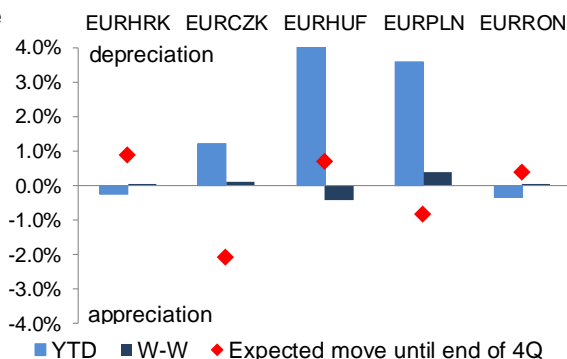


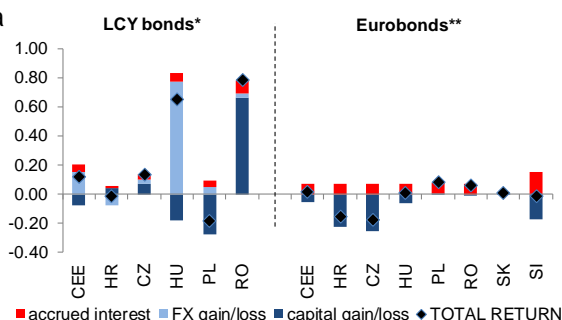
# CEE Market Insights

## Market outlook

The Czech koruna went to a 3-month low shortly before the CNB meeting on Thursday, provoking the central bank to deliver its fifth rate hike this year. We expect a strong rally on the EURCZK, given that the CNB showed a strong commitment to tighten monetary conditions. Any slippage in the currency appreciation will be complemented by higher rates. Given that we expect the EURCZK to slide below 25 in 1Q19, we keep only one rate hike in our baseline for 2019. However, if the koruna fails to appreciate, the CNB will hike three times, in our view.



The performance of CEE bonds was a mixed bag. Improvement in the sentiment of stock markets resulted in a narrowing of sovereign spreads in Euro Area periphery countries, but failed to bring 5Y and 10Y yields down in Hungary and Poland. On the other hand, Romanian 5Y bonds experienced a pretty decent rally (yields went down 15bp w/w), likely driven by local factors, as recently adopted macroprudential measures and the government's proposal for freezing wages in the public sector have reduced the urgency for rate hikes.



## Looking ahead this week:

Monday	Tuesday	Wednesday	Thursday	Friday
<b>CZ, RO:</b> Retail <b>HU:</b> Trade	<b>RO:</b> Target rate <b>CZ:</b> Industry, Trade	<b>PL:</b> Target rate <b>HU, SK:</b> Retail <b>RO:</b> Wages <b>SK:</b> Trade	<b>RS:</b> Target rate <b>HR:</b> Retail, Trade <b>HU:</b> Industry, CPI	<b>RO:</b> Trade <b>CZ:</b> CPI <b>SK, SI:</b> Industry, <b>SI:</b> Trade

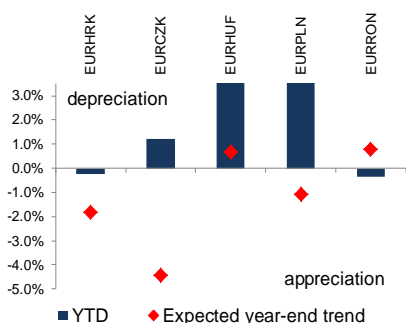
The Romanian central bank will hold its MPC meeting on Tuesday, the last meeting of the year. Our baseline is that the key rate will remain unchanged at 2.5%. The central bank has already introduced a wide array of macroprudential measures in order to tame the credit growth. We expect headline inflation to decline toward 4% by year-end, due to a base effect, while the core inflation stands at 2.7%, thus only slightly above the central point of the inflation target. If the government sticks to its proposal of freezing wages in the public sector submitted to the EC a couple of weeks ago, the central bank will get much more room for maneuver and will wait for its next rate hike until the ECB takes action or signals tightening. The Polish central bank will keep rates unchanged on Wednesday and likely reiterate that stability of rates throughout 2019 is the most likely scenario. We share this view, and both the latest core inflation and PMI data supports this scenario. The MPC meeting held will also be held in Serbia this week. The Serbian central bank should keep the key rate unchanged at 3% on Thursday. There will be plenty of monthly data published this week, mainly retail sales, industrial output and foreign trade balances. Also, October inflation will be released for the Czech Republic and Hungary, with annual inflation edging slightly down in the Czech Republic and up in Hungary.

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

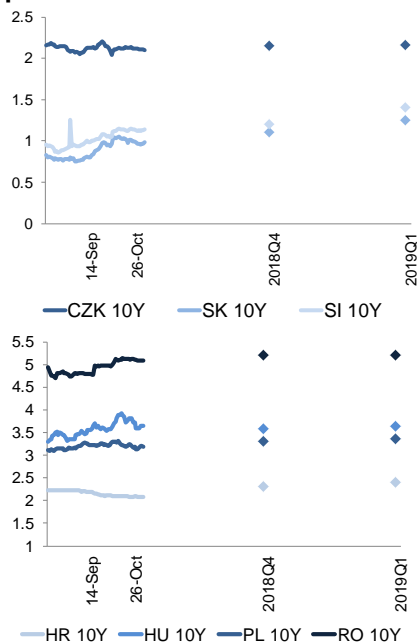
- CZ:** Czech National Bank increased main 2W repo rate by 25bp to 1.75%
- PL:** Flash CPI arrived at 1.7% y/y in October, deceleration compared to 1.9% y/y seen in September
- CEE:** PMIs edged down in October, but remained above 50 in Poland and Czech Republic
- RS:** GDP flash estimate shows that headline growth figure landed at 3.7% y/y in 3Q18

## 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:

On Tuesday, all seats in the House of Representatives and one-third of seats in the Senate will be awarded in the course of the mid-term elections. Currently, the Republicans hold the majorities in both chambers of the US Congress. The outcome is completely open. Current polls show several very tight races, making both a change in majorities as well as a continuation of the status quo possible.

The meeting of the Federal Open Market Committee (FOMC) this week has little potential for surprises. On Thursday, after the end of the meeting, an unchanged bandwidth for the key interest rate should be announced. However, at the same time, the committee will leave no doubt that the course of further gradual interest rate hikes will continue. In our view (and the markets'), the next rate hike in December is all but certain.

### CEE currencies:

The Czech koruna went to a 3-month low shortly before the CNB meeting on Thursday, provoking the central bank to deliver its fifth rate hike this year. According to the CNB's FX projection, the central bank sees the average EUR/CZK exchange rate at 24.7 and 24.2 in 2019 and 2020, respectively. At this moment, we expect the koruna to appreciate below the 25 mark in 1Q19, but any kind of slippage would likely trigger more than just the one rate hike penciled into our current forecasts. FX trading activity was rather low last week, due to many public holidays in the region. The Hungarian forint gained almost 1% vs. the euro in the second half of the week.

### CEE rates and yields:

If the koruna starts appreciating again, we expect the CNB to deliver only one additional hike in roughly the middle of next year, as the appreciating koruna should tighten monetary conditions sufficiently. This is the baseline scenario in our forecast. However, if the koruna remains weak during the next year, the CNB will hike three times, in our view. In 2020, the CNB will add two additional 25bp hikes.

## Calendar

Time	Country	Indicator	Period	Survey	Erste Est.	Prev.	Pre Comment
<b>5-Nov</b>							
8:00	RO	Retail Sales (y/y)	Sep		2.1%	1.7%	Fading impact of fiscal stimulus along with statistical effect related to very strong growth rates in 2017 currently affecting retail sales.
9:00	CZ	Retail Sales (y/y)	Sep		4.2%	2.5%	Growth in retail sales still driven by favorable development of labor market and positive sentiment of households.
9:00	HU	Trade Balance	Aug F			51	
<b>6-Nov</b>							
	RO	Target Rate	Nov	2.5%	2.5%	2.5%	Unchanged policy rate after NBR already took some measures to limit growth of retail lending in 2019.
	CZ	Trade Balance	Sep		15.8	14.5	Positive development of trade balance reflects continued strength of exports. However, strong exports being offset by rising import volumes and high oil prices.
9:00	CZ	Industrial Production (y/y)	Sep		1.8%	1.9%	Industrial production driven by both domestic and foreign demand. Acting in opposite direction are lack of workforce and high capacity utilization in numerous sectors.
<b>7-Nov</b>							
	PL	Target Rate	Nov	1.5%	1.5%	1.5%	We continue to see policy rate as stable at this meeting. New growth and inflation projection to be published.
8:00	RO	Wages (y/y)	Sep		12.8%	12.9%	Wages apparently losing some speed at present.
9:00	HU	Retail Sales (y/y)	Sep		6.0%	6.8%	Retail sales statistics reflect strong consumer consumption.
9:00	SK	Retail Sales (y/y)	Sep		4.2%	3.0%	Solid growth of retail sales expected, given supportive labor market and consumer sentiment development.
9:00	SK	Trade Balance	Sep		293	-81.7	After more volatile summer months, foreign trade dynamics should inch higher, albeit some effect of new testing standards in car sector may be felt.
12:00	RS	PPI (y/y)	Oct			2.6%	
<b>8-Nov</b>							
9:00	HU	Industrial Production (y/y)	Sep		5.1%	4.5%	
9:00	HU	CPI (y/y)	Oct	3.7%	3.7%	3.6%	Seasonal patterns and fuel price increases coupled with low base figures from last year imply further acceleration in yearly inflation rate. However, 12-month rate could slow down from November
11:00	HR	Retail Sales (y/y)	Sep F		3.8%	3.1%	Consumption expected to maintain positive trends, with retail trade growth additionally accelerating in September.
11:00	HR	Trade Balance	Aug		-5129	-6241.1	Both exports and imports keeping up vivid double-digit growth pace.
12:00	RS	Target Rate	Nov		3%	3.0%	NBS expected to remain on hold, as inflation still moving closer to lower bound of target interval.
<b>9-Nov</b>							
8:00	RO	Trade Balance	Sep		-1.1	-1393.2	Expansionary fiscal policy led to widening of trade deficit for goods.
9:00	SK	Industrial Production (y/y)	Sep		2.5%	2.2%	Good growth in industrial production should continue, albeit small impact of new testing standards in car sector possible in September (mostly due to Germany).
9:00	CZ	CPI (y/y)	Oct		2.2%	2.3%	Tight labor market and strong domestic demand constitute most important pro-inflationary factors. Main anti-inflationary factor is sound productivity growth.
9:00	SK	Wages (y/y)	Sep			4.7%	
10:30	SI	Industrial Production (y/y)	Sep		5.2%	0.1	Industrial production seen as maintaining strong growth trends in September.
10:30	SI	Trade Balance	Sep		250	0.04	Trade balance showing steady developments, with both exports and imports maintaining steady growth dynamics.
11:00	HR	PPI (y/y)	Oct			3.40%	

Sources:

Bloomberg, Reuters

## Capital market forecasts

Government bond yields					
	current	2018Q4	2019Q1	2019Q2	2019Q3
<b>Croatia 10Y</b>	2.08	2.30	2.40	2.40	2.50
spread (bps)	165	168	166	153	153
<b>Czech Rep. 10Y</b>	2.10	2.15	2.16	2.20	2.26
spread (bps)	167	153	142	133	129
<b>Hungary 10Y</b>	3.65	3.58	3.63	3.73	3.75
spread (bps)	322	296	289	286	278
<b>Poland 10Y</b>	3.19	3.30	3.35	3.40	3.50
spread (bps)	276	268	261	253	253
<b>Romania10Y</b>	5.08	5.20	5.20	5.40	5.40
spread (bps)	465	458	446	453	443
<b>Slovakia 10Y</b>	0.98	1.10	1.25	1.27	1.30
spread (bps)	55	48	51	40	33
<b>Slovenia 10Y</b>	1.14	1.20	1.40	1.50	1.50
spread (bps)	71	58	66	63	53
<b>Serbia 5Y</b>	3.50	3.90	3.95	3.95	4.00
<b>DE10Y (BBG)*</b>	<b>0.43</b>	<b>0.62</b>	<b>0.74</b>	<b>0.87</b>	<b>0.97</b>

3M Money Market Rate					
	current	2018Q4	2019Q1	2019Q2	2019Q3
<b>Croatia</b>	0.49	0.50	0.50	0.60	0.70
<b>Czech Republic</b>	1.96	1.91	1.92	1.97	2.11
<b>Hungary</b>	0.16	0.20	0.45	0.55	0.75
<b>Poland</b>	1.72	1.73	1.73	1.73	1.73
<b>Romania</b>	3.29	2.80	3.10	3.30	3.30
<b>Serbia</b>	2.98	2.95	2.95	3.05	3.20
<b>Eurozone</b>	-0.32	-0.30	-0.30	-0.30	-0.10

FX					
	current	2018Q4	2019Q1	2019Q2	2019Q3
<b>EURHRK</b>	7.44	7.50	7.45	7.30	7.45
forwards		7.44	7.44	7.44	7.44
<b>EURCZK</b>	25.81	25.30	24.85	24.70	24.60
forwards		25.83	25.83	25.83	25.83
<b>EURHUF</b>	321.8	325.0	325.0	325.0	325.0
forwards		325.0	325.1	325.1	325.1
<b>EURPLN</b>	4.32	4.29	4.30	4.28	4.26
forwards		4.32	4.32	4.32	4.32
<b>EURRON</b>	4.66	4.68	4.69	4.70	4.75
forwards		4.66	4.66	4.66	4.66
<b>EURRSD</b>	118.3	118.5	118.5	118.5	118.5
forwards		-	-	-	-
<b>EURUSD</b>	1.14	1.13	1.15	1.16	1.18

Key Interest Rate					
	current	2018Q4	2019Q1	2019Q2	2019Q3
<b>Croatia</b>	0.30	0.30	0.30	0.30	0.30
<b>Czech Republic</b>	1.75	1.75	1.75	1.75	2.00
<b>Hungary</b>	0.90	0.90	0.90	0.90	0.90
<b>Poland</b>	1.50	1.50	1.50	1.50	1.50
<b>Romania</b>	2.50	2.50	2.75	3.00	3.00
<b>Serbia</b>	3.00	3.00	3.00	3.00	3.00
<b>Eurozone</b>	0.00	0.00	0.00	0.00	0.00

## Macro forecasts

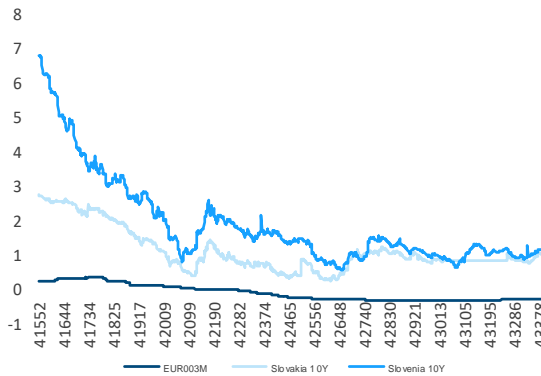
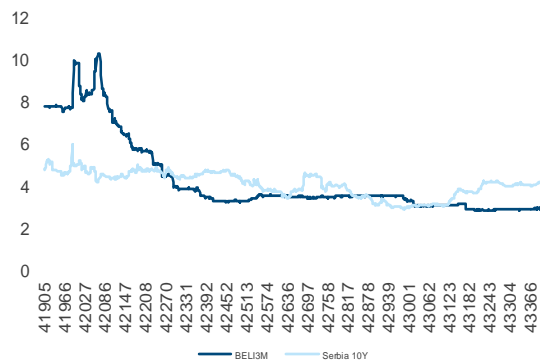
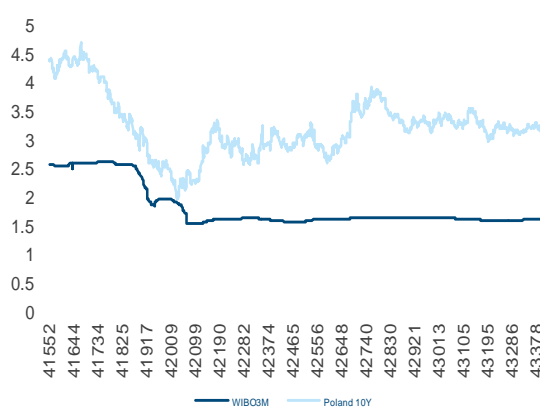
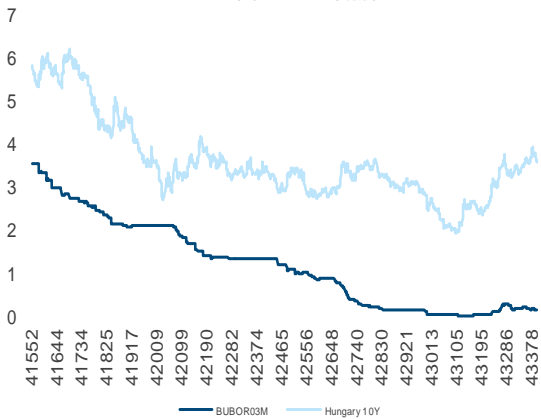
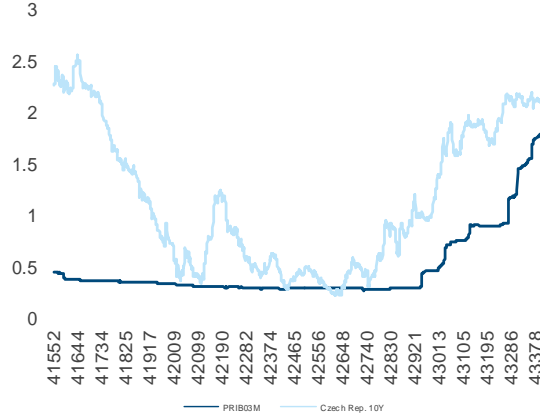
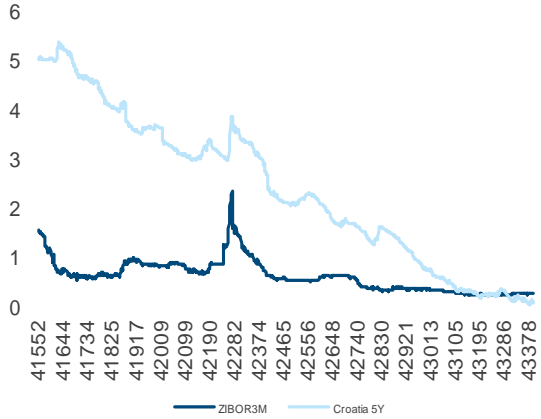
Real GDP growth (%)	2017	2018f	2019f	2020f	Average inflation (%)	2017	2018f	2019f	2020f	Unemployment (%)	2017	2018f	2019f	2020f
Croatia	2.9	2.8	2.7	2.6	Croatia	1.1	1.7	1.8	2.0	Croatia	11.3	9.6	8.7	8.1
Czech Republic	4.5	3.5	3.0	2.9	Czech Republic	2.4	2.3	2.1	1.9	Czech Republic	2.4	2.4	2.8	3.2
Hungary	4.1	4.3	3.5	2.8	Hungary	2.4	2.9	3.3	3.1	Hungary	4.2	3.7	3.9	3.9
Poland	4.6	4.9	3.8	3.4	Poland	2.0	1.7	2.0	2.4	Poland	7.2	6.4	6.2	6.0
Romania	7.3	3.8	3.4	3.9	Romania	1.3	4.7	3.3	2.9	Romania	4.9	4.6	4.8	5.0
Serbia	1.9	4.3	3.7	3.4	Serbia	3.0	2.0	2.4	3.2	Serbia	13.2	12.7	11.7	10.2
Slovakia	3.2	3.9	4.2	3.6	Slovakia	1.3	2.6	2.5	2.5	Slovakia	8.1	6.8	6.3	5.8
Slovenia	4.9	4.2	3.8	3.3	Slovenia	1.4	1.7	1.9	2.2	Slovenia	6.6	5.5	4.9	4.7
<b>CEE8 average</b>	<b>4.7</b>	<b>4.2</b>	<b>3.6</b>	<b>3.3</b>	<b>CEE8 average</b>	<b>1.9</b>	<b>2.5</b>	<b>2.4</b>	<b>2.5</b>	<b>CEE8 average</b>	<b>6.2</b>	<b>5.5</b>	<b>5.4</b>	<b>5.3</b>

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	71.0	68.2	Croatia	3.9	2.7	1.9	1.0	Croatia	0.8	0.0	-0.5	-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	73.6	72.8	70.9	69.0	Hungary	3.2	1.9	1.4	1.2	Hungary	-2.0	-2.3	-2.3	-2.5
Poland	50.6	50.4	50.5	49.7	Poland	0.2	-0.1	-0.4	-0.7	Poland	-1.7	-1.5	-1.9	-2.1
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	61.3	54.8	52.0	49.3	Serbia	-5.6	-5.2	-4.8	-4.4	Serbia	1.2	0.5	-0.5	-0.5
Slovakia	50.9	49.0	47.8	46.1	Slovakia	-2.1	-1.2	-0.5	0.4	Slovakia	-0.8	-0.8	-0.7	-0.4
Slovenia	72.4	69.2	66.6	63.3	Slovenia	7.2	7.9	7.6	6.9	Slovenia	0.0	0.0	0.0	0.0
<b>CEE8 average</b>	<b>50.3</b>	<b>49.1</b>	<b>48.3</b>	<b>46.9</b>	<b>CEE8 average</b>	<b>0.2</b>	<b>-0.2</b>	<b>-0.4</b>	<b>-0.5</b>	<b>CEE8 average</b>	<b>-1.1</b>	<b>-1.3</b>	<b>-1.5</b>	<b>-1.5</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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