ERSTE GROUP

CEE Insights

Fixed Income and Foreign Exchange – 20 November 2009

Croatia: Exchange rate stabilized slightly above 7.30

Czech Republic: CZK now 'about right', in our estimation

Hungary: CB to cut base rate by 50bp next Monday

Poland: NBP to keep rates unchanged

Romania: First round of presidential election this Sunday

Ukraine: GDP down 15.9% in 3Q

Market outlook

After a strong rally among CEE currencies, which at mid-week had brought the Polish zloty and Hungarian forint close to their highest levels since January, the USD surge reversed the development and the currencies erased the gains made since last Friday. The Czech koruna did not experience any rally at the beginning of this week, as the currency started the week already strong, but has now slid about 2% since mid-week together with its peers. Data published this week in CEE had only a minor impact on markets. The Romanian central bank cut the minimum reserves requirement on FX liabilities to 25% from 30% (we thought that they were going to do it a week ago at their regular meeting), which should release about EUR 1.2bn of liquidity that commercial banks had had to keep with the central bank. This should ease tensions regarding the FX market and government financing. The Romanian authorities still have to adopt a fiscal consolidation plan before they get another tranche from the IMF. The first round of the presidential election, to take place this weekend, is unlikely to end Romania's political deadlock. More action can be expected after the second round, scheduled for December 6, when two big rivals, President Basescu (supported by the Democrat Liberal Party) and Social Democrat Mircea Geoana, are likely to meet.

Next week, the Hungarian and Polish central banks will decide on rates. The NBH is likely to cut rates by 50bp (although 25bp cannot be ruled out), supported by falling inflation, the 3Q economic contraction and the forint's moving within a reasonable range. For its part, the Polish central bank is to keep rates stable.

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	Instrument	Current	w/w	m/m	ytd	Spreads vs. Euroland		
						current	- 1m	02/01/2009
Czech Republic	EUR/CZK	25.88	-1.6%	0.3%	3.8%			
	3Y (yield/bp)	2.64	0	0	-69	101	67	147
	10Y (yield/bp)	4.19	-1	9	3	93	78	122
	5Y CDS	83	5	14	-102			
Croatia	EUR/HRK	7.334	-0.5%	-1.5%	0.2%			
	4Y (yield/bp)	6.87	-32	-168	-26	479	628	483
	8Y (yield/bp)	6.89	-29	-138	-9	382	522	407
	5Y CDS	259	0	49	-181			
Hungary	EUR/HUF	269.3	-0.2%	-1.3%	-1.5%			
	3Y (yield/bp)	6.97	17	21	-259	533	490	771
	10Y (yield/bp)	7.44	23	34	-78	418	378	527
	5Y CDS	211	0	14	-238			
Poland	EUR/PLN	4.151	-1.2%	0.5%	-0.1%			
	3Y (yield/bp)	5.36	39	44	5	372	306	346
	10Y (yield/bp)	6.19	7	34	80	292	278	244
	5Y CDS	116	0	5	-163			
Romania	EUR/RON	4.285	0.5%	0.1%	-5.9%			
	5Y CDS	291	6	62	-409			
Slovakia	3Y (yield/bp)	2.65	-2	-10	-156	101	82	233
	10Y (yield/bp)	4.44	-1	-12	-29	118	125	171
	5Y CDS	71	5	13	-99			
Ukraine	EUR/UAH	12.03	1.0%	2.5%	-9.3%			
	2Y (yield/bp)	26.0	0	100	100	2465	2370	2325
	5Y CDS	1564	173	285	-1516			

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

Positions

#	Position	Date of opening	Instruments	Values			P/L (%)			Target P/L (%)	
				Entry	Today	Target	curr.	+carry	p.a.	flat	p.a.
26	short EUR/PLN	12/8/2009	6M Wibid/6M Euribor	4.22/1.06%	4.15	3.95	1.01%	1.88%	6.8%	6.7%	13.8%
			EUR/PLN	4.19							

Rationale at inception

26) Since the beginning of this year, the zloty exchange rate has been strongly influenced by market sentiment. For the first months of the year high risk aversion and distaste for the regional currencies and assets were characteristic, which resulted in significant depreciation across the region. Since June, the zloty seems to have returned to appreciating trend. In light of improving global as well as domestic macro data and recent signs of stabilization on financial markets, we believe that the appreciating trend is indeed sustainable and will lead to further gains of the zloty in the coming months

Closed positions

#	Recommendation	opened	closed	P/L inc.carry
1	long: PLGB10y / 4m Euribor	16/09/2005	27/10/2005	-3.0%
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 EURFRA 9	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	3.9%
22	Buy EURFRA, sell SKKFRA	04/04/2008	18/04/2008	26bp
23	Long EUR/CZK	29/04/2008	19/06/2008	-3.8%
24	short EUR/RON	05/08/2008	14/10/2008	-4.7%
25	short EUR/PLN	09/09/2008	21/10/2008	-3% (stop-loss)
27	short GEGB/long CZGB	12/08/2009	22/10/2009	4.9%
28	long 4y HUGB / 6m Euribor	08/09/2009	18/11/2009	7.4%

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Question of the week

How heavy gross and net issuance of government securities do you expect for next year?

Next year, a forint debt of HUF 2,400bn will expire, while the amount of the expiring FX debt will only be about HUF 400bn. The financing need of the budget in **Hungary** is expected to be roughly HUF 1,000bn. Thus, the gross issuance of government papers would amount to HUF 3,800bn (14% of GDP). No big money is expected from privatization. Please note, however, that EUR 5.8bn (approximately HUF 1,600bn) has not been disbursed from the IMF-EC-World Bank joint sources, while a big part of the already drawn EUR 14.2bn is in the reserves of the central bank. These sources could substantially decrease next year's gross issuance to well below 8% of GDP, depending on the decision of fiscal authorities. If the situation on financial markets remains normal, the debt should be financed via the market, rather than via the above emergency loans.

Orsolya Nyeste, Erste Bank Hungary

The **Polish** budget draft for 2010 envisages a deficit of PLN 52.2bn. In addition to that, a debt of PLN 80bn is maturing in 2010. On the other side, the government expects an inflow of some PLN 26.7bn from the privatization of state-owned companies (although here the actual value could be lower, as the plan is quite ambitious and sale of some of the companies on the list could be problematic), which might reduce gross issuance to about 7.6% of GDP (from 9.6% without privatization).

Jana Krajcova, Ceska sporitelna

After the first review in August, the IMF mentioned a budget deficit target for **Romania** of below 6% of GDP in 2010. However, we see this as a pretty daunting task for the government, in light of past experiences and the current difficulties in pushing forward with reforms in the public sector. Our view is that the budget deficit in 2010 is more likely to stand somewhere between 6.5% and 7% of GDP.

Dumitru Dulgheru, Banka Comerciala Romana

It is unlikely that the **Ukrainian** government will be able to place any substantial amounts of local or foreign currency-denominated securities on the market next year. The current yields on USD Eurobonds are quite high - up to 16% for short-term maturities. They are unlikely to decline without the renewal of IMF support for Ukraine. The local market is struggling to regain liquidity after the 25% local currency deposit loss since the start of the crisis. Most likely, the government will try to place 2-5% of GDP worth of local currency bonds with the National Bank next year, while perhaps up to 2% of GDP can be absorbed by local banks.

Maryan Zablotskyy, Erste Bank Ukraine

Next year, the **Czech** deficit will be around CZK 151bn, plus around CZK 80bn of old debt will mature, and there will be an additional CZK 20bn on top of that (buyback and addition to reserves). All in all, CZK 249bn worth of gross issuance can be expected (around 6.6% GDP).

Martin Lobotka, Ceska sporitelna

For 2010, we expect **Slovakia's** fiscal deficit and net issuance at around EUR 4bn, or 6% of GDP. With maturing debt worth some EUR 3.5bn, we expect the gross issuance to exceed 11% of GDP. This is slightly above the 2009 level and far higher than in the previous four years, when gross issuance stood at 4-6% of GDP.

Michal Musak, Slovenska sporitelna

In 2010, the **Croatian** government has to refinance securities worth some HRK 28bn (8% of GDP), while new financing needs should amount to some HRK 7-8bn (2-2.5% of GDP), given the expected fiscal gap for 2010. As the new budget has not been presented yet, a proportion of the gap could be filled by alternative financing channels. Therefore, net issuance may be lower. Overall gross issuance is likely to stand around 10% of GDP for 2010, dominated by refinancing of short-term papers.

Alen Kovac, Erste Bank Croatia

Major markets

Eurozone: Friendly November indicators ahead

After a quiet week without any important macro data, next week will offer first details on the 3Q economy. German GDP increased +0.7% q/q in 3Q and it will be particularly interesting to see where the improvement came from. In addition to this more detailed picture, we will get some indicators reflecting the economic development in November. On Monday, the manufacturing and service PMIs are expected to reflect a further improvement compared to October, when the Eurozone manufacturing PMI successfully passed 50, the threshold for expansion. On Tuesday, the German Ifo business climate should confirm an ongoing recovery in November. The week will close with some more confidence indicators (consumer, economic, industrial, services) for the Eurozone. All in all, the news flow should not cause any disappointment on financial markets next week.

Series of data before Thanksgiving weekend

The upcoming week will be a short one in the US, due to the Thanksgiving holiday on Thursday. So, all releases will be squeezed into the first three days of the week. Monday will bring existing home sales. Consumer confidence (on Tuesday) likely stagnated, while the second estimate of 3Q GDP might bring a slight downward revision. The minutes of the unspectacular FOMC meeting from the beginning of November will follow later that day. Durable goods orders, initial jobless claims, the Univ. of Michigan index and new home sales will be the last releases of the week on Wednesday. For us, the most interesting data next week will be GDP and the structure. Revisions to either side of the preliminary release could give the market some short-term direction. The other data will hardly give any significant indications on the strength of the economy. The two housing market indicators should show further gains, but these are heavily influenced by an incentive program. The two consumer sentiment indicators are not expected to have moved, but higher gasoline prices in November are a downside risk. Durable goods orders are a fair (though highly volatile) indicator of investments and should get some attention. Overall, markets will be largely determined by positioning before the holiday weekend and the data should confirm a moderately growing US economy.

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Forecasts

	Intervention Rate		3m Money Market Rate				10y Govt. Yield		FX	
	EUL	USA	EUL	Fwd	USA	Fwd	EUL	USA	EUR/USD	Fwd
Spot	1.00	0 - 0.25	0.67		0.26		3.26	3.32	1.482	
Dec-09	1.00	0 - 0.25	1.00	0.97	0.30	0.38	3.50	3.70	1.55	1.482
Mar-10	1.00	0 - 0.25	1.10	1.34	0.40	0.96	3.70	4.10	1.53	1.481
Jun-10	1.00	0 - 0.25	1.20	1.43	0.60	1.48	3.90	4.30	1.55	1.479
Sep-10	1.00	0.50	1.30	1.59	0.90	1.54	4.10	4.50	1.50	1.478

Croatia

Exchange rate stabilized slightly above 7.30

The kuna showed some additional weakness this week, but recently managed to stabilize in the 7.31-7.33 region. Lower T-bill issuance and a reduced public sector liquidity enhancement pipeline continued to work in the direction of depreciation. Coupled with corporate sector debt repayment and hefty liquidity, pressures are likely to remain skewed on the depreciation side. Given the currently benign exchange rate movement, the CNB has stood still, apart from skipping the REPO auction this week. Nevertheless, we continue to see the CNB stepping in if pressure mounts, in order to sterilize excess liquidity. As a result of the solid liquidity, MM rates are at extremely low levels, with the short end above 1% and the long end around the repo rate (6%); these should remain around present levels if FX market developments stay broadly stable. The MoF skipped this week's T-bill auction.

October CPI points slightly upwards

The CPI figure for October points slightly upwards, at 1.3% y/y. The monthly figure also indicates weak pressures, up 0.1% m/m, mostly stemming from seasonally higher clothing and footwear prices. On the other hand, declining prices of food and beverages and transportation acted in a disinflationary manner. Other categories recorded no significant changes on the monthly level. It is clear that weak domestic demand is supporting price competitiveness among retailers. Hence, apart from some upward movement in the +2% y/y region, the following months should not bring any significant upward pressures, given the base effect. Our average CPI forecast for the year remains at 2.6% y/y.

As for upcoming releases, next week's calendar is empty, but today we have two figures scheduled. The flash unemployment rate is one; we see it as continuing on its upward path. Thus, we expect the unemployment rate to go from 14.7% in September to the 15.3-15.5% region in October. The other figure is industrial production, from which we do not expect any surprises, with it remaining close to around -10% and unlikely to show improvement.

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Czech Republic

CZK now 'about right', in our estimation

This past week was a short one in the Czech Republic, with no data up for release. Comments from board members Hampl and Singer cast light on their decisions at the November 5 meeting. Hampl said that the economy might become structurally altered by (with potential output to be lower after) the crisis; hence, demand pressures might become more pronounced, and hence no need to lower rates further. Singer (who voted for a cut at the last meeting) said that the koruna is a risk; hence, more relaxed monetary conditions would be welcome. We view the CZK right now as being 'about right' (i.e. fundamentally justified), but acknowledge that further rapid strengthening towards 25 would be something the economy might not need right now. The CZK weakened somewhat on Singer's comments (to 25.7), but still stayed close to fundamentally justified values. We do not think any large weakening is in order, but should that happen, with the crown moving above 26, we would advise entering into a long position. All in all, this confirms that there is more to the resistance of the majority of the board members to lowering rates than just the currency; as the minutes already showed, there were other reasons as well ('financial stability', 'lower efficiency of monetary policy when rates are low'). As such, it might be harder for the three of those who voted for a cut in November to find another vote.

This week, preliminary data on October industrial production should come out. This will be the first release unaffected by the scrap premium (which ended in September), so it will be interesting to see whether there are at least some signs of a sustainable recovery (i.e. whether other segments are able to make up for the necessarily lower growth in the car industry). Given the pickup in German exports and the close relationship between them and Czech exports, we think that this can happen.

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Hungary

CB to cut base rate by 50bp next Monday

Next week, the rate setting meeting of the central bank (to be held on Monday) will be the focus on the markets. The central bank carried out a total reduction in the base rate of 250bp (to 7%) in July-October and is expected to continue the rate cutting cycle in November. The forint weakening seen at the beginning of this month suggested that monetary council members would be more cautious this month and would shift to steps of 25bp, instead of the usual 50bp. However, domestic markets consolidated in a relatively short period of time; thus, maintaining the 50bp rate cutting step seems likely in November. In addition, the 3Q GDP figures reinforced the picture of the weak state of the real economy, while the October 12-month CPI inflation rate was again lower than expected. These macro facts have kept rate cutting expectations strong on the markets in recent days. And last but not least, the most recent wage statistics showed that the increase in regular (ex-bonus) gross wages in the private sector further slowed in September, to 4.1% y/y, from the 4.8% y/y seen in August. All in all, the CB is expected to carry out another 50bp reduction in the base rate (to 6.50%) on Monday. The main figures of the November Inflation Report of the bank's staff will also come out on Monday afternoon, at the time of the rate announcement. The new inflation forecasts are expected to show the lack of inflation pressure in the economy. Thus, the central bank's viewpoint regarding the timing of the economic recovery could be more interesting. The full report will be released on Wednesday morning. As for the base rate prospects, the rate cutting cycle is to continue in the coming months. However, the timing and magnitude will remain dependent on the overall market sentiment, which is difficult to predict. We expect the central bank to be able to reduce the base rate below 6% by March 2010, without jeopardizing the forint exchange rate.

Small correction on markets

The forint has strengthened this week. However, the level of 265 per euro proved a strong resistance point. In the second half of the week, the exchange rate corrected somewhat to the weaker side, as sentiment on global capital markets has turned a bit worse and the dollar appreciated against the euro. The results of bond auctions held on Thursday were mixed, as demand for the 3Y bond was extremely high, while that for 5Y and 10Y bonds proved very poor. The Debt Management Agency increased the accepted amount by HUF 5bn from the 3Y paper and decreased it by the same amount from the 5Y paper. There was also some upward correction on the bond market this week and the tone of the monetary council could be decisive regarding the future yield path.

Apart from the outcome of the monetary meeting, the August-October unemployment figures (to be released on Thursday) and the 3Q investment figures (Friday) should attract some attention. The unemployment rate may have continued accelerating in the period. As for investments, the bad 3Q GDP figures suggested a week ago that investment could have also remained in negative territory in July-September.

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Poland

September industrial output stronger than expected

Polish sold industrial output contracted by 1.2% y/y, less then we (-1.9%) and the market (-2.0%) expected. In monthly terms, industrial output grew by 1.9%. For comparison, the September figures were -1.3% y/y and +15% m/m. After adjusting for seasonal effects, industrial production grew by 0.6%, both y/y and m/m. The manufacturing sector added in monthly terms 1.1%, which translated into a y/y contraction of 1.1% y/y (September: +15.6% m/m and -1% y/y). The mining sector contracted by 3.7% in monthly terms and by 11.1% in yearly terms (September: +18.4% m/m and -10.2% y/y). Utilities improved, growing by 18.3% m/m and 1.9% y/y (September: +7.2% m/m and -0.7% y/y). This is revised, seasonally-unadjusted data. The construction sector grew by 7.6% m/m and 2.7% y/y (September: 6.1% m/m and 5.7% y/y). After adjusting for seasonal effects, the sector contracted by 0.2% m/m, while in yearly terms it added 5.3%. Polish producer prices grew more than expected. In monthly terms, they added 0.3%, which resulted in 2.0% y/y growth (September: +1.6% y/y and -0.2% m/m). We expected +0.1% m/m and +1.6% y/y, while the market anticipated +1.7% y/y. The data confirms the continued recovery of the Polish industrial sector, which seems viable without the support of the German scrap subsidy. Even though the manufacturing data is slightly worse than in September, the breakdown data shows an improvement of some exporting divisions (e.g. computers and electronics, paper products). The prospects for industrial production to grow in the coming months (in yearly terms) are even better because of the base effect. In nominal terms, the industrial sector should be supported by a continued revival in export markets.

NBP to keep rates unchanged

Next week's data on unemployment and retail sales should be supported by seasonality, which should help to keep them relatively stable. The meeting of the Monetary Policy Council will be in focus, but it should not bring any surprises. In light of the improving macro data, the MPC changed the informal bias of the monetary policy from easing to neutral at its latest meeting. Thus, rates should remain flat in the coming months. Sources of risk include the 3Q GDP data and the zloty; if the former is weaker than expected, it might provoke one further mild cut, while if the zloty were to approach very weak levels (around 4.50), it might provoke an earlier hike. However, we do not assign a high probability to any of these events. We expect the next change of rates to be upwards, a move that should come late in the first half of next year.

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Romania

Central bank cut FX minimum reserves to 25% i special meeting

The board of the central bank held a special meeting on Monday and decided to cut the minimum reserve requirement ratio on FX-denominated liabilities with residual maturities below two years to 25% (from 30%). The decision will take effect on November 24. At the last monetary policy meeting on November 3, the central bank kept the key rate unchanged at 8%, also leaving alone the minimum reserves requirements for both RON and FX. Our view at that moment indicated a possible cut in FX minimum reserves. The IMF and EC recently postponed the next disbursements for Romania, due to the political uncertainties and delays in adopting the 2010 state budget with a lower deficit. The Ministry of Finance was thus left in a rather difficult position in terms of funding the budget deficit in November and December. This decision will ensure better financing of the fiscal deficit from domestic resources, while preserving the macroeconomic equilibrium. At the end of October, the budget deficit stood at 5.2% of GDP, but it is estimated to exceed the official target agreed with the IMF at the end of this year (7.3% of GDP). The Ministry of Finance will absorb the additional liquidity (estimated at around EUR 1.2bn) through the issuance of 1Y EUR-denominated T-bills on the local market next week.

First round of presidential election this Sunday

According to the latest polls, President Basescu (supported by the Democrat Liberal Party) has the edge over Social Democrat Mircea Geoana and Liberal Crin Antonescu in round one, while in round two (scheduled for December 6) Geoana is given a better chance to win the election. Other candidates are independent Sorin Oprescu (the mayor of Bucharest), Corneliu Vadim Tudor (the president of the Great Romania Party), George Becali (a billionaire businessman and the president of the New Generation – Christian Democrat Party) and Kelemen Hunor from the Democratic Union of Hungarians in Romania. Although a lot of promises are tossed around in a presidential campaign as to who has a better economic program, the president has limited powers to directly influence the country's governance (except for the nomination of the PM) and implementation of the necessary reforms. President Basescu said that Romania could further reduce the flat tax rate to 14% in 2011 if the country returns to higher economic growth rates. Meanwhile, he advocates the maintenance of the 16% flat tax in the short term, favoring a VAT hike to secure higher revenues for the state budget. He wants to restructure public expenditures and increase efficiency in spending public resources. He initiated a referendum to be held on the same day with the first round of the presidential election (November 22), which aims at creating the legal framework to reduce the number of MPs to a maximum 300 (from 471 at present). Geoana wants an immediate anti-crisis program for the next 6-12 months to renew economic growth. The main focus is on fiscal stimulus for investors, higher employment of young people and maintaining employees over 45 years old, re-launching lending activity and a one-year moratorium on repayment of loans taken by SMEs, a differentiated VAT quota for basic services, introduction of a progressive tax to replace the flat tax, reducing fiscal contributions and a 0% tax for reinvested profit starting with 2010. He also plans to launch a state securities tender worth RON 60bn addressed solely to domestic companies and the population with an interest rate of 9.5%. These state securities would be listed on the Bucharest

Stock Exchange to boost trading activity. The funds would be invested in agriculture and infrastructure programs. Our opinion is that, no matter what government comes to power after the presidential election, it will have few options on what should be done next. Establishing a fully empowered new government supported by a comfortable majority and a strong drive to push ahead with delayed public reforms already agreed with international financial institutions are key ingredients for securing fiscal consolidation in the medium term and improving the country's outlook. Political tensions between the major political parties are not helping in the achievement of the ambitious macroeconomic targets agreed with the external partners, especially as these performance indicators are difficult to achieve even during stable political times. Pressures on FX rates could diminish after the second round of the presidential election, while short-term interest rates could come closer to the key rate. However, this also depends on the speed at which the new government is formed and the determination to implement tough reform measures and thus keep the IMF deal on track.

Largest foreign banks reaffirmed their commitment to Romania

The parent banks of the largest nine banks operating in Romania met in Brussels on Wednesday and agreed to maintain their exposure to the country and ensure adequate capital levels of over 10% for their local entities. The meeting was attended by the representatives of the National Bank of Romania, IMF, EC, EBRD, EIB, World Bank and ECB and was a follow-up to those held in March and May, when the banks initially committed to maintain their exposure to Romania. This might be seen as good news for the markets, but the next government should push forward with reforms in order to receive the next disbursements from the IMF and EC. According to a press statement from an IMF official, the Fund is considering disbursing the third and fourth tranches together in March, given the possible delays in adopting the 2010 state budget with a lower deficit.

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Ukraine

GDP down 15.9% in 3Q

According to preliminary estimates of the State Statistics Committee, 3Q real GDP contracted by 15.9% y/y. The figure is preliminary and may be followed by a revision (probably of less than a percentage point). A full 3Q GDP breakdown will be published on December 30. The 3Q GDP change probably came as a slightly negative surprise for local economists (and for us), as we anticipated a decline of slightly above 14% y/y. We mostly focus on industrial production dynamics in our estimation of the GDP change bases. The deteriorated economic sentiment during July and August may have contributed to the slightly worsened domestic demand. We have revised slightly our GDP forecast for 2009 downwards to a 13.1% full-year decline for 2009. The strong base effect will most likely help 4Q GDP post a change of close to 0% in y/y terms.

Our outlook for 2010 anticipates minor economic growth of 2%. On one hand, due to tight liquidity conditions, industries did not accumulate excessive inventories (like most western economies did), which promises high responsiveness of production to increased external demand. Exports are mostly oriented toward CIS, Asian and Middle Eastern countries' economies, most of which are expected to grow in 2010. On the other hand, scarce credit conditions, caused by problems in the banking sector and high sovereign spreads, make it hard for Ukrainian companies to attract loans. Due to the largely low quality of products and high inefficiencies in production, Ukrainian industries lack competitive advantages. It is unlikely that the current 8% of GDP government fiscal cash deficit can be extrapolated to next year. We should thus see some cutback of government expenditures in 2010. All of these factors point to limited economic growth in 2010.

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Capital markets forecasts

	Exchange Rate vs EUR											
	CZK	Forward	HRK	Forward	HUF	Forward	PLN	Forward	RON	Forward	UAH	Forward
Spot	25.7		7.32		268.7		4.13		4.28		12.30	-
Dec-09	25.3	25.7	7.35	7.35	270.0	270.6	4.05	4.14	4.30	4.32	12.15	12.98
Mar-09	25.2	25.7	7.50	7.50	270.0	273.3	3.93	4.17	4.23	4.42	12.70	13.74
June-10	24.5	25.8	7.35	7.35	270.0	275.9	3.83	4.19	4.20	4.52	12.40	14.42
Sept-10	24.2	25.8	7.40	7.40	265.0	278.2	3.76	4.21	4.10	4.61	12.15	15.11

	Intervention Rate						3M Money Market Rate											
	CZ	HR	HU	PL	RO	UA	CZ	Fwd	HU	Fwd	PL	Fwd	RO	Fwd	UA	Fwd
Spot	1.25	6.00	7.00	3.50	8.00	10.25	1.81		6.83		4.19		10.39		17.94	-
Dec-09	1.25	6.00	6.50	3.50	8.00	10.25	1.72	1.81	6.40	6.19	4.07	4.28	10.25	9.62	14.00	-
Mar-09	1.25	6.00	5.75	3.50	7.75	10.25	1.72	1.78	5.80	5.79	4.03	4.31	9.90	8.61	9.00	-
June-10	1.50	6.00	5.50	3.75	7.50	9.75	1.89	1.86	5.50	5.78	4.15	4.47	9.50	7.36	8.00	-
Sept-10	1.50	6.00	5.50	4.00	7.50	9.75	2.01	2.54	5.50	5.96	4.25	4.73	9.00	6.29	7.00	-

	10y Govt. Yield					5y Govt. Yield	2y Govt. Yield
	CZ	HR	HU	PL	SK	RO	UA
Spot	4.19	6.89	7.35	6.16	4.47	10.8	26.0
Dec-09	4.40	7.00	7.20	6.10	4.70	10.0	25.0
Mar-09	4.30	8.00	6.80	6.00	4.80	9.8	22.0
June-10	4.20	7.50	6.70	5.90	4.80	9.4	18.0
Sept-10	4.20	7.50	6.60	5.85	5.00	9.0	15.0

Long-term forecasts

Real GDP growth (%)	2008	2009f	2010f	2011f
Czech Republic	2.6	-4.9	1.4	2.4
Croatia	2.4	-5.5	0.0	2.1
Hungary	0.6	-6.2	0.3	2.6
Poland	4.8	1.2	2.6	3.4
Romania	7.1	-8.0	0.2	1.7
Serbia	5.4	-4.2	0.0	1.8
Slovakia	6.4	-5.2	2.6	4.2
Ukraine	2.1	-12.0	2.0	5.0
CEE8 weighted average	**4.0**	**-4.3**	**1.6**	**3.1**

Unemployment (%)	2008	2009f	2010f	2011f
Czech Republic	5.4	8.2	9.5	9.0
Croatia	8.4	9.7	11.7	11.2
Hungary	7.8	9.9	9.8	9.0
Poland	7.1	11.1	12.2	9.6
Romania	4.0	6.4	8.2	8.9
Serbia	13.7	16.5	18.5	18.5
Slovakia	9.6	12.1	13.3	13.1
Ukraine	6.4	9.9	9.4	8.6
CEE8 weighted average	**6.8**	**10.0**	**10.9**	**9.8**

C/A (%GDP)	2008	2009f	2010f	2011f
Czech Republic	-3.1	-1.4	-1.6	-1.7
Croatia	-9.4	-4.8	-4.4	-5.0
Hungary	-7.2	-1.6	-2.0	-2.3
Poland	-5.0	-2.0	-3.1	-4.8
Romania	-12.3	-5.1	-4.7	-4.5
Serbia	-17.4	-7.0	-6.0	-7.8
Slovakia	-6.5	-3.3	-3.0	-3.6
Ukraine	-6.7	0.0	1.0	2.0
CEE8 weighted average	**-6.8**	**-2.3**	**-2.5**	**-3.2**

CPI (%), eoy	2008	2009f	2010f	2011f
Czech Republic	4.7	0.8	1.8	2.8
Croatia	2.9	4.0	4.5	3.5
Hungary	3.5	5.8	2.5	3.1
Poland	3.3	3.2	2.4	3.7
Romania	6.3	4.4	4.5	3.9
Serbia	8.6	7.7	7.8	7.0
Slovakia	4.4	0.9	3.0	4.2
Ukraine	22.3	13.0	13.0	9.0
CEE8 weighted average	**6.7**	**4.6**	**4.3**	**4.4**

3M rates (average, %)	2008	2009f	2010f	2011f
Czech Republic	4.0	2.2	1.9	2.7
Croatia	7.0	9.8	8.3	6.8
Hungary	8.9	8.7	5.7	5.4
Poland	6.3	4.3	4.3	5.3
Romania	13.0	11.1	9.2	7.9
Serbia	15.6	14.6	11.3	10.7
Slovakia	4.2	1.2	1.4	3.3
Ukraine	14.8	18.0	11.0	7.0
CEE8 weighted average	**8.5**	**7.6**	**5.8**	**5.6**

Budget Balance (%GDP)	2008	2009f	2010f	2011f
Czech Republic	-6.6	-5.5	-4.8	-3.7
Croatia	-1.6	-3.0	-3.0	-2.0
Hungary	-3.4	-3.9	-4.0	-3.5
Poland	-2.2	-5.1	-6.2	-4.1
Romania	-4.9	-7.3	-6.6	-5.6
Serbia	-2.5	-4.5	-4.0	-3.5
Slovakia	-2.2	-6.0	-6.0	-4.8
Ukraine	-1.2	-5.0	-4.0	-3.0
CEE8 weighted average	**-3.2**	**-5.3**	**-5.3**	**-4.0**

Looking ahead

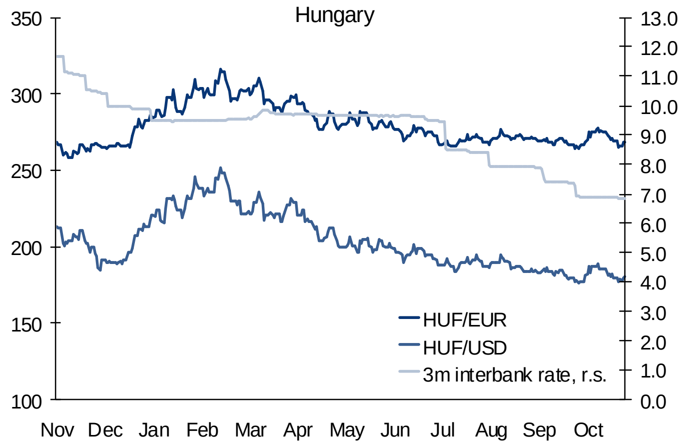
Country	Date	Release/event/figures	Our expectation	Consensus*
Czech Republic	26/30-Nov	Industrial Production, P, Oct % y/y		
Croatia		No data releases scheduled		
Hungary	23-Nov	CB rate-setting meeting	50bp cut (to 6.50%)	50bp cut (to 6.50%)
	23-Nov	Sept Retail sales	-7.3% y/y	-6.6% y/y
	26-Nov	Aug-Oct Unemployment rate	10.4%	10.5%
	27-Nov	3Q09 Investments	-	-
Poland	25-Nov	Retail sales, Oct % y/y	2.6%	2.6%
	25-Nov	Unemployment rate, Oct %	10.9%	11.1%
	25-Nov	Base Rate Announcement, %	no change (3.5%)	no change (3.5%)
Romania	22-Nov	Presidential elections		
	27-Nov	Construction permits - Oct-09		
Slovakia	27-Nov	October PPI	-5.8% y/y	-
	27-Nov	November economic sentiment	78.6	-
Ukraine		No data releases scheduled		

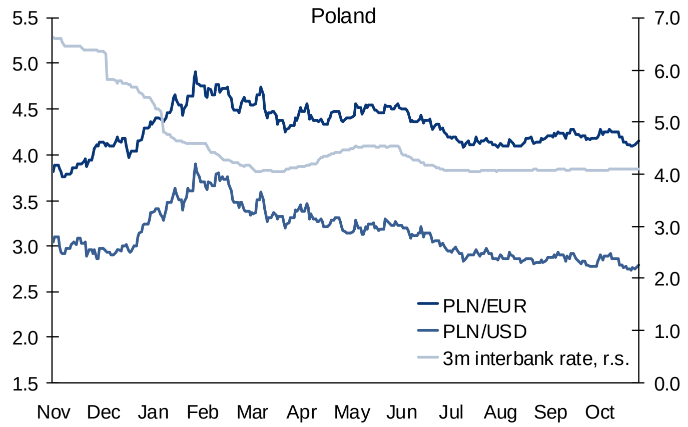
**Sources: Bloomberg, Reuters*

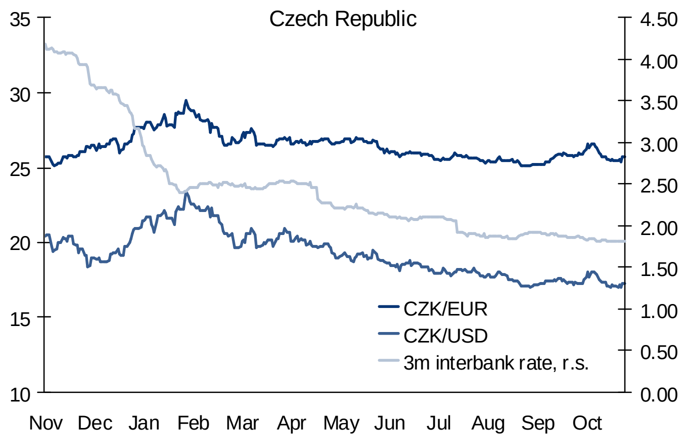
Auction diary

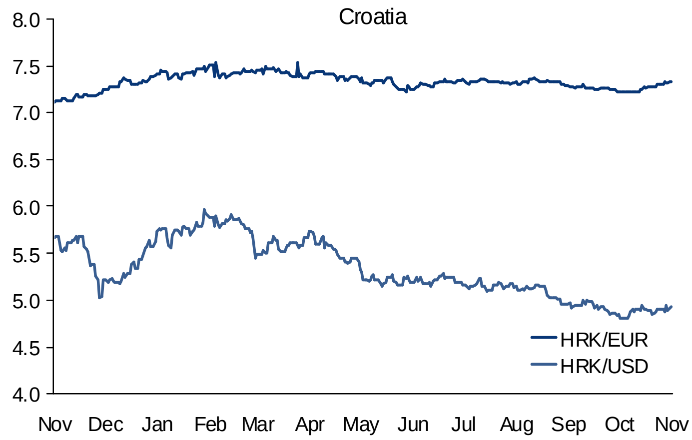
Country	Auction-date	Pay-date	Maturity	Cupon	Offer	Forecast
Czech Republic	26-Nov	27-Nov	2010-Nov-10		CZK 5bn	
Hungary	23-Nov	25-Nov	2009-Dec-30	-	HUF 40bn	
	24-Nov	2-Dec	2010-Mar-03	-	HUF 40bn	
	26-Nov	2-Dec	2010-Oct-20	-	HUF 40bn	
Poland		No auction scheduled				
Romania	23-Nov	25-Nov	1Y	-	RON 1bn	10%
	26-Nov	30-Nov	1Y	-	EUR 500m	-
Slovakia	23-Nov	25-Nov	2010-July-14	-		-
Ukraine		No auction scheduled				

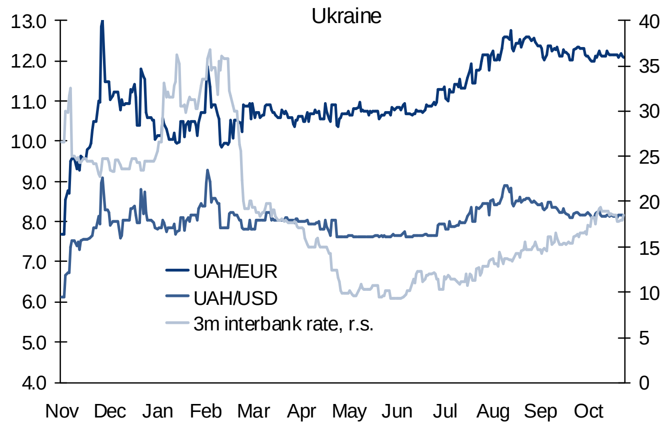
Exchange rates and interest rates (52 weeks)

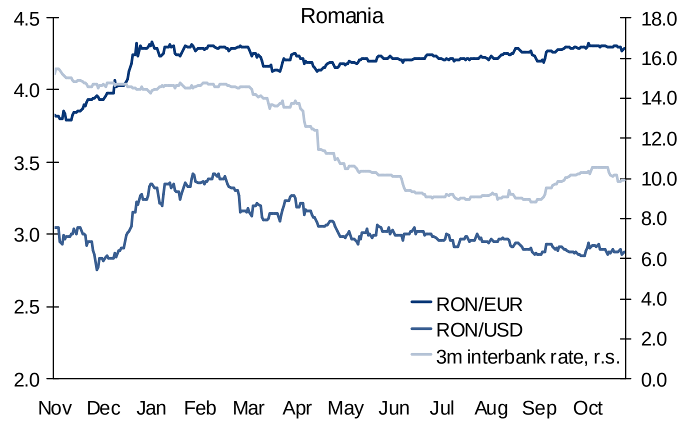






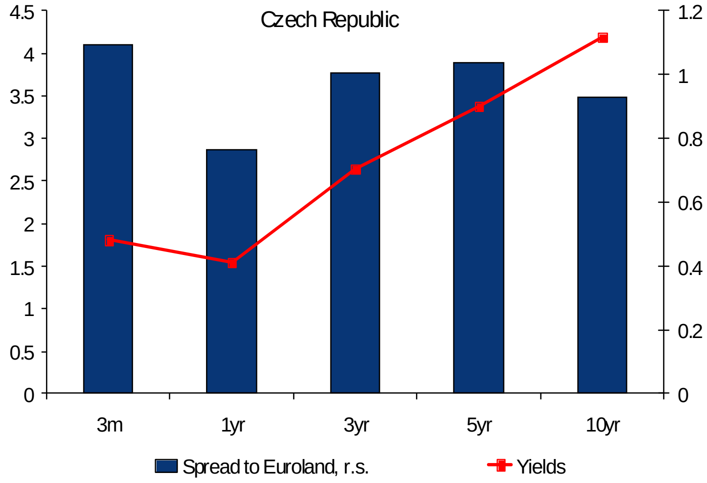






Source: Bloomberg

Benchmarks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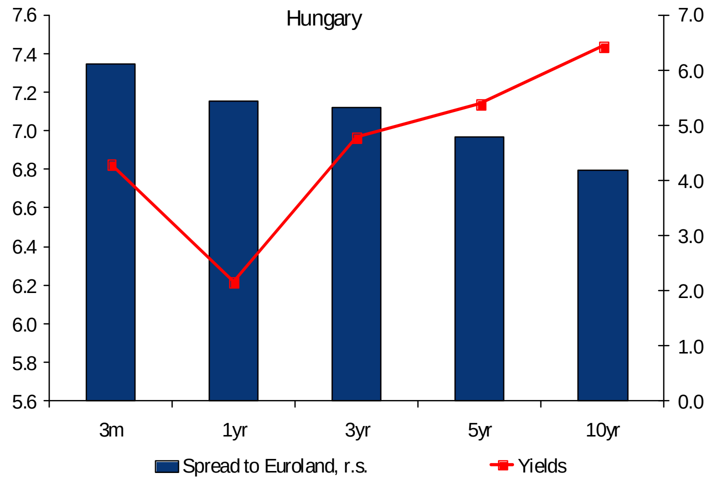
Spread to Euroland, r.s.
Yields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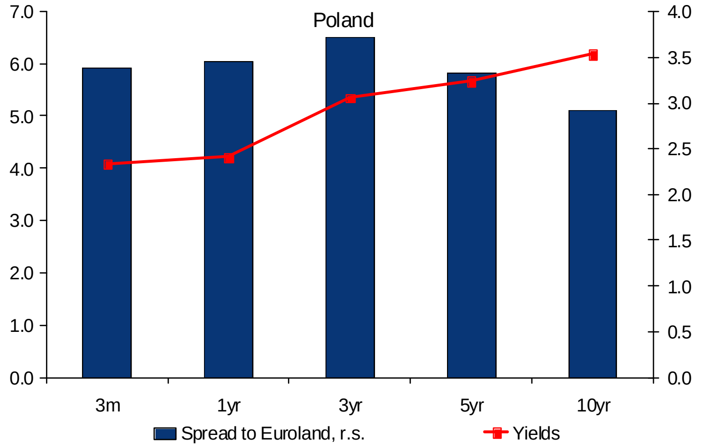
Yields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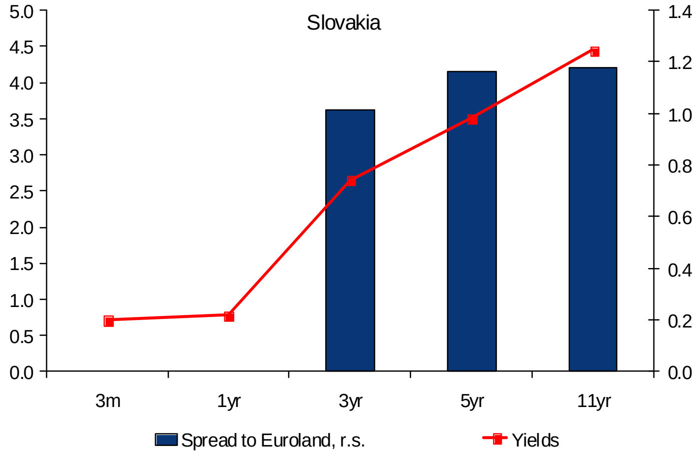
Spread to Euroland, r.s.
Yields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3m
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5yr
11yr
Spread to Euroland, r.s.
Yields

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