

# Economic growth to ease visibly in 2020

Weaker domestic demand as well as uncertainty related to spread of COVID-19 is to drag economic growth down to 2.2% in 2020. We expect inflation in February to rise slightly to 4.6% y/y, due to high food and services prices.

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## Watch this week

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### March 13 | Inflation to marginally increase in February

We see February inflation at 4.6% y/y (0.6% m/m), slightly above market expectations at 4.4% y/y. We think that the growth of food and services prices remained strong and was the main factor behind the increase of the headline figure. In our view, the disinflationary effect of dropping oil prices since the beginning of 2020 will likely be more visible in the March figure. We continue to see the FY20 inflation forecast at 3.6%; however, the drop of the oil price to below USD 40/barrel as an aftermath to the lack of an agreement between OPEC countries and Russia poses downside risks to our forecast.

### Forecast revision | We revise our FY20 growth forecast down

We revised our FY20 growth forecast to 2.2%, due to weaker domestic demand as well as increasing fears over the spread of SARS-CoV-2019. We see private consumption easing to 3.0% in 2020, as consumer sentiment has weakened and labor market conditions are likely to ease. Investment growth will likely drop to 1.0% this year, due to increasing market uncertainty, which drags private investment down, slowing the utilization of EU funds, and the political cycle not providing a boost to public investment. As far as monetary policy is concerned, we keep our call for stable rates until the end of 2021. However, if inflation eases on the back of dropping oil prices and economic growth slows down considerably, the central bank could consider cutting rates in 2H20.

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

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## Last week's highlights

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- Central bank kept rates unchanged at 1.5%. According to March projection, inflation is expected at 3.7% in 2020 (2.8% in November projection) and at 2.7% in 2021 (2.6% in November projection). GDP growth is expected at 3.2% in 2020 (3.6% in November) and at 3.0% in 2021 (3.3% in November projection).

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## Market developments

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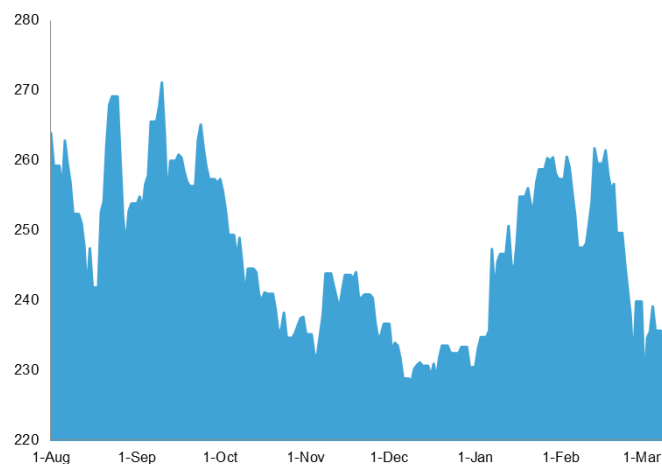
### Bond market drivers | Virus infected bond market

Over the course of the week, the 10Y yield remained fairly stable and moved around 1.7%. However, the developments over the weekend, i.e. further spread of the SARS-CoV-2019 and no agreement between OPEC countries and Russia regarding the cut of oil supply, resulted in a panic on financial markets. As a result, the long end of the Polish curve dropped by 30bp within a day (as of March 9), mirroring the core market development. The 10Y Bund dropped further into negative territory towards -0.9%. As a result, the spread over the 10Y Bund narrowed to around 220bp. We see the spread in the coming weeks staying around the current level of 220bp. If the situation on the markets calms down and we see core market yields going up, we could see a similar move on the long end of the Polish curve. FRAs went down further and dropped below 1%, suggesting monetary easing in Poland. However, we continue to believe that monetary policy will remain stable in the coming months.

### FX market drivers | EURPLN follows market fears

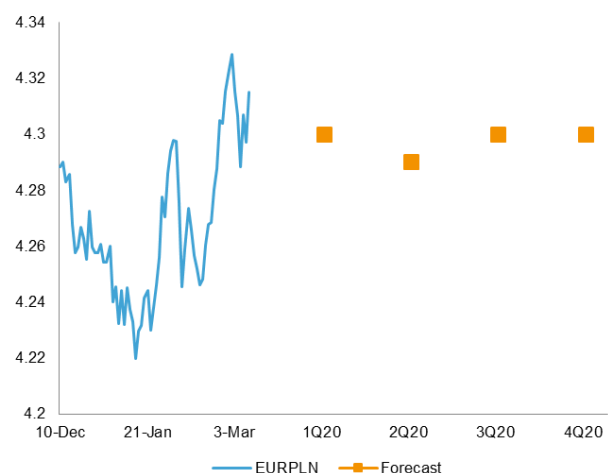
The zloty remains solely under the influence of the spread of the Coronavirus and the development of the EURUSD pair. The expectations for US rate cuts are the main driver behind the EURUSD development. The meeting of the ECB Council could trigger a movement of the pair, should expectations of a rate cut be disappointed. Therefore, we could see increased volatility on the EURPLN.

#### 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
10. Mar	8:00	RO	GDP (y/y)	4Q P	4.3%	<b>4.3%</b>	4.3%	Gross fixed capital formation probably increased strongly in 4Q19 against the backdrop of an important rise in public CAPEX in November and December.
	9:00	CZ	CPI (y/y)	Feb	3.6%	<b>3.3%</b>	3.6%	Food prices, sound domestic demand and tight labor market are the most important proinflationary factors. Despite the expected slowdown in y/y terms (January figure was 3.6%), More supportive base effect, huge m/m drop of fuel prices and correction of seasonal food prices imply slowdown of the headline rate.
	9:00	HU	CPI (y/y)	Feb	4.2%	<b>4.1%</b>	4.7%	
	9:00	HU	Trade Balance	Jan P	346.00		114.49	
	9:00	SK	Industrial Production (y/y)	Jan			-7%	
	9:00	SK	Trade Balance	Jan			-24.26	
	10:30	SI	Industrial Production (y/y)	Jan		<b>1.0%</b>	1%	Industrial production seen maintaining positive footprint also in January, though at modest growth rate
	11:00	HR	Trade Balance	Dec			-5321	
11. Mar	8:00	RO	CPI (y/y)	Feb	3.2%	<b>3.1%</b>	3.6%	Important decline in inflation rate to 3.1% y/y in February from 3.6% y/y in January after cheaper car fuel.
	8:00	RO	Trade Balance	Jan		<b>-1.00</b>	-1768.4	Trade deficit for goods is still high as long as fiscal policy remains expansionary.
	10:30	SI	Trade Balance	Jan			-0.36	
	11:00	HR	Retail Sales (y/y)	Jan		<b>3.8%</b>	4.5%	Retail trade expected to keep solid growth trajectory
	11:00	HR	PPI (y/y)	Feb			1.3%	
12. Mar	8:00	RO	Industrial Production (y/y)	Jan	-6.0%	<b>-6.7%</b>	-6.9%	Weak external orders for local manufacturing and a loss of competitiveness in recent years following an increase in wages and flat or even stronger leu in real terms.
	9:00	CZ	Industrial Production (y/y)	Jan		<b>-0.8%</b>	-3.4%	We expect industrial production recovered at the very beginning of the year, mainly due to improved foreign demand.
	9:00	SK	Wages (y/y)	Jan			0.8%	
	12:00	RS	CPI (y/y)	Feb		<b>1.7%</b>	2%	We expect the yearly print to ease a bit given base effect.
	12:00	RS	Trade Balance	Jan			-946.5	
	12:00	RS	Central Bank Rate	Mar 12		<b>2.25%</b>	2.25%	We see the NBS on hold in March. ECB meeting is on the same day, and the NBS will likely wait and take time to see possible ECB measures first.
13. Mar	8:00	RO	Wages (y/y)	Jan		<b>9.0%</b>	12.95%	Nominal wage growth to slow down in 2020; the bulk of planned wage hikes in public sector were already enacted in previous years and minimum wages increased slower in 2020
	9:00	CZ	Retail Sales (y/y)	Jan	3.8%	<b>3.8%</b>	4.8%	Tight labor market and solid domestic demand still imply a favorable development of retail sales. We expect sales to be growing with a relatively fast pace during the whole year.
	9:00	SK	CPI (y/y)	Feb			3%	
	10:00	PL	CPI (y/y)	Feb	4.4%	<b>4.6%</b>	4.4%	Inflation to move further on the back of food and services prices.

Source: Bloomberg, Erste Group Research

## Market forecasts

### Government bond yields

	current	2020Q2	2020Q3	2020Q4	2021Q1
<b>Croatia 10Y</b>	0.6	0.6	0.5	0.5	0.5
spread (bps)	150	110	90	70	60
<b>Czechia 10Y</b>	1.0	1.7	1.7	1.8	1.9
spread (bps)	184	219	214	197	198
<b>Hungary 10Y</b>	1.8	2.2	2.3	2.4	2.5
spread (bps)	264	271	265	256	264
<b>Poland 10Y</b>	1.3	1.8	1.8	1.9	1.9
spread (bps)	223	225	220	210	195
<b>Romania 10Y</b>	3.9	4.0	4.1	4.1	4.1
spread (bps)	479	452	446	428	417
<b>Slovakia 10Y</b>	-0.2	0.2	0.3	0.4	-
spread (bps)	68	67	67	57	-
<b>Slovenia 10Y</b>	-0.07	0.30	0.30	0.30	0.40
spread (bps)	82	80	70	50	50
<b>Serbia 5Y</b>	2.3	2.3	2.2	2.1	2.1
spread (bps)	321	280	260	230	220
<b>DE10Y</b>	-0.9	-0.5	-0.4	-0.2	-0.1

### 3M Money Market Rate

	current	2020Q2	2020Q3	2020Q4	2021Q1
<b>Czechia</b>	2.34	2.29	2.30	2.30	2.30
<b>Hungary</b>	0.69	0.60	0.55	0.50	0.55
<b>Poland</b>	1.70	1.71	1.71	1.71	1.71
<b>Romania</b>	2.85	2.90	3.10	3.00	3.00
<b>Serbia</b>	1.62	1.37	1.37	1.12	1.12
<b>Eurozone</b>	-0.47	-0.50	-0.50	-0.50	-0.50

Source: Bloomberg, Erste Group Research

### FX

	current	2020Q2	2020Q3	2020Q4	2021Q1
<b>EURHRK</b>	7.55	7.48	7.48	7.50	7.50
forwards		7.55	7.55	7.55	7.55
<b>EURCZK</b>	25.49	24.85	24.74	24.60	24.54
forwards		25.67	25.79	25.89	25.97
<b>EURHUF</b>	336.62	335.00	335.00	335.00	335.00
forwards		338.09	339.29	340.48	341.58
<b>EURPLN</b>	4.32	4.29	4.30	4.30	4.31
forwards		4.34	4.36	4.38	4.40
<b>EURRON</b>	4.82	4.82	4.85	4.87	4.89
forwards		4.87	4.91	4.95	5.00
<b>EURRSD</b>	117.60	117.40	117.20	117.30	117.30
forwards		-	-	-	-
<b>EURUSD</b>	1.14	1.13	1.15	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	0.00

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