CENTRAL EUROPEAN WEEKLY

NOVEMBER 7, 2006

- **Czech Republic**
  The koruna hits new all-time highs
- **Slovakia**
  NBS leaves rates unchanged but sees demand-driven risks
- **Poland**
  EUR/PLN within reach of 3.80 support
- **Hungary**
  Forint firms to 5.5-month maximum
- **Slovenia**
  Considerable price decrease in October

HIGHLIGHTS

The bullish trend on forex markets in Central Europe is not over. Both the Czech koruna and the Slovak koruna are hitting new all-time highs, and the Polish zloty is not far from its all-time high either. Even the Hungarian forint is strengthening towards levels that had seemed to be unimaginable for this currency until recently. Appreciation is thus the regional phenomenon, while the strong correlation among Central European currencies, which was very weak only a short time ago, has been established recent weeks.

As fundamental indicators have not changed significantly in any of these countries, the recent rapid appreciation of the Central European markets is based purely on a change in market sentiment. This change in the investor mood occurred outside the region, as CE currencies are currently profiting from a sudden wave of demand from foreign institutional investors while domestic players are surprised by the latest developments.

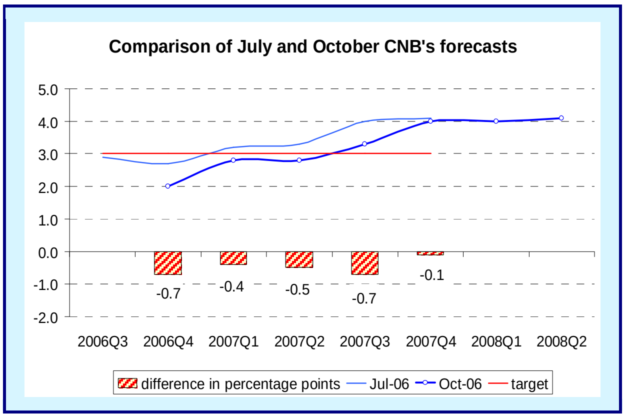
The question is why foreign funds and banks have decided to increase their exposure in Central Europe now. If we look at stimuli from global markets, a partial explanation can be the rise in stock markets in the United States and the Eurozone, seen in the last three months. Obviously, investors' appetite for risky assets on global scale has undoubtedly increased, and Central European assets can benefit from this. If we think apart from the rise in yields on core markets after Friday's release of the U.S. payrolls figures, the high stock prices and relatively low interest rates/yields are an ideal combination for emerging markets and thus Central Europe too.

Nevertheless, the strange situation on global markets, when stock prices remain high and bond yields stagnate at low levels, will not last forever, and this also applies to the bullish sentiment on Central European forex markets. When core markets start to eliminate this unusual divergence seen between equities and bond yields (while the initial phase of this correction has been in place since Friday's US labour market figures), the optimism that is driving Central European currencies up will diminish.

CZECH REPUBLIC

Five months have passed since the elections to the Lower Chamber of Parliament and the Czech Republic still lacks a stable government, which would be based on Lower Chamber's confidence. The hope of resolving this situation after the senatorial elections has proved to be false so far because the Social Democrats (ČSSD) refused to support the project of the 'rainbow coalition', which would lead the country to early elections. ČSSD would still like best to be given the chance to form its own new government, but right-wing parties oppose this. Thus the Czech Republic has seen the first attempt at forming a new government so far and is still waiting for the second one. In the meantime, the likelihood of adopting an Amendment to the Constitution to simplify the dissolution of the Lower Chamber of Parliament by a vote, without requiring three failed attempts at forming a new government, is increasing.

The Czech National Bank released its new inflation report, based on which the CNB Board decided on interest rate settings in the last week of October. The new forecast is much more optimistic about the one-year inflation outlook than the CNB's forecast released three months ago. For this period the central bank has revised its quarterly inflation forecast by up to 0.7%! However, the central bank is still fairly pessimistic about the inflation outlook beyond one year. This is due in part to the uncertainties about the timing of the impact of cigarette excise taxes.



The CNB remains very pessimistic about inflation adjusted for the above-mentioned tax changes because it predicts that this inflation will rise at a stable rate since the middle of 2007, exceed the 3% target at the end of next year, and hit more than 3.5% by the middle of 2008. This negative outlook can be partly explained by central bank's usual pessimism, stemming from its never-ending story about the closing output gap and the stable exchange rate of the koruna. The existing results of CNB's forecasts compared to actual data are good evidence of CNB overestimating its inflation outlooks, and thus the forecasts released within the coming quarters are likely to fall again.

Given the significant reduction of the one-year inflation forecast and the record-breaking levels of the Czech koruna, we expect that the CNB will not unnecessarily hasten to raise rates, and will not raise them until January 2008.

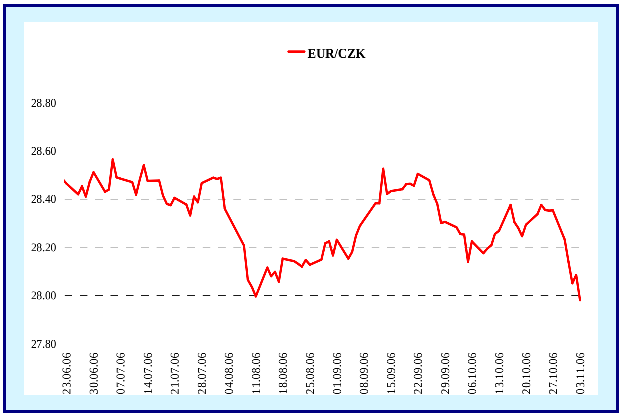
Notwithstanding the approaching ECB meeting, the **Czech koruna** strengthened last week. Particularly buying by large London investors, stemming from the persisting declines in global yields in the first half of the week, maintained the upbeat mood in the whole of the Central European region. The Czech currency, unlike its regional counterparts, strengthened somewhat faster this time, thus offsetting its previous losses against the other Central European currencies. The EUR/CZK pair broke through the support levels at the 28.28 level as well as EUR/CZK 28.12 did not stop until it hit strong technical barriers near its all-time highs. On Thursday, the nervousness surrounding the ECB meeting and the fall of U.S. stocks triggered a moderate negative correction. On Friday, however, after the release of strong U.S. payrolls data, which made global bonds fall, this negative correction surprisingly petered out. Hence the Czech koruna touched it's new all time highs at EUR/CZK 27.875.

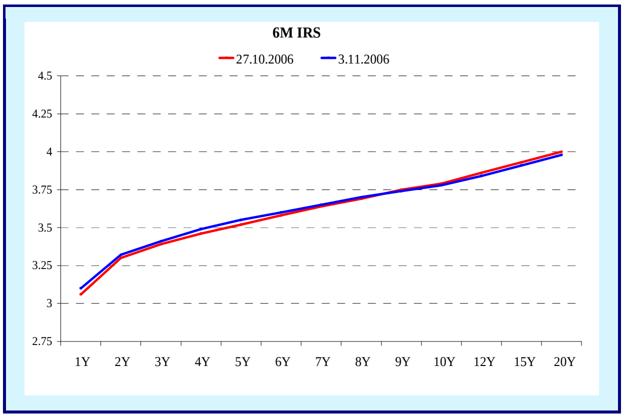
The Czech koruna might pay increased attention to domestic figures this week. Above all, the significant decline in Czech inflation has the potential to reverse the latest rise in rates on the money market and thus stop further appreciation of the Czech koruna. Besides, we expect a continuing rise in global yields and limited room for the rise in U.S. stocks – both factors are again somewhat unfavourable for the Czech currency. On the other hand the Koruna has just broke through the current all time highs and it might stay in more positive mood at the beginning of the week. Nevertheless there are no fundamental factors (neither local nor global) that would stay behind recent gains of the Czech currency; it is just pure hectic regional optimism that should due to our opinion disappear during this week. Hence we believe the EUR/CZK pair should move back above EUR/CZK 28.00 this week.

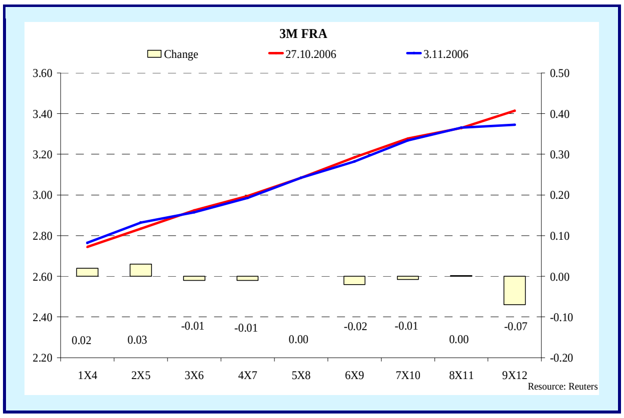
Czech bond prices rose last week, and thus mostly followed on the heels of neighbouring developed markets. They continued to rise in spite of a higher state budget deficit. However, an earlier shutdown of Friday's trading session prevented a correction, which bonds on global markets saw after the release of U.S. statistics. Also, a successful auction of the 2.30%/2008 government bond, with demand exceeding supply almost three times, was held last week. Thus the only unfavourable event for bonds was the Finance Ministry's announcement that it would increase the amount of the bonds issued in this quarter from CZK 44 bn to CZK 59 bn, with a 30Y bond to be issued for the first time.

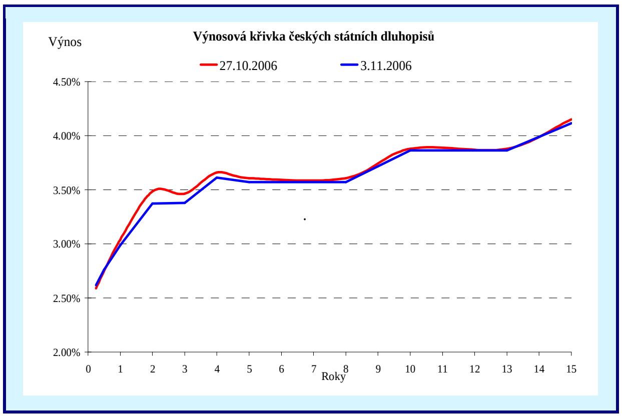
This week the market should initially take note of Friday's events on developed markets and cope with the increased supply of new securities. Also, an auction of the

2.55%/2010 bond for CZK 6 bn, which will probably be subscribed without problems, should be held on Wednesday. As far as data releases are concerned, October's inflation is expected to be low, and this should curb a decline in prices in the second half of the week. Nevertheless, the Eurozone, where yields will probably rise, will also affect the Czech market this week.









Comparative table for Czech government bonds

Title	Price 03.11.06	Yield 03.11.06	Price change (bps.) to 27.10.06	Yield change (bps.) to 27.10.06	Modif. Duration 03.11.06
GOV/ 2.3 / 26.09.08	98.07	3.37	22	-11	1.8
GOV/ 3.8 / 22.03.09	100.93	3.38	19	-9	2.2
GOV/ 2.55 / 18.10.10	96.15	3.61	18	-5	3.7
GOV/ 6.55 / 05.10.11	113.18	3.57	12	-4	4.2
GOV/ 3.8 / 11.04.15	99.29	3.90	25	-4	6.9
GOV/ 6.95 / 26.01.16	123.54	3.86	11	-2	6.8
GOV/ 4.6 / 18.08.18	105.43	4.01	22	-2	9.0
GOV/ 3.75 / 12.09.20	96.20	4.11	37	-4	10.5

EXPECTED DATA

▪ **Tuesday, November 7**
Construction output (September) 6.8% y/y

Given the previous construction output trend and the very favourable weather, we believe that the construction sector continued to perform well in September. The reasonable figure should be particularly encouraged by the stable inflow of funds to infrastructure investments and to housing construction. We expect the full-year rise in construction output of 5.5%.

▪ **Wednesday, November 8, 9:00**
CPI (October) -0.3% m/m, 1.5% y/y

We expect that October's month-on-month fall in consumer prices was due in particular to the decline in fuel prices and the reduction in the regulated prices of natural gas for households. Food prices involve a great uncertainty. On the one hand, increased energy prices are driving food prices up; on the other hand, food prices are influenced by seasonal effects and the bad news on this year's crop. The year-on-year inflation rate will down to well below 2%, in our opinion, and will start to slowly rise within the coming months.

▪ **Thursday, November 9**
Industrial output (September) 5.6% y/y

We expect that September's industrial output figure was slightly worse than the figures shown in previous months. The reason is the high comparison base of last year, when the production of the second domestic car factory was being launched; in addition, this factory halted production in September this year. Another major factor is one business day less, which will reduce industrial output by approximately 2%. For the whole of this year we expect an 8.5% rise in industrial output in real terms.

SLOVAKIA

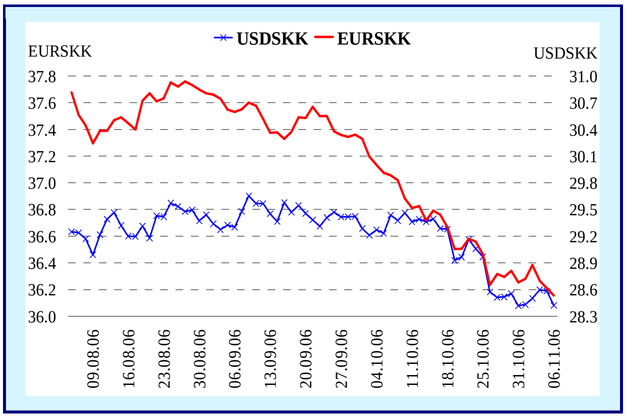
October's NBS Board meeting sprang a moderate surprise, as interest rates remained unchanged, with the base rate at 4.75% while a majority of the market as well as we expected a 25 bps rate hike. As the reasons for its decision the bank cited the strengthened koruna (which firmed by approximately 3% over the last month) and lower risks stemming from cost factors (oil and energy prices). Even so, the NBS added that the risk of demand-pull inflationary pressures persisted, due in particular to high wage growth and the economy remaining in a positive output gap.

A new medium-term forecast, in which the National Bank of Slovakia slightly increased its harmonised inflation prediction for the end of this year (to 4.1% from 3.9%), was released along with its decision on rates. However, the bank sees next year's inflation more optimistically, expecting 2.6% at the end of the year instead of the previously predicted 2.8%. What is more, the forecast most probably does not include the announced 3.1% reduction of gas prices in early 2007, which will cut inflation by 0.3 p.p. at the year end.. Thus compliance with the Maastricht inflation criterion now looks much more optimistic. The forecast for the end of 2008 remained unchanged at 2.0%.

We still see the potential for one additional 25 bps rate hike before the end of this year. Most of the market as well as we believe that rates will be raised as early as the end of November. However, we cannot rule out December either because the GDP and wage development data for the third quarter will already be available to the NBS at that time. Our opinion is that the rate hike, if any, would mark the end of the monetary tightening cycle. However, the exchange rate of the koruna and oil prices on global markets are still the crucial factors for this.

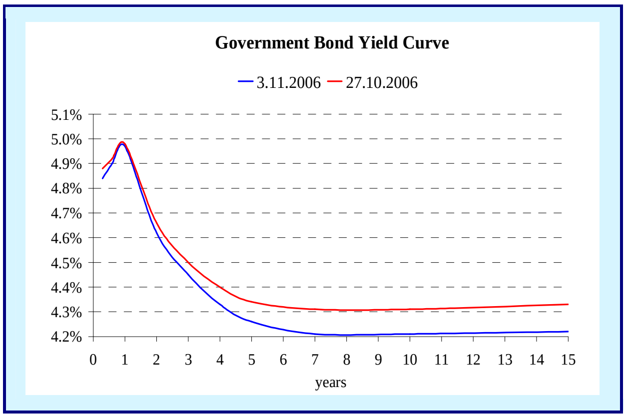
The koruna hovered within the bounds of EUR/SKK 36.25-36.47 last week. The central bank's decision did not influence the exchange rate, which was at the mercy of external factors in particular. A trend of moderate depreciation of the currency, due to foreign investors taking profits, dominated the second half of the week.

This week is replete with interesting data releases but perhaps only Friday's inflation and foreign trade data can actually influence the exchange rate. However, this will only be true if these figures significantly differ from market expectations. On Monday, bullish sentiment drove the koruna to a new all-time high of EUR/SKK 36.144. If the sentiment remains positive, we might go even lower to 36.10. On the other hand,the koruna has appreciated significantly over the last few weeks, which means a correction period should arrive. In this case, an important factor will be whether the koruna breaks through the resistance level of SKK 36.50 per EUR. If it does, it may subsequently weaken by 20-30 hallers. Nonetheless, much will depend on the regional mood and global investors' attitude towards emerging markets.



The yield curve went down along its full length last week, the most at the long end, where yields, following their European counterparts, fell by 9 bps. The short end went down by a moderate 3 bps, mainly in reaction to the central bank's decision to leave rates unchanged.

Traders on the bond market will particularly await Friday's inflation data. As the year-on-year inflation rate will go down significantly, short-term yields may continue falling because part of the market may view the inflation fall as narrowing the room for another tightening of the monetary policy. However, this inflation fall will be due to the comparison base effect only, and inflation will again approach 4% by the end of the year. The long end of the curve will move on the back of key markets, as usual.



Indicative yields of government bonds

	Coupon	Maturity	Issue volume	Bid	Ask
SD200	0.0	14.1.2007	SKK 40.0 bn	5.00	4.00
SD191	5.0	5.3.2008	SKK 15.0 bn	n.a.	n.a.
SD203	4.8	14.4.2009	SKK 40.0 bn	4.55	4.11
SD189	4.9	5.2.2010	SKK 15.00 bn	4.53	4.20
SD174	7.5	13.3.2012	SKK 8.31 bn	n.a.	n.a.
SD188	5.0	22.1.2013	SKK 15.0 bn	4.42	4.24
SD199	4.8	2.7.2013	SKK 6.8 bn	4.40	4.23
SD202	4.9	11.2.2014	SKK 24.7 bn	4.31	4.24
SD204	5.3	18.5.2019	SKK 34.4 bn	4.44	4.24
SD205	0.0	5.4.2012	SKK 11.7 bn	4.44	4.20

Source: Bratislava Stock Exchange, CSOB

Interest rate fixing on the money market

% p.a.	O/N	1W	2W	1M	2M	3M	6M	9M	12M
30.10.2006	4.26/4.56	4.58/4.86	4.64/4.93	4.68/4.97	4.73/5.01	4.75/5.03	4.79/5.07	4.79/5.07	4.77/5.05
6.11.2006	4.26/4.54	4.57/4.86	4.59/4.87	4.63/4.89	4.69/4.96	4.72/4.98	4.72/4.97	4.71/4.98	4.71/4.97

EXPECTED DATA

■ **Wednesday, November 8, 9:00**

Industrial output (September) 14.0% y/y

We expect that the favourable trend in industry will persist. The main reason will be car production, followed by metals, machinery and the electrical industry.

Construction output (September) 19.3% y/y

■ **Thursday, November 9, 9:00**

Retail sales (September) 8.5% y/y

Retail sales are maintaining their fast rise this year, and this should also be true in September. The reasons are the continuing high wage growth and the improving situation on the labour market.

■ **Friday, November 10, 9:00**

Inflation (October) 0.1% m/m, 3.6% y/y

Food, pharmaceuticals and partly also the increase in heat prices should be responsible for the moderate month-on-month rise in consumer prices. Fuel prices, by contrast, should have an anti-inflationary effect. Nevertheless, the year-on-year inflation rate will go down significantly because of the comparison base effect.

Foreign trade (September) SKK -2.1 bn

Exports should maintain their fast rise, fuelled by the automotive industry in particular. Imports should be partly influenced by the decline in oil prices on global markets, as this will reduce pressure on the imports of mineral resources.

POLAND

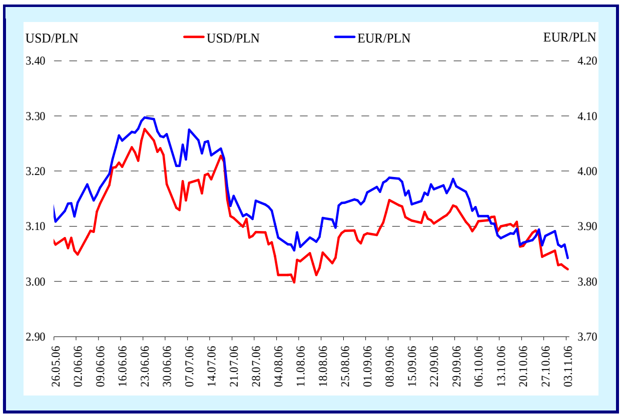
Interest rate hike no earlier than in January...
The situation on the MPC front has remained more or less intact over the course of the week, even though the signals have become more mixed recently. On the one hand Mirosław Pietrewicz of the Monetary Policy Council stressed that October's inflation projection did not see the CPI exceed the upper bound of the NBP’s target range and therefore a fuller assessment of the perspectives for inflation and possible decisions on interest rates would only be possible after the January projection was available. This is typically soft wording from Pietrewicz and simultaneously the view that we believe has been dominant in the Council to date. Pietrewicz believes that the data on GDP in Q3 will be important from the point of view of current monetary policy - in particular whether the structure of growth turns out to be similar to that of 2Q (which itself did not give rise greater inflationary pressure concerns due to strong investment growth and surprising positive net export contribution). Interestingly, the Central Statistical Office will announce the information on the GDP as late as on 30 November, one day after the penultimate MPC meeting of this year. Bearing in mind that the MPC has not changed interest rates once in December since 1998, this clearly suggests that the first rate hike can take place no earlier than at the beginning of 2007. On the other hand though, the most recent statement from MPC moderate, Jan Czekaj, may give rise to certain doubts as to the views which are currently dominant among the Council members. Czekaj did not discard the possibility of a hike as early as this year, although at same time he announced that as such it was not a foregone conclusion. At the same time, he denied the speculations that the Council would want to increase the cost of money because of the approaching change the NBP president post. Our base scenario assumes that the dove majority will remain intact at least until the year end, and probably a while longer. This arises primarily from the October decision to leave interest rates unchanged (despite the clearly worse inflation projection and, as can be presumed, the strong persuasion by the hawks to increase the cost of money pre-emptively as early as in October). The set of economic data this month (which will be valuable, because it is the first information from 4Q) should not significantly change the medium-term perspectives for monetary policy. In addition, the next inflation projection prepared under the supervision of the new president of the NBP will be available in January. In this situation, it is difficult to expect the scales to (unexpectedly) tilt to the favour of the hawks just yet.

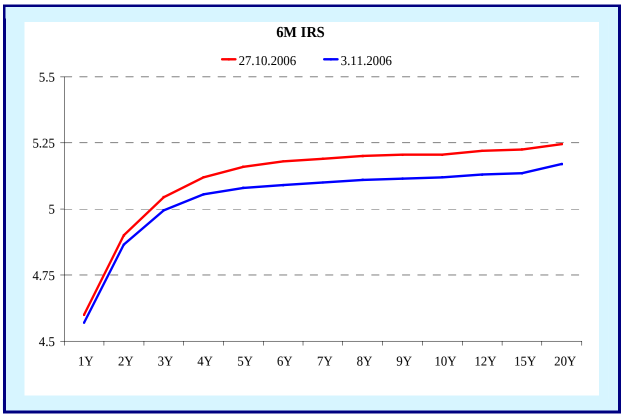
MoF: Drop in inflation in October...
The finance ministry expects that annual inflation dropped last month to 1.2% from 1.6% in September. According to the ministry, despite the seasonally higher food prices (particularly fruit and vegetables), the CPI rose by just 0.1% m/m, due largely to the large drop in fuel prices (4.4% m/m). Our estimates also show that the annual consumer inflation rate declined in October compared with September, although we believe that the size of the drop was not as large as seen by the MoF. We expect a slightly higher rise in food prices (0.8% m/m), almost identical drop in fuel prices (4.0% m/m) and y/y inflation at a level of 1.3-1.4% (0.2-0.3% m/m). We expect that net core inflation (excluding fuel and food prices) increased slightly, although, after rounding, it remained at 1.4% y/y. The ministry simultaneously revised its year-end inflation projection down from 2.1-2.2% to 1.9% y/y. We are also slightly less optimistic here - we believe that the CPI will increase to 2.0% or slightly more in December before approaching the NBP’s 2.5% y/y target at the end of Q1 next year.

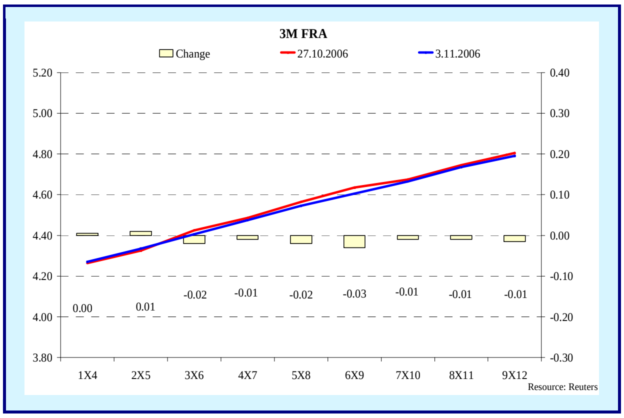
The zloty gained against both the euro and the dollar last week and, surprisingly, ended trade below the EUR/PLN 3.85 mark. Bulls returned to the market on Tuesday, following the correction that had lasted since the previous week and pushed the pair closer to 3.90 on Monday. In consequence, even though the market was closed on Wednesday, the EUR/PLN (unsuccessfully) tested the level of 3.85. The second half of the week was far more interesting due to the ECB decision on Thursday and the US labour market data on Friday, but even though the data came in stronger than expected they did not bring a breakthrough on the domestic FX market. The zloty ended the week at 3.8400 EUR/PLN due to global repositioning which started ahead of the (stronger-than-expected) US payrolls.
With the domestic calendar empty the regional sentiment will be key for the zloty in the coming days. Technically the break past 3.85 late on Friday opens the road to more gains, and possibly a move closer to 3.80 area, but we do not discard the possibility of a technical correction in case the zloty’s regional peers (the forint in particular) retreat somewhat. This could push the EUR/PLN pair back into the 3.85-3.90 range.

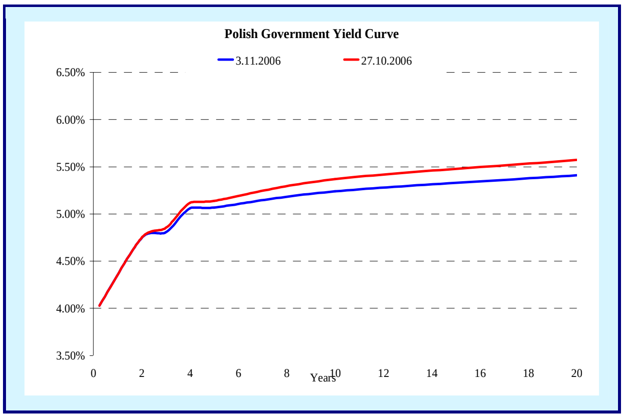
Polish bond yields continued to drop last week, aided by the improving regional sentiment and the strengthening of the zloty, as well as the rising prices on the core markets. Bonds at the short end of the curve have been relatively less buoyant in the face of the approaching start to the tightening cycle but gained approximately 6 bps while yields for longer maturities dropped by 10 bps and the yield curve flattened slightly for the second week in a row.
No important domestic macroeconomic data will be published in the coming days and hence the situation on the domestic bond market (particularly at the long end of the curve) will continue to depend on the regional sentiment, core markets and the zloty. After several weeks of sound increases, it appears increasingly likely that the market will want some breathing space after the hefty gains, which saw yields drop by up to 20 pbs for longer maturities in October. Therefore, even though the zloty’s strength points to more gains the room for bonds to inch higher appears limited. We expect consolidation near the current levels over the

coming days in anticipation of the first macroeconomic data this month (on the current account, inflation and salaries).









Comparative table for Polish government bonds

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GOV/ 0 / 12.12.08	90.74	4.75	-133	-0.33	2.00
GOV/ 6 / 24.05.09	102.76	4.81	9	-4.57	2.27
GOV/ 6 / 24.11.10	103.36	5.06	20	-5.77	3.35
GOV/ 4.25 / 24.05.11	96.73	5.07	29	-7.13	3.94
GOV/ 6.25 / 24.10.15	107.08	5.24	46	-6.49	6.83
GOV/ 5.75 / 23.09.22	103.55	5.41	96	-9.04	10.30

EXPECTED DATA

- **Monday, November 13, 14:00**
  C/A balance (September) EUR -560 M.
  Balance of trade (September) EUR -500 M.

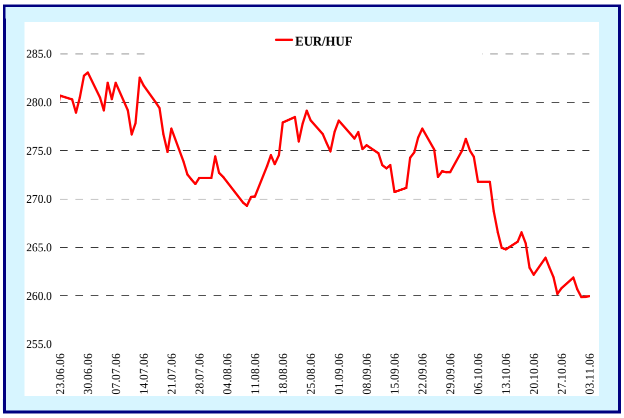
We expect a slight improvement in the current account in September - mainly because of the improved balance of income (driven by EU funding). At the same time we expect that exports grew slightly slower and imports increased at a gently higher y/y rate than in August, which translated into a marginally wider trade deficit.

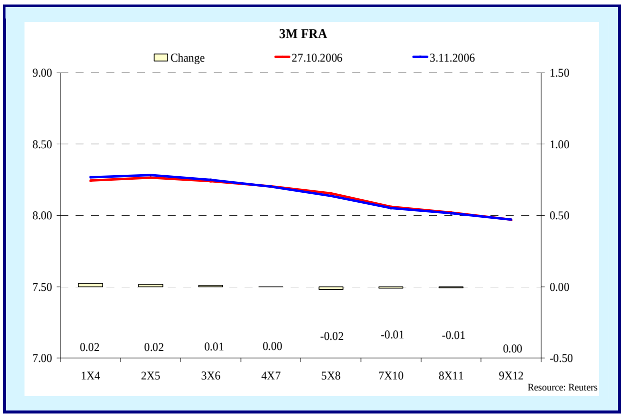
HUNGARY

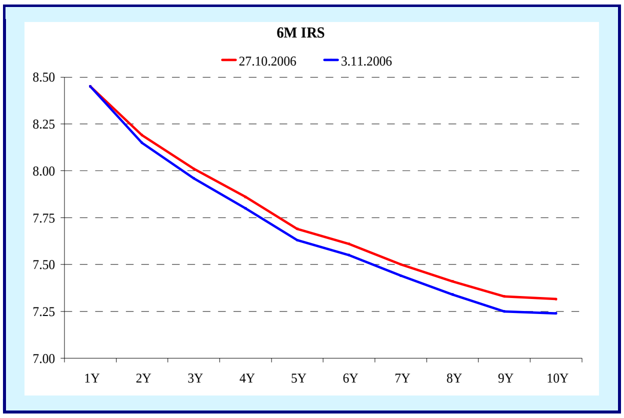
The government presented Parliament with the 2007draft state budget, which did not include much new information, however. It is the same version as that included in the Convergence Programme, and envisages a deficit of 6.8% of GDP. The Finance Minister reiterated at a press conference that the budget included reserves of HUF 220 bn to prevent exceeding the deficit target, as has been the case almost regularly in past years. Independent economists, rating agencies as well as the Hungarian central bank are mostly of the opinion that the government is deliberately underestimating some revenues to ensure that the budget targets are met. We endorse this opinion, although we must add that the preparations of some key healthcare, education and pension system reforms are still underway. In addition, there is a risk that the already-approved reforms may not be implemented quite strictly. Negotiations with Audi are evidence of this, as Finance Minister Janos Veres admitted that the ‘solidarity tax’, because of which Audi wanted to suspend its EUR 1 bn investment, planned for the next 5 years, might be toned down by allowing deductions of research and development expenditure.
Parliament is due to vote on the budget on December 21 but, as the coalition has a clear majority in Parliament, it should be passed without problems.

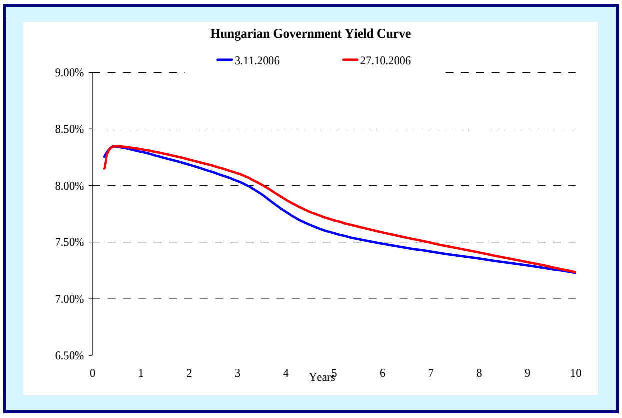
Last week did not provide many domestic stimuli in Hungary, and thus the **forint paid attention to regional developments**. These were particularly influenced by the fall in yields in key markets, to which all Central European currencies, including the forint, reacted by appreciating, even during Wednesday’s holiday, when the Hungarian currency firmed to 5.5-month high of EUR/HUF 258.85 . The situation changed on Thursday, when Central Europe reacted to the decline in U.S. stocks, and the forint offset some of its gains of the beginning of the week. Even so, the Hungarian currency is still very strong, hovering around HUF 260 per EUR.
This week’s calendar will include more economic events than last week in Hungary. However, the other markets will continue to play the greatest role. We believe that the forint is currently overvalued thus we expect correction in days ahead.

Hungarian bonds lacked any major domestic stimuli last week, and thus they followed on the heels of the zloty throughout the week, with yields, except the shortest maturities (1Y and less), going down by approximately 10 basis points.
We believe that there is not much room left for bond prices to rise from the current values. As the yield curve has fallen by approximately 50 basis points since the start of October, we expect a correction rather than a price rise.
On Thursday there will be an auction of 3Y and 15Y benchmarks. We believe that current positive sentiment will ensure sufficient demand.









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GOV/ 7.25 / 12.06.12	98.58	7.58	535	-12	4.3
GOV/ 6.75 / 24.02.17	96.63	7.23	113	-16	6.9
GOV/ 7.5 / 12.11.20	103.34	7.12	107	-12	8.0

EXPECTED DATA

■ **Tuesday, November 7, 9:00**

Industrial output (September) 8.1% y/y

The PMI business mood index indicates that September's industrial output slowed down. One of the contributors to this was clearly the lower number of business days than in September last year.

Budget deficit (January-October) HUF -1506 bn

We expect that the Finance Ministry slightly overestimated its forecast, as usual. Our opinion is that the monthly budget deficit fell to HUF 50 bn.

■ **Thursday, November 9, 9:00**

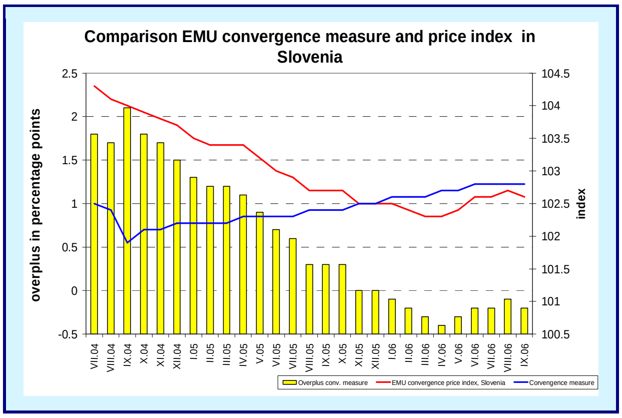
Foreign trade (September) EUR -200 m

We believe that September's foreign trade deficit fell compared to August. Our opinion is that this was influenced by oil prices, which fell significantly in September; in addition, demand in Western Europe is still high. The PMI business mood index also shows that exports performed well. On the other hand, the appreciation of the forint against the euro did not affect the competitiveness of Hungary's exports, in our opinion.

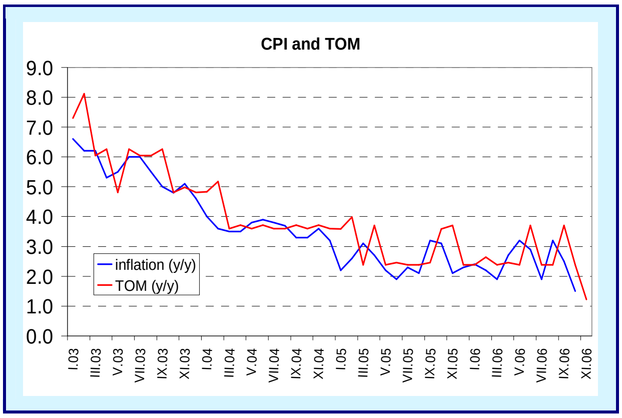
SLOVENIA

The October deflation was characterised by low prices of fuels, utility services and package holidays. In October the consumer prices at the monthly level dropped by 0.8%, while the inflation was 1.5% at the annual level, which is the lowest ever. The most considerable reduction in October was noticed in the prices of housing (4.0%), transportation. recreation and culture (2.6%), food and non-alcoholic beverages (0.7%). The movement in the prices of housing was to a large extent influenced by lower prices of utility services (by 13.6% on average) because of the changed way of charging water consumption. The price of water consumption in Ljubljana thus dropped by 28.5%; in the same group, a considerable reduction was also recorded in liquid fuels (9.9%). Automotive fuels were on average by 8.6% cheaper. Following the new government regulation on the formation of the prices of oil products, the model of adjusting these prices every 14 days re-entered into force which resulted in the fact that three changes in these prices impacted the October deflation (one increase and two decreases). In October, the prices in the groups of clothing and footwear dropped by 5.7%, those of alcoholic beverages and tobacco products by 1.1% and those of various goods and services by 1%. The most considerable increase was recorded in the prices of clothing (by 7.3%) and footwear (by 2%) because of the new autumn-winter collection.

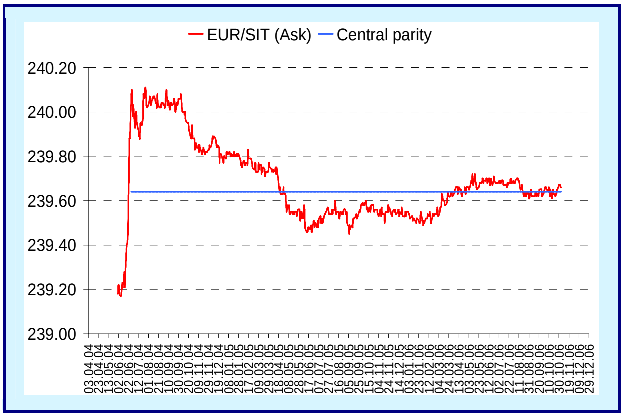
A significant price reduction at the monthly level also impacted the 12-month average price growth which again dropped by 0.1 percentage point so that it now stands at 2.4%. The growth in prices measured with the harmonised consumer price index was also negative in October (-0.7%) which impacted the 12-month average price increase measured with the "EMU convergence price index" standing at 2.5%. The most recent data for September 2006 show that the convergence criterion regarding inflation rate was 2.8%, which means that Slovenia was by 0.2 percentage points under the limit value.



TOM (the base interest rate) dropped to 0.1% monthly for the first time and stands at 1.22% (it was 3.71% last November). If the November inflation is negative (between -1.5 and - 0.4), TOM will reach 0.1% at the monthly and 1.18% at the annual level also in December; however, if the consumer price index is between 0.3 and 0.8, which is more likely, TOM will again reach 0.2% and 2.38% at the monthly and the annual levels, respectively.



Not much action was observed on the **market of Government securities** last week. Only a handful of transactions were concluded in treasury bills and government bonds. The most traded bond was the 5-year RS61, as the total value of transactions amounted to SIT 1.7 billion (€ 7.1 million). The bond carrying a 3.25% coupon interest rate reached yields between 3.87% and 3.94% on the secondary market. The investors showed great interest also in the RS62 bond and the three-month treasury bill. The yields of Slovene government bonds with nominal interest rate range around 20 to 40 basis points above those of German benchmark bonds.



Slovenian government bonds - currency clause

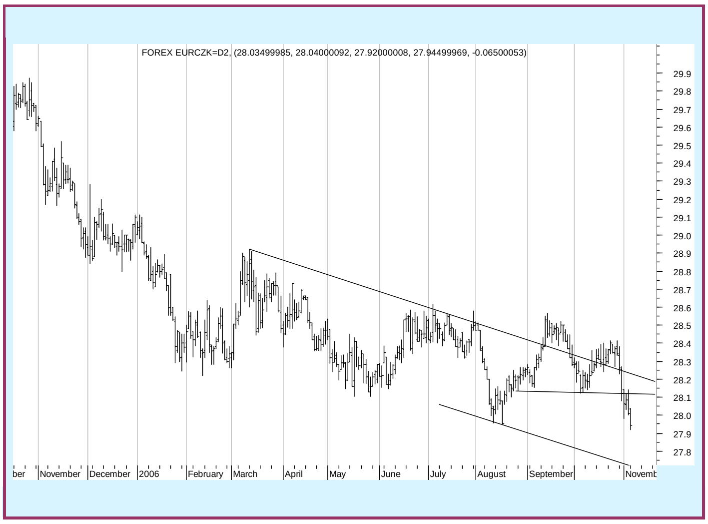
Bond			Price	Yield	Price change bps	Yield change bps	MDuration (cls)
			3.11.2006	**3.11.2006**	**3.11.2006**	**3.11.2006**	**3.11.2006**
SIRS26=LJ	1.VI.11	5.375%	106.00	3.91%	0	0	3.96
SIRS29=LJ	15.I.12	5.375%	106.00	4.07%	0	0	4.34
SIRS48=LJ	2.XII.12	4.750%	102.61	4.25%	0	0	5.00
SIRS50=LJ	24.II.13	4.500%	101.16	4.28%	0	0	5.25
SIRS38=LJ	19.IV.17	5.625%	110.00	4.41%	98	-11	7.75
SIRS53=LJ	8.IV.18	4.875%	106.60	4.14%	0	0	8.54
SIRS49=LJ	10.I.22	4.750%	104.20	4.36%	0	0	10.39

Slovenian government bonds

SIRS55=LJ	11.II.07	5.000%	100.49	3.07%	0	0	0.26
SIRS52=LJ	8.IV.08	6.250%	103.45	3.71%	0	0	1.32
SIRS58=LJ	17.IV.08	3.250%	99.11	3.88%	0	0	1.37
SIRS56=LJ	11.II.09	4.875%	102.56	3.67%	0	0	2.06
SIRS60=LJ	31.III.10	3.500%	99.41	3.68%	0	0	3.10
SIRS61=LJ	23.I.11	3.250%	97.22	3.98%	6	-1	3.76
SIRS54=LJ	15.X.13	5.750%	109.89	4.09%	0	0	5.73
SIRS57=LJ	15.X.14	4.875%	105.40	4.07%	0	0	6.53
SIRS59=LJ	17.II.16	4.000%	102.00	3.74%	0	0	7.46
SIRS62=LJ	23.III.17	3.500%	94.80	4.12%	18	-2	8.31

FOREX TECHNICALS

▪ EUR/CZK: (27.9500)



DAILY CHARTS:
Currently below the inverted channel top year high, with ST Double Top while below 28.1200 (see graph): 1st support area at 27.9110/ .9060 (weekly/ monthly envelopes), with next levels at 27.8250/ .8110 (1st target off 28.1200/ 1st Irregular B off 28.5650), ahead of 27.7740/ .7220 (1st LT Irregular B off 33.4100/ 2nd Irregular B off 28.5650): favored as ST range bottom.
If wrong, 2nd target off 28.1200 stands at 27.6750.

1st Resistance area at 28.1370 (weekly envelope), with next levels at 28.1800/ .2050 (weekly ST MA↓/ breakdown hourly), ahead of 28.3330/ .3480 (breakdown daily/ weekly LT MA↓): sustained trade above would be indication something wrong with the CZK.

▪ EUR/PLN (3.8300)

The drop off 3.9935 has put the pair below the Uptrendline off year low: now trying to extend below the neckline of a ST Double Top (3.8530: see graph): 1st Support area at 3.8255 (current reaction low off 4.1350), with next levels at 3.8065/ .8057 (weekly projection band bottom/ weekly envelope) and 3.8000 (May low): tough on 1st tests.

1st Resistance comes in at 3.8631 (weekly envelope), with next level at 3.8975 (last week high): ideal area to stay below to keep current mood intact on Zloty.

▪ EUR/HUF (259.80)

Pair below neckline of a ST Double Top off (268.90) and retesting the broken channel top off 2005 low (see graph).
1st Resistance area at 261.48/ .71 (weekly ST MA↓/ weekly envelope), with next levels at 263.20 (last week high), ahead of 265.00/ 265.20 (Oct 24 high/ MT breakdown daily): sustained trade above would indicate something wrong with HUF.

Support at 258.85/ .75 (last week low/ May low), with next levels at 258.05/ 257.82 (61.8% 241.33 to 285.10/ weekly Bollinger bottom), favored as range bottom.
If wrong on that call, next Support at 256.94 (76.4% 248.25 to 285.10), ahead of 255.22 (weekly envelope).

▪ EUR/SKK (36.1800)

New low and currently below Falling wedge bottom off year high (see graph).
1st Resistance at 36.3740 (weekly envelope), with next levels at 36.4430 (weekly ST MA↓), ahead of 36.4700 (last week high): ideal area to stay below to keep current mood intact on SKK.

Support area at 36.1500 (2nd Irregular B off 38.8800), with next levels at 36.0380/ .0220 (weekly Bollinger bottom/ weekly envelope): tough on 1st tests.

TABLES

Official interest rates (end of the period)

		Current	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Last change	
Czech Rep.	2W repo rate	2.50	2.50	2.75	2.75	3.00	3.00	25 bps	9/27/2006
Hungary	2W deposite r.	8.00	8.25	8.25	8.25	8.25	8.00	25 bps	10/24/2006
Poland	2W inter. rate	4.00	4.00	4.00	4.00	4.25	4.50	-25 bps	2/28/2006
Slovakia	2W repo rate	4.75	5.00	5.50	5.50	5.50	5.50	25 bps	9/26/2006

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

		Current	Dec-06	Mar-07	Jun-07	Sep-07	Sep-07
Czech Rep.	PRIBOR	2.67	2.75	2.88	2.98	3.10	3.18
Hungary	BUBOR	8.2	8.40	8.35	8.30	8.10	7.90
Poland	WIBOR	4.21	4.20	4.30	4.50	4.70	4.70
Slovakia	BRIBOR	4.98	5.10	5.05	5.05	5.00	4.90

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

	Current	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07
Czech Rep.	3.8	3.95	4.05	4.00	3.95	3.96
Hungary	7.25	7.10	7.10	7.00	6.90	6.80
Poland	5.148	5.30	5.25	5.20	5.20	5.30
Slovakia	4.37	4.40	4.30	4.25	4.20	4.70

Exchange rates (end of the period)

		Current	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07
Czech Rep.	EUR/CZK	27.95	28.40	28.00	28.00	27.85	27.80
Hungary	EUR/HUF	259.9	266.0	265.5	265.0	264.5	264.0
Poland	EUR/PLN	3.827	3.800	3.800	3.800	3.800	3.750
Slovakia	EUR/SKK	36.17	36.70	36.00	36.60	36.30	36.00

GDP

	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2007
Czech Rep.	*6.2*	5.4	4.7	4.5	4.7	5.0
Hungary	*3.8*	3.6	3.6	3.3	2.8	2.5
Poland	*5.5*	5.5	5.1	4.7	5.0	4.9
Slovakia	*6.7*	*6.5*	6.0	6.3	6.5	6.6

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

	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07
Czech Rep.	*2.7*	2.7	3.0	2.9	3.3	3.7
Hungary	*5.9*	6.3	6.9	7.4	5.8	4.5
Poland	*1.6*	2.0	2.6	2.2	2.3	2.6
Slovakia	*4.6*	4.0	3.4	3.1	3.0	2.8

Current Account as % of GDP

	2005	2006
Czech Rep.	-2.1	-3.0
Hungary	-7.0	-6.3
Poland	-1.6	-2.0
Slovakia	-7.8	-6.5

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

	2005	2006
Czech Rep.	-3.6	-3.5
Hungary	-6.1	-8.7
Poland	-2.9	-2.6
Slovakia	-2.9	-2.5

CALENDAR

				Period	Reality	Consensus	Previous
Monday - October 30							
	09:00	HU	PPI y/y	September 06	9.0		9.7
	09:00	HU	PPI m/m	September 06	0.1		0.3
	11:00	SK	T-bond auction 0.0%/ 2012				
Tuesday - October 31							
	09:00	HU	Foreign trade (EUR mn), details	August 06			
	15:00	SK	NBS Bank Board meeting		0 bps		25 bps
Wednesday - November 1							
	14:00	CZ	State budget (CZK bn)	October 06	-12.7		1.5
Thursday - November 2							
	09:00	SK	State budget (SKK bn)	October 06	-1.1		-5.1
	12:00	PL	2Y T-bonds auction (bln PLN)		1.4		1.2
Friday - November 3							
	09:00	CZ	Trade balance CZK bn	September 06	7.5	5.0	-2.1
	10:00	CZ	CNB Minutes	10/26/2006			

				Period	CSOB	Consensus	Previous
Tuesday - November 7							
	09:00	CZ	Construction output y/y	September 06	6.8		6.4
	09:00	HU	Industrial production y/y, p	September 06	8.1	8.5	9.0
		HU	Public Budget Deficit, (HUF bn, YTD)	October 06	-1506.4		-1456.4
Wednesday - November 8							
	09:00	CZ	CPI m/m	October 06	-0.3	-0.2	-0.7
	09:00	CZ	CPI y/y	October 06	1.5	1.6	2.7
	09:00	CZ	Unemployment rate	October 06	7.6	7.5	7.8
	09:00	SK	Industrial output y/y	September 06	14.0	12.7	13.7
	09:00	SK	Construction output y/y	September 06	19.3		21.6
	12:00	PL	7Y floaters auction (bln PLN)		2.3		1.5
	12:00	PL	12Y CPI linked bonds auction (bln PLN)		0.5		0.0
Thursday - November 9							
	09:00	CZ	Industrial production y/y	September 06	5.6	8.0	7.4
	09:00	HU	Foreign trade (EUR mn), p	September 06	200.0	170.0	287.9
	09:00	SK	Retail Sales y/y	September 06	8.2	7.5	8.0
	09:00	SK	Real wage in industry y/y	September 06			1.3
	09:00	SK	Employment in industry y/y	September 06			-1.8
	10:30	SLO	PPI y/y	October 06	0.02		2.7
	10:30	SLO	Trade balance in mio EUR	September 06	-100		-144
	10:30	SLO	Industrial Output y/y	September 06	0.07		10.9
	11:00	HU	T-bond Auction (3-year)				
	11:00	HU	T-bond Auction (15-year)				
Friday - November 10							
	09:00	SK	CPI m/m	October 06	0.1	0.1	-0.3
	09:00	SK	CPI y/y	October 06	3.6	3.6	4.6
	09:00	SK	Core inflation m/m	October 06	0.0	0.0	-0.3
	09:00	SK	Core inflation y/y	October 06	2.3	2.3	2.4
	09:00	SK	Foreign trade (SKK bn)	September 06	-2.1	-2.1	-4.4
	14:00	HU	NBH Minutes				
Monday - November 13							
	14:00	PL	Current Account EUR m	September 06	-560		-610
	14:00	PL	Trade balance EUR m	September 06	-500		-453
Tuesday - November 14							
	09:00	CZ	PPI m/m	October 06	0.2	-0.1	-0.2
	09:00	CZ	PPI y/y	October 06	2.2	1.9	2.4
	09:00	HU	CPI y/y	October 06	6.1	6.2	5.9
	09:00	HU	CPI m/m	October 06	0.4		2.5

	09:00	HU	GDP, p (y/y)	Q3 2006	3.6		3.8
	10:00	CZ	Current account (CZK bn)	September 06	-5.0		-14.3
	14:00	PL	M3 y/y	October 06			13.0
Wednesday - November 15							
	09:00	CZ	Retail Sales y/y	September 06	6.1	6.0	6.8
	09:00	HU	Industrial production y/y, details	September 06			
	09:00	SK	GDP flash estimate y/y	Q3 2006	6.5	6.6	6.7
	09:00	SK	Unemployment %	October 06	9.8		9.8
	12:00	PL	CPI y/y	October 06	1.4		1.6
	12:00	PL	CPI m/m	October 06	0.3		0.2
	12:00	PL	5Y T-bonds auction (bln PLN)		1.5-2.5		2.0
	14:00	PL	Budget Deficit PLN bn	October 06	18.5		14.5
		PL	5-year government bond				
		PL	11-year government bond				
Thursday - November 16							
	09:00	HU	Wages (gross nominal, y/y)	September 06			
	09:00	SK	HICP y/y	October 06	3.5	3.3	4.5
	14:00	PL	Wages y/y	October 06	5.5		5.2

(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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