Slovakia | Macro Outlook

Domestic demand returns to the driving seat
ECB loosens monetary policy
Slovak yields strongly affected by loose monetary policy of the ECB
Dollar should remain strong

Economy (%)	2019e	2020e	2021e
GDP (real, y/y)	2.5	2.3	2.6
Unempl. Rate	5.8	5.9	5.7
CPI (y/y)	2.6	2.3	2.0
Retail Sales (y/y)	1.0	2.4	2.7
Ind. Prod. (y/y)	5.0	3.0	3.4
Public Debt/GDP	48.2	47.4	46.3

Source: Erste Group Research

Market	Spot	19Q4	20Q1	20Q2
ECB Target R.	0.00	0.00	0.00	0.00
3M Euribor	-0.43	-0.50	-0.50	-0.50
EUR/USD	1.10	1.10	1.12	1.15
10Y Bond (%)*	-0.33	-0.05	0.05	0.10

Source: FactSet, Erste Group Research

Rating	Current	Outlook
Moodys	A2	pos
S&P	A+	stable
Fitch	A+	stable

Source: Erste Group Research

General	2019
Population mn	5.5
GDP/Capita EUR	17,219

Source: Erste Group Research

Spot Rates as of:
11th Sep. 2019

Analysts:

Katarina Muchova
muchova.katarina@slsp.sk
+421 2 486 24762

Maria Valachyova
valachyova.maria@slsp.sk
+421 2 4862 4185

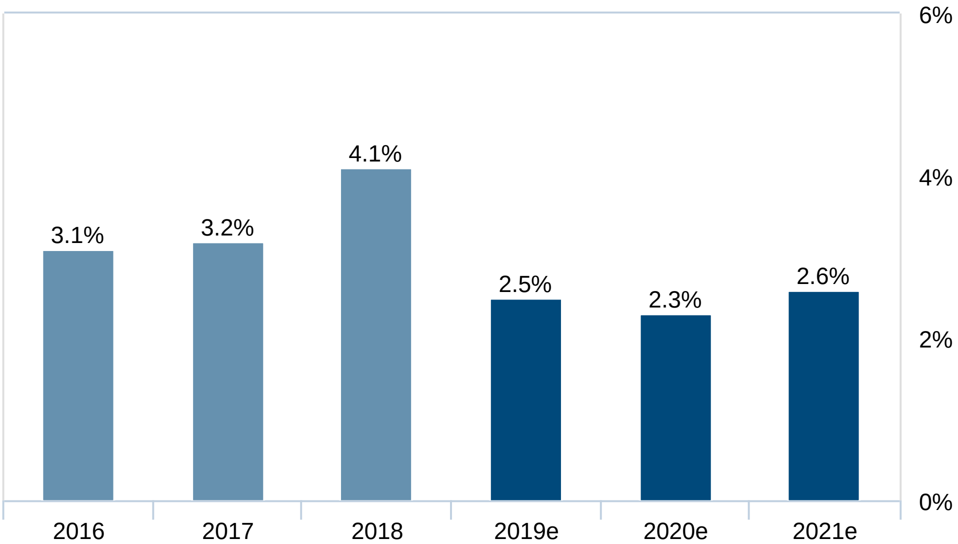
Rainer Singer (Eurozone)
+43 (0)5 0100 17331
RainerSinger@erstegroup.com

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

Real GDP growth reached 2% y/y in 2Q19, decelerating from the 3.7% y/y in 1Q19. The key reason behind the slowdown was the disappointing performance of net exports. In light of the recent data and ongoing tensions in the global economy, we have adjusted our GDP growth forecast downwards: from 3.4% to 2.5% in 2019 and from 3.3% to 2.3% in 2020. Even though the domestic side of the economy should continue to support growth, external environment remains overcast (slower growth in Germany and China, uncertain Brexit outcome, unresolved protectionism and possible impact on local car makers). Moreover, this year's high base on inventories will likely cause a mild correction next year.

Labour market remains in a good condition as the unemployment rate fell to all-time low of 5.7% (-0.9pp y/y) in 2Q19. However, the pace of employment growth eased to 0.5% y/y in 2Q19, amidst somewhat cloudier economic environment. Nominal wage growth exceeded expectations and accelerated to 9.7% y/y in 2Q19, reflecting still tight labour market and recent administrative changes (night and weekend work). We now expect this year's nominal wage growth at 7.3% before easing to 4.8% in 2020. Unemployment rate should hover around 5.8-5.9% in 2019-20, respectively. Inflation is expected to reach 2.6% this year and 2.3% in 2020, driven by food, service and energy prices.

GDP (real,y/y)



Source: Erste Group Research

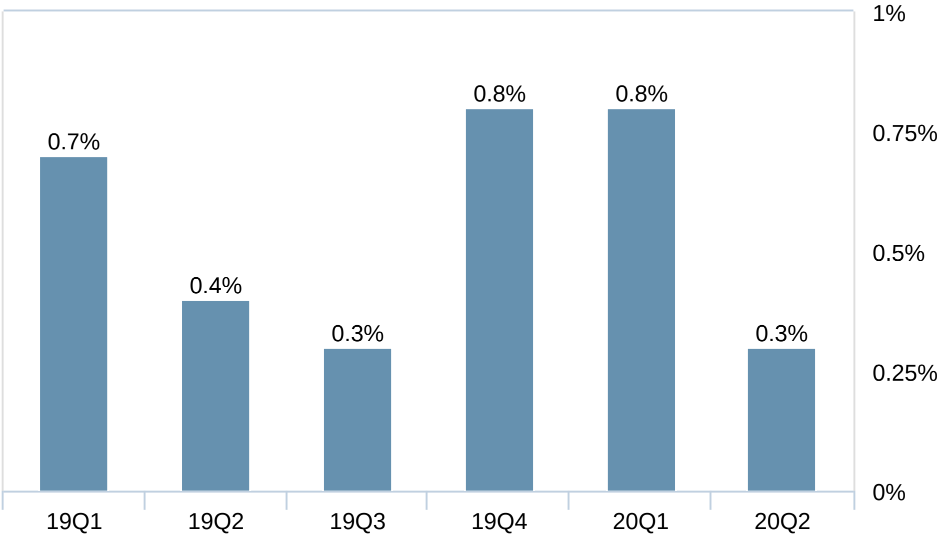
GDP

Domestic demand returns to the driving seat

Real GDP rose by 2% y/y in 2Q19 (0.5% q/q), easing from the 3.7% y/y at the beginning of the year. The key factor behind the slowdown was foreign trade as net exports contributed -2.6pp to the GDP growth pace. Gross fixed investment fell by 3.7% y/y, affected by the high base last year, linked to the building of the fourth car plant. However, due to the strong rise in inventories, gross investment was up by 11.9% y/y and thus contributed 2.8pp to GDP growth. Households fared better than in 1Q19 (but still devoted a substantial part of their income to savings), as their consumption rose by 1.9% y/y and added 1pp to GDP growth.

In light of the recent data, we have adjusted our GDP growth forecast downwards: from 3.4% to 2.5% in 2019 and from 3.3% to 2.3% in 2020. The revisions reflect the much weaker than expected 2Q 2019 as well as the ongoing tensions in the global economy. Even though the domestic side of the economy should continue to support growth, the external environment remains overcast - slower growth in Germany and China, uncertain Brexit outcome, unresolved protectionism in foreign trade and possible impact on local car makers. Furthermore, this year's high investment base on inventories will likely cause a mild correction next year.

GDP (real, s.a., q/q)



Source: Erste Group Research

Annual	2017	2018	2019e	2020e	2021e
GDP real	3.2%	4.1%	2.5%	2.3%	2.6%
CPI (y/y)	1.3%	2.5%	2.6%	2.3%	2.0%
Private Consumption	3.5%	3.0%	1.8%	2.2%	2.3%

Source: Erste Group Research

Inflation

Inflationary pressures to ease a bit next year

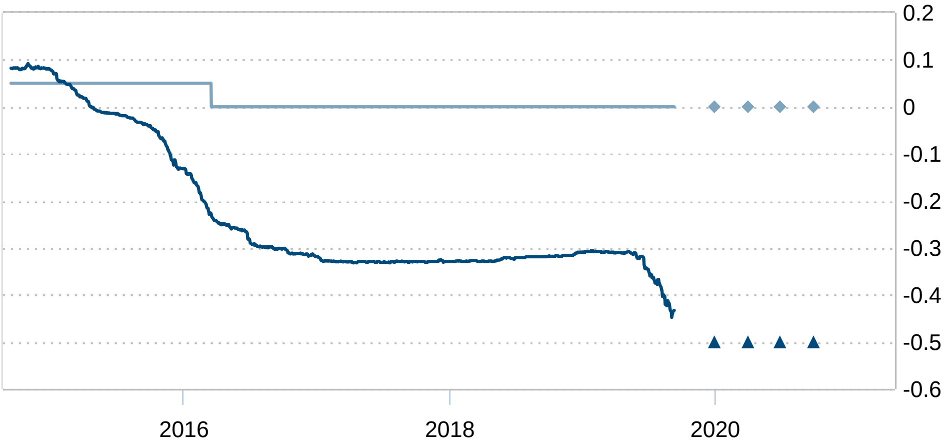
Inflation gathered speed and may average 2.6% this year, before easing to 2.3% next year. Core inflation is expected to slow down from its last year's average (2.8%) to 2.3% and 2.4% in 2019-20, respectively. Consumer price increases are mainly driven by food, services and energy prices. Higher service prices reflect growing disposable income of households amidst labour market improvement. Given the development in commodity and oil prices, energy prices are likely to play a role in the milder inflation figures in the upcoming few months.

ECB Monetary Policy

ECB loosens monetary policy

The forthcoming meeting of the Governing Council on 12 September will bring a number of measures to monetary easing. The ECB had already announced these in July in order to stimulate the economy. The reason given for this was the adverse environment for the economy (trade war in the USA/China, Brexit) combined with an inflation rate that persistently remains well below the target. We expect a reformulated interest rate outlook that should keep interest rate expectations low in the medium term, a reduction in the deposit rate from -0.4% to -0.5% and the announcement of a program to buy securities. The greatest uncertainty is likely to be over the introduction of the purchase program.

Eurozone Short Term Yields



Source: FactSet, Erste Group Research

Market (%)	Spot	19Q4	20Q1	20Q2	20Q3
Target Rate	0.00	0.00	0.00	0.00	0.00
3M Rate	-0.43	-0.50	-0.50	-0.50	-0.50

Source: FactSet, Erste Group Research

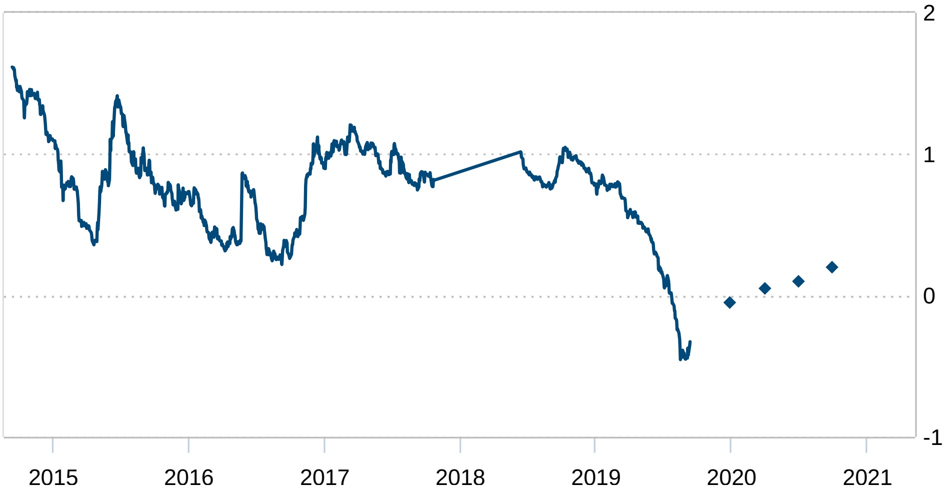
Bond Yields

Slovak yields strongly affected by loose monetary policy of the ECB

Slovak 10Y government bond yields moved into the negative territory in July and have remained there. They followed the development of German Bunds and are reflecting more dovish ECB, cautious Fed and higher uncertainty (Brexit, trade). The ECB is easing its monetary policy stance further, amidst the lukewarm GDP and inflation development in Europe and various external risks. Domestically, labour market improvement and tax collection help to trim the budget deficit, which fell to 0.7% of GDP in 2018. The current balanced budget proposal for 2019 is unlikely to be achieved though.

We expect fiscal deficit at 0.8% of GDP this year, due to risks regarding the municipalities' performance and the slowdown in economic growth. Next year may yield a fiscal deficit of 0.7% of GDP. Government debt, comfortably under the Maastricht's 60% of GDP, fell below 50% of GDP already in 2018 and should inch down further. Overall, yields on government bonds could increase somewhat reflecting Slovak inflation and fiscal policy setup. However, more uncertain path of monetary policy in the US and cautious ECB will play a key role in keeping the yields depressed. We expect the 10-year government bond yield at -0.05% at the end of 2019 before rising to 0.3% towards the end of 2020.

10Y Generic Govt. Bond Yield (%)



Source: Datastream, Erste Group Research

Market	Spot	19Q4	20Q1	20Q2	20Q3
10Y Bond*	-0.33	-0.05	0.05	0.10	0.20

Source: Datastream, Erste Group Research

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

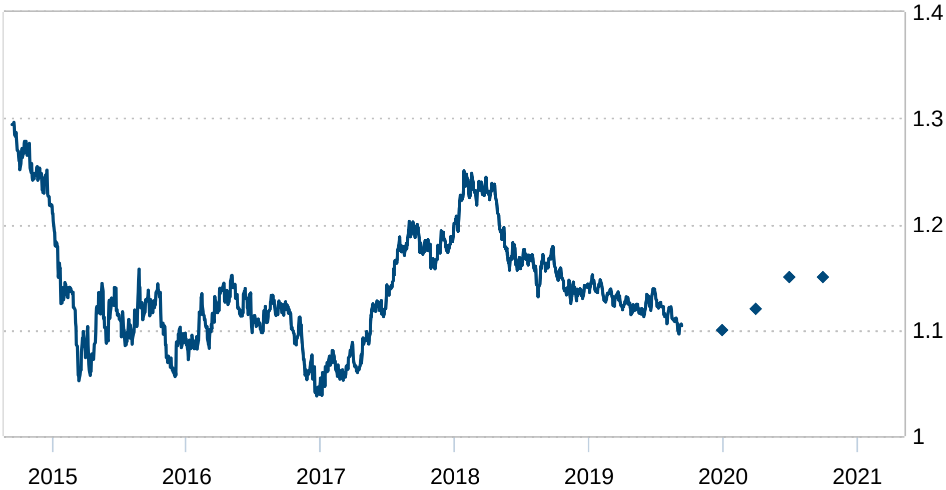
Euro

Dollar should remain strong

With the further escalation of the trade war between the USA and China in August and no solution for the Brexit in sight, the concern in the markets has generally increased.

Most recently, the risks posed by the Brexit were crucial for EURUSD. Over the coming weeks, we continue to expect an eventful development. A final decision as to whether the United Kingdom will leave the EU on November 1 will probably only be made immediately before this date. Thus, the strong dollar should remain well supported. In the meantime, the euro could fall below the 1.1 dollar mark. Towards the end of the year, the euro could rise above the 1.1 dollar mark again.

EUR/USD



Source: FactSet, Erste Group Research

	Spot	19Q4	20Q1	20Q2	20Q3
EUR/USD	1.10	1.10	1.12	1.15	1.15
vs. Spot		*0%*	*1.8%*	*4.5%*	*4.5%*

Source: FactSet, Erste Group Research

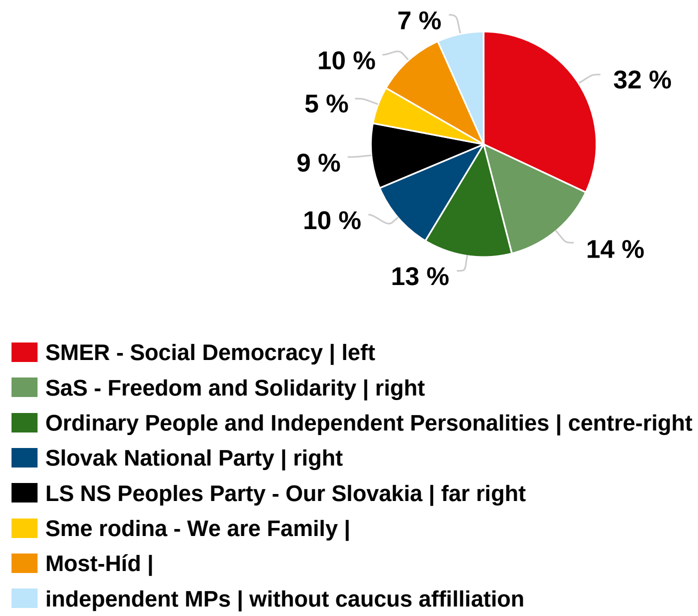
Politics

Parliamentary democracy

There are 3 coalition parties in the government: nationalistic SNS and centre-right Most led by SMER-Social Democracy which previously ruled alone. The government largely continues in the policy-making of the previous government. The political scene was shaken in March 2018 as the murder of investigative journalist J.Kuciak and his fiancée sparked nation-wide protests and led to the resignation of the Prime Minister. The situation calmed down after the government reshuffle (new PM is still from SMER: Peter Pellegrini). Slovakia has a new female president Zuzana Caputová (pro-European, left of centre), who overwhelmingly won the presidential elections in March.

The government is discussing measures it would like to enact before the parliamentary elections in February 2020. The package may amount to EUR 500-700 mn (0.5-0.7% of GDP) but given the slowdown in economic growth and the corresponding impact on public finances, it may be slightly smaller. Yet, it is likely to put a strain on the fiscal stance. Among the key proposals is the introduction of a 15% income tax just for small companies (currently a flat 21% rate), lower VAT on select foodstuffs, increasing the basic tax deductible for employees and changes to the maternity benefits system, plus a possible 13th pension. Minimum wage will likely rise to EUR 580 (currently at EUR 520).

Parliament Seats



Source: Erste Group Research

Last Election:
2016, March

Next Election:
2020, February

Forecasts

Annual	2013	2014	2015	2016	2017	2018	2019e	2020e	2021e
Real GDP growth	1.5	2.8	4.2	3.1	3.2	4.1	2.5	2.3	2.6
Inflation (CPI, avg)	1.4	-0.1	-0.3	-0.5	1.3	2.5	2.6	2.3	2.0
Unemployment rate (avg)	14.2	13.2	11.5	9.6	8.1	6.6	5.8	5.9	5.7
Retail sales growth	0.1	3.6	1.7	2.2	6.0	3.6	1.0	2.4	2.7
Industrial output growth	1.5	3.2	6.6	4.6	3.3	4.4	5.0	3.0	3.4
Private consumption growth	-0.8	1.4	2.3	2.9	3.5	3.0	1.8	2.2	2.3
Fixed capital formation growth	-0.9	3.0	21.9	-9.4	3.4	6.8	1.5	2.9	3.0
Percent of GDP									
Trade balance	3.9	3.6	1.3	2.0	0.8	0.1	-0.3	0.3	1.0
Current account balance	1.9	1.1	-1.7	-2.2	-2.0	-2.5	-2.8	-1.6	-0.8
Foreign direct investment	0.9	0.2	-0.5	1.0	0.6	1.5	0.6	0.5	0.5
Budget balance	-2.7	-2.7	-2.6	-2.2	-0.8	-0.7	-0.8	-0.7	-0.3
Public debt	54.7	53.5	52.2	51.8	50.9	48.9	48.2	47.4	46.3
External debt, gross	82.1	90.0	85.2	92.2	111.0	113.0	106.6	102.0	95.5
(percent)									
CB policy rate (avg.)	0.55	0.16	0.05	0.01	0.00	0.00	0.00	n.a.	n.a.
3m interbank offer rate (avg.)	0.22	0.20	-0.02	-0.26	-0.33	-0.32	-0.36	n.a.	n.a.
5Y Yield (average)*	1.08	n.a.	n.a.	n.a.	-0.08	0.13	-0.16	0.00	0.28
10Y Yield (average)*	2.72	1.75	0.90	0.66	0.94	0.86	0.06	0.18	0.70

Source: Erste Group Research

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

Group Research

Head of Group Research	
Friedrich Mostböck, CEFA	+43 (0)5 0100 11902
Major Markets & Credit Research	
Head: Gudrun Egger, CEFA	+43 (0)5 0100 11909
Ralf Burchert, CEFA (Sub-Sovereigns & Agencies)	+43 (0)5 0100 16314
Hans Engel (Senior Analyst Global Equities)	+43 (0)5 0100 19835
Margarita Grushanina (Economist AT, Quant Analyst)	+43 (0)5 0100 11957
Peter Kaufmann, CFA (Corporate Bonds)	+43 (0)5 0100 11183
Stephan Lingnau (Global Equities)	+43 (0)5 0100 16574
Heiko Langer (Financials & Covered Bonds)	+43 (0)5 0100 85509
Bernadett Povazsai-Römhild, CEFA (Corporate Bonds)	+43 (0)5 0100 17203
Carmen Riefler-Kowarsch (Financials & Covered Bonds)	+43 (0)5 0100 19632
Elena Statelov, CIIA (Corporate Bonds)	+43 (0)5 0100 19641
Gerald Walek, CFA (Economist Euro, CHF)	+43 (0)5 0100 16360
Rainer Singer (Senior Economist Euro, US)	+43 (0)5 0100 17331
Macro/Fixed Income Research CEE	
Head CEE: Juraj Kotian (Macro/FI)	+43 (0)5 0100 17357
Zoltan Arokszallasi, CFA (Fixed income)	+43 (0)5 0100 18781
Katarzyna Rzentarzewska (Fixed income)	+43 (0)5 0100 17356
Malgorzata Krzywicka (Fixed Income)	+43 (0)5 0100 17338
CEE Equity Research	
Head: Henning Eßkuchen	+43 (0)5 0100 19634
Daniel Lion, CIIA (Technology/Industrial Goods&Services)	+43 (0)5 0100 17420
Michael Marschallinger, CFA	+43 (0)5 0100 17906
Nora Nagy	+43 (0)5 0100 17416
Thomas Unger, CFA (Banks, Insurance)	+43 (0)5 0100 16314
Christoph Schultes, MBA, CIIA (Real Estate)	+43 (0)5 0100 11523
Vladimira Urbankova, MBA (Pharma)	+43 (0)5 0100 17343
Martina Valenta, MBA	+43 (0)5 0100 11913
Editor Research CEE	
Brett Aarons	+420 956 711 014
Research Croatia/Serbia	
Head: Mladen Dodig (Equity)	+381 11 22 09 178
Head: Alen Kovac (Fixed income)	+385 62 37 1383
Anto Augustinovic (Equity)	+385 62 37 2833
Magdalena Dolenec (Equity)	+385 72 37 1407
Mate Jelic (Fixed income)	+385 72 37 1443
Ivana Rogic (Fixed income)	+385 62 37 2419
Davor Spoljar, CFA (Equity)	+385 62 37 2825
Research Czech Republic	
Head: David Navratil (Fixed income)	+420 956 765 439
Head: Petr Bartek (Equity)	+420 956 765 227
Marek Dongres (Equity)	+420 956 765 218
Jan Safranek (Equity)	+420 956 765 218
Jiri Polansky (Fixed Income)	+420 956 765 192
Roman Sedmera (Fixed Income)	+420 956 765 391
Michal Skorepa (Fixed income)	+420 956 765 456
Research Hungary	
Head: Jozsef Miro	+361 235 5131
Andras Nagy (Equity)	+361 235-5132
Orsolya Nyeste (Fixed Income)	+36 1 268 4428
Tamas Pletser (Equity)	+361 235-5135
Research Poland	
Director of Research: Tomasz Duda (Equity)	+48 22 330 6253
Konrad Grygo (Equity)	+48 22 330 6254
Michal Pilch (Equity)	+48 22 330 6255
Cezary Bernatek (Equity)	+48 22 330 6256
Mateusz Krupa, CFA (Equity)	+48 22 330 6251
Emil Poplawski (Equity)	+48 22 330 6252
Research Romania	
Head: Horia Braun-Erdei	+40 3735 10424
Caius Rapanu (Equity)	+40 3735 10441
Eugen Sinca (Fixed income)	+40 3735 10435
Dorina Ilasco (Fixed Income)	+40 3735 10436
Research Slovakia	
Head: Maria Valachyova, (Fixed income)	+421 2 4862 4185
Katarina Muchova (Fixed income)	+421 2 4862 4762
Research Turkey	
Berke Gümüs (Equity)	+90 2129120445
Gizem Akkan (Equity)	+90 2129120445

Treasury - Erste Bank Vienna

Group Markets Retail Sales	
Group Markets Retail and Agency Business	
Head: Christian Reiss	+43 (0)5 0100 84012
Group Markets Execution	
Head: Kurt Gerhold	+43 (0)5 0100 84232
Retail & Sparkassen Sales	
Head: Uwe Kolar	+43 (0)5 0100 83214
Markets Retail Sales AT	
Head: Markus Kaller	+43 (0)5 0100 84239
Corporate Treasury Product Distribution AT	
Head: Christian Skopek	+43 (0)5 0100 84146
Fixed Income Institutional Sales	
Bank and Institutional Sales	
Institutional Distribution non CEE	
Head: Jaromir Malak	+43 (0)5 0100 84254
Bernd Bollhof	+49 (0)30 8105800 5525
Charles-Henry de Fontenilles	+43 (0)5 0100 84115
Rene Klasen	+49 (0)30 8105800 5521
Christopher Lampe-Traupe	+49 (0)30 8105800-5507
Christian Kienesberger	+43 (0) 5 0100 84323
Karin Rattay	+43 (0) 5 0100 84118
Bernd Thaler	+43 (0) 5 0100 84119
Bank Distribution	
Head: Marc Friebertshäuser	+49 (0)711 810400 5540
Sven Kienzle	+49 (0)711 810400 5541
Michael Schmotz	+43 (0)5 0100 85542
Ulrich Inhofner	+43 (0)50100 85544
Klaus Vosseler	+49 (0)711 810400 5560
Andreas Goll	+49 (0)711 810400 5561
Mathias Gindele	+49 (0)711 810400 5562
Institutional Distribution CEE	
Head: Jaromir Malak	+43 (0)50100 84254
Institutional Distribution PL and CIS	
Pawel Kielek	+48 22 538 6223
Michal Jarmakowicz	+43 50100 85611
Institutional Distribution Slovakia	
Head: Sarlota Sipulova	+421 2 4862 5619
Monika Smelikova	+421 2 4862 5629
Institutional Distribution Czech Republic	
Head: Ondrej Cech	+420 2 2499 5577
Milan Bartos	+420 2 2499 5562
Barbara Suvadova	+420 2 2499 5590
Institutional Asset Management Sales	
Head: Petr Holecek	+420 956 765 453
Martin Perina	+420 956 765 106
Petr Valenta	+420 956 765 140
Blanca Weinerova	+420 956 765 317
David Petracek	+420 956 765 809
Institutional Distribution Croatia	
Head: Antun Buric	+385 (0)72 37 2439
Natalija Zujic	+385 (0)72 37 1638
Zvonimir Tukac	+385 (0)72 37 17 87
Institutional Sales Hungary	
Head: Peter Csizmadia	+361 237 8211
Attila Hollo	+36 1 2378209
Gabor Balint	+36 1 2378205
Institutional Distribution Romania and Bulgaria	
Head: Ciprian Mitu	+43 (0)50100 85612
Crisitan Adascalita	+40 373 516 531
Business Support	
Bettina Mahoric	+43 (0)50100 86441

Disclaimer

This publication was prepared by Erste Group Bank AG or any of its consolidated subsidiaries (together with consolidated subsidiaries "Erste Group") as other information pursuant to the Circular of the Austrian Financial Market Authority regarding information including marketing communication pursuant to the Austrian Securities Supervision Act. This publication serves interested investors as additional source of information and provides general information, information about product features or macroeconomic information without emphasizing product selling marketing statements. This publication does not constitute marketing communication pursuant to Art. 36 (2) Austrian Securities Supervision Act as no direct buying incentives were included in this publication, which is of information character. This publication does not constitute investment research pursuant to § 36 (1) Austrian Securities Supervision Act. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and it is not subject to the prohibition on dealing ahead of the dissemination of investment research. The information only serves as non-binding and additional information and is based on the level of knowledge of the person in charge of drawing up the information on the respective date of its preparation. The content of the publication can be changed at any time without notice. This publication does not constitute or form part of, and should not be construed as, an offer, recommendation or invitation to subscribe for or purchase any securities, and neither this publication nor anything contained herein shall form the basis of or be relied on in connection with or act as an inducement to enter into any contract or inclusion of a security or financial product in a trading strategy. Information provided in this publication are based on publicly available sources which Erste Group considers as reliable, however, without verifying any such information by independent third persons. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the forecasts, opinions and expectations contained herein are fair and reasonable, Erste Group (including its representatives and employees) neither expressly nor tacitly makes any guarantee as to or assumes any liability for the up-to-dateness, completeness and correctness of the content of this publication. Erste Group may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Erste Group endorses, recommends or approves any material on the linked page or accessible from it. Neither a company of Erste Group nor any of its respective managing directors, supervisory board members, executive board members, directors, officers of other employees shall be in any way liable for any costs, losses or damages (including subsequent damages, indirect damages and loss of profit) howsoever arising from the use of or reliance on this publication. Any opinion, estimate or projection expressed in this publication reflects the current judgment of the author(s) on the date of publication of this document and do not necessarily reflect the opinions of Erste Group. They are subject to change without prior notice. Erste Group has no obligation to update, modify or amend this publication or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. The past performance of securities or financial instruments is not indicative for future results. No assurance can be given that any financial instrument or issuer described herein would yield favorable investment results or that particular price levels may be reached. Forecasts in this publication are based on assumptions which are supported by objective data. However, the used forecasts are not indicative for future performance of securities or financial instrument. Erste Group, its affiliates, principals or employees may have a long or short position or may transact in the financial instrument(s) referred to herein or may trade in such financial instruments with other customers on a principal basis. Erste Group may act as a market maker in the financial instruments or companies discussed herein and may also perform or seek to perform investment banking services for those companies. Erste Group may act upon or use the information or conclusion contained in this publication before it is distributed to other persons. This publication is subject to the copyright of Erste Group and may not be copied, distributed or partially or in total provided or transmitted to unauthorized recipients. By accepting this publication, a recipient hereof agrees to be bound by the foregoing limitations.

Published By:
Erste Group Bank AG
Group Research
1100 Wien, Am Belvedere 1
Head Office: Wien
Commercial Register No: FN 33209m
Commercial Court of Vienna
Erste Group Homepage: www.erstegroup.com