

Central bank to keep rates stable

Stability of rates broadly expected. Central bank to publish new growth and inflation projection. Disappointing PMI reading for October puts into question economic growth in quarters to come. 2Y yield reacted sharply to weaker PMI and inflation.

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Watch this week

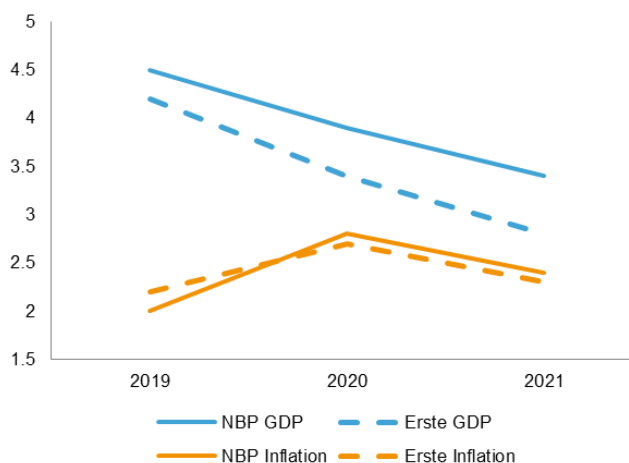
November 4 | PMI dissapoints in October

The PMI arrived at 45.6 in October, marking the strongest downturn in manufacturing since mid-2009. Although the PMI has not been the best gauge of GDP growth, October's reading suggests a rather pessimistic outlook for the quarters to come and the scale of the slowdown could be bigger than previously anticipated. Moreover, the expectations for production (12-month outlook) are the weakest since the series began in 2012. We keep our call for 3Q19 GDP growth at 4.0% y/y (due next week) but a slide below 4% cannot be ruled out.

November 6 | Central bank to stay dovish

The MPC meeting should bring no surprises, as it is broadly expected that rates will remain stable. Moreover, the basic findings of the new inflation and growth projection will be presented. We are less optimistic than the National Bank and thus expect to see a downward revision of the growth projection. The inflation path will depend on assumptions regarding next year's energy prices development.

National Bank of Poland more optimistic on growth



Source: NBP, Erste Group Research

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Note: Past performance is not necessarily indicative of future results.

Last week's highlights

- Flash inflation arrived at 2.5% y/y (0.2% m/m) in October.

Market developments

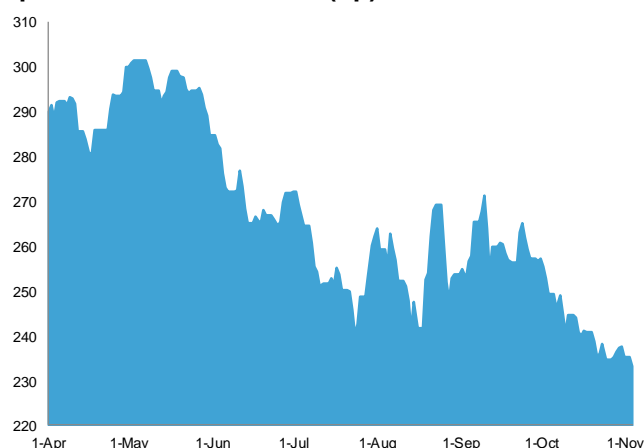
Bond market drivers | 2Y yield reacts to lower inflation and PMI

Last week, development on the short end of the curve was more interesting, with the 2Y yield going down by almost 10bp. Low flash inflation and the weak PMI reading for October (released today in the morning) put downward pressure on the 2Y yield, reflecting the gloomier outlook. Despite this, FRAs hold steady, pointing to stable monetary policy in the months to come. On the long end, the 10Y yield went down by around 5bp during the week closely following German Bund development. The spread over the 10Y Bund narrowed further and holds below 235bp. The central bank meeting should be a non-event for the markets, as stability of rates is broadly expected. The yield curve might get some direction from the new inflation and growth projection, especially in light of the weak PMI reading. As far as global markets are concerned, there is no major macro news this week.

FX market drivers | Zloty returns to downward trend

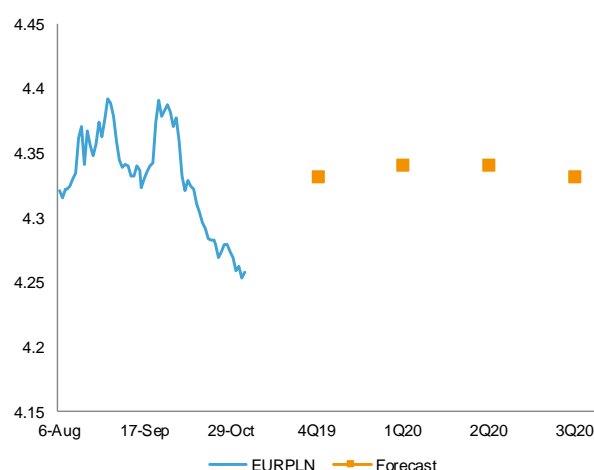
After short-lived stabilization, the EURPLN returned to its downward move as the zloty appreciated by almost 0.6% against the EUR over the course of the week. Despite lower liquidity at the end of the week (due to the public holiday), the zloty benefited from global risk-on mode and strengthened further. We see the recent strong appreciation of the zloty as a market overreaction and there is likely not much space for further strengthening. This week, the EURUSD will likely get its direction from last week's important US releases, namely the labor market report and the ISM index.

Spread vs. German Bund (bp)



Source: Bloomberg, Erste Group Research

EURPLN



Source: Bloomberg, Erste Group Research

Upcoming in CEE

Date	Time	Country	Indicator	Period	Survey	Erste Est.	Prev.	Comment
05.Nov			No releases scheduled					
06.Nov		CZ	Trade Balance	Sep		12.5	32.21	Despite low growth in the Euro Area, foreign demand is still relatively sound, which in turn has been affecting trade balance.
		PL	Target Rate	Nov	1.5%	1.5%	1.5%	Policy rate to remain flat.
		RO	Target Rate	Nov		2.5%	2.5%	Flat monetary policy rate as the NBR is trying to balance domestic inflationary pressures with the ECB's dovish stance.
	8:00	RO	Retail Sales (y/y)	Sep		7.1%	8%	Higher pensions in September (+15%) and improving consumer sentiment according to EC's survey.
	9:00	CZ	Industrial Production (y/y)	Sep	4.5%	4.5%	-3.8%	In September, industrial production was significantly affected by calendar effect. After adjustment for different number of working days, we expect industrial output to be slightly negative in y/y terms, mainly due to weak German data.
	9:00	HU	Retail Sales (y/y)	Sep		6.1%	5.8%	The base effect from last year and still strong consumer confidence indicators imply high retail sales figures for September.
	9:00	SK	Retail Sales (y/y)	Sep		0.0%	-2.9%	After a disappointing few months (despite the good labour market situation), retail sales development could have stabilised in September.
07.Nov	8:00	RO	Wages (y/y)	Sep		14.0%	14.05%	Wages in private sector increased faster than those in public area in recent months as government's loose income policy is nearing an end.
	9:00	CZ	Retail Sales (y/y)	Sep	6.6%	7.3%	1.4%	Due to sound labor market, growth of retail sales is still relatively high. Moreover, the September figure will be positively influenced by higher number of working days.
	12:00	RS	PPI (y/y)	Oct			-0.1%	
	12:00	RS	Target Rate	Nov			2.5%	
	13:00	CZ	Target Rate	Nov	2.0%	2.0%	2.0%	Due to gradual weakening of inflation and risks in the world economy, we expect the CNB to keep rates stable in November. During the meeting, Czech central bankers will discuss pros and cons of two scenarios (stability or a hike).
08.Nov	9:00	HU	Industrial Production (y/y)	Sep		2.5%	2.7%	Business confidence indicators are pointing towards further slowdown in the industrial performance
	9:00	HU	CPI (y/y)	Oct		2.8%	2.8%	The headline CPI rate might have remained flat in October, before another rising expected for November and December.
	9:00	HU	CPI (m/m)	Oct		0.5%	0.1%	The relatively high monthly index could mainly be explained by fuel price increase.
	9:00	SK	Trade Balance	Sep		100	-212.03	Foreign trade balance should inch up after a more volatile summer but a major improvement will be hindered by clouded external environment.
	10:30	SI	Industrial Production (y/y)	Sep		2.5%	0.8%	Industrial production growth, following mild increase in August, expected to slightly accelerate in September
	10:30	SI	Trade Balance	Sep			0.02	
	11:00	HR	PPI (y/y)	Oct			-0.4%	
	11:00	HR	Trade Balance	Aug			-4822.6	

Source: Bloomberg, Erste Group Research

Market forecasts

Government bond yields

	current	2019Q4	2020Q1	2020Q2	2020Q3
Croatia 10Y	0.5	0.4	0.4	0.4	0.4
spread (bps)	85	80	70	60	60
Czechia 10Y	1.4	1.5	1.6	1.7	1.7
spread (bps)	173	188	190	188	194
Hungary 10Y	1.9	2.1	2.2	2.2	2.2
spread (bps)	229	249	245	241	245
Poland 10Y	2.0	2.0	2.0	2.1	2.1
spread (bps)	232	235	230	225	225
Romania10Y	4.2	4.4	4.5	4.5	4.6
spread (bps)	455	480	480	470	480
Slovakia 10Y	0.1	-0.1	0.1	0.1	0.2
spread (bps)	44	35	35	30	40
Slovenia 10Y	0.09	0.00	0.00	0.00	0.00
spread (bps)	47	40	30	20	20
Serbia 5Y	2.7	3.0	2.9	2.7	2.5
spread (bps)	303	340	320	290	270
DE10Y	-0.4	-0.4	-0.3	-0.2	-0.2

3M Money Market Rate

	current	2019Q4	2020Q1	2020Q2	2020Q3
Croatia	0.42	0.50	0.50	0.50	0.50
Czechia	2.18	2.13	2.12	2.12	2.12
Hungary	0.20	0.21	0.22	0.25	0.25
Poland	1.71	1.72	1.72	1.72	1.72
Romania	2.99	3.00	2.90	2.90	3.20
Serbia	1.97	1.90	1.90	1.80	1.70
Eurozone	-0.40	-0.40	-0.40	-0.40	-0.40

Source: Bloomberg, Erste Group Research

FX

	current	2019Q4	2020Q1	2020Q2	2020Q3
EURHRK	7.45	7.42	7.42	7.38	7.40
forwards		7.45	7.45	7.45	7.45
EURCZK	25.51	25.50	25.34	25.04	24.86
forwards		25.58	25.72	25.87	26.01
EURHUF	328.30	334.00	335.00	335.00	335.00
forwards		328.56	328.96	329.47	330.03
EURPLN	4.26	4.33	4.34	4.34	4.33
forwards		4.27	4.30	4.32	4.34
EURRON	4.75	4.77	4.79	4.82	4.85
forwards		4.78	4.82	4.86	4.90
EURRSD	117.50	118.00	118.00	117.70	117.70
forwards		-	-	-	-
EURUSD	1.12	1.13	1.15	1.15	1.15

Key Interest Rate

	current	2019Q4	2020Q1	2020Q2	2020Q3
Croatia	0.3	0.3	0.3	0.3	0.3
Czechia	2.0	2.0	2.0	2.0	2.0
Hungary	0.9	0.9	0.9	0.9	0.9
Poland	1.5	1.5	1.5	1.5	1.5
Romania	2.5	2.5	2.5	2.5	2.5
Serbia	2.5	2.5	2.5	2.5	2.5
Eurozone	0.0	0.0	0.0	0.0	0.0

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