

June 2010

## FINANCIAL MARKET REPORT

### MACROECONOMIC DEVELOPMENT

#### Czech Republic

According to the data published at the beginning of July consumer prices remained unchanged during June. In the year-on-year comparison consumer prices then rose by 1,2 percent after the same growth in May. The June price development was better than most analysts had expected and confirmed the current state of economy where the inflation pressure on the part of demand is practically zero. The year-on-year inflation is slightly above the bottom level of the target inflation zone of the Czech National Bank. It estimated the year-on-year inflation on the level of 0,9 percent, nevertheless, it sees no risk for the future inflation development in a slight exceeding this prognosis. The so called monetary political inflation deprived of the impacts of indirect taxes changes reached the value of 0,1 percent on a year-on-year basis.

The registered unemployment rate dropped to the level of 8,5 percent in June from 8,7 percent in May. The growing export and seasonal works have brought the lowest unemployment rate during the last eight months. The June figure was 0,1 percent better than the medium data of the analysts. However, more like than the establishment of a declining trend the stabilization on the labour market is concerned. Domestic enterprises are still very careful when recruiting new workers. On the contrary, with the arrival of new graduates the repeated growth of unemployment above the level of 9 percent is expected.

The data on the development of the domestic consumer demand was a pleasant surprise in May where resale sales rose by 3,1 percent on a year-on-year basis this month. However, the optimism is hindered by the fact that such a growth was dragged solely by the sales of motor vehicles which rose by 3,8 percent on a year-on-year basis. On the contrary, the consumption in the other segments confirmed the very slow domestic demand. Upon the clearance of seasonal influences the sales declined by 0,8 percent on a year-on-year basis.

On the contrary, May was a favourable month for the development of the domestic industry. In particular thanks to the export demand the industrial production rose by 16,9 percent on a year-on-year basis this month. Moreover, the volume of new orders rose by 27,2 percent, which indicates that the favourable development in the domestic industry can be expected also in the following months. The main dragger of the growth was the production of motor vehicles as well as in the previous months. It has been the fastest growth in the industry since January 2001. The industrial production so continues in the relatively stable reviving.

The increased demand from abroad continues to be favourably reflected in the foreign trade balance development where a surplus of 12,3 billion crowns was shown in May. Exports having been growing continuously since November last year rose by 24,4 percent while imports rose by 25,9 percent. The revival of the foreign trade is experienced also in the growth of volume of trade, which has constituted the biggest growth since 2005. The business activity is on the pre-crisis level of 2008. Also the short-term prospect is optimistic.

At its monetary political session at the end of June the Central Bank left the key interest rates unchanged. The fortnightly REPO rate stayed on the level of 0,75 percent, 0,25 percent below the

comparable rate of the ECB. The personal changes upon the governor Tuma's resignation do not indicate, in our opinion, a change in the approach of the central bank. According to the latest comments of some central bankers it seems very improbable that the current monetary policies will remain unchanged for a long time. We believe that the CNB will proceed to the first increase in the CNB's rates as late as in the next year.

## Slovak Republic

The June development on the markets of the European Union was surprisingly hectic again. After a certain calming down on the bond markets after the European states started to seriously think of examining and improving their bond position Hungary expressed their view. The local representatives incontinently mentioned the possibility that they do not want to save money and will rather support the growth. It increased the risk surcharges of the indebted countries again and the situation calmed down after nearly a month. Moreover, the Greece's rating was decreased to a speculative level by Moody's. However, there were also a few positive reports, but fortunately, the local markets had a bigger influence in consequence of this. From the perspective of the markets only the elections in the Czech Republic and also that in Slovakia two weeks later turned out positively. Here the coalition of four "middle-left-handed" parties which want to continue in the reform of the last Government got into the Government. This unexpectedly good result was perceived well and the Slovak state bonds thus did not react any significantly to the growth of risk premiums of the other European states.

Neither the Central European bank had a peaceful month. Nevertheless, the rates stayed unchanged as expected and it is sure that the policy of new rates will continue. The main steps made by the ECB during the months was the purchase of state bonds of several most indebted countries to avert their collapse. Another significant event was the end of the unlimited 12-month loan from the previous year when banks had received more than EUR 440 billion to preserve liquidity of the bank sector. Currently, the banks borrowed much lower amount, which shows certain improvement of the situation in the bank sector. However, the result was a slight growth of short rates dragged until now to unrealistically low levels by the extreme surplus of liquidity. The result of these events was making the fundamental data the markets paid sufficient attention to less important. In short, the macrodata of the European Union was not so bad as the mood on the markets was developing during the month. The data was more or less neutral and confirmed the slow growth. The result of the industry was better again, the inflation did not continue to decline and the sentiment indicators are still close to their local maxima. Nevertheless, the fiscal tightening of belts can undermine the current feeble growth. Moreover, for example the resale sales were negative again on a year-on-year basis and the M3 monetary aggregate shows a decline too, which are not the signs of strongly growing economy.

The statistics of Slovakia are mixed. The positive things are the new estimates of the economic growth presented both by the central bank and the Ministry of Finance. They both see higher growth this year than that until now (3,7 or 3,2 percent) and in 2011 about 4 percent. The latest data on the GNP growth for the 1Q 2010 confirms that the economy grew by beautiful 4,8 percent (annualized)! In the 4Q 2009 it was -2,6 percent. The bad news was the budget deficit for the first 6 months which reached 85 percent of the annual plan and the second half-year is usually much worse. The Ministry of Finance expects a deficit of about 5 percent of the GNP in 2010, but the risk of the deficit being significantly higher is growing.

The other macroeconomic figures confirm the trend of a weak growth dragged by the industry as in the Euro zone. The unemployment is still above 12 percent (Spain has approximately 20 percent). The harmonized inflation is a mere 0,7 percent on a year-on-year basis. Resale sales are still negative on a year-on-year basis. The positive performance is maintained by the industry whose production was 31 percent higher than a year ago. Here also the influence of the falling Euro could be seen enabling Slovak companies to export more cheaply and thus more.

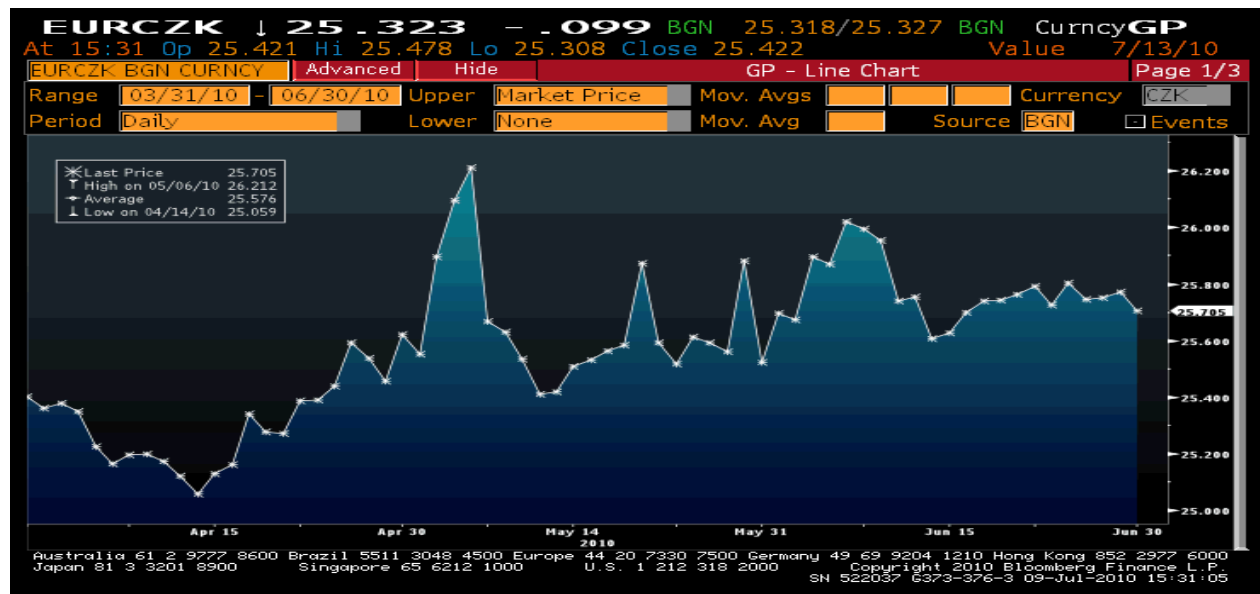
## FINANCIAL MARKET DEVELOPMENT

### A) FOREIGN EXCHANGE MARKET

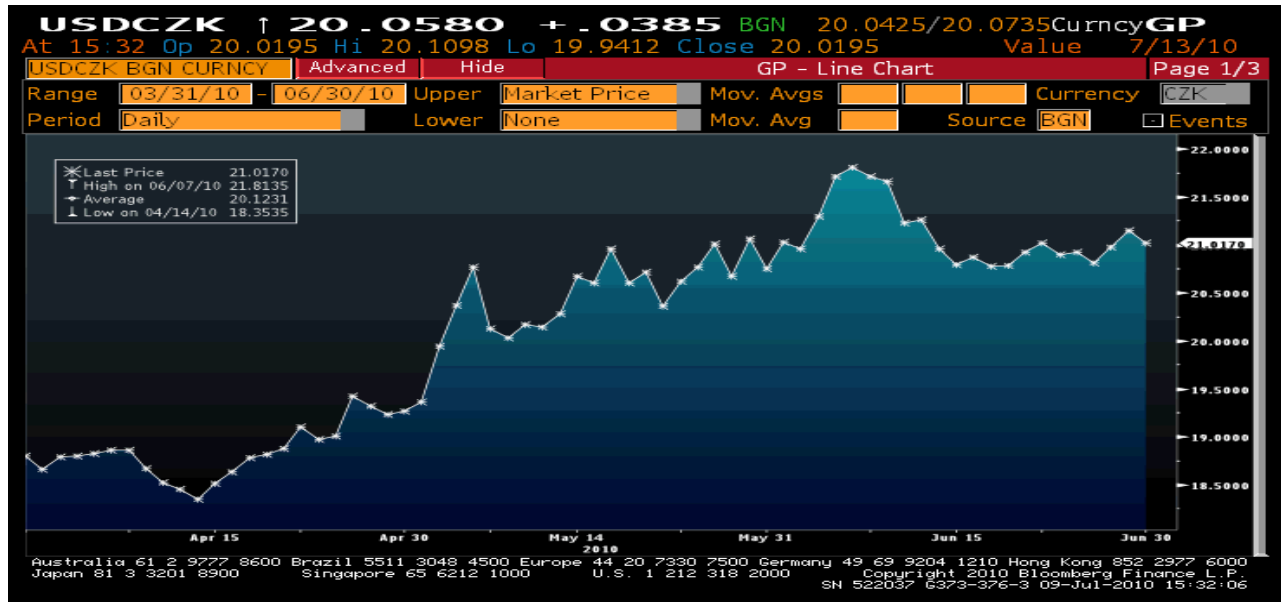
#### Czech Republic

At the beginning of June there was a strong weakening of the Czech crown towards the Euro in connection with the escalation of fiscal problems of the peripheral states of the Eurozone. After a few days the situation calmed down again, nevertheless, the Czech crown continued weakening during the month. The development was very similar towards the USD. The dollar performed the role of a safe port and continued strengthening towards the other currencies.

*Graph of the development of foreign exchange rate of the crown towards the Euro in the last 3 months: (growth of the curve means the weakening of the crown towards the Euro and vice versa)*



*Graph of the development of the exchange rate of the crown towards the dollar in the last 3 months: (growth of the curve means the weakening of the crown towards the dollar and vice versa)*

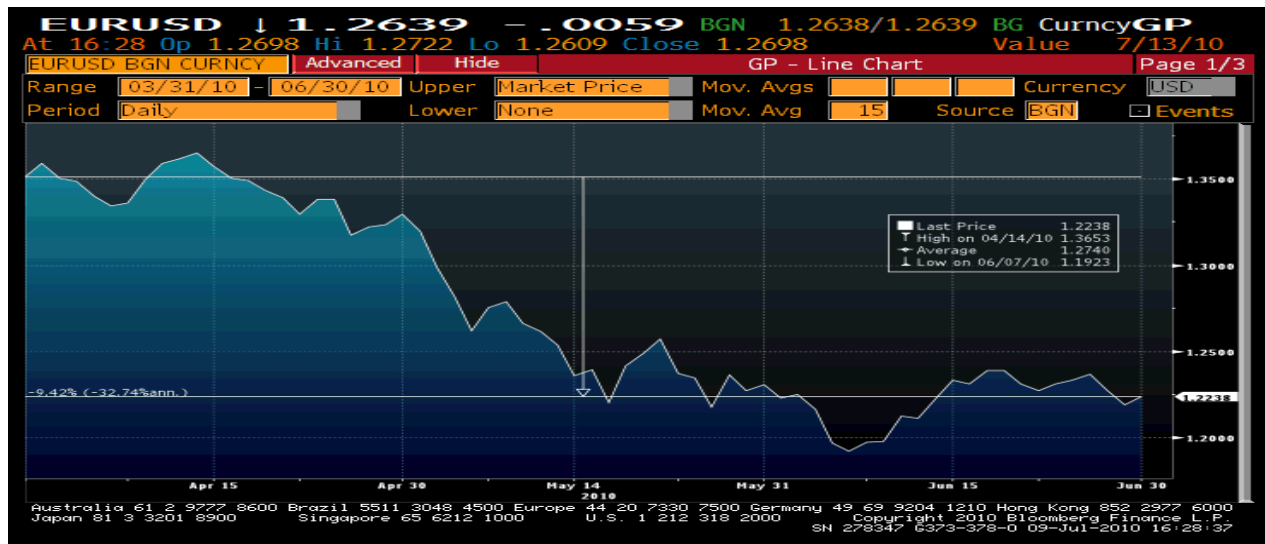


### Slovak Republic

This year' trend of the weakening of the European currency stopped in June. Nevertheless, the dollar has prevailed by 9 percent over the Euro in the last 3 months. The further development will depend on how the European Union will deal with the problems of its members (especially Greece) and how the European economy will react to the strong fiscal restriction expected.

Graph of the development of the foreign exchange rate of the Euro towards the dollar in the last 3 months:

(growth of the curve means the strengthening of the Euro towards the dollar and vice versa)

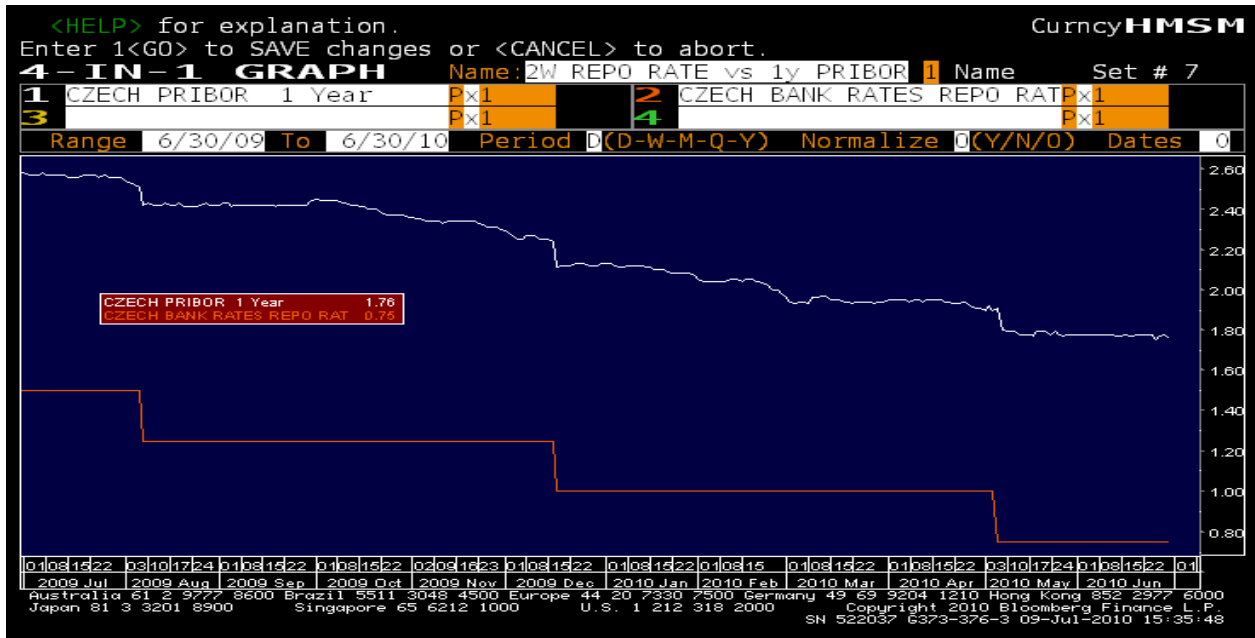


## B) MONEY MARKETS

### Czech Republic

The market rates of the money market stayed practically without any big volatility for the whole month.

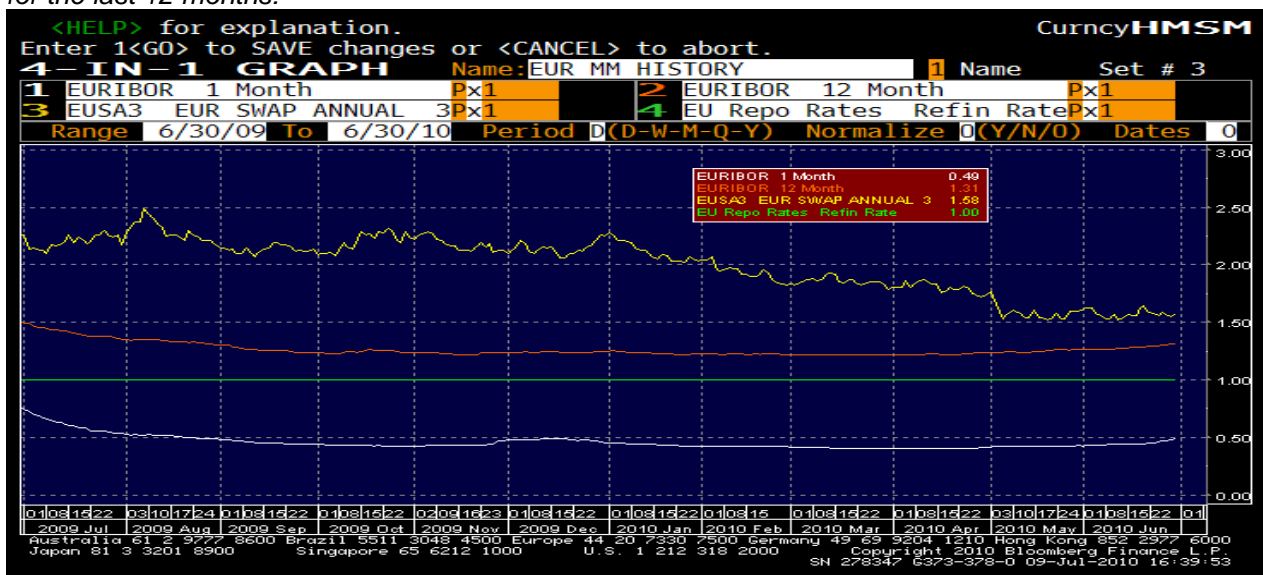
Development of the two-week repo-rate of the CNB and one-year PRIBOR market rate in the last 12 months:



**Slovak Republic**

Boredom on the money market continued. The short-term rates just slightly moved upwards as a certain withdrawing of part of liquidity from the markets is expected upon paying off the last year's unlimited 12-month credit to the banks. However, the basic rate will probably preserve the mere one percent for a long time. The annual Euribor is still on the level of 1,31 percent.

Graph of the development of the so called ECB's refi-rate (green) and 1M (white) or 12M Euribor (red) for the last 12 months:

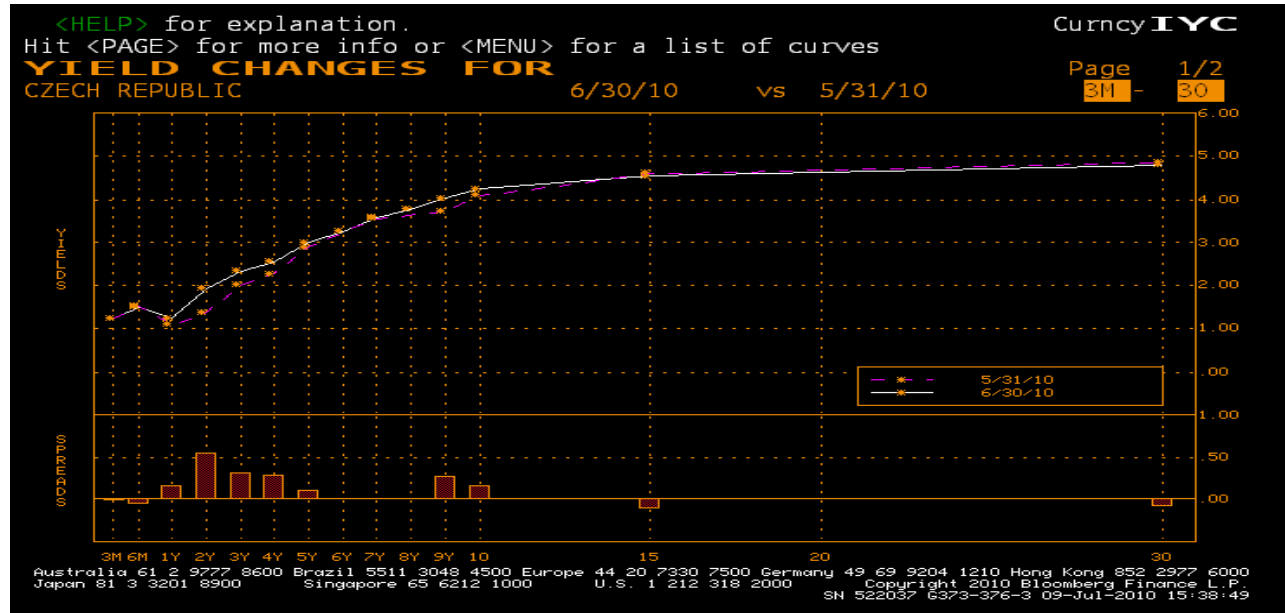


### C) BOND MARKETS

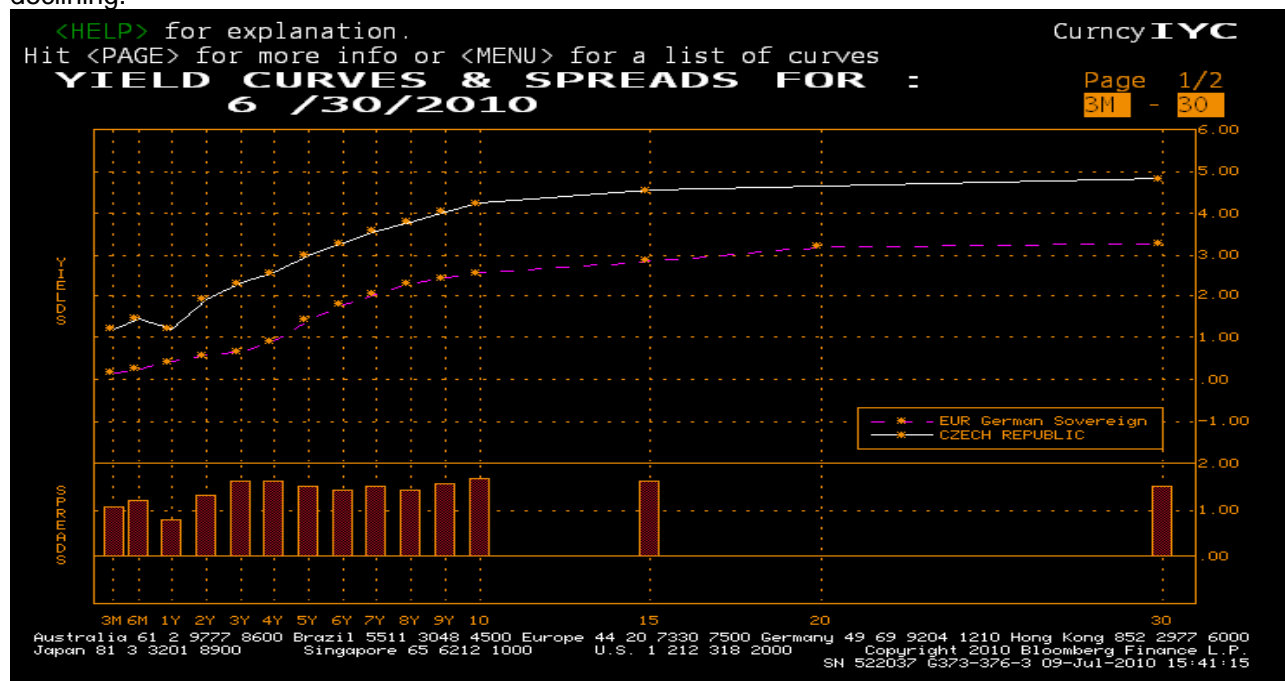
#### Czech Republic

The global growth of risk surcharges lead also to the growth of the Czech state bond yields, in particular at the shorter end of the yield curve. However, at the end of the month the situation calmed down and the yields of state bonds started to decline again.

Graph of a change in the yield curve of the Czech state bonds in the last month:



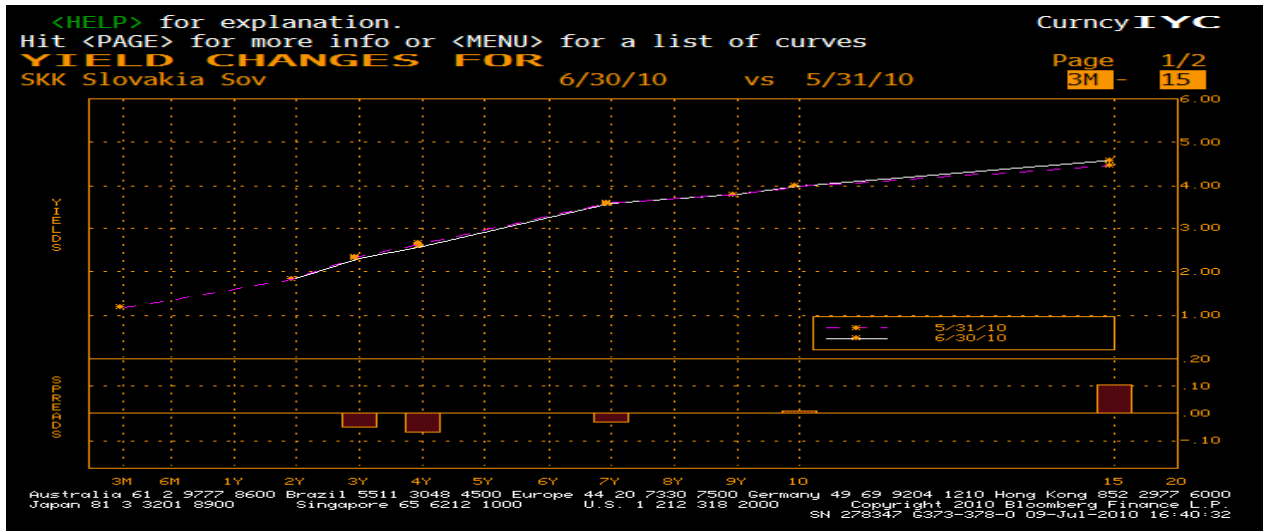
The following graph shows the comparison of the yields to maturity of the Czech state bonds with the German ones. The growth of risk surcharges mentioned could be seen also in the further deepening of the difference in the yields of Czech and German state bonds since yields of the German bonds were declining.



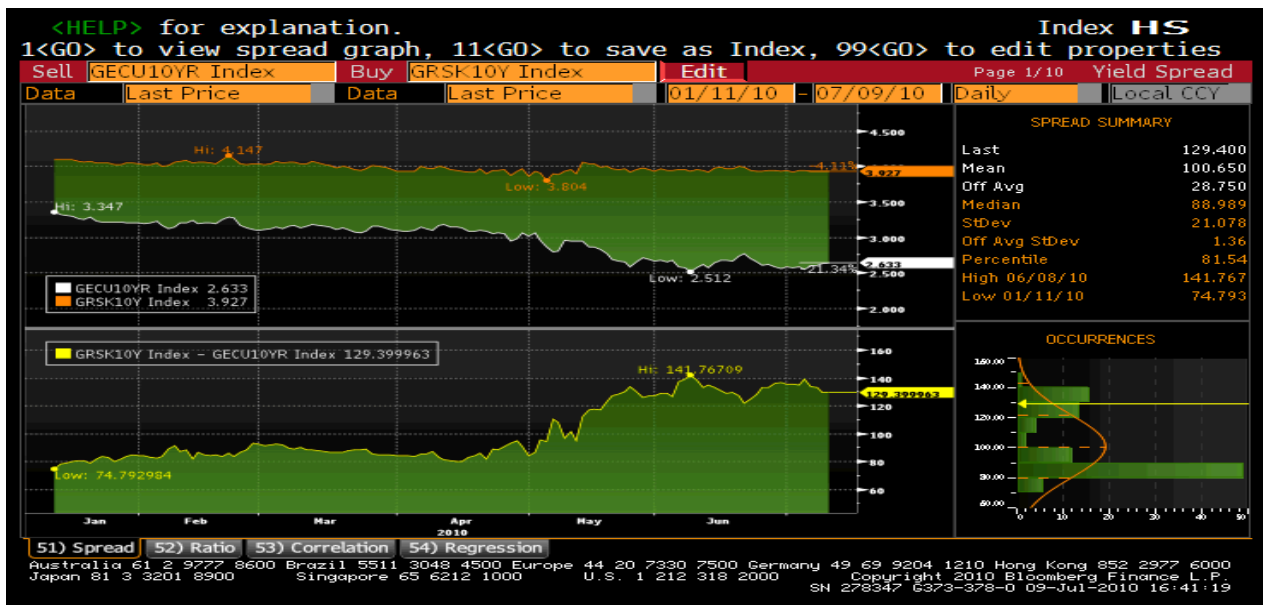
### Slovak Republic

Slovak state bonds experienced a peaceful month. Despite of the significant yields volatility the Slovak ones remained stable and the yield curve did not move much.

Graph of a change in the yield curve of the Slovak state bonds in the last month:  
(the shift of the yield cruve upwards is negative for the bonds market prices and vice versa)



The following graph shows the relative comparison of the yield of a Slovak 10-year state bond and a German state bond. It is evident that the Sloval bonds currently bear about 130 bps higher yield than the German ones. In the last month the risk surcharge of the local bonds has not changed much compared to the German ones.



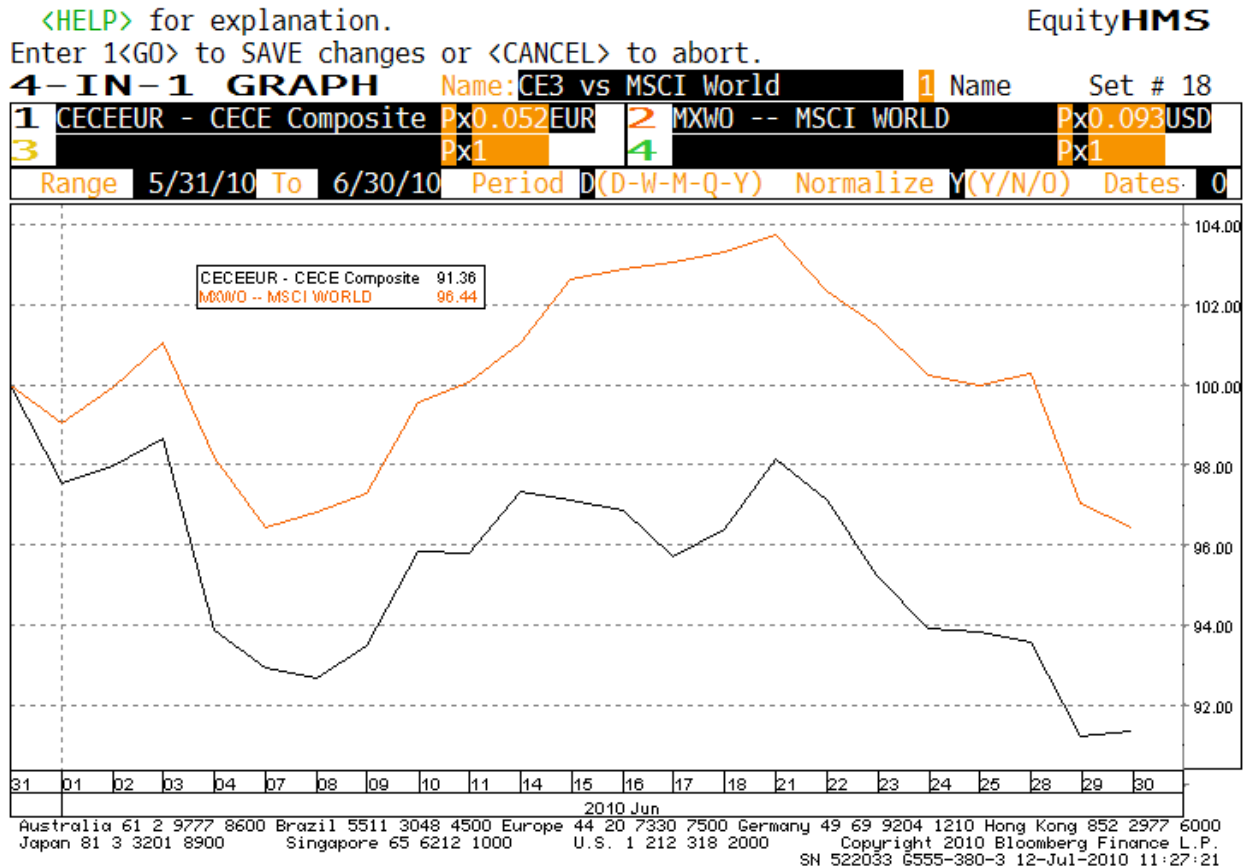
## D) STOCK MARKETS

In this month the stock markets showed an increased volatility again and in their efficiency they, unfortunately, continued in the results of the previous month and made their losses deeper. On the first days of the month stock markets continued to fall, in particular after the indicators from the American labour market which were a big disappointment since in particular the private sector created much fewer job positions than expected, which renewed concerns about feasible economic revival. Neither the labour market in Europe brought any optimistic data since the unemployment in the Eurozone grew up to the level of 10,1 percent. Another factor which negatively influenced world markets was the very unhappy declaration of the new Government representatives in Hungary about a possible bankruptcy of this country and the amount of their debts.

The last week in the month lapsed was negative for stock markets and stock markets lost their previous profits and incurred losses. The main reason for this change in the sentiment and mood were again the growing concerns about strength and duration of the world economic revival. These concerns appeared after the fiscal savings adopted in particular in Europe and which could cause return to the recession in consequence of saving and limiting Government's expenses and influence the growth of the economic revival on a worldwide basis. Also the week macroeconomic data, in particular in the USA where the consumer trust declined, contributed to the decline of shares and neither the Chinese macroeconomic data brought a change of the mood. It more like contributed to the growth of concerns about the possible return of the recession.

In June the efficiency of the individual central-European markets was slightly worse in their local currencies than the efficiency of the developed stock markets. The best efficiency in the local currencies in the last month was achieved by the Hungarian stock market followed by the Polish stock market and significantly worse efficiency was achieved by the Czech stock market.

The graph shows the monthly balance of the CECE central-European index (in EUR, dark) and MSCI World index (in USD, light)



### Efficiency of Selected Stock Markets Expressed in the Czech crown

	Czech PX index	Polish WIG Index	Hungarian BUX Index	American S&P 500 index	West European Eurotop 100 index	MSCI World index
Month	-6,29%	-5,79%	-7,42%	- 5,65%	-0,47%	-2,62%
From 1.1.2010	-1,20%	-4,55%	-8,31%	+5,43%	-8,87%	+1,65%

### PROSPECT

The persisting key factor which will influence the development on the markets also in the near future will be the manner of dealing with debt crisis of the “peripheral” states of the Eurozone and the perception of its trustworthiness on the part of the investors. It seems now that the markets react sceptically, which can be seen in the weakening of the Euro and the extreme growth of nervousness on the markets and the related volatility. It is bad news for the risky types of assets. However, as soon as Europe decides and shows the clear strength to cut on expenses and budgets, the markets may turn upwards fast. From the fundamental perspective not being paid so much attention to under the current debt crisis it is evident that the key world economies are getting better slowly. The risk is the expected fiscal restriction which could slow down the feeble growth. With regard to the extent of the current problems a period of increased cautiousness and sensitivity of the investors shown in the form of an increased volatility on the stock and bond markets can be expected.

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