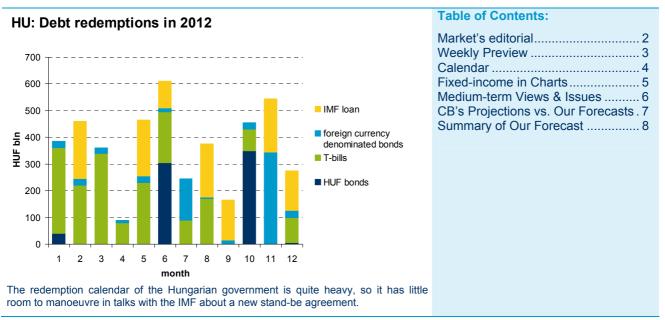


Central European Weekly Written by CSOB Prague and K&H Budapest

Weekly Highlights:

- CE currencies continue to recover
- Regional governments successfully issued their debts
- Hungarian government is ready to modify disputed legislation
- MNB is going to deliver third 50 bps rate hike in row

Chart of the Week: redemption calendar of Hungary's government





Market's editorial

Regional Forex and fixed-income markets rally

Both Central European currencies and Hungarian bonds recovered strongly last week. For instance the Polish zloty strengthened by 2.1% the Hungarian forint by 1.9%, while the Czech koruna, following on their heels, appreciated by 0.5%.

CE governments successfully issued their bonds

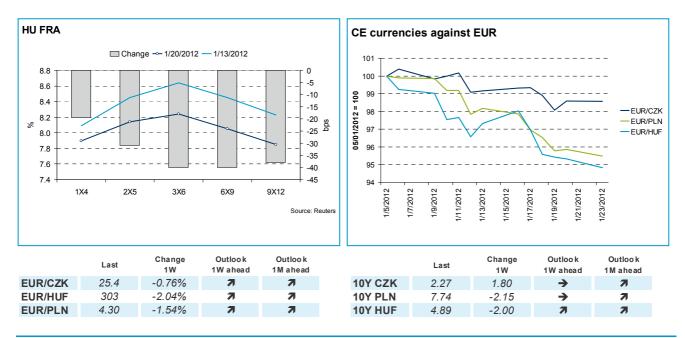
The main reason was the positive development at the peripheries of the eurozone. Markets quite reasonably withstood the series of rating downgrades of nine countries and the eurozone's bailout fund (EFSF). Later in the week, notwithstanding their rating downgrades, Spain and France held very successful auctions. Following their example, most auctions in Central Europe were also fairly successful. Poland's two-year auction attracted almost record-breaking demand, while the Hungarian, Slovak, and Czech bond markets also rallied, albeit the Czech 5Y variable-coupon auction lagged behind expectations.

Hungary's government on more cooperative note

As concern Hungary and its road for a new stand-by loan the IMF said it would like to see Hungary agreeing with the EU before talks about a new loan could start. This may slow down the process and may force Hungary to give in a lot of concessions about fiscal policy and other issues. The government on the other hand indicated this morning that it is ready to negotiate about any issues, even the flat-tax may be modified, which means that most likely talks will continue and sooner or later there will be an agreement. Markets have gone a bit too far in our view, when the forint appreciated to the EUR/HUF 302 level and we may see a correction from here to between EUR/HUF 305-310 levels. We expect the size of the loan to reach €15-20bn and cover external debt redemptions until 2015, which would be a safe position if achieved.

MNB will deliver another 50 bps rate hike

Hungary will remain in focus not only because of ongoing talks with the IMF, but because of its monetary policy. The Hungarian central bank is expected to hike the base rate by 50bps to 7.50%. The weak forint and unfinished talks with the IMF are warranting another hike, while faster negotiations may limit the end of the tightening cycle. The market is currently expecting to end at 8.25%, but we think it could be a bit below this at 8.00%. The December inflation data was broadly in line with expectations thus the weak forint has so far left prices broadly unaffected due to the weak demand. There is however the risk that this may change and the exchange rate may slowly pass through onto prices.





Weekly Preview

TUE 14:00

MNB base rate

	This	Last
	meeting	change
rate level (in %)	7.50	11/2011
change in bps	50	50

HU: NBH raises base rate by another 50 bps

The Hungarian central bank is expected to hike the base rate by 50bps to 7.50%. The weak forint and unfinished talks with the IMF are warranting another hike, while faster negotiations may limit the end of the tightening cycle. The market is currently expecting to end at 8.25%, but we think it could be a bit below this at 8.00%. The December inflation data was broadly in line with expectations thus the weak forint has so far left prices broadly unaffected due to the weak demand. There is how-ever the risk that this may change and the exchange rate may slowly pass through onto prices.

PL: The economy grew by 4.1% in 2011

We expect that the Polish economy grew by as much as 4.1% Y/Y in 2011, mainly due to the very favourable figures for the first three quarters as we expect the GDP growth dipped below 4% Y/Y in the last quarter. Nevertheless, despite the slower growth in Q4/2011, the Polish economy by far outperformed its regional peers last year. However, we expect that factors that kept the Polish economy expanding rapidly in 2011 will gradually step aside and we estimate that the economy might grow at a slower pace (about 3 %) next year. More specifically, a room for relatively loose fiscal policy seems to have diminished and higher interest rates should, in our view, contribute to a slowdown in both households' consumption as well as private and public investment.

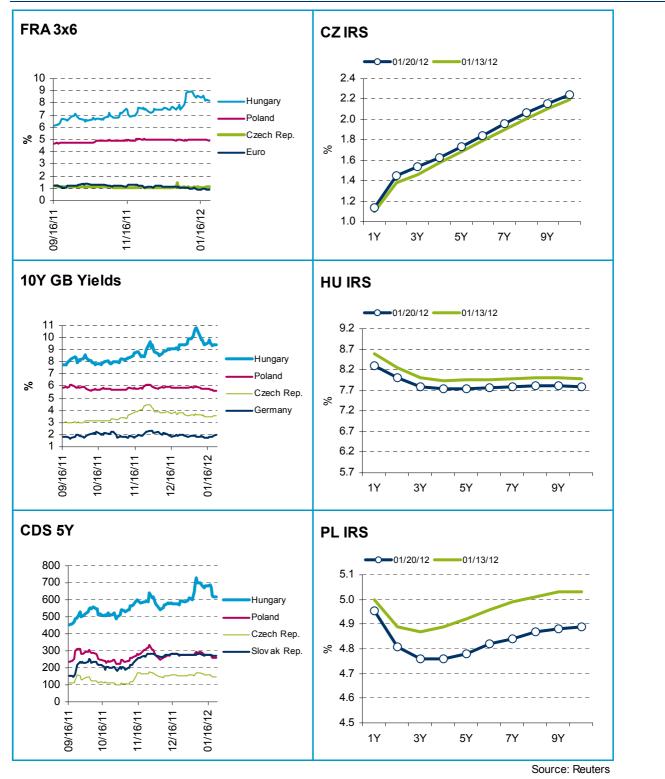


Calendar

Country	Date	Time	Indicator	Period		Forecast		Consensus		Previous	
obuilting	Date	THILE	indicator		renou		y/y	m/m	y/y	m/m	y/y
HU	01/24/2012	14:00	NBH meeting	%	01/2012	7.5		7.5		7	
HU	01/25/2012	9:00	Retail sales	%	11/2011				-0.2		0.6
PL	01/27/2012	10:00	Retail sales	%	12/2011			22.6	10	-5.5	12.6
PL	01/27/2012	10:00	GDP	%	4Q/2011*A			4.2		3.8	
PL	01/27/2012	10:00	Unemplo yment rate	%	12/2011			12.5		12.1	
PL	01/27/2012	14:00	CPI	%	01/2012 *P						4.8



Fixed-income in Charts





Central European Weekly

Medium-term Views & Issues

The Czech Republic Hungary Poland Although the situation in the gov-Most of the economists now expect We believe that Poland's economic growth for may be 4.1% in 2011 erning coalition after some turmoil a recession for Hungary in 2012 has stabilized again, tensions in partly because some foreign banks (due to the very favourable figures the government coalition might will have to drastically improve for the first three quarters). Neverreturn during discussions of the 2012 budget. The government intheir loan/deposit ratios. theless, we expect that factors that The kept the Polish economy growing growth forecast could be a point in tends to change the system of dithe IMF talks. A weaker growth during the World Financial Crisis rect taxes radically and to unify outlook may also require additional will gradually step aside and we gradually the VAT rate in order to fiscal measures. The IMF would estimate that the economy will push the deficit below 3 percent of like to see 'tangible' steps from the grow at a slower pace next year. GDP by 2013. Despite the positive government, but did not specify More specifically, a room for relaoutlook of the public budgets, the tively loose fiscal policy seems to what tangible means here. The government does not intend to set next step could be that the EU also have diminished and higher intera target date for the euro adoption replies to the government message est rates should, in our view, conin the Czech Republic. and that we may see how negotiatribute to a slowdown in both tions could continue. As a base households' consumption as well case, we think a deal could be as private and public investment. reached till the end of February. Inflation increased above the cen-The Hungarian central bank Fears of inflation remaining above tral bank's target in October driven matched analysts' expectations the target in medium term led to by food and fuel prices. Fuel prices and hiked the base rate by 100bps the further round of monetary tightas well as prices of agricultural in aggregate by the end of 2011. ening in Poland. The National Bank commodities continue to pose a We expect two more 50bps rate of Poland increased the reference risk for future inflation. In January rate already for the third time this hikes, so the base rate should hit the inflation will jump above the 3% 8.00% in 2012. year by 25 bps to 4.50%. Although as a result of V.A.T. increase. On the rate of inflation should stay the other hand, weak domestic above the target in the rest of 2011, the inflation expectations have stabilized and employment demand should counter a rise in inflation. We expect the CNB to growth remains sluggish. Furthermaintain its wait-and-see policy at more global risk has somewhat least until the end of the next year. The first rate hike delivered by the intensified recently. Hence we believe the NBP should stay on hold Czech central bank is probable in 2013H1. for some time, at least through 1. quarter 2012. The Czech koruna should remain Talks between Hungary and the The Polish zloty remains under under pressure because of the IMF/EU has been ongoing slowly, pressure. The coordinated action escalating tension surrounding which means that on the positive of Polish state owned bank BGK and Polish central bank (NBP) proeuro-crisis management. Nevertheside there is some advance, while less, if the worst case scenario of negotiations will take time because vided certain relief to the Polish eurozone meltdown is avoided, the both side are giving in concessions currency. Nevertheless the motivakoruna has potential to appreciate. only marginally.. The FX market tion to intervene in 2012 may be However, after re-pricing of sysweaker due to changed methodolmay react to incoming news over temic risks, slow continuation of the short-term, which is probably a ogy of debt/GDP calculation and real convergence does not argue range between 308 and 315/€, lower sensitivity to FX volatility. Hence we are afraid escalating for dramatic gains of the Czech while we expect the forint to apprecurrency over 2012. Putting it tociate after negotiations reach a key tensions on the eurozone markets gether, after current correction with point and the main fundamentals of can weigh heavily on the Polish short term target around 26.6 the agreement are formulated. We markets and the zloty can easily EUR/CZK. we continue to see the expect the currency to appreciate move above 4.80 EUR/PLN in koruna stronger in 12- month horito 290/€ by the year-end. 3month horizon. zon at 24.50 EUR/CZK.

Growth & kev issues

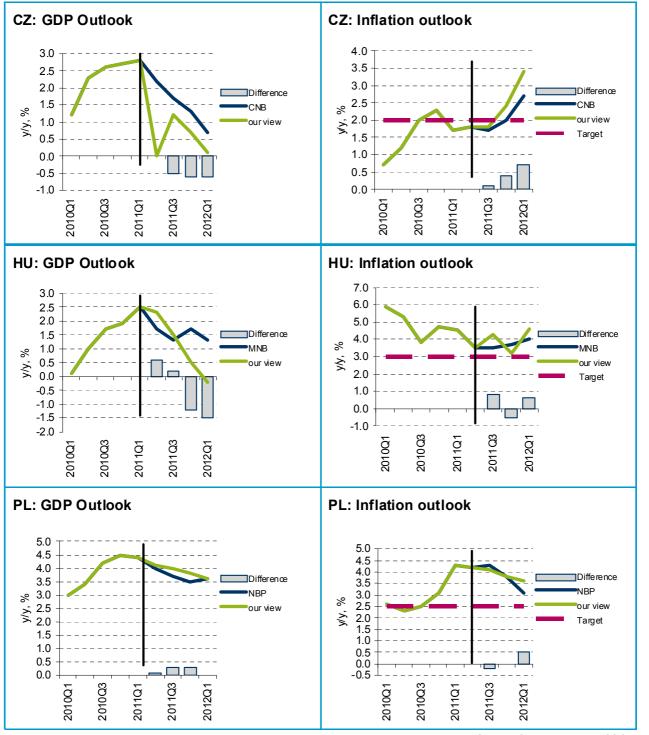
rates **Dutlook for official & market**

Forex Outlook

6



CB's Projections vs. Our Forecasts



Source: CNB, NBP, MNB, CSOB



Summary of Our Forecast

Atungary 2W deposit r. 7.00 6.00 7.00 8.00 8.00 8.00 50 bps 12/20/2011 Poland 2W inter. rate 4.50 4.50 4.50 4.50 4.50 4.75 4.75 25 bps 6/9/2011 Short-term interest rates 3M */BOR (end of the period) Current 2011Q3 2012Q1 2012Q2 2012Q3 Short-term interest rates 3M */BOR 1.17 1.17 1.17 1.12 1.10 1.12 Short-term interest rates 101 1.17 1.17 1.17 1.12 1.10 1.12 Short-term interest rates 107 IRS (end of the period) Current 2011Q3 2011Q4 2012Q1 2012Q2 2012Q3 Carech Rep. CZ10Y 2.2659 2.05 2.24 2.25 2.40 2.60 Jungary HU10Y 7.74 7.50 7.50 9.25 9.25 9.00 Poland PL10Y 4.89 4.80 5.00 5.10 5.20 Exchange rates (end of	Official inter	est rates (end o	of the period)						
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