



Central European Daily

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Due to the Christmas Holidays no reports will be available from December 17th till January 2nd. Season's greetings

Headlines

Currencies: Higher US PPI extends negative correction in the region

Fixed Income: Polish yields inch higher after CPI surprised on the upside

Currencies

| Currencies | Close | change |
|------------|-------|--------|
| EUR/CZK | 26,22 | 0,6% |
| EUR/HUF | 252,4 | 0,1% |
| EUR/PLN | 3,588 | 0,4% |
| USD/PLN | 2,444 | 0,5% |
| EUR/SKK | 33,30 | 0,5% |
| EUR/USD | 1,466 | -0,2% |
| USD/JPY | 112,3 | 0,0% |

The **Polish zloty** gave back nearly all of Thursday's gains yesterday in a globally inspired profit taking. The EUR/PLN retreated south for a brief moment later in the session in reaction to the higher than expected CPI numbers, which fueled renewed expectations for a rate hike next week (more in FI part), but was eventually unable to hold on to the frail gains.

The recent range of 3.56-3.60 for the EUR/PLN remains firmly in place though and should hold till the end of the session today as activity slows heading in the second half of the month. All the remaining relevant macro publications are due next week, so the sentiment will remain fully dependant on the level of global risk aversion in the hours to come

The **Hungarian bonds** saw some modest selling pressure as uncertainty about future inflation path and slowly increasing core market yields during past weeks are reasons to reduce duration risk on the fixed income market, while it is hard to find a good reason to expect lower yields in the next couple of weeks. Similar type of year-end trading could be repeated unless the above-mentioned political debate about the health care reform would bring tensions between the ruling parties to the surface.

Yesterday the **Czech koruna** weakened quite dramatically up to the 26.30 area. The negative sentiment was mainly driven by mounting risk aversion caused by the combination of higher US PPI and the sell off on the European equity markets.

Today, we believe the beginning of the session could be slightly positive for the Czech koruna as the opening calls on the European equity markets are higher after the sharp sell off. Nevertheless later during the day the US core CPI outcome and the subsequent reaction of the global equity markets should be decisive. In case of the outcome on the consensus, we might feel further relief on the Czech FX market. We see strong technical resistances at 26.35 EUR/CZK.



The **Slovak koruna** was hit by a fresh wave of selling amid increased global risk aversion with the currency pair moving to EUR/SKK 33.35. This move was consistent with the weakening of the other currencies in the region.

Today, the November harmonized inflation will be published and although we don't expect any impact on the exchange rate, the figure should confirm that Slovakia still fulfils the Maastricht inflation criterion. Yesterday's development has confirmed that the global sentiment is still fragile and the koruna remains vulnerable despite strong fundamentals. The liquidity is low at the moment which suggests that there are chances for higher volatility. The risk aversion development will be the key for further moves, but the unit should not leave the range of EUR/SKK 33.20-33.45.

EURPLN ↑ 3.5943 - .0069 BBLC 3.5941/3.5944 BBLC
At 8:57 Op 3.6016 Hi 3.6043 Lo 3.5912 Prev 3.6012 Value 12/18/07



EUR/PLN: Zloty weakens on renewed risk aversion and tests key zloty support level

Fixed income

| Bonds 2Y | Close | |
|------------|-------|-------|
| Czech Rep. | 4,26 | 0,04 |
| Hungary 3Y | 7,50 | 0,01 |
| Poland | 6,22 | 0,03 |
| Slovakia | 4,53 | -0,02 |
| Eurozone | 3,99 | -0,04 |
| USA | 3,20 | 0,00 |

| Bonds 10Y | Close | |
|-------------|-------|-------|
| Czech Rep. | 4,70 | 0,01 |
| Hungary | 7,00 | 0,00 |
| Poland | 5,85 | -0,01 |
| Slovakia 7Y | 4,75 | 0,10 |
| Eurozone | 4,32 | -0,01 |
| USA | 4,14 | -0,02 |

Polish yields inched markedly higher by up to 9-10 bps as the November CPI surprised to the upside spurring renewed hopes for a rate hike as early as next week, before recovering some ground before the end of the session. The headline result came in at 3.6% y/y, i.e. not only above the market consensus of 3.4% y/y, but also the slightly more aggressive FinMin estimate of 3.5% y/y. Food and fuel prices were responsible for the rise, just like in other countries in the region, but the implied core inflation (ex-food and -fuel) seems to be on the rise as well from 1.4% to at least 1.5% y/y. The core component remains benign, but an upward trend is already visible and given the strength of the labor market and administrative price hikes likely to come early next year (heating gas, electricity) we expect the measure to rise further in the months to come. Even more so since the strengthening of the zloty may be less pronounced in the foreseeable future which would put pressure on import prices.

The calendar is empty, and apart from any unexpected comments from rate setters, we see no relevant market movers today. The sentiment has deteriorated further this week, particularly for shorter maturities, as inflation fears continue to fuel rate hike expectations. At the same time the globally driven weakening of the PLN is putting additional pressure on the long end of the curve. While we see little room for yields to drop at least until the MPC rate meeting next week, further downside for prices seems limited as well as the market is already pricing in quite an aggressive tightening scenario of 4-5 hikes in 2008.

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The **Czech yield curve** flattened yesterday as the Czech market decoupled (probably just for a while) from its Euro-zone counterpart. Interestingly, yields at the front end of the curve dropped despite the much weaker koruna.

Today, the market might try to catch core markets developments, which it missed yesterday. Hence, yields might continue to move up, especially at the short end of the curve as traders might take into account the weaker koruna more seriously.

Tables of rates

| IBOR 3M | | | Close | | | FRA 3x6 | | | Close | | | Central Bank Rate | | |
|------------|------|-------|------------|------|------|------------|------|-----|-------|--|--|-------------------|--|--|
| Czech Rep. | 4,06 | 0,02 | Czech Rep. | 4,20 | 0,00 | Czech Rep. | 3,50 | 25 | | | | | | |
| Hungary | 7,50 | 0,00 | Hungary | 7,41 | 0,00 | Hungary | 7,50 | -25 | | | | | | |
| Poland | 5,65 | 0,01 | Poland | 6,11 | 0,02 | Poland | 5,00 | 25 | | | | | | |
| Slovakia | 4,31 | -0,01 | Slovakia | 4,45 | 0,03 | Slovakia | 4,25 | -25 | | | | | | |
| Eurozone | 4,95 | 0,00 | Eurozone | 4,61 | 0,02 | Eurozone | 4,00 | 25 | | | | | | |
| USA | 4,99 | -0,07 | USA | 4,45 | 0,08 | USA | 4,25 | -25 | | | | | | |

| IRS 2Y | | | Close | | | IRS 10Y | | | Close | | | STOCKS | | | close | | |
|------------|------|------|------------|------|-------|-----------|---------|-------|-------|--|--|--------|--|--|-------|--|--|
| Czech Rep. | 4,23 | 0,00 | Czech Rep. | 4,56 | 0,01 | PX | 1805,8 | -2,0% | | | | | | | | | |
| Hungary | 7,39 | 0,03 | Hungary | 6,79 | 0,03 | BUX | 26583,2 | -0,6% | | | | | | | | | |
| Poland | 6,20 | 0,03 | Poland | 5,81 | 0,00 | WIG | 57462,7 | -2,0% | | | | | | | | | |
| Slovakia | 4,56 | 0,02 | Slovakia | 4,76 | 0,01 | Eurostoxx | 4396,07 | -1,7% | | | | | | | | | |
| Eurozone | 4,66 | 0,01 | Eurozone | 4,72 | -0,01 | DAX | 7994,3 | -1,0% | | | | | | | | | |
| USA | 4,08 | 0,00 | USA | 4,45 | -0,03 | S&P | 1475,4 | -1,6% | | | | | | | | | |

Closing or snapped values at 16:30 CET, change is over previous day, last change in bps

Calendar

| | Date | Time | Indicator | Period | Forecast | | Consensus | | Previous | |
|----|------------|-------|-----------------------|------------|----------|------|-----------|-----|----------|------|
| | | | | | m/m | y/y | m/m | y/y | m/m | y/y |
| HU | 14.12.2007 | 09:00 | Industrial output (%) | 10/2007 *F | | | | | | 6.2 |
| SK | 14.12.2007 | 09:00 | HICP (%) | 11/2007 | 0.3 | 2.2 | 0.3 | 2.2 | 0.7 | 2.4 |
| CZ | 14.12.2007 | 09:00 | PPI (%) | 11/2007 | 0.3 | 5.0 | 0.4 | 5.0 | 0.4 | 4.4 |
| PL | 14.12.2007 | 14:00 | Money supply M3 (%) | 11/2007 | | 13.0 | | | | 13.6 |

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