

## Fixed Income and Foreign Exchange

## CEE Insights

- **Croatia:** March trade balance figures confirmed 1Q slump
- **Czech Republic:** No rate change expected for next week
- **Hungary:** Central bank hiked base rate by 25bp to 8.25%
- **Poland:** Key rate left unchanged
- **Romania:** RON correction continued this week
- **Slovakia:** EC to give positive assessment of Slovak euro ambitions next week

# Overview

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## Croatia:

- Industrial production hit brakes to 0.2% y/y
- March trade balance figures confirmed 1Q slump



## Czech Republic:

- No rate change expected for next week
- Strong 1Q foreign trade performance



## Hungary:

- Central bank hiked base rate by 25bp to 8.25%
- Bond auctions in focus next week



## Poland:

- Key rate left unchanged



## Romania:

- Romania intends to sell state securities worth RON 1 bn in May
- RON correction continued this week
- Central bank likely to keep key rate on hold at 9.5%



## Slovakia:

- EC to give positive assessment of Slovak euro ambitions next week
- Central bank left interest rates unchanged...
- ...but rates might be lowered already this month

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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        | 25.32   | -0.7% | -1.0% | 4.9%  |                      |      |            |
|                  | 3Y (yield bp)  | 4.28    | 0     | 0     | -4    | 49                   | 80   | 41         |
|                  | 10Y (yield bp) | 4.78    | 3     | -5    | 4     | 66                   | 93   | 53         |
| Croatia          | EUR/HRK        | 7.264   | 0.0%  | 0.1%  | 0.5%  |                      |      |            |
|                  | 3Y (yield bp)  | 5.64    | -1    | -16   | 33    | 189                  | 236  | 140        |
|                  | 10Y (yield bp) | 5.79    | 0     | 0     | 25    | 166                  | 188  | 135        |
| Hungary          | EUR/HUF        | 252.1   | 0.0%  | 2.4%  | 0.4%  |                      |      |            |
|                  | 3Y (yield bp)  | 9.08    | 6     | -53   | 153   | 530                  | 609  | 365        |
|                  | 10Y (yield bp) | 8.10    | 13    | -4    | 99    | 398                  | 424  | 290        |
| Poland           | EUR/PLN        | 3.462   | -0.8% | 1.2%  | 4.0%  |                      |      |            |
|                  | 3Y (yield bp)  | 6.16    | -3    | -5    | -3    | 238                  | 269  | 229        |
|                  | 10Y (yield bp) | 5.98    | -1    | -4    | 1     | 186                  | 207  | 176        |
| Romania          | EUR/RON        | 3.663   | -2.1% | 1.5%  | -2.3% |                      |      |            |
| Slovakia         | EUR/SKK        | 32.22   | 0.5%  | 0.6%  | 4.2%  |                      |      |            |
|                  | 3Y (yield bp)  | 4.45    | 2     | 16    | -14   | 57                   | 66   | 52         |
|                  | 11Y (yield bp) | 4.72    | -2    | 9     | -10   | 60                   | 63   | 48         |
| Ukraine          | EUR/UAH        | 7.50    | 0.8%  | 4.0%  | -1.7% |                      |      |            |
|                  | 3Y (yield bp)  | 11.00   | 0     | 2     | 4     | 718                  | 544  | 361        |

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](mailto: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 |     |
|---------------|-------------|------|-------------|------|-------------|-----|-------------|------|-------------|------|-------------|------|-------------|-----|
| <b>Spot</b>   | 25.3        | 25.3 | 7.26        |      | 252         |     | 3.46        | 3.46 | 3.68        |      | 32.2        | 32.2 | 7.6         |     |
| <b>Jun-08</b> | 25.8        | 25.3 | 7.22        | 7.22 | 255         | 254 | 3.60        | 3.46 | 3.65        | 3.72 | 32.5        | 32.2 | 7.4         | 7.7 |
| <b>Sep-08</b> | 26.4        | 25.3 | 7.25        | 7.25 | 256         | 256 | 3.51        | 3.47 | 3.58        | 3.78 | 32.5        | 32.2 | 7.1         | 8.1 |
| <b>Dec-08</b> | 25.9        | 25.2 | 7.30        | 7.30 | 256         | 259 | 3.45        | 3.49 | 3.50        | 3.84 | 32.5        | 32.1 | 6.7         | 8.3 |
| <b>Mar-09</b> | 25.9        | 25.2 | 7.25        | 7.25 | 255         | 261 | 3.40        | 3.50 | 3.50        | 3.90 | -           | 32.1 | 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 |
|---------------|------|------|------|------|------|------|-------|--------|--------|--------|--------|--------|--------|
| <b>Spot</b>   | 3.75 | 4.81 | 8.25 | 5.75 | 9.50 | 4.25 | 10.00 | 4.13   | 8.43   | 6.34   | 11.87  | 4.30   | 4.30   |
| <b>Jun-08</b> | 3.75 | 4.50 | 8.50 | 6.25 | 9.50 | 4.00 | 12.00 | 4.03   | 8.30   | 6.45   | 10.04  | 4.50   | 4.38   |
| <b>Sep-08</b> | 4.00 | 4.25 | 8.50 | 6.25 | 9.50 | 3.75 | 12.00 | 4.06   | 8.20   | 6.45   | 9.96   | 4.30   | 4.43   |
| <b>Dec-08</b> | 4.00 | 4.00 | 8.25 | 6.25 | 9.00 | 3.50 | 12.00 | 4.09   | 8.10   | 6.45   | 9.00   | 4.10   | 4.47   |
| <b>Mar-09</b> | 4.00 | 4.00 | 8.00 | 6.25 | 8.25 | -    |       | 4.14   | 7.90   | 6.35   | 8.50   | 3.91   | 14.00  |

### 10y Govt. Yield

### 5y Govt. Yield

### 3y Govt. Yield

|               | CZ   | HR   | HU   | PL   | SK   | RO   | UA   |
|---------------|------|------|------|------|------|------|------|
| <b>Spot</b>   | 4.78 | 7.29 | 8.10 | 5.99 | 4.70 | 10.5 | 7.8  |
| <b>Jun-08</b> | 4.70 | 5.60 | 7.90 | 5.90 | 4.65 | 10.1 | 9.8  |
| <b>Sep-08</b> | 4.60 | 5.40 | 7.70 | 5.90 | 4.65 | 9.6  | 10.4 |
| <b>Dec-08</b> | 4.70 | 5.30 | 7.20 | 5.55 | 4.70 | 9.3  | 9.4  |
| <b>Mar-09</b> | 4.80 | 5.30 | 6.90 | 5.45 | 4.80 | 8.6  | 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        |
| <b>CEE8 weighted average</b> | <b>6.3</b> | <b>6.2</b> | <b>5.2</b> | <b>5.4</b> |

| 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        | 5.0        | 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       |
| <b>CEE8 weighted average</b> | <b>4.2</b> | <b>6.6</b> | <b>6.0</b> | <b>4.9</b> |

| 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        | 7.8        | 7.6        |
| 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        |
| <b>CEE8 weighted average</b> | <b>10.6</b> | <b>8.8</b> | <b>7.9</b> | <b>7.3</b> |

| 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        | 8.2        | 7.6        |
| 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       |
| <b>CEE8 weighted average</b> | <b>6.6</b> | <b>6.0</b> | <b>7.4</b> | <b>6.5</b> |

| 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        |
| <b>CEE8 weighted average</b> | <b>-5.2</b> | <b>-6.0</b> | <b>-6.7</b> | <b>-6.7</b> |

| 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        |
| <b>CEE8 weighted average</b> | <b>-3.5</b> | <b>-2.5</b> | <b>-2.9</b> | <b>-2.9</b> |

# Diaries

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## Looking ahead

| Country               | Date   | Release/event/figures                     | Our expectation | Consensus* |
|-----------------------|--------|---|-----------------|------------|
| <b>Czech Republic</b> | May-06 | Trade Balance, CZK bn., March             | 14.6            | 15.0       |
|                       | May-07 | CNB, rate-setting meeting, %              | 3.75            | 3.75       |
| <b>Croatia</b>        | 7-May  | Retail trade                              | 5.0% y/y        |            |
|                       | 8-May  | PPI                                       | 7.6% y/y        | -          |
| <b>Hungary</b>        | May-07 | April budget balance                      | HUF-13bn        | -          |
|                       | May-08 | March Industrial output                   | 6% y/y          | -          |
|                       | May-09 | March Trade balance                       | EUR 50mn        | -          |
| <b>Poland</b>         |        |   |                 |            |
| <b>Romania</b>        | 6 May  | Monetary policy meeting - key rate        | 9.5%            | 9.5%       |
|                       | 8 May  | Industrial production - March y/y         | 7.2%            | -          |
|                       | 9 May  | Trade deficit FOB-CIF March (EUR million) | 1,500           | -          |
| <b>Slovakia</b>       | May-07 | EC convergence report                     |                 |            |
|                       | May-09 | March industrial production               | 6% y/y          | n.a.       |
| <b>Ukraine</b>        | 6-May  | March CPI                                 |                 |            |
|                       | 7-May  | March PPI                                 |                 |            |

\*Sources: Bloomberg, Reuters

## Auction diary

| Country               | Code | Auction-date         | Pay-date  | Maturity      | Cupon | Offer           | Forecast |
|-----------------------|------|----------------------|-----------|---------------|-------|-----------------|----------|
| <b>Czech Republic</b> |      | No auction scheduled |           |               |       |                 |          |
| <b>Hungary</b>        |      | May-06               | May-14    | Aug-13-2008   | -     | HUF 40bn        | 8.40%    |
|                       |      | May-08               | May-14    | April-22-2011 | 6.75% | HUF 70bn        | 9.00%    |
|                       |      | May-08               | May-14    | Nov-24-2023   | 6.00% | HUF 15bn        | 7.85%    |
| <b>Poland</b>         |      |                      |           |               |       |                 |          |
| <b>Romania</b>        |      | 08-May-08            | 12-May-08 | 3Y            | 8.00% | RON 200 million | 9.40%    |
| <b>Slovakia</b>       |      |                      |           |               |       |                 |          |
| No auction scheduled  |      |                      |           |               |       |                 |          |
| <b>Ukraine</b>        |      | May-05               | May-07    | May-05-10     |       |                 | 7.7%     |
|                       |      | May-05               | May-07    | Sep-28-2011   |       |                 | 7.9%     |

# Major Markets

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## Major markets

### ECB Council on hold

ECB President Trichet will maintain the message that the actual interest rate level is appropriate to counter inflation risks at the press conference after the ECB Council meeting on May 8. This should finally put an end to fears of interest rate hikes this year, but still does not open the way for cuts. As we expect the economic data to deteriorate in the coming weeks and the yearly inflation rate to trend lower on the back of basis effects, we still see a chance of lower key rates in the second half. Even in the case that key rates are not changed, market rates should finally decrease, as the risk premium on the 3M Euribor now accounts for 70 basis points. Next week's data will comprise factory orders and industrial production for Germany, as well as industrial production for France. New orders are expected to decrease slightly again, as the Purchasing Manager Index showed a weaker reading in this respect in March. Industrial production should have remained stable, as the still high order backlog points to higher production, while base effects from the construction industry point to a decrease in March.

### Eventful week still not over

After a rather eventful week, which is still not over, only indicators of minor importance are scheduled for next week. The indicators released this week were mostly in line with market expectations. Consumer confidence dropped further, GDP growth for 1Q barely made it into positive territory and the ISM indicated a stagnation to slight contraction of the manufacturing sector. The Fed Funds target rate was cut by 25bp to 2%. The wording in the press release did not rule out further cuts, but still sounded a bit less concerned about the economy, which was due to the stable indicators, albeit at a low level. In accordance with the market, we think that rates have bottomed in this cycle. Still, today's labor market report has the potential to impact expectations. We think that the data will confirm our assessment. Next week, the ISM index for non-manufacturing industries will be released on Monday and, as usual, should have only a limited impact on financial markets. FX markets might react to the trade balance data on Friday, but also here it will likely not last long. We expect the bond market to move sideways, while the dollar might gain further vs. the euro.

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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              | 2.00 | 4.85                 |          | 2.78 |          | 4.11            | 3.77 | 1.548   |          |
| Jun-08 | 4.00              | 2.00 | 4.50                 | 4.98     | 2.00 | 2.89     | 4.00            | 3.80 | 1.52    | 1.545    |
| Sep-08 | 3.75              | 2.00 | 4.30                 | 4.84     | 2.10 | 2.99     | 4.30            | 4.20 | 1.47    | 1.538    |
| Dec-08 | 3.50              | 2.00 | 4.10                 | 4.88     | 2.20 | 3.04     | 4.50            | 4.40 | 1.40    | 1.531    |
| Mar-09 | 3.75              | 2.00 | 4.10                 | 4.31     | 2.30 | 3.10     | 4.60            | 4.60 | 1.38    | 1.526    |

## Croatia

### **Industrial production hit brakes to 0.2% y/y**

Short-term indicators in the last two weeks showed rather poor performance. Hence, after a solid first two months, industrial production saw a significant slowdown in March, recording only a 0.2% m/m increase. The slowdown was influenced by the Easter holidays, which this year were in March, thus affecting the number of working days. The manufacturing segment finished in the negative zone on an annual basis for the first time since mid-2006 and was the main factor behind the poor figures. Still, overall 1Q industrial production continued at a reasonably high rate of 4.7% y/y, thus supporting mild optimism for the 1Q GDP figures.

### **March trade balance figures confirmed 1Q slump**

The poor trade balance performance was also confirmed in March, as the trade balance deficit hit an all-time high monthly deficit of EUR 974mn. On the yearly basis, exports declined by 2.2%, while import dynamics were also low, posting a 3.1% increase. Overall, export-import coverage fell to just 42.2%, the lowest figure since 4Q05. Hence, the overall 1Q trade balance was a disappointment, recording an 18.1% higher deficit of EUR 2.7bn, while exports covered 44.9% of imports. Exports are negatively influenced by the falling level of competitiveness and lighter economic activity among Croatia's trading partners, while higher energy and food prices (among other factors) are taking their toll on the import side. The outlook for 2008 remains relatively unfavorable, as we see the trade balance deficit remaining in the 25+% of GDP zone.

The market offered few developments, as the exchange rate remained in the recently well-trodden range of 7.25-7.27, with rather low volatility and no strong movements to either side. Also, bond market yields remained unchanged, as the bond market continued to record low turnovers. Money market developments remained stable, with rates staying on a downward trajectory, as the period of reserve calculation is coming to an end.

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## Czech Republic

### **No rate change expected for next week**

Next week, the CNB is scheduled to hold its third meeting this year. We are in line with the market in expecting no change. What is going to be important is the new prognosis, which will tell us what changes were made in the economic outlook in the wake of stronger than expected 1Q data (industrial production, foreign trade, retail sales). We think that this data, coupled with the still solid outlook for the Eurozone (a slowdown is expected, but nothing dramatic), should translate into higher growth (than originally forecasted; we expect 5.8% y/y in 1Q) and should thus shift the interest rate path implicit in the CNB Staff prognosis upward (in contrast with the one from January). We expect the board to emphasize the strong koruna as the factor preventing the board from having to hike further. Also, the tight labor market will most likely again be mentioned as a risk (given the high headline). All in all, the board will in all likelihood adopt a wait-and-see strategy (which is what, for example, the Polish central bank essentially did at its last meeting as well). As we expect the CZK to weaken (due to a turnaround in the US and CEE economic indicators starting to show signs of a mild slowdown), the possibility of one more hike this year is not ruled out (+lower inflation target as of January 2010).

### **Strong 1Q foreign trade performance**

Among other data next week, the trade balance should confirm the strong performance of 1Q foreign trade. Our expectation of a March surplus of CZK 14.6bn almost mirrors that of the market (CZK +15bn). Foreign trade will thus contribute substantially to the 1Q growth. Eventually, the strong CZK (as well as the slowdown in the EU) should work its way into foreign trade; we expect a deteriorating trade balance in the remainder of the year.

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## Hungary

### **Central bank hiked base rate by 25bp to 8.25%**

At its Monday meeting, the central bank hiked the base rate by 25bp to 8.25%. We had expected no change, but the final outcome was in line with the market consensus. The council's statement mentioned the reasons for hiking the base rate as follows: (1) The council sees continued risks to the achievability of the inflation target next year. (2) According to the latest wage figures, wage growth will slow by less than previously expected, which may increase cost inflation pressure in the economy. At the same time, both the council's statement and the governor mentioned (at the press conference) that wage figures were not "clear" and the assessment of them was difficult, due to some one-off impacts. (3) The disinflation effect of the current negative output gap is less unanimous and spectacular than earlier expected. Finally, the statement concluded that, if meeting inflation targets makes it necessary, the council is ready to take further steps to reach price stability. After the Monday meeting, we have changed our base rate forecast. Based on the changed risk assessment and the maintained hawkish tone of the council, as well as its strong willingness to express the central bank's commitment to the mid-term inflation target of 3% y/y, another 25bp rate hike seems likely in May. However, it is hard to predict at what level the peak of the current rate hiking cycle will stand; our current forecast is that the rate hiking cycle will come to an end at 8.50%. However, the questions as to when and in what manner the CB will be able to turn to delivering rate reductions from the current rate hiking process could come up at any time this year. We expect the CB to "take back" just 25bp from rate hikes at the end of the year, assuming an improving global market environment and a convincing slowdown in the 12-month inflation rate by that time.

### **Bond auctions in focus next week**

Next week, only second-tier data will be released, among which the April budget balance figures should get the most attention. The Finance Ministry earlier predicted a small deficit of HUF 13bn for the fourth month of the year. Having been closed on Thursday and Friday, the domestic market could open next week with a bit more volatility, as players may react to important data and events on major markets taking place on these days (especially the labor market data in the US) with a time lag. In the absence of important macro figures, the 3-year and 15-year bond auctions to be held next Thursday should be the focus of market participants.

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## Poland

### **Key rate left unchanged**

The Polish central bank left the key rate unchanged at its meeting last week (as the majority of analysts expected; we anticipated a hike of 25bps). This was basically a direct response to the uncertainty created by the recent data from the real economy (industrial production, retail sales) - the MPC acknowledged this explicitly. Overall, the statement remained hawkish, indeed almost to an extent leading one to wonder why the hike was not delivered now. The major concerns are still the tight labor market and high inflation (which will likely remain above the upper limit of the deviations from the target in the near future as well), plus the risk that the longer it remains off the target, the higher the risk to expectations this will pose. This is basically the same issue as that faced by the Czech National Bank. The difference is that the PLN, while undoubtedly having risen spectacularly since the beginning of the year (the MPC referred to this as "zloty appreciation" instead of the earlier "stable zloty", an interesting change), does not have such a strong impact on prices in the Polish economy as the CZK has in the Czech economy. We think that the MPC is now in a wait-and-see mode and can (and will) switch rapidly back into a hiking mode as soon as the current data turns out to be only a one-off decrease. This is also supported by the mindset of the board. After all, the sentence reading "the Council does not rule out that to bring inflation back to target will require further monetary tightening in the future" is pretty clear.

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## Romania

### ***Romania intends to sell state securities worth RON 1 bn in May***

The MinFin released the debt calendar for May and announced its intention to borrow one billion lei from the local primary market. In this respect, the MEF will organize four auctions - two for selling T-bills and another two for benchmark bonds. The MinFin intends to borrow RON 700mn in the short term and only RON 300mn in the medium and long terms, as it hopes that yields will undergo a downward trend in the medium run. The first auction will be held on May 8, when Romania will try to sell three-year benchmark bonds worth RON 200mn for a coupon rate of 8.0% per year. At the last 3Y bond auction, the cut-off rate accepted by the MEF stood at 10% and there is little chance that the yields would outpace 10.0% this time, especially as the MEF has just cashed in substantial amounts of money from the VAT payments. Thus far, the MinFin has borrowed only RON 1.5bn from the local market out of the RON 5.8bn initially planned for the first four months of the year. In 2008, the MinFin targets a general budget deficit of 2.3% of GDP, which means a shortfall of at least RON 11bn, so the MEF might borrow heavily from the local primary market in the second semester of 2008, when it will start to record a budgetary deficit.

### ***RON correction continued this week***

The Romanian currency started the week on a weak foot, as it dropped to the 3.69 zone on Tuesday, losing 1.6% in just one trading day. The RON suffered the sharpest intraday correction among its regional peers, which were also affected, as investors reduced their exposures to emerging currencies in favor of the greenback. Towards the end of the week, the local currency recovered some of the earlier losses and strengthened to 3.66 on Friday. Liquidity conditions remained tight on the Romanian money market, as a new mandatory reserve period has just started and the commercial banks are quoting interbank deposits for 11/12% bids/asks. The central bank did not sterilize anything from the money market this week, as there was no surplus liquidity in the banking system. The central bank held a single deposit auction this week, on Tuesday, which did not stir the interest of the commercial banks, as no bids were placed.

### ***Central bank likely to keep key rate on hold at 9.5%***

Next week, the NBR will hold a monetary policy meeting (May 6). After the rebound of inflation starting in August 2007, the central bank underwent a tightening policy and hiked the key rate by 250 basis points. We believe that the NBR will keep the monetary policy rate on hold at 9.5% at this meeting, as the Administration Board will take some time to fully assess the effects of the previous hikes. We estimate that the inflationary pressures will ease in the coming quarters and that headline inflation will have reached a maximum of 8.6% in March. The interbank interest rates recently rose to well above the sterilization rate, being quoted at 11/12% bids/asks, as the high level of the mandatory reserve requirements puts a heavy burden on liquidity conditions in the Romanian money market. Liquidity has been sensibly restrained in the past few months and it is possible that the central bank will become a net creditor to the Romanian banking system, as the commercial banks have in recent times rarely resorted to NBR deposit auctions. We believe that the NBR will maintain the current ratio of the minimum reserve requirement at 20% for RON and 40% for foreign currency-denominated liabilities.

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## Slovakia

### **EC to give positive assessment of Slovak euro ambitions next week**

Last week, the European Commission published its spring forecasts, which showed that the Commission assumes the sustainability of low inflation in Slovakia. The Commission foresees Slovak harmonized inflation on average at 3.8% this year and at 3.2% in 2009. At the same time, the Maastricht limit was seen by the EC at 4.1% and 3.4% in 2008 and 2009, respectively. This means that Slovak inflation will stay below the reference limit in both years. With the forecasts' release, the probability that the European Commission will give a positive assessment to Slovakia in its convergence report (which is the most crucial report in the euro-bid process and which will be published next Wednesday) has increased, in our view, and we see it as almost certain. The impact of the positive assessment on the koruna is hard to guess. The psychological effect might play a role, but, on the other hand, a positive assessment is broadly expected. After the release of the EC forecasts, the koruna temporarily firmed to below 32.20 EUR/SKK from the earlier 32.35, but later bounced back to 32.25.

The media released information last week that the leaked EC convergence report indeed contained a positive assessment for Slovakia. On the inflation front, the report supposedly said that average inflation "is well below the reference value and is likely to remain below the reference value in the months ahead, albeit with a narrowing margin". The report allegedly concludes that "Slovakia fulfils the conditions for the adoption of the euro".

### **Central bank left interest rates unchanged...**

The Slovak central bank met regarding interest rates last Tuesday and, in line with widespread expectations, left interest rates unchanged (the key 2W repo rate stayed at 4.25%). The economic outlook and inflation forecasts spoke in favor of stable interest rates this month as well, while the strong koruna guaranteed tight monetary conditions. Governor Sramko reiterated at a press conference that demand-led inflationary pressures remained contained. In its new quarterly prognosis, the central bank kept its end-2008 forecast of harmonized inflation at 2.8%, while the end-2009 estimate was upped to 3.1%. We see the figures as higher, both at 3.6%.

### **...but rates might be lowered already this month**

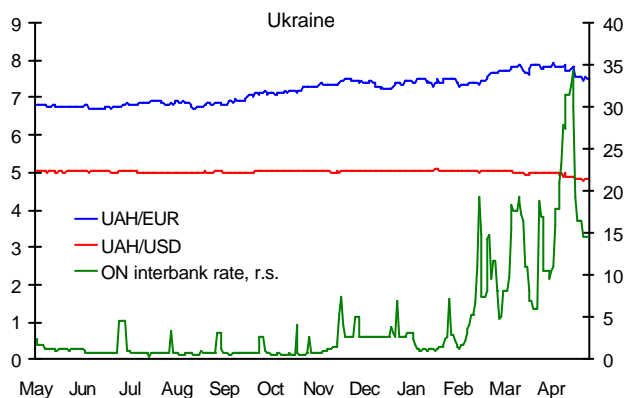
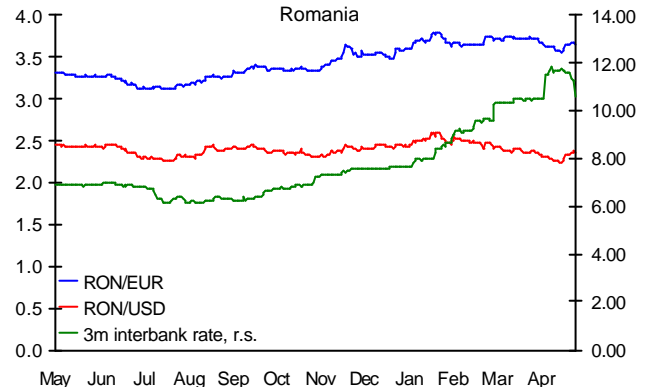
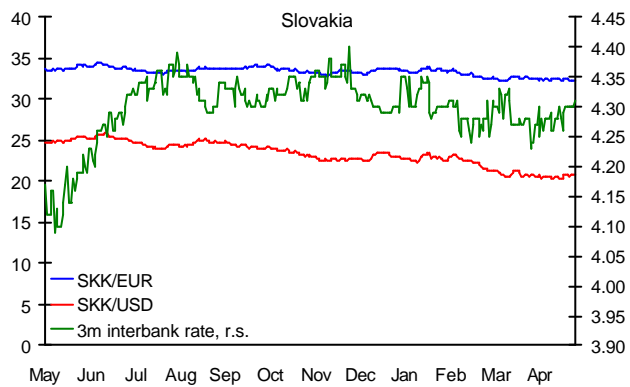
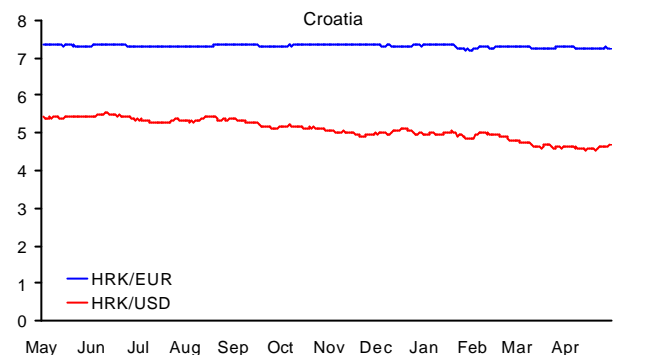
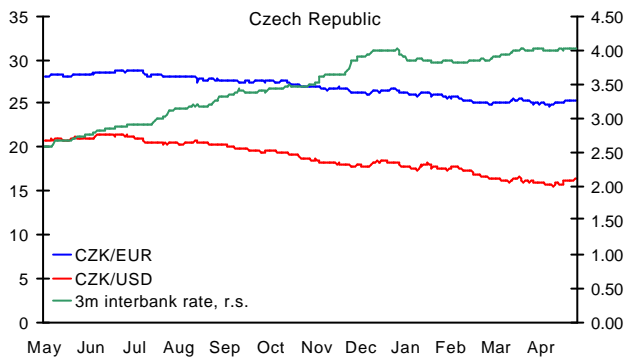
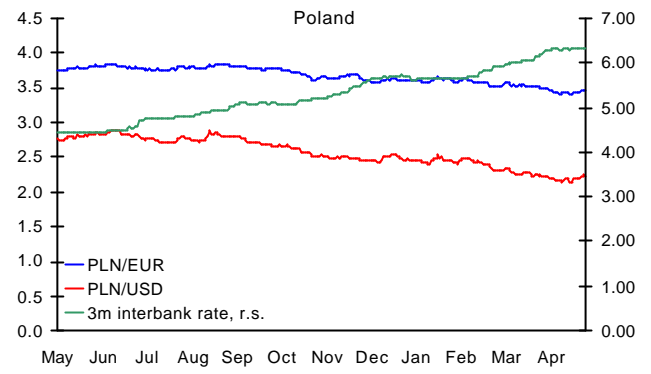
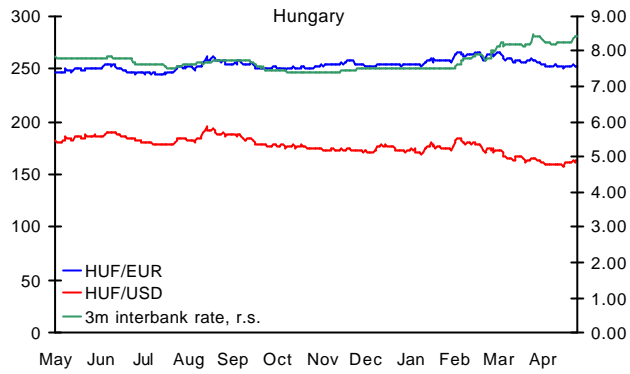
In May, after the EC decision on euro adoption in Slovakia is known, the NBS might lower the official interest rates to the level prevailing in the Eurozone, i.e. to 4% (as a different monetary policy from that of the ECB will no longer be in effect). Later on, the NBS will likely follow the steps of the ECB. We assume two rate cuts in the second half of the year, which would bring the key (Slovak and ECB) interest rates to 3.5% by the year-end.

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# Appendix Charts

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## Exchange rates and interest rates (52 weeks)



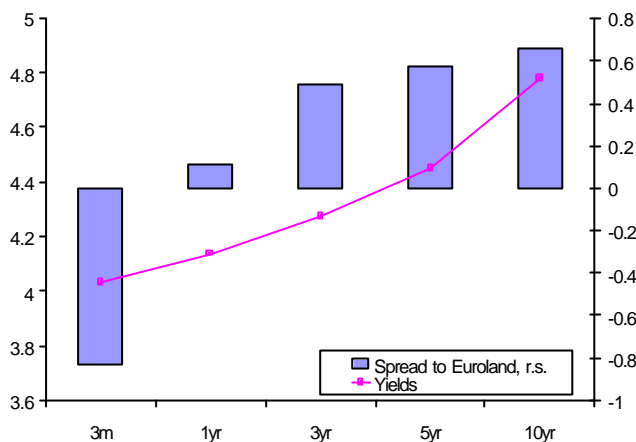
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# Appendix Forwards

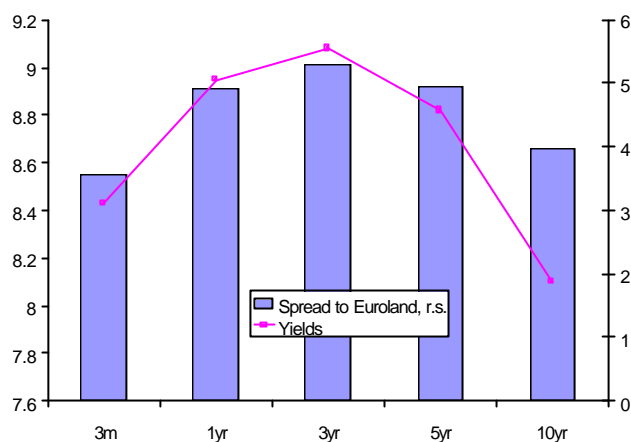
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## Benchmarks

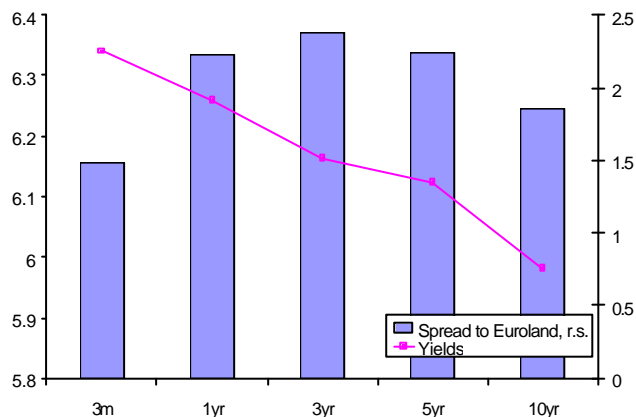
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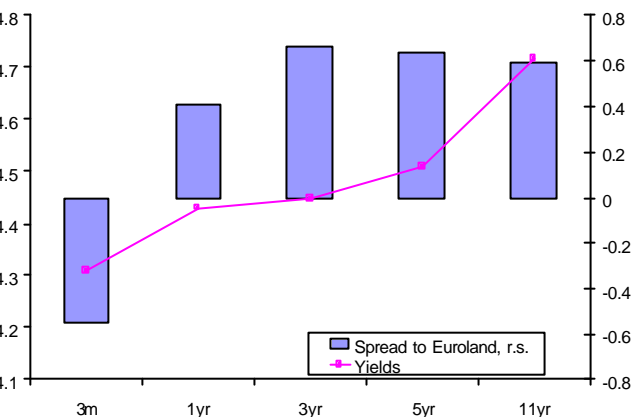
### Hungary



### Poland



### Slovakia



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