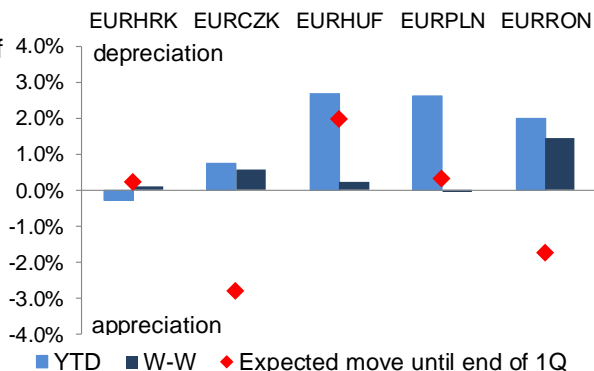




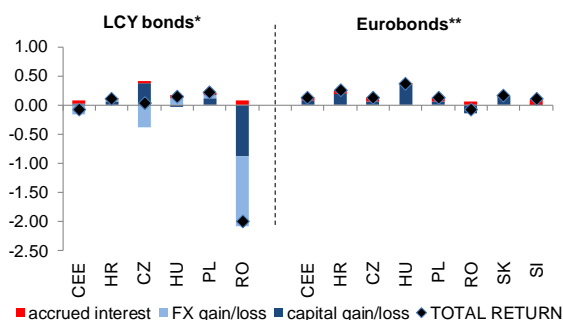
CEE Market Insights

Market outlook

Regional currencies mostly fell last week, although some of them were relatively stable, especially the zloty and forint. This was definitely not true for the Romanian leu, which, in a sudden fall, depreciated to all-time lows. In the absence of more policy clarity, the RON may fall even further. However, for the time being, we have not changed our year-end forecast for the EURRON, currently at 4.77. As for the CZK, which also fell slightly last week, we still see it appreciating in the upcoming months. However, if the CNB decides to somewhat change its hawkish approach, then the koruna could also be at weaker levels than our current forecast envisages.



Yields fell by a few basis points everywhere in CEE apart from Romania, where a yield increase of around 10-20bp was observable by Friday afternoon w/w on the whole curve. Short-term rates also inched higher in Romania, with the 3M ROBOR nearing 3% by Friday. A slight decline of Czech short-term rates was observable, alongside the mild decline of FRAs in Hungary.



Looking ahead this week:

| Monday | Tuesday | Wednesday | Thursday | Friday |
|---------|---------------------------------|------------------|---|--------------------------------------|
| SK: PPI | HU: Target Rate HR: Industry | HU: Unemployment | RO: Unemployment HU: PPI RS: GDP, Industry, Retail PL: GDP | HU, PL, CZ: PMI HU: Trade Balance |

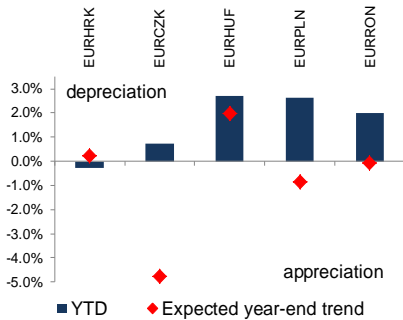
This week, the Hungarian central bank holds a meeting. While no change of policy rate is broadly expected, markets will likely be waiting for details on normalization of monetary policy, a commitment to which was recently expressed by the MNB. However, as inflation is expected to remain below the 3% target for most of the year, we would not rule out the MNB not yet starting to detail plans for normalization, and thus, we also keep our calls for a weaker HUF in place for now. Toward the end of the week, we will know the first estimate of the Serbian and Polish economic performances last year. In Serbia, the publication of 4Q18 growth at 3.4% would be consistent with the 4.2% growth for the whole year. In Poland, we will only see the FY18 figure, as the 4Q18 data is due mid-February. We believe that Poland's expansion pace was solid in 2018 and should arrive at 5.1%. In Croatia, industrial output for December will be published. In Serbia, the retail sales growth figure is also scheduled. The end of the week will bring market sentiment indicators for January. They are likely to set the tone for the beginning of the year, in particular whether the concerns about the strength of the growth in 2019 are grounded.

In case you missed it last week...

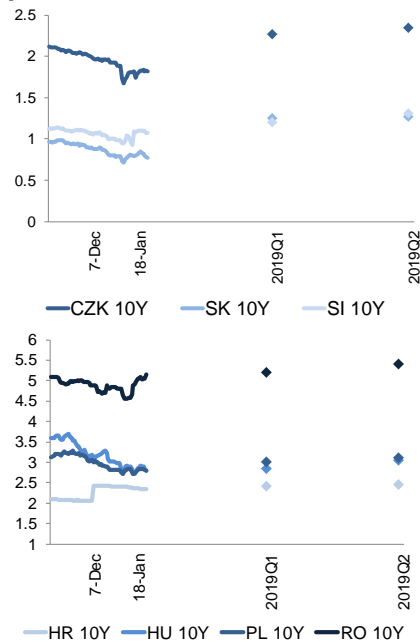
- SK: Fitch affirmed Slovakia's rating at A+ with stable outlook
- RO: Romanian leu weakened substantially last week and EURRON hit all-time low of 4.77
- SK: Slovakia sold 2028 bond price at yield of 0.83% and 2047 bond priced at yield of 1.88%
- PL: Disappointing retail sales growth (nominal at 4.9% y/y in December, real at 3.9%) suggests slowdown
- CZ: CNB Board Tomas Holub said that interest rate may not be increased at next couple of meetings

FX and bond market stable in CEE

YTD change on FX market



10Y government bond yields, percent



Source: Erste Group Research, Bloomberg.

On global markets:

At the ECB meeting last week, President Draghi acknowledged the increased downward risks to the economy. However, he said that the ECB might need some more time to assess the situation. At the next meeting in March new staff projections will be available. Should weaker growth momentum last longer, it would take longer for inflation to reach the monetary policy goal. However, as the markets have lowered their interest rate expectations, the resulting flattening of the yield curve has already provided an increasing degree of accommodation of monetary policy.

CEE currencies:

Regional currencies mostly fell last week, although some of them were relatively stable, especially the zloty and forint. This was definitely not true for the Romanian leu, which, in a sudden fall, depreciated to all-time lows, as the EURRON reached levels above 4.78 on Wednesday. The weakening is not a surprise if we note that the leu was relatively stable since last summer, when international woes hit regional peers, but the NBR was able to take care of the exchange rate until now. This is getting increasingly difficult, as payments in the new banking tax are tied to interbank rate levels, and thus, the NBR's ability to steer monetary conditions through setting the interest rate level is impaired. Therefore, options to alleviate pressure on the RON are also fewer. Simultaneous comments from the government in criticizing the NBR for keeping the ROBOR high and a reminder that the stability of the RON is the NBR's responsibility clearly illustrate that the central bank is between a rock and a hard place in deciding what to do. The current situation calls for more policy clarity in how exactly the government wants taxes to be paid and a credible plan for how to reassuringly keep the budget deficit under control. Some Romanian media sources indicate a possible policy meeting of key decision makers on February 4 that is hoped to bring more clarity, but the earlier that reassuring news comes, the better. In the absence of more clarity, the RON may fall even further. However, for the time being, we have not changed our year-end forecast for the EURRON, currently at 4.77. Apart from the leu, the Czech koruna also weakened, but to a lesser extent and in a much less stressful situation. Weakening of the CZK was triggered by central banker Holub, who said he would 'not advertise' a rate hike at the next meeting on February 7, as external growth risks, the low oil price and market expectations for a delayed policy normalization from the ECB lower the need for hikes. Although we still see the CZK appreciating, due to the high interest rate differential, if the CNB decides to somewhat change its approach (as suggested by Holub), then the koruna could also be at weaker levels than our current forecast envisages.

CEE rates and yields:

Yields fell by a few basis points everywhere in CEE apart from Romania, where a yield increase of around 10-20bp was observable by Friday afternoon w/w on the whole curve. The latter is tied to policy uncertainty; the new rules would make it costly for banks to add bonds to their balance sheets, as this would increase their taxes, while the new rules require pension funds (also large players on the bond market) to multiply their capital base by mid-year, threatening the very existence of the sector. Thus, demand for government securities is lowered. Short-term rates also inched higher in Romania, with the 3M ROBOR nearing 3% by Friday. A slight decline of Czech short-term rates was observable (courtesy of rate-setter Holub's comments, described above), alongside the mild decline of FRAs in Hungary.

Calendar

| Time | Country | Indicator | Period | Survey | Erste Est. | Prev. | Pre Comment |
|---------------|---------|-----------------------------|--------|--------|--------------|---------|--|
| 28-Jan | | | | | | | |
| 9:00 | SK | PPI (y/y) | Dec | | 5.2% | 5.8% | Some easing expected in inflationary pressures in production. |
| 29-Jan | | | | | | | |
| 11:00 | HR | Industrial Production (y/y) | Dec | | -0.4% | -0.8% | Industrial production decline expected to further moderate in December. |
| 14:00 | HU | Target Rate | Jan 29 | 0.9% | 0.90% | 0.9% | |
| 14:30 | SK | Current Account Balance | Nov | | | -204.34 | |
| 30-Jan | | | | | | | |
| 9:00 | HU | Unemployment Rate | Dec | 3.6% | | 3.6% | |
| 31-Jan | | | | | | | |
| | RO | Unemployment Rate | Dec | | | 3.31% | |
| 9:00 | HU | PPI (y/y) | Dec | | | 5.1% | |
| 10:00 | PL | GDP Annual (y/y) | 2018 | 5.0% | 5.1% | 4.8% | Given strong quarterly figures in 2018 (1-3Q), we expect annual growth to accelerate to above 5%. |
| 12:00 | RS | Industrial Production (y/y) | Dec | | 1.2% | -1% | We see sluggish growth as positive; manufacturing output offset by mining slump. |
| 12:00 | RS | Retail Sales (y/y) | Dec | | 4.5% | 6.1% | Strong growth as consumers front-loaded expected wage increases in 2019. |
| 12:00 | RS | Trade Balance | Dec | | -670 | -504.3 | Despite strong export dynamics, demand-driven imports still dominant. |
| 12:00 | RS | GDP (y/y) | 4Q P | | 3.40% | 3.8% | Private consumption and strong investments bode well for headline figure, while net exports contribution remains negative. |
| 1-Feb | | | | | | | |
| 9:00 | HU | Trade Balance | Nov F | | | 496 | |

Sources: Bloomberg, Reuters

Capital market forecasts

| Government bond yields | | | | | |
|------------------------|-------------|-------------|-------------|-------------|-------------|
| | current | 2019Q1 | 2019Q2 | 2019Q3 | 2019Q4 |
| Croatia 10Y | 2.34 | 2.40 | 2.45 | 2.50 | 2.60 |
| spread (bps) | 216 | 198 | 186 | 182 | 180 |
| Czech Rep. 10Y | 1.82 | 2.26 | 2.34 | 2.43 | 2.51 |
| spread (bps) | 164 | 184 | 175 | 175 | 171 |
| Hungary 10Y | 2.80 | 2.84 | 3.03 | 3.28 | 3.32 |
| spread (bps) | 261 | 242 | 244 | 260 | 252 |
| Poland 10Y | 2.79 | 3.00 | 3.10 | 3.15 | 3.20 |
| spread (bps) | 261 | 258 | 251 | 247 | 240 |
| Romania10Y | 5.16 | 5.20 | 5.40 | 5.40 | 5.40 |
| spread (bps) | 498 | 478 | 481 | 472 | 460 |
| Slovakia 10Y | 0.77 | 1.25 | 1.27 | 1.30 | 1.55 |
| spread (bps) | 59 | 83 | 68 | 62 | 75 |
| Slovenia 10Y | 1.07 | 1.20 | 1.30 | 1.40 | 1.50 |
| spread (bps) | 89 | 78 | 71 | 72 | 70 |
| Serbia 5Y | 3.36 | 3.60 | 3.60 | 3.65 | 3.70 |
| DE10Y (BBG)* | 0.18 | 0.42 | 0.59 | 0.68 | 0.80 |

| 3M Money Market Rate | | | | | |
|-----------------------|---------|--------|--------|--------|--------|
| | current | 2019Q1 | 2019Q2 | 2019Q3 | 2019Q4 |
| Croatia | 0.49 | 0.50 | 0.55 | 0.55 | 0.60 |
| Czech Republic | 2.00 | 1.92 | 1.97 | 2.11 | 2.19 |
| Hungary | 0.14 | 0.19 | 0.40 | 0.70 | 0.85 |
| Poland | 1.72 | 1.73 | 1.73 | 1.73 | 1.73 |
| Romania | 3.11 | 3.30 | 3.30 | 3.30 | 3.30 |
| Serbia | 3.10 | 3.07 | 3.07 | 3.07 | 3.32 |
| Eurozone | -0.31 | -0.30 | -0.30 | -0.10 | - |

| FX | | | | | |
|---------------|---------|--------|--------|--------|--------|
| | current | 2019Q1 | 2019Q2 | 2019Q3 | 2019Q4 |
| EURHRK | 7.43 | 7.45 | 7.30 | 7.42 | 7.45 |
| forwards | | 7.43 | 7.43 | 7.43 | 7.43 |
| EURCZK | 25.68 | 25.00 | 24.70 | 24.60 | 24.50 |
| forwards | | 25.71 | 25.71 | 25.71 | 25.71 |
| EURHUF | 318.3 | 325.0 | 325.0 | 325.0 | 325.0 |
| forwards | | 321.5 | 321.5 | 321.5 | 321.5 |
| EURPLN | 4.29 | 4.30 | 4.28 | 4.26 | 4.25 |
| forwards | | 4.29 | 4.29 | 4.29 | 4.29 |
| EURRON | 4.77 | 4.69 | 4.70 | 4.75 | 4.77 |
| forwards | | 4.77 | 4.77 | 4.77 | 4.77 |
| EURRSD | 118.5 | 118.5 | 118.5 | 118.5 | 119.0 |
| forwards | | - | - | - | - |
| EURUSD | 1.13 | 1.11 | 1.12 | 1.14 | - |

| Key Interest Rate | | | | | |
|-----------------------|---------|--------|--------|--------|--------|
| | current | 2019Q1 | 2019Q2 | 2019Q3 | 2019Q4 |
| Croatia | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| Czech Republic | 1.75 | 1.75 | 1.75 | 2.00 | 2.00 |
| Hungary | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 |
| Poland | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| Romania | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 |
| Serbia | 3.00 | 3.00 | 3.00 | 3.00 | 3.25 |
| Eurozone | 0.00 | 0.00 | 0.00 | 0.00 | - |

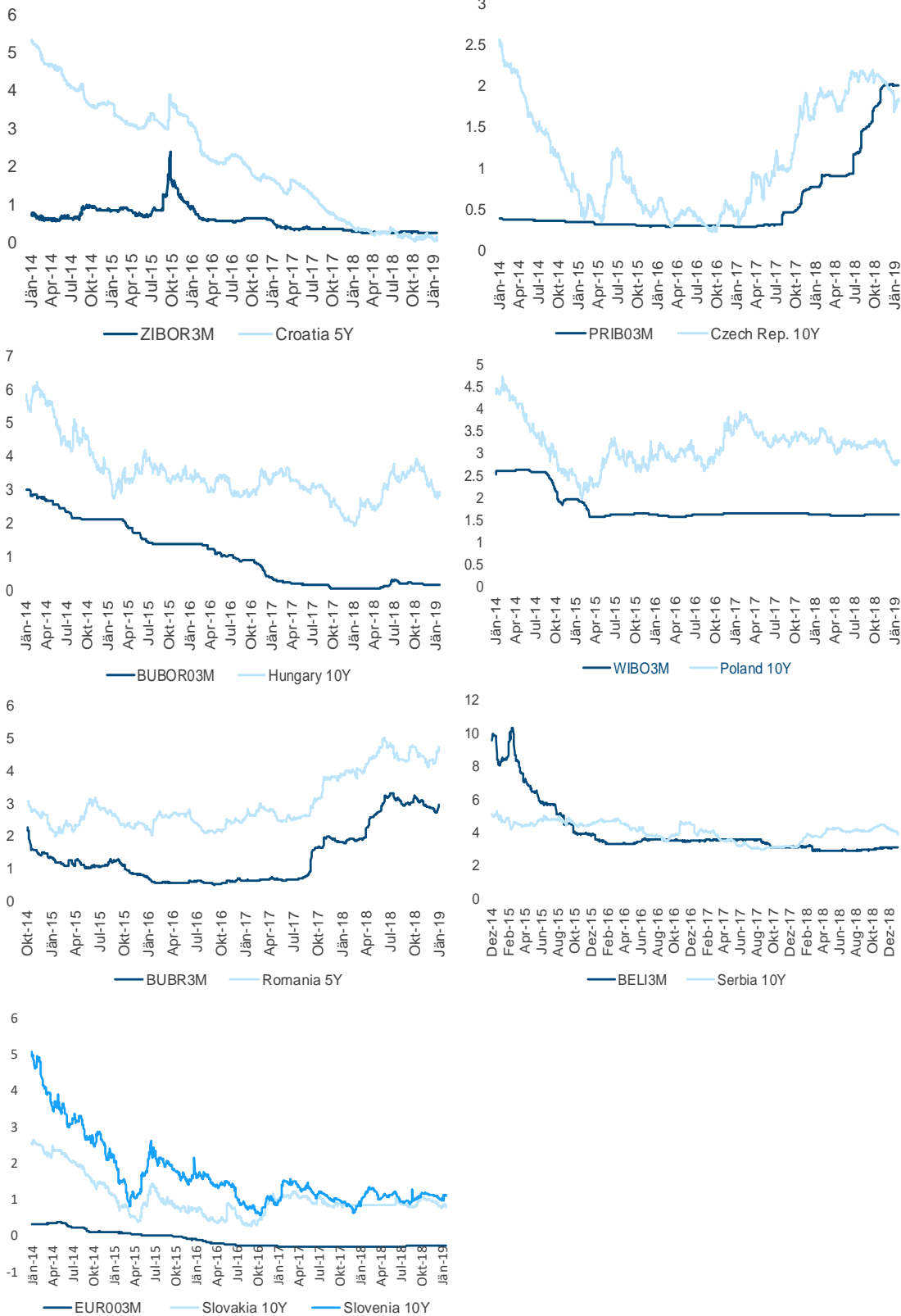
Macro forecasts

| Real GDP growth (%) | 2017 | 2018f | 2019f | 2020f | Average inflation (%) | 2017 | 2018f | 2019f | 2020f | Unemployment (%) | 2017 | 2018f | 2019f | 2020f |
|---------------------|------------|------------|------------|------------|-----------------------|------------|------------|------------|------------|---------------------|------------|------------|------------|------------|
| Croatia | 2.9 | 2.8 | 2.6 | 2.5 | Croatia | 1.1 | 1.5 | 1.0 | 1.5 | Croatia | 11.3 | 8.8 | 7.8 | 7.3 |
| Czech Republic | 4.5 | 3.0 | 3.0 | 2.9 | Czech Republic | 2.4 | 2.2 | 2.1 | 1.9 | Czech Republic | 2.4 | 2.3 | 2.6 | 3.1 |
| Hungary | 4.1 | 4.6 | 3.6 | 2.9 | Hungary | 2.4 | 2.8 | 2.8 | 3.1 | Hungary | 4.2 | 3.7 | 3.9 | 3.9 |
| Poland | 4.8 | 5.1 | 3.8 | 3.3 | Poland | 2.0 | 1.6 | 1.9 | 2.5 | Poland | 7.2 | 6.2 | 6.2 | 6.3 |
| Romania | 7.0 | 4.3 | 3.4 | 3.9 | Romania | 1.3 | 4.6 | 3.2 | 3.1 | Romania | 4.9 | 4.6 | 4.8 | 5.0 |
| Serbia | 2.0 | 4.2 | 3.3 | 2.8 | Serbia | 3.1 | 2.0 | 2.4 | 2.8 | Serbia | 14.1 | 13.0 | 12.0 | 10.4 |
| Slovakia | 3.2 | 4.3 | 4.3 | 3.6 | Slovakia | 1.3 | 2.6 | 2.5 | 2.5 | Slovakia | 8.1 | 6.7 | 6.2 | 5.7 |
| Slovenia | 4.9 | 4.4 | 3.6 | 3.3 | Slovenia | 1.4 | 1.8 | 2.1 | 2.2 | Slovenia | 6.6 | 5.5 | 4.9 | 4.7 |
| CEE8 average | 4.7 | 4.4 | 3.6 | 3.3 | CEE8 average | 1.9 | 2.4 | 2.3 | 2.5 | CEE8 average | 6.2 | 5.4 | 5.4 | 5.4 |

| Public debt (% of GDP) | 2017 | 2018f | 2019f | 2020f | C/A (%GDP) | 2017 | 2018f | 2019f | 2020f | Budget Balance (%GDP) | 2017 | 2018f | 2019f | 2020f |
|------------------------|-------------|-------------|-------------|-------------|---------------------|------------|-------------|-------------|-------------|-----------------------|-------------|-------------|-------------|-------------|
| Croatia | 77.5 | 73.9 | 71.1 | 68.6 | Croatia | 4.0 | 2.8 | 2.4 | 1.3 | Croatia | 0.8 | 0.2 | 0.0 | -0.5 |
| Czech Republic | 34.6 | 32.6 | 30.8 | 28.9 | Czech Republic | 1.1 | 0.7 | 0.6 | 0.4 | Czech Republic | 1.5 | 0.3 | 0.4 | 0.3 |
| Hungary | 73.3 | 71.8 | 69.0 | 67.0 | Hungary | 3.2 | 1.4 | 0.8 | 1.8 | Hungary | -2.2 | -2.0 | -1.8 | -1.8 |
| Poland | 50.6 | 49.9 | 49.8 | 48.7 | Poland | 0.2 | -0.4 | -0.5 | -0.7 | Poland | -1.7 | -0.4 | -1.4 | -1.5 |
| Romania | 35.0 | 35.2 | 35.8 | 35.8 | Romania | -3.2 | -3.8 | -4.1 | -4.0 | Romania | -2.9 | -3.3 | -3.0 | -2.5 |
| Serbia | 57.9 | 53.7 | 51.3 | 49.0 | Serbia | -5.2 | -6.6 | -6.7 | -7.2 | Serbia | 1.1 | 0.9 | -0.5 | -0.5 |
| Slovakia | 50.9 | 48.9 | 47.6 | 45.9 | Slovakia | -2.0 | -1.3 | -0.7 | 0.4 | Slovakia | -0.8 | -0.8 | -0.7 | -0.4 |
| Slovenia | 72.4 | 67.8 | 65.5 | 61.9 | Slovenia | 7.2 | 7.6 | 7.4 | 6.8 | Slovenia | 0.0 | 0.0 | 0.50 | 0.3 |
| CEE8 average | 50.2 | 48.8 | 47.8 | 46.3 | CEE8 average | 0.2 | -0.4 | -0.6 | -0.6 | CEE8 average | -1.1 | -0.9 | -1.2 | -1.2 |

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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28 January 2019

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