CEE Research

May 23, 2008

Fixed Income and Foreign Exchange

CEE Insights

- **Czech Republic:** March retail sales surprised on downside
- **Hungary:** Base rate expected to be raised to 8.50%
- **Poland:** Rates likely unchanged at next MPC meeting
- **Romania:** Romanian currency weakens, due to bearish mood among investors
- **Slovakia:** With no opposition to firming, koruna still has potential
- **Ukraine:** NBU strengthened hryvnia by 4%

ERSTE BANK

Overview

http://global.treasury.erstebank.com

Czech Republic:

- March retail sales surprised on downside
- Eurobond presentations coming up

Hungary:

- Base rate expected to be raised to 8.50%
- Forint closer to 240

Poland:

- Rates likely unchanged at next MPC meeting
- Industrial output surprised on upside
- Exports still strong

Romania:

- Romanian currency weakens, due to bearish mood among investors
- Liquidity increased slightly towards end of current reserve period
- Romania sold 5Y benchmark bonds for average yield of 9.47%

Slovakia:

- With no opposition to firming, koruna still has potential
- NBS governor: No hurry to align rates with ECB

Ukraine:

- NBU strengthened hryvnia by 4%
- Impact of hryvnia appreciation
- Second wave of liquidity squeeze

Rainer Singer (Co-Head CEE FI Research) rainer.singer@erstebank.at
Juraj Kotian (Co-Head CEE FI Research) juraj.kotian@erstebank.at

Thursday's close		Current	w/w	m/m	ytd	Spreads vs. Euroland		
						current	- 1m	02/01/2008
Czech Republic	EUR/CZK	25.12	-0.3%	-0.3%	5.7%			
	3Y (yield bp)	4.33	1	0	1	54	73	41
	10Y (yield bp)	4.93	9	22	19	80	81	53
Croatia	EUR/HRK	7.248	0.0%	0.2%	0.7%			
	2Y (yield bp)	5.63	0	-3	32	156	186	140
	9Y (yield bp)	5.80	0	2	26	156	167	135
Hungary	EUR/HUF	245.2	1.8%	2.6%	3.2%			
	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	3.413	-0.5%	0.0%	5.5%			
	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	3.670	-0.3%	-3.1%	-2.5%			
Slovakia	EUR/SKK	31.13	1.6%	3.9%	7.8%			
	3Y (yield bp)	4.54	6	15	-5	25	49	52
	9Y (yield bp)	4.77	4	4	-5	48	58	48
Ukraine	EUR/UAH	7.52	-1.5%	4.4%	-2.0%			
	3Y (yield bp)	11.50	0.8	1.4	4.0	737	619	361

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

Trading Ideas

http://global.treasury.erstebank.com

Positions

#	Position	Date of opening	Instruments	Entry values	Today's values	P/L (%)	P/L incl. carry (%)	P/L p.a.incl. carry (%)	Target values	Target P/L incl. carry	Target P/L p.a. (%)
23	long EUR/CZK	05/05/2008	3M Pribid/3m Euribor EUR/CZK	3,99/4,86 % 25.25	25.09	-0.64%	-0.59%	-12.03%	26.2	4.00%	16.00%

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

http://global.treasury.erstebank.com

Capital markets forecasts

Exchange Rate vs EUR

	CZK	Forward	HRK	Forward	HUF	Forward	PLN	Forward	RON	Forward	SKK	Forward	UAH	Forward
Spot	25.1		7.25		245		3.41		3.68		31.1		7.6	-
Jun-08	25.4	25.1	7.22	7.22	248	246	3.60	3.41	3.65	3.70	30.5	31.1	7.3	7.7
Sep-08	26.2	25.1	7.25	7.25	256	248	3.51	3.43	3.58	3.76	30.5	31.0	7.1	8.0
Dec-08	25.9	25.0	7.30	7.30	256	251	3.45	3.44	3.50	3.82	30.5	31.0	6.7	8.2
Mar-09	25.7	25.0	7.25	7.25	255	253	3.40	3.45	3.50	3.87	-	31.0	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	5.10	8.25	5.75	9.75	4.25	12.00	4.15		8.55		6.44		11.15		4.32		16.98	-
Jun-08	3.75	4.75	8.50	6.25	9.75	4.00	12.00	4.03	4.20	8.35	8.65	6.45	6.51	10.04	9.82	4.50	4.38	15.25	-
Sep-08	4.00	4.25	8.50	6.25	9.75	3.75	12.00	4.06	4.05	8.20	8.75	6.45	6.56	9.96	8.54	4.30	4.52	14.00	-
Dec-08	4.00	4.00	8.25	6.25	9.50	3.50	12.00	4.09	4.13	8.10	8.70	6.45	6.49	9.50	6.34	4.10	4.78	13.50	-
Mar-09	4.00	4.00	8.00	6.25	8.50	-	-	4.14	4.18	7.90	8.54	6.35	6.13	8.70	4.99	-	4.37	13.00	-

	10y Govt. Yield					5y Govt. Yield	3y Govt. Yield
	CZ	HR	HU	PL	SK	RO	UA
Spot	4.90	5.80	8.10	6.19	4.77	10.20	11.5
Jun-08	4.70	5.70	7.90	5.90	4.65	10.10	11.2
Sep-08	4.60	5.60	7.70	5.90	4.65	9.60	11
Dec-08	4.70	5.50	7.20	5.55	4.70	9.30	10.4
Mar-09	4.80	5.40	6.90	5.45	4.80	8.40	-

Long-term forecasts

GDP growth (%)	2006	2007	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	2007	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	6.2	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	19.2	12.0
CEE8 weighted average	**4.2**	**6.6**	**6.1**	**4.5**

Unemployment (%)	2006	2007	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	6.5	6.1
CEE8 weighted average	**10.6**	**8.8**	**7.9**	**7.2**

3M rates (average, %)	2006	2007	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	9.6	14.5	12.0
CEE8 weighted average	**6.6**	**6.0**	**7.7**	**6.7**

C/A (%GDP)	2006	2007	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	-7.0
CEE8 weighted average	**-5.2**	**-6.0**	**-6.7**	**-6.8**

Budget Balance (%GDP)	2006	2007	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

http://global.treasury.erstebank.com

Looking ahead

Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	No data releases scheduled			
Croatia	30-May	Trade balance	€ -800mn	
Hungary	May-26	Minutes of the April monetary meeting	25bp hike (to 8.50%)	25bp hike (to 8.50%)
	May-30	April PPI	6.6% y/y	-
	May-30	1Q08 Investments	-	-
Poland	May-28	Retail Sales, % Yoy, April		19.0%
	May-28	Unemployment, %, April		10.6%
	May-28	Central bank rate-setting meeting	5.8%	5.8%
	May-30	GDP, Q1, YoY, %		5.9%
Romania	No data releases scheduled			
Slovakia	May-27	CB policy rate	no change (4.25%)	no change
	May-28	April PPI	5.6% y/y	5.7% y/y
Ukraine	No data releases scheduled			

**Sources: Bloomberg, Reuters*

Auction diary

Country	Code	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic		No auction scheduled					
Hungary		May-27	Jun-04	Sept-06-2008	-	HUF 40bn	8.50%
		May-28	Jun-04	Nov-19-2008	-	HUF 25bn	8.80%
		May-29	Jun-04	June-03-2009	-	HUF 40bn	8.90%
Poland		May-26	May-28	May-27-2009		PLN 2000-3000 mln	
Romania		28-May-08	30-May-08	1Y		RON 200 mn	10.40%
Slovakia		May-26	May-28	May-10-26	4.5%		4.95%
Ukraine		26-May	28-May	05-May-10	8.00%		7.70%
		26-May	28-May	28-Sep-11	9.50%		7.90%

Major markets

Yields to remain elevated

For next week, inflation data for Germany is scheduled. Starting Tuesday, the "Bundeslaender" data will be released, followed by the countrywide numbers. These will be preliminary estimates for May and should show an acceleration, with gasoline prices the most obvious contributor. The final number for 1Q GDP growth is scheduled for Tuesday. While the overall number should be very close to the preliminary estimate, the market will keep an eye on the composition, which was not released yet. Private consumption will be watched especially closely, as it is the prerequisite for self-sustained growth of the economy. On Thursday, the unemployment rate for May will likely have declined further (albeit marginally). The week will close with retail sales for April, which are expected to have improved over the previous month. For France, sentiment indicators from enterprises (Tuesday) and consumers (Wednesday) are scheduled. The indicators in the pipeline for Euroland will not be able to change the bearish sentiment on the bond market after the release of the Ifo Index this week and should at least keep yields elevated.

Numerous indicators unlikely to trigger any breakout

For the US, another week of more or less second-tier data lies ahead. Consumer confidence is scheduled for Tuesday and will of course be strongly affected by ever-rising gasoline prices and the continued downturn on the housing market. On the same day, new home sales will confirm the latter. While the sales number might have stabilized, prices very likely continued on their decline. Durable goods orders on Wednesday will give some indication about investments among companies. The muted outlook for the economy as a whole will be mirrored in this number. The second estimate of 1Q GDP data, on the other hand, might lift sentiment, as growth should be revised upwards, although remaining at a low level. The final estimate of the Univ. of Michigan Index will close the week and here the same things apply as for consumer confidence on Tuesday. Fed officials will give speeches on Tuesday and Thursday. The topics do not sound very promising with respect to providing any market guidance. The bond market should continue the sideways movement that set in at the beginning of May. For the EUR/USD, the downward potential has decreased after the strong Ifo Index, but the relation should stay clear of the past high of 1.6.

Veronika Lammer, veronika.lammer@erstebank.at
Rainer Singer, rainer.singer@erstebank.at

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	4.86		2.64		4.26	3.89	1.572	
Jun-08	4.00	2.00	4.50	5.02	2.20	2.80	4.00	3.80	1.52	1.570
Sep-08	3.75	2.00	4.30	4.91	2.30	3.01	4.30	4.20	1.47	1.562
Dec-08	3.50	2.00	4.10	4.94	2.30	3.11	4.50	4.40	1.40	1.555
Mar-09	3.75	2.00	4.10	4.84	2.40	3.25	4.60	4.60	1.38	1.548

Czech Republic

March retail sales surprised on downside

March retail sales surprised on the downside last week, recording the first y/y drop in a little over four years, dropping 2.9% y/y (incl. car sales; seasonally-unadjusted and real). This is thus the third piece of data to come out in April that was surprisingly disappointing for observers (both the trade balance and industrial production surprised on the downside earlier). Certainly, the effect of the lower number of working days in March (and higher base from the previous year) played a role. However, it still seems that, if this were indeed only about seasonality, the seasonal effect would be somewhat higher than one would normally expect. Thus, it will be critical to keep an eye on further data releases to find out whether this was the beginning of a trend, or merely a blip. We expect a slowdown this year (consumers' purchasing power has been sapped by high inflation; net exports are to slow, on the back of the slowing EU economy), but only later in the year.

Eurobond presentations coming up

In a separate development, the Ministry of Finance's Eduard Janota said that the presentations about the upcoming Eurobond emission are scheduled in six European cities in the next week. The estimated volume is up to EUR 1bn, the maturity anywhere between 10 and 20 years, all dependent on the actual demand from investors. Also, since the planned volume of Eurobond emission this year is up to CZK 90bn, Janota did not rule out the possibility of another emission this year. Should this indeed come to pass, the domestic supply of bonds would be reduced; one would then expect (cet. par.) yields to fall. However, since the domestic demand in auctions this year has not exactly been huge, this effect might be somewhat limited in magnitude.

As for next week, there are no data releases scheduled.

Martin Lobotka, mlobotka@csas.cz

Hungary

Base rate expected to be raised to 8.50%

The rate setting meeting of the central bank to be held on Monday will be the focus next week. We expect another 25bp rate rise, after the 75bp (altogether) carried out in March and April. Concerning the inflation outlook, the risk assessment of the Council changed in the last couple of months. Thus, they are expected to continue expressing their commitment to the mid-term inflation target of 3% y/y by continuing the current small hiking cycle, even in May. The publication of the next Quarterly Inflation Report (due on Monday, as well) could be another argument for more rate hikes, as the bank's 2009 inflation forecast is expected to be slightly raised again, due to the fact that the possible favorable effects of the stronger forint on prices of industrial products would be offset by high oil prices, which negatively influences gas prices. We do not expect, however, that the rate decision will be unanimous on Monday. Please note that, despite the hawkish Council statement one month ago, the minutes of the April meeting showed that among 11 council members, four voted to keep the base rate on hold. The April inflation figures showed a one percentage point slowdown in the 12-month index of market services, while the March nominal wage figures surprised on the downside, as ex bonus wage growth in the private sector fell to 7.7% y/y, from the 10.4% y/y published for February. All in all, our current forecast is that the rate hiking cycle will come to an end at 8.50%, especially if the forint exchange rate remains at its current stronger level against the euro.

Forint closer to 240

The forint showed quite spectacular appreciation during the week. Based on the improving mood on global markets (partly due to higher than expected German IFO data), the exchange rate against the euro started to approach the level of 240, but finally did not reach it and a correction set in. The expected 25bp hike in the base rate in May (resulting in an even higher interest rate differential), increasing the credibility of the central bank and improving economic balance situation, decreasing the country's financing needs, mean important fundamental support for the stronger exchange rate. The forint is expected to preserve its current strength in the near future. Breaking through the strong end of the old band (240 EUR/HUF) is not expected to be easy, however, due to technical reasons, as sizeable barrier option positions exist with knock-out levels of 239-240 EUR/HUF. This should bring volatile trading on the market in the coming period.

Orsolya.Nyeste, orsolya.nyeste@erstebank.hu

Poland

Rates likely unchanged at next MPC meeting

We have heard another batch of Monetary Policy Committee (MPC) members' comments this week. The equilibrium is inclined towards unchanged rates at the May MPC meeting, as confessed to by known hawk Noga. He said that the Council is still in a tightening mode and that rates should go up at next week's meeting. However, he is a realist, so he does not think that there will be a majority on the Council to hike rates. The stance of the doves was presented by MPC member Owsiak. He said that interest rates should remain unchanged at least until June, when the new inflation prognosis is ready. The MPC should not rush, partly because previous tightening has not had enough time to influence the economy. Another MPC member, Wojtyna, said that one more rate hike could be appropriate, but it would make little difference whether the hike happens in May or June. The MPC members' opinions also influenced our expectations on further development of interest rates. We now think that the development over the last few weeks suggests that a rate increase in May has not been ruled out, but is not likely. If the strong growth of the economy (especially wages, retail sales and industrial output) persists, then at least one more rate hike is likely.

Industrial output surprised on upside

Polish industrial output for April surprised on the upside. The data shows that the economy is still growing vigorously and it is expected that such strong growth will continue for the foreseeable future. Also, average wages beat expectations, with y/y growth of 12.6%. Net inflation (CPI excluding all food and fuel prices) rose 2.8% y/y in April, above expectations. PPI rose 2.5% y/y in April, slightly below the forecast. Neither of these numbers should significantly influence monetary policy.

Exports still strong

The Polish economy may expand by 6% in the second quarter, according to Deputy Finance Minister Zajdel-Kurowska. Strong output data signal durably strong exports. Inflation at 4% may linger on; however, it could ease in the second half of the year. The good performance of the economy also positively influences the budget - this year's deficit should end significantly under the planned PLN 27.1bn. Zajdel-Kurowska estimated that the deficit would end below PLN 20bn.

This week's development on Polish financial markets was partly influenced by Thursday's holiday, which caused a relatively quiet end of the working week. The zloty retreated moderately; the correction may be supported next week by unchanged rates. However, we do not think that this is the beginning of a trend reversal, as there is still room for at least one rate hike and the Polish economy is growing vigorously.

Luboš Mokráš, lmokras@csas.cz

Romania

Romanian currency weakens, due to bearish mood among investors

The Romanian currency held on quite strong at the beginning of the week, trading in the 3.63-3.64 zone, but it lacked the strength to rally further. The EUR/RON reversed its upward move and reached 3.69 on Thursday, on the back of the bearish mood among investors, stirred by negative US data and a new historic high for oil. The contraction of risk appetite among foreign investors affected the Romanian currency, as it is believed to bear higher risk, due to the current account shortfall. However, the issuance of state debt instruments offers some support to the leu, as Romania started to pay high yields for financing in local currency. The volumes traded on the forex market were substantial, resulting mainly from off-shore players' orders. On Friday, the RON recovered some of its earlier losses, trading in the 3.66-3.67 zone. The RON might post further losses next week, testing the 3.70 resistance zone.

Liquidity increased slightly towards end of current reserve period

This week, liquidity has increased slightly on the Romanian money market, as the end of the current reserve period was approaching and the banks have already constituted a large part of their mandatory reserve requirements. Therefore, the commercial banks placed RON 3.6bn at the NBR's regular deposit auction on Monday. Further evidence of the improving liquidity conditions on the local money market is the fact that eight banks submitted bids at the NBR's 1-week deposit auction for the fixed interest rate of 9.75%. The short-term interbank deposits were traded for 9.5-10%/10-10.5% interest rates until Wednesday. On Thursday, overnight interest rates surged to 9.5-14.0%/10.2-18.0% bids/asks, as demand for the leu increased substantially, stemming from corporate entities' monthly payments to the state budget. On Friday, overnight interest rates fell sharply to the 6.5/8% level, as it was the last day of the reserve period and banks have already constituted their reserves. Next week, the short-term interbank interest rates are likely to recover to near the monetary policy rate, as a new reserve period will be starting.

Romania sold 5Y benchmark bonds for average yield of 9.47%

On May 22, the MinFin held an auction for 5Y benchmark bonds, the longest maturity thus far this year, worth RON 100mn. The overall offer of primary dealers reached RON 430mn, but the MinFin accepted the initial announced amount of RON 100mn for the first time in the last four months (during which the MinFin drained only a small part of the initially announced amount). The MinFin decided to pay a maximum yield of 9.49%, while the average yield was 9.47%, slightly lower than at the previous comparative auction. Next week, Romania intends to sell 1Y discounted treasury bills worth RON 200mn. At the last auction, the MinFin paid a maximum yield of 10.49% per annum and it is likely that this will be the threshold this time as well.

Melania Hancila, melania.hancila@bcr.ro

Slovakia

With no opposition to firming, koruna still has potential

CB Governor Ivan Sramko said that, from the long-term view, the trend of the koruna is largely in line with economic development. He added that there is no reason to comment on short-term currency trends. This contrasts with previous comments and steps taken by the CB against the firming of the koruna, which was often viewed as excessive in the past. We read this as alignment of the CB with the preference of the public and politicians for a strong conversion rate. The koruna, which has been constantly pushing to new highs, was near 31.10 EUR/SKK on Friday. With all opposition to the currency's firming now gone, the koruna still has upside potential. The limit is the lower band of the ERM-2 band at 30.1, and the extent of the actual firming will depend on a political decision, rather than anything else. More specifically, it will depend on the timing of the ERM-2 central parity revaluation. We expect the spot exchange rate to be used as the conversion rate.

NBS governor: No hurry to align rates with ECB

In separate comments, Sramko suggested that the Slovak central bank might not hurry with harmonization of its rates with those of the ECB. Sramko said that it would not be logical at present and that several factors need to be considered. The comments are contrary to our previous expectations, as we expected the CB to align interest rates with the Eurozone's sooner than later. This seems to rule out an interest rate cut next Tuesday. However, since an independent monetary policy will be ineffective once the euro conversion rate is known, we still anticipate an early 25bp cut in June or July.

Michal Mušák, musak.michal@slsp.sk
Mária Valachyová, valachyova.maria@slsp.sk

Ukraine

NBU strengthened hryvnia by 4%

On May 22, 2008, the board of the National Bank of Ukraine (NBU) changed the official exchange rate to 4.85 UAH/USD, thus revaluing the hryvnia by 3.96%. However, in the evening, the NBU Council vetoed the board's decision. The situation should become clearer over the next few days, but the NBU is holding to the decision of its board. The official exchange rate remained unchanged at 5.05 UAH/USD since its last revaluation by 4.7% in April 2005. During recent years, the NBU has maintained the pegged currency regime, tying the UAH to the USD and conducting interventions on the market when the hryvnia exchange rate was approaching the set currency band limits.

During the last two months, the NBU has stopped intervening on the interbank foreign exchange market. Due to high demand for hryvnia during the recent liquidity squeeze, the exchange rate has left the official currency band of 4.95-5.25, which the NBU Council set for 2008. Following NBU head V. Stelmakh's announcement last Friday, May 16, about the intention to change the official exchange rate, the hryvnia has sharply appreciated and reached 4.55 UAH/USD on May 21, a 4.6% change (10% YTD). However, the market is moving back in the direction of the new official exchange rate, erasing some early gains. NBU officials brought clarity to the market, resuming interventions and buying USD at the level of 4.8 UAH/USD, which might be the new lower currency band limit.

Impact of hryvnia appreciation

Hryvnia appreciation will hurt Ukrainian exporters, as 80% of all trade is denominated in USD, and will increase the price competitiveness of imported goods and services. This will widen the trade and current account deficit, the latter reached -9.4% of GDP in 1Q08. The stronger hryvnia will have a positive soothing impact on inflation in the short term, as it will reduce the impact of imported inflation. The state budget will be positively affected, due to the reduced cost of external public debt. A positive cost effect will be felt by retailers (food, cars, oil) and the chemical and cement industries (gas price decrease). Export-oriented steel, chemical and machine-building companies will face a revenue reduction in local currency. Domestic-oriented companies and banks will be neutrally impacted by hryvnia appreciation.

Second wave of liquidity squeeze

The local money market has faced a second severe drop in liquidity, because of the tax payment due date and the increased money flow to state Treasury accounts. The previous one was during April, when the 1M MM rate soared from 13% to 23%.Since May 13, the excess/available liquidity has been on the decrease, reaching UAH 2bn at the beginning of this week. The 1M MM rate has soared to 20.5%, from 14-15% a week ago. Intending to help the banks to move smoothly beyond the current liquidity drop, the NBU has injected UAH 7.2bn via refinancing over the last three days. The situation should improve over the next few days, as the Ministry of Finance began to inject liquidity via the VAT reimbursement program. The 1M MM rate decreased on May 22 by 200bp to 18.4%.

The Ministry of Finance expects a further increase of revenues from customs and taxes, due to more effective collection and the elimination of some shadow schemes - the consolidated budget surplus was UAH 5.6bn in 1Q08. Liquidity may improve at the beginning of 2H08, when the state Treasury will be more active on the expenditure side.

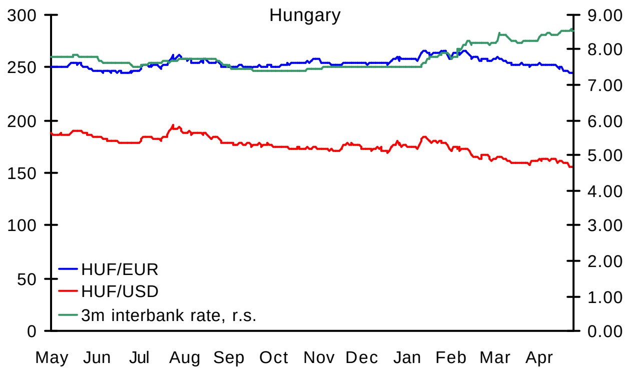
The current liquidity situation has been caused by the NBU's tightening policy, which is geared at lowering inflation in the country. However, there is no clear inflation targeting plan, as the government and NBU act more in a separate way.

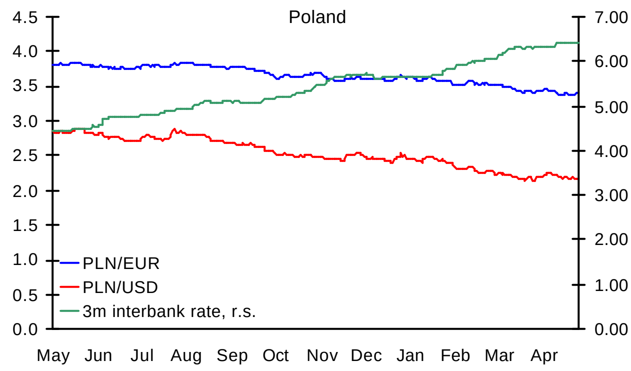
Viktor Stefanyshyn, Viktor.Stefanyshyn@erstebank.ua
Roman Oliynyk, Roman.Oliynyk@erstebank.ua

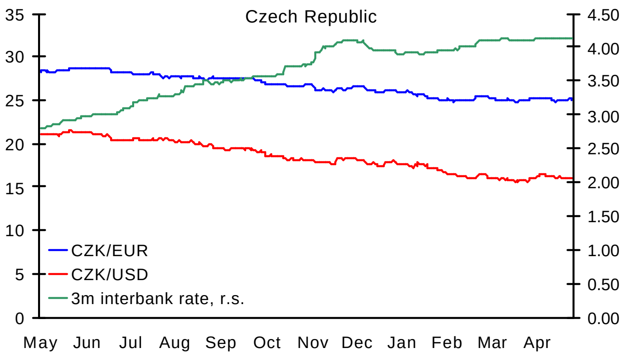
Appendix Charts

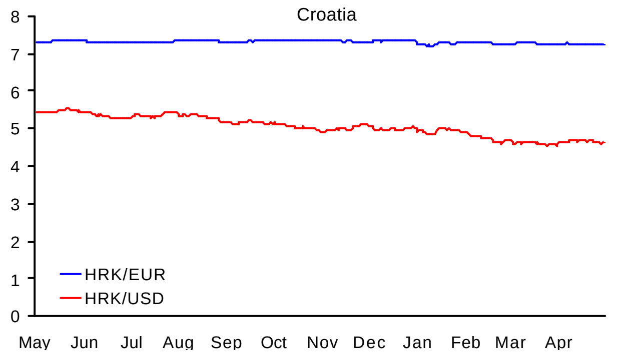
http://global.treasury.erstebank.com

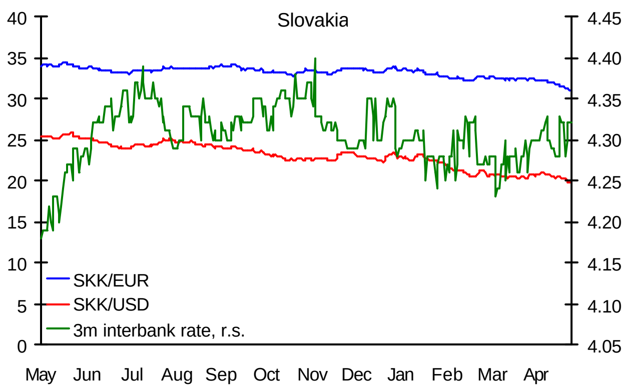
Exchange rates and interest rates (52 weeks)

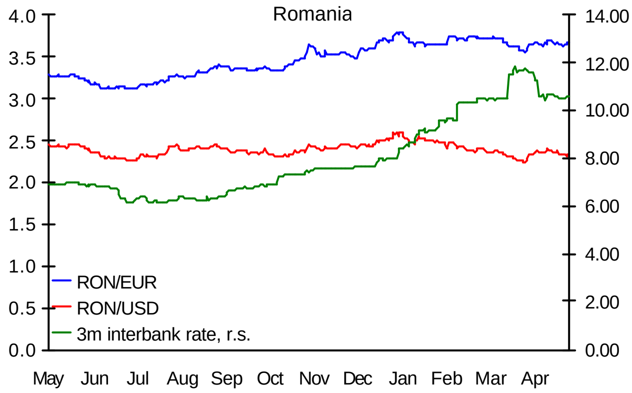


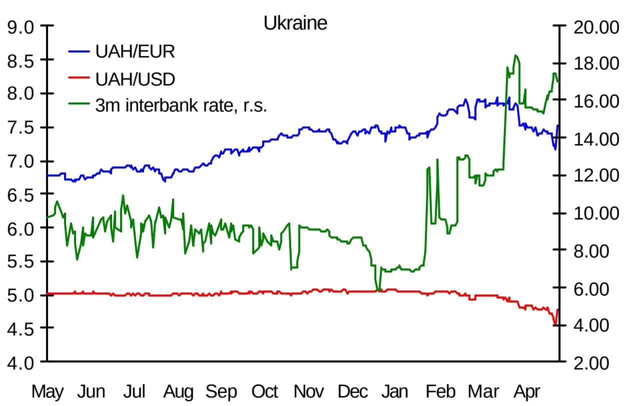












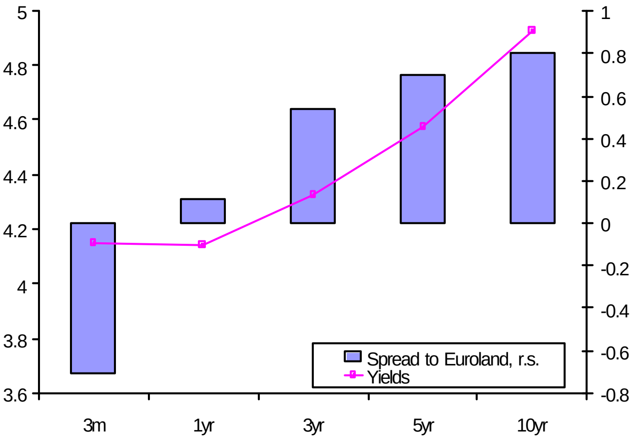
Source: Bloomberg

Appendix Forwards

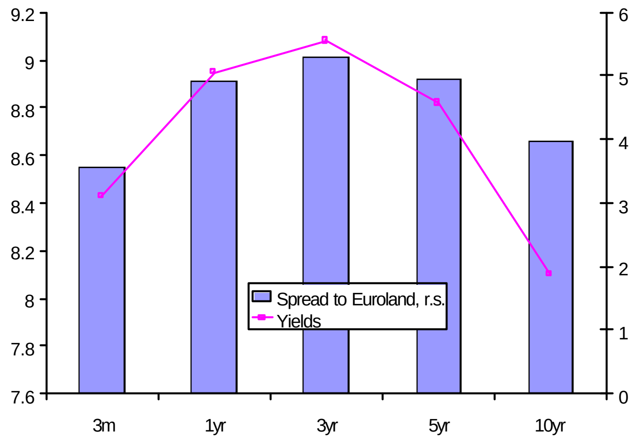
http://global.treasury.erstebank.com

Benchmarks

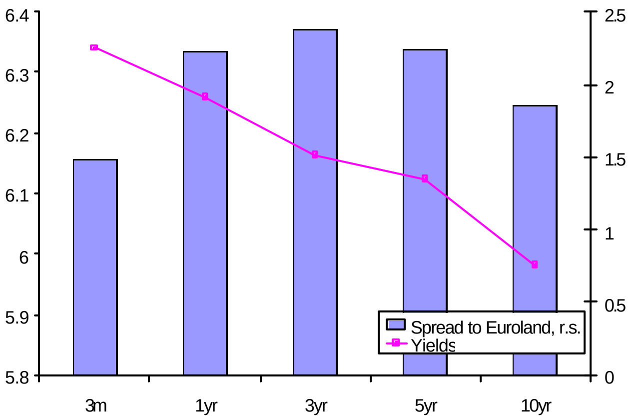
Czech Republic



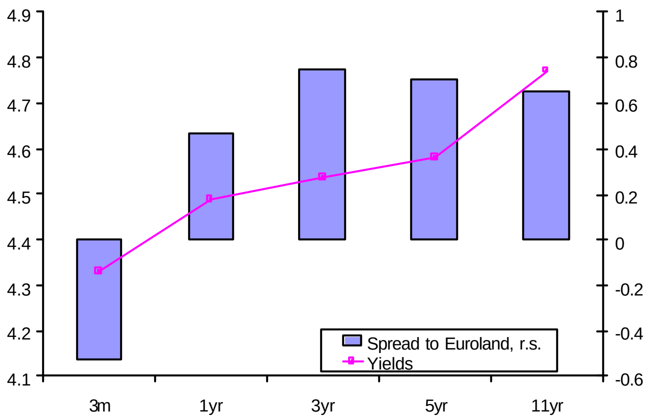
Hungary



Poland



Slovakia



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

Erste Bank Homepage: www.erstebank.at On Bloomberg please type: ERBK <GO>.

Contacts

http://global.treasury.erstebank.com

Group Research

Head of Group Research
Friedrich Mostböck, CEFA +43 (0)5 0100 - 11902

CEE Equity Research
Co-Head: Günther Artner, CFA +43 (0)5 0100 - 11523
Co-Head: Henning Eßkuchen +43 (0)5 0100 - 19634
Günter Hohberger *(Banks)* +43 (0)5 0100 - 17354
Franz Hörl, CFA *(Steel, Construction)* +43 (0)5 0100 - 18506
Gernot Jany, CFA *(Banks, Real Estate)* +43 (0)5 0100 - 11903
Daniel Lion *(IT)* +43 (0)5 0100 - 17420
Martina Valenta, MBA *(Transp., Paper)* +43 (0)5 0100 - 11913
Christoph Schultes, CIIA *(Ins., Util.)* +43 (0)5 0100 - 16314
Vera Sutedja, CFA *(Telecom)* +43 (0)5 0100 - 11905
Thomas Unger *(Telecom)* +43 (0)5 0100 - 17344
Vladimira Urbankova *(Pharma)* +43 (0)5 0100 - 17343
Gerald Walek, CFA *(Machinery)* +43 (0)5 0100 - 16360

International Equities
Hans Engel *(Market strategist)* +43 (0)5 0100 - 19835
Ronald Stöferle *(Asia)* +43 (0)5 0100 - 11723
Jürgen Rene Ulamec, CEFA *(Europe)* +43 (0)5 0100 - 16574

Macro/Fixed Income Research
Head: Veronika Lammer *(Euroland)* +43 (0)5 0100 - 11909
Alihan Karadagoglu *(Corporates)* +43 (0)5 0100 - 19633
Rainer Singer *(US)* +43 (0)5 0100 - 11185
Elena Statelov, CIIA *(Corporates)* +43 (0)5 0100 - 19641
Mildred Hager (SW, Japan) +43 (0)5 0100 - 17331

Macro/Fixed Income Research CEE
Co-Head CEE: Juraj Kotian *(Macro/FI)* +43 (0)5 0100 - 17357
Co-Head CEE: Rainer Singer *(Macro/FI)* +43 (0)5 0100 - 11185

Editor Research CEE
Brett Aarons +420 2 24995 - 904

Research, Croatia/Serbia
Head:Mladen Dodig +38 1 112200 - 866
Damir Cukman *(Equity)* +38 5 6237 - 2820
Ivan Gojnic *(Equity)* +38 1 112200 - 852
Alen Kovac *(Fixed income)* +38 5 6237 - 1383
Uros Mladenovic *(Equity)* +38 1 112200 - 872
Davor Spoljar *(Equity)* +38 5 6237 - 2825

Research, Czech Republic
Head: David Navratil *(Fixed income)* +420 2 24995 - 439
Petr Bartek *(Equity)* +420 2 24995 - 227
Maria Hermanova *(Fixed income)* +420 2 24995 - 232
Lenka Slamova *(Equity)* +420 2 24995 - 289
Radim Kramule *(Equity)* +420 2 24995 - 213
Martin Lobotka *(Fixed income)* +420 2 24995 - 192
Lubos Mokras *(Fixed income)* +420 2 24995 - 456
Jakub Zidon *(Equity)* +420 2 24995 - 340

Research, Hungary
Head: József Miró *(Equity)* +36 1 235 - 5131
Zoltan Arokszallasi *(Equity)* +36 1 235 - 5135
Mihaly Tatar *(Equity)* +36 1 235 - 5134
Orsolya Nyeste *(Fixed income)* +36 1 373 - 2830

Research, Poland
Head: Artur Iwanski *(Equity)* +48 2 23306 - 253
Magda Jagodzinska *(Equity)* +48 2 23306 - 250
Marcelina Hawryluk *(Equity)* +48 2 23306 - 255
Tomasz Kasowicz *(Equity)* +48 2 23306 - 251
Piotr Lopaciuk *(Equity)* +48 2 23306 - 252
Marek Czachor *(Equity)* +48 2 23306 - 254

Research, Romania
Head: Lucian Claudiu Anghel +40 2 1312 - 6773
Mihai Caruntu *(Equity)* +40 2 1311 - 2754
Dumitru Dulgheru *(Fixed income)* +40 2 1312 6773 - 1028
Cristian Mladin *(Fixed income)* +40 2 1312 6773 - 1028
Loredana Oancea *(Equity)* +40 2 1311 - 2754
Raluca Ungureanu *(Equity)* +40 2 1311 - 2754

Research, Slovakia
Head: Juraj Barta *(Fixed income)* +42 1 25957 - 4166
Michal Musak *(Fixed income)* +42 1 25957 - 4512
Maria Valachyova *(Fixed income)* +42 1 25957 - 4185

Research, Ukraine
Viktor Stefanyshyn *(Fixed income)* +38 044 593 - 1784
Roman Oliynyk *(Fixed income)* +38 044 593 - 9188

Institutional Sales

Head of Sales Equities & Derivatives
Michal Rizek +44 207 623 - 4154
Brigitte Zeitlberger-Schmid +43 (0)5 0100 - 83123

Equity Sales Vienna XETRA & CEE
Hind Al Jassani +43 (0)5 0100 - 83111
Werner Fuerst +43 (0)5 0100 - 83114
Josef Kerekes +43 (0)5 0100 - 83125
Cormac Lyden +43 (0)5 0100 - 83127
Stefan Raidl +43 (0)5 0100 - 83113
Simone Rentschler +43 (0)5 0100 - 83124

Sales Derivatives
Christian Luig +43 (0)5 0100 - 83181
Manuel Kessler +43 (0)5 0100 - 83182
Sabine Kircher +43 (0)5 0100 - 83161
Christian Klikovich +43 (0)5 0100 - 83162
Armin Pfingstl +43 (0)5 0100 - 83171
Roman Rafeiner +43 (0)5 0100 - 83172

Equity Sales, London
Dieter Benesch +44 207 623 - 4154
Tatyana Dachyshyn +44 207 623 - 4154
Jarek Dudko, CFA +44 207 623 - 4154
Federica Gessi-Castelli +44 207 623 - 4154
Declan Wooloughan +44 207 623 - 4154

Sales, Croatia
Zeljka Kajkut *(Equity)* +38 5 6237 - 2811
Damir Eror *(Equity)* +38 5 6237 - 2813

Sales, Czech Republic
Michal Brezna *(Equity)* +420 2 24995 - 523
Ondrej Cech *(Fixed income)* +420 2 24995 - 577
Michal Rizek +420 2 24995 - 537
Jiri Smehlik *(Equity)* +420 2 24995 - 510
Pavel Zdichynec *(Fixed income)* +420 2 24995 - 590

Sales, Hungary
Gregor Glatzer *(Equity)* +36 1 235 - 5144
Krisztián Kandik *(Equity)* +36 1 235 - 5140
Istvan Kovacs *(Fixed income)* +36 1 235 - 5846

Sales, Poland
Head: Andrzej Tabor +48 2 23306 - 203
Pawel Czuprynski *(Equity)* +48 2 23306 - 212
Lukasz Mitan *(Equity)* +48 2 23306 - 213
Jacek Krysinski *(Equity)* +48 2 23306 - 218

Sales, Slovakia
Head: Dusan Svitek +42 1 25050 - 5620
Rado Stopiak *(Derivatives)* +42 1 25050 - 5601
Andrea Slesarova *(Client sales)* +42 1 25050 - 5629

Treasury - Erste Bank Vienna

Sales Retail & Sparkassen
Head: Manfred Neuwirth +43 (0)5 0100 - 84250

Equity Retail Sales
Head: Kurt Gerhold +43 (0)5 0100 - 84232

Domestic Sales Fixed Income
Head: Thomas Schaufler +43 (0)5 0100 - 84225

Treasury Domestic Sales
Head: Gottfried Huscava +43 (0)5 0100 - 84130

Corporate Desk
Head: Leopold Sokolicek +43 (0)5 0100 - 84601
Alexandra Blach +43 (0)5 0100 - 84141
Roman Friesacher +43 (0)5 0100 - 84143
Helmut Kirchner +43 (0)5 0100 - 84144
Christian Skopek +43 (0)5 0100 - 84146

Fixed Income Institutional Desk
Head: Thomas Almen +43 (0)5 0100 - 84323
Martina Fux +43 (0)5 0100 - 84113
Michael Konczer +43 (0)5 0100 - 84121
Ingo Lusch +43 (0)5 0100 - 84111
Ulrich Inhofner +43 (0)5 0100 - 84324
Karin Rauscher +43 (0)5 0100 - 84112
Michael Schmotz +43 (0)5 0100 - 84114