Bond Research

December 2007

Euro-Visions

Economic and Capital Market Forecast

- Euroland: Growth expected to slow, but not plunge
- No change to euro key lending rates in 1HY
- US: Impact of housing crisis uncertain, but recession should be avoided
- CEE: Business cycle seems to have already peaked
- Corporate Bonds: Volatility to persist until 1Q 2008

ERSTE BANK

Overview

Even though the 2008 **outlook for Euroland's economy** is overshadowed by a number of negative influences, the chances are good that we will see only a **slight dip in the upswing** towards 2%. Supportive are the high employment rates, solid corporate earnings, productivity gains achieved and the sustained upswing on the emerging markets. The **inflation rate** will remain in the range of 3% in the 1HY 2008 due to the high energy and food prices and will move towards 2% again only in 2HY. **Second-round effects** have occurred only in **isolated** cases up to now, but there is a risk of that the higher costs will be passed on more massively than in the past years.

Monetary policy is in a tight spot between economic uncertainty and the turmoil on the capital markets as well as being confronted with growing inflationary risks. We assume that the ECB Council will leave **key lending rates unchanged** until 2HY and will only raise them in 4Q when the outcome of the credit crisis becomes clearer. Currently, **government bonds** do not only have a security premium, but also a liquidity premium and for this reason they are trading at clearly overvalued levels. As the crisis eases, valuations are expected to normalize again, i.e., yields should rise again over the course of the year and by the autumn of 2008, they should reach their starting level of before the crisis.

Based on the continued correction on the US housing market, which will ultimately lead to falling home prices, we expect only **sluggish growth** of the **US economy** in the coming quarters. Moreover, there is also insecurity about the magnitude of the write-offs that will have to be made by US financial institutions. In this context, the situation will **remain tense** in the first quarter of next year, because interest rate adjustments to mortgage loans will lead to further defaults on payment. The main focus of the central bank is currently on the financial sector, and **interest rate cuts seem feasible** only for the purpose of stabilizing the situation. The yield level on the bond market is determined by the crisis of confidence within the financial sector. This **risk premium** should **dissipate** in the course of the first half-year, albeit only to a slight extent at first. Finally, we expect the **US dollar to recover in the coming year**. Market expectations regarding US interest rate cuts are in our view exaggerated and the price drop of the US currency of the last few months might have triggered more exchange rate hedging transactions - forward USD selling - that would be lacking in the coming year.

We expect the **economy to slow** in most **CEE countries**, but this is expected to have largely cyclical causes. In an environment of high energy and food prices, and economic growth that is still relatively strong, the main concern of central banks will be **inflationary risks**. Therefore, a more restrictive monetary policy may be expected in most countries, even if the starting levels and the environments vary widely from country to country. The exceptions to the rule are Hungary and Slovakia. **Hungary's** development is still influenced strongly by the measures being taken to reduce the **current account and budget deficit**, with interest rates declining only gradually along with inflation. The direction of **Slovak monetary** policy will be decided by its **accession** to **EMU** in **2009**. As regards **currencies**, we believe that most of the region has further **firming potential**, at least on the one-year horizon. We expect to see changes to exchange rate regimes in Slovakia and the Ukraine. These changes should result in firmer exchange rates in both countries.

The greatest risk factor for the further development of spreads next year on the **EUR corporate bond market** is in our view the **banking crisis**. Generally, we expect the crisis on the financial markets to last until 1Q 2008 and spreads to continue **volatile at a high level**. There are fears that the stricter accounting rules of the US FASB (FAS 157) will force even more write-off in the billions by US banks in connection with risky debt securities. Only as **2Q** is the market expected to **calm** and thus risk premiums to narrow. However, a movement to past lows is improbable, and the level of yield premiums should remain high.

Content

Content

Analysts:

Dumitru Teodor Dulgheru
Maria Hermanova
Alihan Karadagoglu
Thomas Karall
Alen Kovac
Veronika Lammer
Martin Lobotka
Michal Musak
Orsolya Nyeste
Rainer Singer
Elena Statelov
Mária Valachyová

Interest rate and yield forecasts

3 month money market rates

End of month	current	Mar-08	Jun-08	Sep-08	Dec-08
EURO	4.72	4.35	4.15	4.15	4.35
Japan	0.94	1.00	1.20	1.30	1.40
USA	5.05	4.70	4.30	4.20	4.20
Switzerland	2.75	2.75	2.75	2.75	3.00
Spread to Euribor	-1.97	-1.35	-1.15	-1.15	-1.35

End of month	current	Mar-08	Jun-08	Sep-08	Dec-08
Croatia	7.57	n.a.	n.a.	n.a.	n.a.
Poland	5.54	5.60	5.70	5.70	5.70
Czech Republic	3.82	3.40	3.55	3.60	3.90
Romania	7.56	8.20	8.20	7.70	7.70
Slovakia	4.05	4.30	4.35	4.35	4.30
Hungary	7.48	7.20	6.95	6.70	6.40

10y Yields

End of month	current	Mar-08	Jun-08	Sep-08	Dec-08
Germany	4.00	4.30	4.60	4.70	4.70
Austria	4.13	4.40	4.65	4.75	4.75
Spread to GE	0.14	0.10	0.05	0.05	0.05
France	4.13	4.40	4.65	4.75	4.75
Spread to GE	0.14	0.10	0.05	0.05	0.05
Netherlands	4.11	4.40	4.65	4.75	4.75
Spread to GE	0.12	0.10	0.05	0.05	0.05
Spain	4.21	4.50	4.65	4.75	4.75
Spread to GE	0.22	0.20	0.05	0.05	0.05
Italy	4.37	4.60	4.85	4.95	4.95
Spread to GE	0.38	0.30	0.25	0.25	0.25
Belgium	4.22	4.50	4.65	4.75	4.75
Spread to GE	0.23	0.20	0.05	0.05	0.05
Portugal	4.14	4.45	4.75	4.85	4.85
Spread to GE	0.14	0.15	0.15	0.15	0.15
Ireland	4.23	4.50	4.65	4.75	4.75
Spread to GE	0.23	0.20	0.05	0.05	0.05
Finland	4.12	4.40	4.65	4.75	4.75
Spread to GE	0.13	0.10	0.05	0.05	0.05
Greece	4.35	4.60	4.90	5.00	5.00
Spread to GE	0.36	0.30	0.30	0.30	0.30
USA 10Y	3.91	4.20	4.50	4.60	4.60
USA 30Y	4.33	4.50	4.90	5.00	5.10

End of month	current	Mar-08	Jun-08	Sep-08	Dec-08
Croatia	5.48	5.10	5.10	5.20	5.20
Poland	5.72	5.65	5.60	5.55	5.50
Czech Republic	4.63	4.80	4.90	4.80	4.80
Romania*	8.10	7.50	7.50	7.40	7.40
Slovakia	4.70	4.80	4.80	4.80	4.90
Hungary	6.83	6.50	6.10	6.00	5.80

* 5y

Source: Erste Bank Research

FX forecasts

Exchange rates

End of month	current	Mar-08	Jun-08	Sep-08	Dec-08
EUR/USD	1.4831	1.43	1.38	1.35	1.35
EUR/JPY	160.23	153.0	144.9	141.8	139.1
USD/JPY	108.03	107.0	105.0	105.0	103.0
EUR/CHF	1.63	1.60	1.55	1.55	1.55
USD/CHF	1.10	1.12	1.12	1.15	1.15

End of month	current	Mar-08	Jun-08	Sep-08	Dec-08
EUR/HRK	7.32	7.30	7.25	7.25	7.3
EUR/PLN	3.65	3.55	3.6	3.55	3.51
EUR/CZK	26.4	27.2	27.1	26.5	26.3
EUR/RON	3.53	3.45	3.40	3.35	3.40
EUR/SKK	33.4	32.4	32.5	32.5	32.5
EUR/HUF	254	255	255	256	256

Source: Erste Bank Research

Economy

Changes y/y

GDP growth in %	2006	2007e	2008f	2009f
Austria	3.3	3.4	2.4	2.5
Germany	3.1	2.6	2.1	2.3
France	2.2	2.2	1.9	2.2
Italy	1.9	2.0	1.6	1.8
Spain	3.9	3.8	2.5	2.5
Netherlands	3.0	2.7	2.4	2.7
Euroland	2.9	2.6	2.1	2.3
USA	3.3	2.2	2.2	2.6
Japan	2.2	2.0	2.2	2.4
Switzerland	2.7	2.5	2.3	2.2

Real GDP (growth y/y %)	2006	2007e	2008f	2009f
Croatia	4.8	5.9	4.7	4.9
Poland	6.2	6.5	5.5	5.8
Czech Republic	6.4	5.9	4.3	5.4
Romania	7.7	5.7	6.1	6.0
Serbia	5.7	6.9	6.6	6.8
Slovakia	8.5	8.9	7.2	5.3
Ukraine	7.1	7.1	6.6	6.0
Hungary	3.9	1.7	2.5	3.5

Inflation in %	2006	2007e	2008f	2009f
Austria	1.5	1.9	2.0	1.7
Germany	1.8	2.3	2.2	2.0
France	1.8	1.6	2.1	1.9
Italy	2.4	2.0	2.4	2.2
Spain	3.1	2.6	3.3	3.0
Netherlands	2.6	1.7	2.3	2.6
Euroland	2.2	2.1	2.6	2.3
USA	3.2	2.8	1.9	2.2
Japan	0.3	0.0	0.5	1.0
Switzerland	1.1	1.6	1.8	2.0

CPI (y/y, average%)	2006	2007e	2008f	2009f
Croatia	3.2	2.7	3.4	3.0
Poland	1.3	2.4	3.2	2.9
Czech Republic	2.5	2.7	5.3	3.6
Romania	6.6	4.8	6.0	4.7
Serbia	20.9	20.0	19.0	18.0
Slovakia	4.5	2.7	3.4	3.5
Ukraine	9.2	12.5	13.2	10.8
Hungary	3.9	7.9	5.2	3.0

Source: Erste Bank Research

10y benchmark performance

	current	Mar-08	Performance	Jun-08	Performance	Sep-08	Performance	Dec-08	Performance
Germany	4.00	4.30	-1.06%	4.60	-2.24%	4.70	-1.85%	4.70	-0.74%
Austria	4.13	4.40	-0.69%	4.65	-1.46%	4.75	-1.05%	4.75	0.08%
Spread to GE	0.14	0.10		0.05		0.05		0.05	
France	4.13	4.40	-0.73%	4.65	-1.52%	4.75	-1.11%	4.75	0.02%
Spread to GE	0.14	0.10		0.05		0.05		0.05	
Netherlands	4.11	4.40	-0.67%	4.65	-1.28%	4.75	-0.80%	4.75	0.33%
Spread to GE	0.12	0.10		0.05		0.05		0.05	
Spain	4.21	4.50	-0.85%	4.65	-0.86%	4.75	-0.46%	4.75	0.68%
Spread to GE	0.22	0.20		0.05		0.05		0.05	
Italy	4.37	4.60	-0.22%	4.85	-0.87%	4.95	-0.38%	4.95	0.80%
Spread to GE	0.38	0.30		0.25		0.25		0.25	
Belgium	4.22	4.50	-0.75%	4.65	-0.76%	4.75	-0.35%	4.75	0.79%
Spread to GE	0.23	0.20		0.05		0.05		0.05	
Portugal	4.14	4.45	-0.67%	4.75	-1.43%	4.85	-0.87%	4.85	0.29%
Spread to GE	0.14	0.15		0.15		0.15		0.15	
Ireland	4.23	4.50	-0.47%	4.65	-0.36%	4.75	0.13%	4.75	1.27%
Spread to GE	0.23	0.20		0.05		0.05		0.05	
Finland	4.12	4.40	-0.79%	4.65	-1.57%	4.75	-1.16%	4.75	-0.03%
Spread to GE	0.13	0.10		0.05		0.05		0.05	
Greece	4.35	4.60	-0.45%	4.90	-1.51%	5.00	-1.03%	5.00	0.16%
Spread to GE	0.36	0.30		0.30		0.30		0.30	
USA 10Y	3.91	4.20	-0.96%	4.50	-2.14%	4.60	-1.76%	4.60	-0.68%
USA 30Y	4.33	4.50	-1.28%	4.90	-6.11%	5.00	-6.38%	5.10	-6.62%

Euroland

Economy

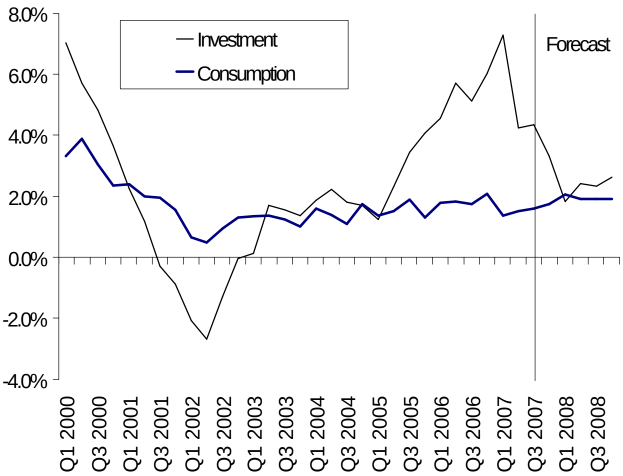
y/y change	Share of GDP	2005	2006	2007e	2008f	2009f
Private consumption	57.0%	1.5%	1.9%	1.6%	1.9%	2.3%
Public consumption	19.6%	1.4%	2.0%	1.9%	1.7%	1.5%
Investment	21.4%	2.8%	5.4%	4.8%	2.3%	2.8%
Inventories EUR bn		13.9	12.0	10.0	6.0	7.0
Domestic demand	98.2%	1.9%	2.6%	2.4%	1.9%	2.4%
Exports	41.1%	4.6%	8.0%	5.4%	4.6%	5.1%
Imports	39.3%	5.4%	7.7%	4.7%	4.5%	5.4%
External balance EUR bn	1.8%	131.1	149.8	178.8	187.7	189.3
GDP real	100.0%	1.6%	2.9%	2.6%	2.1%	2.3%

Source: Datastream, Erste Bank Research

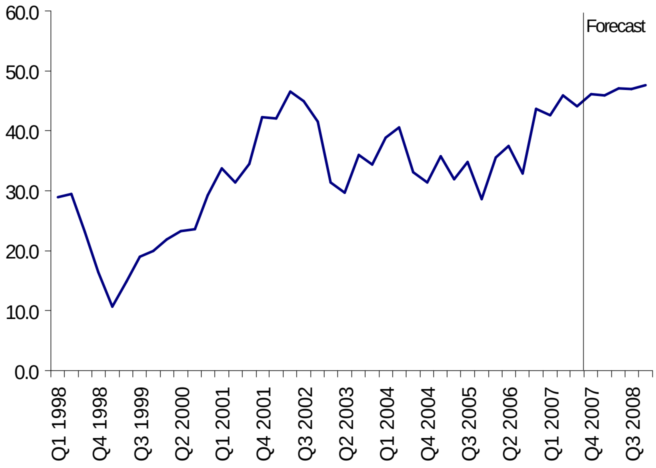
Robust economy in 2007

The year 2007 started out with surprisingly strong growth and ended with an uncertain outlook for 2008. In the first half of 2007, the annual growth rate was 2.8%, although there was a plunge in private consumption, as expected in Germany due to the hike in VAT. Investment activity more than compensated this negative effect. Almost simultaneously with the beginning of second half-year, the financial market crisis started and hit a robustly growing, optimistic economy. GDP data for 3Q do not yet show any effects of the crisis, and at 0.7% q/q growth, the economy even did very well. The data available up to now for 4Q lead one to expect slightly slower economic growth, and overall, we expect real GDP to rise by 2.6% for 2007.

Investments and consumption y/y in %



Net exports in EURbn per quarter



Source: Datastream

The list of risks has become longer

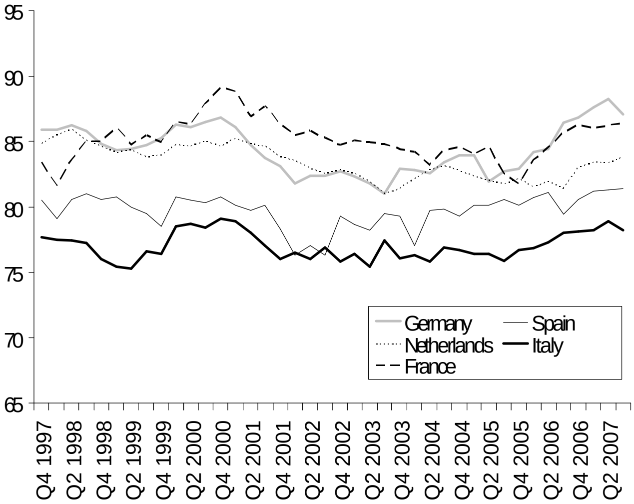
The outlook for the year 2008 is overshadowed by some negative developments. The list of risks for 2008 includes - like in the past - energy price trends and weaker demand from the US. New additions are other inflationary risks such as rising food prices and possible second-round effects as well as risks from the banking crisis. In our forecast, we assume that loans will become more expensive, but do not believe that lending policies will become more restrictive for investments in capital goods or for consumer loans. As regards inflationary risks, we do not expect any further increase in food or energy prices. The USD is expected to recover from its currently very low level in 2008. We have revised our forecast prepared in May of sustained strong growth in 2008 downwards to a growth expectation of +2.1%, which is slightly below the potential growth line.

Euroland

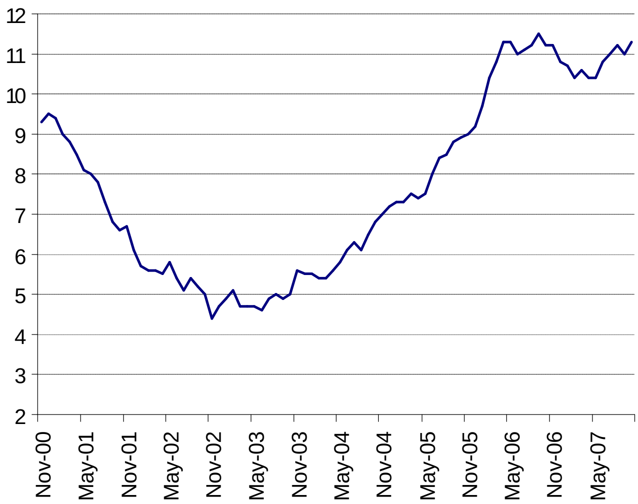
Investment activity losing steam, but still contributing to growth

Investment activity was the driving force behind the strong growth that prevailed well into the first quarter of 2007. Even though investment activity seems to have peaked, the euro zone is now benefiting from years of restraint, as a backlog in demand has built up that point to sustained investment activity in 2008. This is being bolstered by the still high level of capacity utilization, the strong rise in corporate profits and higher productivity. An indication of the fact that the current turmoil on the credit markets has not brought investment activity to a standstill are - apart from GDP data for 3Q - the figures on lending to companies outside the financial sector. Year-on-year, loans have risen by almost 11%.

Capacity utilization in %



Growth in lending to companies y/y/ in %



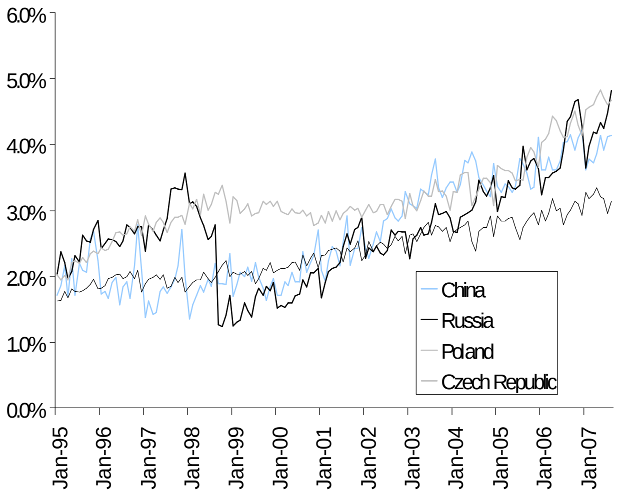
Source: Datastream

Exports slower over medium term due to steep rise of the euro

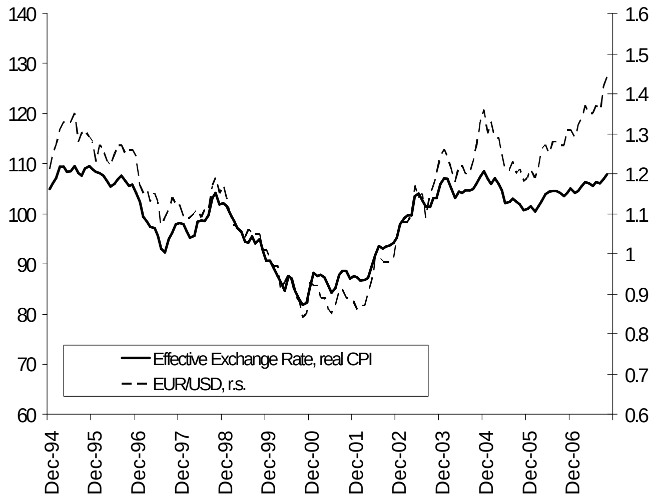
Net exports were up again in 2007 although the euro continues to firm. The rise of the euro over the USD at a simultaneously slowing US economy is reflected quite clearly in the stagnation of exports to the region, but at the same time, exports to other markets have increased massively. The rates of increase were mainly higher in demand from oil-exporting countries for products from the euro area as well as regarding exports to China and the CEE countries. Thus, the share of exports to the US in total exports declined to only 12%, while the share to China, Russia and Poland is now almost 15%. The upswing in the emerging markets is causing a shift in trade relations, and this trend is expected to continue in the next two years. The main criterion for assessing the export dynamic is economic growth in the target countries. A second argument is the exchange rate trend. As economic growth in the emerging markets is still robust, the environment for the exporting economy is generally positive. However, the high external value of the euro is expected to check this dynamic a bit. Overall, net exports are expected to stagnate in the next two years.

Euroland

Share of target countries in total exports



External value of the euro



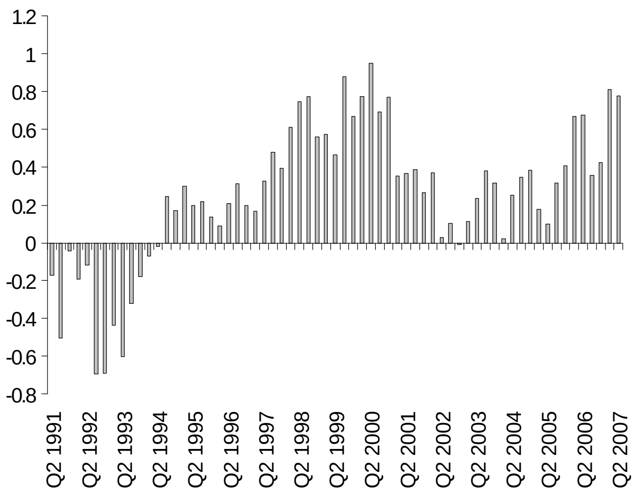
Source: Datastream

High employment rates expected to support consumption in the coming two years

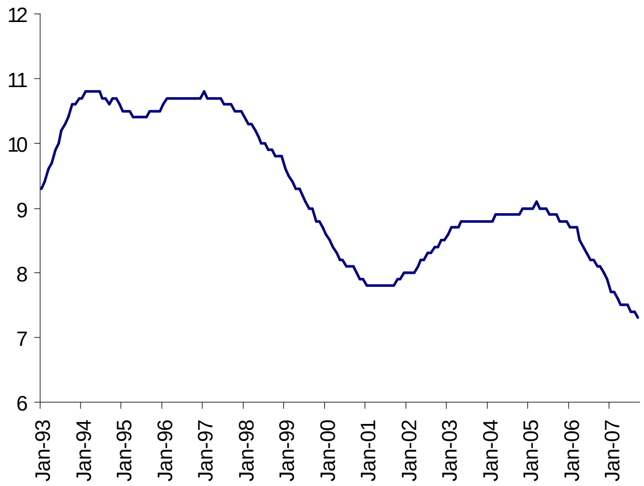
Employment has increased significantly in the last two years. In 2006 and 2007, the growth rate of open positions reached 1.5% and the outlook is bright for 2008 as well. The lively investment activity of the past few quarters has even lifted demand for personnel in the manufacturing sector. Companies from the service sector recently increased their plans for hiring personnel. In 2008, the number of additional jobs is expected to grow further, but the growth rate should return to the level of 1%. Before this backdrop, private consumption is expected to gain significance.

Private consumption grew at below average rates in the past few years. Even in 2006, which was marked by rising employment and advance purchasing in Germany, the growth rate remained below 2%. Nonetheless, we expect the dynamic to strengthen in 2008 and 2009. In our opinion, the signs pointing in this direction are, apart from the additional income of newly hired employees, also the sentiment of greater job security which eases the necessity to save as a precaution. However, the higher prices for energy and food will be a burden and directly weaken purchasing power. The generally slightly higher negotiated wages are expected to more than compensate this disadvantage in 2008.

Employment growth in 100,000 positions per quarter



Unemployment rate in %



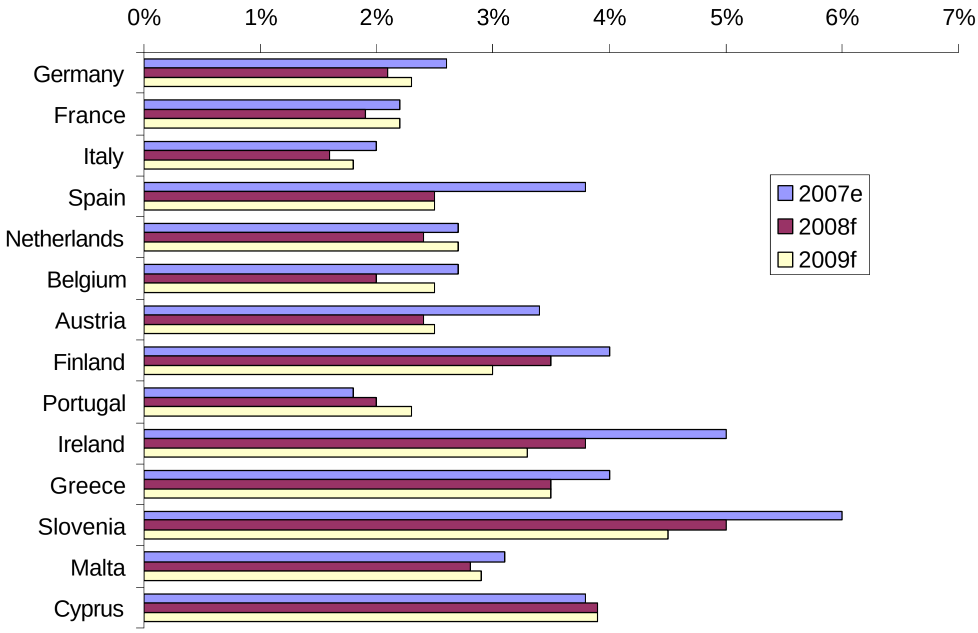
Source: Datastream

Euroland

Forecasting risks

The risks to the economic forecast are in weaker-than-expected growth. The reasons for a more sluggish economy could be tighter lending to companies and consumers, another steep rise in commodity prices or a plunge of the USD. In all of these cases, one would have to reckon with a lasting slowdown in growth. Less of a threat for Euroland's economy would be a recession in the US in our opinion.

GDP growth of participating countries



Source: Erste Bank Research

Inflation

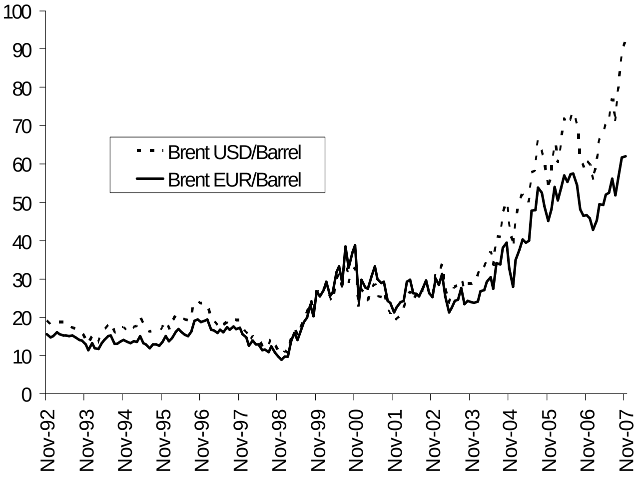
Inflation climbs to nearly 3%

The inflation rates rose very steeply in the months of October and November. At an high oil price, the Euroland inflation has reached 3% in November. In Germany, this figure has also been reported for November, with the hike in VAT in January 2007 probably adding an extra 0.7% to the overall annual inflation rate.

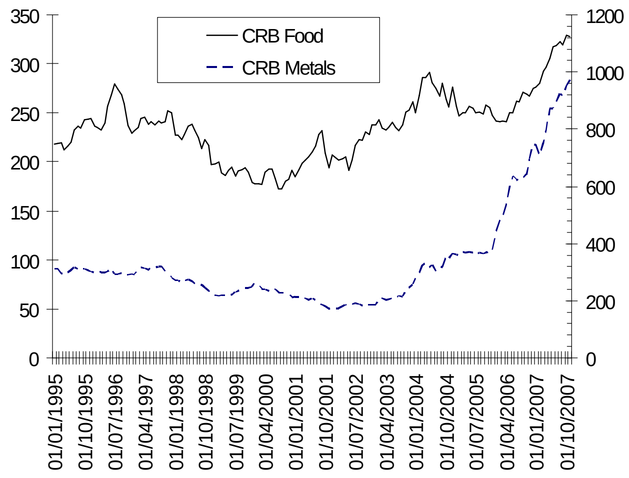
Commodity prices still high

The further development of inflation depends, on the one hand, on the further course of commodity prices - especially for fuel and food - and on the other, on possible second-round effects. We expect commodity prices to go on a sideways trend in 2008. The continued rising demand from the emerging markets should be able to compensate the dip in the economy in the US. On the supply side, crude oil prices will probably continue to be weighed down by political insecurity. The high energy costs are having an impact on food prices. Over the long term, expansion in agriculture and thus a greater supply is expected, but for now, these factors are not being taken into account as a cost-lowering influence. The important weather factor cannot be estimated. Therefore, we expect the oil price and food prices to remain at a high level, but not to rise further.

Oil price in euro



Commodity prices - food and metals, Index

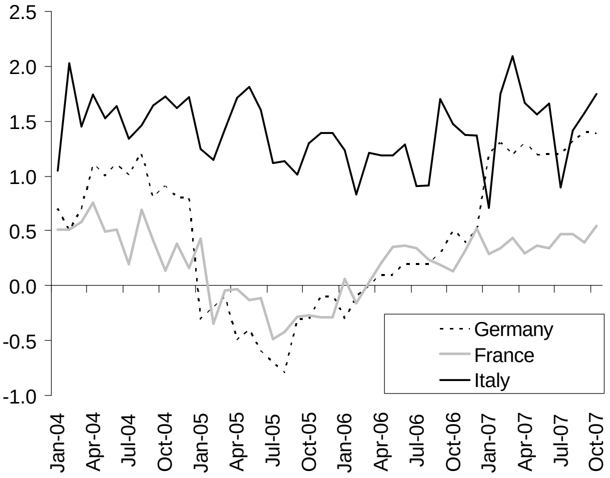


Source: Datastream

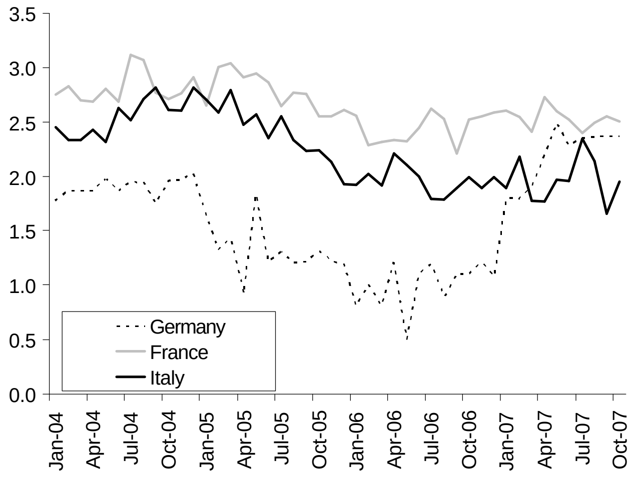
Second-round effects only in a few areas for now

The second-round effects have been clearly identified only for foods, which have become more expensive due to higher energy prices. In the group of "other goods and services", no clear trend has yet been identified and wage negotiations have been moderate across a broad front. However, dissatisfaction with years of low real wage increases is growing and producer prices are indicating higher prices for consumer goods as well as for non-durable and durable goods. The charts below show the inflationary trends in the segments of goods exclusive of energy, and foods and services in the three largest participating countries. It is easily recognizable that the prices of services are trending sideways and as regards goods, a flat uptrend seems to be forming. The two charts clearly illustrate that the phase of deflation in Germany is over, even though the uptrend was distorted in 2007 by the VAT hike.

Industrial goods without energy, y/y in %



Service Sector, y/y in %



Source: Datastream

Inflation rate 2008 much higher due to base effect in the energy and food sectors

The inflation-driving factors of energy and food contrast with the inflation-dampening effects of a high external value of the euro and a slightly cooling off economy. We expect the second-round effects to play a minor role in the coming year and the most influential factors to be the base effects. These effects alone have already caused inflation to rise to 2.6% on the annual average, with values of up to 3% being possible in the first quarter. The core inflation rate exclusive of energy and food is expected to be around 2% by contrast. We expect an inflation rate of 2.3% for 2009.

We have prepared our inflationary forecast for 2008 based on the following assumptions:

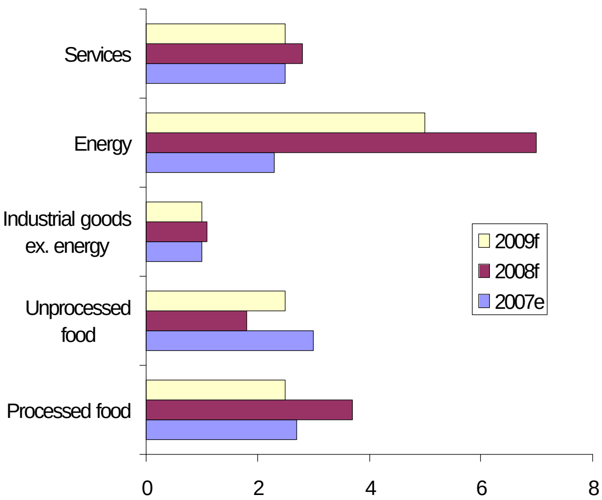
- The oil price will be 95 USD/ barrel on average in 2008.

- Over the course of the year, the USD may recover vs. the euro towards a level of 1.35 EUR/USD in 2008

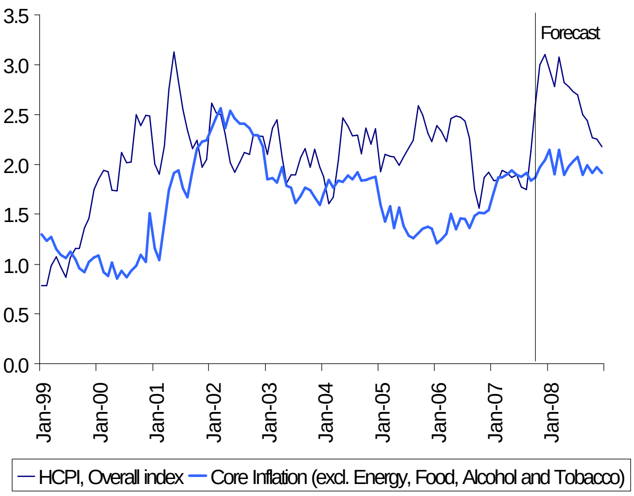
- Global market prices for foods will not rise further, but are trading sideways.

- There will be nearly no second-round effects on services and industrial goods.

Components of inflation forecast, y/y in %



Inflation rate and forecast, y/y in %

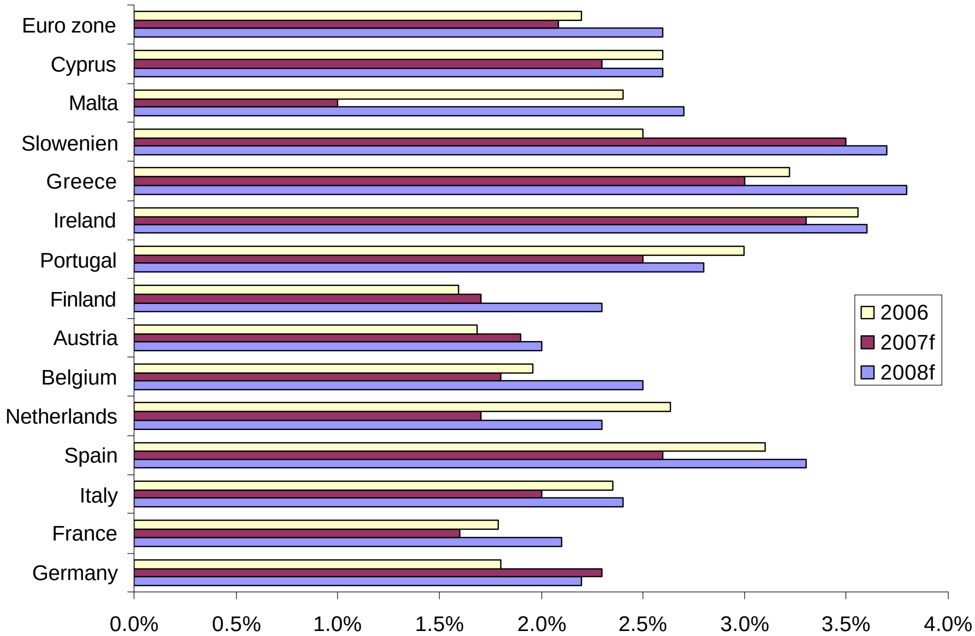


Source: Datastream, Erste Bank Research

Risk of a longer-lasting rise of inflation

However, the risk of this forecast clearly points upwards. On the one hand, another rise of commodity prices cannot be ruled out, and on the other, the environment of higher and growing employment and greater consumer demand speaks in favour of second-round effects. Unlike earlier price shocks, which only had effects in individual years, the oil price has been on the rise since 2003 and has therefore already caused purchasing power to decline for several years and the costs for companies to rise. The increase in food prices seen up to now could trigger demands for much higher wage hikes. The good earnings situation of companies and the high employment levels appear as a good setting for negotiating higher wages. However, price discipline among companies might slacken before a backdrop of stable and rising demand, and steeper prices for services and goods may follow.

Inflation rates of the member countries, y/y



Source: Datastream, Erste Bank Research

Monetary Policy

ECB continues to wait

At present, the ECB perceives its main task in ensuring a functioning money market and in striving to calm markets. The ECB does this, on the one hand, by making it clear that no further interest rate hikes are to be expected, and on the other, by stressing that it would appropriately counter any inflationary risks. There seems to be an agreement that the main focus is on the second-round effects. As long as no signs of such effects crop up, exogenous price shocks from fuels and foods will be viewed as temporary phases. This stance is possible at the current - in our view neutral - interest rate level and before the backdrop of a high external value of the euro.

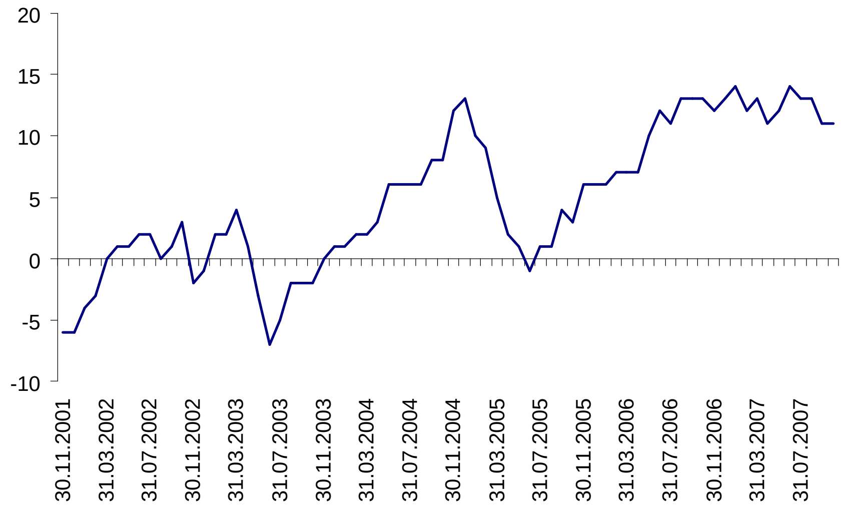
Second-round effects and inflationary expectations

As second-round effects - once they have started - are hard to stop, the ECB is watching out for any first signs of such a development. This is being done by using various indicators for inflationary expectations. These include the findings of surveys among consumers and businesses as well as their assessment of price trends and surveys among economists regarding their long-term assessment of inflation in addition to the data collected on the capital markets.

Indicators for inflationary expectations show divergent results

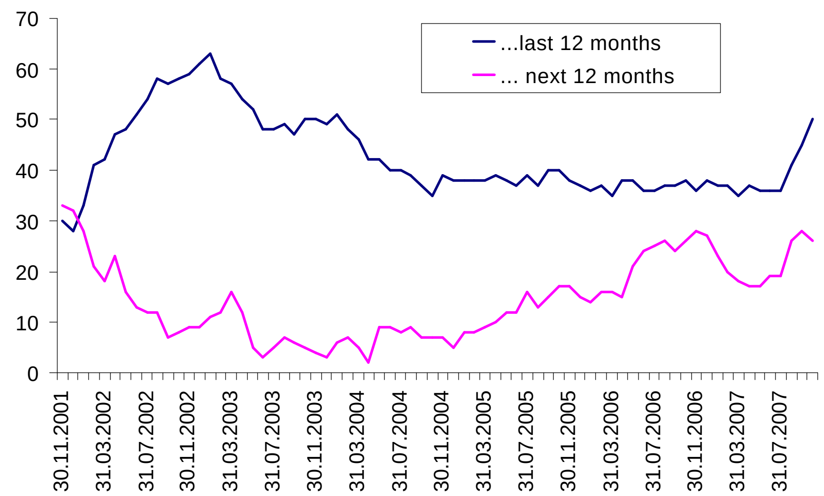
In the recent past, some of these indicators have confirmed an upwards trend, while a few others have moved sideways. Thus, economists are convinced that the long-term inflation figure will be 2% or just below. The assessment of the obtainable selling prices by companies even declined slightly in the past few months. Consumers have perceived the rise in food prices since the summer as significant and have raised their expectations regarding further price trends.

Assessment of selling prices by companies



Source: Bloomberg

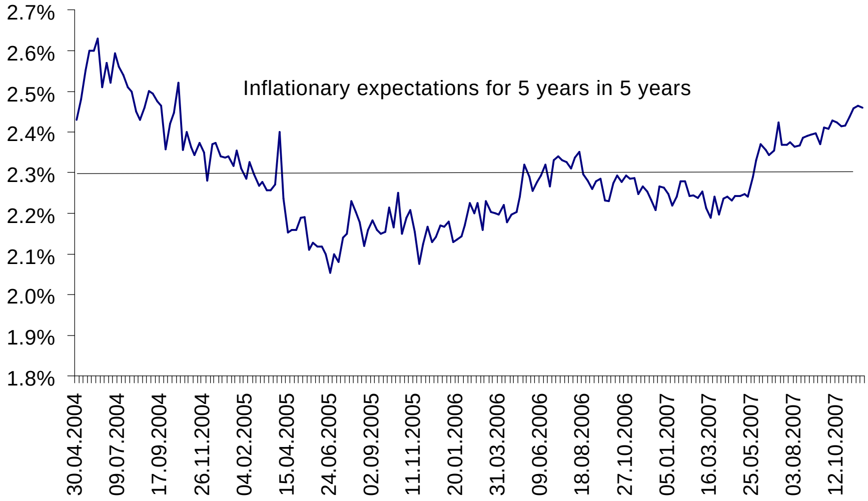
Consumers: Assessment of price trends of ...



Source: Bloomberg

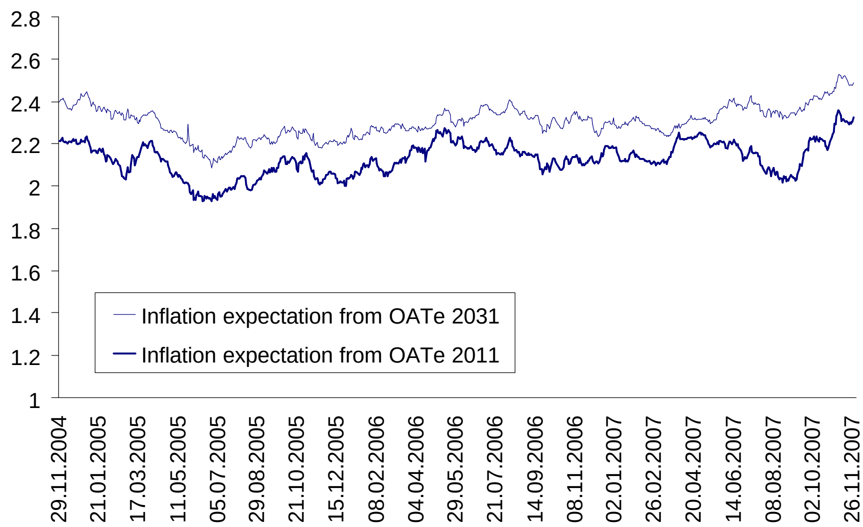
The inflationary expectations on financial markets have been pointing upwards since the end of 2Q. Thus, the five-year indicator of inflationary expectations that ECB President Trichet referred to at his last press conference - derived from inflation-linked swaps in this case - estimates inflation for five years in five years to reach 2.5%, which is 0.2% higher than the average of the past 3.5 years. A similar course is being shown by the expectations derived direct from inflation-protected government bonds.

Inflationary expectations derived from swap rates



Source: Bloomberg, Erste Bank Research

Inflationary expectations derived from government bonds, in %



Source: Bloomberg, Erste Bank Research

How will the ECB Council react?

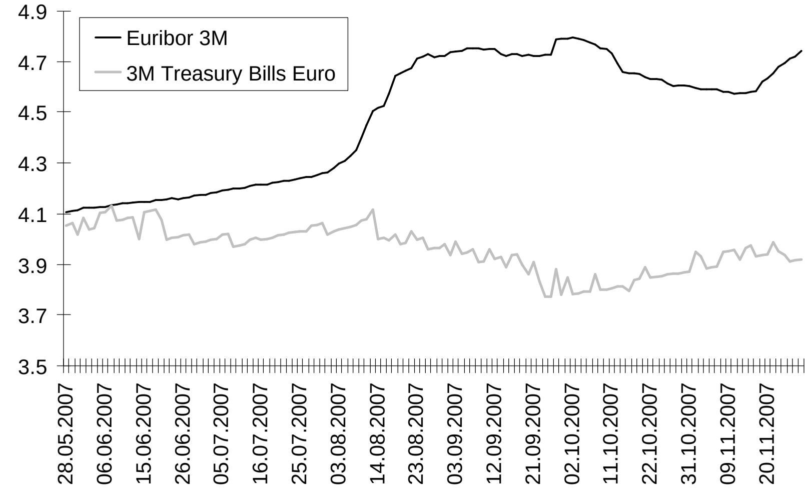
The question is as of when will the ECB Council view an intervention as necessary. When all indicators point in this direction or when a certain threshold is reached? There is no clear answer to this question. At present, no need for action is perceived. Another question is whether it will take action irrespective of all other factors such as growth or exchange rates. We do not assume this. As already seen in this crisis, all factors are considered when taking a decision.

Key lending rates unchanged at 4% into 3Q

Before a backdrop of a crisis on financial markets that will probably last into the first quarter of 2008, the still high external value of the euro and the expected cooling off of the economy to just below potential growth, we do not perceive any need to take action until the middle of next year for the ECB Council. We expect an economic recovery to start in the US in 3Q and the exchange rate to drop below 1.4 EUR/USD. This will raise the probability of an interest rate hike in 3Q, but in our core scenario, the ECB Council will only take action in 4Q 2008 when it becomes certain that the economy in Euroland is picking up again.

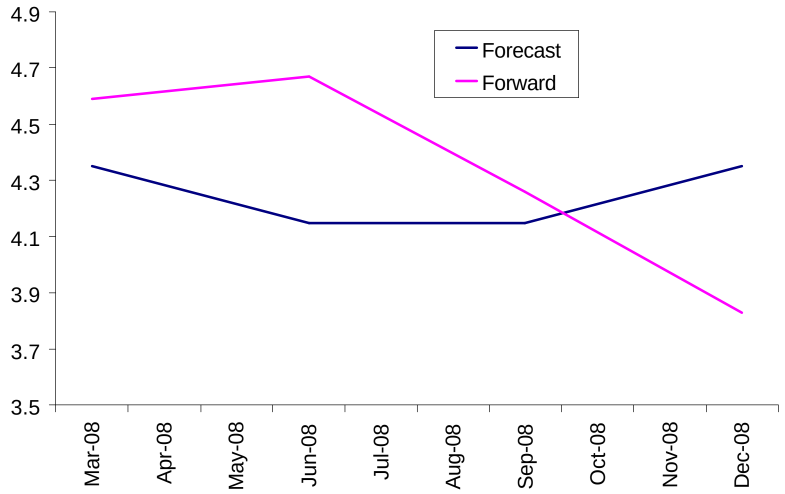
Interest rates on the inter-bank market have moved even further away from key lending rates in the past few months and even further from government bonds with similar maturities. In the course of the first months of next year, this security premium is expected to decrease again. We expect a decline in 1Q of the 3M Euribor to 4.35% and by mid-year, the Euribor is expected to hit 4.15%. A comparison with currently priced in expectations in the market presents a completely different picture that can be explained by the distortion of the interest rate curve due to the market turbulence.

Inter-bank market rate and government interest rate in %



Source: Bloomberg, Erste Bank Research

Forwards and forecasts of 3m EURIBOR in %



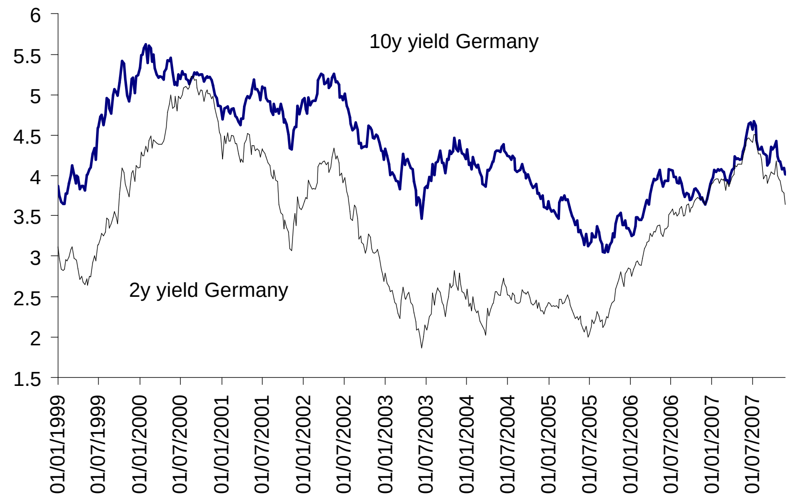
Source: Bloomberg, Erste Bank Research

Bond market

Save havens at any price

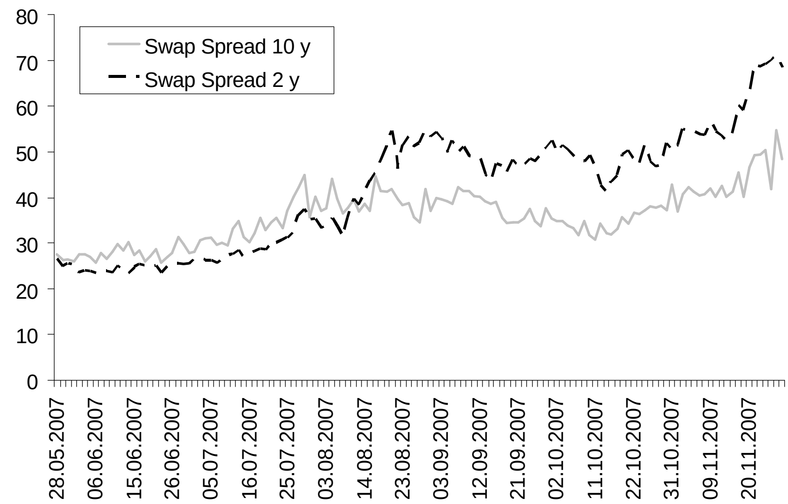
The government bonds markets were the only safe havens in the past few weeks and months in a sea of turmoil. The nervousness was so great that even in this segment quality differentiations were made. Thus, German government bonds outperformed all other euro government bonds due to their high credit ratings and liquidity. Yield premiums of other AAA euro government bonds rose from nearly 0 in 2Q to now over 10 basis points. Government bonds with lower credit ratings even attained premiums of 35 basis points. The swap market responded with strongly widening spreads and the chart shows that after a first shock in the months of July and August, spreads widened again in November massively. Since August, two-year swap spreads have been higher than the ten-year ones.

Yields of German government bonds in %



Source: Bloomberg

Swap spreads in basis points

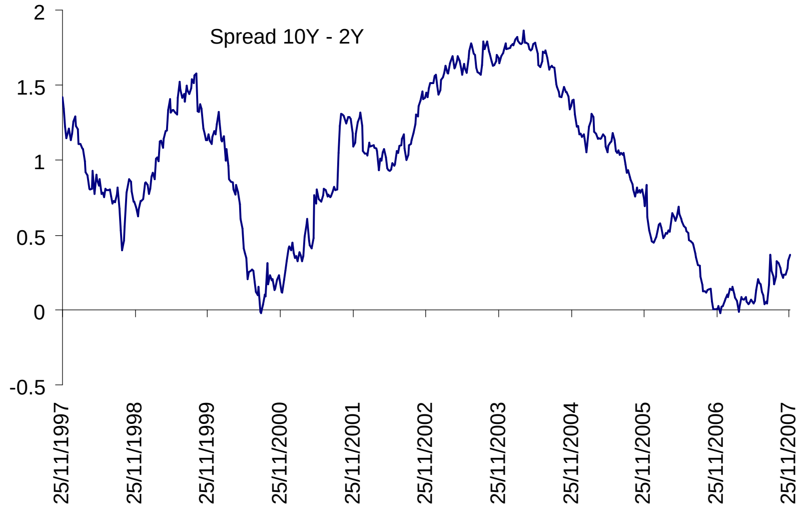


Source: Bloomberg

Yield curve has steepened

The trend towards low-risk investments additionally favours short-term bonds and therefore, the yield curve of government bonds has steepened starting from the short end. As in the past few years, the time spread of euro government bonds followed that of US Treasuries. As interest rate cuts have been expected for the US - and these were also carried out - it was possible to argue the steepening of the yield curve rationally for a while even though now it seems to have advanced too far. However, for Euroland, only very few analysts expect interest rate cuts on the one year horizon, making a rational explanation difficult in this case. This is also shown in the swap rates for which a steepening of the curve has been determined, although it was much weaker. Thus, the time spread of 10 years yields minus 2 years yields is currently 33 basis points for government bonds and 16 basis points for swap rates.

Time spread government bonds

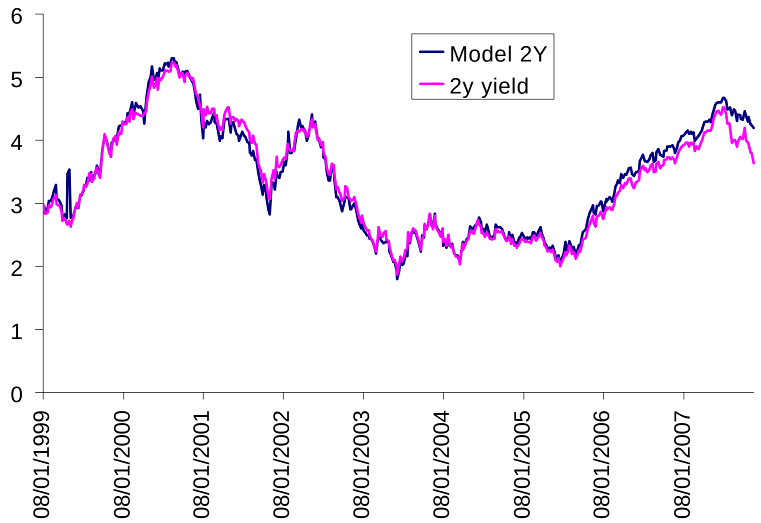


Source: Bloomberg, Erste Bank Research

Government bonds of all maturities overvalued

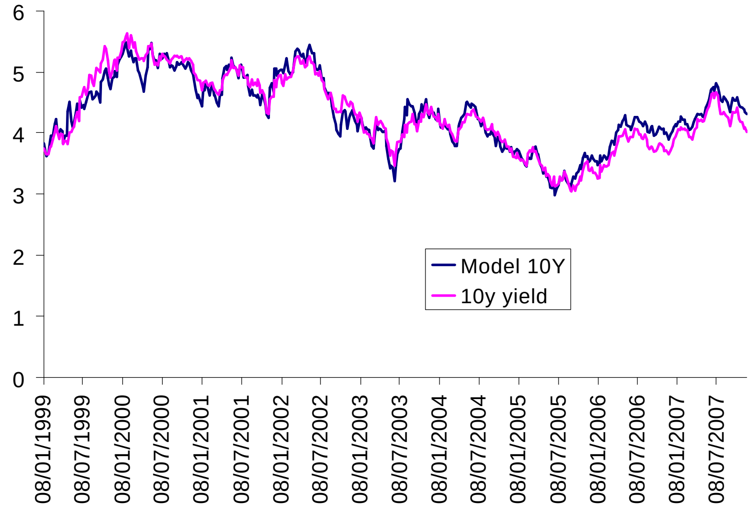
It is not only short government bonds, but the entire maturity range that seems extremely overvalued at present. According to our models, 10-year German bonds would be appropriated valued at a yield of 4.30%, and for two-year bonds, the fair value would currently be 4.20%. For fundamental consideration, ten-year German government bond yields with just over 4% seems massively overpriced in an environment marked by an inflation rate of 3%, an outlook of further inflation pressure, and key lending rates of 4%. Nonetheless, we do not expect any major changes until the end of 2007. As a growing number of submarkets are becoming illiquid - bid/ask spreads are at an unnaturally high level - government bonds enjoy not only a security bonus but also a liquidity bonus.

Valuation of 2y German government bonds



Source: Datastream, Erste Bank Research

Valuation 10y German government bonds

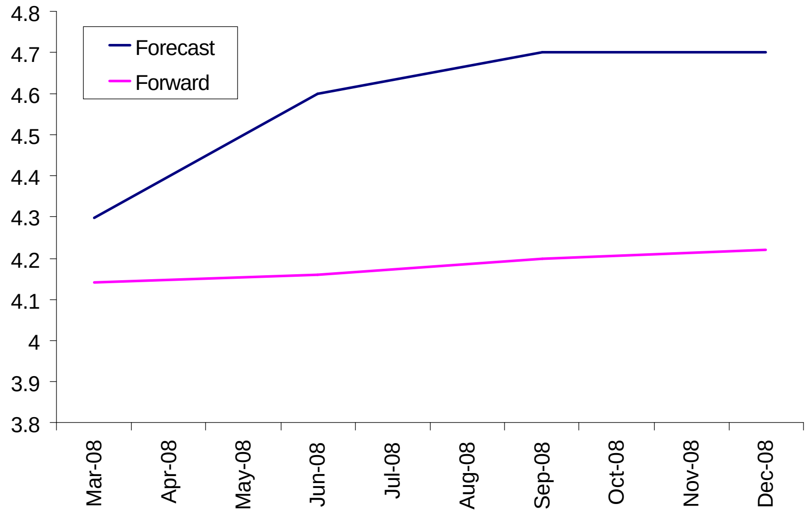


Source: Datastream, Erste Bank Research

Crisis expected to ease in the course of 1 HY

A calming of the current market turbulence seems probable in the first quarter. Initial relief is expected for sure around the end of the year, as with the start of the new year, investors will again be willing to take risks, even more so considering that risk premiums have risen considerably. However, a real relaxation of the crisis will only come about after the financial statements for the 2007 are presented and the effects of the stricter US accounting standards (see Corporate Bond section) on US banks become clear. In line with this assessment, we expect government bond yields to rise over the course of the year, with the strongest movement expected for 2Q. The starting situation of before the crisis of 4.7% on 10-year government bonds should be reached again by September 2008. The swap spreads are expected to decrease at the same pace, resulting in the 10-year swap premiums hitting 30bps by mid-year.

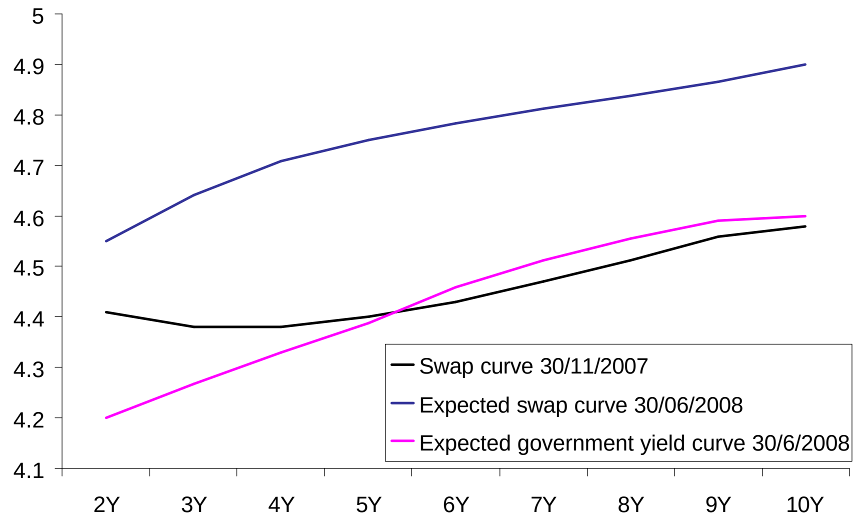
Forecast: 10y government bond yields



Source: Bloomberg, Erste Bank Research

Euroland

Forecast: Yield curve swaps and government bonds



Source: Datastream, Erste Bank Research

Veronika Lammer

Economy

y/y change	2006	2007	2008f	2009f
GDP grow th (%)	2.9	2.2	2.2	2.6
Investments (%)	2.8	-3.8	1.9	2.7
Private consumptions (%)	3.1	2.8	1.4	2.3
Exports (%)	6.9	8.4	8.0	7.7
Imports (%)	5.9	5.9	2.1	2.4
Current account balance (% of GDP)	-6.6	-5.5	-4.8	-4.5
CPI (y/y, average%)	3.2	2.8	1.9	2.2
Unemployment rate (%)	4.6	4.6	5.2	5.5
Govt. budget balance (% of GDP)	-1.9	-1.4	-1.3	-1.6
Public debt (% of GDP)	37.0	36.6	36.1	35.8

Source: Congressional Budget Office, Erste Bank Research

US economy will grow slowly

The subprime crisis, the housing crisis, the financial market crisis, etc. that have dominated market events in the past few months are, in fact, a series of problems that are interrelated due the real estate market, but concern different areas of the economy. The common denominator is the insecurity over the ultimate damage to the economy.

The three stages of the emergence of the crisis

A brief summary of the events of the past years in three stages: 1st Stage: Low interest rates (global) led to a boom on the US housing market as of 2003. The higher prices and growing demand fed on each other and low interest rates made it possible for households to significantly increase their levels of indebtedness and in this manner supported economic growth. 2 nd Stage: When the real estate boom lost steam sometime in 2005, mortgage providers attempted to prolong it by granting more loans to subprime debtors. This was not very difficult considering that the loans could be resold to investors in securitized form. 3rd Stage: To top it off, financial institutions also invested considerable funds in derivatives that were often made-to-order structured products and therefore illiquid. The difficulty in valuating these products due to lacking market prices, the generally underestimated potential for losses, the lacking transferability and the uncertainty about further write-offs are the causes of the persistent tension on the financial markets.

Weakening consumer demand, recovery of the financial sector only in 2Q

The correction on the US real estate market will persist far into the year 2008 due to the still existing overcapacities. Our outlook for the economy rests on two major assumptions:

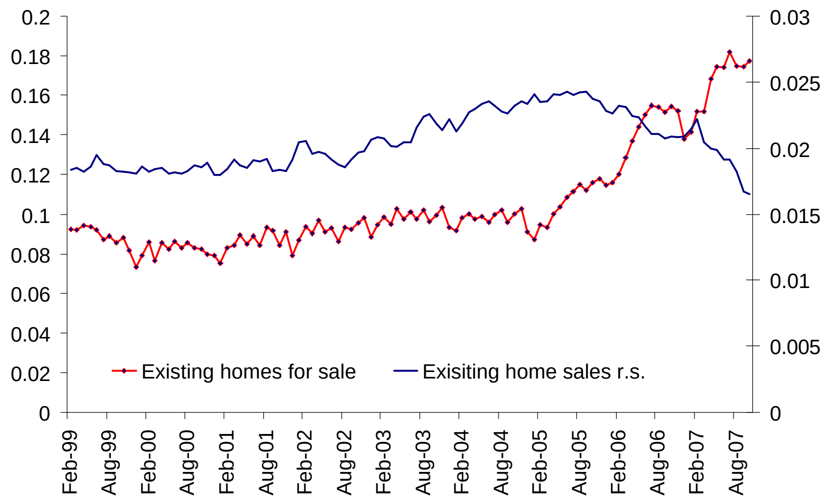
1.) Prices of single family homes will decrease. The wealth tied up in these properties will diminish, and this will have a negative effect on the propensity to consume. We therefore expect only weak growth in consumer spending in the coming quarters.

2.) The effects on the US financial sector are not yet over, as the defaults on payment by mortgage debtors will continue to rise in the period ahead. This will be caused mainly by the adjustments to interest rates for significant volumes of subprime loans in the coming months. However, we assume that the US financial sector will not be bent out of shape for any longer-lasting period, because the losses should be absorbable for the overall sector, even if the actual magnitude of the write-offs is ultimately hard to assess.

High levels of inventories point to a decline of real estate prices

We would first like to discuss consumption that has managed to hold up quite well up to now. Why should consumers become more cautious in their spending habits in the coming months? The reason is that up to now, at least at the national level, there have hardly been any declines in home prices. This will change due to the large volume of inventories. Additionally, demand from the subprime customer segment, which as already mentioned was responsible for the prolongation of the boom will disappear. Just as scantily as home prices have dropped up to now, neither have we seen any decline in inventories (= unsold homes). So, the actual correction still lies ahead for the real estate market.

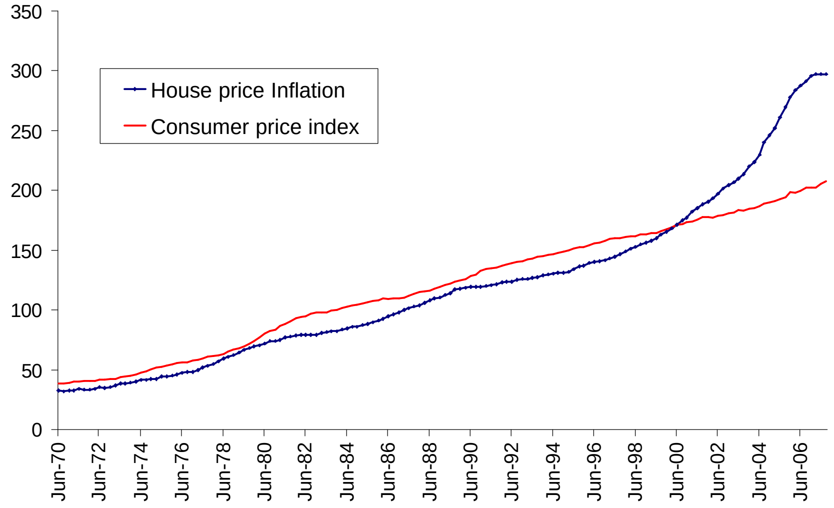
Existing homes/population



Source: Bloomberg

The need for consolidation in inventories can be assessed for the medium to long term and is around 40%. What is difficult to assess is the degree of overvaluation, because of the following: there are a number of price indices in the US, the general inflationary trends must be taken into account, and homes can hardly be standardized. We have selected the Conventional House Price Index published by Freddie Mac, because it followed the consumer price index pretty closely until the year 2000, and the divergence of the indeces afterwards coincides with the housing boom. This benchmark reveals an average overvaluation of homes of around 25%. It is improbable that prices will actually drop by this extent though. Because the growing population seems to have been the decisive factor that has kept home prices from ever falling in the US - at least at the national level - even though there have been housing crises in the past. However, this time the distortion seems to have been greater than ever before, and for this reason, we assume that prices will actually fall this time, albeit not the extent mentioned above. We estimate that households will retain some of the price increases of the past few years and consumer confidence will not become too gloomy for this reason. We therefore expect consumer spending to ease, but not to decline.

Price development



Source: Freddie Mac, Bloomberg

Foreclosures will affect a relatively small percentage of households

The effects mentioned above concern most households. The effects will be heftier on those households that are no longer able to service their loans and thus stand to lose their homes. There are various estimates regarding how many households will ultimately be affected by this development. Even if one bases assumptions on the most pessimistic calculations, the impact on the economy should remain minor. Two million households could be affected by foreclosures in total according to a study by the Center for Responsible Lending, which corresponds to around 2% of the population. Even if consumer spending by these households drops by one-quarter - which is hardly feasible - this would still correspond to only half-a-percent of overall spending.

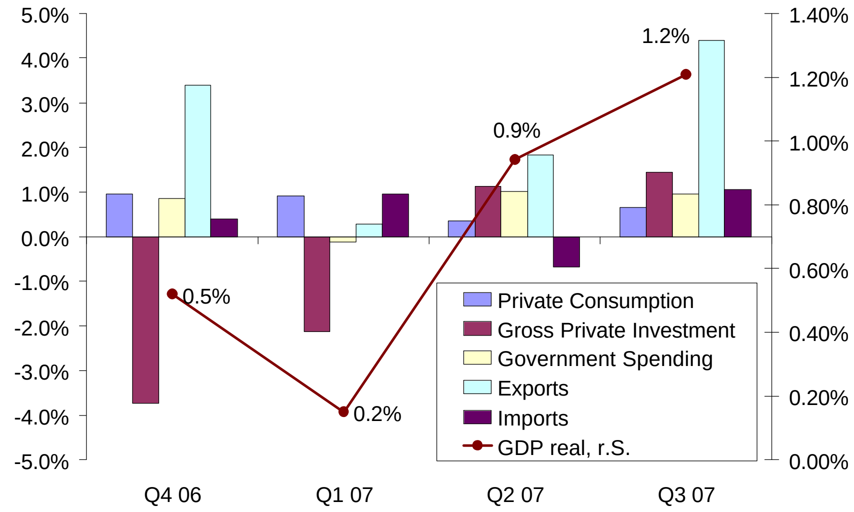
The risks within the financial sector is uncertain

It is hard to estimate the further write-offs of the financial sector, because no one knows how high the defaults on mortgage loans will be and which financial products are still on the books of the banks. According to estimates, among others, by the IMF, around 20% to 25% of subprime mortgages will be foreclosed. Assuming a loss ratio of 50%, the loss is estimated at USD 130 to 150bn for credit portfolios. What remains to be discussed are the derivatives held by the financial institutions on the US mortgage market. The IMF estimates this potential loss at a further USD 200bn; the total sum of write-offs is expected to be around USD 350bn, which is around 3.5% of the total assets of US banks. As has already become apparent, the collapse of the subprime market is spreading beyond the US and the losses will be posted mainly by US banks, but not only. While the extent of the defaults can be at least marked out, the magnitude of the losses by the diverse banks is completely unclear. Therefore, a concentration of losses to an extent that would even affect lending practices cannot be ruled out. The rather reluctant news releases regarding the losses incurred up to now by individual banks has not contributed to easing fears regarding this risk. Taking these risks into account, the scope and the probable distribution of the write-offs, we think that a recovery of the US financial sector (with the firm support of the Fed; more details below) has the highest probability, but only as of 2Q of next year. The first quarter of the year will still suffer, as the interest rate adjustments to mortgage loans still lie ahead that will cause even more defaults, although these are already included in the estimates of total losses. However, the bad newsflows will not stop for now.

Negative effects of the subprime crisis will encounter a solidly growing US economy

The last argument against an upcoming recession in the US is the still relatively good US economy. The dynamic on the labour market has slowed, but employment is still on the rise. Wage growth is stable at a high level. Retail sales are losing dynamic, but are still reporting solid growth rates. Overall economic growth will be moderate for the full year, but precisely the last two quarters showed acceleration.

GDP growth by sectors, q/q



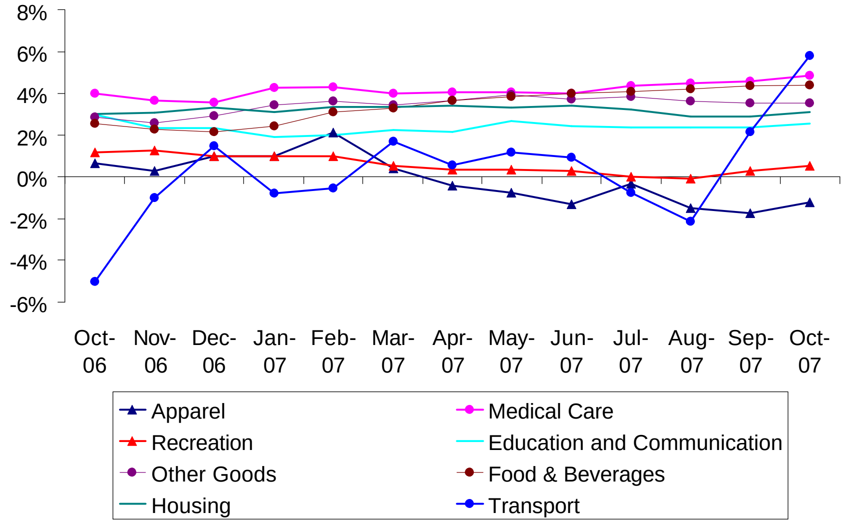
Source: Bloomberg

Inflation

Housing costs expected to ease inflation

The inflationary risks that have been repeatedly mentioned by the US Fed until recently refered mainly to the potential, as these risk were hardly ascertainable from the actual data readings. At the same time, the fears were quite understandable in an environment of high capacity utilization of economic resources and rising commodity prices. The product groups have not shown - and still are not showing - any uniform trend. The chart presents the ones with a rising price trend with small dots and those with a falling trend with triangles. The inflation rate remained largely unchanged in the area of housing, education and telecommunication. Particularly surprising is the former considering the correction on the housing market. At the same time, this has occurred up to now without any significant price declines. However, it can hardly be explained why the inflation rate for rents, which is decisive for measuring housing costs, has accelerated in such an environment recently.

Price changes of components of the consumer basket, y/y in %

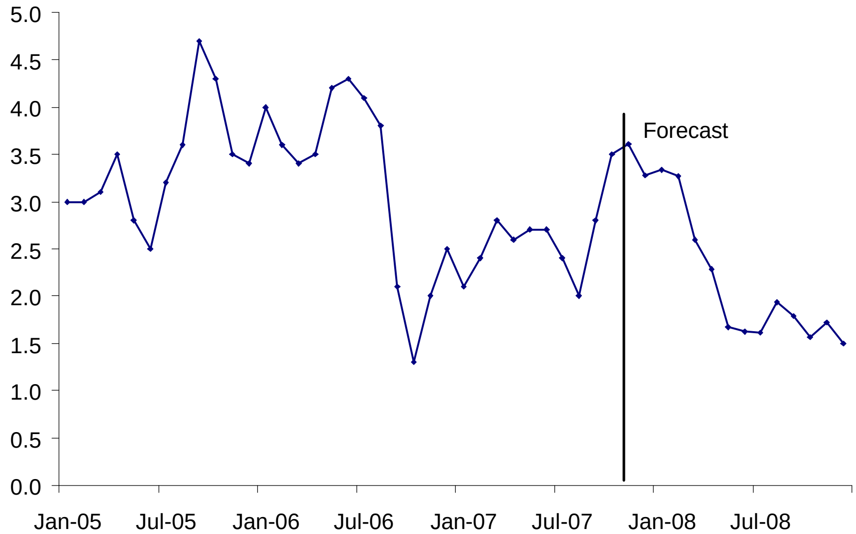


Source: Bloomberg

The unknown variable is, as always, commodity prices

Assuming that the prices of single-family homes go down, this should ultimately lead to, at least, much lower rates of increase for rents. For inflation, this means that there is still downside potential. As the decline in home prices is still ahead of us and this will only spread to the rents with a lag, which flow into inflation measurements and due to the base effects of oil prices, the annual inflation rate will only start to drop significantly in 2Q. The price developments of commodities, and these include foods, are as usual the big unknowns. Our current estimates are based on an unchanged oil price and a slight acceleration of inflation for food prices. The core rate of the inflation measurement excludes these areas, but includes housing costs where price trends can be identified more clearly. Thus, it is possible to forecast a decrease of the core inflation rate with greater certainty than the overall inflation rate.

Consumer prises, y/y in %



Source: Bloomberg, Erste Bank calculations

Monetary policy

Over the short term, crisis management could shift into the foreground for the Fed

As already mentioned, inflationary fears of the US Fed were justified up until the summer of this year. At the same time, an economic downswing could have been expected earlier due to the correction on the real estate market. The extent of the problems in the financial sector has surprised markets and the greatest factor of insecurity for the assessment of monetary policy is how many skeletons are still in the closets of the banks. It has become increasingly likely that the tense situation on financial markets will become the critical factor for US monetary policy. The most recent statements imply that crisis management is currently the preoccupation determining the considerations of the Fed. The renewed wave of turbulence on financial markets has left its mark and it seems as if the central bank would like to counteract the effects by cutting interest rates even before the end of the year. Over the long term, a central bank cannot have any interest in signalling to the financial sector that it will "fix" the situation in any case of emergency, which is something Fed representatives have repeatedly stressed. Furthermore, the risk weighting between inflation and economic growth was neutral after the last interest rate decision. But the tense situation on the financial markets with the correspondingly high yield premiums is heightening the risk for the economy from the perspective of the central bank to an extent that calls for quick action. As the write-offs by US financial institutions will continue in the coming quarters as well, even short-term interest rate cuts, which could be retracted when the situation calms again, are feasible.

Inflationary risks point to neutral interest rate level by mid-year

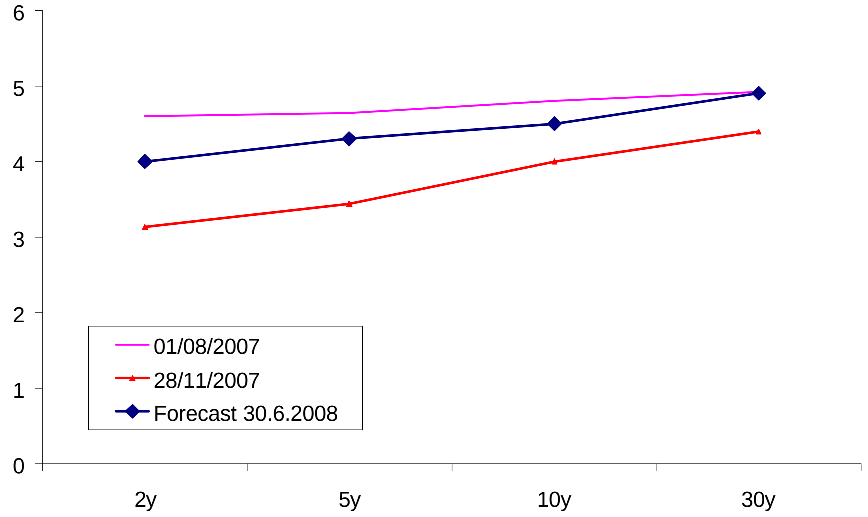
As regards the real economy, the central bank should not forget that although there are signs of an economic slowdown, high capacity utilization still prevails and any premature fuelling of the economy carries the risk of inflation. This is even truer considering that the US economy will miss falling into recession and interest rates have already been cut by a hefty 75bps. The most recent statements and the extremely volatile financial markets have increased insecurity for monetary policy in the coming months. With the calming of the situation in 2Q, we expect key lending rates to hit 4% by mid-year.

Bond market

Risk aversion has led to the overvaluation of government bonds

The current valuation of US government bonds is determined by the prevailing risk aversion in an environment of bad newsflows from the financial sector. Money markets are still tense and thus the only haven for safe liquidity is the government bond market. These high liquidity premium is revealed the most clearly by the short-term maturities. Thus, the market is pricing in a yield on two-year maturities in one year of just over 3%, and for two-year bonds, yield expectation in two years is only marginally higher. It is expected that the Fed will lower interest rates in the coming years to at least this level, which would mean a decrease by minus 150bps. This is a recessionary scenario which cannot be ruled out, but it is not in line with the expectations of the Fed or with ours, nor with the consensus estimates of market participants. We expect the liquidity premium to dissipate even if this were to take until 2Q. Bad newsflows such as high write-offs in the US financial sector are expected, at least well into 1Q. Finally, it can hardly be forecasted when the first brave souls will move out of Treasuries. As regards short maturities, we expect yields to rise by around 100bp over the course of 2008, and at the long end, by around half as much. A flattening of the curve starting out from the short end does not fit into the expected stage of the business cycle, but the steepening of the past few months was attributed to special effects which are expected to correct next year.

Yield curves



Source: Bloomberg, Erste Bank calculations

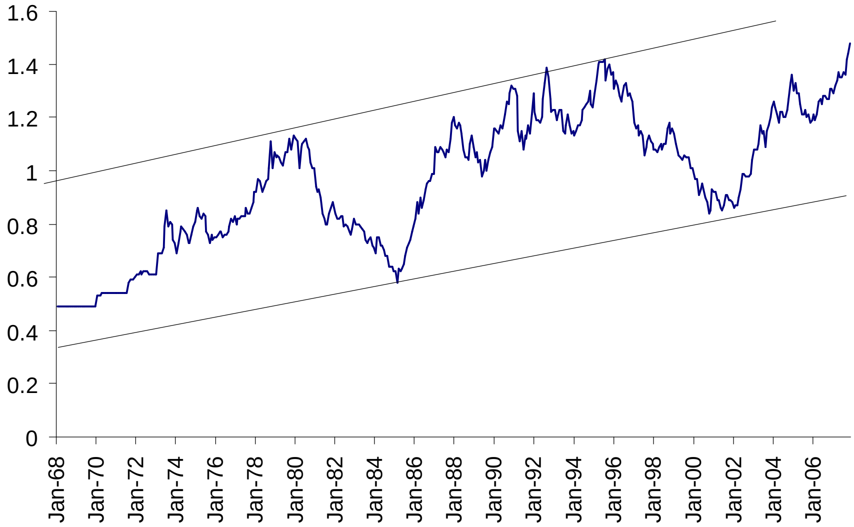
US dollar

Sentiment for the USD hits low - Still, there are arguments for a recovery

The downslide of the USD has caused nervousness on markets. It is no wonder considering that the US currency jumped from one low versus the euro to the next and even dropped with considerable ease the lowest level ever versus the euro if one bases it on the DM exchange rate for the period before 1999. To highlight how easily the tables can turn, I wanted to quote a few comments from the year 2000 when the euro hit its all-time low. The search for the right phrase was difficult and I had to widen the search text even more. Finally, I wrote: "euro drops to new low against the dollar". Google asked if I possible meant: "euro drops to new law against the dollar," which in my opinion is meaningless, but goes to show that the search engine considered it more likely than to research for the euro low.

Sentiment on markets is in fact very dim. The crisis on the mortgage market and the difficulties of the financial sector in conjunction with the calls for an end to the global US hegemony, and finally, the deliberations of smaller Arab oil-exporting nations to reconsider the pegging of their currencies to the USD have all contributed to the gloomy outlook. It is in fact hard to believe in a recovery of the USD in such an environment. It is true that the USD is on a long-term downtrend, but it is also true that counter-movements that lasted in some cases for several years interrupted this trend. For several reasons we believe that such a countermovement lies ahead. The latest weakening of the USD was fast and was driven more by panic than by fundamental data. One reason could be that the rapid decline of the USD exchange rate near the end of year triggered exchange rate hedging transactions. This USD selling will be lacking next year though, and will thus ease the pressure on the USD. Another argument for a recovery of the USD is the exaggerated expectations of interest rate cuts in the US. Finally, the argument of an improved US trade balance that is expected to be supported by better export figures - due to the low valuation of the USD - as well as by lower import growth rates due to the sluggish US economy.

EUR(DEM)/USD, since 1968



Source: Datastream

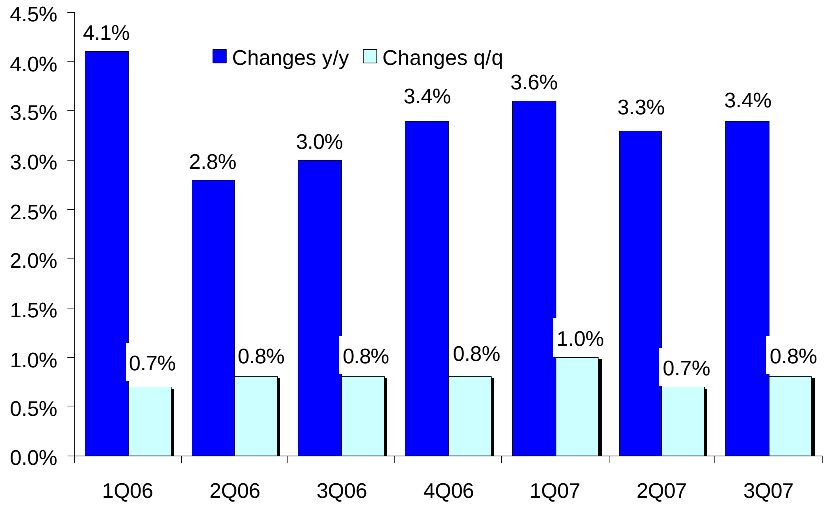
Rainer Singer

Economic Growth in Austria: +3.4% in 3Q 2007

No signs of financial crisis yet

According to the Wifo quick estimate, economic growth in 3Q 2007 was 0.8% q/q and 3.4% y/y. The growth drivers were exports (+1.2% q/q), while consumption spending of private households (+0.5% q/q) remained the weak point of economic development.

GDP growth



Source: WIFO

Investment activity presented a divided picture (+0.4% q/q): Investments in machines and electronic apparatus remained dynamic, while investments in vehicles and construction lagged behind the projections of manufacturers. Industry expanded robustly in 3Q (+1.3% q/q) again, but growth seems to have already peaked. The corresponding index value for industrial production dropped in July to its long-year mean.

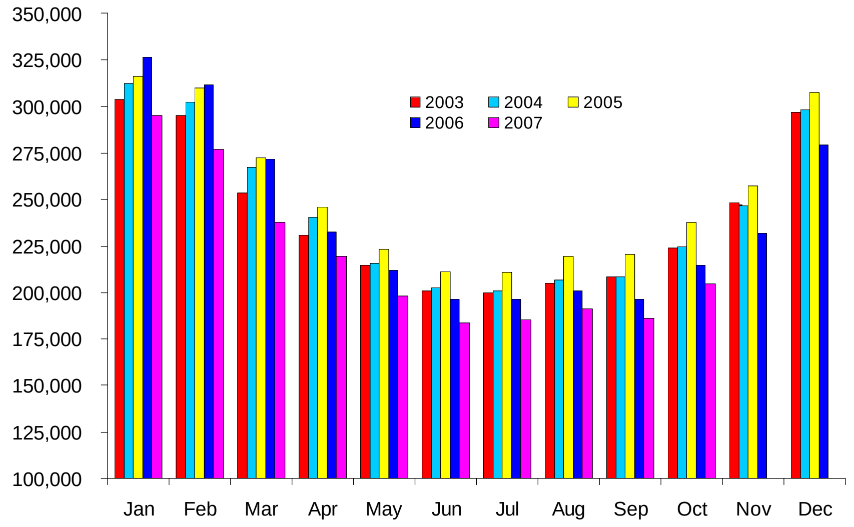
Unemployment rate dropped further

The unemployment rate dropped versus October of the previous year by 9,766 persons to 204,840 jobless (-4.6%). Just like in the previous month, the number of persons in training measures was down again from 14% or 8,802 persons to a total level of 54,153. The rate of dependent employment rose in October to 3,374,050 (+53,783; +1.6%) dependently employed persons.

The unemployment rate "Austrian version" was 5.7% in the reporting month, thus 0.4% percentage points lower than in October of the previous year. A look at the average unemployment rate from January to October shows that the decline was 0.6 percentage points from 6.7% during the like period of the previous year to 6.1% this year.

Austria

Unemployment - registered unemployed persons

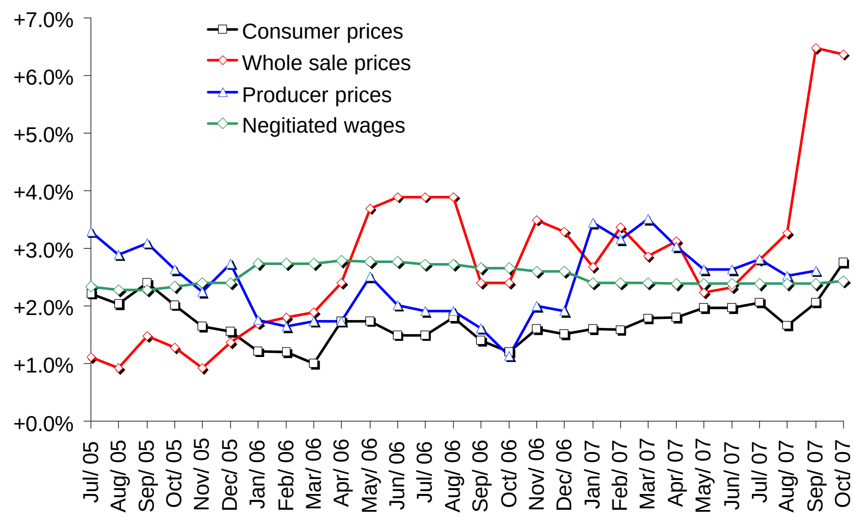


Source: AMS

Higher prices

The inflation rate was 2.8% in October. The principal drivers of prices were foods and non-alcoholic beverages (+6.2%), which accounted for over one-fourth of the inflation rise. As regards foods (+6.5%), dairy products and eggs (+15.3%) as well as bread and grain products (+6.2%) were the principal causes of inflation in this spending group.

Prices and wages in Austria



Source: Statistik Austria

Spending on housing, water and energy (+3.9%) also contributed one-fourth to inflation. By contrast, an inflation-dampening effect came from the spending group telecommunication (-4.5%) as well as telephone and telefax services (-5.0%). The average inflation rate from January to October was 1.9%.

Industry reports very good figures

In July 2007, the manufacturing industry achieved a production value of EUR 12.1bn (+8.2%) with 571,521 employees (+2.1%).

During the reporting month, incoming orders were EUR 7.4bn, which is 6.6% more than in the previous year. Apart from the low order intake from abroad (-4.8%), orders from the EU (+10.7%) and third countries were much higher (+13.5%). The level of unprocessed orders at the end of the reporting month was EUR 34.2bn (+10.7%). The construction sector (building and civil engineering including related industries) achieved construction output of EUR 2.5bn (+8.9%) in the reporting month with 208,134 employees (+0.7%).

The level of order intake in the reporting month corresponded to a construction volume of almost EUR 2.1bn (+11.9%), and order intake at the end of the month was EUR 8.6bn (+4.2%).

Decline in the trade sector

In August, sales revenues declined in the trade sector (-1.3%), with only the retail trade reporting positive growth rates for the reporting month (real +0.7%). In real terms, automobile trade (-1.6%) and wholesale (-2.0%) failed to reach the levels of the like month of the previous year.

The preliminary result for the retail sector in September (nominal +1.9%) allows one to assume that developments will improve again.

On the labour market, the rise in the number of (dependent) gainfully employed persons by +2.4% to 531,483 persons contrasted sharply with the decline in unemployed persons by 5.5% to 34,874 persons. The unemployment rate as calculated in Austria was 6.0% in September, 50 basis points lower than in September of the previous year (6.5%).

Expansion in the service sector

Austrian service companies (restaurants, travel agencies, data processing, business-related services, land transport, accommodations, air transport and telecommunications) developed positively in the 1HY 2007 vs. the previous year and reported a nominal increase in sales revenues of 4.6%. Employment was up vs. the previous year by 2.9%.

Foreign trade on growth trend

In August, the total value of imports based on preliminary figures was EUR 8.4bn (+1.3% vs. August 2006) and the figure for exports was EUR 8.1bn (+4.1%). The decline in the balance of goods and services was EUR 275.6m in the reporting month versus EUR 490.4m in August 2006.

Import of goods from the member states of the EU-27 amounted to EUR 6.1bn (-0.5%), and the corresponding deliveries were EUR 5.6bn (+2.6%). The trade deficit of EUR 450.4m was lower than in the previous year (EUR 623.2m).

Development of exports and imports - nominal changes m/m

Source: Statistik Austria

Austria

Tourism reports gains

The summer season 2007 reported some 55m overnight stays (+3.3%). The arrivals rose by 4.5%. The trend in overnight stays by domestic guests (+3.7%) and of foreign guests (+3.1%) was positive.

Particularly high was the rate of overnight stays among guests from the Netherlands (+9.3%) and Switzerland (+5.7%). All province reported higher overnight stays; the greatest rise was seen in Vorarlberg (+8.8%) and Lower Austria (+6.4%).

Higher current account surplus

Austria's current account reported a surplus for the first half-year 2007 of EUR 5.5bn that was much higher than during the corresponding period of the previous year (EUR 3.9bn). The surplus of the trade balance was up from EUR 6.9bn in the previous year to EUR 8.7bn in the reporting year.

The income balance was negative in the period of observation with EUR 2.3bn (previous year EUR 1.9bn).

The sub-balance of current transfers that also contains the transfer of payments with EU institutions reported a decline of EUR 1.0bn, which was lower than in the previous year (EUR 1.1bn).

Austria as an exporter of capital

The financial account reported net capital outflows during 1HY of EUR 7.3bn versus the outflow of EUR 5.9bn in the previous year. This development is driven by the trend in Other Investments and Portfolio Investments. In the case of Other Investments, capital exports were up from EUR 5.2bn to EUR 18.8bn.

Portfolio investments revealed a net capital inflow of EUR 14.6bn versus a capital outflow of EUR 2.3bn during the like period of the previous year. Foreigners invested almost EUR 45.6bn in Austrian securities, while vice versa Austrians invested EUR 31bn in foreign securities. In the case of direct investments (details see below), the amount of EUR 2.1bn represents a slightly lower net capital exports (prev. year EUR 2.2bn).

Banks predominant in direct investments

The direct investments of Austria abroad hit EUR 14bn in 1HY 2007 which was higher than in the previous calendar years. The total volume breaks down as follows: EUR 4.9bn in Croatia, EUR 2.8bn in Turkey, EUR 1.8bn in Russia, EUR 1.2bn in Bulgaria and EUR 1.1bn in Hungary. It was especially Austrian banks that invested larger amounts abroad. Direct investments in Hungary are related with the purchase of MOL shares by OMV. Direct investments by foreigners in Austrian were EUR 12bn in 1HY07. The biggest investor was Italy with EUR 9.1bn which is explained by UniCredit receiving a total of 55m new shares from Bank Austria for the transfer of the Eastern European business to Bank Austria. In contrast, Germany posted a minus of EUR 11.4bn after the retreat of Hypo Vereinsbank. The second large transaction included in the statistics on direct investments was the sale of BAWAG to the US fund Cerberus.

Decline of bankruptcies

In the first three quarters of 2007, the number of company failures rose by 3.7% to 4,800 cases. The downtrend was particularly strong as regards bankruptcies dismissed by the court due to a lack of assets, which rose by 8.0% to 2,497 cases. The number of proceedings opened was up by 1.5% to 2,303 insolvencies in the reporting period.

There was no change in the current known volume of insolvency debts versus the first three quarters of the previous year: it was EUR 1.8bn.

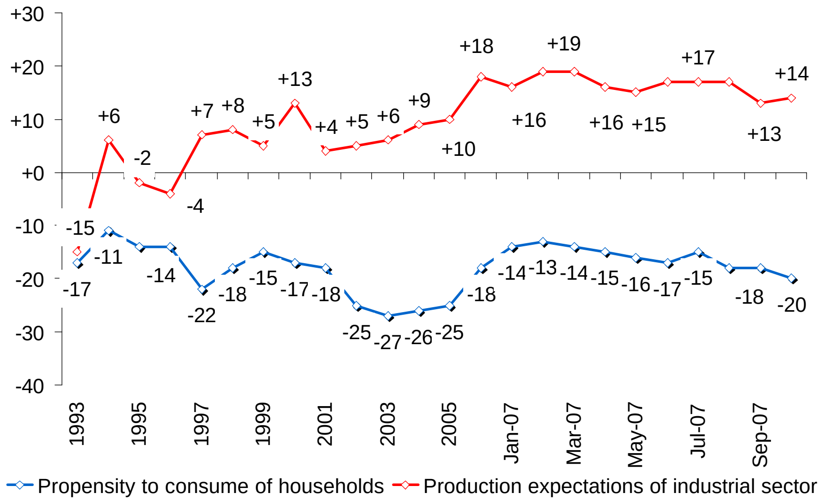
Steep rise in private bankruptcies

Bankruptcies of individuals also rose very steeply in the first three quarters of 2007 by 16% to 6,497 cases. The increase in proceedings opened was even higher (+16.7%) than those dismissed due to lack of funds (+12.1%). The estimated volume of insolvencies among private individuals was up by more than one-quarter to EUR 758m.

Gloomier sentiment

The leading economic indicators such as the consumption propensity of private households and production expectations of industry are currently below the annual average. However, among businesses, the positive responses outweighed the negative ones by 14%. The average figure for the period year-to-date was 16%.

Propensity to consume and production expectations - Balance of positive and negative answers



Source: Oesterreichische Nationalbank (OeNB)

Among consumers there was a considerable overhang of negative answers over positive ones. The response to the question, "Do you plan any larger purchases in the next 12 months?" was answered in October 20% more by "No" than by "Yes". On the average up to now this year, the negative figure was 16%

Economic Forecast for Austria: Low growth dynamic 2008

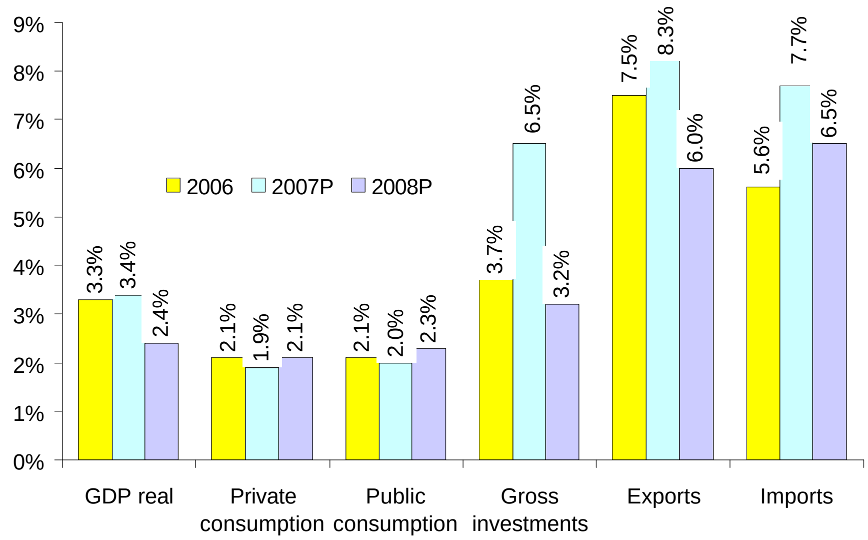
Deterioration of international framework conditions

This year, the Austrian economy will be able continue the very robust high growth trend of last year and stands to grow by 3.2% (IHS) to 3.4% (WIFO). This means that Austria will remain on the fast lane, because the prospects for growth are prognosticated at levels far above those of the euro area for this year (+2.6%) and also of the entire EU (+2.9%).

In 2008, the economy will only expand in line with the long-term mean of 2.4% (WIFO) and 2.6% (IHS), but still higher than the euro area (+2.1%).

The weakening global economy and faltering domestic consumption are the main reasons for the slower dynamic. At present, the effects of the international financial crisis on the real economy are still unknown.

Development of demand components



Source: WIFO

Weaker domestic demand

In contrast to earlier business cycles, this time, the lively investment activity is not expected to spread into a consumption boom. One of the main reasons stated for this development is that the per capita income of private households not very high and after the deduction of taxes and inflation, the result is only stagnation y/y. Thanks to the investment boom, domestic demand will expand this year by 2.9% (previous year 2.2%), but will drop below this growth level already next year (2.4%).

Lagging private consumption spending

In 2007, private consumption will expand according to the forecast by 1.9% versus 2.1% in the previous year. In 2008, there is not much room for further expansion in consumption spending: a rise in real net income per capita of 0.3% (2007: 0.0%) would make an increase in private consumption of 2.1% feasible for 2008, even though this may still be classified as moderate in the late phase of the business cycle.

Expansive public spending

Consumption spending by the public sector (public spending) will increase in 2007 by 2.0% and in 2008 by 2.3%. IHS even estimates the bandwidth for the annual increase at +2.1% (2007) and +2.8% (2008). On the spending side, growth is steep in the areas of education, science, judiciary system, and military. Relief comes from the lower unemployment rate and the related decrease of the costs of passive labour market policy.

Austria

Slackening investment cycle

The cycle has completed the jump from exporting boom to an investment boom. The excellent profit trends, high capacity utilization and the confident mood among businesses to date are feeding through to livelier investment activity among companies.

Overall, investments will rise this year by 6.3% and in slow in 2008 (+3.7%). Investments in plant and equipment will advance this year by 8% and next year by 4.5%. This development will also be boosted by investments in construction this year, which are supported by the stable trend in civil engineering, the continued recovery of housing and the higher growth in industrial construction by 5%. In 2008, investments in construction will advance by 3.0%.

GDP growth and demand components

	2005	2006	2007P	2008P
	Percent change over previous year - real			
GDP	2.0%	3.3%	3.4%	2.4%
Private consumption	2.0%	2.1%	1.9%	2.1%
Public consumption	1.9%	2.1%	2.0%	2.3%
Gross investments	-1.3%	3.7%	6.5%	3.2%
Gross non-residential	0.3%	3.8%	6.3%	3.7%
Equipment	0.7%	2.1%	8.0%	4.5%
Structures	0.1%	5.1%	5.0%	3.0%
Exports	6.2%	7.5%	8.3%	6.0%
Goods	3.2%	6.8%	9.0%	6.5%
Tourism	2.0%	0.5%	1.7%	2.6%
Imports	5.0%	5.6%	7.7%	6.5%
Goods	2.8%	3.8%	8.4%	6.2%
Tourism	-6.9%	3.1%	1.9%	2.4%
Total demand	3.0%	4.1%	4.9%	3.8%
Domestic demand	1.3%	2.2%	2.9%	2.4%

Source: WIFO, Statistic Austria

Lower export growth

This year, the economy is being sustained by exports. Demand from the euro area and especially from Germany, the new EU countries from southeast Europe and from the oil-exporting countries is the driver of the excellent development of Austria's foreign trade. The slowing of the global economy, the appreciation of the euro and the high levels reached by foreign trade are all factors that point to slower economic growth next year. The forecast for this year states an increase in the export of goods of 9.0% and of 6.5% for next year. With the increase in domestic demand, the import of goods will rise steeply this year (+8.4%) and in 2008 (+6.2%) as well.

Industry and construction sector are pillars of economic growth

The exporting boom is significantly stimulating manufacturing. Real added value in manufacturing could grow this year by 7.3% and by 3.0% in 2008. The reasons for the slowdown are the effects of the international financial crisis and the adverse financing terms. The added value in the construction industry will increase by 4.5% in the current year and 3.0% in 2008.

The finance and banking sector is forecasted to grow 2.0% this year and 1.5% in 2008. Therefore, the solid development of the previous year (+4.8%) will probably continue, though at a much slower pace.

Austria

Wifo forecasts an increase in value added in the trade sector by 1.8% real in 2007. For the year 2008, the forecast states a growth rate of 2.2%. The hotel and restaurant industry is set to expand this year by 1.3% and by 2.0% in 2008. The energy and water supply segments will expand in 2007 by 1.0% and in 2008 by 2.5%. The value added of the public sector is expected to be (+0.3%) for 2007 and just slightly above zero (+0.6%) for 2008.

Internal Austrian stability pact fails

The good economy is still boosting the tax revenues of the state. The new estimates for the overall government deficit are therefore accordingly encouraging. Wifo believes that the Maastricht deficit will be -0.4% of GDP this year, and -0.5% for 2008. However, a fact that contradicts the attainment of the forecasts is that the federal provinces have failed to meet the so-called internal Austrian stability pact. This is due to the need for reform in the areas of education and hospitals as well as the time delay in the implementation of the structural reform plan for the healthcare sector.

Unemployment decreases only slightly

The robust rise in production will once again entail a rise by 1.9% in the number of active employed persons. Around one-third of this increase in growth was due to foreign labour and unemployed having found new jobs. The decline in unemployment will be 6.3% this year, but only 0.4% next year. In 2008, employment will rise by only 0.9%. Based on these trends, the unemployment rate will decrease in 2007 to 6.3% (2006: 6.8%) and 6.2% in 2008. According to the Eurostat definition, the decline in the unemployment rate is estimated at 4.8% (2006), 4.3% (2007) to 4.2% (2008).

Selected economic and structural figures

	2005	2006	2007P	2008P
	Structural Figures (balances in % of gdp)			
Current account balance	2.1%	3.2%	3.5%	3.7%
Government budget according to Maastricht-Definition	-1.6%	-1.1%	-0.4%	-0.5%
	Percent change over previous year			
Inflation rate (national CPI)	2.3%	1.5%	1.9%	2.0%
+ Core inflation	1.5%	1.3%	1.8%	1.9%
Employed persons	0.8%	1.2%	0.9%	0.7%
	Unemployment rates			
according to AMS	7.3%	6.8%	6.3%	6.2%
according to EUROSTAT	5.2%	4.8%	4.3%	4.2%

Source: WIFO

Higher inflation

The inflation rate estimated for this year and next is much higher than in 2006. Despite the good economic development and high money supply growth, no steep rise of inflation has been forecasted. The inflation rate will increase according to the Wifo forecast from 1.5% in 2006 to 1.9% in 2007 and 2.0% in 2008. The main reasons for the still moderate increase in consumer prices are the expected slowdown of the global economy, weak domestic demand, moderate wage growth and the stabilization of energy prices, the strength of the euro and, generally the increasing globalization with fierce price competition.

Austria

Stagnating real net income

A robust economy, sinking unemployment, rising employment and low inflation rates are expected to result in higher effective wages. Still, real net income will stagnate in the forecasting period.

Gross income per capita will probably grow at the same rate as the year 2006 (+2.6%) and expand to 3.0% in 2008. Real per capita income, i.e., net of inflation based on gross income, is expected to increase 0.7% per employee in 2007 and will drop back to 1.0% in 2008. The tax progression will ultimately ensure that the net real income per capita will stagnate this year and rise just slightly above the zero line in 2008.

Thomas Karall

Croatia

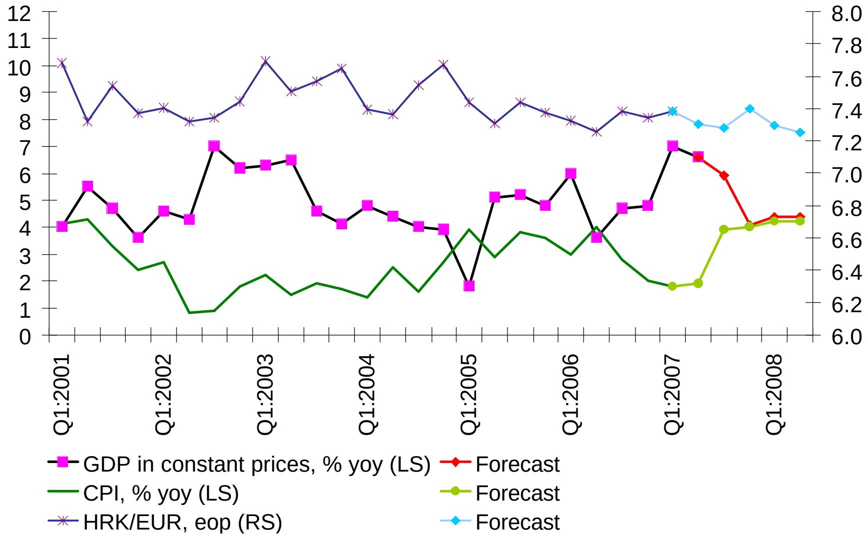
	2006	2007e	2008f	2009f
Real GDP (grow th y/y %)	4.8	5.9	4.7	4.9
Private Consumption (grow th y/y %)	3.5	5.7	3.5	3.8
Fixed Capital Formation (grow th y/y %)	10.9	6.7	7.5	9.0
CPI (y/y, average%)	3.2	2.7	3.4	3.0
Current account balance (% of GDP)	-7.8	-8.1	-8.0	-8.3
Govt. budget balance (% of GDP)	-3.0	-2.6	-3.0	-3.0
Short term interest rate (3 months) year-end	4.6	6.0	5.0	5.0
Long term interest rate (10 years) year-end	4.7	5.2	5.2	5.0
EUR/HRK, year-end	7.35	7.40	7.30	7.30

Economy

2007 above expectations, 2008 to bring some moderation

1H07 real sector performance exceeded our expectations, as GDP growth rates amounted to 7.0% y/y in 1Q and 6.6% y/y in 2Q. The main boost to the strong economic performance came from the strong upsurge in private consumption, as rates exceeded 6% y/y (the highest rates since 2002). Consumption spending profited from the banking sector's greater orientation toward consumer credit (as a result of credit growth limits and pressures on the margins). Also, low inflation figures in 1H07 had positively affected purchasing power, while the wealth effect from capital markets was also supportive of consumption. Fixed capital formation also drove GDP growth, although some moderation occurred, in line with expectations, as the high base from previous years and tighter monetary conditions pointed in that direction. The acceleration of public consumption (slightly below 3% y/y) came as no surprise, in light of the upcoming elections. On the external side, the contribution of net exports remained negative. The outlook for 2007 remains positive, as short-term indicators are looking favorable in 3Q. Therefore, our latest forecast for FY07 growth stands at 5.9% y/y. As far as 2008 is concerned, some moderation is expected, as certain risks to GDP performance are stemming from the monetary measures (after a period of adjustment, the CNB measures are starting to produce stronger effects and further moderation of credit should occur). Furthermore, the slowdown in Euroland (and, presumably, the region) should put an additional burden on the growth rates. The current 2008 GDP forecast stands at 4.7% y/y. The current account deficit is expected to widen to above 8% of GDP in 2007, while for 2008 we see a stabilization trend, as growth momentum should somewhat ease the pressure.

GDP, Inflation and exchange rate



Source: Croatian Bureau of Statistics, CNB, ESB calculations

Inflation upsurge

Accelerating inflation was expected towards the end of 2007, but the extent of the pressure came as a surprise. The second half reversed the favorable base effect and brought stronger pressure on the supply side. Once again, headline inflation showed high sensitivity to supply-side pressure, as CPI quickly picked up from around 2% y/y and peaked in October at 4.3% y/y. Food and oil prices fueled the recent inflation pressure. In 1H08, the inflation rate is likely to remain under pressure, as some other food products are likely to experience price increases. Also, higher oil prices should spill over into CPI inflation to a greater extent, as the effect has been neutralized so far by the weaker dollar and administrative cap on retail gasoline prices. In 1H08, the base effect should continue to negatively influence y/y rates and some pressure is likely to come from possible administrative price hikes in the period after the elections. Therefore, we expect inflation to remain in the 4-5% region throughout 1H08.

Monetary policy

CNB to continue tightening monetary policy in 2008

The CNB recently announced the course of monetary policy for 2008. According to the CNB governor, the central bank will stick with credit growth limits in 2008. The allowable pace should remain at 1% pm, i.e. 12% pa. Some other modifications of the current monetary setup were also announced, but the final measures will only be known after the December CNB Council meeting. The governor thus announced that banks would have to purchase CNB bills in the amount of 75% of excess credit (50% this year). On top of that, there will be a tighter approach regarding CNB reverse REPO auctions, meaning that banking sector refinancing through that channel should decline in 2008. Coupled with the announcement that the Lombard rate would also rise from 7.5% to 9.0%, it is evident that the CNB wants to see interest rates at higher levels. With the current marginal reserve requirement and high global interest rates, inflows from abroad via the banking sector are limited. Therefore, banks will have to continue relying on domestic sources of finance. Monetary conditions will remain tight and credit growth is expected to moderate further, in line with the CNB target.

Exchange rate to remain stable

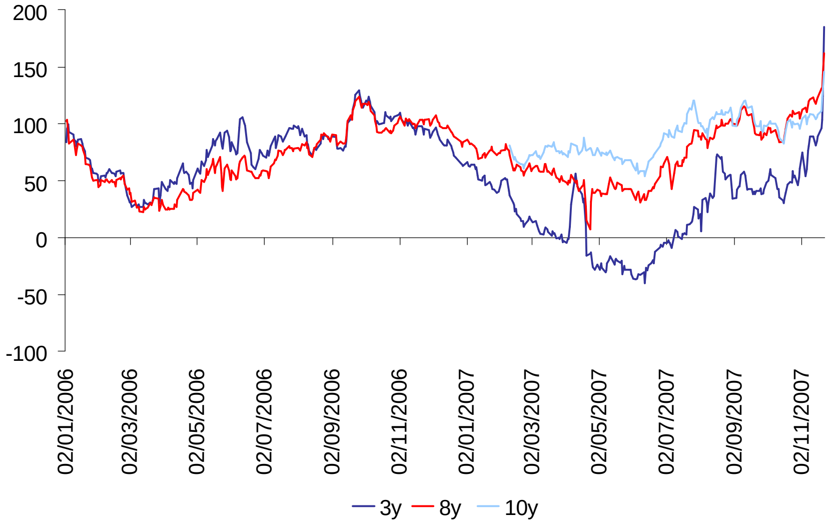
The exchange rate continued to move in a narrow band around 7.35 after the usual appreciation pressure during the tourist season. One-off pressure occurred in late September, due to the IPO process of T-HT (the national telecom company), but the CNB intervened with a record-high amount. In 2008, the exchange rate is expected to continue to move in a tight range and the CNB has declared its orientation toward stable exchange rate movements. Towards year-end, the outlook remains gloomy, as high MM interest rates and tight kuna liquidity are boosting appreciation pressures somewhat. On the other hand, seasonal factors and the trade balance deficit should work in the opposite direction; we see the 7.35-7.40 range as most likely. In 1H08, appreciation pressures should gradually prevail and the exchange rate should again be on a strengthening path. Therefore, we see the 7.25-7.35 range as most likely.

Capital markets

MM pressure spreading on bond market

Summer brought strengthened pressure on kuna liquidity, which was to some extent expected, as summer months usually bring tighter liquidity. Nevertheless, the MM pressures proved to be of a more permanent nature, as demand for kuna liquidity remained high. This was largely due to still strong credit activity and lack of external funding (as mentioned earlier; due to monetary regulation). In addition, the CNB's stance towards REPO auctions changed and the CNB drained only some liquidity by declining certain bids at the auctions and not holding them at all. MM rates thus went up to double-digit levels for a while and on average hovered significantly above the CNB repo rate (3.5%) and recent average MM rates (4-5%). The bond market showed significant insensitivity to such movements and yields remained stable in the region slightly above 5%. Nevertheless, November brought some changes, as turbulence on the equity market triggered a sell-off of government bonds (due to the need for liquid funds); in combination with the governor's statement (which indicated a continuation of the tight monetary environment), this changed the sentiment and yields corrected towards the 5.5% region. The outlook for the market in the coming months remains unclear and should remain tied to the overall system liquidity.

Yield spread of pure kuna bonds vs Euroland bonds



Source: ESB Research

Alen Kovac

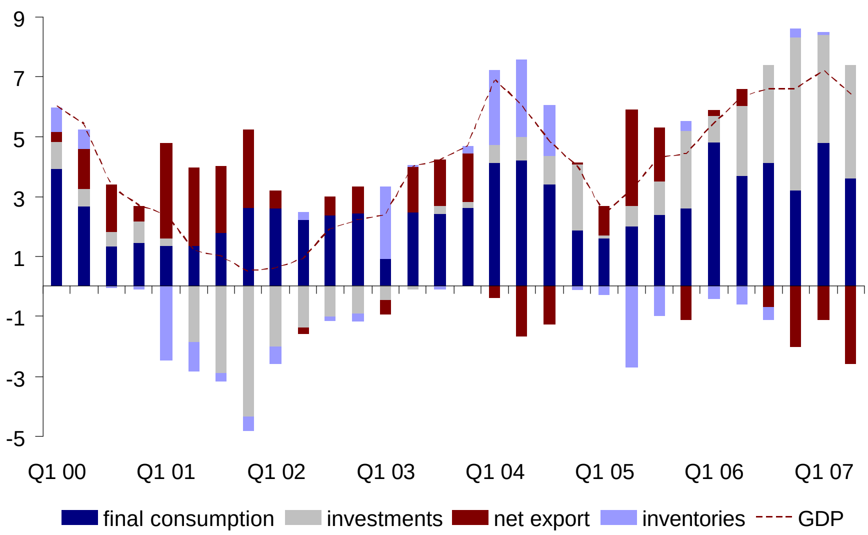
	2006	2007e	2008f	2009f
Real GDP (grow th y/y %)	6.2	6.5	5.5	5.8
Private Consumption (grow th y/y %)	4.9	6.1	5.8	5.7
Fixed Capital Formation (grow th y/y %)	15.6	20.5	13.2	15.4
CPI (y/y, average%)	1.3	2.4	3.2	2.9
Current account balance (% of GDP)	-3.2	-4.1	-4.5	-4.9
Govt. budget balance (% of GDP)	-3.9	-3.2	-3.4	-3.1
Short term interest rate (3 months) year-end	4.2	5.3	5.7	5.2
Long term interest rate (10 years) year-end	5.2	5.7	5.5	5.0
EUR/PLN, year-end	3.83	3.60	3.51	3.43

Economy

Economy to gallop at solid pace next year, despite moderate slowdown

The Polish economy is enjoying good times. The economic revival witnessed last year was not only sustained, but even further reinforced. Our forecasts suggest that GDP will expand by 6.5% y/y in 2007, with such high dynamics not seen for ten years. However, there are signs that such growth is already above the potential speed limit. Many sectors report shortages of workers, capacity utilization is at historical highs and the current account keeps widening as higher imports are needed to satisfy hungry domestic demand. We are skeptical as to the preservation of the current pace of expansion in 2008 and count on a moderate slowdown of GDP growth to the zone around 5.5%. However, this will still be a solid number in the regional context. The economies of the Eurozone and US will cool down, which will also have some impact on the Polish economy (although not dramatic). Structure-wise, net exports will continue to exert a drag (slowdown in exports, imports being fed by domestic demand).

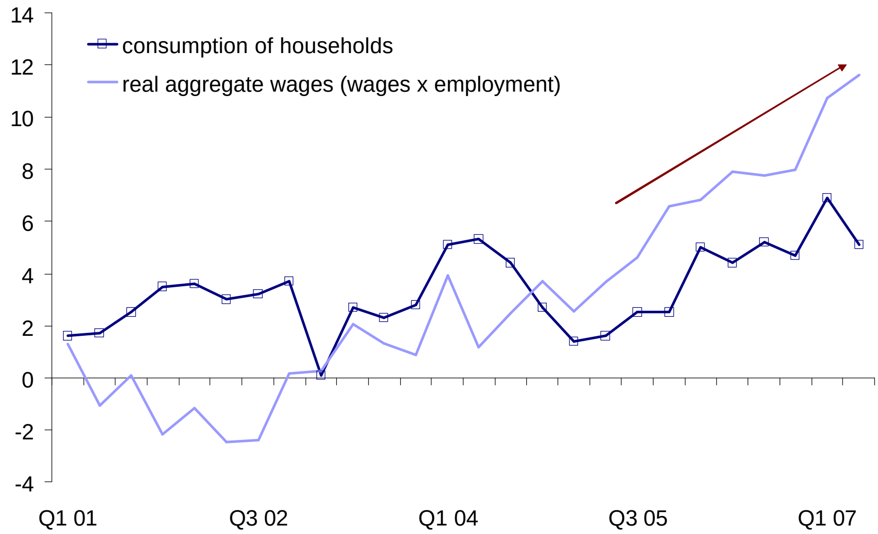
GDP growth rates in %p



Source: GUS, CS

To the contrary, domestic demand will remain firmly in the driver's seat, albeit expanding somewhat more slowly. Some slowdown of investment dynamics might be seen in the first quarter, as their volume was boosted by the exceptionally warm winter last year, which created a higher comparison base. However, investment growth will remain in a respectable double-digit area over the next year. One of the reasons is that production capacity utilization in enterprises is at a record high and it will yet take some time until the solid domestic demand is satisfied. Furthermore, the financial standing of enterprises is still very good and the stream of EU funds and FDI inflows will not dry up. The other significant component of the domestic demand, consumption of households, will decelerate to only a small extent, on the back of slightly milder wage dynamics and a slower unemployment decline. However, it will still remain robust, especially when compared to the previous years. Purchasing power will also be boosted by the further decline in the disability pension contributions of employees as of January (2pp, meaning higher net wages), the income of Poles working abroad and support from measures approved by the previous government (e.g. pro-family tax deductions).

Households, growth rates in %



Source: GUS, CS

New government brings hope to markets, promising more fiscal discipline and euro target date

Poles voted for a change on the political scene in October, handing the reins of government to two opposition parties - Civic Platform (PO) and the Peasants' Party (PP). The election outcome gives great hope for political stability in Poland, not seen for a long time. Not only has the number of parties in Parliament been reduced, but the populists also stayed outside the gates. From an economic point of view, we are not yet convinced that all of the points on PO's economic program will be brought to life. In particular, it might be hard to win agreement on the tax simplification proposal (flat tax). However, there are some theses that the two parties seem to be able to agree on. First of all, both recognize the necessity for a more responsible fiscal policy. Instead of anchoring the budget deficit (as was the practice of the previous government), PO wants to take advantage of the buoyant economic growth to consolidate public finances and restrain expenditures (inflation plus 3%). The second important area is adoption of the euro. Practically all of the parties except for PiS (including LiD, which plans to stay in the opposition) fancy the idea of EMU entry and 2012 or 2013 are mentioned as possible target dates. This will provide an important anchor for the market and will act as a disciplining factor for fiscal policies. We think that some minor reform steps are possible as well. Moreover, the privatization process should resume.

Inflation to hover above central bank target next year

The food price shock witnessed in many European economies has not bypassed Poland and, together with rising oil prices on world markets, nudged up the inflation rate to above the inflation target of the central bank (2.5%) in autumn. These two exogenous factors represent the main risks for price development in 2008 (particularly food, which has a significant weighting in the consumer basket). Moreover, a special promotion by an Internet operator that helped to compress inflation in August should come to an end at the beginning of 2008, pushing the price level up. From the viewpoint of monetary policy, it will be important to monitor the extent to which merchants use the start of the new year as an opportunity to adjust their price lists. As domestic demand remains powerful, we forecast the demand pressures gradually showing up in the inflation rate. Positively, the stronger zloty offers some shield in the field of tradables. All in all, we see inflation increasing further to above the tolerance band of the central bank in the first quarter of 2008 (towards 3.8-4.0%), while slowing back into the band in the second quarter.

Monetary policy

Central bank to stay in tightening mode

With the inflation rate nosing up, the economy growing above its speed limit and the labor market becoming still tighter, the central bank started a rate hiking cycle this year that should stretch at least into the first half of next year. True, the recent inflation surge comes primarily on the back of a supply-side shock (food), which monetary policy should not react to, in theory. However, there is a non-negligible risk of possible second-round effects, given that the economy is operating above its potential. Surprisingly, the net core inflation remained relatively well-behaved up to now, but we think it is only a matter of time until it starts rising, given the strength of household purchasing power. The central bank's inflation prognosis confirms an upward trend in key rates. In 2009, the central trajectory overshoots not only the inflation target (2.5%), but also the upper end of the tolerance band (3.5%). We read this as a strong signal that further rate hikes are in the pipeline. The tightening cycle should culminate in 1H08 at 5.50-5.75%.

Capital markets

Zloty to stay on firming path

The election outcome was warmly welcomed by the markets and, although the initial reaction may have been a bit overdone, we believe that a more business-oriented cabinet will be a positive factor for the currency in the quarters ahead (in contrast to the previous government, which suffered from frequent infighting and was a cause of market volatility). Development on the major markets will be one of the most important inputs for the zloty development. Assuming that no recession of the US economy is in the pipeline and nervousness on world financial markets gradually settles, positive Polish fundamentals should catch the eyes of investors once again and help the zloty to appreciate. The economy will still grow much faster than the Eurozone, the budget should be brought under control and euro adoption should get closer. The current account deficit will widen further, but FDIs should cover it to a large extent. Moreover, the central bank's determination to hike key rates will also act as a supportive factor. Hence, we believe that the zloty should peek below 3.60 EUR/PLN in the first quarter and firm to 3.51 by the year-end.

Bond spreads to narrow, once global risk aversion wanes

On the fixed income front, there is space for a resumption of the convergence play on bonds, once the target date for euro adoption is set. Additionally, the new government is keen to restart the privatization process, which means lower bond issuance, even if the borrowing needs remain at the same level. Hence, the spreads on bonds should gradually narrow on both the middle and long segment of the curve. The short end might stay elevated in the next couple of months, as we doubt that rate hike expectations will evaporate quickly, although some mild decline cannot be ruled out at these tenors.

Maria Hermanova

Romania

	2006	2007e	2008f	2009f
Real GDP (grow th y/y %)	7.7	5.7	6.1	6.0
Private Consumption (grow th y/y %)	12.6	10.2	8.8	7.8
Fixed Capital Formation (grow th y/y %)	16.1	18.0	14.0	12.5
CPI (y/y, average%)	6.6	4.8	6.0	4.7
Current account balance (% of GDP)	-10.3	-13.7	-14.7	-14.7
Govt. budget balance (% of GDP)	-1.6	-2.4	-2.7	-2.7
Short term interest rate (3 months) year-end	8.6	7.8	7.7	7.1
EUR/RON, year-end	3.38	3.50	3.40	3.30

Economy

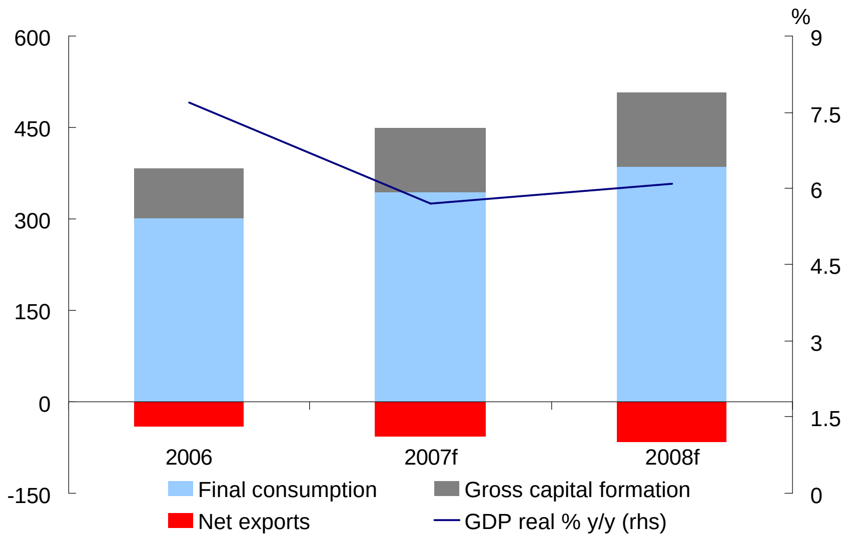
Fairly positive results in 2007

Economic growth is expected to slow down to below 6% in 2007 in comparison with the previous year, due largely to the decline in agriculture (following the severe drought in Romania) and lower net taxes on products in 1H07. In terms of expenditures, it is expected that the negative impact of net exports on GDP formation will be pretty high, which shows that the Romanian economy has not reached critical mass in terms of competitiveness. The good news is that gross capital formation picked up in 2007; this will certainly play a significant role in further increasing productivity gains, which have been at a high level throughout this year.

Good economic growth in 2008, but external imbalance still high

For the first part of 2008, we expect economic growth of around 6%, while final consumption is likely to slow down and gross capital formation will remain much higher than the real increase of overall GDP. The Romanian economy will continue to be substantially affected by its sizable current account deficit, which could be even higher than the one seen in 2007. The trade balance deficit should remain the key driver of the swelling current account deficit in 2008, while current transfers, mainly remittances from Romanians working abroad, will again be an important mitigating factor.

GDP by segments, in RON bn and %



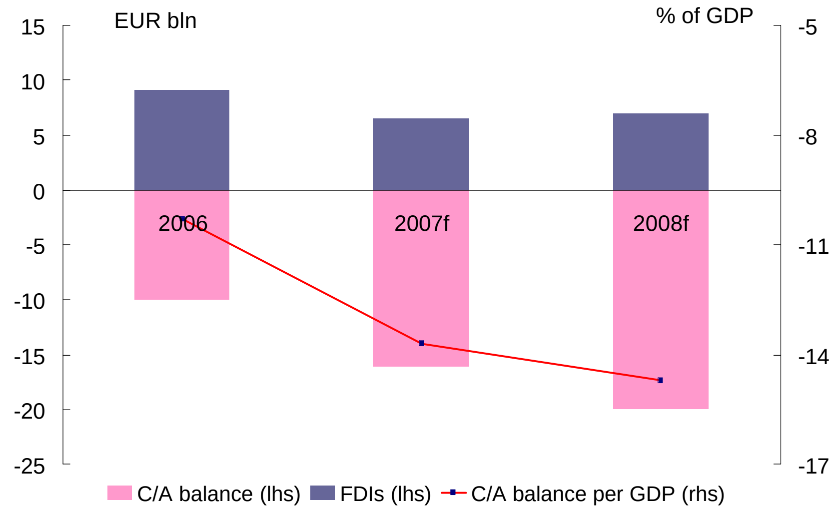
Source: NIS, BCR Research

Romania

FDI and EU money to fund good proportion of C/A deficit

A positive aspect related to the external imbalance is that FDIs (net inflows) are expected to cover a good proportion of the C/A deficit. This will somewhat reduce the pressure increasing Romania's foreign debt (which is much lower than in the peer countries as a percentage of GDP). In addition, 2008 will be the first year since EU accession in which structural funds are expected to pour in. Even though the absorption rate is likely to be low, considering the peer countries' experience, they will have positive effects on overall economic developments, including the FX rate.

C/A balance

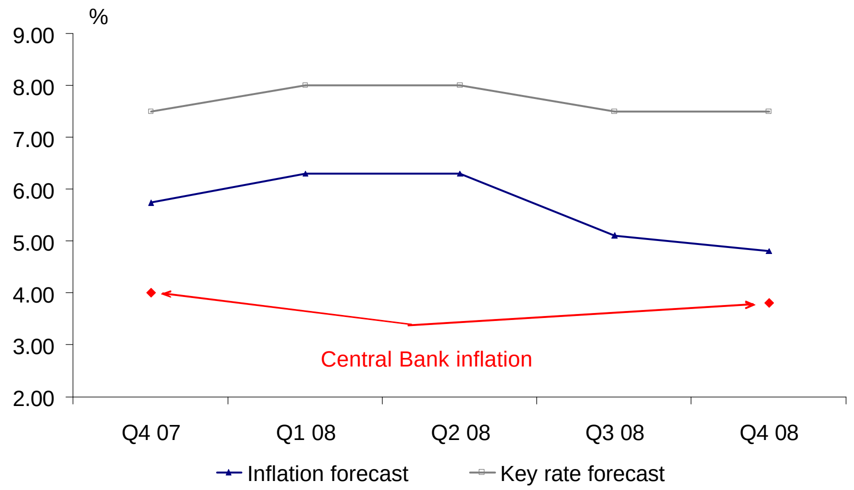


Source: NIS, NBR

Inflation pressures higher in 2H07

In terms of inflation, the latest trends in the market show Romania's poor resilience during unfavorable conditions (triggered by domestic and international developments). The disinflation process has come to a halt and the outlook for the first half of 2008 indicates the persistence of inflationary pressures. Disinflation is likely to resume only in the second part of 2008, but our estimate takes into consideration normal weather conditions (volatile prices are not affected), further postponements of hikes in administered prices (according to a recent statement from the minister of finance) and tougher monetary policy measures by the central bank.

Inflation development, y/y



Source: NIS, NBR

Monetary policy

Monetary policy expected to tighten

The significant upturn of inflation in 3Q07 and the persistence of some risks that could impair the inflation outlook in the medium term suggest an even more restrictive monetary policy in 2008, particularly in the first half of the year. The central bank could be forced to increase the key rate by 25-50 basis points in 1H08, due to the recent pension hikes approved by Parliament (which are planned to continue in 2008), the rebound of FX loans in 3Q, potential excess demand in 3Q (reflected by the acceleration of retail sales), the too lax fiscal policy in an election year and other potential risk factors, such as the international context (oil price, inflation in the Eurozone). At the same time, mandatory reserves are expected to remain at the current high levels, while now even a possible relaxation in the calculation base of MRR looks very unlikely, at least in the first part of next year.

Capital markets

RON likely to return to appreciation path, but more slowly in 2008

After strong appreciation in the first seven months of this year, the RON reversed its trend, under the influence of the turmoil on international markets, as well as the more cautious approach among short-term investors caused by the economic slowdown and external imbalance, which culminated in the recent downgrade of the country's outlook by S&P. Since the effects of the turmoil will be felt further on, the current outlook for the RON - which very much depends on investor sentiment, due to the shallowness of the FX market - suggests that the RON is more likely to end 2007 close to 3.5 against the EUR. Next year, the RON should appreciate based on the good economic growth anticipated and tighter monetary policy, which will be supportive in terms of interest rate differential attractiveness.

2008 budget yet to be endorsed by Parliament

The planned relaxation of fiscal policy in 2007, which included a consolidated budged deficit of 2.7% of GDP, currently has a lower profile, as government spending has fallen short of initial projections, while budget revenues have grown steadily. Recently, the Ministry of Finance announced a new budged deficit for 2007 of 2.4% of GDP. So far, 11 out of 39 tenders were called off, most of them in 4Q. Total state securities issued this year amounted to EUR 2.7bn, out of which EUR 1.5bn were short-term debt instruments. The government displayed little determination in issuing state securities throughout 2007, not to mention that the nominal amounts of most tenders were undersized, intended rather to cover liquidity gaps than to fund long-term projects. So, both domestic and foreign investors were unable to quench their thirst in terms of placing liquidities at higher interest rates, and this had a significant impact on the recent RON depreciation. In addition, the planned Eurobond tender scheduled for 4Q07 has been postponed until early 2008. The reason behind this was again the liquidity gap (repayment of existing international debt maturing in mid-2008). So far, the Ministry of Finance has not disclosed its plans regarding state securities issuance in 2008 and the ambitious budget for next year has yet to be approved by Parliament.

Dumitru Teodor Dulgheru

Serbia

	2006	2007e	2008f	2009f
Real GDP (grow th y/y %)	5.7	6.9	6.6	6.8
CPI (y/y, average%)	20.9	20.0	19.0	18.0
Current account balance (% of GDP)	62.8	61.6	63.7	70.5
Govt. budget balance (% of GDP)	15.8	10.6	10.0	9.3
Short term interest rate (3 months) year-end	66.8	58.0	58.0	62.0
EUR/RSD, year-end	79.0	79.0	78.0	76.0

Political risk remains pronounced

Political risks in Serbia have been pronounced in recent periods. Some of the risks have been alleviated as a new democratic government was formed, after lengthy negotiations. Nevertheless, the Kosovo issue remains open and the outcome is still unclear, as negotiations are showing little progress. A resolution would definitely facilitate faster real convergence and would lead to a more stable economic environment. Further instability would likely increase the uncertainty and have unfavorable effects on the potential economic performance. The conclusion therefore remains the same - Serbia should seek a solution to the Kosovo issue, in order to boost the convergence process and EU negotiations.

Economy

Strong economic performance and widening C/A deficit

After a slowdown in 2006 (GDP growth: 5.7% y/y), GDP expansion is anticipated to accelerate in 2007. 1H07 brought GDP growth above expectations. 1Q07 witnessed robust 8.4% y/y growth, while the 2Q07 performance was just a bit slower, recording 7.7% y/y. As expected, the service sector's contribution to the strong real sector performance was the greatest, while wholesale and retail trade grew especially briskly, profiting from robust wage and credit growth. We continue to see domestic demand driving solid GDP performance in the coming quarters and thus anticipate a FY07 growth rate of close to 7% and only slightly lower in 2008. On the other hand, the current account deficit remains an issue, as we expected further widening towards 15% of GDP this year. The C/A deficit widening does not come as a surprise, despite the solid export performance, due to the strong economic performance, which drives demand for both consumer and investment goods. Nevertheless, despite high levels of international reserves and stable capital inflows from abroad, Serbia should seek to ensure political and macro stability, in order to erase some of the risks related to C/A deficit financing.

Accelerating inflation in 2H07

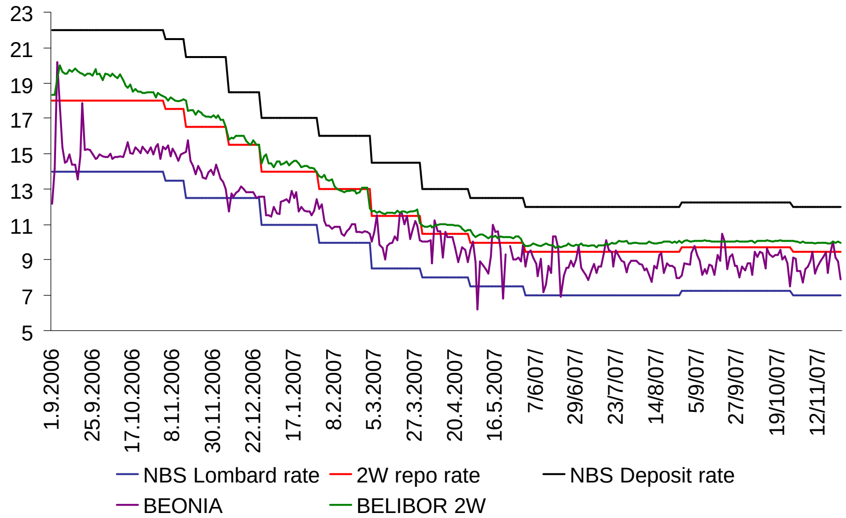
Accelerating inflation was somewhat expected in 2H07, as the strongly favorable base effect disappears. On top of that, some pressures arose on the supply side, mainly from agricultural prices, which, alongside some administrative price hikes, boosted the pressure further. Retail prices accelerated from 4.4% y/y in May to 8.5% y/y in October. We see inflation stabilizing at current levels and hovering around 6.3% on average, significantly lower than in 2006 (12.8%).

Monetary policy

Monetary stance to remain tight

The NBS' stance has continued to be tight throughout 2007, with further efforts to curb credit growth. The reserve requirement remained high: for foreign sources of finance, it is 45%, thus reducing incentives for the banking sector to find financing abroad (as in Croatia). This was confirmed by a decline of banking sector foreign liabilities. The FX-linked base reserve requirement remained at 40%, while the dinar-base reserve requirement was lowered to 5%. Hence, the NBS continues to stimulate a stronger orientation toward dinar sources of finance. Nevertheless, developments in this direction have thus far had limited potential. On top of that, the NBS introduced another prudential measure with the aim to affect the structure of placements and overall placement growth. The NBS thus prescribed that bank placements to households (excluding mortgage loans) may not exceed 200% of share capital, while in 2008 this measure will be further tightened to 150% of share capital. On one hand, this measure made consumer credit more expensive. On the other hand, it forced banks to import additional capital from abroad, which resulted in increasing capitalization of the banking sector. Overall monetary policy should continue to pursue a tight course in 2008, in order to moderate the strong credit growth and shift preferences away from consumer lending.

Money market rates



Source: National Bank of Serbia

NBS hiked base rate for first time

A period of extensive rate cuts brought the 2W REPO rate from 18% to 9.5%. The rationale behind these moves involved moderating inflation pressures and the high cost of excess liquidity sterilization. As 2H07 brought boosting inflation pressures, the NBS took a more defensive stance and hiked the rate for the first time, by 25bps to 9.75%. Soon after, the NBS again lowered the rate to 9.50%, which may have come as a slight surprise, given the course of recent inflation developments. The NBS' communications still indicated an easing of inflationary pressures and fine-tuning of exchange rate developments. Some mixed signals have recently come from the NBS, so the course of interest rate movements remains gloomy. However, in the coming months, the 2W rate will likely remain around present levels, with a slightly higher likelihood of an upward revision, albeit remaining in the ± 1% region.

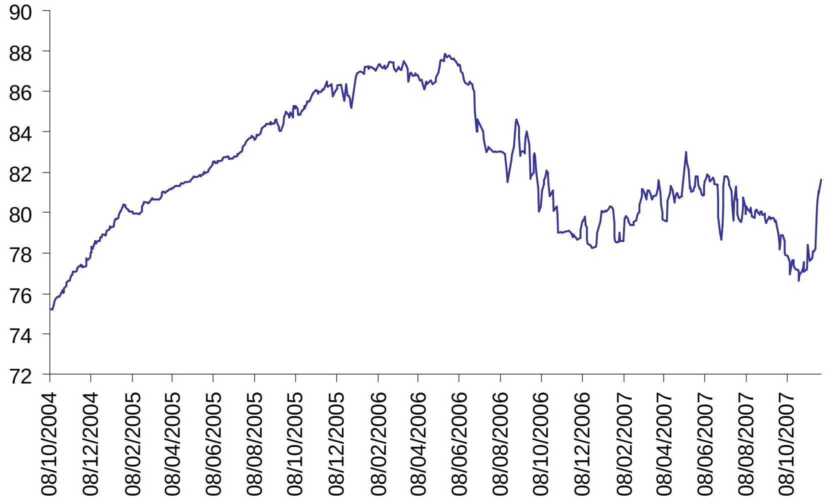
Capital markets

Volatility on FX market

The exchange rate continued to move in the range of RSD 78-82 per EUR until October, when appreciation pressures mounted, pushing the exchange rate into 76-77 RSD/EUR territory. Appreciation pressures were fueled by capital intakes by banks, in order to align with monetary regulation. However, pressures soon shifted in the opposite direction, due to rising uncertainties regarding Kosovo. Thus, the exchange rate suddenly depreciated towards the 81-82 region, once again confirming the exchange rate's sensitivity to political developments. The outlook remains unchanged and we see mid-term pressures on the appreciation side. The dinar still carries political risk linked to Kosovo's status, so short-term volatility is likely to remain, again confirming the slightly wider fluctuation band for the RSD. Money market developments continue to be determined by the NBS 2W REPO rate. Hence, MM rate volatility in comparison to previous years is significantly lower. The bond market, on the other hand, remains thin and dependent on the frozen currency savings bonds. The Ministry of Finance's financing needs are not significant in terms of fiscal performance, so it is still unclear to what extent the bond market will develop in the coming years.

Serbia

EUR/RSD



Source: National Bank of Serbia

Alen Kovac

Slovakia

	2006	2007e	2008f	2009f
Real GDP (growth y/y %)	8.5	8.9	7.2	5.3
Private Consumption (growth y/y %)	5.9	6.4	5.4	5.0
Fixed Capital Formation (growth y/y %)	6.6	4.7	5.5	6.0
CPI (y/y, average%)	4.5	2.7	3.4	3.5
Current account balance (% of GDP)	-7.2	-3.3	-3.1	-2.8
Govt. budget balance (% of GDP)	-3.3	-2.9	-2.4	-2.6
Short term interest rate (3 months) year-end	4.7	4.3	4.4	4.1
Long term interest rate (10 years) year-end	4.3	4.7	4.9	4.8
EUR/SKK, year-end	34.7	32.5	32.5	32.5

Economy

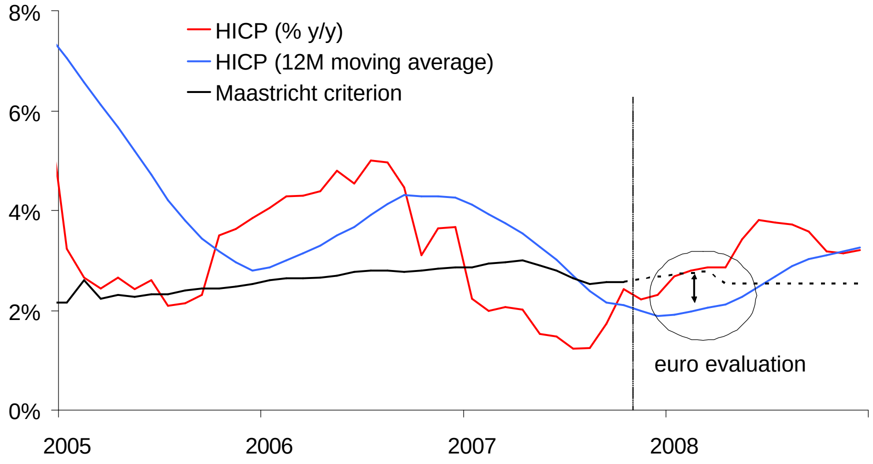
Slovak economy still in high gear

The economic boom in Slovakia does not show signs of cooling yet, as the Statistical Office's flash estimate showed that the economy grew by 9.4% y/y in 3Q07 (after 9.0% y/y in 1H07). The structure is not yet known, but industrial output and retail sales suggest that export-oriented industries (such as cars and electronics) had a significant impact, with domestic demand also playing a strong pro-growth role. Our estimate of the full-2007 GDP growth is 8.9% y/y, while next year should bring some deceleration to around 7.2% y/y. However, comparison with the previous period has become difficult, since the Statistical Office has made methodology changes and only some revised data has been released so far (in particular, the quarterly data has not been published yet).

Slovakia has started to meet inflation criterion

During summer, price growth decelerated and harmonized inflation fell to as low as 1.2% y/y. As a consequence, Slovakia met the convergence inflation criterion for the first time in August. Even though the Europe-wide phenomenon of strong food price growth led inflation back upwards (to 2.4% y/y in October), Slovakia seems well on track to meet the euro price criterion when it is evaluated in spring 2008. We expect 12M average harmonized inflation at around 2.0% at that time, below the reference limit (anticipated within 2.5-3.0%). Since the January growth of regulated energy prices should be zero to moderate (depending on the commodity), food prices pose the biggest upward threat for inflation. Even if this risk materializes, the existing cushion should be sufficient (any inflation acceleration would affect less than half of the months that will be averaged). We expect inflation acceleration later in 2008 to around 3% by the year-end.

Consumer prices



Source: Eurostat, SLSP

Euro adoption more likely than not

For euro adoption, the biggest lingering question mark is the issue of sustainability, especially concerning inflation, since it remains unclear how this will be evaluated. Options include looking at the spot inflation, medium-term outlook or koruna-adjusted inflation, and all cases might theoretically provide arguments for an unfavorable ruling.

On the fiscal front, EU Commissioner Joaquin Almunia suggested that the government-approved 2008 budget seems sustainable. The proposal, which still needs Parliament's blessing, envisages a fiscal deficit of 2.3% of GDP in 2008, down from this year's initial plan of 2.9% (the actual figure will probably be better). Overall, we estimate the probability that Slovakia will switch to the euro in 2009 at around 75%.

Monetary policy

Central bank in wait-and-see mode

The central bank has kept interest rates stable since the last 25bp cut that took place in April, and we believe that the NBS currently feels no need to alter them. While inflation has accelerated recently, food - the main reason for the pickup - is an external factor, on which interest rate setting has little impact. Moreover, the koruna has recently appreciated to close to its historical high, tightening the monetary conditions. Hence, we expect the central bank to wait for ECB moves. The NBS base rate at 4.25% is 25bp above the ECB reference rate. If the ECB addresses EMU inflation concerns with one more 25bp hike, Slovak rates would likely stay on hold until euro adoption. On the contrary, a no-change scenario by the ECB would require one last 25bp cut by the NBS, probably in 2Q08, once Slovakia's EMU entry is secured (alternatively, the NBS could deliver this cut to counter the koruna's appreciation, if needed). Regardless of ECB steps, the same 2Q08 timing applies for when the currently asymmetric corridor of O/N rates around the central rate (2.25/5.75%) could be changed to the ECB's standard of 100bp on both sides.

Capital markets

Timely euro adoption key issue for markets

The single most important market driver in the coming period will be the probability of euro adoption, in line with the 2009 plan. The better the perception of Slovakia's Eurozone chances, the better for the koruna and bonds. For bonds, euro adoption means yield convergence, while on the FX market, foreign investors are interested in as strong an exchange rate as possible once their assets are converted back to the euro in 2009. The less likely scenario of a euro delay would bring a T-bond yield pickup and closing of FX positions, leading to significant koruna weakening in the initial period (even though long-term arguments for appreciation would remain).

We expect ERM-2 central parity reset next year

In keeping with our view that Slovakia will switch to the euro in 2009, we expect currency appreciation in the period ahead. The key question is how strong a koruna is acceptable to the central bank. We expect one more revaluation of the ERM-2 central parity, probably at the beginning of next year. The purpose of this would be to stabilize the koruna development, since such a move should be a clear signal to markets as to where the final conversion rate will stand. If revaluation takes place, the two most important factors taken into account by the central bank will probably be the estimated equilibrium exchange rate and the spot market rate (we believe that the authorities would like to avoid setting the conversion rate far from the spot rate, so that revaluation does not cause a one-off non-market shock that would affect the value of investors' portfolios). On balance, we estimate the final euro conversion rate within 32.5-33.0 EUR/SKK.

Recent spread widening provides opportunity to buy Slovak bonds

On the bond market, there was recently a pickup of the spread between Slovak and German T bonds, especially as Slovak bonds did not join the late downward movement of euro yields. As a consequence, the 10Y spread has risen to 60bp (on the bid side). Since euro adoption is probably just one year away, after which we expect the long-term Slovak-Eurozone spread at 10-30bp, we see value in buying Slovak T-bonds. The downside is their poor liquidity, as Slovak bonds trade with a wide 15-30bp bid-ask spread and are thus more suitable for held-to-maturity portfolios than for active trading.

Michal Mušák
Mária Valachyová

Czech Republic

	2006	2007e	2008f	2009f
Real GDP (grow th y/y %)	6.4	5.9	4.3	5.4
Private Consumption (grow th y/y %)	4.4	7.0	3.2	3.5
Fixed Capital Formation (grow th y/y %)	7.6	4.0	5.7	7.5
CPI (y/y, average%)	2.5	2.7	5.3	3.6
Current account balance (% of GDP)	-3.0	-3.4	-4.0	-3.4
Govt. budget balance (% of GDP)	-3.3	-3.9	-3.3	-2.8
Short term interest rate (3 months) year-end	2.7	3.5	3.9	4.6
Long term interest rate (10 years) year-end	4.1	4.4	4.8	4.7
EUR/CZK, year-end	27.5	26.9	26.3	25.4

Economy

Reforms - growth to slow down...

The economy remained strong over the first three quarters of 2007, having grown by 6% in the second quarter (the last quarter for which finalized data is available). The driver remained the same - household consumption, which increased at a real 6.5% in the period. For full-year 2007, the growth rate should reach 5.9%. Next year is going to be different, in that we are likely to see some slowdown to around 4.0-4.5%. What is going to be behind this?

There is one common cause - the reforms that were approved by Parliament in late August and that are set to become law as of January 1. The major components of the reform package are the cut in personal income tax (and gradual decrease in the corporate income tax), the rise in VAT and cuts in (some areas of) social spending. The impact of these changes in terms of aggregate consumption (and, subsequently, growth) will be negative, with consumption negatively influenced via two channels. First, there is a direct effect of lower social spending and higher VAT. Second, the indirect effect of uneven distribution of PIT reform benefits (skewed towards people with higher income and, consequently, lower marginal propensity to consume) will also work to lower the aggregate consumption. All in all, consumption will grow, but more slowly than in 2007 - at a real y/y growth rate of around 3%.

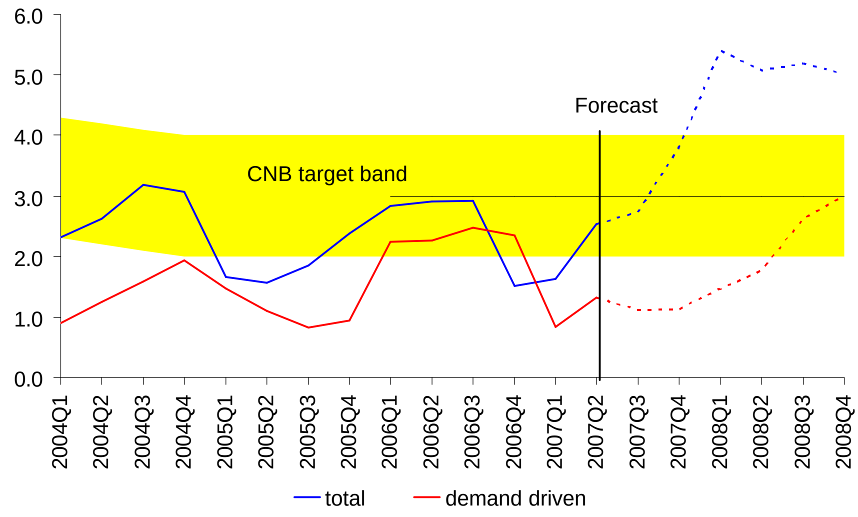
As for the factors that should help sustain consumption, the labor market sticks out. The (registered) unemployment rate dropped to as low as 5.8% in October (from 7.4% in October 2006) and the number of vacancies firms are trying to fill is high. The overall lack of skilled workers will thus continue to raise the bargaining power of those already employed. The effect on consumption will be limited, however - the unions' demands are somewhat moderate (8% y/y growth in nominal wages) and, as discussed below, inflation (of around 5%) will bite into wages and limit real wage growth. Also, unemployment is not likely to fall any lower, due to the shrinking pool of available workers and general mismatch between those available and those sought after.

...and inflation to take trip upwards

As indicated, a host of factors will contribute to rising inflation in 2008, sending inflation to above 5%. Most of these will be of a cost related nature, rather than demand related. The prelude to the inflation rise to come out in January already played out in part in October, mainly on the back of food price increases. The headline in the Czech Republic shot up to 4% and will go even higher next year, owing to the (non-recurring) price shocks (mainly VAT). We expect inflation to average around 5.2% in 2008. As for the implications for the CNB, the situation is rather tough for the bank, since it needs to counter what is basically cost-driven inflation (demand-driven inflation remains subdued) with tools primarily designed to fight demand-driven inflation. The labor market, however, remains tight and threatens to feed higher headline inflation into higher core inflation (even though the unions, as mentioned, appear to remain restrained for the moment). The risk, however, is that the higher inflation will become built into expectations - this second-round effect is something the CNB will want to prevent.

Czech Republic

Consumer prices



Source: CS estimates, Bloomberg

Monetary Policy

Rise in rates, but no rush

Monetary policy will have its hands tied to some extent by the nature of the price shocks - as mentioned, it is mainly cost factors that will drive the inflation. Also, the slowdown in consumption will work to limit the growth of demand inflation, and so will further reduce the need to hike the rates, everything else equal. On top of that, the stronger koruna already does a lot to tighten the monetary conditions - the CNB prognosis likely assumed a currency exchange rate of around 27.30; the current levels of 26.60-26.70 thus constitute a strong anti-inflationary risk to the prognosis (which was consistent with a gradual rise in rates). Yes, there is a tight labor market, but that is about the only clear pro-inflationary threat that there appears to be.

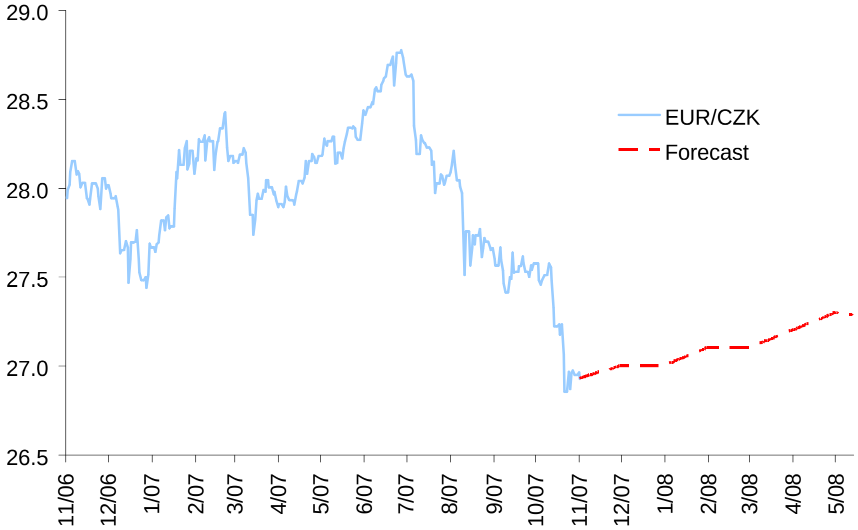
All in all, we think that the rates will grow, but at a slower rate - we only forecast two rate hikes until the end of 2008 (so that the key rate will end up at 3.75% at the end of 2008). The risk to the outlook remains the further worsening of credit conditions, which could then slow the Eurozone (and Czech exports there) down.

Capital markets

CZK to weaken before starting to strengthen again

The koruna strengthened in two big waves since July - the first one was primarily driven by carry trades unwinding, the other by the sell-off of dollars and the stampede to CEE currencies that (mostly) boast solid macro fundamentals and growth prospects. Except for the HUF (which is on a different exchange rate regime), all other CEE currencies have strengthened since July - the koruna so much that it has reached (in our view) the point where its value is not fundamentally justified. We expect a weakening of the CZK in the first few months of next year before the currency re-embarks on its strengthening path and finishes the end of 2008 at 26.30.

EUR/CZK



Source: CS estimates, Bloomberg

As for bonds, there is space for growth of longer-term yields (narrowing of the spreads vis-à-vis Bund yields, which we expect to increase in terms of yields). Domestic factors will work in the opposite direction - lower net issuance (due to the cut in spending) and lower domestic demand for bonds (decrease in the deposit-to-loans ratio at domestic institutions).

Martin Lobotka

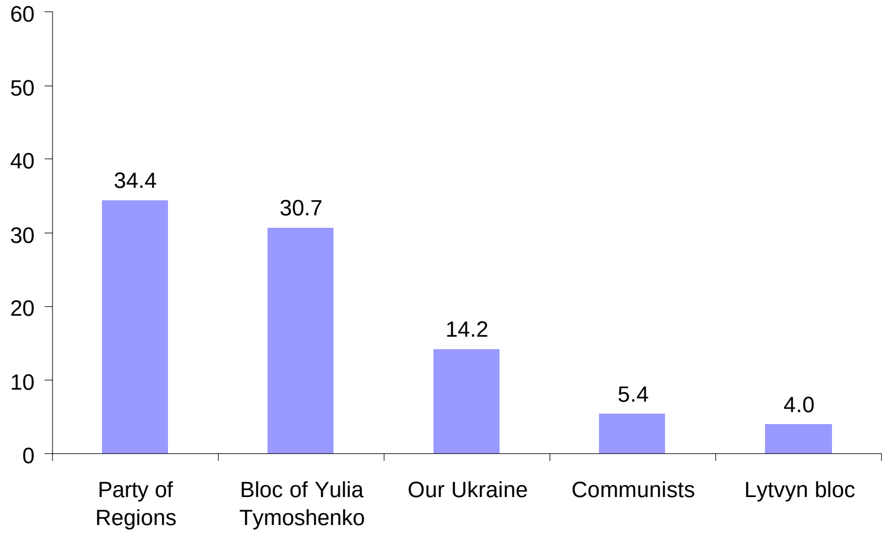
Ukraine

	2006	2007e	2008f	2009f
Real GDP (grow th y/y %)	7.1	7.1	6.6	6.0
Private Consumption (grow th y/y %)	14.4	13.0	12.0	12.0
Fixed Capital Formation (grow th y/y %)	18.7	23.0	10.0	8.0
CPI (y/y, average%)	9.2	12.5	13.2	10.8
Current account balance (% of GDP)	-2.9	-3.5	-2.6	-2.2
Govt. budget balance (% of GDP)	-0.7	-2.8	-2.7	-3.0
Short term interest rate (3 months) year-end	15.0	8.0	7.5	7.0
EUR/UAH, year-end	6.65	7.32	6.31	5.70

A slim victory of opposition

The parliamentary elections in September brought the expected slim victory for the opposition forces of the Block of Yulia Tymoshenko (BYT) and the Our Ukraine Block (OU). The government has not been formed yet. However, Tymoshenko is likely to be appointed as prime minister. Her party should get economic ministries, while Our Ukraine should control the power ministries. The new ruling coalition has only a two-vote majority in Parliament (out of 450 seats), as (surprisingly to us) the Lytvyn Block was not invited to join the coalition. With the current fragile majority, political conflicts are likely to resurface. The approval of the 2008 budget will be the first key test of the coalition.

Election results, in %



Source: Central Election Commission of Ukraine

Economy

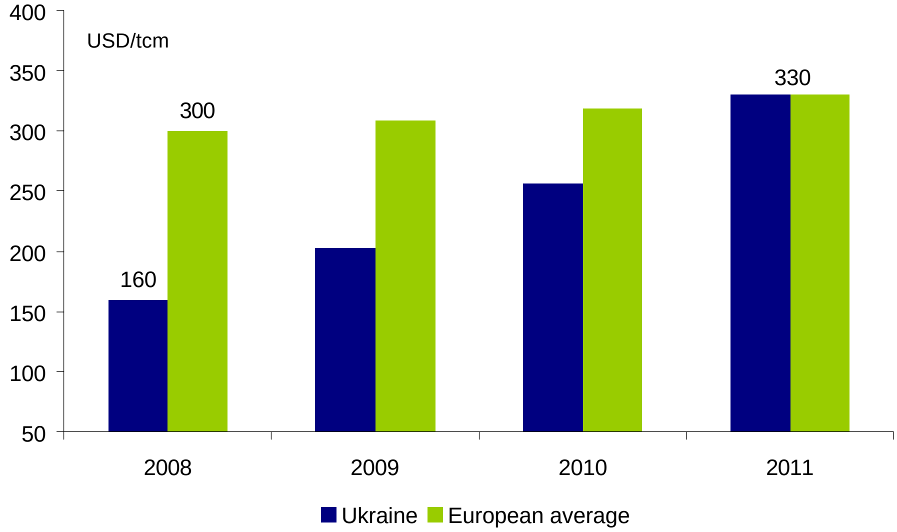
Economy to be further supported by domestic demand

Economic growth remained upbeat in the first three quarters of 2007, although it slowed down slightly to an estimated 6% in 3Q07 (from the 8% seen in the first half of the year). The growth could stabilize at around 6.5-7% in the first half of 2008, supported by ample household consumption and investment growth. Household consumption continued to be driven by income and credit growth, while investments kept around 20% real annual growth rates during 2Q07. Export growth will slow down in the course of 2008, due especially to the high base from a year ago, as well as smaller contributions from metal exports. Imports continue to be boosted by surging domestic demand and income. Current transfers and the positive service balance partially offset the surging trade deficit, and the current account deficit remains comfortably covered by FDI inflow. Risks to economic growth include external demand for metal production and absorption of the shocks from natural gas prices.

Inflation to stay elevated, due to food and energy prices

Inflation accelerated above expectations, as food prices soared during autumn. As elsewhere in Europe, prices of wheat, milk products and meat rose significantly. As food prices have almost a 60% share in the CPI basket (in CE-4, countries it is only about 20%), they brought inflation up to above 14% y/y in October. Inflation is going to stay at elevated levels in the first half of 2008, not only due to food prices, but also due to the hike in natural gas prices . It is still unclear how much of the hike will also touch households , but PPI is going to be hit for sure (now witnessing 20% y/y growth). The rising disposable income of households poses another risk to demand-driven inflation pressures.

Prices of natural gas could converge to European average by 2011



Source: Unian

Monetary Policy

Central bank tightened monetary policy

Reacting to accelerating inflation and increased demand for the hryvnia, the central bank widened the spread on overnight facility in mid-November (the refinancing rate was raised to 12%, up from 9% on loans secured by government bonds, and from 10% to 12.5% on unsecured loans). The key discount rate and the overnight sterilization rates remained unchanged at 8% and 0.1%, respectively. The central bank also increased the minimum reserve requirements for the banks, namely for funds in foreign currencies (to 4-5% of the fund value) in order to tighten conditions for borrowing in foreign currency. The NBU also resumed conducting deposit certificate operations, draining liquidity from the market. These practices will very likely continue in the near future, as inflation will not decrease to single-digit territory anytime soon.

[1)] The Stats Office started to release real GDP data on prices in the previous period, whereas before we referred to the average 2001 price data as real GDP. In the new methodology, GDP growth in 1H07 reached 8% y/y, compared to 9.3% in the older methodology. According to the monthly statistics, the growth in the first three quarters of 2007 stood at 7.3% y/y.

[2)] Gazprom allegedly agreed with Ukraine that natural gas prices will go up by 23% to 160 USD/tcm as of 2008 and further each year until they converge to the European average by 2011, implying annual growth of around 30% until the price reaches around 330 USD/tcm in 2011, vs. the current 300 USD/tcm paid in Europe.

[3)] A hike in prices of natural gas by 37% at the beginning of 2007 has still not been transferred onto households. The weight of natural gas in the CPI index is 2%.

Capital markets

We bet on hryvnia revaluation in 1H08

Discussion about the revaluation of the hryvnia exchange rate intensified in the last weeks, especially in light of the climbing inflation. The central bank, facing a choice between inflation and economic competitiveness, refused a revaluation in the near term and indeed decided not to publish exchange rate forecasts, so as to prevent the public from taking the forecast as the allowed corridor for currency moves. However, once the political situation settles, we expect gradual revaluation of the USD/UAH exchange rate (to 4.95 USD/UAH to start and later in the year to 4.85 USD/UAH). The fact that Volodymyr Stelmakh, an advocate of the hryvnia revaluation, stayed on as NBU governor might help the case.

After the slight drop in September, the bond market stabilized in October (yields of 3Y GB were issued on the primary market at 6.4%, down from 6.6% in September). A further decline in yields could come with the appreciating hryvnia, i.e. with applying a wider band for the exchange rate.

Mária Valachyová

Hungary

	2006	2007e	2008f	2009f
Real GDP (grow th y/y %)	3.9	1.7	2.5	3.5
Private Consumption (grow th y/y %)	1.4	-1.2	0.2	3.2
Fixed Capital Formation (grow th y/y %)	-2.1	-0.5	3.0	5.3
CPI (y/y, average%)	3.9	7.9	5.2	3.0
Current account balance (% of GDP)	-6.5	-5.1	-4.5	-4.1
Govt. budget balance (% of GDP)	-9.2	-6.0	-4.2	-4.1
Short term interest rate (3 months) year-end	8.1	7.4	6.4	5.7
Long term interest rate (10 years) year-end	6.7	6.6	5.8	5.5
EUR/HUF, year-end	252	255	256	255

Economy

GDP growth expected below 2% y/y in 2007…

The Statistical Office reported GDP growth of just 1% y/y for 3Q07, after the 2.7% y/y and 1.2% y/y published for the first and second quarters, respectively. Thanks to the impressive performance of the Eurozone's economies, exports have remained the key growth driver this year, while the structure of the ongoing fiscal adjustment has led to a declining contribution to GDP from domestic demand. All in all, the economic performance shows that the austerity package has been biting strongly and the growth sacrifice of the fiscal adjustment package has proven greater than predicted earlier. Thus, the overall 2007 GDP growth now seems sure to remain at 2% y/y.

….and should expand below potential in mid run

Regarding the mid-term outlook, GDP growth is expected to accelerate somewhat from 2008. However, it is unlikely to reach 4-5% per annum in the mid run. Hence, a negative output gap should remain in 2008. We trust that the prospects for economic growth in Euroland will remain relatively favorable. Thus, exports will be able to preserve their strength in the coming year as well. However, the contribution to GDP from domestic demand should remain sluggish. Analyzing the two main elements of domestic demand, both consumer and investment spending have been under downward pressure this year. Household consumption is expected to drop to a lesser extent this year than net real wages, due to the phenomenon of consumption smoothing, suggesting that household consumption may revive in the mid run. As for the intensification of investment activity, we have some concerns. Problems around the overall low investment growth are closely related to the lagging structural reforms, among which comprehensive tax reform should have top priority, in order to increase the country's competitiveness.

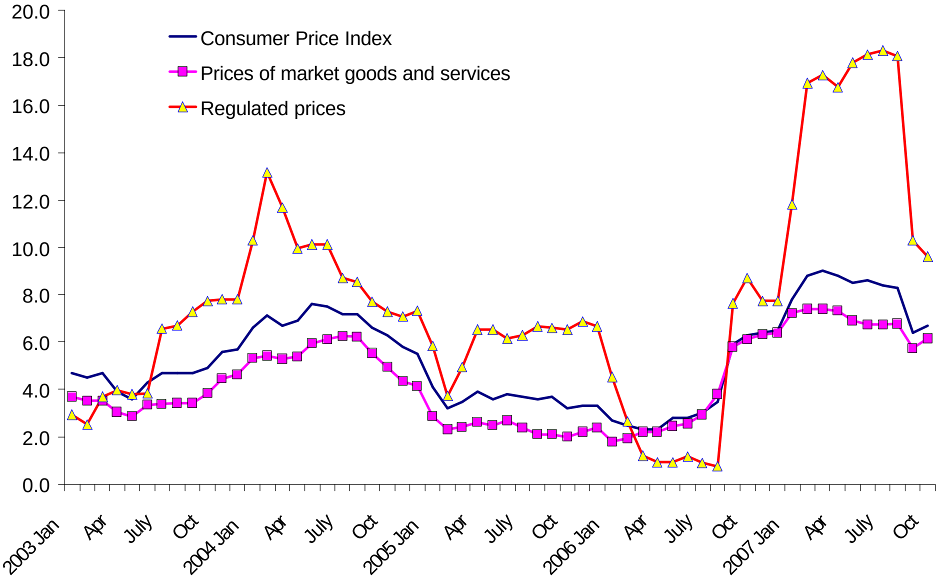
Inflation peaked in 2007

2007 can be characterized by another sharp acceleration in the 12-month inflation rates. Based on the continuing adjustment in administrative prices (in tandem with the decreasing budget subsidies), CPI inflation peaked at 9% y/y in March. A slowdown to 6.4% y/y arrived in the ninth month of the year, due to a base effect, as the price-increasing element of the fiscal austerity package started to be implemented in September 2006.

Inflation to decline in 2008, but to lesser extent than expected

As for the last quarter of this year, the base effect no longer supports any slowdown in the 12-month index. In addition, the ongoing sharp acceleration in food and fuel prices should again lead to some acceleration in the 12-month indexes and inflation will again rise to close to 7% y/y in December. Apart from the possible spillover effects of the food and fuel factors, uncertainties surrounding the price changes in utilities and regulatory services, as well as wage formation in the private sector all make the 2008 inflation outlook uncertain. Our base scenario is, however, that inflation will decline in 2008, but to a lesser extent than expected earlier. The 4Q07 inflation acceleration negatively affects the 1H08 prospects, which could lead to a higher yearly average rate in 2008, as well. There is still chance, however, that the 12-month CPI inflation will stand below 4% at the end of next year, provided that the forint exchange rate preserves its relative strength and there are not overly strong second-round effects (stemming from the food and fuel factors).

Consumer prices, y/y in %



Source: Central Statistical Office

Monetary Policy

Monetary policy to remain cautious

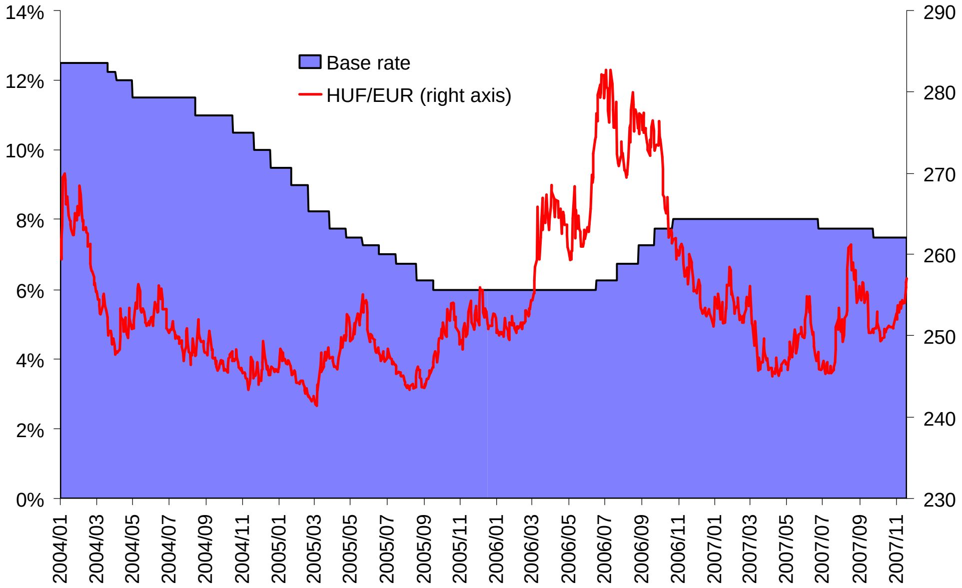
The central bank has pursued a more cautious monetary policy than the markets expected. The base rate was cut - in two steps - from 8% to just 7.50% this year. As far as the domestic fundamental outlook is concerned, the Monetary Council expects a negative output gap and a gradual inflation slowdown - reaching the 3% CPI target by 2009 - in the coming two years. Both factors suggest further rate reductions. However, the ongoing exogenous inflation shocks increase the likelihood of the central bank further putting off rate reductions. As food and oil prices are non-monetary factors, in this situation, the Council would keep an eye on wage developments - whether they indicate increasing inflationary expectations or not. As for future prospects, the timing of the next rate move remains uncertain; the central bank is expected to be very cautious in making future rate decisions. Supposing anchored inflationary expectations, no significant second-round inflation effects and improvement in the global market environment (which is again deteriorating at present), the central bank could cut the base rate to 7% by June 2008 and to 6.50% by the end of next year.

Capital markets

Exchange rate remains volatile

Due to the jitters around the sub-prime crisis, sentiment on international markets has turned for the worse and risk premiums have again started to increase. Despite the fact that the country's economic balance situation improved significantly in 2007 (lower budget and C/A deficit figures), Hungary's exposure to changes in global risk appetite is still seen as high. Thus, the forint should remain one of the most vulnerable currencies in the region. As the rate cutting cycle will likely drag on for a longer period, this should provide some support for the local currency. However, no spectacular recovery is expected in a market environment in which risk aversion is dominant. Thus, the forint exchange rate is not expected to show a clear trend and should be very strongly correlated with changes in global risk appetite.

Base rate and EUR/HUF



Source: Central Statistical Office

Bonds should be attractive for long-term players

The fiscal deficit reduction will continue in 2008, while we believe that inflation will slow down close to the mid-term target by 2009. Hence, the fundamental outlook makes long-term government bonds attractive at their current levels. However, possibilities for yield drops are limited in the short run, due to the current less favorable global market environment. To sum up, increasing risk premiums and the bad short-term inflation outlook make it too risky for short-term investors to enter the bond market; for the longer run, we remain bullish on Hungarian long-term bonds and the forint. We still see space for gains, with long-term bond yields approaching Hungary's regional peers' level.

Orsolya Nyeste

Corporate Bonds

Review

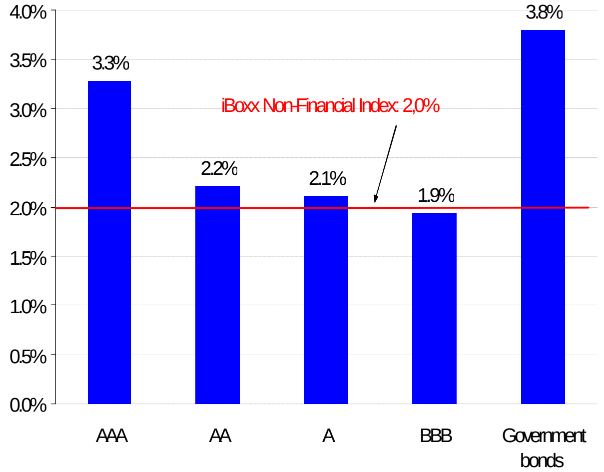
The weakness in the market for subprime mortgage loans triggered a major turmoil on bond markets in the second half of the year. In the past five months, volatility and risk premiums have risen steeply on credit markets. The spreads of corporate bonds in the iBoxx EUR Non-Financials Index are currently around 50bps over the level at the beginning of the year of around 121bps. CDS indices also reflect the insecurity prevailing on markets. The costs of hedging against the default risk on corporate bonds have increased exorbitantly.

The subprime crisis has caused liquidity to drop on the market and has been highly unsettling for investors. The second wave of the credit crisis in the US of November fuelled insecurity again; this second wave was caused by the renewed need for write-offs among major banking institutions. Government bonds benefited from the heightened risk aversion and posted steeply declining yields.

Thus, government bonds have performed much better than corporate bonds since the start of the year. At the sector level, the securities of the automobile sector performed well, posting +2.5% and underperforming government bonds by "only" 0.4%. The weakest performance was posted by industrial bonds with +1.5% and utilities with +1.8% with longer-than-average maturities.

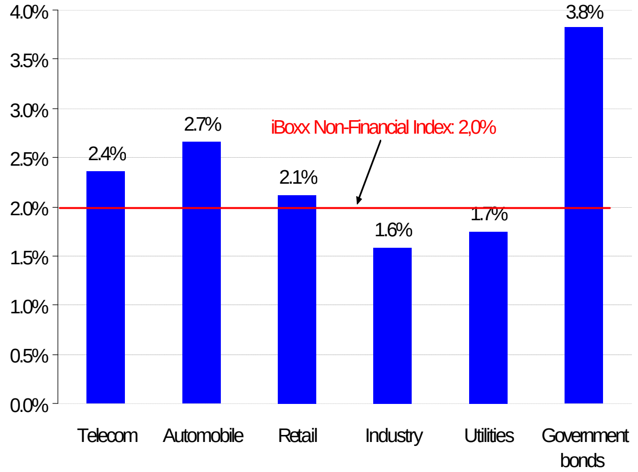
iBoxx Index: Total performance since 1/1/2007

by rating categories



*Source: iBoxx, Erste Group Research, * until 21/11/2007*

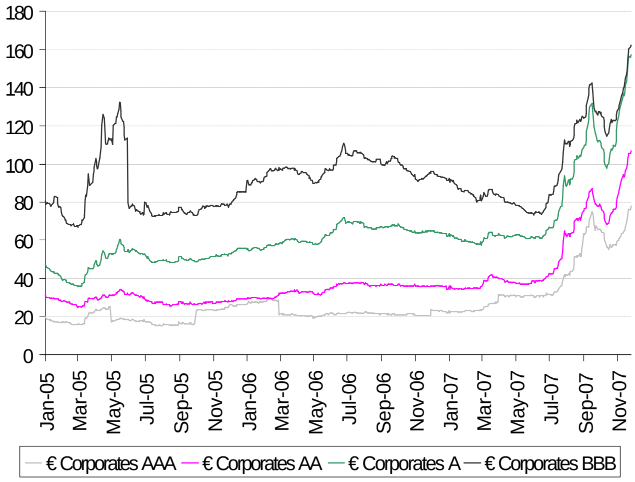
by sectors



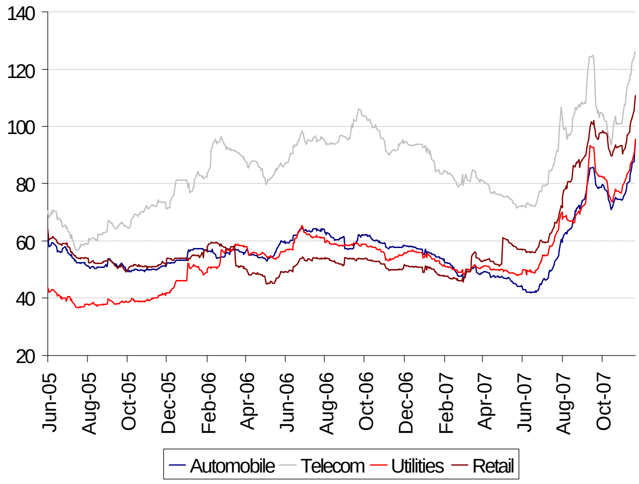
Source: iBoxx, Erste Group Research

Corporate Bonds

iBoxx Index: Development of spreads by rating categories



by sectors



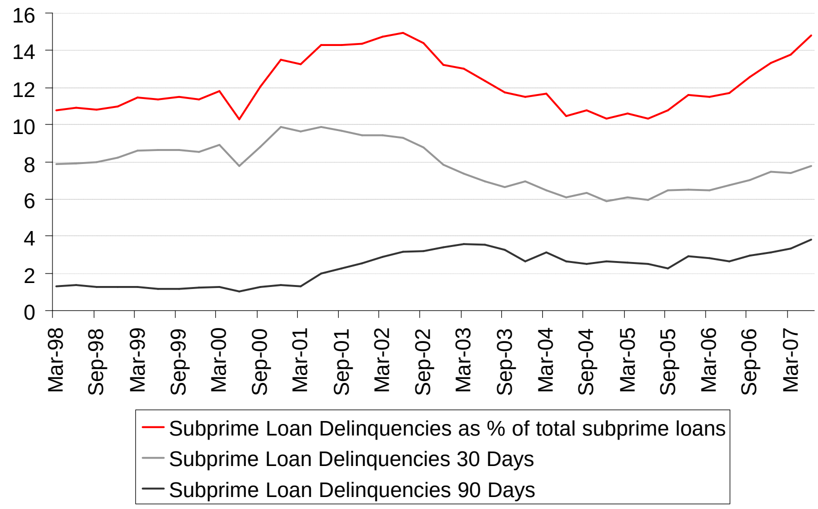
Source: iBoxx, Erste Group Research

Outlook

US Real Estate Crisis remains greatest risk in 2008 as well

In our view, the US real estate crisis will remain the unknown variable next year and thus the greatest risk in the market. As illustrated by the chart below, the number of mortgage loans in default in the subprime segment had started to rise already at the end of June 2005. In the past few months, the default rate on loans rose steeply, hitting the 15% of the year 2002. In this context, it is important to mention that the volume of subprime mortgages increased significantly over the last years, which doubtlessly will add to the pressure in the coming years.

US mortgage loans in default on payment



Source: Bloomberg, Erste Group Research

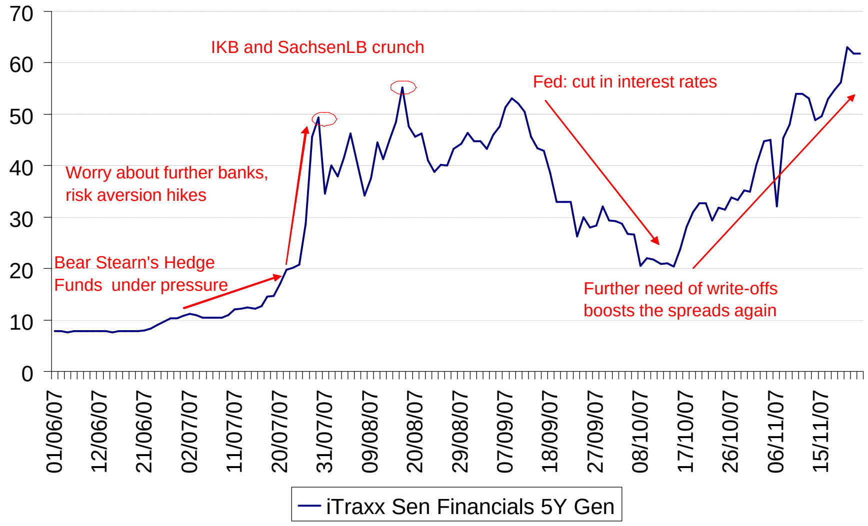
Banks under the greatest pressure…

The rise of real estate prices in the US over the past few years has given buyers an incentive to take out fast loans, thus steeply driving up the volume of such loans. On the other side, the high demand for structure products created an incentive for many banks to grant loans to low-grade debtors, as it was possible to sell these swiftly in securitized forms on the capital market (residential mortgage-backed securities).

Corporate Bonds

Only when the default rate on loan repayments started to rise, did many banks invested in the subprime segment come under pressure. The consequence: high depreciation that led to profit warnings and losses. The rating agencies corrected their valuations of structured products downwards in connection with the rising default rates on the mortgage market. This did not only push up risk premiums on subprime mortgage loans, also heavily burdened senior tranches.

iTraxx Senior Financials 5Y Spread



Source: Bloomberg, Erste Group Research

…new US accounting rules will reveal need for higher write-offs in 2008

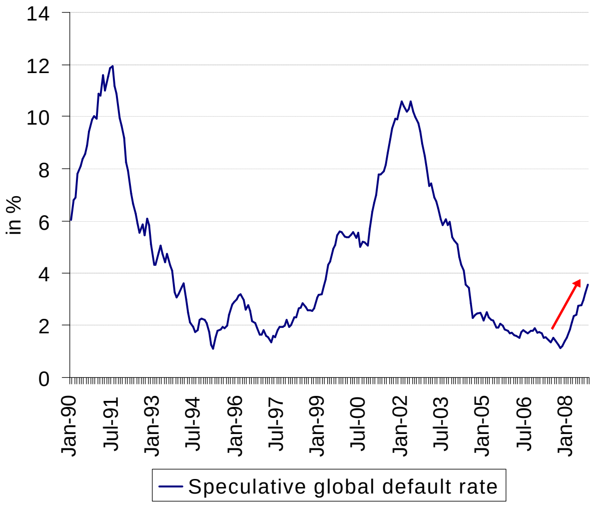
Another source of pressure on US banks is in our view the change to the accounting rule FAS 157 of the US Financial Accounting Standards Board (FASB) that entered into force on 15 November 2007. Rule FAS 157 was published in 2006 and refers "fair value measurements". There are fears that the changed accounting standard will force US banks to write off further USD billions in connection with risky debt securities. This concerns the valuation of risky debt securities (such as collateralized debt obligations), which have been declared illiquid assets due to lacking market prices up to now and were thus valuated according to internal bank models on the accounts. The new standard will make it harder to valuate such instruments according to proprietary models as of 15 November. A valuation in line with the market could result in the need for further depreciation and this has been estimated to amount to USD 100bn by some banks.

Default rate: lower than ever

Despite the turmoil on the capital market, the global speculative default rate is still on a downtrend. Thus, it hit 1.1% in October and was thus 0.2%-points below the figure for September. Historically, it has now reached the lowest level since January 1990. Moody's rating agency believes that the default rate will rise, by the latest when companies start refinancing the higher costs. Moody's assumes a default rate of 3.6% for the end of October 2008.

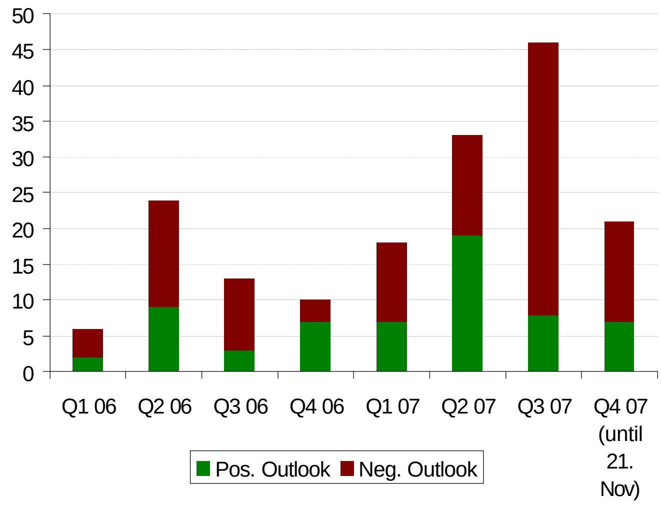
Corporate Bonds

Speculative default rate



Source: Datastream, Erste Group Research

Outlook change at Moody's: West European companies

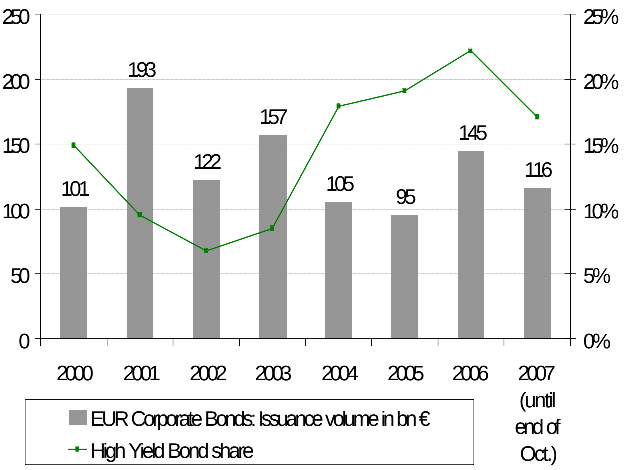


Source: Bloomberg, Erste Group Research

Primary market: Higher costs are a burden

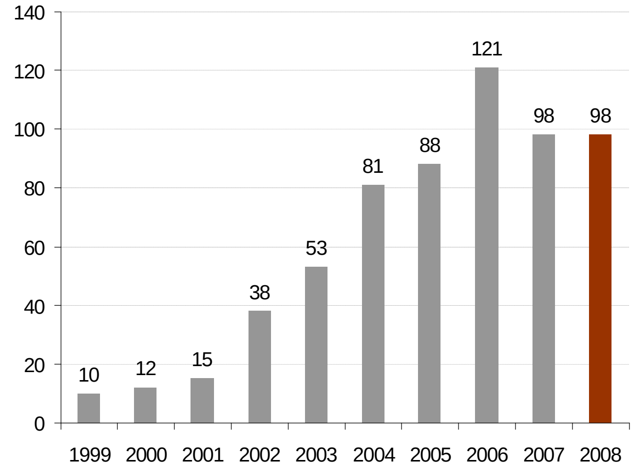
The heightened risk aversion among investors has caused the EUR primary market to nearly dry out. The higher costs have also led a large number of companies to either cancel or postpone planned issues. The financing terms have become very tight for high-yields and the HY share in the issuing volume has declined for the first time since 2002. Despite the higher costs, we do not expect the primary market to collapse in 2008. We believe that issuers from the investment-grade segment will dominate, while the HY share is expected to continue to decline in the first two quarters.

EUR Corporate Bond Market Gross issuing volumes



Source: Ixis, Bondware, Erste Group Research

Redemptions in EURmn



Source: Ixis, Bondware, Erste Group Research

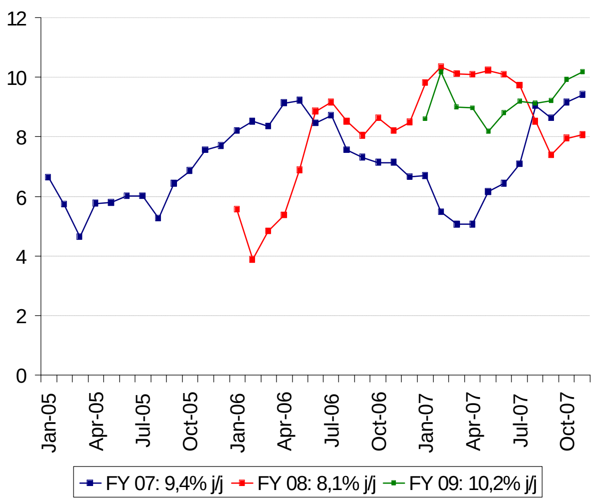
The fundamental situation is expected to be supportive of spreads

The fundamental situation of most companies (exclusive of financial institutions) has not become worse in the last two quarters. 3Q results were mostly positive. For the EuroStoxx 50 companies, earnings growth for 2007 is estimated at 9.4% versus the previous year, and it is not expected to slow much (8.1%) in 2008; for 2009 expectations are 10.2%. The indebtedness ratio (net indebtedness/EBITDA) has exhibited a slightly rising tendency since 2005 that is expected to weaken slightly over the next two years.

Corporate Bonds

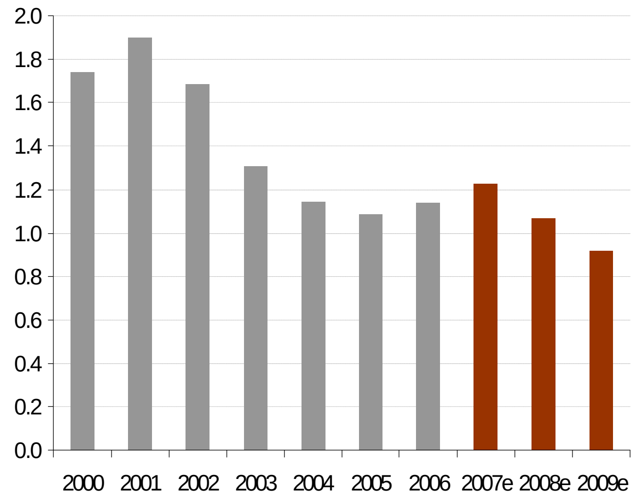
Earnings expectations and the indebtedness situation thus point to a solid credit environment, even though a large share of earnings will be used for shareholder-friendly measures.

EuroStoxx50 companies
Earnings expectations in %, y/y



Source: JCF, Erste Group Research

EuroStoxx50 companies (excl. banks)
Net indebtedness/EBITDA



Source: JCF, Erste Group Research

Conclusion

In our view, the biggest risk factors for the further development of spreads of EUR corporate bonds are - from today's perspective - mainly the banking crisis that will entail more restrictive lending, and the effects of the US mortgage disaster on the US economy. We already revised the growth outlook for the US economy downwards and estimate only 2.2% y/y for 2008, but do not believe that there will be a recession. In Euroland, economic growth is expected to continue to be robust and we are targeting 2.1% next year.

No pressure is expected to come from the primary market. The pipeline should be sufficiently full in 2008, with investment-grade issuers being the most active, while access to the capital market will remain difficult for high yield companies due to the higher costs. The fundamental situation of European companies is in our view still stable and we expect the level of indebtedness to decrease further, though only slightly next year.

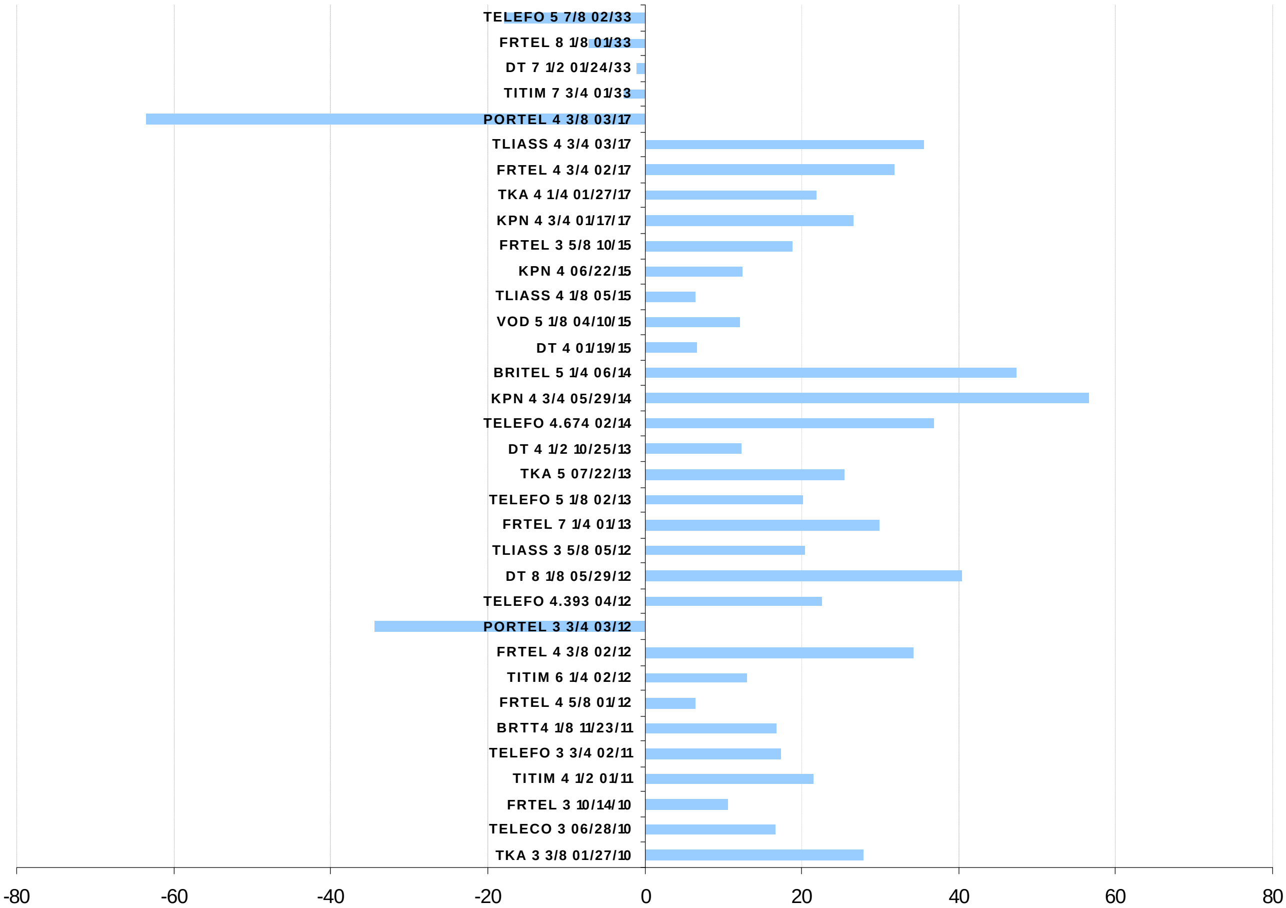
Overall, we expect the volatile spreads trends to persist in 1Q 2008 driven by expectations of further turbulence as a result of the US mortgage crisis. Only as 2Q is the market expected to calm and thus risk premiums to narrow. However, lows are improbable and level of yield premiums should remain high.

Sector outlook

Telecom: Market to slight underperformer

Since the beginning of the year, the **telecom sector** has developed second-best, attaining an absolute performance of 2.1% right after automobile bonds. The consensus estimate for the current and coming years for the telecom sector indicates declining free cash flow generation that serves as a measure for a company's capability to repay loans. In the light of the upcoming scheduled redemptions of bonds in 2008, we expect to see livelier activity on the primary market, with the new issues featuring much more attractive risk premiums. A first sign of this was the placement of the euro bonds of KPN (+74bps) and British Telecom (+ 90bps) in the second half of 2007 with high spreads over mid-swaps. Despite the steady decrease in the level of indebtedness, telecoms must pursue a sometimes more aggressive financial policy in order to secure growth outside their home markets. This expansionary policy could lead to rating actions and adjustments to outlooks. On the horizon of the next three to six months, telecom bonds are expected to develop slightly below the market average.

Telecom: Change of spreads since 1/1/2007, in bp

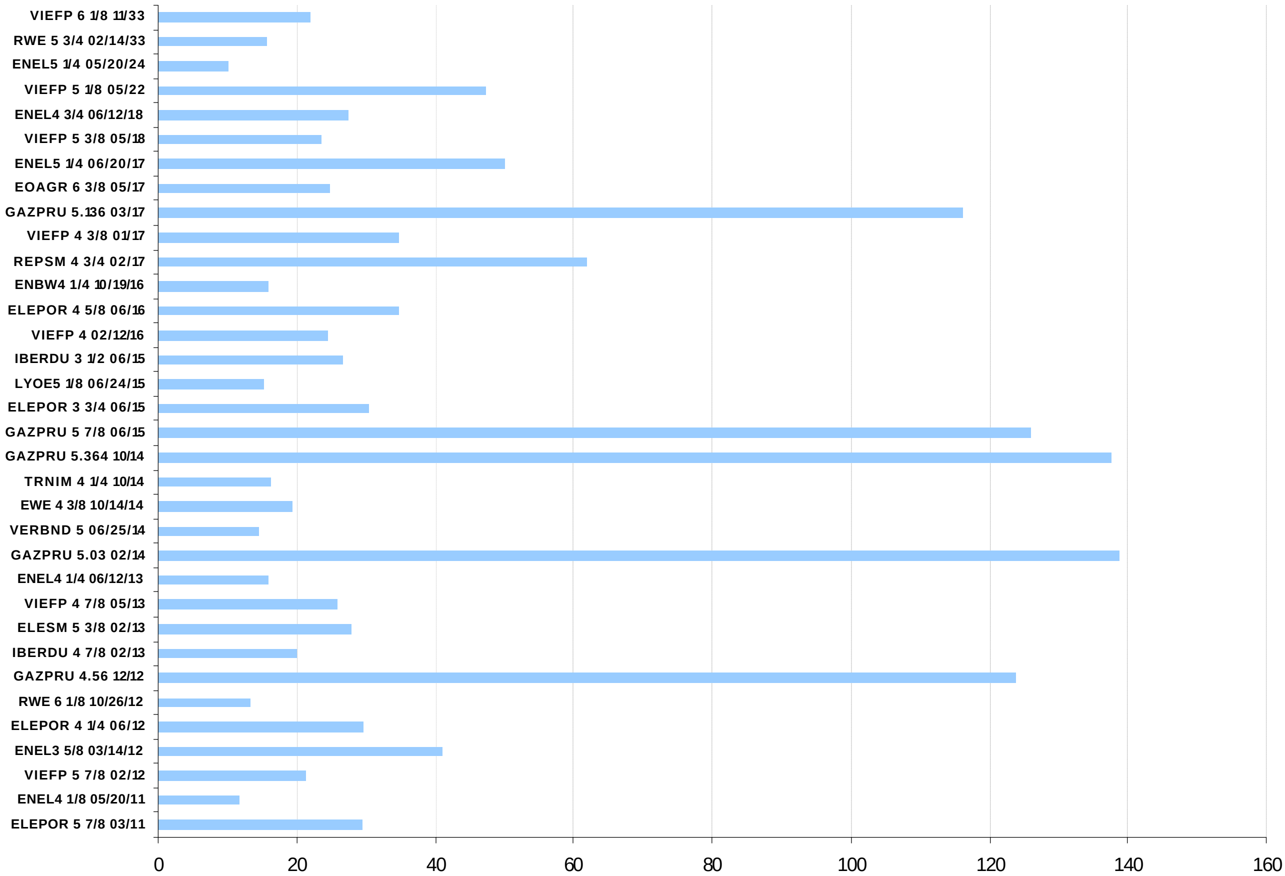


Source: Bloomberg, Erste Group Research 29/11/2007

Utility: Market to slight outperformer

At an overall performance of 1.7% since the start of the year, the **utilities sector** is slightly below the average of the market of 2.0%. The sustained high energy and electricity prices continue to indicate stable cash flows for the utility sector. Even though capital costs are on the rise throughout the industry due to increasing investment activity - especially in renewable energy - the sector is reducing debts relatively fast. As regards mergers and acquisitions, companies are expected to continue their offensive growth strategies in Eastern Europe: among others, in the Russian electricity market that is growing at a rate of 5% to 6% p.a. The refinancing of outstanding bonds, M&A activities and stock buyback programmes prompt us to expect a greater potential in issuing activity for 2008. Overall, we assess utilities as market to slight outperformers.

Utility: Change of spreads since 1/1/2007, in bp



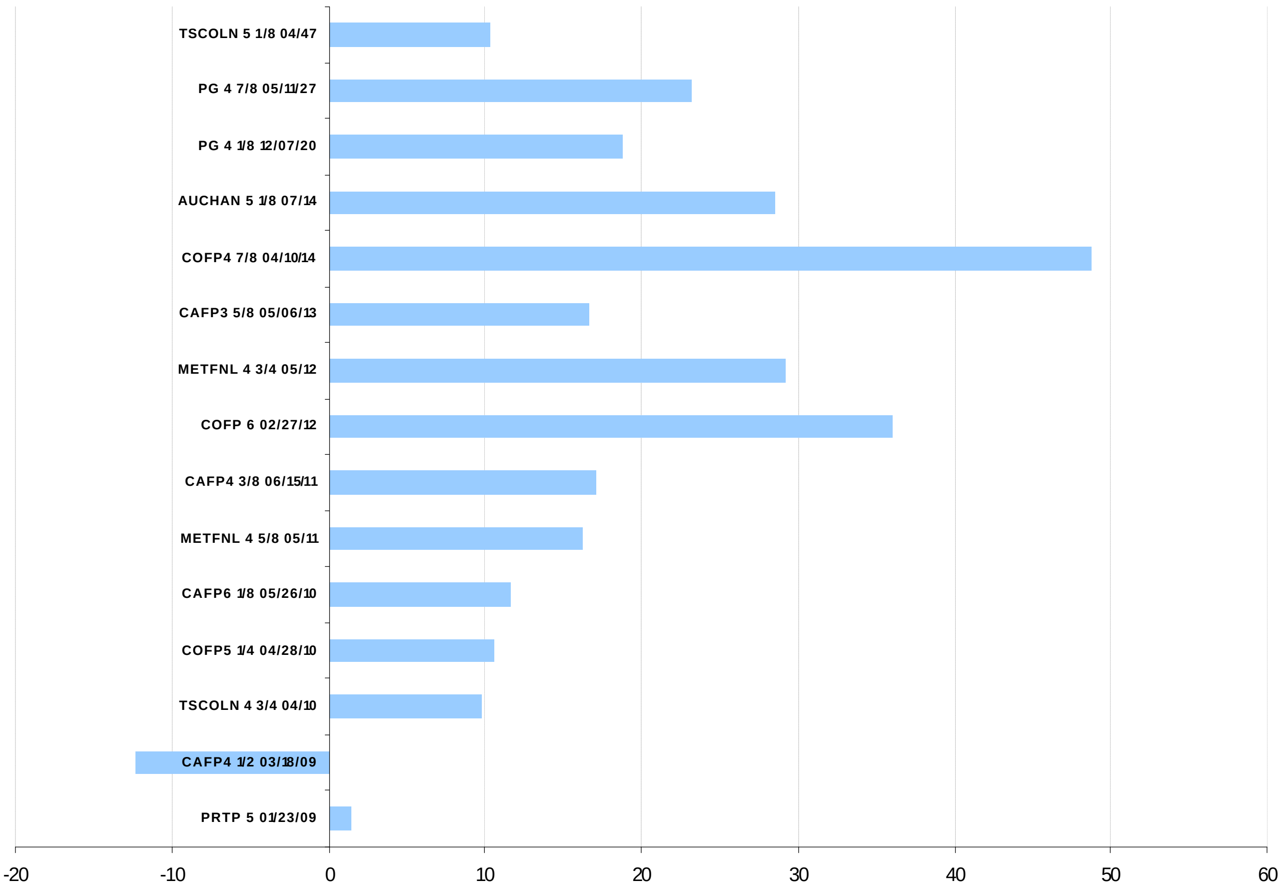
Source: Bloomberg, Erste Group Research 29/11/2007

Corporate Bonds

Retail: Market performer

The **retail trade sector** performed slightly above the market average with an absolute performance of 2%. The strongly growing domestic demand in the threshold countries - including Eastern Europe - is the most important growth driver for the European retail trade industry at present. Sales revenues generated in foreign markets (Metro, average 2y growth is 12% vs. German market with -0.2%) are pointing to a further expansion volumes and accordingly higher demand for capital. The biggest representative of the industry is in the investment-grade segment and enjoys a long-term outlook of "stable". After the accounting scandal at the former US subsidiary in 2002, the Dutch Ahold company has returned to the investment grade range and is preparing to make new acquisitions. We expect a development in line with the market average: market performer.

Retail: Change of spreads since 1/1/2007, in bp



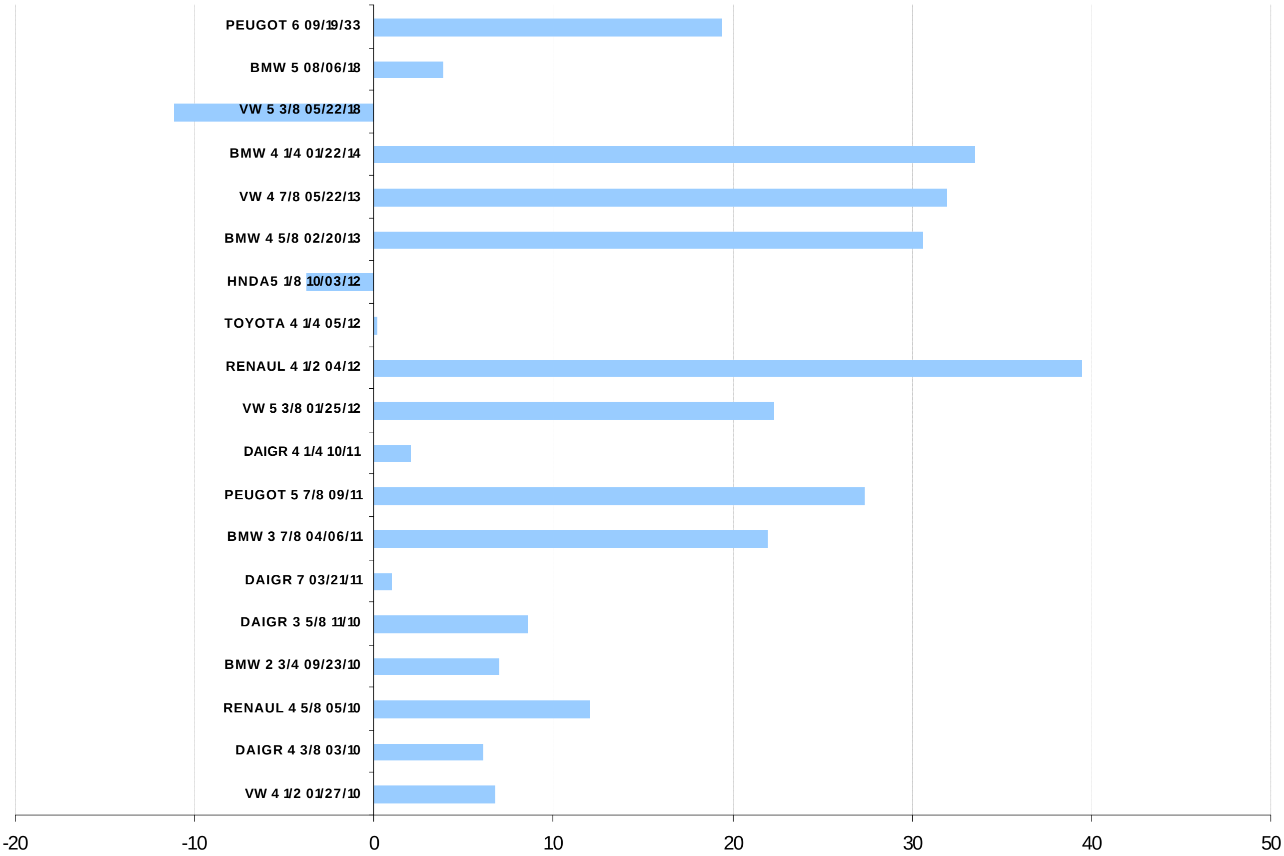
Source: Bloomberg, Erste Group Research 29/11/2007

Corporate Bonds

Automobile: Market performer

The **automobile sector** performed well in the midst of the US mortgage crisis and recorded the best overall performance of all sectors since the start of the year at a gain of 2.5%. We believe that the difficult market situation will continue to be a burden on the development of the sector: overcapacities, especially in the US, and the fierce competitive pressure from the Asian manufacturers. Moreover, the tighter restrictions on CO2 emissions for new cars sold in Europe are some of the new challenges that lie ahead (reduction from 160g/km in 2006 to 120g/km by 2012). This will cause the production costs of European automobile manufacturers to increase and will create pressure on margins. A positive effect is that the restructuring efforts have improved ratings (Daimler, Fiat). We expect this rating trend to remain stable next year. Still, adjustments cannot be ruled out: utility vehicle alliance between MAN/Scania/VW and the possible takeover of VW by Porsche. We assess automobile issues as market performers.

Automobile: Change of spreads since 1/1/2007, in bp



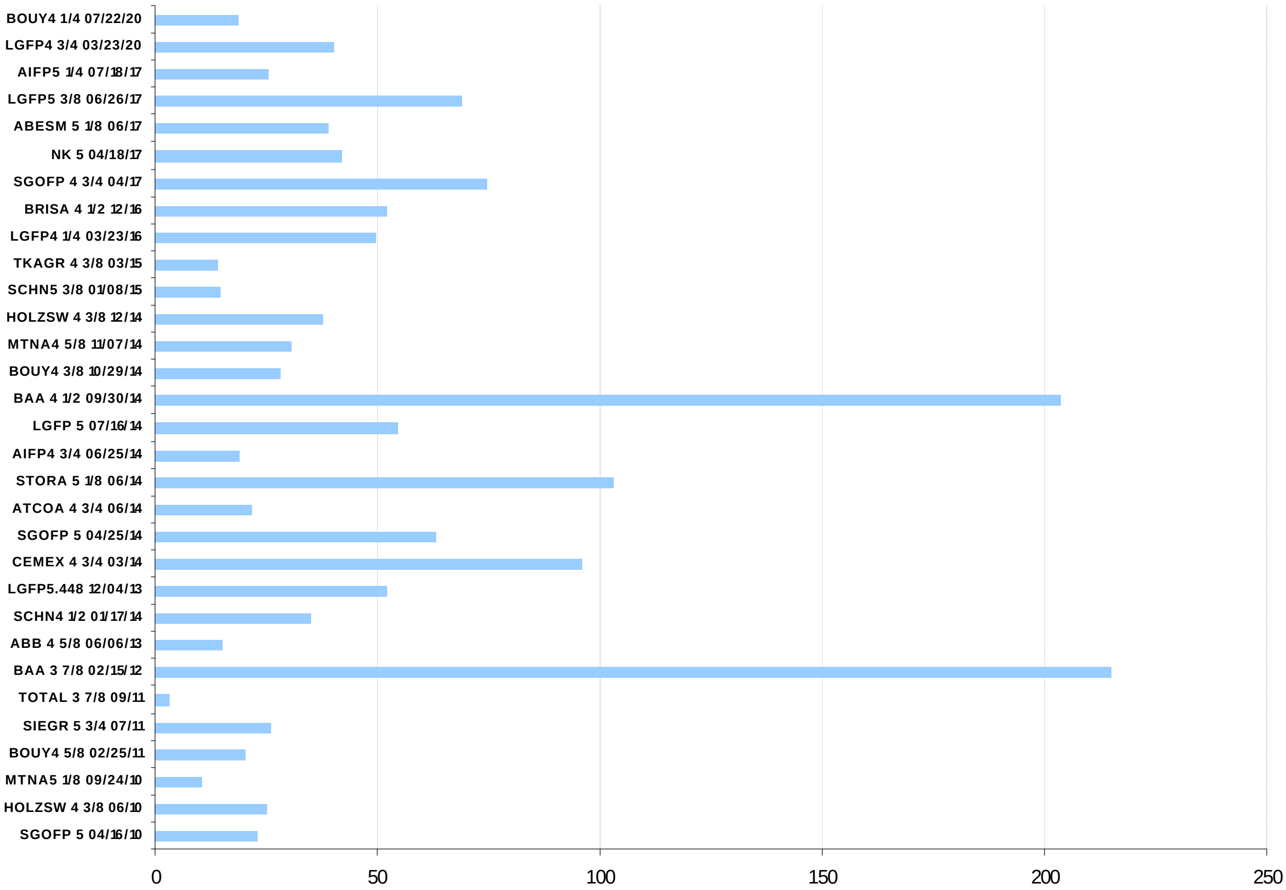
Source: Bloomberg, Erste Group Research 29/11/2007

Corporate Bonds

Industry: Market to slight underperformer

Bonds from the **industrial sector** have developed the worst since the beginning of the year, attaining an absolute performance of +1.5%. It was mainly construction material manufacturers that suffered from the collapse of the US housing market and posted significantly widening yields. Due to the high degree of exposure of the industry in the US, our assessment is therefore negative. Steel corporations are profiting from robust demand especially from Eastern Europe, India and China. The merger of Tata and Corus implies a consolidation trend in the sector aimed to improve the cost structure and to enlarge the market share. Thus, the greatest fluctuations are expected to be warded off by the cyclical effects. The outlook for most companies is stable (positive for ThyssenKrupp). We expect a development in line with the market average.

Industry: Change of spreads since 1/1/2007, in bp



Source: Bloomberg, Erste Group Research 29/11/2007

Alihan Karadagoglu
Elena Statelov

Publisher: Erste Bank der oesterreichischen Sparkassen AG
Graben 21; A-1011 Vienna, P.O. Box 162
Telex 11-5818,
Phone +43 (0)50 100 ext.

Printed by: SPV Druck GesmbH

Published and printed in: Vienna

Responsible for contents: Fritz Mostböck, CEFA

Sent to print on: December 6, 2007

Important web pages

ERSTE BANK

	Erste Bank	http://www.erstebank.at
	Erste Bank Treasury	http://treasury.erstebank.com
	Sparkassen	http://www.sparkasse.at
	ecetra.com	http://ecetra.com
	Brokerjet	http://www.brokerjet.at
	Erste Netbanking	http://www.netbanking.at

International Organisations

	OECD	http://www.oecd.org
	Internationaler Währungsfond	http://www.imf.org
	Weltbank	http://www.worldbank.org

European Institutions

	Europäischer Rat	http://ue.eu.int/de/summ.htm
	Europäische Kommission	http://europa.eu.int/comm/index_de.htm
	Europäisches Parlament	http://www.europarl.eu.int/home/
	Europäischer Gerichtshof	http://curia.eu.int/de/index.htm

Statistical Offices

Europa	Eurostat	http://europa.eu.int/comm/eurostat/
Dänemark	Denmark Statistics	http://www.dst.dk
Deutschland	Statistisches Bundesamt	http://www.destatis.de/
Finnland	Statistics Finland	http://www.stat.fi
Frankreich	I.N.S.E.E.	http://www.insee.fr
Irland	Central Statistics Office	http://www.cso.ie
Italien	Instituto Nazionale di Statistica	http://www.istat.it
Luxemburg	Service Central de la Statistique	http://www.statec.lu
Niederlande	Central Bureau vor de Statistiek	http://www.cbs.nl
Österreich	Österreichisches Statistisches Zentralamt	http://www.statistik.at
Portugal	Instituto Nacional des Estatistica	http://www.ine.pt
Schweden	Statistics Sweden	http://www.scb.se
Spanien	Instituto National de Estadistica	http://www.ine.es
UK	Office for National Statistics	http://www.statistics.gov.uk

Central banks

Euroland	Europäische Zentralbank	http://www.ecb.int
Belgien	Nationale Bank van België	http://www.bnb.be
Dänemark	Danmarks Nationalbank	http://www.nationalbanken.dk
Deutschland	Deutsche Bundesbank	http://www.bundesbank.de
Finnland	Suomen Pankki	http://www.bof.fi
Frankreich	Banque de France	http://www.banque-france.fr
Italien	Banca d´Italia	http://www.bancaditalia.it
Luxemburg	Banque Centrale du Luxembourg	http://www.bcl.lu
Niederlande	De Nederlandsche Bank	http://www.dnb.nl
Österreich	Oesterreichische Nationalbank	http://www.oenb.at
Portugal	Banco de Portugal	http://www.bportugal.pt
Spanien	Banco de España	http://www.bde.es
Schweden	Sveriges Riksbank	http://www.riksbank.se
UK	Bank of England	http://www.bankofengland.co.uk
Schweiz	Bank for International Settlements	http://www.bis.org/

Stock exchanges

	Wiener Börse AG	http://www.wienerboerse.at
	Deutsche Börse AG	http://www.deutsche-boerse.com
	LIFFE	http://www.liffe.com
	Matif	http://www.matif.fr

Contacts

Group Research

Head of Group Research	
Friedrich Mostböck, CEFA	+43 (0)50 100-11902
CEE Equity Research	
Co-Head: Günther Artner, CFA	+43 (0)50 100-11523
Co-Head: Henning Eßkuchen	+43 (0)50 100-19634
Günter Hohberger *(Banks)*	+43 (0)50 100-17354
Franz Hörl, CFA *(Steel, Construction)*	+43 (0)50 100-18506
Gernot Jany *(Banks, Real Estate)*	+43 (0)50 100-11903
Daniel Lion *(IT)*	+43 (0)50 100-17420
Martina Valenta, MBA *(Transp., Paper)*	+43 (0)50 100-11913
Christoph Schultes *(Insurance, Utilities)*	+43 (0)50 100-16314
Vera Sutedja, CFA *(Telecom)*	+43 (0)50 100-11905
Vladimira Urbankova *(Pharma)*	+4202 24 995 940
Gerald Walek, CFA *(Machinery)*	+43 (0)50 100-16360
International Equities	
Hans Engel *(Market strategist)*	+43 (0)50 100-19835
Ronald Stöferle *(Asia)*	+43 (0)50 100-11723
Jürgen Rene Ulamec, CEFA *(Europe)*	+43 (0)50 100-16574
Macro/Fixed Income Research	
Head: Veronika Lammer *(Euroland,SW)*	+43 (0)50 100-11909
Alihan Karadagoglu *(Corporates)*	+43 (0)50 100-19633
Rainer Singer *(US, Japan)*	+43 (0)50 100-11185
Elena Statelov, CIIA *(Corporates)*	+43 (0)50 100-19641
Macro/Fixed Income Research CEE	
Co-Head CEE: Juraj Kotian *(Macro/FI)*	+43 (0)50 100-17357
Co-Head CEE: Rainer Singer *(Macro/FI)*	+43 (0)50 100-11185
Editor Research CEE	
Brett Aarons	+420 224 995 904

Research, Croatia/Serbia	
Head:Mladen Dodig	+381 11 22 00 866
Damir Cukman *(Equity)*	+385 62 37 28 12
Ivan Gojnic *(Equity)*	+381 11 22 00 852
Alen Kovac *(Fixed income)*	+385 62 37 13 83
Uros Mladenovic *(Equity)*	+381 11 22 00 872
Davor Spoljar *(Equity)*	+385 (62) 372 825

Research, Czech Republic	
Head: Viktor Kotlan *(Fixed income)*	+420 224 995-217
Petr Bartek *(Equity)*	+420 224 995 227
Maria Hermanova *(Fixed income)*	+420 224 995 232
Jan Hajek, CFA *(Equity)*	+420 224 995 324
Radim Kramule *(Equity)*	+420 224 995 213
Martin Lobotka *(Fixed income)*	+420 224 995 192
Lubos Mokras *(Fixed income)*	+420 224 995 456
David Navratil *(Fixed income)*	+420 224 995 439
Jakub Zidon *(Equity)*	+420 224 995 340

Research, Hungary	
Head: József Miró *(Equity)*	+361 235-5131
György Zalányi *(Equity)*	+361-235-5135
Orsolya Nyeste *(Fixed income)*	+361 373-2830

Research, Poland	
Head: Artur Iwanski *(Equity)*	+48 22 3306253
Magda Jagodzinska *(Equity)*	+48 22 3306250
Marcelina Hawryluk *(Equity)*	+48 22 3306255
Tomasz Kasowicz *(Equity)*	+48 22 3306251
Piotr Lopaciuk *(Equity)*	+48 22 3306252
Marek Czachor *(Equity)*	+48 22 3306254

Research, Romania	
Head: Lucian Claudiu Anghel	+4021 312 6773
Mihai Caruntu *(Equity)*	+4021 311 27 54
Dumitru Dulgheru *(Fixed income)*	+4021 312 6773 1028
Cristian Mladin *(Fixed income)*	+4021 312 6773 1028
Loredana Oancea *(Equity)*	+4021 311 27 54
Raluca Ungureanu *(Equity)*	+4021 311 27 54

Research, Slovakia	
Head: Juraj Barta *(Fixed income)*	+421 2 59 57 4166
Michal Musak *(Fixed income)*	+421 2 59 57 4512
Maria Valachyova *(Fixed income)*	+421 2 59 57 4185

Institutional Sales

Head of Sales Equities & Derivatives	
Michal Rizek	+4420 7623-4154
Brigitte Zeitlberger-Schmid	+43 (0)50 100-83123
Equity Sales Vienna XETRA & CEE	
Hind Al Jassani	+43 (0)50 100-83111
Werner Fuerst	+43 (0)50 100-83114
Josef Kerekes	+43 (0)50 100-83125
Ana Milatovic	+43 (0)50 100-83131
Stefan Raidl	+43 (0)50 100-83113
Simone Rentschler	+43 (0)50 100-83124
Sales Derivatives	
Christian Luig	+43 (0)50 100-83181
Manuel Kessler	+43 (0)50 100-83182
Sabine Kircher	+43 (0)50 100-83161
Christian Klikovich	+43 (0)50 100-83162
Armin Pfingstl	+43 (0)50 100-83171
Roman Rafeiner	+43 (0)50 100-83172
Equity Sales, London	
Dieter Benesch	+4420 7623-4154
Tatyana Dachyshyn	+4420 7623 4154
Jarek Dudko, CFA	+4420 7623 4154
Federica Gessi-Castelli	+4420 7623-4154
Declan Wooloughan	+4420 7623-4154
Sales, Croatia	
Zeljka Kajkut *(Equity)*	+385 62 37 28 11
Damir Eror *(Equity)*	+385 62 37 28 13

Sales, Czech Republic	
Michal Brezna *(Equity)*	+420 224 995-523
Ondrej Cech *(Fixed income)*	+420 224 995-577
Michal Rizek	+420 2 2499 5537
Jiri Smehlik *(Equity)*	+420 224 995-510
Pavel Zdichynec *(Fixed income)*	+420 224 995-590

Sales, Hungary	
Róbert Barlai *(Fixed income)*	+361 235-5844
Gregor Glatzer *(Equity)*	+361 235-5144
Krisztián Kandik *(Equity)*	+361 235-5140
Zoltán Szabó *(Fixed income)*	+361 235-5144

Sales, Poland	
Head: Andrzej Tabor	+4822 330 62 03
Pawel Czuprynski *(Equity)*	+4822 330 62 12
Lukasz Mitan *(Equity)*	+4822 330 62 13
Jacek Krysinski *(Equity)*	+4822 330 62 18

Sales, Slovakia	
Head: Dusan Svitek	+421 2 5050-5620
Rado Stopiak *(Derivatives)*	+421 2 5050-5601
Andrea Slesarova *(Client sales)*	+421 2 5050-5629

Treasury - Erste Bank Vienna

Sales Retail & Sparkassen	
Head: Manfred Neuwirth	+43 (0)50100-84250
Equity Retail Sales	
Head: Kurt Gerhold	+43 (0)50100-84232
Domestic Sales Fixed Income	
Head: Thomas Schaufler	+43 (0)50100-84225
Treasury Domestic Sales	
Head: Gottfried Huscava	+43 (0)50100-84130
Corporate Desk	
Head: Leopold Sokolicek	+43 (0)50100-84601
Alexandra Blach	+43 (0)50100-84141
Roman Friesacher	+43 (0)50100-84143
Helmut Kirchner	+43 (0)50100-84144
Christian Skopek	+43 (0)50100-84146
Fixed Income Institutional Desk	
Head: Thomas Almen	+43 (0)50100-84323
Martina Fux	+43 (0)50100-84113
Michael Konczer	+43 (0)50100-84121
Ingo Lusch	+43 (0)50100-84111
Ulrich Inhofner	+43 (0)50100-84324
Karin Rauscher	+43 (0)50100-84112
Michael Schmotz	+43 (0)50100-84114