

## Central bank to keep rates stable, but...

...situation recently became tricky, with surging inflation and markets pricing in rate cuts due to spread of COVID-19 in Europe. Markets to follow global news regarding virus developments. Further drops of yields and FRAs cannot be ruled out.

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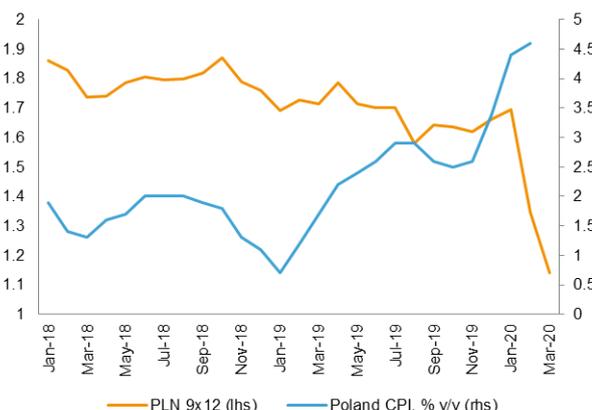
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### Watch this week

#### March 4 | Central bank to keep rates stable

We expect the National Bank of Poland to keep rates unchanged at 1.5%. In light of the COVID-19 outbreak and increasing market uncertainty, inflation development and rate expectations decoupled from each other. Inflation surged to 4.4% y/y in January and is expected to remain above the upper bound of the inflation target for the most of 2020. Polish forward rates, however, dropped strongly in recent days, reflecting the rising uncertainty and pricing in expectations for a 50bp cut within a one-year horizon. We think that the central bank will not decide to cut rates, as such a decision could harm its credibility given inflation development. We also believe that the motion to hike is unlikely to gather a majority. The MPC will also present the main findings of the new inflation and growth projection. We expect the inflation path to be increased from the 2.8% expected in November, while growth expectations might be cut from the 3.4% anticipated in 2019.

#### Market expectations and inflation decoupled in Poland



Source: Bloomberg, Erste Group Research

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

### Last week's highlights

- Final [4Q19 GDP growth landed at 3.2% y/y](#). Domestic demand remained key driver and added 2.1pp to headline number. Net exports remained shining star of growth in 2H19 and contributed impressive 1.1pp.
- February PMI arrived at 48.2, slightly above market expectations.
- MPC member Zubelewicz (hawkish) said in interview that possible rate hike should take place as soon as possible. In his view, appropriate target rate level would be 2% to ensure "long-term stability of Polish money".

## Market developments

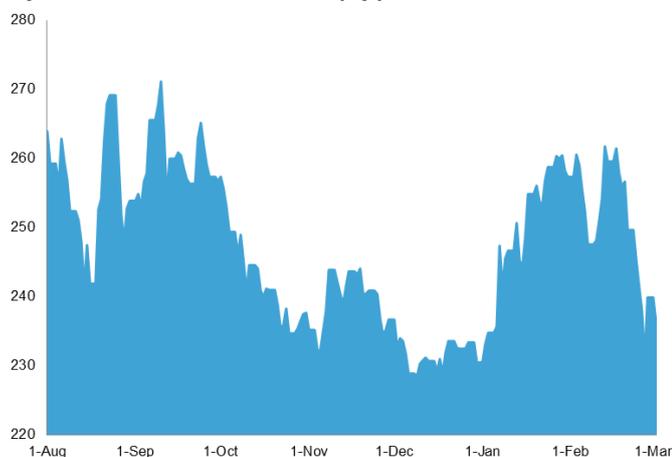
### Bond market drivers | Market in panic due to COVID-19

Global markets turned into full panic mode on the back of news surrounding the spread of COVID-19 outside of China. Poland followed core market development and recorded substantial drops along the whole yield curve. Over the course of the week, the 2Y yield dropped by 10bp, 5Y by almost 15bp, while the 10Y LCY yield decreased by 20bp. The latter bottomed out on Friday morning at 1.65%, which is the lowest level in history. As a result, the spread over 10Y German Bund narrowed to 240bp. Monday morning brought further decreases, especially on the short end of the curve, with the 2Y dropping by an additional 15bp. Market expectations have changed significantly in recent days and 9x12 FRAs suggest a 50bp cut in Poland within one year. We think that this is an overreaction and we do not expect the central bank to change rates at the upcoming meeting. If the pessimistic news regarding the spread of COVID-19 and its potential impact on the global economy continues to flow, we could see further drops in yields and rates in Poland. The press conference of the central bank will likely gather market attention due to the significant change in expectations of future inflation and growth path.

### FX market drivers | EURPLN follows market fears

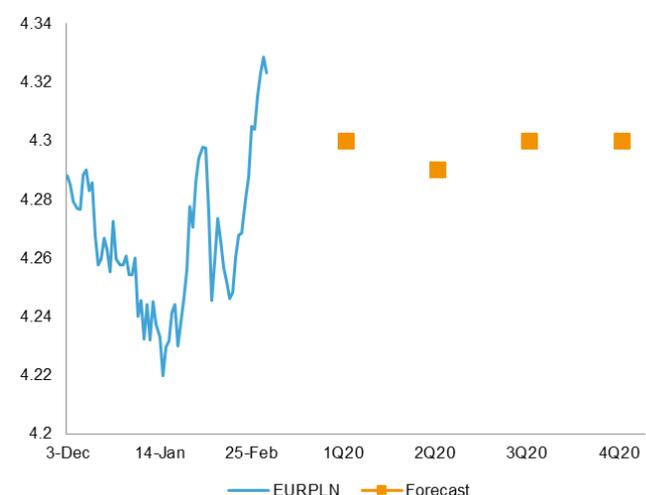
The outflow of investors from more risky assets took its toll on the zloty and it depreciated to above 4.32 vs. EUR. We think that the FX market will focus on the COVID-19 news and we could see some further weakening of the zloty this week.

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   |
|---------|-------|---------|-----------------------------|--------|--------|---------------|--------|---|
| 03. Mar |       | RO      | Unemployment Rate           | Jan    |        |               | 2.97%  |   |
|         | 8:00  | RO      | PPI (y/y)                   | Jan    |        |               | 3.9%   |   |
|         | 9:00  | CZ      | GDP (y/y)                   | 4Q P   | 1.7%   |               | 1.7%   | Structure of growth to be published.  |
|         | 9:00  | HU      | PPI (y/y)                   | Jan    |        |               | 2.4%   |   |
|         | 9:00  | HU      | Trade Balance               | Dec F  |        |               | 134.21 |   |
| 04. Mar |       | PL      | Central Bank Rate           | Mar    | 1.5%   | <b>1.5%</b>   | 1.5%   | Despite surging inflation and increasing market expectations for rate cut, we expect central bank to keep rates unchanged.              |
|         | 8:00  | RO      | Retail Sales (y/y)          | Jan    |        | <b>7.0%</b>   | 8.3%   | Strong retail sales helped by rising wages and gradual decline in inflation rate.   |
|         | 9:00  | HU      | Retail Sales (y/y)          | Jan    | 5.9%   | <b>6.2%</b>   | 6.1%   | Retail sales might have preserved strong momentum at beginning of year.   |
|         | 9:00  | SK      | Retail Sales (y/y)          | Jan    |        | <b>-2.7%</b>  | -2.5%  | Despite still favourable labour market situation, retail sales growth is likely to have remained subdued.                               |
| 06. Mar | 9:00  | CZ      | Wages (y/y)                 | 4Q     | 3.4%   | <b>3.90%</b>  | 4.0%   | High demand for new available employees and their low supply are main factors behind low unemployment rate and high wage growth.        |
|         | 9:00  | HU      | Industrial Production (y/y) | Jan    | -0.6%  | <b>-1.20%</b> | -3.7%  | On monthly level, small rebound expected; however, yearly index might have remained in negative territory.                              |
|         | 9:00  | SK      | GDP (y/y)                   | 4Q F   | 2.1%   | <b>2.10%</b>  | 2.1%   | We expect domestic demand as the main driver of GDP growth, with a small contribution of net exports.                                   |
|         | 11:00 | HR      | Industrial Production (y/y) | Jan    |        | <b>-2.20%</b> | -2.2%  | Industrial production expected to maintain negative footprint seen in recent months, with base effect also weighing on headline figure. |
|         | 12:00 | RS      | PPI (y/y)                   | Feb    |        |               | 1%     |   |

Source: Bloomberg, Erste Group Research

## Market forecasts

### Government bond yields

|                     | current | 2020Q2 | 2020Q3 | 2020Q4 | 2021Q1 |
|---------------------|---------|--------|--------|--------|--------|
| <b>Croatia 10Y</b>  | 0.6     | 0.5    | 0.5    | 0.5    | -      |
| spread (bps)        | 122     | 80     | 60     | 60     | -      |
| <b>Czechia 10Y</b>  | 1.2     | 1.7    | 1.7    | 1.8    | 1.9    |
| spread (bps)        | 182     | 199    | 184    | 187    | 188    |
| <b>Hungary 10Y</b>  | 2.1     | 2.2    | 2.3    | 2.4    | 2.5    |
| spread (bps)        | 274     | 251    | 235    | 246    | 254    |
| <b>Poland 10Y</b>   | 1.7     | 1.9    | 2.0    | 2.0    | 2.1    |
| spread (bps)        | 235     | 220    | 205    | 210    | 205    |
| <b>Romania 10Y</b>  | 4.0     | 4.0    | 4.1    | 4.1    | 4.1    |
| spread (bps)        | 465     | 432    | 416    | 418    | 407    |
| <b>Slovakia 10Y</b> | -0.1    | 0.2    | 0.3    | 0.4    | -      |
| spread (bps)        | 52      | 47     | 37     | 47     | -      |
| <b>Slovenia 10Y</b> | -0.05   | 0.30   | 0.30   | 0.30   | 0.40   |
| spread (bps)        | 59      | 60     | 40     | 40     | 40     |
| <b>Serbia 5Y</b>    | 2.4     | 2.3    | 2.2    | 2.1    | 2.1    |
| spread (bps)        | 300     | 260    | 230    | 220    | 210    |
| <b>DE10Y</b>        | -0.6    | -0.3   | -0.1   | -0.1   | 0.0    |

### 3M Money Market Rate

|                 | current | 2020Q2 | 2020Q3 | 2020Q4 | 2021Q1 |
|-----------------|---------|--------|--------|--------|--------|
| <b>Czechia</b>  | 2.37    | 2.29   | 2.30   | 2.30   | 2.30   |
| <b>Hungary</b>  | 0.63    | 0.75   | 0.80   | 0.85   | 0.85   |
| <b>Poland</b>   | 1.71    | 1.71   | 1.71   | 1.71   | 1.71   |
| <b>Romania</b>  | 2.94    | 2.90   | 3.10   | 3.00   | 3.00   |
| <b>Serbia</b>   | 1.62    | 1.37   | 1.37   | 1.12   | 1.12   |
| <b>Eurozone</b> | -0.43   | -0.40  | -0.40  | -0.40  | -      |

Source: Bloomberg, Erste Group Research

### FX

|               | current | 2020Q2 | 2020Q3 | 2020Q4 | 2021Q1 |
|---------------|---------|--------|--------|--------|--------|
| <b>EURHRK</b> | 7.48    | 7.40   | 7.42   | 7.45   | 7.42   |
| forwards      |         | 7.48   | 7.48   | 7.48   | 7.48   |
| <b>EURCZK</b> | 25.48   | 24.85  | 24.74  | 24.60  | 24.54  |
| forwards      |         | 25.69  | 25.83  | 25.95  | 26.05  |
| <b>EURHUF</b> | 337.75  | 335.00 | 335.00 | 335.00 | 335.00 |
| forwards      |         | 339.20 | 340.39 | 341.57 | 342.67 |
| <b>EURPLN</b> | 4.32    | 4.29   | 4.30   | 4.30   | 4.31   |
| forwards      |         | 4.35   | 4.37   | 4.39   | 4.41   |
| <b>EURRON</b> | 4.81    | 4.82   | 4.85   | 4.87   | 4.89   |
| forwards      |         | 4.87   | 4.91   | 4.95   | 5.00   |
| <b>EURRSD</b> | 117.54  | 117.40 | 117.20 | 117.30 | 117.30 |
| forwards      |         | -      | -      | -      | -      |
| <b>EURUSD</b> | 1.11    | 1.13   | 1.15   | 1.15   | -      |

### Key Interest Rate

|                 | current | 2020Q2 | 2020Q3 | 2020Q4 | 2021Q1 |
|-----------------|---------|--------|--------|--------|--------|
| <b>Croatia</b>  | 0.30    | 0.30   | 0.30   | 0.30   | -      |
| <b>Czechia</b>  | 2.25    | 2.25   | 2.25   | 2.25   | 2.25   |
| <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   | 2.50   | 2.50   | 2.50   |
| <b>Serbia</b>   | 2.25    | 2.00   | 2.00   | 1.75   | 1.75   |
| <b>Eurozone</b> | 0.00    | 0.00   | 0.00   | 0.00   | -      |

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### Published by:

**Erste Group Bank AG**  
**Group Research**  
**1100 Vienna, Austria, Am Belvedere 1**  
**Head Office: Wien**  
**Commercial Register No: FN 33209m**  
**Commercial Court of Vienna**

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