gradually appreciate towards 4.85 UAH/USD during 2008.

Recent NBU monetary policy has drained too much liquidity

Since the fourth quarter of 2007, the NBU has announced that it will fight the growth of retail lending and the rising amount of external borrowing by banks, which it perceives to be the major factor propelling inflation increases. Though their recent 'contractionary' monetary policy has reduced liquidity of the local banking system substantially: the excess liquidity has decreased to currently UAH 2-3bn from UAH 10bn in January 2008 and the money market rates have set new historic records (3M: >18%). Such a situation has influenced the foreign exchange market, as banks were selling cheaper US dollars in exchange for much more expensive hryvnia resources. This has kept the exchange rate close to its stronger band. Recently, the NBU began to inject on average UAH 1-1.5bn daily and has lifted the restriction on how many times can banks apply to the NBU for refinancing. Initially the NBU was targeting the decrease in lending growth (mostly in FX) and the decrease in external bank borrowing. However, it has achieved a slightly different effect: facing the high cost of hrynia resources, some of the major banks have stopped their lending programmes in hryvnia completely while others have raised their rates.NBU officials have stated that they are aware of the seriousness of the situation and are taking measures to come out of it. The National Bank will now most probably concentrate on gradual easing of monetary policy conditions and stabilization of the liquidity situation.

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Appendix Charts

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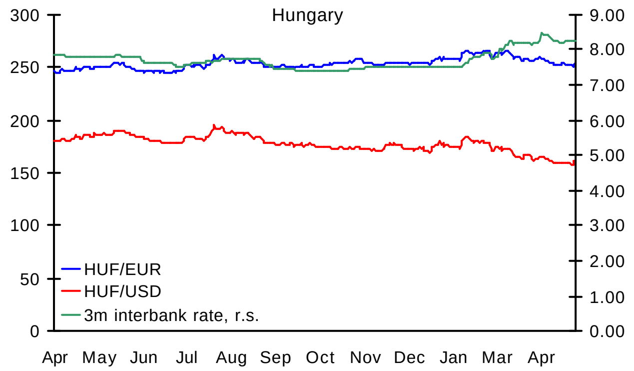
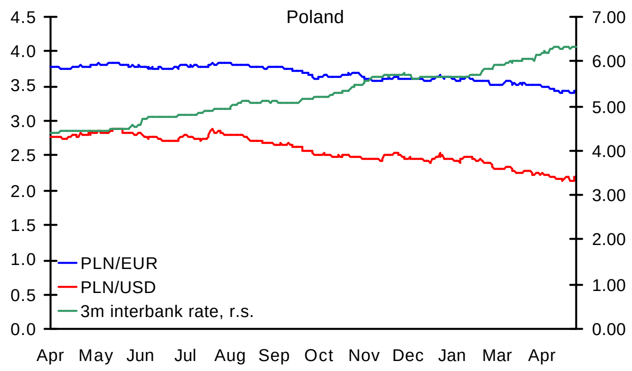
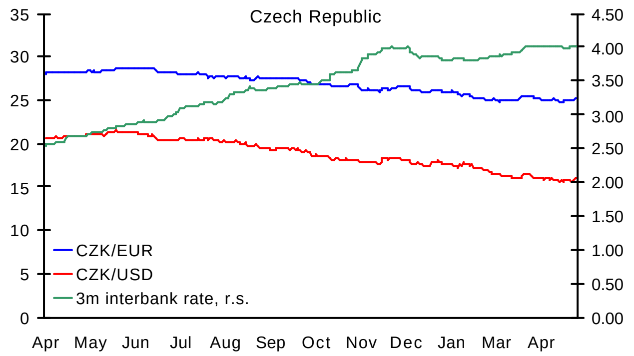
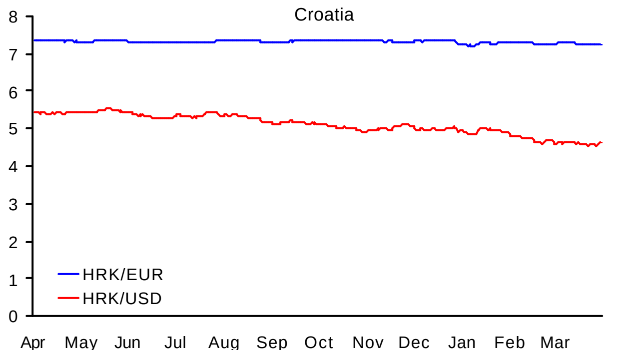
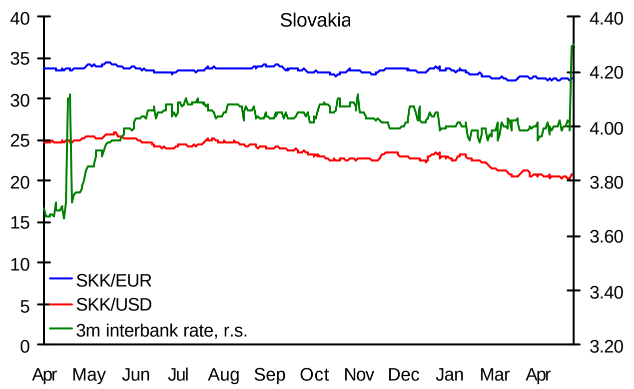
Exchange rates and interest rates (52 weeks)

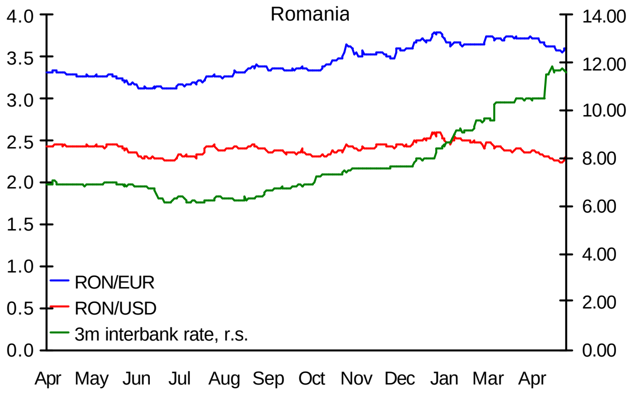


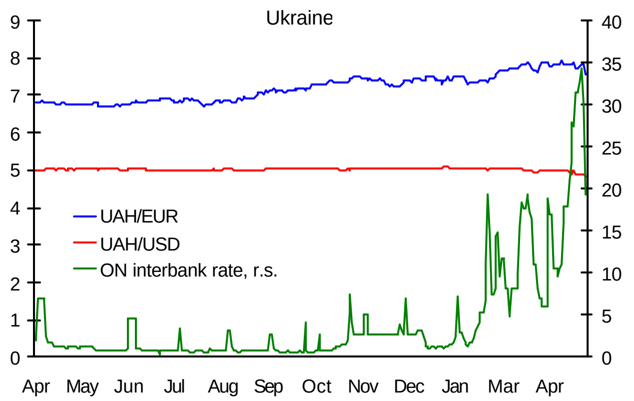












Source: Bloomberg

Appendix Forwards

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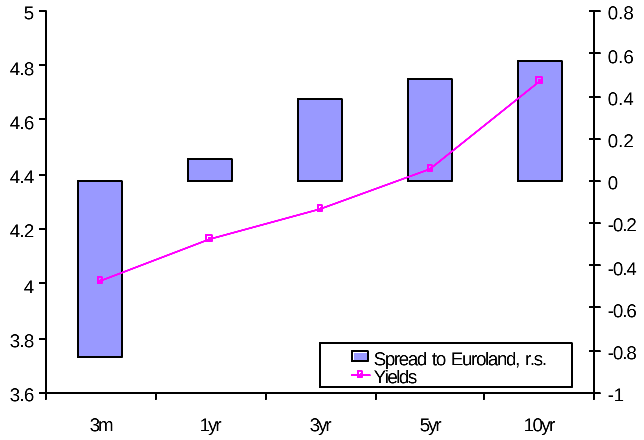
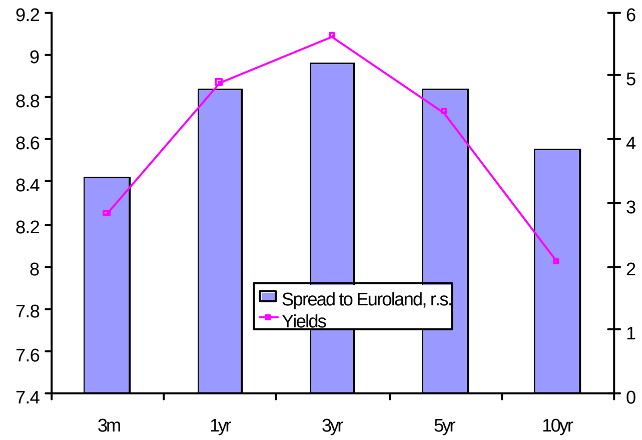
Benchmarks

Czech Republic



Hungary



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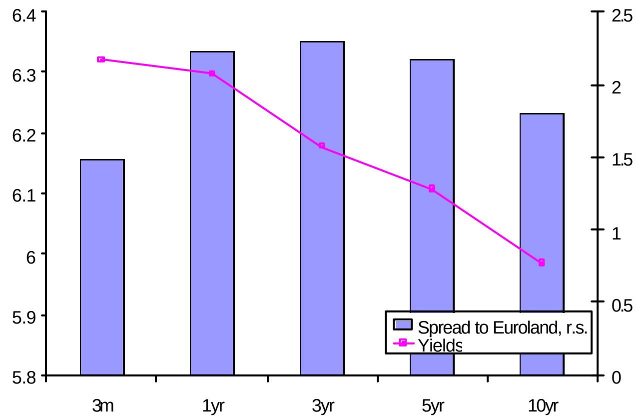
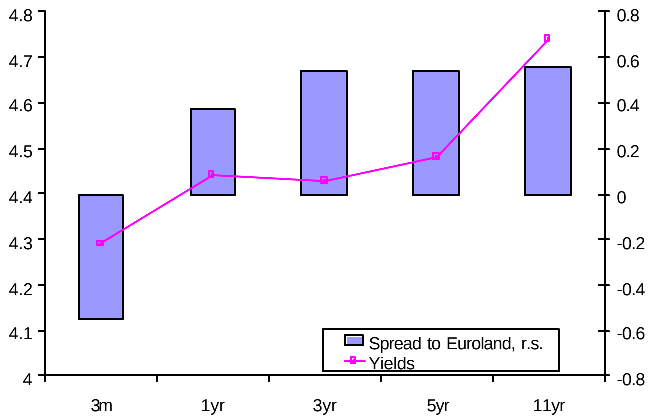


Slovakia



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