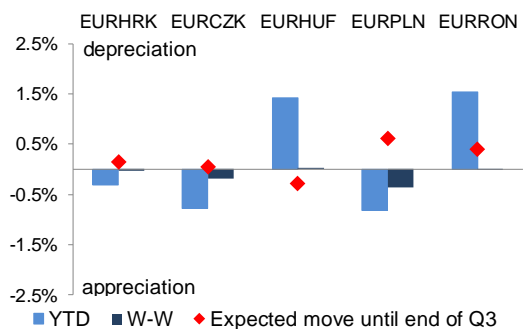




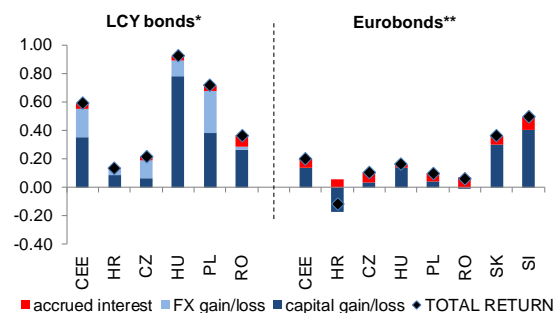
CEE Market Insights

Market outlook

Intensifying expectations for lower global rates were visible on local currency markets. Gains were somewhat mild, however, as European car registration data was poor for June, which indicates weaker export prospects for the region. While risks to external balances are negative for FX, the fact that inflationary risks are higher in CEE than in the Eurozone also means that central banks are unlikely to be as dovish as markets are increasingly expecting the ECB to become. The MNB in Hungary could remain rather dovish, however, which means that the HUF may continue to be subject to higher volatility than its peers.



Slovakia has also joined the sub-zero group for government bonds, as its 10Y ask yield fell below zero percent last week. Yield declines across the region were triggered by Bund yield movements. As FX inflows are still very intensive in Serbia, prompting the NBS to sell dinars, we are leaning towards further rate easing by the central bank soon. Going forward, CEE yields could continue to be heavily affected by major market bond developments.



Looking ahead this week:

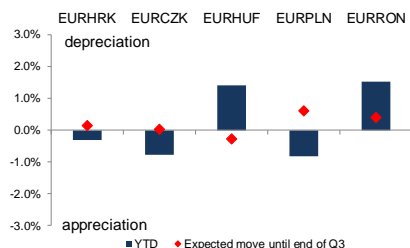
Monday	Tuesday	Wednesday	Thursday	Friday
	HU: Target Rate PL: Unemployment SK: Current Account		RS: Wages	SK: PPI

We will certainly see more details on the rectification of the Romanian budget in the coming days, as the data on fiscal balances for EU countries in 1Q19 published by Eurostat on Friday showed alarming numbers for Romania. According to Eurostat, Romania posted a 4.5% of GDP deficit in 1Q19 in seasonally-adjusted terms (annualized), while the seasonally-unadjusted deficit to GDP ratio was 1.1pp higher in 1Q19 compared to 1Q18. The government has changed some of its plan to levy a tax on special pensions for certain professions via selective taxes. In order to avoid a collision with the constitution, the new proposal of a 'solidarity tax' should be applied on all pensions above a certain threshold (i.e. above RON 10,000). The Hungarian central bank will hold its MPC meeting on Tuesday. It should not bring any surprises. The central bank will likely reiterate that there is no need to tighten the policy, as domestic inflation pressures are offset by lower imported inflation and the deteriorating external environment.

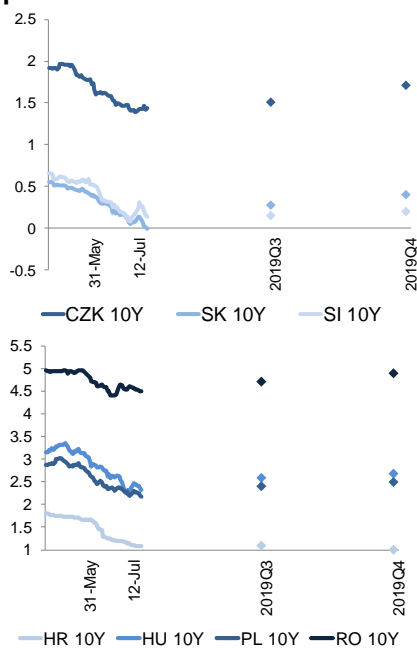
In case you missed it last week...

- EU: European car sales plummeted 7.9% y/y in June
- PL: June [Industrial production](#) and [Retail sales disappointed](#); our GDP Nowcast points to 4.5% growth in 2Q19
- HR: June [inflation landed few notches below our expectations](#) (0.6% vs. 0.8% y/y)
- SK: [Inflation eased mildly in June](#) from the previous month (2.6% vs. 2.7% y/y)
- RS: Central bank continued in interventions (worth EUR 120m) even after recent rate cut
- RO: Romania posted public deficit 4.5% of GDP in 1Q19 in s.a. terms according to Eurostat
- HR: Six ministers have been replaced; general elections and EU presidency are scheduled for next year
- SI: Fitch upgraded the rating by one notch to 'A-' with a stable outlook, move is no surprise

YTD change on FX market



10Y government bond yields, percent



Source: Erste Group Research, Bloomberg.

On global markets:

Market speculations have started whether the ECB will adapt a more “symmetrical” nature to its price stability target, which would probably dampen short-term interest rate expectations for a longer period of time, so that inflation rates above 2% can be achieved in the longer term. Next week, we expect the ECB to open up more room for maneuver and change its forward guidance on interest rates. This would prepare markets for the possibility of interest rate cuts. In the US, the Q2 GDP will be released. EURUSD has remained in a sideways movement.

CEE currencies:

The story on global markets remains the intensifying expectations for lower rates, which, amid the relative scarcity of local news during summer holidays, is force majeure for CEE markets, too. Unsurprisingly, regional currencies somewhat benefited from these ever-lower global interest rate expectations last week. On the other hand, export prospects are worsening after poor car registration data for Europe was released. It is hard to tell the extent to which the lower amount of working days in June played a role in this poor reading, which also certainly impacted the Polish releases last week. However, the demand slowdown on German markets is definitely having at least some impact, and thus the outlook for exports is not the best at the moment. As domestic demand is still booming in CEE, this could put pressure on net exports and thus on currencies as well. The HUF was the weakest currency in the region for some days last week, given the very dovish central bank behavior. One should not expect major weakening of regional currencies either, however, even for the HUF. This is due to the fact that the region is (perhaps apart from Croatia) having stronger inflationary pressure than the Eurozone, which speaks against local central banks embarking on monetary easing to the same extent that is becoming increasingly likely in the Eurozone and the US.

CEE rates and yields:

The fall of German Bund yields last week triggered yield decreases in CEE markets as well, but there were some differences across the countries. In Hungary and Poland, where nominal yields are still above 2 percent and fiscal developments are not very worrisome, spreads against Bunds further compressed. Unsurprisingly, regional countries that are already inside the Euro Area also strongly benefited, with the Slovak 10Y ask yield falling below zero percent for the first time in history. Romanian yields also fell, albeit to a lesser extent, unsurprisingly due to the ongoing fiscal woes there. Markets are waiting for exact plans on how pensions will be taxed, but the market is flush with liquidity, as demonstrated by the huge interest at last week’s 2020 RON government paper auction. In Serbia – where the policy rate was cut earlier in July by 25bp to 2.75% - the fact that the NBS continued to intervene on the FX market to fend off inflows makes us think that additional rate easing might come soon from the central bank. Czech yields failed to follow this trend, but this is due to the relatively hawkish central bank. Going forward, CEE yields could continue to be heavily affected by major market bond developments.

Calendar

Time	Country	Indicator	Period	Survey	Erste Est.	Prev.	Pre Comment
22-Jul							
No releases scheduled							
23-Jul							
10:00	PL	Unemployment Rate	Jun	5.3%	5.3%	5.4%	Unemployment rate to hit record-low level
14:00	HU	Target Rate	Jul	0.9%	0.9%	0.9%	MNB is expected to maintain accommodative stance of its monetary policy, given changed rate outlook on major markets and expected mitigating of domestic inflation figures
14:30	SK	Current Account Balance	May			-336.52	
24-Jul							
No releases scheduled							
25-Jul							
12:00	RS	Wages (y/y)	May			11.1%	
26-Jul							
9:00	SK	PPI (y/y)	Jun		3.7%	4.2%	Producer price growth is expected at milder rate than in May

Sources: Bloomberg, Reuters

Capital market forecasts

Government bond yields					
	current	2019Q3	2019Q4	2020Q1	2020Q2
Croatia 10Y	1.08	1.10	1.00	1.00	1.00
spread (bps)	140	140	110	90	90
Czech Rep. 10Y	1.44	1.51	1.71	1.87	1.99
spread (bps)	176	181	181	177	189
Hungary 10Y	2.33	2.59	2.68	2.81	2.90
spread (bps)	265	289	278	271	280
Poland 10Y	2.17	2.40	2.50	2.55	2.65
spread (bps)	249	270	260	245	255
Romania10Y	4.50	4.70	4.90	5.10	5.20
spread (bps)	483	500	500	500	510
Slovakia 10Y	0.00	0.28	0.40	0.55	0.55
spread (bps)	32	58	50	45	45
Slovenia 10Y	0.14	0.15	0.20	0.20	0.20
spread (bps)	46	45	30	10	10
Serbia 5Y	3.20	2.80	3.00	2.90	2.70
DE10Y*	-0.32	-0.30	-0.10	0.10	0.10

FX					
	current	2019Q3	2019Q4	2020Q1	2020Q2
EURHRK	7.39	7.40	7.42	7.42	7.38
forwards		7.39	7.39	7.39	7.39
EURCZK	25.55	25.55	25.30	25.14	24.88
forwards		25.66	25.78	25.92	26.07
EURHUF	325.4	325.0	325.0	325.0	325.0
forwards		325.9	326.5	327.2	327.9
EURPLN	4.26	4.28	4.30	4.31	4.30
forwards		4.27	4.30	4.32	4.35
EURRON	4.73	4.75	4.77	4.79	4.82
forwards		4.76	4.80	4.85	4.89
EURRSD	117.7	117.7	118.0	118.0	117.8
forwards		-	-	-	-
EURUSD	1.12	1.10	1.13	1.15	1.18

3M Money Market Rate						Key Interest Rate					
	current	2019Q3	2019Q4	2020Q1	2020Q2		current	2019Q3	2019Q4	2020Q1	2020Q2
Croatia	0.48	0.50	0.50	0.50	0.50	Croatia	0.30	0.30	0.30	0.30	0.30
Czech Republic	2.16	2.16	2.16	2.22	2.36	Czech Republic	2.00	2.00	2.00	2.00	2.25
Hungary	0.26	0.25	0.25	0.35	0.45	Hungary	0.90	0.90	0.90	0.90	0.90
Poland	1.72	1.72	1.72	1.72	1.72	Poland	1.50	1.50	1.50	1.50	1.50
Romania	3.11	3.40	3.40	3.30	3.30	Romania	2.50	2.50	2.50	2.50	2.50
Serbia	2.58	2.45	2.48	2.47	2.48	Serbia	2.75	2.50	2.50	2.50	2.50
Eurozone	-0.38	-0.30	-0.30	-0.30	-0.30	Eurozone	0.00	0.00	0.00	0.00	0.00

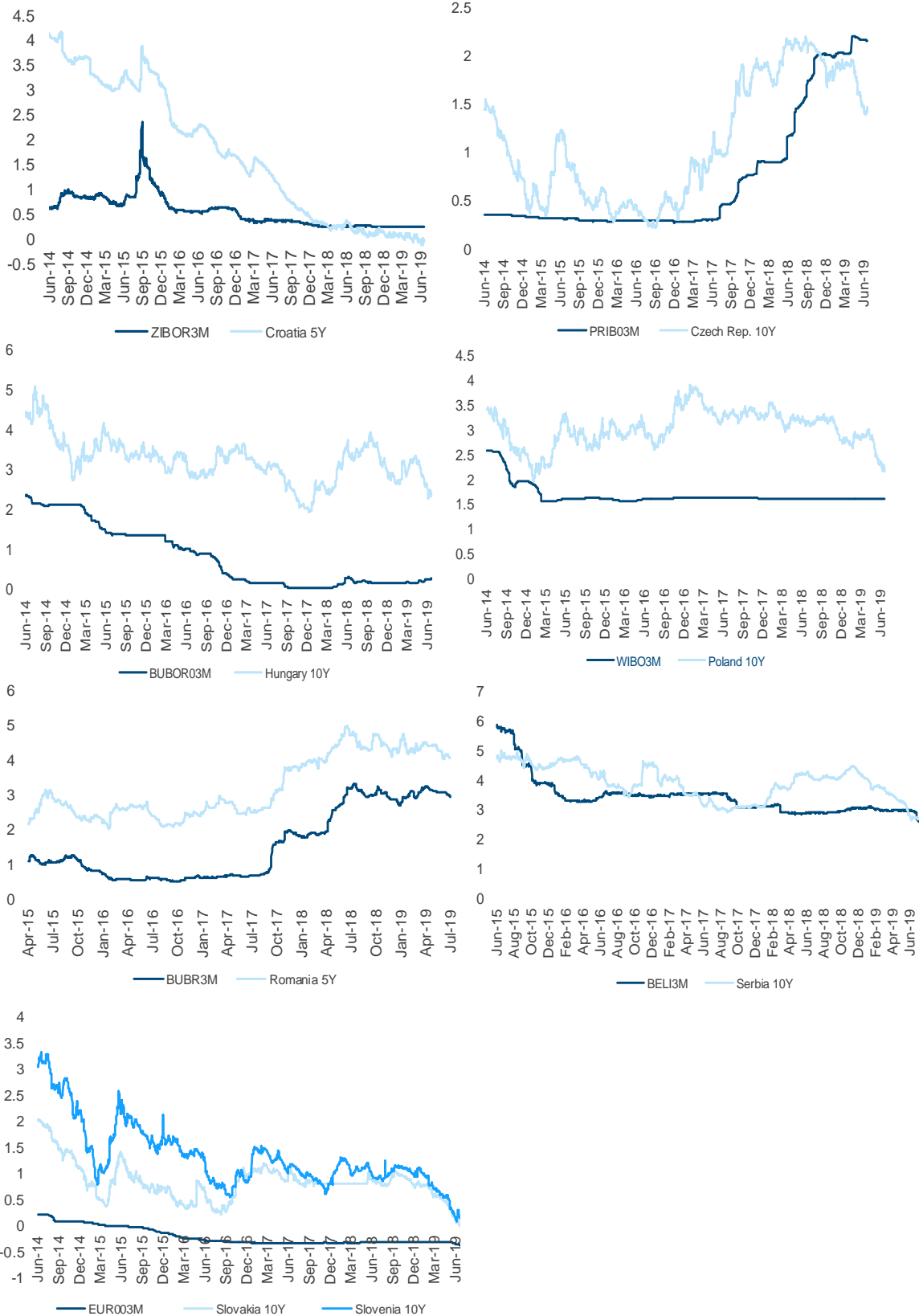
Macro forecasts

Real GDP growth (%)					Average inflation (%)					Unemployment (%)				
	2017	2018	2019f	2020f		2017	2018	2019f	2020f		2017	2018	2019f	2020f
Croatia	2.9	2.6	3.2	2.5	Croatia	1.1	1.5	1.0	1.3	Croatia	11.3	8.4	7.4	6.4
Czech Republic	4.5	2.9	2.6	2.8	Czech Republic	2.5	2.1	2.6	2.2	Czech Republic	2.9	2.3	3.0	3.3
Hungary	4.1	4.9	4.5	3.3	Hungary	2.4	2.8	3.3	3.3	Hungary	4.2	3.7	3.6	3.5
Poland	4.8	5.1	4.8	4.0	Poland	2.0	1.6	2.4	2.7	Poland	7.3	6.1	6.0	6.4
Romania	7.0	4.1	4.5	3.8	Romania	1.3	4.6	4.0	3.3	Romania	4.9	4.2	3.8	4.0
Serbia	2.0	4.3	3.3	3.5	Serbia	3.2	2.0	2.1	1.8	Serbia	13.5	12.7	10.6	9.8
Slovakia	3.2	4.1	3.4	3.3	Slovakia	1.3	2.5	2.5	2.5	Slovakia	8.1	6.5	5.8	5.7
Slovenia	4.9	4.5	3.2	3.1	Slovenia	1.4	1.7	1.5	1.9	Slovenia	6.6	5.1	4.2	3.7
CEE8 average	4.7	4.4	4.1	3.5	CEE8 average	1.9	2.4	2.7	2.7	CEE8 average	6.3	5.2	5.1	5.2

Public debt (% of GDP)					C/A (%GDP)					Budget Balance (%GDP)				
	2017	2018	2019f	2020f		2017	2018	2019f	2020f		2017	2018	2019f	2020f
Croatia	77.8	74.6	71.2	68.9	Croatia	3.7	2.6	1.4	-0.1	Croatia	0.8	0.2	0.0	-0.5
Czech Republic	34.6	32.7	31.0	30.1	Czech Republic	1.7	0.3	0.4	0.5	Czech Republic	1.6	0.9	0.6	0.3
Hungary	73.4	70.8	68.2	66.4	Hungary	2.8	0.5	-0.1	0.7	Hungary	-2.2	-2.2	-1.8	-1.5
Poland	50.6	48.9	48.0	46.5	Poland	0.2	-0.7	-0.5	-0.7	Poland	-1.5	-0.4	-1.5	-0.8
Romania	35.2	35.0	34.5	36.0	Romania	-3.2	-4.5	-4.8	-5.2	Romania	-2.7	-3.0	-3.0	-4.0
Serbia	59.3	53.6	51.3	49.2	Serbia	-5.2	-5.2	-6.3	-6.0	Serbia	1.1	0.6	-0.5	-0.5
Slovakia	50.9	48.9	47.7	46.2	Slovakia	-2.0	-2.5	-2.2	-1.5	Slovakia	-0.8	-0.7	-0.7	-0.4
Slovenia	74.1	70.1	66.5	63.0	Slovenia	7.2	7.0	6.4	5.7	Slovenia	0.0	0.0	0.70	0.8
CEE8 average	50.3	48.4	46.9	45.7	CEE8 average	0.2	-0.9	-1.0	-1.1	CEE8 average	-1.0	-0.7	-1.2	-1.1

Note: *Information on past performance is not a reliable indicator for future performance. Forecasts are not a reliable indicator for future performance.

Appendix



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