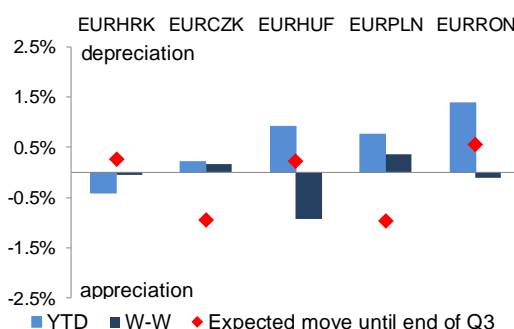


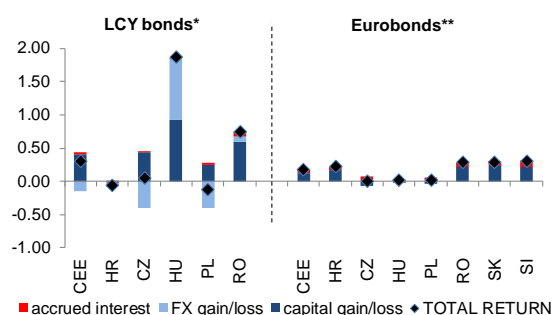
# CEE Market Insights

## Market outlook

The moment of truth could come this week, as 2Q19 GDP releases could indicate how much the German manufacturing slowdown plagued CEE growth. This could easily have implications for regional currencies and rates, too. Last week's positive performance of the HUF (vs. the CZK and PLN) could likely be due to the fact that investors believe that monetary policy could become more dovish in the latter two countries, while the MNB in Hungary was already the most dovish among its peers. The CZK and PLN could remain weak in the absence of reassuring news regarding global trade disputes, while the HUF is also unlikely to appreciate further in this case.



Yield spreads largely continued to decrease in CEE. Investors can increasingly imagine monetary easing in the region, and while hefty domestic demand and wage growth put upward pressure on inflationary developments, the Hungarian release last week, which indicated lower core price developments, could mean that CEE need not face a blow-up in inflation. As for our forecasts, we took our CZGB yield outlook under revision – we are unlikely to see any pronounced yield increases in the Czech Republic anytime soon.



## Looking ahead this week:

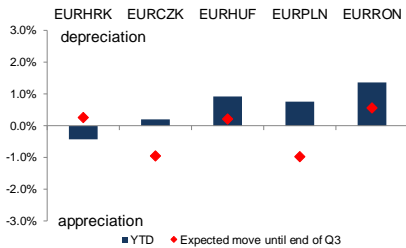
Monday	Tuesday	Wednesday	Thursday	Friday
RO, CZ, RS: CPI	RO: Current Account SK: CPI PL: Trade Balance	CZ, HU: GDP RO: GDP, Industry PL: GDP, CPI	RS: Current Account	HR: CPI CZ: PPI

Did the CEE region remain resilient to the gloomier external environment in 2Q19? This week, flash GDP releases will provide us with the first answers to that question. We expect the growth momentum to remain strong and arrive at 4.6% y/y in Hungary, Poland and Romania, while in the Czech Republic we expect it to be 2.6% y/y. Domestic demand should remain the main growth driver and should compensate for lower external demand. Moreover, the July inflation reading will be published across the region and we see a mixed pattern among the countries. On the one hand, in the Czech Republic, Romania and Slovakia, price pressure is expected to accelerate. On the other hand, headline inflation in Croatia is to remain stable below 1%, while in Serbia it is to marginally decelerate. The Romanian MinFin published the budget rectification plan that should be approved by the government this week. Given the introduction of new excise taxes and increases of already existing ones, we put our inflation forecast under revision. Inflation could be a maximum 0.5pp higher at year-end than our current forecast. Lastly, industrial production data for June will be released in Romania and we expect it to remain in negative territory for the third month in a row due to weak external demand.

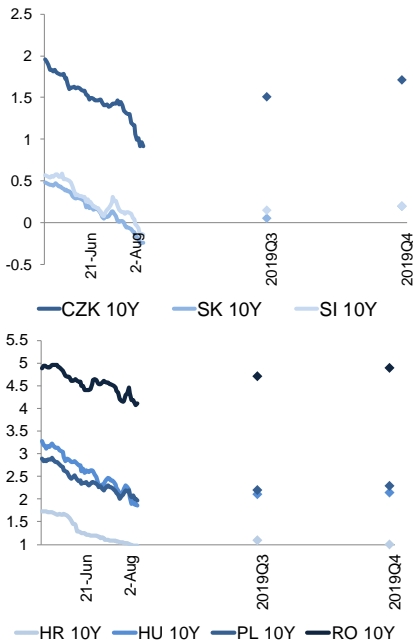
## In case you missed it last week...

- RS: [Additional quarter point rate cut](#). We expect NBS to keep key rate unchanged until end-2019.
- RO: [No surprise from NBR](#), which kept policy rate flat at 2.5%. We expect stability of rates until end-2019.
- RO: Budget rectification. MinFin plans to increase and introduce new excise taxes to keep budget under control.
- CZ: [Further negative signs](#). Industrial production went deeper into negative territory, to -3.8% y/y in June.
- HU: [Industry no longer so resilient](#). Industrial production came in at 4.1% y/y in June, below expectations.
- HU: [Easing of price pressure](#). Inflation slowed to 3.3% y/y in June on back of lower prices of fuel and durables.
- SI: [Industry decelerated](#). Industrial production growth dropped to 1.1% y/y in June.

**YTD change on FX market**



**10Y government bond yields, percent**



Source: Erste Group Research, Bloomberg.

**On global markets:**

Italy has set course for snap elections in the autumn. Final confirmation will bring a vote of no-confidence, likely to take place this week. So far, the EURUSD has hardly reacted to the increased uncertainty. The exchange rate could get some direction from this week's releases. The first estimate of German 2Q GDP is scheduled, but more important will be US CPI and retail sales, both for the month of July.

**CEE currencies:**

The forint has become the positive outlier in the region after the Hungarian currency did not join the negative moves observed elsewhere last week. While the forint had a gap to close, as the HUF has been weaker than other regional currencies against the euro since the beginning of 2Q19, the ever-lower global rate expectations may trigger more pronounced expectations of rate easing in the region where interbank rates are in more positive territory (Poland and the Czech Republic) than in Hungary. Additionally, the amount of crowded-out liquidity on interbank markets became a much more important focus of the MNB, and no change is currently expected in this regard in Hungary. All this reduced the attractiveness of the CZK and PLN more than the HUF. In the absence of reassuring comments regarding the global trade woes, the koruna could stay at the current, weak levels. The zloty is also unlikely to appreciate much from current levels. As for the HUF, further appreciation is unlikely, however, given the similar exposure to global trade developments to that of the Czech Republic, and the dovish bias of the central bank.

**CEE rates and yields:**

Spreads of CEE government bonds above German Bunds could not stop shrinking last week, which continues to be driven by global rate expectation developments. It seems that CEE bonds could even benefit from risk-off sentiment, as evidenced by the continued drop in yields on Friday, despite the huge increase in BTP yields in Italy after early elections in autumn became increasingly likely there. Hungary showed the largest yield drop in 10Y govies in the region w/w (by around 25bp), where the rather favorable fiscal release (indicating that, without the negative balance on EU funds, the budget would be in a surplus YTD in July) also underlines the stability of public finances. In Romania, rates did not really decrease, while government bond yields did. Fiscal consolidation measures were announced last week, but these could raise inflation further, explaining these divergent moves well for Romania. Czech swap rates declined the most in the region around the 1Y-4Y segment, but this is also no surprise, given that CNB meeting minutes indicated that central bankers were discussing a what-if scenario of growth on main export markets halving, and also noting that small upside deviations from the 2% inflation target could easily be tolerated, amid notable growth risks. We currently have our CZGB yield forecasts under revision for a likely cut – it seems unlikely to see any pronounced yield increases in the near future. As for Serbia, the rate cut to 2.5% was delivered as expected; for the time being, we do not expect more to come.

## Calendar

Time	Country	Indicator	Period	Survey	Erste Est.	Prev.	Pre Comment
<b>12-Aug</b>							
8:00	RO	CPI (y/y)	Jul		<b>4.2%</b>	3.84%	Inflation probably increased in July due to base effect.
8:00	RO	CPI (m/m)	Jul		<b>-0.2%</b>	-0.23%	Cheaper vegetables and natural gas in July.
9:00	CZ	CPI (y/y)	Jul	2.7%	<b>2.8%</b>	2.7%	Tight labor market, sound domestic demand and development of food prices still stand behind relatively high inflation.
12:00	RS	CPI (y/y)	Jul		<b>1.4%</b>	1.5%	July CPI expected to additionally decelerate due to base effect.
12:00	RS	CPI (m/m)	Jul			-0.3%	
<b>13-Aug</b>							
	RO	Current Account Balance	Jun			-3401	
9:00	SK	CPI (y/y)	Jul		<b>2.8%</b>	2.6%	Mild acceleration in inflation rate expected for July.
9:00	SK	CPI (m/m)	Jul		<b>0.0%</b>	0.1%	Compared to previous month, consumer prices likely to have remained largely unchanged.
14:00	PL	Trade Balance	Jun	-70		96	
<b>14-Aug</b>							
8:00	RO	Industrial Production (y/y)	Jun		<b>-3.4%</b>	-1.7%	Very weak industrial production due to shrinking external demand.
8:00	RO	GDP (q/q)	2Q A		<b>0.8%</b>	1.29%	Domestic demand most likely remained top economic growth driver.
9:00	CZ	GDP (q/q)	2Q A	0.5%	<b>0.5%</b>	0.6%	Development of Czech economy remained favorable in 2Q, mainly due to solid household consumption and private investment.
9:00	CZ	GDP (y/y)	2Q A	2.6%	<b>2.6%</b>	2.8%	GDP growth driven mainly by labor market and positive sentiment of households and high investment expenditures of firms into robotization. Contribution of net exports should be slightly negative, mainly due to lower foreign demand.
9:00	HU	GDP (y/y)	2Q P		<b>4.6%</b>	5.3%	Economy could slow in 2Q19 as European slowdown reaches Hungary: industrial production and internal demand could mitigate, while agricultural performance might continue decreasing.
10:00	PL	CPI (y/y)	Jul F		<b>2.9%</b>	2.9%	Flash inflation reading to be confirmed.
10:00	PL	CPI (m/m)	Jul F				
10:00	PL	GDP (y/y)	2Q P	4.5%	<b>4.6%</b>	4.7%	We believe that GDP growth will also sustain solid growth in 2Q19, supported by private consumption and investment growth.
<b>15-Aug</b>							
	RS	Current Account Balance	Jun			-124.2	
<b>16-Aug</b>							
9:00	CZ	PPI (y/y)	Jul	2.2%	<b>2.3%</b>	2.5%	PPI inflation affected mainly by lack of new available employees, which in turn increases labor costs of firms.
11:00	HR	CPI (y/y)	Jul		<b>0.6%</b>	0.6%	Inflation expected to remain in tight band in July.

Sources: Bloomberg, Reuters

## Capital market forecasts

Government bond yields					
	current	2019Q3	2019Q4	2020Q1	2020Q2
<b>Croatia 10Y</b>	0.97	1.10	1.00	1.00	1.00
spread (bps)	155	160	140	130	130
<b>Czech Rep. 10Y</b>	0.92	1.51	1.71	1.87	1.99
spread (bps)	151	201	211	217	229
<b>Hungary 10Y</b>	1.85	2.11	2.15	2.31	2.46
spread (bps)	243	261	255	261	276
<b>Poland 10Y</b>	1.97	2.20	2.30	2.35	2.30
spread (bps)	256	270	270	265	260
<b>Romania10Y</b>	4.10	4.70	4.90	5.10	5.20
spread (bps)	469	520	530	540	550
<b>Slovakia 10Y</b>	-0.24	0.05	0.20	0.30	0.35
spread (bps)	35	55	60	60	65
<b>Slovenia 10Y</b>	-0.14	0.15	0.20	0.20	0.20
spread (bps)	44	65	60	50	50
<b>Serbia 5Y</b>	3.06	2.80	3.00	2.90	2.70
<b>DE10Y</b>	-0.59	-0.50	-0.40	-0.30	-0.30

FX					
	current	2019Q3	2019Q4	2020Q1	2020Q2
<b>EURHRK</b>	7.39	7.40	7.42	7.42	7.38
forwards		7.39	7.39	7.39	7.39
<b>EURCZK</b>	25.81	25.55	25.30	25.14	24.88
forwards		25.90	26.01	26.12	26.26
<b>EURHUF</b>	324.9	325.0	325.0	325.0	325.0
forwards		325.3	325.8	326.3	327.0
<b>EURPLN</b>	4.32	4.28	4.30	4.31	4.30
forwards		4.33	4.36	4.38	4.40
<b>EURRON</b>	4.73	4.75	4.77	4.79	4.82
forwards		4.75	4.79	4.83	4.87
<b>EURRSD</b>	117.7	117.7	118.0	118.0	117.8
forwards		-	-	-	-
<b>EURUSD</b>	1.12	1.10	1.10	1.12	1.15

3M Money Market Rate						Key Interest Rate					
	current	2019Q3	2019Q4	2020Q1	2020Q2		current	2019Q3	2019Q4	2020Q1	2020Q2
<b>Croatia</b>	0.47	0.50	0.50	0.50	0.50	<b>Croatia</b>	0.30	0.30	0.30	0.30	0.30
<b>Czech Republic</b>	2.14	2.16	2.16	2.22	2.36	<b>Czech Republic</b>	2.00	2.00	2.00	2.00	2.25
<b>Hungary</b>	0.25	0.25	0.25	0.35	0.45	<b>Hungary</b>	0.90	0.90	0.90	0.90	0.90
<b>Poland</b>	1.72	1.72	1.72	1.72	1.72	<b>Poland</b>	1.50	1.50	1.50	1.50	1.50
<b>Romania</b>	3.09	3.40	3.40	3.30	3.30	<b>Romania</b>	2.50	2.50	2.50	2.50	2.50
<b>Serbia</b>	2.26	2.45	2.48	2.47	2.48	<b>Serbia</b>	2.50	2.50	2.50	2.50	2.50
<b>Eurozone</b>	-0.40	-0.40	-0.50	-0.50	-0.50	<b>Eurozone</b>	0.00	0.00	0.00	0.00	0.00

## Macro forecasts

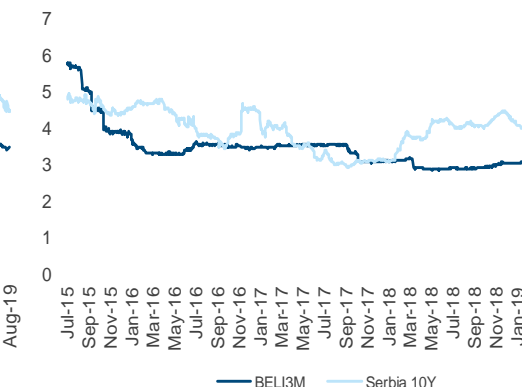
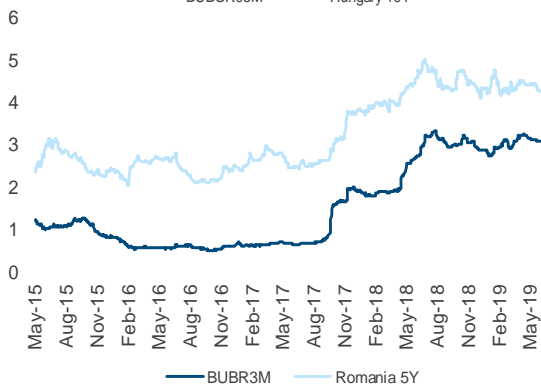
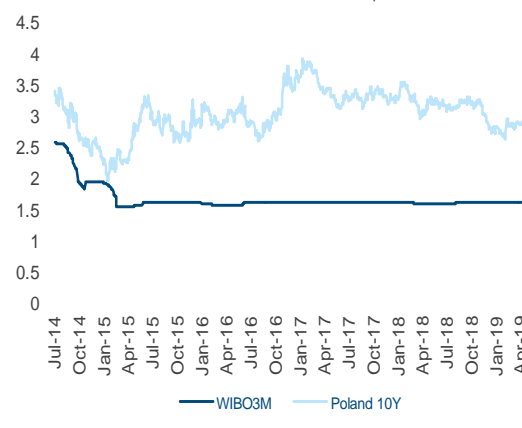
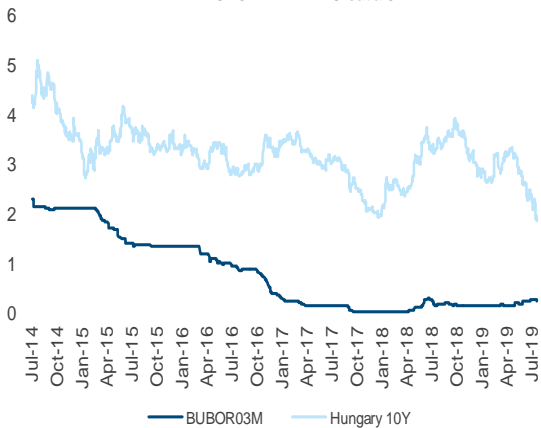
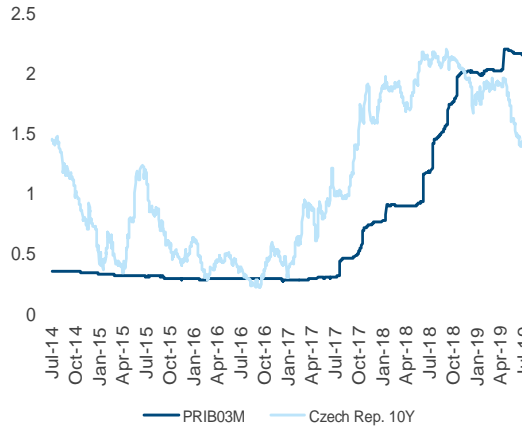
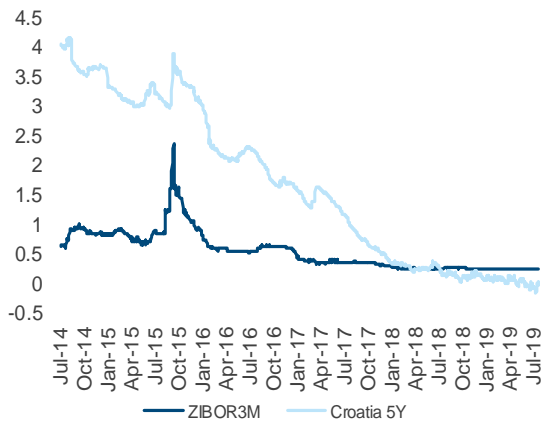
Real GDP growth (%)					Average inflation (%)					Unemployment (%)				
	2017	2018	2019f	2020f		2017	2018	2019f	2020f		2017	2018	2019f	2020f
Croatia	2.9	2.6	3.2	2.5	Croatia	1.1	1.5	1.0	1.3	Croatia	11.3	8.4	7.4	6.4
Czech Republic	4.5	2.9	2.6	2.8	Czech Republic	2.5	2.1	2.6	2.2	Czech Republic	2.9	2.3	3.0	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	3.5	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
<b>CEE8 average</b>	<b>4.7</b>	<b>4.4</b>	<b>4.1</b>	<b>3.5</b>	<b>CEE8 average</b>	<b>1.9</b>	<b>2.4</b>	<b>2.7</b>	<b>2.7</b>	<b>CEE8 average</b>	<b>6.3</b>	<b>5.2</b>	<b>5.0</b>	<b>5.2</b>

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
<b>CEE8 average</b>	<b>50.3</b>	<b>48.4</b>	<b>46.9</b>	<b>45.7</b>	<b>CEE8 average</b>	<b>0.2</b>	<b>-0.9</b>	<b>-1.0</b>	<b>-1.1</b>	<b>CEE8 average</b>	<b>-1.0</b>	<b>-0.7</b>	<b>-1.2</b>	<b>-1.1</b>

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

## Appendix



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

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