CENTRAL EUROPEAN WEEKLY

JUNE 27, 2006

- **Czech Republic**
  Koruna under modest pressure, yields sharply up
- **Slovakia**
  EUR/SKK above the central parity; NBS intervenes
- **Poland**
  Minister of Finance Gilowska dismissed
- **Hungary**
  Forint almost hit central parity
- **Slovenia**
  Banks are successfully preparing for euro adoption

HIGHLIGHTS

The fundamental question that numerous investors in Central Europe are asking today is: Where will the forint bottom out? Although the Hungarian government is trying to calm down markets by providing increasingly detailed information on the oncoming austerity measures, the forint is depreciating and, at the end of last week, tested the 'central parity' of the official fluctuation band of the National Bank of Hungary. However, the problems of the Hungarian currency are not stemming from investors' distrust of the efficiency of the macroeconomic austerity package, which should bear fruit in the long term. In addition to the persisting rise in yields in the Untied States and particularly the Eurozone, the forint has had surprisingly little support from the central bank and the government to date. Most of NBH Monetary Council Members have been playing down the impact of the weak forint on inflation so far, and Prime Minister Gyurscány himself talked about the forint depreciating to EUR/HUF 282. Unless the Hungarian currency finds support in the statements and behaviour of both the central bank and the government, it will be hard for it to get a foothold now that high-interest currencies on emerging markets are very vulnerable.

However, we cannot blame only the forint and the rise in yields in core markets for the fall of Central-European currencies and bond prices. Another reason is the unfortunate development of the political scene across the whole region, which is not helping to stabilise it either. The persisting post-election deadlock in the Czech Republic, the chance that nationalists will be represented in Slovakia's new government and the resignation of the Polish Finance Minister, who was liked by markets, contributed to the overall negative mood in the region.

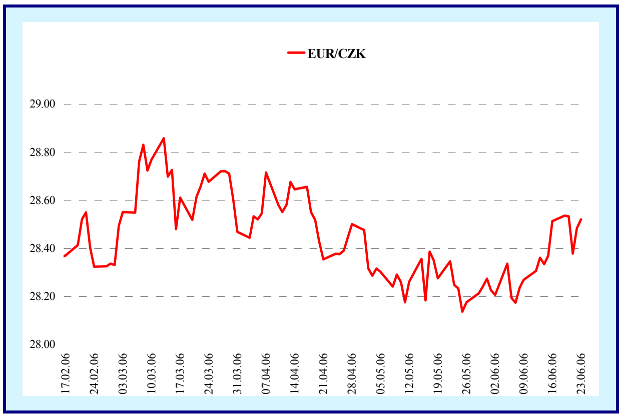
Nonetheless, the meetings of central banks should hold the spotlight this week. As we do not believe that the National Bank of Slovakia, the National Bank of Poland or the Czech National Bank will change their base rates, the short end of the curve can be considered attractive at the moment. The reason is that, in the wake of the depreciation, yields at the short end of the curve have increased and are not consistent with our outlook for official interest rates.

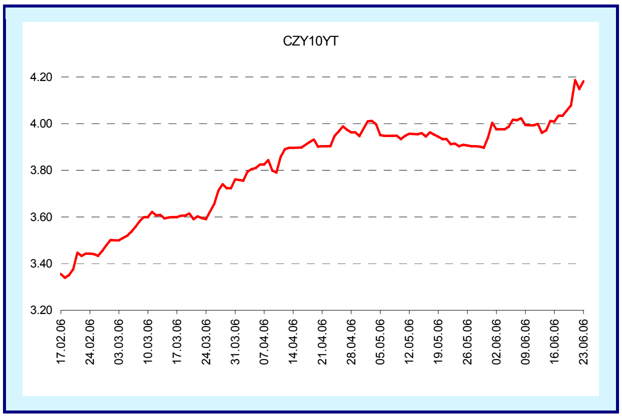
CZECH REPUBLIC

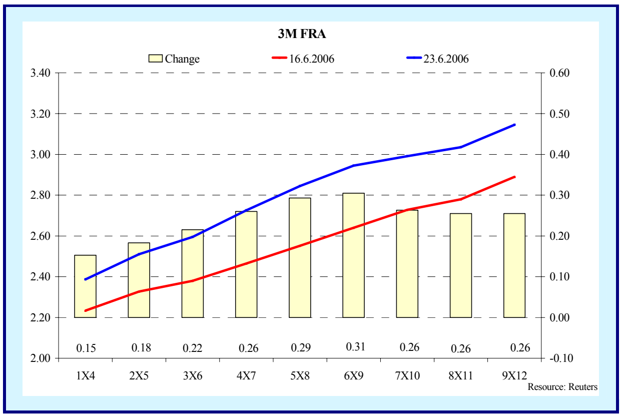
Last week the parties negotiating on the **future government coalition** held talks on their coalition agreement that would define room for a government declaration, which the new government would present to the Lower Chamber of Parliament. The parties have even come to an agreement on taxes and indicate that there is the chance of introducing a flat-rate tax. As for VAT, some exemptions on specified items should be imposed. Nevertheless, the parties still lack enough support for Parliament to back their government in a vote of confidence.

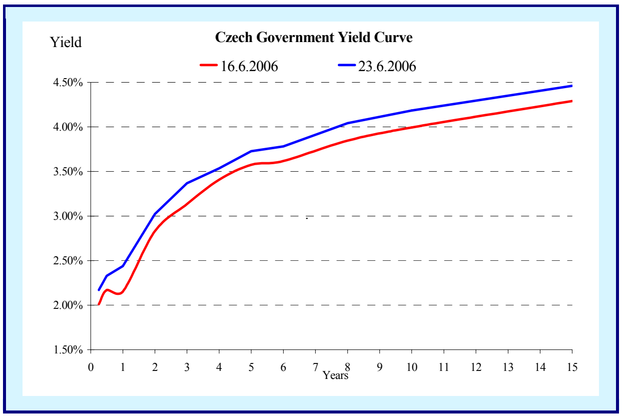
The **Czech koruna** came under pressure because of the unexpected falls of the Hungarian forint. Unsure statements from Hungarian Prime Minister Gyurcsany and the hesitating approach of the central bank have weakened the forint by almost 7% since the beginning of the month. Compared to this, the koruna's depreciation of 0.5% appears to be very moderate.
The koruna faces two risks this week, the Hungarian forint continues to weaken significantly and the U.S. Fed meeting boosts the expectations of a hike in U.S. rates. If this 'killing combination' occurs, not even the Czech koruna will resist the pressure and may depreciate significantly for a 'very short time' (i.e. beyond the support level of CZK 28.589 per EUR or CZK 28.73 per EUR, but certainly not to more than CZK 28.92 per EUR).
However, we do not altogether believe that this catastrophic scenario will happen because the depreciation of the Hungarian forint against the other Central-European currencies is partly based on fundamental indicators, and the other regional currencies need not necessarily follow suit. What is more, meetings of three of the four Central-European central banks (the National Bank of Slovakia, the Czech National Bank and the National Bank of Poland) take place in the first week and, although we do not expect them to change rates, the CNB in particular has enough room to raise its rates earlier than expected (because the koruna is weakening and this has been an important anti-inflationary factor so far,). On the other hand, we believe that markets in the Untied States are now excessively hawkish in anticipation of another rate hike and may be greatly disappointed after the FOMC meeting, and this is good for emerging markets and the whole of the Central-European region.

Czech bond prices fell last week when, given the lack of domestic events, they followed on the heels of the Eurozone. Yields rose evenly on average, by an incredible 19 bps, because of concern about the rise in rates on global markets and the fact that some investors had left Central Europe.
Wednesday was an unlucky day for fixed income securities, when the issue of 9Y bond 3.80%/2015 for CZK 7 bn was not subscribed. Bonds for only CZK 3.85 bn were sold at an average yield of 4.16%.
The meetings of the central banks will be the keynote of this week. The NBS Board meeting will be held first, on Tuesday, followed by Wednesday's meeting of the National Bank of Poland, and the CNB Board meeting on Thursday, held concurrently with the FOMC meeting in the United States. While a rate hike in the United States is being anticipated, Central-European central bank's are not considering rate changes at the moment, although the first rate hike considerations occurred in the Czech Republic after the depreciation on regional forex markets. Otherwise, this week is again poor in domestic statistical data releases. Hence we may be in for increased nervousness and increased volatility before the CNB and FOMC meetings. Domestic bonds are likely to follow on the heels of the Eurozone again and, in spite of their high yields, we can expect that the prices of these bonds will continue to go down.









Comparative table for government bonds

Title	Price 23/06/06	Yield 23/06/06	Price change (bps.) to 16/06/06	Yield change (bps.) to 16/06/06	Modif. Duration 23/06/06
GOV/ 2.9 / 17/03/08	99.69	3.08	-31	19	1.7
GOV/ 2.3 / 26/09/08	97.99	3.24	-44	21	2.1
GOV/ 3.8 / 22/03/09	101.11	3.36	-50	19	2.6
GOV/ 2.55 / 18/10/10	95.21	3.77	-59	16	3.9
GOV/ 6.55 / 05/10/11	112.91	3.80	-79	15	4.3
GOV/ 3.7 / 16/06/13	97.93	4.05	-106	18	6.0
GOV/ 3.8 / 11/04/15	97.02	4.21	-129	18	7.3
GOV/ 6.95 / 26/01/16	121.48	4.18	-154	17	7.1
GOV/ 4.6 / 18/08/18	102.37	4.34	-158	17	8.9
GOV/ 3.75 / 12/09/20	92.63	4.46	-159	16	10.4

EXPECTED DATA

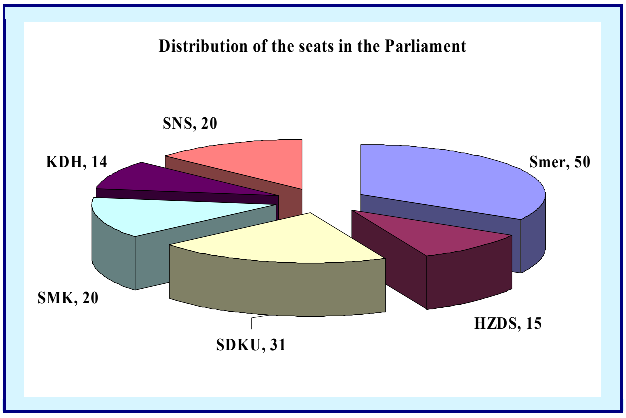
- **Thursday, June 29**

CNB Board meeting **no change**

We believe that the Czech National Bank will leave its interest rates unchanged this time. However, CNB Board Members may tell the subsequent press conference that rates might be raised soon due to the present increased inflation rate. Higher inflation and the slightly weaker koruna are easing the current monetary conditions, and thus providing room for rate hike considerations, and this is influencing market expectations.

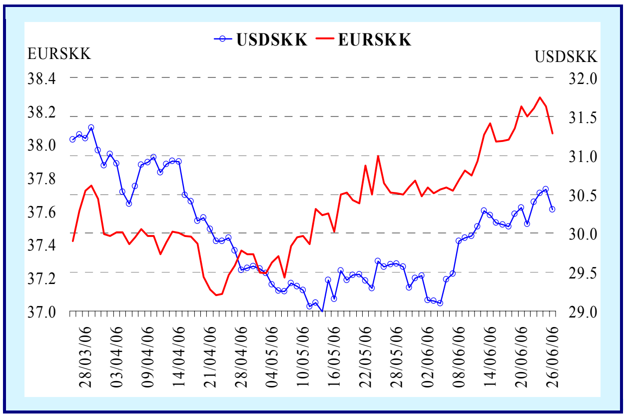
SLOVAKIA

The talks on the composition of a new government have begun. The leader of the winning SMER (Social Democrats), Robert Fico, was appointed by the President to form a new government. He has already met all the Parliamentary parties. The Slovak National Party (SNS) and the Movement for Democratic Slovakia (HZDS) stated after the meeting that there were no programme differences and obstacles between these two parties and the SMER that would prevent them forming a joint government. Thus this government could be theoretically formed without problems. The question is, however, how would it be viewed abroad. The opinions among Christian Democrats (KDH) are divided, with some members in favour of leaving for the opposition while others would like to see the KDH in the government. Anyway, the Christian Democrats refuse to cooperate with the HZDS and the SNS. Thus the coalition of SMER + KDH + SNS is ruled out. The Party of the Hungarian Coalition (SMK) is not ruling out its membership of the new government provided that it is not the only right-wing party. Thus everyone is waiting for the KDH's decision, as this will probably determine the composition of the future Cabinet. Available information indicates that the coalitions of SMER + KDH + SMK or SMER + SNS + HZDS are the most probable. The former alternative would be neutral to slightly positive for markets while the latter would be viewed negatively. On Sunday, Mr. Fico said that Smer will lead further negotiations with only two parties and he would present their names on Monday.



The negative regional mood and the uncertainty surrounding the composition of the future government made the **koruna** depreciate to more than the central parity of SKK 38.455 per EUR, i.e. to a 7-month low. The central bank intervened on the market when the koruna hit SKK 38.55 per EUR, commenting that the depreciation was not based on fundamental indicators. The Slovak currency returned to stronger levels of around SKK 38.20 per EUR after the intervention.

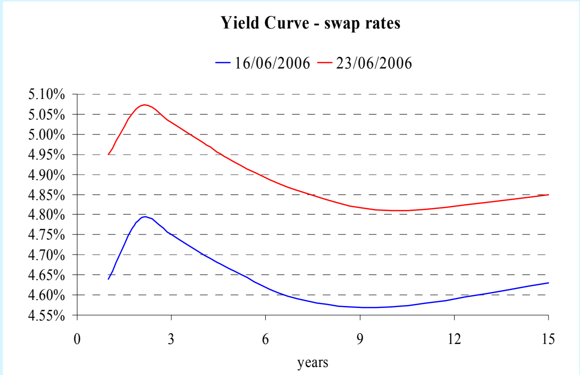
The persisting uncertainty about the future government will continue to affect the koruna. The market is afraid that fundamental changes to Slovakia's reforms will be made and that the adoption of the euro, scheduled for 2009, will be postponed. SMER's position on this issue is unclear. First, the party leader Fico confirmed that he would stick to the deadline but later said that he would analyse whether it would be good for Slovakia to keep this deadline or not. If it is not good for Slovaks, he will consider revising the deadline. The risk of the currency depreciating further will persist, although the NBS has shown where its tolerance limit lies



The bank would probably again defend the **koruna** near SKK 38.55-38.60 per EUR. The NBS has enough FX reserves, USD 17 bn according to the latest data. Nevertheless, if the coming government postpones the date of accession to the Eurozone, it will not make sense for the NBS to defend the Slovak currency at these levels.

An important event of this week will be the NBS Board meeting. The bank is not expected to change rates. If it does not, it will have a neutral effect on the market. However, the subsequent press conference will draw attention. Another factor that will influence the koruna will be the regional sentiment. Thursday's Fed meeting will also play a role. Until a new government is formed, we expect the koruna to stay near SKK 38.30 per EUR and trading to be cautious. However, the Slovak currency will continue to be sensitive to any negative news from the political scene, which may again nudge it to the vicinity of the central parity.

Bond prices fell hand in hand with the depreciation of the koruna. The yield curve went up along the full length, the most at the short end, where yields rose by 30 bps. The weak koruna is fuelling expectations of more rate hikes. 5Y yields rose to the same extent. The long end of the curve was up by 23 bps. Not only the depreciation of the koruna but also the rise in European yields was responsible for this. The key event for markets will be the central bank meeting. The bank is not expected to change rates. However, its subsequent press conference will be important. The weak koruna is easing the monetary conditions, and therefore the central bank's comment may include indications of tightening the monetary policy. FRA 3x6 quotations reflect future rate hikes of 75 bps. Risks are currently inclined to this scenario in particular. The inflation rise will speed up slightly, and we cannot rule out another rise in regulated prices either. Unless the koruna appreciates, another rate hike is highly probable.



Indicative yields of government bonds

	Coupon	Maturity	Issue volume	Bid	Ask
SD200	0.0	14.1.2007	SKK 40.0 bn	4.73	4.25
SD191	5.0	5.3.2008	SKK 15.0 bn	5.00	4.50
SD203	4.8	14.4.2009	SKK 40.0 bn	4.97	4.60
SD189	4.9	5.2.2010	SKK 15.0 bn	4.89	4.58
SD174	7.5	13.3.2012	SKK 8.31 bn	4.85	4.66
SD205	0.0	5.4.2012	SKK 11.2 bn	4.85	4.62
SD188	5.0	22.1.2013	SKK 15.0 bn	4.85	4.67
SD199	4.8	2.7.2013	SKK 6.8 bn	n.a.	n.a.
SD202	4.9	11.2.2014	SKK 24.7 bn	4.90	4.74
SD204	5.3	18.5.2019	SKK 25.8 bn	4.95	4.74

Source: Bratislava Stock Exchange, CSOB

Interest rate fixing on the money market

% p.a.	O/N	1W	2W	1M	2M	3M	6M	9M	12M
19/06/2006	4.52/4.82	3.70/4.00	3.71/4.00	3.78/4.05	3.81/4.07	3.88/4.14	4.09/4.36	4.28/4.55	4.36/4.64
26/06/2006	4.74/5.04	3.80/4.08	3.80/4.08	3.93/4.20	3.94/4.22	3.99/4.27	4.33/4.59	4.42/4.68	4.51/4.77

EXPECTED DATA

■ **Tuesday, June 27, approx. 11:00**
NBS Board meeting **no change**

The central bank will most probably leave rates unchanged at this meeting after it raised them by 50 bps in May. The key factor that will influence the monetary policy settings the most in the forthcoming period will be the development of the koruna.

■ **Wednesday, June 28, 9:00**
PPI (May) **0.2% m/m, 9.3% y/y**

May's producer price index should not rise very much because global oil markets have calmed down. We also expect a slower rise in energy prices.

POLAND

Large increase in salaries in May...

The average salary in the corporate sector increased in May by 5.2% y/y, after a rise of 4.0% y/y a month earlier. This is a slightly better result than the market expected (4.7% y/y) and is significantly higher than the average for the first four months of this year (slightly below 4.0% y/y). Employment in the sector grew by 3.1% y/y which combined with the sound increase in salaries translated into a sharp increase in the overall payroll (by ...%). Nonetheless given the larger number of working days last month than a year ago, and hence higher productivity in May after an exceptionally poor April, the sharp increase in salaries was no major surprise and therefore the data should not have any impact on the MPC's current policy. Especially since the increase in consumer demand, which is accompanying the improvement of the situation on the labour market and is having an increasingly large input into economic growth, has, so far, generated almost no pressure on prices. Net core inflation (excluding food and fuel prices), which is the key indicator used by both the market and by monetary policy officials to measure demand pressure, remained at a level of 1.0% y/y in May, meaning that the rise in CPI was almost entirely generated from rising food and fuel prices, i.e. supply factors. There is no doubt that the Monetary Policy Council will be carefully watching the situation on the labour market and its impact on the rate of increase in consumer demand and inflation. Even so, the beneficial situation, in which the exceptionally good results of the economy are accompanied by relatively low inflation, is highly likely to remain for the coming few quarters. Therefore, we uphold our view that speculations on a possible interest rate hike at the end of the year are, as of now, unjustified.

Industrial production increased in May most strongly since Poland's accession to the EU...

After the one-off poor results in April, the rate of increase in industrial production rose last month to 19.1% y/y and, although the strong data on salaries indicated that the rate of increase in output exceeded market expectations, the strength of the rebound surprised even the greatest optimists. Such a good result (the best since the boom just before Poland's accession to the EU and one of the best since the start of the economic transformation) was almost entirely due to excellent results in manufacturing, in particular the astounding increase in activity in the sections traditionally strongly related to exports – just to mention the production of home electronics which increased in May by more than 70% y/y and the production of passenger cars which grew by more than 40% compared with the same period last year. So, after a successful first quarter, the Polish economy is also faring well in the second quarter and although there are fewer working days in 2Q this year than in 2005, we believe that the rate of GDP growth will be close to 5.0% y/y. However, although the latest estimates of the rate of growth do not differ significantly from our forecasts to date, the structure is somewhat of a surprise. This is because, despite the general expectations, domestic demand has not yet become the single, independent driving force for the Polish economy - the positive contribution of net exports to growth remained both in 1Q and most probably also in 2Q, whereby, without doubt, the weaker zloty helped a great deal. Moreover after a slightly worse 1Q than expected, investments are also clawing back their arrears. This is evidenced by the robust activity in construction and assembly (13.3% y/y growth in May) and in particular, the strong rocovery of activity in companies involved in preparing land for construction. The economic rebound is not being accompanied by greater price pressure - although the rate of increase in producer prices rose to 2.3% y/y, which was slightly above market expectations of 2.1% y/y, a brief look at the detailed data on PPI shows that this slight error in assessment arose (equally) from the underestimation of the impact of rising commodity prices and the revision of the data for April. At the same time the rate of increase in prices in manufacturing remained at a level close to zero.

The typically hawkish comment from Halina Wasilewska-Trenkner of the MPC, who did not discard the need for an interest rate hike this year, nonetheless proves that the May data, will no doubt become a strong argument supporting greater prudence in monetary policy in the eyes of the conservative part of the MPC. Even so, we do not expect that the Council will make rash decisions based on monthly economic results, and, therefore, we believe that, in the end, the higher than expected rate of increase in salaries, industrial production and also retail sales, will be neutral from the point of view of the Council's current policy. All the more so that the increasing productivity and the continued strong share of net exports in economic growth gives hope that the rate of economic growth over the coming few quarters will be close to its potential and at the same time almost non-inflationary.

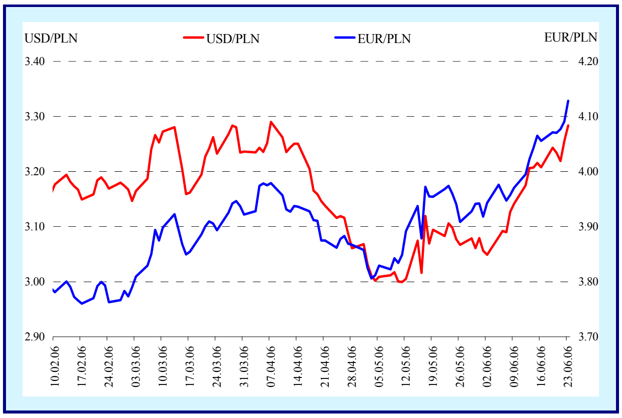
The Minister of Finance, Zyta Gilowska dismissed...

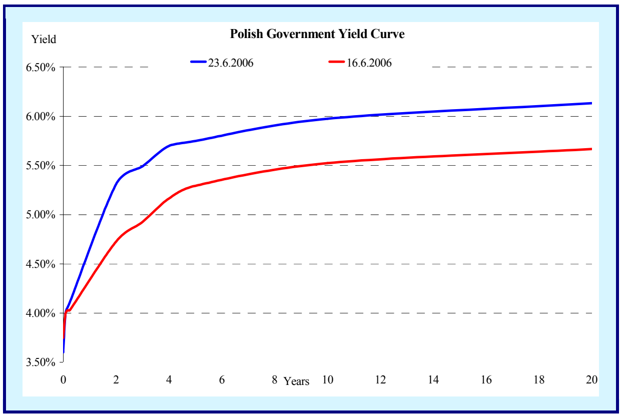
A sharp sell-off engulfed Polish markets on Friday after one of the national daily newspapers announced on Friday morning that the Deputy Prime Minister and the Minister of Finance, Zyta Gilowska, could leave the government if the public interest representative presses charges in the personal inspection court that she filed a false personal inspection declaration. Gilowska denied accusations that she had cooperated with the socialist secret service but gave in under pressure and surrendered her post late in the morning as her case was sent to court for verification. The PM Kazimierz Marcinkiewicz accepted the resignation but also instantly named a successor, which helped the market regain its footing. Kazimierz Marcinkiewicz's economic adviser to date, Paweł Wojciechowski, an economist and a former president of one of the pension funds operating in Poland, was nominated and then sworn in to the FinMin post over the weekend. Wojciechowski and Marcinkiewicz reassured markets that the MinFin would stick to the PLN

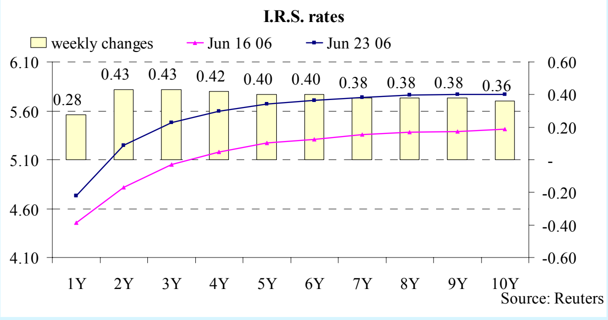
30 bn. deficit target and the fiscal rigidity would remain the key goal of government policy. The swift nomination was received by the majority of investors as a clear sign that the new minister will continue the government's economic policy to date. In our opinion, nothing indicates that things could be any different, but doubtless, some time must pass for the new minister to gain similar acclaim on the market and an equally strong position in the government, as the extraordinarily high-profile, resolute Zyta Gilowska, renown for her liberal economic views. Wojciechowski himself is completely unknown to financial markets and has no position in politics whatsoever, hence even though in terms of policy we should see a smooth transition from Gilowska, the lack of political clout could prove to be a major setback in dealing with the populist government coalition partners in the 2007 budget works.

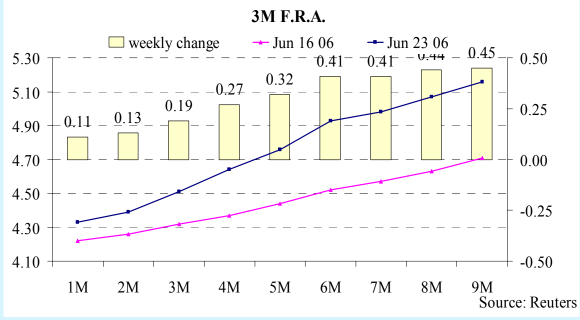
The **zloty** ended last week with a loss of more than one percent against the euro. For many players, the Monday opening level of 4.07 EUR/PLN proved sufficiently attractive to cover for shorts, as a result of which it recovered some of its earlier losses. However, sellers quickly returned to the market as the poor regional sentiment continued to weigh down on the zloty. Under pressure form the broadly softer post-industrial production data bond market, the zloty returned to testing the 4.09 EUR/PLN level. The FX intervention of the Slovakian central bank brought back a scent of optimism and resulted in a successful start to Thursday's session, although, faced with a wave of negative information, the zloty and the bonds ended the week with a clear loss. The exceptionally poor results of the 3Y bond auction in Hungary and S&P's critical report on the perspectives of the new EU member states entering the euro zone proved to be the catalyst for a further drop in prices. However it took the dismissal of FinMin Zyta Gilowska for the EUR/PLN to brake past 4.10, ad further to 4.1270 its weakest level against the euro for almost a year. Before the day was over the new, thoroughly competent, yet almost unknown FinMin was in place and the market quickly regained its footing.
The market's main concern is that new finance minister lacks the needed political background and could find it hard to resist the populist's demands to boost spending. These fears, together with the rather shaky regional sentiment ahead of the FED decision later this week should keep the zloty under pressure in the coming days.

With negative information coming in waves there was only one way for **Polish bonds** to go last week - down. The poor sentiment in the region, sharp declines on the core markets and the series of publications of exceptionally good macroeconomic data, as well as the dismissal of the Minister of Finance at the end of the week, gave investors ample opportunities to sell out. As a result yields increased by approximately 40 bp along the whole of the curve. The largest move took place on Friday. Just as the zloty, bonds nervously responded to the speculations on the dismissal of the Deputy Prime Minister Zyta Gilowska - yields soared by approximately 30 bp from the morning to the time of the announcement of Gilowska's dismissal. When the dismissal of the Minister of Finance from the government became fact, the bonds started to claw back their losses, largely because of the immediate nomination of the new candidate to the post of Minister of Finance, Paweł Wojciechowski. The new FinMin assured market that he would stick to the government's economic policy to date. Despite the comforting words coming from both the PM and new FinMin bonds should remain under pressure as Wojciechowski settles in.
The record low prices of Polish bonds are increasingly strongly encouraging the renewal of long positions. It could appear that the return of buyers to the market is just a question of time, although we believe that a significant drop in yields will depend on the return of calm to the entire region. A greater decline in yields should not be expected until then. The two key events of this week will be the MPC and FED meetings. The market is unanimously expecting that the Polish Monetary Council will not change interest rates and therefore, investors, just as in recent months, will primarily be carefully following the justification to the decision and the comments of the MPC members at Wednesday's press conference. Regarding the FED: if the FOMC signals the need for more tightening we will surely see Polish bonds under renewed pressure later in the week.









Comparative table for Polish government bonds

Title	Price 23/06/06	Yield 23/06/06	Price change (bps.) to 16/06/06	Yield change (bps.) to 16/06/06	Modif. Duration 23/06/06
GOV/ 0 / 24/06/08	101.02	5.20	-90	47.11	1.87
GOV/ 6 / 24/05/09	101.33	5.49	-152	56.08	2.63
GOV/ 5.75 / 24/03/10	100.27	5.66	-166	49.45	3.28
GOV/ 4.25 / 24/05/11	93.83	5.73	-174	43.20	4.30
GOV/ 6.25 / 24/10/15	102.20	5.93	-296	40.74	6.77
GOV/ 5.75 / 23/09/22	96.18	6.12	-466	45.81	10.00

EXPECTED DATA

Wednesday, June 28

MPC meeting, no change in rates

The MPC will not be inclined to cut interest rates at the coming meeting, mainly because of the strong economic activity in the real sphere and the gentle increase in inflation.

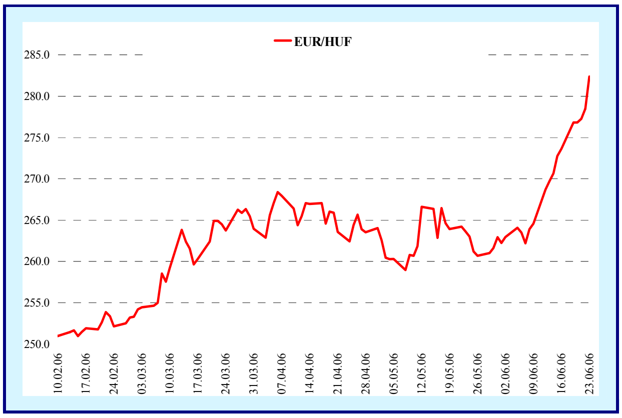
HUNGARY

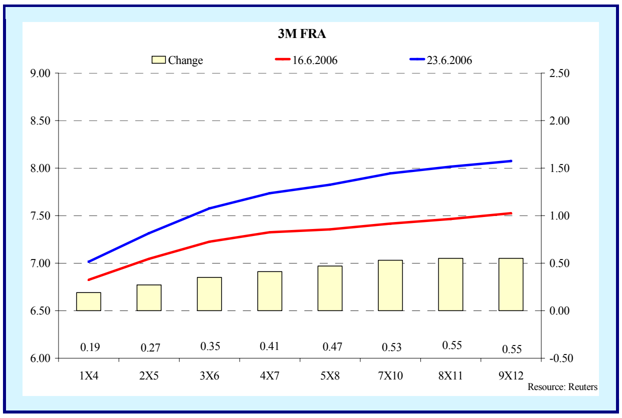
Last week the Finance Ministry presented its **new budget deficit outlook for this year**. The accumulative end-of-year deficit on the cash-flow basis should rise, according to the Finance Ministry, from the originally expected HUF 1,546 bn to HUF 1,768.6 bn. Finance Minister Janos Veres has promised that this target will be hit at all costs. As a precaution, the budget includes a reserve of HUF 50 bn. However, the costs of motorway construction (HUF 238 bn) are postponed to next year's budget, and the deficit of local governments, which is likely to be some HUF 155 bn, is not included in the new plan, either.
The newly forecast budget deficit makes up 7.6% of GDP. Nevertheless, it is calculated on the cash-flow basis, which is not decisive for compliance with the Maastricht criteria. The deficit according to ESA95 is crucial for the European Union. This methodology is based on the accrual basis (every claim or obligation is recorded when it is created and not when the corresponding payment is made). In addition, ESA95 uses a wider definition of the government sector. The 2006 deficit according to ESA95 will be 8% of GDP, as Prime Minister Gyurcsány announced in early June.
Given the different methodologies, comparing the two deficits is difficult. Nonetheless, according to the IMF's latest forecasts, the deficit according to ESA95, which is crucial for international comparisons, will even be 0.5% of GDP higher. Moreover, there is a risk that Eurostat will not allow the exemption of the motorway construction costs and thus the deficit will exceed 9% of GDP (with pension reform costs subtracted).

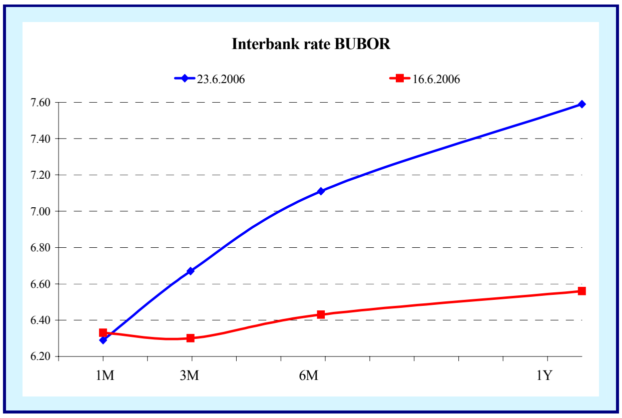
Last week was very unfavorable for the **forint,** which weakened by more than 2% from Monday. The Hungarian currency was under pressure because of Hungary's fiscal problems, the solution of which, proposed by the government in early June, was not positively accepted by markets and led to a rating downgrade by S&P. Another reason for this pressure was the overall negative sentiment towards emerging markets, triggered by rising yields in the United States and Europe. Very bad current account data in the Republic of South Africa and New Zeeland also stimulated the negative mood.

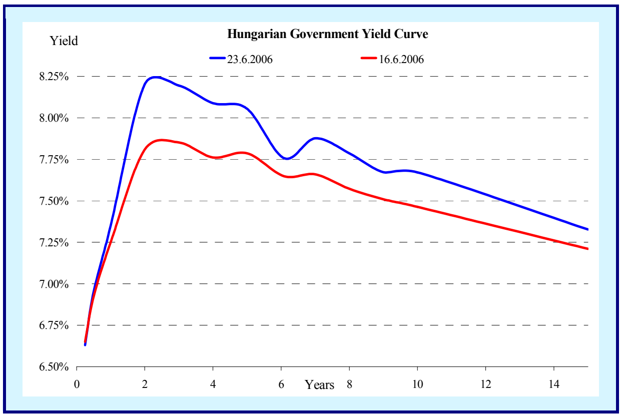
Under the pressure of these negative factors, the forint gradually broke a few all-time lows during the week, hitting the worst level on Friday, when it tested the central parity of HUF 282.36 per EUR.
The Hungarian currency is unlikely to find sufficient stimulus for a major appreciation this week. As the forint is very vulnerable because of Hungary's twin deficit, much will depend on the mood on emerging markets and the reactions to the current situation from government and central bank representatives. Anyway, we expect that the nervousness will persist and the forint will stay at all-time lows.

Hungarian bond prices fell for a third consecutive week, mainly because of speculations that the National Bank of Hungary would have to raise rates again because of inflation pressures, fuelled by the weak forint. Yields rose along the full length of the yield curve and, at the end of the week, reached 1-1.5-year highs. Of course, the decline in bond prices was obvious at the short end of the yield curve in particular. Yields of 1-5Y government bonds rose by approximately 35 bps for the whole of last week. Thus Hungarian bonds weakened faster than those in the Eurozone and the spread widened particularly at the short end, by more than 25 bps. The nervousness in Hungary also affected Thursday's 3Y government bond auction, where the planned amount of bonds supplied was reduced from HUF 70 bn to HUF 55 bn because of surprisingly low demand.
Bonds will probably remain under pressure this week. Clearly the most important event will be the U.S. Fed meeting. The Fed is expected to raise rates by 25 bps but this should not affect Hungarian bonds significantly because the rate hike will come as no surprise for the market. Signals of whether the anticipation of more rate hikes is well-founded or not will be more important from this point of view.









Comparative table for Hungarian government bonds

Title	Price 23/06/06	Yield 23/06/06	Price change (bps.) to 16/06/06	Yield change (bps.) to 16/06/06
GOV/ 6.25 / 24/04/09	95.32	8.16	-62	27
GOV/ 6 / 12/10/11	91.53	8.02	-83	21
GOV/ 5.5 / 12/02/16	85.78	7.63	-82	14
GOV/ 7.5 / 12/11/20	101.45	7.33	-59	7

EXPECTED DATA

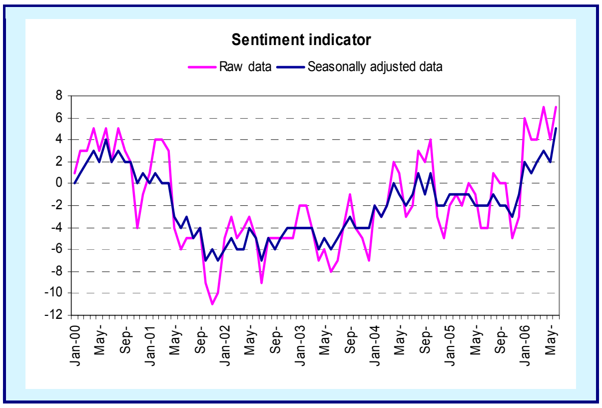
■ **Tuesday, June 27, 9:00**
Unemployment Rate (March-May) 7.5%
We expect that unemployment did not change compared to the previous three months (April to May).

■ **Friday, June 27, 8:30**
Current account (1st quarter) 1616 bn EUR
Although trade deficit remained almost the same in 1st quarter of 2006 in comparison with 4th quarter of 2005, we assume that balance of income, which is encumbered by rising foreign debt, will cause the current account deficit to widen.

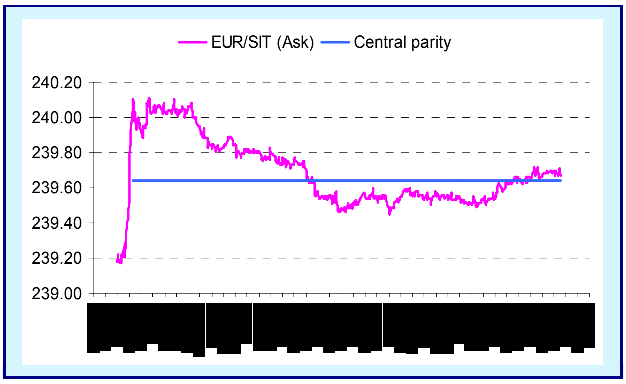
■ **Friday, June 27, 9:00**
PPI (May) 0.4%m/m, 5.7%y/y
The weak forint put pressure on the producer price index to rise in May while falling oil prices counteracted this. Hence we do not expect any significant PPI rise.

SLOVENIA

The Governing Board of the Bank of Slovenia at its regular session discussed the banks' preparation level and the activities for the introduction of the euro. The discussion covered the adjustment of the IT support, legal rules, informing of clients and risk assessment. The Governing Board of the BS established that banks and savings banks provide for suitable management and supervision of the euro introduction project. The banks' preparations for the introduction of the euro are currently focused on completion of IT support adjustment. In addition, the Governing Board discussed also a high rise in the CHF-denominated loans. Since the CHF/SIT exchange rate volatility is much higher than the volatility of EUR/SIT exchange rate and consequently the exposure to currency risk in the event of raising a CHF-denominated loan is greater, the Governing Board of the BS adopted a decision according to which banks should, prior to granting loans other than EUR and SIT loans, inform the clients about the currency and interest rate risks they assume with the loan.



Seasonally adjusted value of **business climate indicator** was in June 2006 2 percentage points higher than in May 2006, and exceeded the respective monthly figure in 2005 and the long-term average by 11 percentage points. Seasonally adjusted confidence indicator in manufacturing in June rose by 3 percentage points compared to May. Particularly the expected production, export orders and demand experienced an upward trend. Compared to the same month of 2005 and the long-term average, the value grew by 16 and 14 percentage points respectively. Seasonally adjusted value of retail indicator has not changed over the previous month and grew compared to last year's June and long-term average by 5 and 8 percentage points respectively. This indicator was favourably influenced mainly by the expected level of sale, purchase and better business position. Seasonally adjusted value of consumer confidence indicator was 2 percentage points higher in June than in May. The increase in the value of the indicator is the result of more optimistic forecast by the consumers as regards the expected unemployment situation in Slovenia in the next twelve months. The consumer confidence indicator is currently 6 percentage points above the long-term average. Seasonally adjusted value of construction confidence indicator was 2 percentage points higher than in May. In comparison with June 2005, it rose by 10 percentage points and was 9 percentage points higher than long-term average. The only indicator that is considered in total business climate indicator and has decreased on a monthly level in June was the service confidence indicator, which dropped by 1 percentage point. The indicator is 5 percentage points higher on the annual level and exceeds the long-term average by 1 percentage point.



On the **foreign-currency market**, the average EUR/SIT exchange rate was stable, at the level of SIT 239.68 per EUR 1. Slovenian media started rumours that the exchange rate should equal the central parity rate, i.e. SIT 239.64 per EUR 1. This was to be proposed also by the European Commission in its report. If these rumours come true, the costs of the euro introduction will be lower. Entities obligated to comply with double marking of prices should use another, adjusted exchange rate. According to the calculations of IMAD (Institute for Macroeconomic Analysis and Development), additional expenses arising from an exchange rate different than the central parity would amount to SIT 1.3 billion (EUR 5.4 million). The European Committee last week published the report on practical preparations for the introduction of the euro. The report describes all details regarding the actual technical and other preparations for the new EU member states. As Slovenia is the only one introducing euro and closest to the introduction, it is to have the main role in the report.

On the secondary market of **government securities**, the market of official market makers (TUVL) last week recorded trading in only two government bonds, namely RS59 and RS62. The trading in each of them amounted to approximately SIT 500 million (EUR 2.1 million). These are 10 and 11-year bonds falling due in 2016 and 2017. RS59 has a 4.0% coupon interest rate and reached a 4.25% return on the secondary market. RS62 has a 3.5% coupon interest rate and was traded at a price between 4.15% and 4.20%. If so far we the time yield curve of Slovenian government bonds with the nominal interest rate has been said to be growing unevenly, it can now be said that the curve is increasing evenly, to 25 basic points above the EUR benchmark. The investors displayed greater interest in treasury bills, which accounted for SIT 2.2 billion in trading (EUR 9.2 million). The most traded were twelve-month treasury bills (DZM), which fall due in about six months. Their return on the secondary market was between 3.18 and 3.30%. At the last auction on 23 May 2006, twelve-month treasury bills reached a 3.36% return based on the accepted price.

Slovenian government bonds

SIRS55=LJ	11-Feb-07	5.000%	101.06	3.23%	0	0	0.61
SIRS52=LJ	8-Apr-08	6.250%	104.26	3.74%	10	-8	1.67
SIRS58=LJ	17-Apr-08	3.250%	99.30	3.65%	0	0	1.72
SIRS56=LJ	11-Feb-09	4.875%	102.65	3.79%	0	0	2.41
SIRS60=LJ	31-Mar-10	3.500%	98.79	3.85%	-129	37	3.44
SIRS61=LJ	23-Jan-11	3.250%	97.40	3.88%	0	0	4.11
SIRS54=LJ	15-Oct-13	5.750%	110.22	4.10%	-362	53	5.79
SIRS57=LJ	15-Oct-14	4.875%	105.45	4.09%	0	0	6.59
SIRS59=LJ	17-Feb-16	4.000%	98.00	4.25%	-211	27	7.74
SIRS62=LJ	23-Mar-17	3.500%	94.14	4.19%	9	-1	8.64

FOREX TECHNICALS

▪ EUR/CZK: (28.5100)

DAILY CHARTS:
In channel off Aug 2004 high with Downtrendline off year high broken (see graph): 1st support area at 28.3670 (weekly envelope), with next levels at 28.3400 (last week low), ahead of 28.2800 (break-up daily June 09): tough.
If wrong, next levels would come in 28.2300/ .2150 (previous MT reaction lows hourly).
1st Resistance area at 28.5850 (current reaction high off 28.1050), with next levels at 28.6020 (weekly envelope), ahead of 28.6240 (weekly LT MA↓): key for MT development.

▪ EUR/PLN (4.1100)

Break of Downtrendline off 2005 high has sent the pair above 3.9960 (neckline of a ST Double Bottom) and the neckline of a MT double Bottom (4.0466: see graph): 1st Support area at 4.0623 (broken weekly Flag off year low), with next levels at 4.0466 (see above), ahead of 4.0336 (weekly ST MA↑): must sustain back below to call end of ST current alert.

1st Resistance comes in at 4.1350 (last week high), with next levels at 4.1460 (weekly projection band top), ahead of 4.1614 (weekly envelope + weekly Starc top): tough.

▪ EUR/HUF (281.30)

Rebound off 258.75 has scored new historic high, approaching Exchange regime Midline (282.36).
1st Resistance area at 282.35/ .36, ahead of 283.20 (weekly projection band top) and 285.54 (weekly envelope): tough.

Support at 275.75 (previous LT high), with next levels at 274.60 (ST break-up weekly), ahead of 272.55 (weekly ST MA↑): must sustain back below to call end of current alert.

- **EUR/SKK** (38.2600)

Currently above channel top off 2004 high and neckline of Double Bottom (37.9000: see graph).
1st Resistance at 38.4550 (breakdown hourly), ahead of 38.4980 (weekly envelope) and 38.5680 (last week high + CB): tough.
If wrong, risk would extend towards 38.7160/ .7280 (weekly projection band top/ weekly Starc top), where pause favored.

Support area at 38.1450 (ST reaction low off 38.5650), with next levels at 38.0850 (weekly envelope), ahead of 38.0050/ .0000 (last week low/ previous year high): must sustain back below to call end of current alert.
37.7090 = broken weekly LT MA↓.

TABLES

Official interest rates (end of the period)

		Current	Jun-06	Sep-06	Dec-06	Mar-07	Last change	
Czech Rep.	2W repo rate	2.00	2.00	2.25	2.25	2.50	25 bps	27/10/2005
Hungary	2W deposite rate	6.25	6.25	7.00	7.00	7.00	25 bps	19/06/2006
Poland	2W intervention rate	4.00	4.00	4.00	4.00	4.00	-25 bps	28/02/2006
Slovakia	2W repo rate	4.00	4.00	4.00	4.50	4.50	50 bps	30/05/2006

*Short-term interest rates 3M *IBOR (end of the period)*

		Current	Jun-06	Sep-06	Dec-06	Mar-07
Czech Rep.	PRIBOR	2.28	2.28	2.35	2.50	2.75
Hungary	BUBOR	6.71	6.70	7.15	7.10	7.20
Poland	WIBOR	4.23	4.10	4.20	4.20	4.30
Slovakia	BRIBOR	4.27	4.10	4.15	4.65	4.65

Long-term interest rates 10Y IRS (end of the period)

	Current	Jun-06	Sep-06	Dec-06	Mar-07
Czech Rep.	4.13	4.20	4.10	4.10	4.05
Hungary	7.71	7.60	7.50	7.30	7.10
Poland	5.86	5.85	5.90	5.80	5.80
Slovakia	4.91	4.90	5.00	5.20	5.20

Exchange rates (end of the period)

		Current	Jun-06	Sep-06	Dec-06	Mar-07
Czech Rep.	EUR/CZK	28.52	28.45	28.50	28.15	28.05
Hungary	EUR/HUF	280.60	280	272	268	263
Poland	EUR/PLN	4.0865	4.10	4.15	4.00	3.95
Slovakia	EUR/SKK	38.17	38.30	37.00	36.60	36.40
	EUR/USD	1.2552	1.320	1.290	1.230	1.220

GDP

	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2001
Czech Rep.	*7.4*	6.4	5.6	4.9	5
Hungary	*4.6*	4	4	4.2	4.1
Poland	*5.2*	5	5	4.9	4.7
Slovakia	*6.3*	*6.3*	6.5	6	6

Inflation (CPI y/y, end of the period)

	May-06	Jun-06	Sep-06	Dec-06	Mar-07
Czech Rep.	*3.1*	2.5	2.6	2.6	2.7
Hungary	*2.8*	2.5	3.2	4.2	5.4
Poland	*0.9*	1.1	0.6	1.5	1.8
Slovakia	*4.8*	4.8	4.9	3.8	3

Current Account as Pct of GDP

	2005	2006
Czech Rep.	-2.7	-2.2
Hungary	-7.3	-7.9
Poland	-1.6	-2
Slovakia	-7.8	-4.2

Public finance balance as Pct of GDP (in ESA95 standards)

	2005	2006
Czech Rep.	-2.6	-3.2
Hungary	-6.1	-8.0
Poland	-2.9	-2.6
Slovakia	-2.9	-3.1

CALENDAR

			Period	CSOB	Consensus	Previous
Monday - 19.June						
11:00	SK	T-bond auction 4.9%/ 2014				
14:00	HU	Monetary council NBH (base rate)		25 bps	0 bps	0 bps
14:00	PL	Wages y/y	May 06	5.2	4.7	4
Tuesday - 20.June						
14:00	PL	Industrial Production y/y	May 06	19.1	12.8	5.8
14:00	PL	PPI y/y	May 06	2.3	2.1	1.6
14:00	PL	PPI m/m	May 06	0.5	0.3	1.4
Wednesday - 21.June						
12:00	CZ	T-Bond Auction (3.8/2015, CZK bn)		7		
12:00	PL	5Y T-bonds auction (bln PLN)		2		1,8-2,8
Thursday - 22.June						
11:00	HU	T-bond Auction (3-year)				
12:00	CZ	T-Bill Auction (9-Month, CZK bn)		5		
Friday - 23.June						
09:00	HU	Retail sales y/y	April 06	5.8		5.6
10:00	PL	Unemployment rate	May 06	16.5	16.5	17.2
10:00	PL	Retail sales y/y	May 06	13.7	11.7	13
10:30	SI	Business tendency				
14:00	PL	Manufacturing Climate Index	June 06	16		17
14:00	PL	Core inflation y/y	May 06	1		1
Tuesday - 27.June						
09:00	HU	Unemployment rate (%)	May 06	7.5		7.5
cca 11:00:00	SK	NBS Bank Board meeting		4	4	4
Wednesday - 28.June						
09:00	SK	PPI m/m, %	May 06	0.2		0.7
09:00	SK	PPI y/y, %	May 06	9.3		9.8
	PL	MPC Meeting	June 06	0 bps.	0 bps.	0 bps.
Thursday - 29.June						
14:00	CZ	CNB Board Meeting	June 06	0 bps.	0 bps	0 bps
Friday - 30.June						
08:30	HU	Current account balance (EUR m)	Q1 2006	-1616	-1700	-1486
09:00	HU	Foreign trade (EUR mn), details	April 06	-188		-266
09:00	HU	PPI y/y	May 06	5.7		5.8
09:00	HU	PPI m/m	May 06	0.4		1.2
10:00	CZ	Gross Foreign Debt (CZK bn)	March 06			
10:30	SI	CPI y/y	June 06	0.032		3.2
Thursday - 6.July						
09:00	HU	Industrial production y/y, p	May 06	8.5	8.2	1.8
11:00	HU	T-bond Auction (5-year)				
11:00	HU	T-bond Auction (10-year)				
Friday - 7.July						
09:00	CZ	Trade balance (CZK bn)	May 06	6		0.156
09:00	HU	Foreign trade (EUR mn), p	May 06	-250		-188
09:00	SK	Industrial production y/y	May 06	12		5.7
09:00	SK	Construction output y/y	May 06	10		11.1
14:00	HU	NBH Minutes				
17:00	HU	Public Budget Deficit, (HUF bn, YTD), p	June 06	1311		981

(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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