CEE Research

May 9, 2008

Fixed Income and Foreign Exchange

CEE Insights

- **Czech Republic:** Rates left unchanged at meeting last week
- **Hungary:** April CPI and 1Q GDP in focus next week
- **Poland:** Hawkish tones from central bank this week
- **Romania:** Real economy remained strong in 1Q08
- **Slovakia:** Slovakia received green light from EC to join Eurozone
- **Ukraine:** April CPI reached 30.2% y/y

Overview

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Czech Republic:

- Rates left unchanged at meeting last week
- March trade balance surprisingly low

Hungary:

- April CPI and 1Q GDP in focus next week
- Domestic market remains calm

Poland:

- Hawkish tones from central bank this week
- Plenty of important data due next week

Romania:

- Real economy remained strong in 1Q08
- Key rate hiked to 9.75%
- Central bank revised its year-end inflation projections for 2008 and 2009
- Romania sold 3Y benchmark bonds for average yield of 9.8%

Slovakia:

- Slovakia received green light from EC to join Eurozone
- Conversion rate still to be decided
- Next week rich in data

Ukraine:

- April CPI reached 30.2% y/y
- Confrontation between president and prime minister
- What could be behind this confrontation?
- How will current confrontation be resolved?

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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	25.12	0.8%	-0.2%	5.7%			
	3Y (yield bp)	4.27	0	0	-4	49	76	41
	10Y (yield bp)	4.70	-8	-14	-4	58	94	53
Croatia	EUR/HRK	7.259	0.1%	0.2%	0.6%			
	3Y (yield bp)	5.63	-1	-5	32	192	214	140
	10Y (yield bp)	5.80	1	4	26	175	176	135
Hungary	EUR/HUF	252.5	-0.1%	0.4%	0.3%			
	3Y (yield bp)	9.08	6	-88	153	530	644	365
	10Y (yield bp)	8.10	13	-4	99	398	424	290
Poland	EUR/PLN	3.409	1.6%	1.4%	5.6%			
	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	3.688	-0.7%	-0.5%	-3.0%			
Slovakia	EUR/SKK	32.03	0.6%	1.3%	4.8%			
	3Y (yield bp)	4.42	-3	12	-17	65	69	52
	11Y (yield bp)	4.70	-2	8	-13	66	61	48
Ukraine	EUR/UAH	7.38	1.5%	6.5%	-0.1%			
	3Y (yield bp)	10.50	-0.5	1.3	3.0	673	564	361

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

Trading Ideas

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Positions

Position #	Date of opening	Instruments	Entry values	Today's values	flat P/L (%)	flat P/L inc. carry (%)	P/L p.a. inc. carry (%)	Target values	Target P/L flat inc. carry (%)	Target P/L p.a. (%)
	05/05/08	3m Pribid/ 3m Euribor	3,99/4,86%			-0.20%	-17.9%	26.2	4.0%	16.0%
23 long EUR/CZK		EUR/CZK	25.25	25.20	-0.21%					

Rationale at inception

23) CZK has been off its fundamental value for some time now (and its current level is also still inconsistent with expectations regarding future rates, as embodied in FRAs, and inflation). On top of that, CZK (thanks to its indirect exposition to US) is a quasi safe-haven in the times when the US economy is going through one of its toughest periods in recent 20 years. We see two possible triggers of correction - dollar turnaround (possibly underway now, also - expected bottom in US rates should stop to damage the greenback) and dividends outflow. Gradually, worse data from region should also start coming in (slowdown in EU will trickle through into CEE).

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		3.40		3.68		32.0		7.4	-
Jun-08	25.8	25.2	7.22	7.22	255	254	3.60	3.41	3.65	3.71	32.5	32.0	7.4	7.5
Sep-08	26.4	25.1	7.25	7.25	256	257	3.51	3.42	3.58	3.77	32.5	32.0	7.1	7.8
Dec-08	25.9	25.1	7.30	7.30	256	259	3.45	3.44	3.50	3.83	32.5	31.9	6.7	8.1
Mar-09	25.9	25.1	7.25	7.25	255	262	3.40	3.45	3.50	3.89	-	31.9	6.6	8.3

	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	4.80	8.25	5.75	9.75	4.25	12.00	4.13		8.44		6.39		11.15		4.30		15.45	-
Jun-08	3.75	4.50	8.50	6.25	9.75	4.00	12.00	4.03	4.14	8.30	8.80	6.45	6.46	10.04	9.52	4.50	4.35	15.00	-
Sep-08	4.00	4.25	8.50	6.25	9.75	3.75	12.00	4.06	4.05	8.20	8.97	6.45	6.47	9.96	8.68	4.30	4.35	14.00	-
Dec-08	4.00	4.00	8.25	6.25	9.50	3.50	12.00	4.09	4.01	8.10	8.92	6.45	6.34	9.50	6.21	4.10	4.34	13.50	-
Mar-09	4.00	4.00	8.00	6.25	8.50	-		4.14	4.13	7.90	8.73	6.35	5.93	8.70	4.87	-	3.92	13.00	-

	10y Govt. Yield					5y Govt. Yield	3y Govt. Yield
	CZ	HR	HU	PL	SK	RO	UA
Spot	4.64	5.80	8.05	5.99	4.70	10.40	10.5
Jun-08	4.70	5.60	7.90	5.90	4.65	10.10	11
Sep-08	4.60	5.40	7.70	5.90	4.65	9.60	11.2
Dec-08	4.70	5.30	7.20	5.55	4.70	9.30	10.4
Mar-09	4.80	5.30	6.90	5.45	4.80	8.40	-

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	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
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	7.8	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
CEE8 weighted average	**10.6**	**8.8**	**7.9**	**7.3**

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	10.1	8.0
Serbia	22.1	11.3	11.2	10.0
Slovakia	4.3	4.3	4.0	4.2
Ukraine	13.5	9.8	14.5	12.0
CEE8 weighted average	**6.6**	**6.0**	**7.7**	**6.7**

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	May-12	CPI	6.3% y/y	6.7% y/y
	May-12	Unemployment	5.3%	5.2%
	May-12	Industry	8.5%	4.0%
	May-15	GDP	5.8%	5.5%
	May-15	C/A balance	CZK 10.4bn	CZK 10.7bn
	May-16	PPI	4.8% y/y	5.1% y/y
Croatia	14-May	CPI	6.0% y/y	
Hungary	May-14	April CPI inflation	6.6% y/y	6.7% y/y
	May-15	1Q08 Flash GDP estimate	1.3% y/y	1.3% y/y
	May-16	Nominal wages	-	-
Poland	May-15	CPI		4% y/y
	May-15	C/A balance		EUR 1.5bn
	May-16	Wages		11.4% y/y
Romania	12 May	CPI - y/y	8.4%	8.5%
		Current account deficit March - EUR mn	1,470	-
Slovakia	May-12	March trade balance	SKK 2.7bn	SKK 3.7bn
	May-13	April CPI inflation	4.1% y/y	4.1% y/y
	May-15	1Q08 Flash GDP estimate	7.0% y/y	7.6% y/y
	May-15	March EU-norm inflation	3.5% y/y	3.6% y/y
Ukraine	12-May	April Industrial Production	7.1% y/y	6.6% y/y
	15-May	April GDP	6.2% y/y	-

**Sources: Bloomberg, Reuters*

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		May-14	May-19	11/04/2011	4.1%	CZK 6bn	4.25%
		May-15	May-16	13/02/2009		CZK 4bn	4.05%
Hungary		May-13	May-21	Aug-21-2008	-	HUF 40bn	8.45%
		May-14	May-21	Nov-19-2008	-	HUF 25bn	8.70%
		May-15	May-21	April-08-2009	-	HUF 40bn	8.90%
Poland		May-15	May-16	09/2022		EUR 1-2.5bn	
Romania		14-May-08	16-May-08	1Y	-	RON 500 mn	10.20%
Slovakia		May-12	May-14	Apr-01-11	-	-	4.40%
Ukraine		12-May	14-May	05-May-10	n.a.		7.70%
		12-May	14-May	28-Sep-11	n.a.		7.90%

Major Markets

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Major markets

ECB on hold, as expected

The ECB Council kept interest rates and the tone of the wording at the press conference on hold. Uncertainty for the future path of the economy was again assessed as high and the risk for the future was on the downside. The opposite was stated for inflation, where risks remained on the upside. The Council expects inflation to remain elevated for a protracted period of time before declining gradually. This week's data already showed the expected weakening in growth with a drop in German factory orders and lower industrial production in Germany and France. However, next week, the first estimate of GDP data for 1Q is expected to show healthy growth of 0.7% q/q for Germany (as indicated by Bundesbank President Axel Weber) and +0.4% q/q for France. For Euroland, this should mean a growth rate of 0.5% q/q. As this is already expected by the market, the risk is more on the downside. We expect a sideways trend in yields between 4% and 4.2% for the next few weeks.

Numerous indicators should confirm stagnating US economy

After a rather quiet week, more important indicators are scheduled for the upcoming week. Retail sales will give an indication on how consumer demand is developing. Markets expect a stagnation in April, which is in our view on the pessimistic side of possible outcomes. Gasoline price increases by more then 6% vs. the previous month might have bolstered the nominal retail sales figure. The development of consumer prices in April will be reported on Wednesday. No doubt, higher gasoline prices will be mirrored in the elevated overall rate, while the core rate is expected to have remained at the long-term average. Markets are skeptical about industrial production in April released on Thursday and forecast a drop of the same amount as the gain in the previous month. This would be in line with the indications from the ISM index, which point to a more or less stagnating US manufacturing sector. Finally, Friday will bring the Univ. of Michigan Index. In the current difficult environment, stagnating consumer sentiment would already be good news. Fed Chairman Bernanke is going to give speeches on Tuesday and Thursday. The topics, Federal Reserve Liquidity Measures and Risk Management at Banking Organizations, respectively, do not promise any interest rate outlook. In total, we expect further confirmation of a stagnating US economy and bond markets to move sideways, while further dollar gains are supported by technicals.

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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		2.72		4.03	3.75	1.547	
Jun-08	4.00	2.00	4.50	5.00	2.00	2.83	4.00	3.80	1.52	1.543
Sep-08	3.75	2.00	4.30	4.83	2.10	2.94	4.30	4.20	1.47	1,53,6
Dec-08	3.50	2.00	4.10	4.86	2.20	3.02	4.50	4.40	1.40	1.529
Mar-09	3.75	2.00	4.10	4.33	2.30	3.02	4.60	4.60	1.38	1.523

Czech Republic

Rates left unchanged at meeting last week

The CNB held its rate setting meeting last week. As expected, it left the rates unchanged (3.75%); voting remained 6/1 (Hampl for a hike) and the prognosis stayed consistent with the fall in rates. Nonetheless, we read the statement and the discussion accompanying it as indicating more skepticism among some of the Board members as regards the fall in PRIBOR projected by the prognosis. Risks to inflation are seen as being rather on the inflationary side - labor market, slower response of the economy to the exchange rate, inflation expectations. On the anti-inflationary side, there is only the "external environment" (read: fallout of the mortgage crisis). The CNB expects growth of 4.7% this year (we agree - the data does not indicate a slowdown of the magnitude forecasted at the end of 2007) and 4.0% next year (we are more inclined to see it close to 5% - TPCA effect redux). Add the lower inflation target looming at the horizon of the monetary policy and it is clear why we think the rates will rise by 25bps this year.

March trade balance surprisingly low

As for the other data released last week, the trade balance for March came in surprisingly low, some 50% lower surplus than in March 2007 (but then again, March 2007 was the strongest month of that year). This offset the excellent first two months of this year, during which the trade balance surplus grew by some 10% y/y, despite rapid strengthening of the CZK at almost the same rate. At the moment, it is impossible to say whether this is a one-off factor or the beginning of a trend (we indeed expect a worsening of the trade balance in 2H). If one claims this (finally) as the effect of the strong currency, then it remains puzzling why exactly now (the CZK has been stronger for quite some time now). The next data on the trade balance will be closely watched for a confirmation of these hypotheses.

Next week, quite a few figures are going to be released, the most important of which are CPI for April and the preliminary GDP growth rate for 1Q. April CPI will be pushed up by oil prices and heating prices, but, driven lower by the strong CZK, we expect a y/y slowdown to 6.4%. As for GDP, this will be stronger than what we thought last year. Strong consumption, driven by the fall in unemployment and lower than expected worsening of foreign trade, will keep the growth at around 5.5-5.6%. Other data up for release next week include unemployment and industrial production, where one can now expect meager growth, given the weak trade balance in March.

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Hungary

April CPI and 1Q GDP in focus next week

Next week, April CPI inflation (to be released on Wednesday) should be the most watched figure. We expect the 12-month rate to slightly slow to 6.6%, from the 6.7% published for March. The April decline in fuel prices could have kept the monthly CPI at a lower level, despite a further increase in food and clothing prices. The CSO will release its flash GDP estimate for the first quarter one day later. The performance of exports could have pushed the y/y growth figure into the 1-1.5% range, despite the relatively high 1Q07 base figure.

Looking back at this week, it was interesting that the March industrial output figures surprised to the negative side, while the trade balance figures surprised to the positive side, which again confirmed the high volatility of monthly developments for these figures. According to the CSO's preliminary and working day-adjusted figures, industrial output rose just 4.3 y/y in March, while the unadjusted figure showed a 1.9% y/y increase. At the same time, the preliminary CSO trade balance again showed a high surplus in March (EUR 169.6mn). The budget deficit amounted to HUF 14.3bn in April, which was slightly higher than the ministry's preliminary forecast of HUF 13bn. The deficit for the first four months of the year amounted to HUF 522.4bn, 47.6% of the latest full-year projection.

Domestic market remains calm

Without any important market events, the forint has moved in a relatively tight range during the week. The 3-year and 15-year bond auctions attracted high demand on Thursday, but yields again rose. Domestic markets seem to remain calm, as market players are not expected to open new positions before the long weekend. Next week, the CPI and GDP figures may again revive the trading.

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Poland

Hawkish tones from central bank this week

The voices emanating from the Polish central bank sounded hawkish this week. Monetary Council members Noga and Filar are both well known hawks, so their assurance that a rate hike is needed in May comes as no surprise and is not very important in terms of the central bank's policy moves. However, the voice of Jan Czekaj is something completely different, as he is a key swing voter and his vote is often decisive in the rate setting process. This important member of the Monetary Council stated that an interest rate hike may be needed in May to dampen inflation, even at the risk of hurting exporters by boosting the zloty further. His April 30 Bloomberg interview explained the break in the rate hiking cycle last month. Czekaj said that May will see the release of several important macroeconomic figures, including GDP for the first quarter. The development of GDP, particularly the output gap, will be important for the evaluation of inflation risks. Thus, Czekaj's interview clearly improved the chances of a rate hike in May, which is in line with our expectation of a further rise of Polish interest rates.

Plenty of important data due next week

Next week will bring a set of important economic releases. The most important will be CPI, which could directly influence both market expectations about the outcome of the May monetary policy meeting and the opinions of Monetary Policy Council members. The market should be sensitive to a higher number (in particular), which increases the risk of secondary inflation pressures. Employment data will show the current status of the sensitive labor market. A lower unemployment rate would also support the case for further hiking. The current account and trade balance could have implications for the zloty (directly) and economic performance (indirectly), and thus GDP and rates. Finally, the budget development may have a marginally positive impact if the good development of the economy provides support for public finances.

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Romania

Real economy remained strong in 1Q08

Construction increased by 32.2% y/y in 1Q08, with a balanced distribution among residential buildings, non-residential buildings and civil engineering work. Industrial production went up by 5.4% y/y, while the capital goods industry reported a strong development (+16.1% y/y). Industrial production in January-February was good, but the March figures were rather disappointing compared to the managers' poll estimates. It seems that the more restrictive monetary policy implemented by the central bank beginning in 4Q07 has not yet produced visible effects in the real economy, due to the lag in the transmission mechanism. At the same time, the Romanian economy was not severely affected by the turmoil on international financial markets and the growth potential remains high. We see these figures as a strong support for the economic growth in 1Q08.

Key rate hiked to 9.75%

At its monetary policy meeting on May 6, the NBR raised the benchmark rate by 25bps to 9.75%, exceeding the expectations of local analysts. We see the decision as rather symbolic, signaling that the central bank is determined to contain inflationary pressures and achieve medium-term disinflation objectives in a sustainable manner. The hike of the key rate by 25bps is likely to have a marginal effect on the Romanian money market, as interbank deposits have stayed in the double-digit area in the past few months, sometimes even exceeding 12%. In light of the recent available data, our base scenario is that the benchmark rate might top 9.75% this year, as inflation is likely to ease slightly in the following months and monetary policy decisions have a lag of transmission of several quarters. However, we do not rule out the possibility of another 25bps increase to 10.0% at the next monetary policy meeting on June 26, when we see the last chance for a rate hike this year, if core inflation remains on a strong upward trend in April and May. We revised our year-end key rate forecast to 9.5%, as we believe that the NBR might make a key rate cut of 25bps at the last monetary policy meeting this year.

Central bank revised its year-end inflation projections for 2008 and 2009

On May 8, the central bank presented its quarterly report on inflation, slightly raising its forecasts on year-end inflation to 6.0% (from 5.9%). The governor explained the sharp rise of inflation in the first quarter of 2008, when headline inflation soared to 8.6% and CORE2 inflation (excluding administered and volatile prices) reached 7.0%, as being caused by shocks on the supply side, excess demand pressures, steep depreciation of the local currency and inflamed inflation expectations. The central bank took market watchers by surprise, as it revised downwards its inflation forecast for 2009 by 40bps to 3.5%, the level of the headline inflation target agreed with the government. We consider the NBR's inflation projection for 2009 rather optimistic. We see that year-end inflation reaching the upper limit of the NBR's target intervall, which is around 4.5%. The NBR is likely trying to decrease inflationary expectations for next year. Given the recently announced administered prices hikes due in July and the continuous rise of fuel prices, we intend to revise our forecast on year-end inflation for 2008. Next week will see the release of the consumer price index for April. We estimate a slight drop in headline inflation to 8.4% (from 8.6%), on the back of currency appreciation, which has an important pass-through effect on services (telephone and air transport charges) and non-food products.

Romania sold 3Y benchmark bonds for average yield of 9.8%

On May 8, the MinFin held an auction for 3Y benchmark bonds for a coupon rate of 8.0% per year. The overall offer of primary dealers reached RON 442mn, while the indicative amount stood at RON 200mn. The MinFin accepted RON 69mn, paying a maximum yield of 10.0%, as we had anticipated. The average accepted yield increased to 9.82% (from 9.8%). Next week, Romania will hold an auction for 6M T-bills for an indicative amount of RON 500mn.

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Slovakia

Slovakia received green light from EC to join Eurozone

The European Commission said that Slovakia met all necessary conditions for adoption of the euro in 2009. The positive assessment was broadly expected, as Slovakia met all of the nominal Maastricht criteria. The only disputable issue was the sustainability of its meeting the inflation criterion in the years ahead. However, the big buffer with which Slovakia met the inflation limit and the analysis of underlying fundamentals were among the arguments that persuaded the EC that it was not just accidental factors standing behind the low Slovak inflation. Indeed, the EC forecasts (released last week) showed that the Commission expects inflation to stay below the Maastricht limit in the forecasted horizon (i.e. until the end of 2009). The convergence report of the ECB was more ambiguous, saying that "there are considerable concerns regarding the sustainability of inflation convergence".

Despite their naming of the risks to inflation sustainability, the assessment of the European institutions was positive. Now, it should take only a formal procedure to get final approval from the European authorities. The Council still has to abrogate the excessive deficit procedure against Slovakia, which should be only a formality, as the

EC confirmed that the excessive deficit has been corrected in a credible and sustainable way to below the 3% (of GDP) limit.

Conversion rate still to be decided

The only open issue remaining is the level of the conversion exchange rate. The final conversion rate will be announced in the beginning of July. We believe that the revaluation of the central parity might be delivered before that time and that the central parity will serve as the final conversion rate. The setting of the parity will likely happen at the (future) spot rate at the time of fixing. Our estimate is in the 32.0-32.5 EUR/SKK band, although current spot rates (the koruna was briefly traded below 32 EUR/SKK after the EC's report) present risks for a stronger conversion rate.

Next week rich in data

Next week will be full of data releases, including the March trade balance, CPI and HICP inflation for April and the 1Q08 flash GDP growth estimate. In April, consumer inflation is likely to moderate somewhat from 4.2% y/y to 4.1% y/y for CPI. We anticipate the monthly price growth at 0.1%, driven by the higher prices of services. Harmonized inflation should also slow down to 3.5% y/y. March merchandise foreign trade, after posting big surpluses in the first two months of the year, should bring a lower surplus, due to the fewer working days (working days tend to affect exports more significantly than imports). Our forecast of the GDP growth at 7.0% is slightly more pessimistic than the market's average of 7.6%.

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Ukraine

April CPI reached 30.2% y/y

Ukraine's CPI growth slowed down to 3.1% m/m in April, vs. 3.8% in March, although in y/y terms it reached 30.2%, which is the highest value since October 2000. Consumer inflation growth was mostly driven by the food group, which showed a 49.2 % y/y increase and accounts for 52% of the CPI basket. Non-food items and services did not have a substantial impact on inflation growth, although the government declared a gradual increase of gas tariffs at 3% per month for retail clients, which should put additional pressure on the CPI starting in May 2008. It has been reported as well that April PPI surged 6.6% m/m (37.5% y/y), on the back of growing coal and steel prices. Inflation has been stimulated by the global increase of prices of food and commodities, the decline in agricultural output in Ukraine in 2007 by 5.6%, the local currency peg to the US dollar (which results in imported inflation), the increased social spending program implemented by the government and pro-inflationary expectations of local producers. We expect inflation to gradually slow down in the second half of the year, as the current monetary tightening policy and anti-inflationary measures by the government and the National Bank will start to show their first results. The good outlook for this year's harvest and the official WTO entry on May 16 will have a soothing effect as well. Our expected end-year CPI remains at 19.2%.

Confrontation between president and prime minister

The privatization of all companies scheduled to be auctioned in 2008 is currently being blocked by President Yushchenko and the pro-presidential head of the State Property Fund of Ukraine (SPFU), V. Semenyuk-Samsonenko. The government, led by Yulia Tymoshenko, has made numerous attempts to overcome presidential decrees and court decisions that have halted the process. In response, the president instantly reissues new decrees that re-block the privatization, thereby maintaining his firm position. Tymoshenko has even made several attempts to replace the pro-president head of the SPFU with the pro-government Andriy Portnov. The recent confrontation resulted in the SPFU having two heads, each considering himself the only legitimate one and issuing contradictory decrees.

What could be behind this confrontation?

If we put aside all official reasons mentioned in the presidential decrees and look back into the history of the relations between these powerful personalities, we might come to the conclusion that the preparation for the coming presidential elections has just begun. The next elections are scheduled for January 2010, or approximately 1.5 years from now. It is clear that the major candidates will be Tymoshenko, Yuschenko and, from the opposition, Viktor Yanukovych. The chances of Tymoshenko becoming the next president are high. According to recent polls, she is the most trusted leader in the current Ukrainian political scene and would have won the elections if they had been held last month. Everyone understands that a lot is riding on how her potential government would perform. Currently, the government needs privatization revenues to carry out its social programs and fill in the state budget.

How will current confrontation be resolved?

The most beneficial outcome would be both parties finding common ground for further cooperation. Despite recent problems, the coalition has stayed intact. On Wednesday, the government announced that they have no intention to forego the planned revenues from the privatization described in the state budget for 2008. Despite such positive remarks, the future of the privatization is unclear at present. Revenues from privatization amounting to USD 1.77bn, or 4.14% of total budget revenues, are planned in the state budget for 2008. The list of companies includes Ukrtelecom (a major fixed-line telecom), Odessa Portside Plant (the second biggest fertilizer producer in Ukraine), Turboatom (the largest turbine manufacturer), electricity generating and distribution companies and others. If carried out, the revenues from the privatizations are expected to be around USD 4-5bn.

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Appendix Charts

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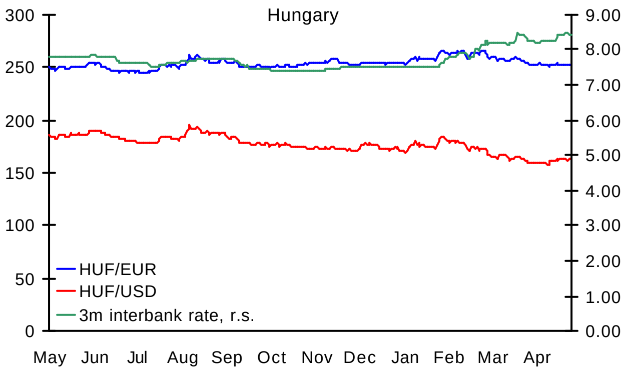
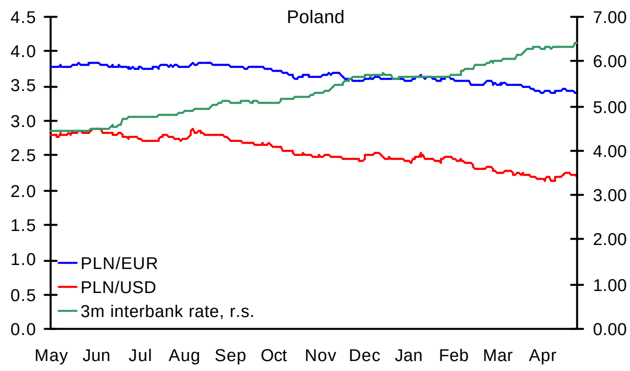
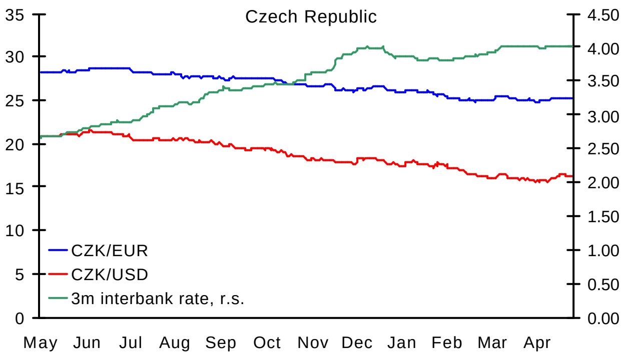
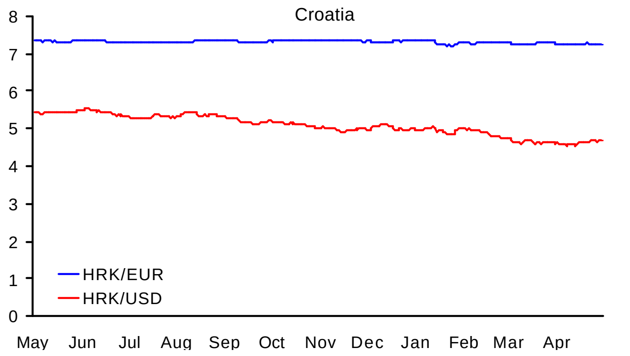
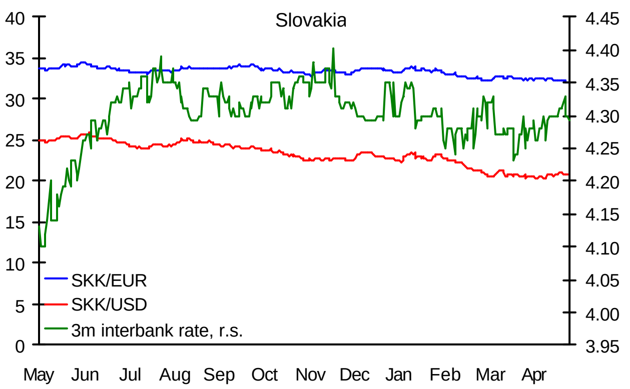
Exchange rates and interest rates (52 weeks)

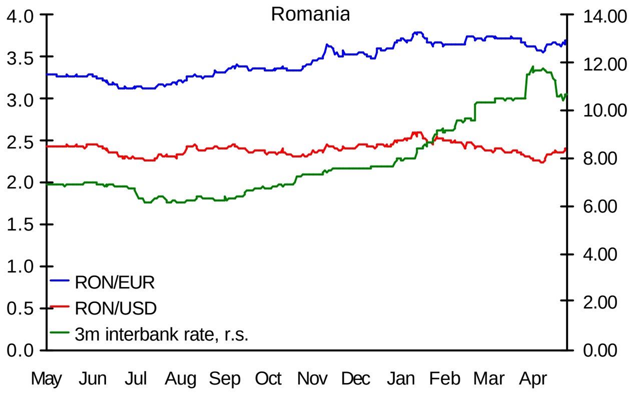


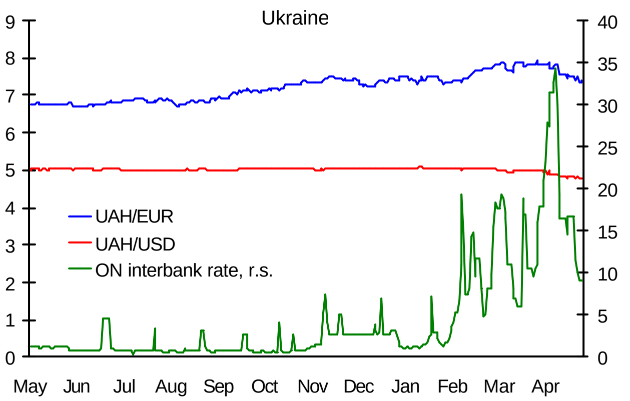












Source: Bloomberg

Appendix Forwards

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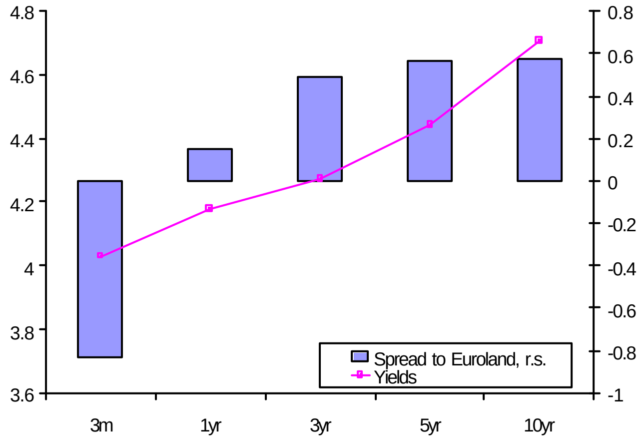
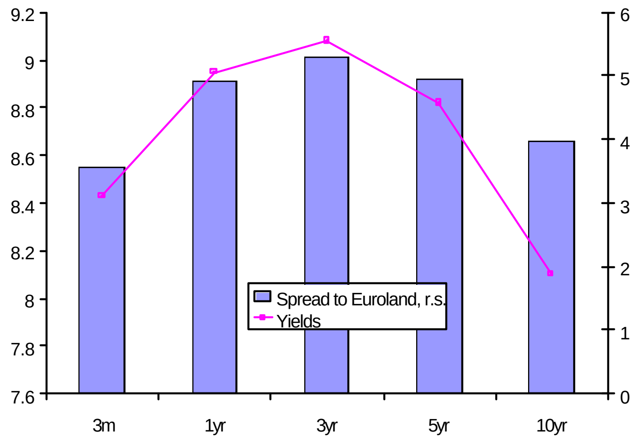
Benchmarks

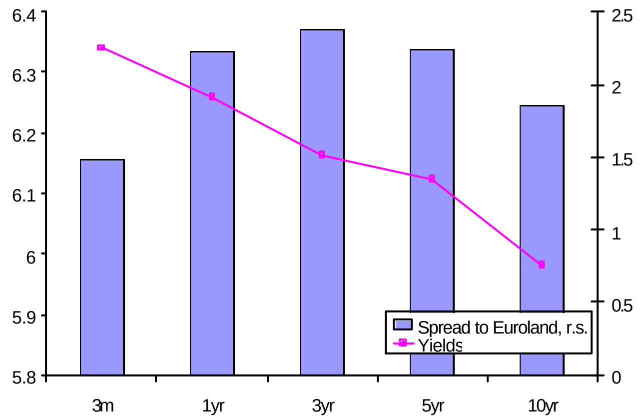
Czech Republic



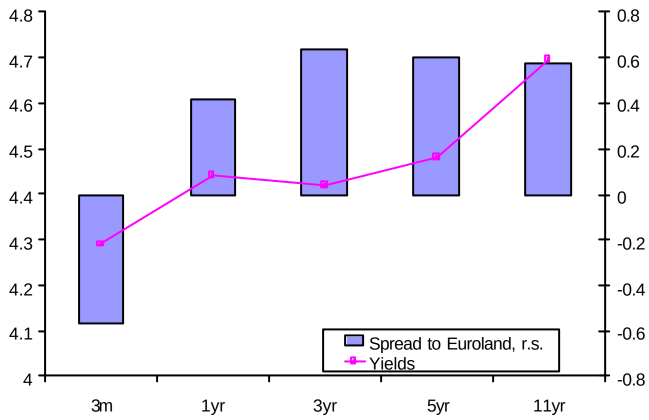
Hungary



Poland



Slovakia



Published by Erste Bank der oesterreichischen Sparkassen AG Börsegasse 14, OE 543 A-1010 Vienna, Austria. Tel. +43 (0)50100-ext.

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