

What was behind inflation surge in March?

Final inflation reading to confirm flash estimate, which surprised to upside and jumped to 3.2% y/y in March. Core inflation likely returned to 3.9% y/y in March. Central bank will hold first QE operation this month. Zloty to continue benefiting from improved global mood.

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Watch this week

April 15 | Final inflation for March

The flash CPI estimate surprised to the upside, arriving at 3.2% y/y (1.0% m/m) in March, well above our and market expectations, shifting this year's inflation path up further. According to the available data, food price growth eased to 0.5% y/y, energy prices went up by 4.2% y/y, while prices of fuel for personal transport increased by 7.2% y/y. We expect the flash reading to be confirmed. On Friday, the National Bank of Poland will release core inflation for March; we see it returning to 3.9% y/y.

The increase of CPI in March was just the first that we expect to observe this year. In Apr-May 2021, the base effect from last year's collapse of fuel prices will increase the pressure on the headline figure. In our view, CPI will exceed the upper band of the central bank's inflation target at 3.5% and will most likely move above 4.0% y/y in that period. In early summer, we should see inflation slightly easing and dropping below the upper band of the inflation target, before returning toward 4.0% y/y in 2H21. We see considerable upside risks to our current FY21 inflation forecast at 3.0%. Despite high inflation pressure and CPI staying visibly above the target throughout the year, we expect the National Bank of Poland to remain on hold and keep the target rate unchanged at 0.1% until at least the end of Governor Glapinski's term in mid-2022 and likely until the end of next year.

Last week's highlights

- [Central bank](#) kept policy rate unchanged at 0.1%. [Governor Glapinski](#) reiterated during press conference that policy rate will most likely remain unchanged until end of his term in mid-2022.
- Governor Glapinski said that last year's profit at NBP reached PLN 9.5bn, from which PLN 8.9bn will be paid to budget.
- MPC member Lon sees current inflation level as appropriate and does not see need to cut interest rates. In view of MPC member Ancyparowicz, there is no risk of inflation persistently exceeding upper bound of target at 3.5%, but short-term jumps cannot be ruled out.
- Government announced that current restrictions will be prolonged until April 18, from previously planned April 9.
- According to preliminary data, unemployment rate went down by 0.1pp to 6.4% in March.

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

Market developments

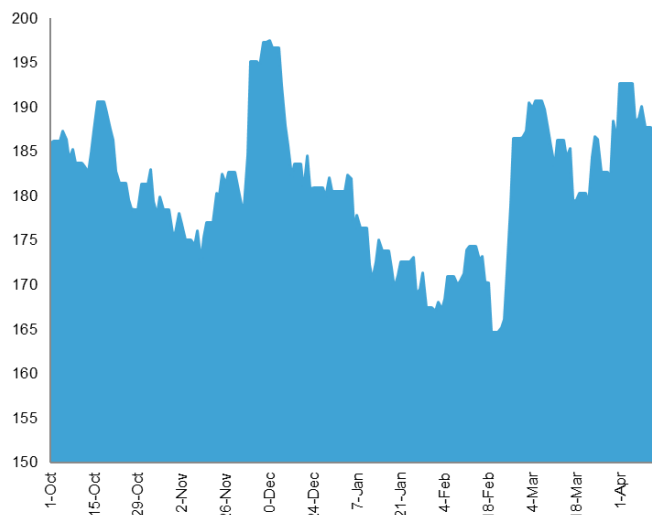
Bond market drivers | 10Y yield moves around 1.55%

Over the course of the week, the long end of the LCY curve was broadly unchanged and the 10Y yield moved close to 1.55%. A similar development was observed on the core market, where the 10Y German Bund fluctuated around -0.32%. The spread over the 10Y Bund narrowed somewhat toward 183bp. Last week, the MinFin sold papers worth PLN 5.4bn in the first bond auction planned for this month. The second auction is scheduled for April 23. After last week's auction, Poland has already covered around 62% of this year's borrowing needs. This week, on Wednesday, the NBP is scheduled to buy bonds. There are two QE operations planned for this month; the second should take place on April 29 and will be held if required. According to Governor Glapinski, the NBP will remain more active on the bond market. Furthermore, on Thursday, BGK will sell bonds and will offer papers maturing in 2027, 2033 and 2040.

FX market drivers | Risk-on mood supported zloty

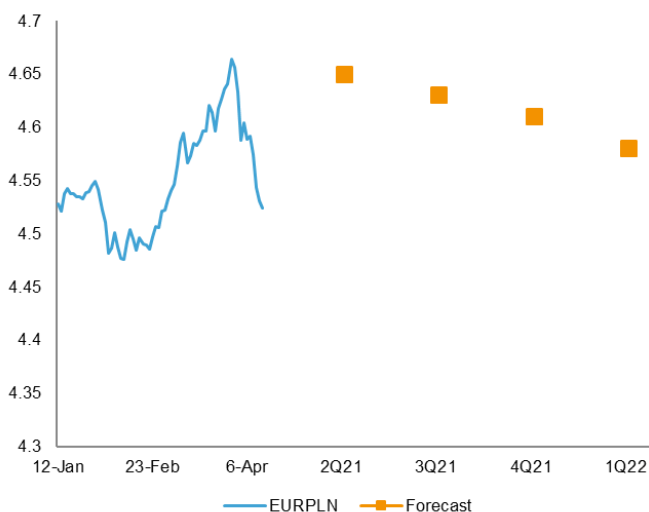
The improved global sentiment and weaker US dollar have been positive for the zloty, which has appreciated since the beginning of 2Q21. After hitting a new 12-year low at 4.66 vs. the EUR, the EURPLN moved toward 4.53. Separately, the recent visible weakening of the zloty softened the NBP's wording regarding the impact of the exchange rate on growth. In their view, the pace of the recovery will also depend on the future development of the exchange rate, unlike earlier, when the NBP communicated that the strong zloty will dampen the rebound. Moreover, the Supreme Court ruling on CHF mortgages has been postponed again until May 11. The upcoming decision of the European Court of Justice on FX loans at the end of April could provide legal guidance to local courts. We think that the zloty will weaken in the coming weeks and will return above 4.60 vs. the EUR, given the unresolved issue of FX mortgages and the central bank's commitment to a dovish monetary policy, despite rising inflation.

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
13.Apr		RO	Current Account Balance (monthly)	Feb			-239	
	8:00	RO	Industrial Production (y/y)	Feb		-1.90%	-0.90%	Mixed signals: better leading indicators, especially confidence of main trading partners and slightly better domestic confidence, while microchips shortages disrupted production for car producers.
	8:00	RO	CPI (y/y)	Mar	3.20%	3.07%	3.16%	We expect slight deceleration due to high statistical base effect.
	8:00	RO	CPI (m/m)	Mar		0.41%	0.41%	
	9:00	CZ	CPI (y/y)	Mar	2.30%	2.20%	2.10%	Inflation still driven mainly by tight labor market. We expect pro-inflationary pressures to gradually start rising from 2Q.
	9:00	CZ	CPI (m/m)	Mar	0.20%	0.10%	0.20%	Slight increase in price level affected by food prices and prices of fuel.
	12:00	RS	Central Bank Rate	Apr		1%	1.00%	No change in policy rate expected in 2021.
	14:00	PL	Trade Balance	Feb	1124		845	
14.Apr	9:00	SK	CPI (y/y)	Mar		1.10%	0.90%	Main driver of inflation was oil prices.
	9:00	SK	CPI (m/m)	Mar		0.20%	0.30%	
15.Apr	10:00	PL	CPI (y/y)	Mar F		3.20%	3.20%	We expect flash reading to be confirmed. Core inflation likely increased and returned to 3.9% y/y.
	10:00	PL	CPI (m/m)	Mar F			1.00%	
16.Apr	11:00	HR	CPI (y/y)	Mar		0.70%	0.30%	Inflation seen as further accelerating in March.
	11:00	HR	CPI (m/m)	Mar			0.30%	

Source: Bloomberg, Erste Group Research

Forecasts

Government bond yields

	current	2021Q2	2021Q3	2021Q4	2022Q1
Croatia 10Y	0.6	0.0	0.5	0.5	0.6
spread (bps)	86	29	72	68	73
Czechia 10Y	1.9	1.8	1.8	1.9	2.0
spread (bps)	224	209	202	205	208
Hungary 10Y	2.7	2.7	2.7	2.7	2.8
spread (bps)	304	294	290	291	297
Poland 10Y	1.6	1.6	1.6	1.7	1.7
spread (bps)	187	189	182	183	183
Romania 10Y	3.1	2.9	2.8	2.8	2.9
spread (bps)	336	319	302	293	303
Slovakia 10Y	-0.1	0.0	0.2	0.3	0.4
spread (bps)	19	29	37	48	48
Slovenia 10Y	0.02	0.10	0.10	0.10	0.20
spread (bps)	33	39	32	28	33
Serbia 5Y	2.3	2.2	2.2	2.2	2.1
spread (bps)	256	249	242	238	223
DE10Y*	-0.3	-0.3	-0.2	-0.2	-0.1

* Spreads based on Bloomberg consensus forecast

FX

	current	2021Q2	2021Q3	2021Q4	2022Q1
EURHRK	7.58	7.50	7.48	7.53	7.53
EURCZK	26.07	25.62	25.54	25.36	25.08
EURHUF	357.80	360.00	360.00	360.00	360.00
EURPLN	4.53	4.65	4.63	4.61	4.58
EURRON	4.92	4.90	4.92	4.95	5.01
EURRSD	117.55	117.50	117.40	117.50	117.50
EURUSD	1.19	1.16	1.16	1.18	1.20

3M Money Market Rate

	current	2021Q2	2021Q3	2021Q4	2022Q1
Czechia	0.36	0.44	0.67	0.83	0.92
Hungary	0.79	0.77	0.77	0.77	0.80
Poland	0.21	0.21	0.21	0.21	0.21
Romania	1.62	1.55	1.50	1.40	1.50
Serbia	0.88	0.86	0.86	0.86	0.86
Eurozone	-0.54	-0.54	-0.54	-0.54	-0.54

Key Interest Rate

	current	2021Q2	2021Q3	2021Q4	2022Q1
Croatia	0.05	0.05	0.05	0.05	0.05
Czechia	0.25	0.25	0.50	0.75	0.75
Hungary	0.60	0.60	0.60	0.60	0.75
Poland	0.10	0.10	0.10	0.10	0.10
Romania	1.25	1.25	1.25	1.25	1.25
Serbia	1.00	1.00	1.00	1.00	1.00
Eurozone	0.00	0.00	0.00	0.00	0.00

Real GDP growth (%)

	2019	2020f	2021f	2022f
Croatia	2.9	-8.4	4.4	4.0
Czechia	2.2	-5.6	3.3	4.3
Hungary	4.6	-5.0	4.4	4.7
Poland	4.5	-2.7	3.4	4.7
Romania	4.1	-3.9	4.2	4.5
Serbia	4.2	-1.0	5.0	4.0
Slovakia	2.3	-5.2	4.0	4.8
Slovenia	3.2	-5.5	4.4	4.1
CEE8 avg	3.8	-4.0	3.8	4.5

Average inflation (%)

	2019	2020f	2021f	2022f
Croatia	0.8	0.1	1.2	1.5
Czechia	2.8	3.2	2.5	2.3
Hungary	3.4	3.3	3.8	3.2
Poland	2.3	3.4	3.0	2.3
Romania	3.8	2.7	3.2	2.4
Serbia	1.9	1.6	2.0	1.9
Slovakia	2.7	1.9	0.9	1.9
Slovenia	1.6	0.0	0.8	1.7
CEE8 avg	2.7	2.8	2.7	2.3

Unemployment (%)

	2019	2020f	2021f	2022f
Croatia	6.6	7.4	8.0	6.9
Czechia	2.0	2.6	3.4	2.8
Hungary	3.4	4.2	4.5	3.8
Poland	5.4	5.9	6.2	5.9
Romania	3.9	4.9	5.9	6.1
Serbia	10.4	9.0	8.9	8.5
Slovakia	5.8	6.7	7.3	6.3
Slovenia	4.4	5.1	5.2	4.9
CEE8 avg	4.6	5.2	5.7	5.3

Public debt (% of GDP)

	2019	2020f	2021f	2022f
Croatia	72.8	87.2	86.0	84.5
Czechia	31.2	38.4	45.0	48.1
Hungary	65.5	80.4	79.7	76.9
Poland	45.7	57.7	58.3	57.4
Romania	35.3	47.3	50.8	52.0
Serbia	52.0	57.4	57.0	55.5
Slovakia	48.5	59.9	63.2	63.2
Slovenia	65.6	78.1	76.9	74.5
CEE8 avg	46.0	57.3	59.1	58.9

C/A (%GDP)

	2019	2020f	2021f	2022f
Croatia	2.8	-1.0	0.2	0.1
Czechia	-0.3	3.2	0.2	0.3
Hungary	-0.5	0.1	-0.2	-0.3
Poland	0.5	3.5	2.1	1.2
Romania	-4.9	-5.2	-4.8	-4.2
Serbia	-6.9	-4.3	-5.3	-5.5
Slovakia	-2.7	-2.7	-1.6	-0.9
Slovenia	5.6	7.3	6.7	5.6
CEE8 avg	-0.8	0.9	0.0	-0.3

Budget Balance (%GDP)

	2019	2020f	2021f	2022f
Croatia	0.4	-8.0	-3.5	-3.0
Czechia	0.3	-6.1	-7.0	-2.7
Hungary	-2.0	-8.1	-7.4	-5.0
Poland	-0.7	-8.8	-5.3	-3.2
Romania	-4.3	-9.1	-7.8	-5.4
Serbia	-0.2	-8.1	-3.5	-1.7
Slovakia	-1.4	-8.0	-6.0	-4.0
Slovenia	0.5	-9.5	-6.0	-4.0
CEE8 avg	-1.2	-8.2	-6.1	-3.7

Source: Bloomberg, Erste Group Research

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