



CENTRAL EUROPEAN WEEKLY

MARCH 7, 2006

- **Czech Republic**
CNB: Higher euro interest rates should weaken koruna
- **Slovakia**
Rate hike encourages koruna to break new records
- **Poland**
MPC again cuts rates
- **Hungary**
High oil and gas prices slows foreign trade improvement
- **Slovenia**
BoS again cuts interest rates



HIGHLIGHTS

Currencies weakened and bond prices fell significantly in Central Europe last week. Discovering what was to blame for this is not difficult; it was the reaction of core bond markets to the latest ECB meeting. Although the hike in the official rate by 25 bps was fully anticipated and the comment from ECB President Trichet was not so hawkish, markets came to the conclusion that the ECB would continue to tighten its monetary policy, and that it would do so faster than previously expected. While before the ECB meeting, markets expected that the ECB would raise its official rates again in June, now the prevailing market opinion is that the ECB will raise them in only two months. This means that the interest-rate differential between CE countries and the Eurozone would shrink faster and this, reduces the attractiveness of CE assets.

Thus, could the ECB raise rates as early as May then? There are several good reasons to assume that the ECB may wait until June. Firstly, the ECB started to raise rates when the first signs of recovery occurred, and this provides the bank with room to tighten its monetary policy gradually. Secondly, Trichet told the press conference that the [ECB] was in the same state of mind as in December, and this could mean that the current rate hike pace (25 bps

every three months) will continue. Thirdly, the ECB may prefer to raise rates in the months when its staff projections are released, and this indicates that another rate hike will be carried out in June.

We must point out that these reasons could be subdued if the released soft and hard data in the Eurozone bears out the robustness of the recovery and markets continue to expect a rate hike in May. Under these circumstances the ECB may be reluctant to find itself 'behind the curve' and it will rather indicate that another rate hike will be carried out in May. The press conference after April's ECB meeting may be crucial from this point of view because Trichet reiterated up until last Thursday that market expectations were set correctly.

What are the conclusions from these reflections for CE currencies and bonds then? Our opinion is that a positive correction will probably occur in Central Europe. It may be triggered by the bond market in the EMU re-endorsing the original scenario of hikes in the official rate. Nonetheless, we do not expect, however, that some CE currencies will hit new highs even in such a case. The reason is that three parliamentary elections, which will be held in Central Europe during this spring, are coming and they will hardly improve the market sentiment.



CZECH REPUBLIC

The released **minutes of the CNB Board meeting** held in the previous week bore out our impression of Governor Tůma's comment made promptly after the meeting. No new substantial information was learnt because the key information on the voting ratio is released immediately after the Board meetings now. The minutes of the meeting confirmed that the CNB Board had relied on the ECB's rate hike, expecting it to have much the same effect on the koruna as a rate cut by the Czech National Bank. Also, the CNB Board proved to be less sensitive towards the strong koruna than expected. The minutes explicitly say: "...widening of the negative interest rate differential against the euro might lead to a decrease in the attractiveness of investing in the Czech koruna and thus to a correction of the recent appreciation of its exchange rate, or at least to an easing of the pressures for further appreciation." This indicates that an exchange rate within the bounds of CZK 28.22-28.62 per EUR is not a reason for the CNB Board to react directly. What is more, this is underlined by the statement that the Board should focus more on the long-term policy rather than moderate adjustments of the monetary policy. The last important point is that the CNB Board considers the downside risks to inflation more significant, although it regards them as weaker than in January. By and large, the Board would like to keep pace with the ECB, and thus the next move should be a rate hike. Only an appreciation of the koruna to less than CZK 28.00 per EUR might threaten this.

In the first half of last week the **Czech koruna** maintained its upbeat mood, triggered by the Czech National Bank. However, the anticipation of Thursday's rate hike in the Eurozone prevented the Czech currency from breaking through CZK 28.26 per EUR. J. C. Trichet worsened the overall mood on emerging markets including Central Europe and the Czech koruna on Thursday by sending a somewhat hawkish statement to markets. On Thursday and Friday the Czech currency weakened to the resistance level of CZK 28.62 per EUR, where it stopped depreciating and closed the week at around CZK 28.50 per EUR. The koruna virtually ignored the minutes of the last CNB Board meeting, which indicate that the central bank is not very willing to cut rates.

We expect that the negative impact of Trichet's hawkish statement on the Czech koruna will peter out this week. The ECB's press conference affected not only the Czech currency but virtually all the emerging markets that largely depend on the Eurozone (all Central-European currencies, the Russian rouble and the Turkish lira). Hence we believe that the koruna is particularly reacting to the overall worsened mood on emerging markets rather than to the widening of the spread between Czech and euro interest rates to -50 bps alone. We should not underestimate the effect of the interest-rate differential on the Czech currency;

on the other hand, however, the Czech Republic's good foreign trade figures (in spite of the strong koruna) and the inflow of foreign direct investments are more important for the equilibrium of the balance of payments (the differential has a negative effect on the financial account through the outflow of portfolio investments). In addition, a positive turnaround occurred on all affected emerging markets on Friday, and this should provide the koruna with room to react more to the series of domestic figures, of which January's foreign trade data, which is expected to bear out the good performance of exports despite the strengthening koruna, may have the greatest impact. We also expect favourable GDP data for the last quarter of 2005, and February's inflation should come as no surprise this time either. Therefore domestic data should be favourable rather than unfavourable for the Czech currency, and should not allow it to break through the resistance level of CZK 28.62 per EUR. On the other hand, the interest rate spread against the Eurozone and the expectation that it will continue to widen will increase the volatility of the Czech currency and discourage it from appreciating rapidly in the medium term.

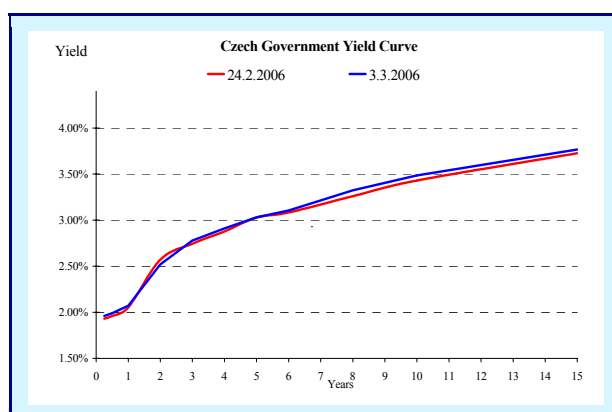
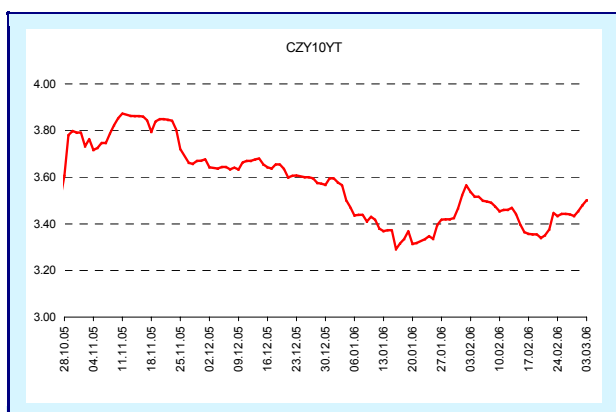
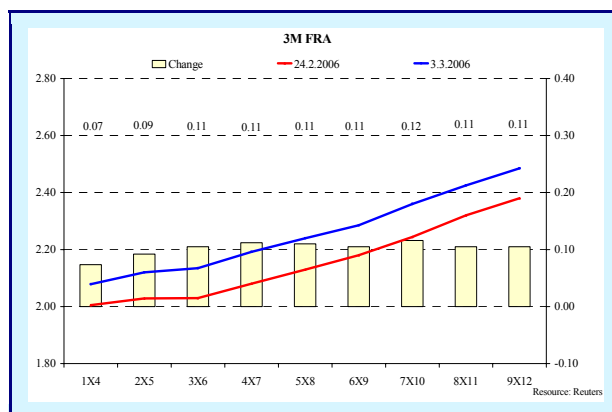
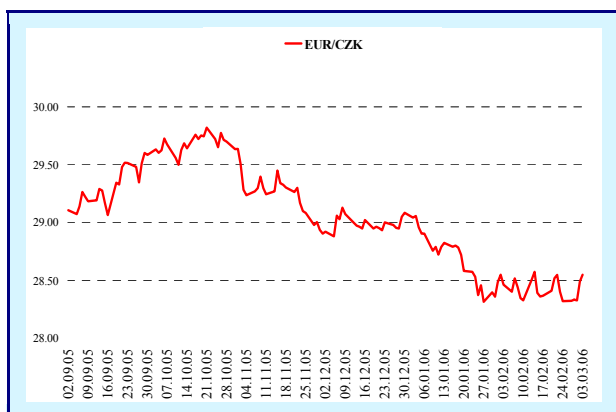
Bond prices continued to fall last week. This was triggered by the Czech National Bank surprisingly leaving rates unchanged in the previous week. The yield curve went up by 7 bps overall. The key events were the release of the issue calendar for the second quarter of this year and the ECB meeting. The issue calendar somewhat surprised the market on Wednesday because some traders probably expected a lower amount of planned issues. The government is going to issue bonds for CZK 40 bn, just as in the first quarter. This is consistent with the full-year plan, which currently envisages a maximum amount of CZK 142 bn (we must only subtract the already-issued securities in Japanese yens for CZK 8 bn from the total maximum amount of CZK 150 bn because the government is planning no other foreign issues for this year at the moment). If we take into account that the amounts of securities issued in the last quarter are, for technical reasons, much lower, the CZK 40 bn is not an excessive amount. In addition, the Finance Ministry is slightly reducing the issues of treasuries. However, the European Central Bank, whose comments on Thursday were viewed by investors as somewhat hawkish, had a much more negative impact on the market. Therefore markets have started to envisage an ECB rate of 3.25% for the end of the year, and this puts increased pressure on the Czech National Bank to raise rates in the second half of 2006. Even so, the Czech market sustained only half the losses that occurred on the euro market.

Friday's minutes of the CNB Board meeting did not influence markets at all because they only corroborated Governor Tůma's previous statements. The CNB does not want to cut rates unless the koruna appreciates to less than

CZK 28.00 per EUR and thus makes the Czech central bank carry out this move.

Almost all data on the condition of the economy will be released this week. The inflation and GDP figures will be particularly important. The inflation data should show the lack of inflationary pressures while the GDP data should bear out the high growth rate of the Czech economy. By and large, the data should thus neither encourage bonds nor

make investors largely sell their bonds. Also, a 2Y securities auction, which is not very important for the market development, however, will be held. Events on global markets, which will particularly await Friday's payrolls in the United States, will play the crucial role again. Thus foreign events should also fuel the somewhat negative market mood.



Comparative table for government bonds

Title	Price 03.03.06	Yield 03.03.06	Price change (bps.) to 24.02.06	Yield change (bps.) to 24.02.06	Modif. Duration 03.03.06
GOV/ 3.95 / 02.08.07	102.13	2.38	-15	9	1.3
GOV/ 2.9 / 17.03.08	100.57	2.61	-17	8	1.9
GOV/ 3.8 / 22.03.09	102.88	2.80	-21	7	2.8
GOV/ 2.55 / 18.10.10	97.67	3.10	-29	7	4.2
GOV/ 6.55 / 05.10.11	117.14	3.15	-47	7	4.7
GOV/ 3.7 / 16.06.13	102.26	3.34	-47	7	6.1
GOV/ 3.8 / 11.04.15	102.28	3.50	-52	7	7.4
GOV/ 6.95 / 26.01.16	128.39	3.50	-71	7	7.5
GOV/ 4.6 / 18.08.18	109.26	3.66	-82	8	9.3
GOV/ 3.75 / 12.09.20	99.58	3.79	-64	6	10.8

EXPECTED DATA

Tuesday, March 7, 9:00

Foreign trade (January) **CZK 10 bn**

Foreign trade usually shows the greatest surpluses at the beginning of a year, and therefore we expect a surplus of up to CZK 10 bn if the existing trend is maintained.

Wednesday, March 8, 9:00

CPI (February) **+0.2% m/m, +2.9% y/y**

Consumer prices did not change very much in February except some seasonal variations. Hence inflation should stagnate at 2.9%.

Unemployment rate (February) **9%**

Unemployment should seasonally fall.

Wednesday, March 8, 10:00

Current account (Q4) **CZK -33 bn**

The revision of the balance of payments data for the last quarter of 2005 should include no substantial information.

Thursday, March 9, 9:00

GDP (Q4) **5% y/y**

The growth rate of the Czech economy sped up in the last quarter of 2005 because exports again fared well. Also, consumption and investments are starting to recover.

Average wage (Q4) **5.8% y/y**

The average wage growth should slow down slightly in the fourth quarter of last year.

Construction output (January) **6% y/y**

Monday, March 13, 9:00

Industrial output (January) **8% y/y**

The rise in industrial output should continue to be high this year. Nevertheless, the expected change in the methodology greatly complicates the forecast.

SLOVAKIA

The National Bank of Slovakia raised rates by 50 bps with the vote result of 7:3. All NBS Board Members were in favour of a rate hike; they only discussed how much to raise rates.

The NBS Board decided to raise its key 2-week repo rate by 0.5% to 3.50% at its February meeting. A rate hike was anticipated, as the central bank has 'tightened' its statements over the last few months. However, the market expected a rate hike of 25 bps. Therefore the central bank's decision came as a small surprise.

The central bank told at the subsequent press conference that inflation risks had been the key reason for its decision. January's consumer inflation exceeded its expectations. We must add, however, that this was due in particular to regulated prices, which the NBS cannot influence by its monetary policy. However, core inflation rate also rose, and this might indicate the occurrence of inflationary pressures. The central bank is particularly afraid that an accelerated inflation rise might have a negative effect on the inflation expectations in the economy. This means that these expectations might subsequently lead to increased pressures on wage growth to accelerate.

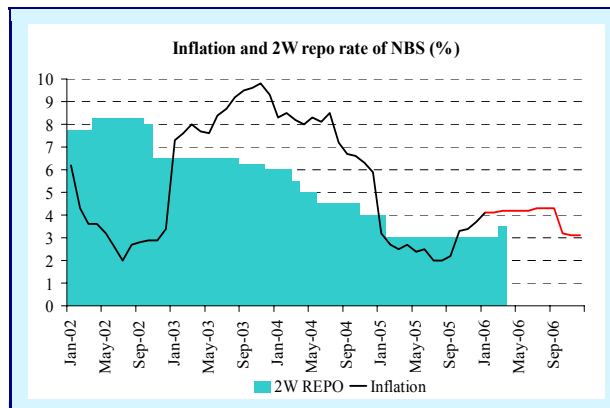
The NBS assumes that the strong economic growth trend will persist and could make the output gap close faster. Our opinion is that, in view of the development of economic indicators, high GDP growth was particularly driven by investments and inventories, and this is not bad news for the economy.

The central bank is probably afraid that high economic growth might encourage consumption and subsequently also demand-pull inflation in the future.

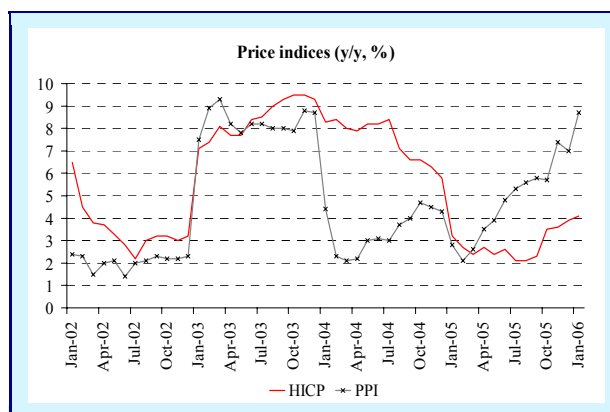
Another reason for tightening the monetary policy could be the fact that the effects of any monetary policy changes always influence the economy with some time lag. If the NBS wants to meet the Maastricht inflation criterion in 2007, it has to react now.

Figures from the real economy will be important for the future development of rates. The central bank will particularly monitor market services, which it considers almost like an indicator of the secondary impacts of the increases in regulated prices and of increased energy prices. Another key factor will be the detailed GDP structure for the last quarter of 2005 (released on March 9).

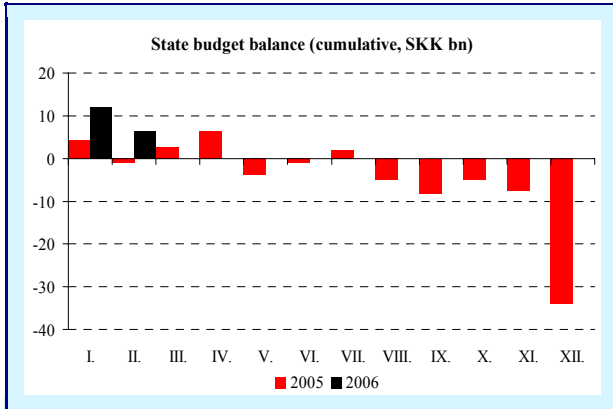
We can not rule out another rate hike (by 25 bps) if demand-pull pressures occur in the economy, secondary effects became obvious, the economy was largely driven by consumption and the koruna was weak. Nonetheless, our basic scenario envisages that rates will remain unchanged until the end of the year. According to our forecast, the high economic growth is based on the above-mentioned investments and inventories. In addition, we expect that monetary conditions will be tightened through the exchange rate channel in the second half of the year, i.e. we expect the koruna to appreciate.



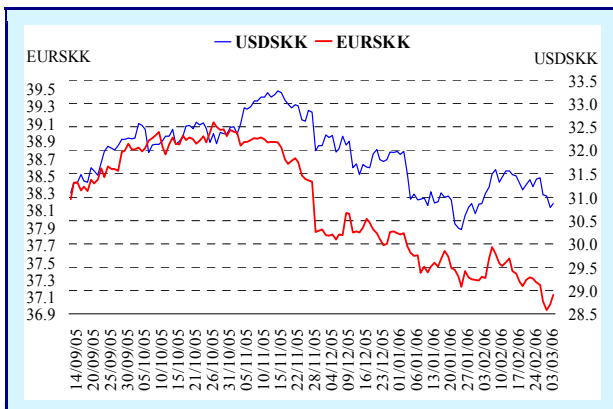
January's **harmonised index of consumer prices (HICP)** rose more than the NBS expected, and also provided the central bank with a reason to raise rates on Monday. The inflation rise was due to the increase in energy prices as well as healthcare prices. Energy prices are not crucial for the Slovak central bank. However, they can trigger a price rise in the other sectors of the economy and thus spread the 'price infection'. Tuesday's release of the producer price index also showed a greater rise than expected. The year-on-year PPI rise sped up from December's 7.0% to 8.7% in January. The PPI is a good leading indicator of the CPI (because a rise in producer prices sooner or later leads to a rise in consumer prices). In the light of this, Wednesday's rate hike by the NBS also seems to be logical.



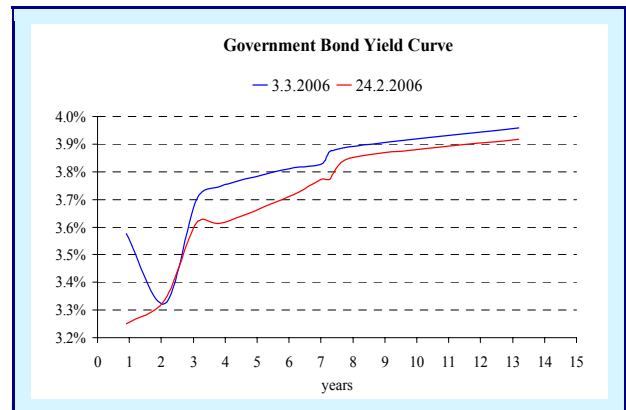
The **state budget** showed a surplus of SKK 6.3 bn for the first two months of this year (the surplus at the end of January was SKK 12 bn), with revenue of SKK 50.4 bn and expenditure of SKK 44.1 bn. Revenue thus reached 18.5% while expenditure reached 13.3% of the full-year plan at the end of February.



Encouraged by the central bank's decision to raise rates by 50 bps, the **Slovak koruna** broke a few records last week. The widened interest-rate differential against the Eurozone and also against the Czech koruna, for example, helped the Slovak currency appreciate. It hit new all-time highs on three consecutive days; at first on Tuesday, once the central bank had raised rates by 50 bps instead of the expected 25 bps. More all-time highs were subsequently hit on Wednesday and Thursday. On Thursday, however, the currency only strengthened in the morning. In the afternoon, the rate hike by the ECB and Trichet's comment triggered a correction throughout Central Europe including Slovakia. At the end of the week the Slovak koruna stood at SKK 37.150 per EUR. This means a correction of approximately 0.6% compared to the all-time high of SKK 36.925 per EUR (hit on Thursday morning). Rumours, which started to spread from London on Wednesday morning, also helped the koruna hit below SKK 37 per EUR. The Slovak currency was set to break through the option barrier and strengthen significantly if it succeeded in breaking through SKK 36.950 per EUR. However, this did not quite happen. This week is full of economic data releases. Industrial output, which should bear out the good export performance of the economy, should catch the eye. However, retail sales and the GDP structure will also draw much attention. These figures will indicate whether and how much the central bank will continue to raise rates. If the data enables the NBS to raise rates, the koruna could benefit from this. Until the data is released, the Slovak currency should react to regional events in particular. The depreciation of the zloty appears to be an especially good investment opportunity; the koruna might follow suit. We expect the Slovak currency to move within the bounds of SKK 36.900-37.200 per EUR.



The **yield curve** went up. The greatest stimulus was provided by the unexpected rate hike of 50 bps, as the market expected that the monetary policy would be tightened by only 25 bps. As a result, the short end of the yield curve (3M to 1Y) rose by approximately 25 bps immediately after the central bank's decision. The long end reacted by a rise of approximately 5 bps. However, the curve also rose on the following days. Thursday's rate hike by the ECB and the hawkish comment from its President Trichet made the curve continue to rise. In particular Thursday's comment made the entire curve go up by approximately 5-6 bps. Another factor was the depreciation of the Slovak currency at the end of the week because market rates followed suit. The FRA market currently envisages another rate hike by the end of the year of approximately 25 bps. This appears to us to be a quite realistic scenario. We currently view the likelihood that rates will remain unchanged and the likelihood of a 25 bps rate hike as the same. Foreign banks expect that the monetary policy will be tightened more significantly, by an additional 50 bps, by the end of the year. We consider this less probable although we cannot completely rule out even this, of course. We expect that market rates will continue to go up slowly this week. Thursday's GDP data may trigger a significant reaction. A significant rise in consumption, if any, would encourage another rise in official rates, and the market would react immediately.



Indicative yields of government bonds

	Coupon	Maturity	Issue volume	Bid	Ask
SD200	0.0	14.1.2007	open	3.65	3.50
SD191	5.0	5.3.2008	SKK 15.0 bn	n.a.	n.a.
SD203	4.8	14.4.2009	SKK 40.0 bn	3.79	3.60
SD189	4.9	5.2.2010	SKK 15.00 bn	3.85	3.65
SD174	7.5	13.3.2012	SKK 8.31 bn	n.a.	n.a.
SD188	5.0	22.1.2013	SKK 15.0 bn	3.90	3.75
SD199	4.8	2.7.2013	SKK 6.8 bn	3.90	3.80
SD202	4.9	11.2.2014	open	3.94	3.84
SD204	5.3	18.5.2019	open	4.05	3.87

Source: Bratislava Stock Exchange, CSOB

Interest rate fixing on the money market

% p.a.	O/N	1W	2W	1M	2M	3M	6M	9M	12M
27/02/2006	1.86/2.16	2.70/2.99	2.74/3.02	2.98/3.26	3.07/3.35	3.14/3.43	3.21/3.51	3.28/3.56	3.34/3.62
06/03/2006	2.41/2.71	3.19/3.47	3.20/3.50	3.23/3.51	3.33/3.61	3.38/3.67	3.45/3.73	3.49/3.77	3.51/3.79

EXPECTED DATA
■ Wednesday, March 8, 9:00
Industrial output (January) 7.5% y/y

The Slovak economy is significantly oriented to exports. Hence industrial output data is often viewed as a leading indicator of exports and, unless imports spring a surprise, also a leading indicator of the balance of foreign trade. We expect a moderate slowdown of the year-on-year rise from 9.4% to 7.5%. Nonetheless, the main reason for this should be the high year-on-year comparison base. Key sectors of the economy should show sound rises.

Construction output (January) 2.0% y/y
Retail sales (January) 4.0% y/y

Retail sales surprisingly slowed down to 4.5% in December from November's 10.1% in spite of December's Christmas shopping. January's sales are usually low. However, given the low comparison base, the slowdown should not be significant. We expect a year-on-year rise of 4.0%.

■ Thursday, March 9, 9:00
GDP (Q4) 7.5% y/y (final)

The Statistical Office has always confirmed its preliminary forecast so far. Therefore we expect that it will again do so this time and confirm economic growth of 7.5%. The growth structure will be important. The economy should be driven by investments (or a change in inventories) and household consumption. If consumption proves to be prevalent, this will again stir up the rate hike discussion.



POLAND

After a record long and exceptionally intense discussion, in accordance with our expectations, the **Monetary Policy Council cut interest rates by a further 25 bps** at February's meeting. This is the second reduction this year and the seventh successive cut since March 2005. As was to be expected, the voting to cut rates in both January and February ended in a result of 6:4 in favour of the doves, which we believe proves that the bipolarity of the Council formed in the second half of last year is increasing. This difference in views is best reflected in the contrast between the soft tone of the official comment on the decision and the statement at the press conference in which Central Bank Governor Leszek Balcerowicz took part. This is because, in the official document, the Council clearly expressed the conviction that, because of the lower than expected level of current inflation, as well as the zloty exchange rate, inflation could be lower in 2006 than according to the latest, relatively soft inflation projection. Meanwhile, at the evening meeting with journalists, the head of the central bank placed far greater emphasis on the appearance of potential risks to inflation. However, although it is natural that the president's voice is more audible during a conference, the contrasting position developed by the Council is a sign that the balance of forces is currently decidedly more advantageous for the Council's dove faction.

Importantly, the results of the recent votes and statements of the individual MPC members appear to confirm that the advantage of the proponents of softening the monetary policy will continue at least until inflation returns to the admissible fluctuation band, which we believe will not occur until 2007. In our base scenario, we assume that the turnaround in domestic demand (particularly investments) will help the Polish economy accelerate in the coming quarters, although we are simultaneously convinced that the increase in economic activity will also not generate significant inflationary pressure. This scenario is supported by the **latest GDP data** for the last quarter of 2005. The rate of economic growth in the last three months of 2005 increased to 4.2% y/y from 3.7% y/y in the previous quarter. The data confirmed expectations about a turnaround in domestic demand, primarily in investments (9.8% y/y), as well as the first case of a negative contribution of the rate of increase in net exports to GDP growth for a long time. On the other hand, the moderate rate of increase in consumption (3.1% y/y) is evidence that the turnaround in economic activity is not generating noticeable inflationary pressure. Therefore, we believe that the slightly better than expected results achieved by the

Polish economy should not obstruct the MPC from further monetary easing. All the more so that the representatives of the Council's dove faction clearly stated that certain structural changes were taking place in the Polish economy that would result in higher growth without threatening price stability. In our base scenario, we assume that the Council

will cut interest rates twice in the coming months because of exceptionally beneficial inflation prospects. We believe that the CPI based on the old basket remained at 0.7% y/y in February and that the headline inflation will stay below the NBP's target until the second half of 2008. The first cut could take place in March. However, whether the Council will decide to reduce rates so quickly will largely depend on the level of the correction to January's inflation data after the annual revision of the inflation basket. It is worth remembering that from the most radical forecasts, it arises that Poland may even be under threat of consumer price deflation in y/y terms in the near future because of the changes in the basket and the continued beneficial trends on the food and fuels markets. Our expectations are not so extreme, although we expect that the revision of the basket could translate into a decline in annual inflation of approximately 0.2% in y/y terms in January and February.

The **zloty** exchange rate fluctuated within the bottom half of the range of 3.75 - 3.80 EUR/PLN throughout most of last week and the market would almost certainly have closed at a level close to its lower threshold if not for the correction following the EBC's decision that affected the whole of the region on Thursday and domestic politics which soured the market sentiment on Friday. After a successful opening at 3.7680 EUR/PLN, the zloty weakened slightly on Tuesday in anticipation of the MPC's decision on interest rates. The 25 bp cut and the relatively soft comment on the decision improved the debt market mood enabling the zloty to almost entirely claw back its losses. The PLN did not react to the critical European Commission report on Wednesday (that was disclosed by journalists last week) on the government's convergence plan, while the slightly better than expected data on GDP pushed the long end of the bond yield curve back upwards and affected the FX market negatively as well. The zloty suffered further losses of more than 1% against the euro after the European Central Bank increased interest rates in the euro zone. Furthermore, the hawkish comment from Jean Claude-Trichet on the decision, in which the head of the ECB indicated that further interest rate hikes are possible, meant that the EUR/PLN started to attack 3.80 on Friday, which has been a key psychological and technical barrier for some time. Friday's attempt, unlike all attacks on 3.80 last month, ended in success - largely due to renewed fears that cracks within the parliamentary stabilization coalition might lead to earlier elections.

This week, the FX market should be relatively calm. The lack of important economic events will mean that the market will be particularly sensitive to changes in regional sentiment, movements in the EUR/USD and domestic politics. From our perspective the threat of snap elections signalled by conservative leaders late last week is merely part of the PiS's strategy aimed at keeping its coalition

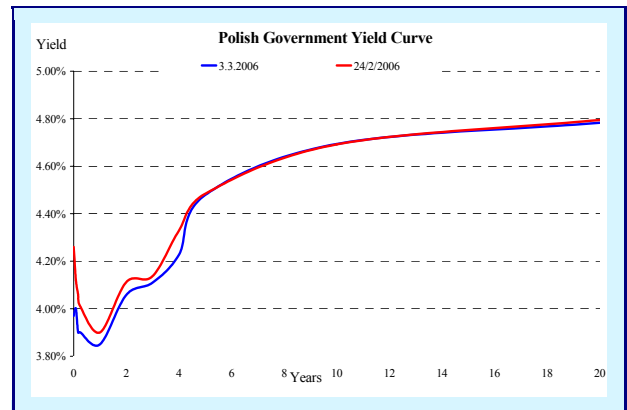
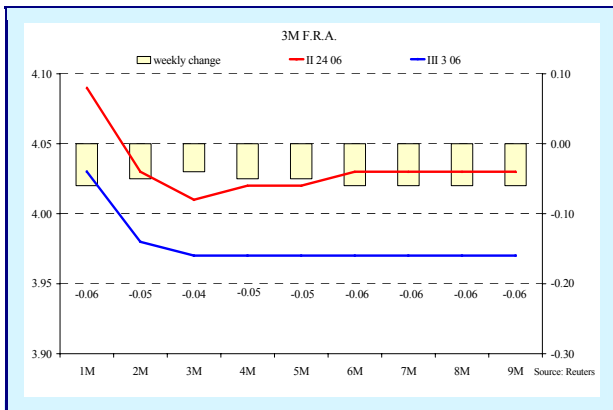
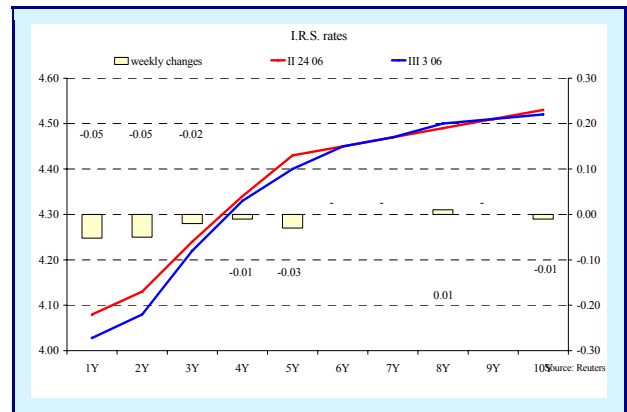
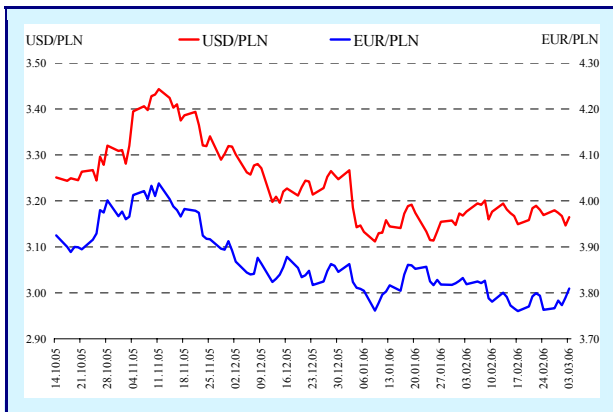


partners in check, hence its impact on the zloty should be short lived.

Polish bond yields dropped last week to their lowest level since September 2005 after the Monetary Policy Council cut interest rates by 25 bp for the second time this year. The market also reacted positively to the relatively soft comment on the Council's decision, which was received by many observers, including us, as a sign that February's cut was not the last in the series of cuts since March 2005. In our base scenario, we currently assume that the Council will cut interest rates twice this year to 3.5%. The prospect of further cuts in interest rates translated into a relatively large amount of interest in Wednesday's 2Y bond auction. The Ministry of Finance sold the whole pool of treasuries worth PLN 2.15 bn from the OK0408 series on Wednesday, with demand exceeding the offer three-fold. The market responded with a gentle drop in prices to the slightly better

than expected GDP numbers, and extended these losses following the ECB's decision on interest rates and the statements from President Trichet on the further tightening of the monetary policy in the euro zone. Renewed fears about the possibility of snap elections pushed the long end of the yield curve gently up just before the closing on Friday to 4.04%, 4.48% and 4.65% respectively for the 2,5 and 10 year benchmarks.

We expect the recent tension between the stabilization pact allies to temporarily fade, as the populists have no other option than to cooperate with the PiS, since their current political ranking is very weak. This should calm the market down in the coming days, following the gentle correction at the end of last week. At the same time with the eco calendar empty domestic politics and core markets will remain the key driving force for Polish bonds this week.



Comparative table for Polish government bonds

Title	Price 03.03.06	Yield 03.03.06	Price change (bps.) to 24.02.06	Yield change (bps.) to 24.02.06	Modif. Duration 03.03.06
GOV/ 0 / 12.04.08	92.00	4.05	23	-8.56	2.05
GOV/ 5.75 / 24.06.08	103.54	4.09	13	-7.07	2.09
GOV/ 6 / 24.05.09	105.19	4.23	21	-7.75	2.81
GOV/ 6 / 24.11.10	106.35	4.47	14	-3.77	4.06
GOV/ 6.25 / 24.10.15	112.18	4.65	49	-6.22	7.21
GOV/ 5.75 / 23.09.22	111.21	4.75	44	-3.71	10.71

EXPECTED DATA

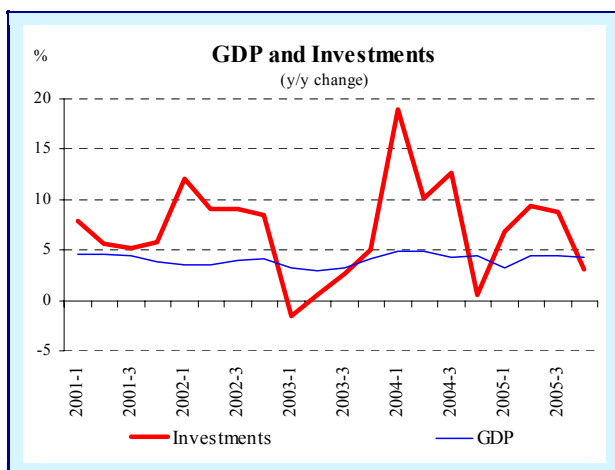
No event expected



HUNGARY

The preliminary GDP and investments data for the fourth quarter of last year did not include much new information. Year-on-year GDP growth was slightly higher than the forecast released by Ecostat (4.3% as opposed to 4.1%), with quarter-on-quarter growth slowing down from 1.1% to 1.0% according to seasonally adjusted data.

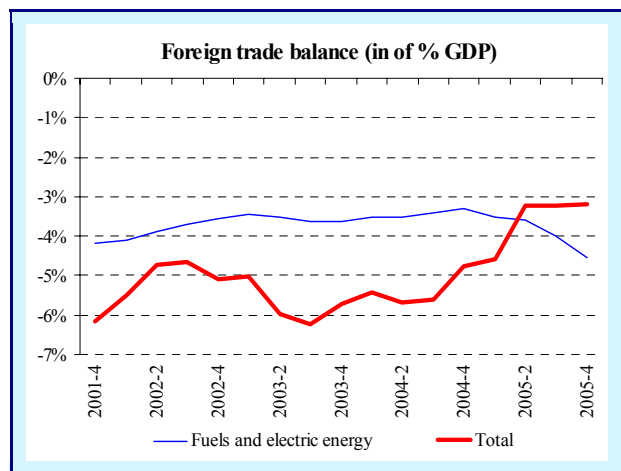
The data on the rise in investments was slightly more interesting. Investments were up by only 3.1% y/y, again driven by motorway construction, while investments in the engineering industry, for instance, rose by only 2.2%. We do not want to draw any far-reaching conclusions from the investment rise slowdown, not even from the somewhat poor rise in the investments in the manufacturing. On the contrary, we should mention favourable news from the micro-economy, indicating that investments will rise soon. Carmaker Suzuki has decided to more than double its output in Hungary by 2010. Don't forget that Suzuki made 137,000 Swift and Ignis vehicles in Hungary last year while at the end of this decade the output should be 300,000 units.



The CSO released the complete foreign trade data for 2005. The figures indicate one important fact: the 2005 foreign trade data would have been much better if the terms of trade had not deteriorated by almost 2%. Of course, the deterioration was due to the import prices of raw materials. The import prices of gas and oil rose by 28% and 42% respectively. As a result, the 2005 balance of fuels and electric energy dropped by EUR 1.34 bn, and practically offset the dramatic rise in the surplus of the balance of machinery and transport equipment (from EUR 2.18 bn to EUR 3.81 bn). Hence, if raw material prices had not increased, the total balance for 2005 could have been better by 1% of GDP.

Unfortunately, raw material prices are still high, and pressure on them to continue rising is persisting. This is not good news for Hungary, which does not have its own deposits of oil and gas, and is a net importer of electricity. Hence we can again expect two conflicting trends in foreign trade this year (in the first half at least). On the one hand, the recovery in Western Europe and particularly Germany

will encourage the exports of machinery and means of transport; on the other hand, the high prices of oil and other raw materials will keep the balance of this foreign trade category deep in the red. Unless raw material prices continue to rise (we do not expect this), the positive effect from the starting upswing in Germany may continue to more than counterbalance the negative impacts of worsened terms of trade.



A hike in the official rate in neighbouring Slovakia by 50 bps and the very negative reactions of European bonds to the outcome of the latest ECB meeting made the forint break through the key resistance EUR/HUF 254.0 and EUR/HUF 254.35, and stay at three-month lows at the moment. The prospects of a faster increase in the EMU's official rate particularly affected the forint.

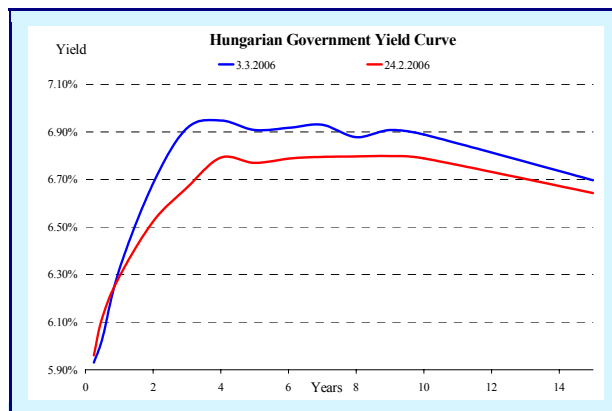
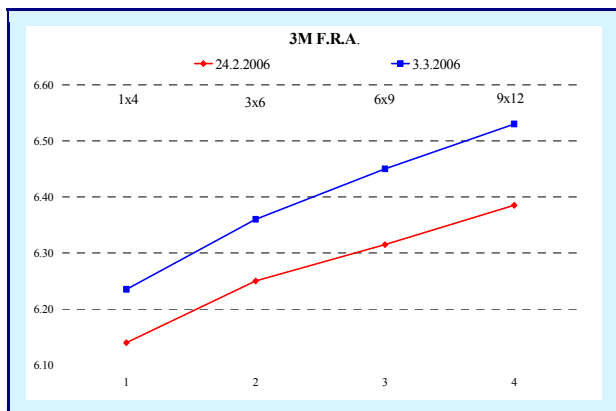
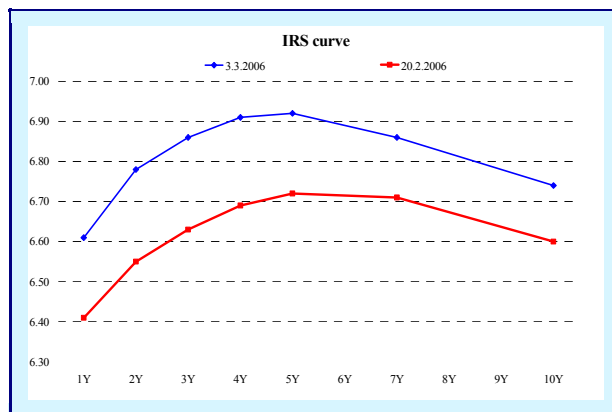
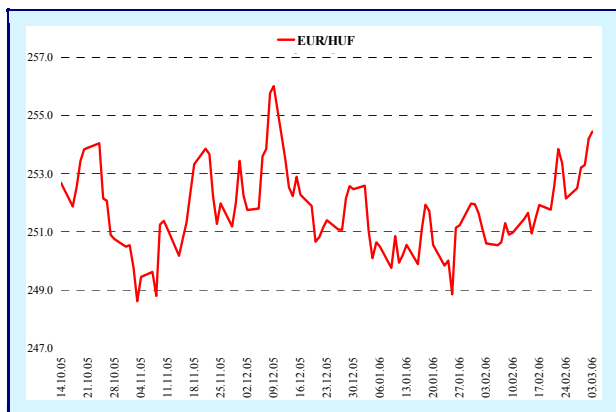
The combination of the rise in yields in the Eurozone and the approaching elections is obviously unfavourable for the Hungarian currency. Given the current circumstances, domestic macroeconomic data will play a minor role. Instead, we must now lay more emphasis on the development of the sentiment on developed bond markets. The key factor for these markets will clearly be the data from the U.S. labour market, which will be released on Friday. The view through the technical analysis is also important: if the forint hit above HUF 255.50 per EUR (the neck line of the double bottom) or even above HUF 256.35 per EUR (a two-year low), it would be a significant price signal and the Hungarian currency would be set to depreciate towards the barrier at HUF 260 per EUR. We cannot rule this out. Nevertheless, the market would have to receive another strong bearish signal, which should not occur, in our opinion (although the above-mentioned US labour market data may involve a risk in this regard).

Last week was not favourable for bonds, in spite of the fact that the result of the 3Y bond auction was excellent. Nonetheless, the rapid deterioration on developed bond markets after the ECB's press conference on Thursday easily discouraged bulls from starting activities on the domestic bond market after the successful auction.

Furthermore, yields soared along the full length of the yield curve at the end of the week.

Domestic bonds are again at the mercy of the mood on developed bond markets, and this means that any (particularly good) domestic news will be ignored. Unless the mood in the EMU and the United States improves, we

cannot believe that a positive reversal on the Hungarian market will occur. Our opinion is that there are risks of a further rise in yields, although we must add that the middle of the yield curve is already close to 7.0%, and this level will be difficult to break through.



Comparative table for Hungarian government bonds

Title	Price 03.03.06	Yield 03.03.06	Price change (bps.) to 24.02.06	Yield change (bps.) to 24.02.06	Modif. Duration 03.03.06
GOV/ 6.25 / 24.04.09	98.07	6.96	-32	12	2.6
GOV/ 6.75 / 12.10.10	95.75	6.95	-381	9	3.7
GOV/ 5.5 / 12.02.16	89.79	6.96	-68	10	7.3
GOV/ 7.5 / 12.11.20	106.69	6.76	0	0	8.8

EXPECTED DATA

■ Tuesday, January 7, 17:00

Public budget balance (February, YTD) HUF -440bn

We expect that the deficit will be close to FinMin's forecast. Anyway, this will be Hungary's highest ever government deficit for February.

■ Wednesday, January 8, 9:00

Industrial production (January) 12.6 % y/y

There should be, beyond doubt, a two-digit year-on-year rise because the values of the Hungarian PMI index in January were high, and a larger number of working days than in January 2005 also had a positive effect.

■ Friday, January 10, 9:00

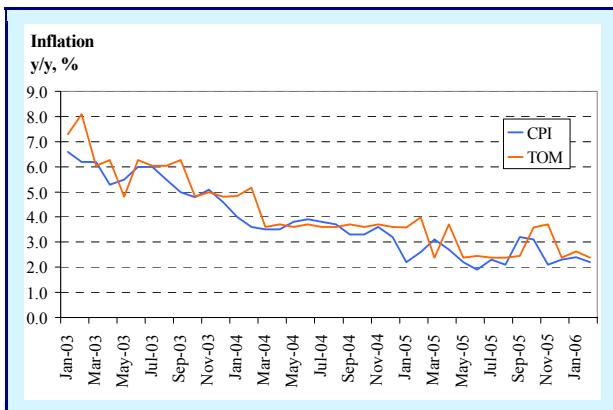
Foreign trade (January) EUR 121 m

We expect that the deficit should go down by EUR 20 m y/y, with the rises in both exports and imports again high. The PMI index, i.e. its high value in the export category, indicates that exports should be favourable. The year-on-year rise in imports should be high too because of high oil and gas prices and the low comparison base.

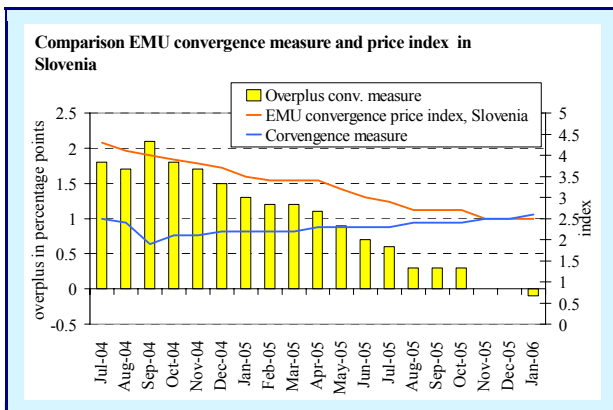


SLOVENIA

Consumer prices rose by 0.4% in February, which means 2.2% inflation at the annual level. Nevertheless, it is far more important that Slovenia meets the inflation criterion in the scope of Maastricht criteria, which are crucial for the introduction of the euro. The growth in prices measured with the harmonised consumer price index was also higher by 0.4%; nevertheless, the 12-month average price increase dropped from 2.5% in January to 2.4% in February.

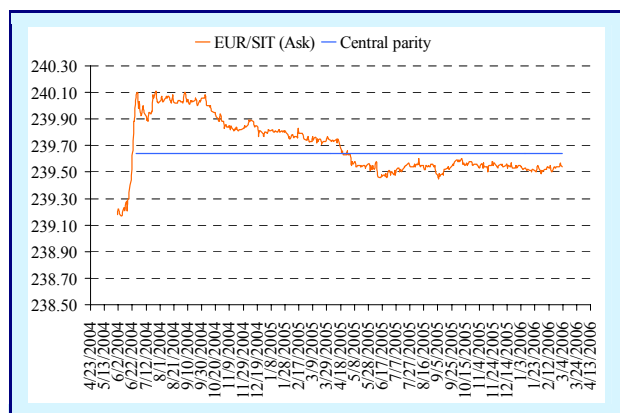


Slovenia has been meeting the convergence criterion of price stability since last November and the trend is expected to continue. The February price growth is mainly the result of higher prices of seasonal products and oil products. The results of harmonised actions of the Government and the Bank of Slovenia whose single important goal at the moment is successful introduction of the euro in the beginning of next year can also be seen in inflation. Both the Government and the Bank of Slovenia claim that all decisions will be adopted in such framework that will not jeopardise the meeting of the convergence criteria. We do not, however, expect that the Bank of Slovenia's latest reduction in interest rates by 25 and 50 basic points could have a significant impact on inflation. Already in the past, companies and individuals mostly decided to raise loans in euros where the interest rate was slightly increased.



In March, monthly **TOM** again stood at 0.2% while it reached 2.38% at the annual level. TOM is expected to fall to the monthly level of 0.1% for the first time in April, which would mean 1.22% at the annual level. This will happen if the March inflation is between -0.5% and 0.6% at the monthly level, which is very likely.

There were no special developments on the **foreign-currency market**, as usually. Last week, the EUR/SIT market exchange rate was close to the central parity, at the average level of SIT 239.55 per EUR 1. The recent reduction in the central bank's interest rates had no significant impact on the value of domestic currency compared to euro. The period of double pricing started in Slovenia, which is of great importance for consumers who will be able to get used to the single European currency before the euro is actually introduced. There is another important issue connected with double pricing, namely, avoidance of price increases, because the merchants must translate tolar prices exactly at the central parity exchange rate, i.e. SIT 239.64 per EUR 1, without raising prices. The establishment of the Eurofon by the Bank of Slovenia is also one of the activities in the scope of the preparations to the introduction of the euro. This is a common communication point at the national level, to which consumers can communicate price increases resulting from the introduction of the euro. Until the determination of the final exchange rate, the prices in euros will only be informative. The target date for the introduction of the euro is still 1 January next year; nevertheless, the president of the ECB, Mr. Trichet, said it was possible that the convergence report on the candidates for the introduction of the euro would only be issued in autumn. This means that Slovenia might have less time to prepare for the introduction of the euro than expected. This could delay the introduction of the euro in Slovenia.



On the **money market**, reference interest rates were reduced as the Governing Board of the Bank of Slovenia decreased the interest rates of its key instruments on March 3, when the ECB increased its key interest rates. The Bank

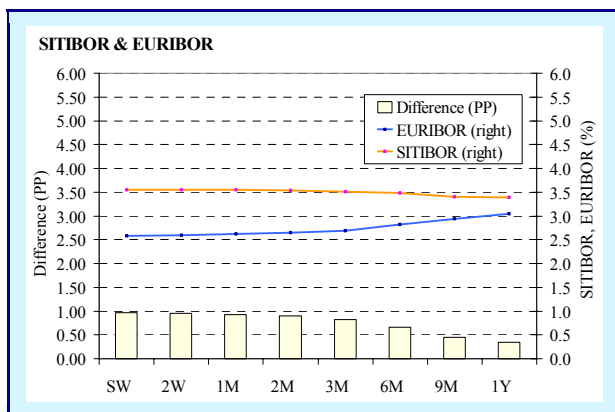


of Slovenia reduced the interest rates of the following key instruments by 25 basic points, so that they now stand at:

- 60-day central bank tolar bills 3.50%;
- lombard loan 4.50%;
- main refinancing rate 3.25%,

and the interest rates of the following key instruments by 50 basic points, so that they now stand at:

- spot/ 1 week buy/sell FX swap 0.75%,
- spot/ 1 week sell/buy FX swap 0.25%.



The reduction in the interest rates reflects the nominal convergence before the entry in the Euro Area. The Governing Board of the Bank of Slovenia estimates that such monetary policy is suitable. The level of interest rates is in line with the goal of achieving the stability of the EUR/SIT nominal exchange rate and the current inflation dynamics and inflation expectations are in line with the mid-term price stability goals. Further convergence of

nominal interest rates was also boosted by the increase in the key interest rate of the ECB. The difference between the two key interest rates of the ECB and the Bank of Slovenia is now merely 0.75 percentage points. The spread between the EURIBOR and the SITIBOR dropped to 35 basic points for maturities of 1 year and 97 basic points for the shortest maturity. Following the reduction of the central bank's interest rates, the SITIBORs dropped by 17 to 25 basic points.

There were two auctions on the primary **market of Government securities** at the end of the year, namely, that of three-month and six-month treasury bills. Potential investors showed the greatest interest in three-month treasury bills since last December, exceeding the offered quota by 3.9 times. Increased demand, together with the recent general reduction of interest rates caused a decrease in the yields of this short-term instrument from 3.43% in January to 3.28%. The interest in six-month treasury bills was somewhat lower, since the demand exceeded the offered quota by 2.7-times. Interest rate dropped from 3.5% in December to 3.32%. Reduced yields on the primary market influenced the reduction in those yields on the secondary market, where the 14-day interval shows a difference in yields of 18 basic points. The interest rate time curve is still falling which leads us to the conclusion that tolar interest rates are going to decrease further. Trading through official market makers was significantly higher last week as the turnover of treasury bills and bonds totalled almost SIT 20 billion. The most popular bond was the 11-year RS62, whose yield ranged between 3.86% and 3.91% while total turnover amounted to almost SIT 3.7 billion.

Slovenian government bonds - currency clause

Bond		Price	Yield	Price change bps	Yield change bps	MDuration (cls)	
		3/3/2006	3/3/2006	3/3/2006	3/3/2006	3/3/2006	
SIRS26=LJ	1-Jun-11	5.375%	106.40	3.99%	-60	12	4.38
SIRS29=LJ	15-Jan-12	5.375%	107.60	3.90%	60	-12	4.99
SIRS48=LJ	2-Dec-12	4.750%	105.50	3.81%	0	0	5.68
SIRS50=LJ	24-Feb-13	4.500%	104.00	3.84%	0	0	5.92
SIRS38=LJ	19-Apr-17	5.625%	115.20	3.91%	-40	4	8.09
SIRS53=LJ	8-Apr-18	4.875%	110.00	3.83%	99	-10	8.86
SIRS49=LJ	10-Jan-22	4.750%	107.00	4.14%	0	0	11.12

Slovenian government bonds

SIRS55=LJ	11-Feb-07	5.000%	100.05	4.93%	-95	101	0.89
SIRS52=LJ	8-Apr-08	6.250%	107.15	2.69%	0	0	1.88
SIRS58=LJ	17-Apr-08	3.250%	99.00	3.75%	-5	3	1.95
SIRS56=LJ	11-Feb-09	4.875%	104.48	3.25%	0	0	2.72
SIRS60=LJ	31-Mar-10	3.500%	99.45	3.65%	0	0	3.62
SIRS61=LJ	23-Jan-11	3.250%	98.80	3.52%	-20	5	4.43
SIRS54=LJ	15-Oct-13	5.750%	113.00	3.75%	100	-15	6.12
SIRS57=LJ	15-Oct-14	4.875%	108.00	3.77%	0	0	6.92
SIRS59=LJ	17-Feb-16	4.000%	102.00	3.76%	0	0	8.10
SIRS62=LJ	23-Mar-17	3.500%	96.90	3.85%	-110	13	8.68



March 7, 2006

CENTRAL EUROPEAN WEEKLY

FOREX TECHNICALS

■ EUR/CZK: (28.5200)

DAILY CHARTS: Channel bottom off 2005 high held (see graph): 1st support area at 28.4010 (weekly ST MA↑), with next levels at 28.3730 (weekly envelope), ahead of 28.2500/ .2200 (last week low/ new low): favored to hold, amid ST overextended conditions.

If wrong, next level at 28.1280 (weekly Bollinger bottom), ahead of 27.9420 (weekly projection band bottom), where rebound expected.

1st Resistance area at 28.6060 (last week high), with next levels at 28.6300 (Feb 14 high + neckline ST Double Bottom?: see chart) and 28.6560 (weekly MT MA↓): ideal area to stay below to keep current mood intact on CZK.



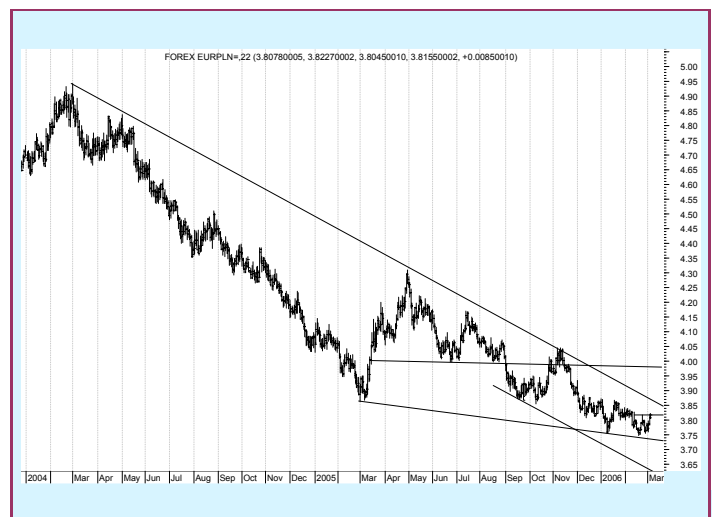
■ EUR/PLN (3.8180)

In LT channel off high and Falling Wedge pattern developing (see graph): 1st Support area at 3.7835 (broken weekly ST MA↓), with next levels at 3.7715 (weekly envelope) ahead of 3.7529/ .7490 (current year lows?) and 3.7425/ 3.7349 (weekly Falling Wedge bottom/ June 2002 low weekly charts): favored to hold.

If wrong, next levels at 3.7222 (weekly projection band bottom) and 3.6980/ 3.6903 (weekly Bollinger bottom/Irregular B limit off 4.3088), where reaction is expected to set in.

1st Resistance comes in at 3.8170 (neckline ST Double Bottom: under test), with next levels at 3.8255 (Feb 13 high), ahead of 3.8354 (weekly envelope).

3.8427 = Jan 31 high: ideal are to stay under to keep current mood intact on PLN.

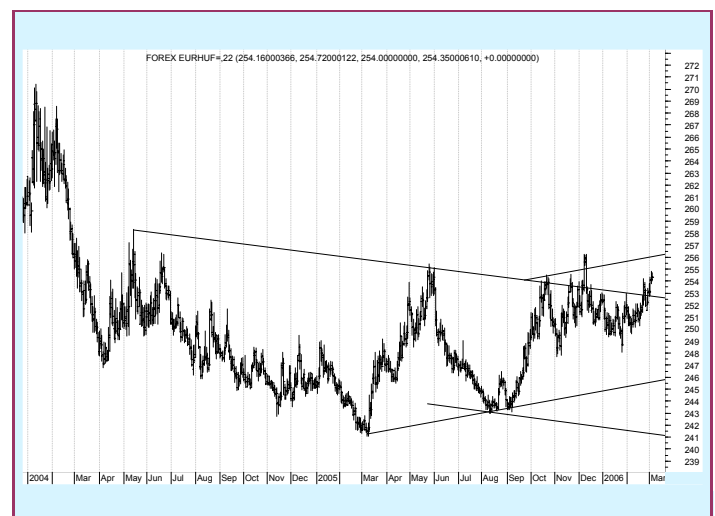


■ EUR/HUF (254.50)

Pair currently back above key area (see graph: inverted channel top off May 2004 high): 1st Resistance area at 254.82 (last week high + weekly Bollinger top), ahead of 255.50/ .78 (weekly projection band top/ weekly envelope): tough.

Failure to hold would have next levels at 256.24 (Dec 08 high), ahead of 257.25 (C wave Equality off 242.95): tough on 1st tests.

Support at 253.19 (weekly envelope), with next levels at 252.54 (weekly ST MA↑), ahead of 251.64/ .40 (weekly Bollinger midline/ ST lows hourly): favored to hold.





March 7, 2006

CENTRAL EUROPEAN WEEKLY

■ **EUR/SKK (37.1600)**

New historic low retested LT channel bottom off July 2003 high, with first 2 targets of Triple Tops from 38.1000 met (36.9970: see graph): 1st Resistance at 37.2000/ 2200 (previous low/ ST breakdown daily), with next levels at 37.2750 (weekly envelope) and 37.4440 (weekly MT MA↓): would like this area to hold to keep current mood intact on SKK.

Support area at 37.0100 (break-up hourly), with next levels at 36.9250/ .9130 (new low/ weekly envelope): tough
 If wrong, next levels at 36.8400 (weekly projection band bottom), ahead of 36.6100/ .5700 (weekly Bollinger bottom/ LT Irregular B limit off 39.9700), where pause expected.





TABLES

Official interest rates

		Current	Mar-06	Jun-06	Sep-06	Dec-06	Last change	
Czech Rep.	2W repo rate	2.00	2.00	2.00	2.25	2.50	25 bps	27/10/2005
Hungary	2W deposit rate	6.00	6.00	6.00	6.00	6.00	-25 bps	19/09/2005
Poland	2W intervention rate	4.00	4.00	3.75	3.50	3.50	-25 bps	28/02/2006
Slovakia	2W repo rate	3.50	3.50	3.50	3.50	3.50	50 bps	28/02/2006

Short-term interest rates 3M *IBOR

		Current	Mar-06	Jun-06	Sep-06	Dec-06
Czech Rep.	PRIBOR	2.06	2.06	2.07	2.45	2.60
Hungary	BUBOR	6.18	6.50	6.30	5.95	5.95
Poland	WIBOR	4.09	4.10	3.85	3.60	3.60
Slovakia	BRIBOR	3.67	3.65	3.70	3.70	3.70

Long-term interest rates 10Y IRS

		Current	Mar-06	Jun-06	Sep-06	Dec-06
Czech Rep.		3.53	3.50	3.50	3.80	3.80
Hungary		6.87	7.15	6.85	6.55	6.55
Poland		4.61	4.60	4.80	5.00	5.00
Slovakia		4.02	3.90	4.00	4.10	4.20

Exchange rates

		Current	Mar-06	Jun-06	Sep-06	Dec-06
Czech Rep.	EUR/CZK	28.575	28.45	28.70	28.40	28.00
Hungary	EUR/HUF	254.87	260	255	251	251
Poland	EUR/PLN	3.829	3.78	3.85	3.90	3.75
Slovakia	EUR/SKK	37.221	37.00	37.80	37.00	36.60
	EUR/USD	1.2026	1.20	1.23	1.24	1.19

GDP

	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006
Czech Rep.	4.9	5	4.8	4.9	5
Hungary	4.5	4.3	4.6	3.8	4
Poland	3.7	4.2	4.6	4.5	4.2
Slovakia	6.2	7.5	6	6	5.5

Inflation (CPI y/y)

	Jan-06	Mar-06	Jun-06	Sep-06	Dec-06
Czech Rep.	2.9	3	2.5	2.6	2.6
Hungary	2.7	1.8	1.3	1.5	2
Poland	0.7	0.7	1.1	1	1.4
Slovakia	4.1	4.2	4.3	4.1	3.1

C/A in Pct of GDP

	2005	2006
Czech Rep.	-2.7	-2.2
Hungary	-8	-8.1
Poland	-1.6	-2.5
Slovakia	-7.8	-4.2

Public finance balance in Pct of GDP

	2005	2006
Czech Rep.	-2.8	-3.4
Hungary	-6.1	-6.6
Poland	-2.9	-2.6
Slovakia	-3.1	-3.1



CALENDAR

			Period	Reality	Consensus	Previous
Monday - February 27						
09:00	SK	HICP y/y. %	January 06	4.1	4.0	3.6
11:00	SK	T-bond auction 4.9%/ 2014				
14:00	HU	Inflation report				
14:00	HU	Monetary council NBH (base rate)		0 bps	0 bps	0 bps
Tuesday - February 28						
09:00	HU	PPI y/y	January 06	4.4		4.7
09:00	HU	PPI m/m	January 06	0.4		0.0
09:00	SK	PPI m/m. %	January 06	1.4	0.4	-0.6
09:00	SK	PPI y/y. %	January 06	8.7	7.5	7.0
10:00	CZ	Money supply M2 y/y	January 06	8.9		8.0
11:00	SK	NBS Bank Board meeting		50 bps	25 bps	0 bps
-	PL	MPC Meeting	February 06	-25 bps.	0 bps.	-25 bps.
Wednesday - March 1						
09:00	HU	GDP. p (y/y)	Q4 2005	4.2	4.2	4.5
09:00	SK	State budget (SKK bn)	February 06	-5.7		12.1
12:00	PL	2Y T-bonds auction (bln PLN)		1.8	-	2.3
c. 15:00	CZ	State budget balance CZK bn	February 06	-4.0		3.43
16:00	PL	GDP y/y	Q4	4.2	-	3.7
16:00	PL	Consumption y/y	Q4	3.1	-	2.7
16:00	PL	Investments y/y	Q4	9.8	-	5.7
Thursday - March 2						
11:00	HU	T-bond Auction (3-year)				
Friday - March 3						
09:00	HU	Foreign trade (EUR mn). details	December 05	-180.0		190.2
10:00	CZ	CNB Minutes	23.02.06			

			Period	CSOB	Consensus	Previous
Tuesday - March 7						
09:00	CZ	Trade balance (CZK bn)	January 06	10.0		-3.9
10:00	CZ	CNB reserves (EUR bn)	February 06			
17:00	HU	Public Budget Deficit. (HUF bn. YTD). p	February 06	440	440	140
17:00	HU	Public Budget Deficit. (HUF bn. YTD). p	February 06			
Wednesday - March 8						
09:00	CZ	CPI m/m	February 05	0.2	0.2	1.4
09:00	CZ	CPI y/y	February 05	2.9	2.9	2.9
09:00	CZ	Unemployment rate	February 05	9.0	9.0	9.2
09:00	HU	Industrial production y/y. p	January 06	12.6	7.6	12.8
09:00	SK	Industrial output y/y	January 06	7.5		9.4
09:00	SK	Construction output y/y	January 06	2.0		0.5
09:00	SK	Retail Sales y/y	January 06	4.0		4.5
10:00	CZ	Balance of Payments. C/A (CZK bn)	Q4 2005	-33.0		-32.5
12:00	CZ	T-Bond Auction (2.3/2008. CZK bn)		6.0		
12:00	PL	20Y T-bonds auction (bln PLN)		-	-	1.2
Thursday - March 9						
09:00	CZ	GDP y/y	Q4 2005	5.0	5.0	4.9
09:00	CZ	Wages y/y	Q4 2005	5.8		6.2
09:00	CZ	Construction Activity y/y	January 06	6.0		8.6
09:00	SK	GDP	Q4 2005	7.5		6.2
12:00	CZ	T-Bill Auction (3-Month. CZK bn)		6.0		
Friday - March 10						
09:00	HU	Foreign trade (EUR m). p	January 06	-121	-150	-189
09:00	HU	GDP. details (y/y)	Q4 2005	4.3	4.2	4.5
14:00	HU	NBH Minutes				

			Period	CSOB	Consensus	Previous
Monday - March 13						
09:00	CZ	Industry Output y/y	January 06	8.0	8.0	7.2
09:00	SK	CPI m/m	February 06	0.3		2.1
09:00	SK	CPI y/y	February 06	4.1		4.1
09:00	SK	Core inflation m/m	February 06	0.3		1.1
09:00	SK	Core inflation y/y	February 06	1.9		1.9
Tuesday - March 14						
09:00	CZ	PPI m/m	February 05	0.2	0.2	1.0
09:00	CZ	PPI y/y	February 05	0.3	0.3	0.3
09:00	HU	CPI y/y	February 06	2.3	2.3	2.7
09:00	HU	CPI m/m	February 06	0.0		0.1
09:00	SK	Foreign trade (SKK bn)	January 06	-2.5		-25.2
16:00	PL	Current Account EUR m	January 06	-	-	-410
16:00	PL	Trade balance EUR m	January 06	-	-	-339
16:00	PL	M3 y/y	February 06	-	-	10.2
Wednesday - March 15						
10:00	CZ	Balance of Payments. C/A (CZK bn)	January 06			-11.9
10:00	SK	Unemployment rate y/y	February 06	11.9		11.8
12:00	PL	5Y T-bonds auction (bln PLN)		-	-	2.88
16:00	PL	Budget Deficit PLN bn	February 06	-	-	-0.708
16:00	PL	CPI y/y	February 06	-	-	0.7
16:00	PL	CPI m/m	February 06	-	-	0.2
16:00	PL	Wages y/y	February 06	-	-	3.6
Thursday - March 16						
09:00	HU	Industrial production y/y. details	January 06			
09:00	SK	HICP y/y. %	February 06	4.3		4.1
11:00	HU	T-bond Auction (5-year)				
11:00	HU	T-bond Auction (10-year)				
12:00	CZ	T-Bill Auction (9-Month. CZK bn)		6.0		
	HU	Public Budget (details)	February 06			
Friday - March 17						
09:00	CZ	Retail sales y/y	January 06	2.0	3.0	2.1
09:00	HU	Wages (gross nominal. y/y)	January 06	4.9		5.4
16:00	PL	Industrial Production y/y	February 06	-	-	9.5
16:00	PL	PPI y/y	February 06	-	-	0.5
16:00	PL	PPI m/m	February 06	-	-	0.1

(Figures are in % and not seasonally adjusted: m/m-month on month rise; y/y-year on year rise; r-revised; p-preliminary)

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