Nové zdroje rastu v krajinách Strednej a východnej Európy

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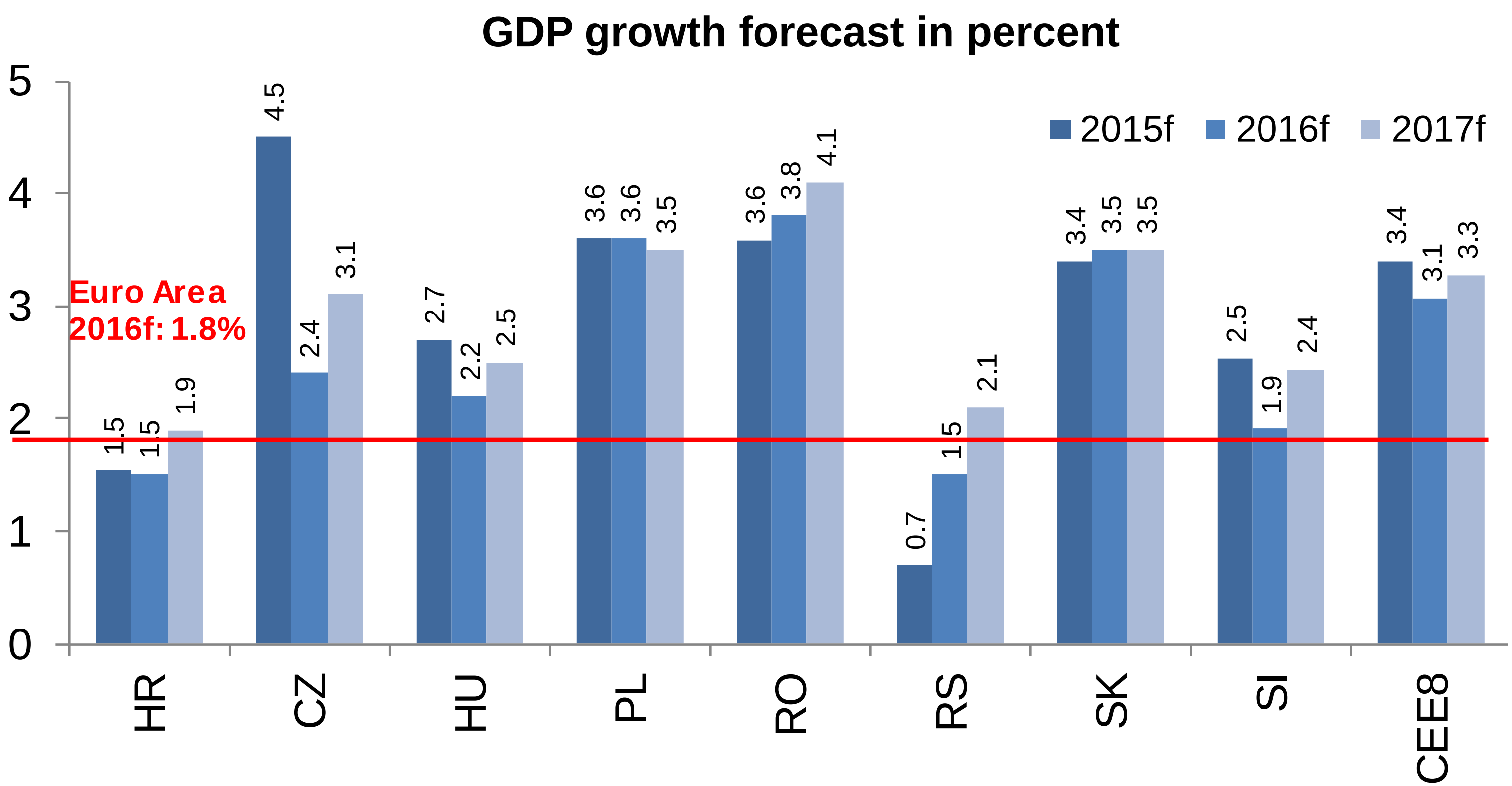
Studené - 4. február 2016

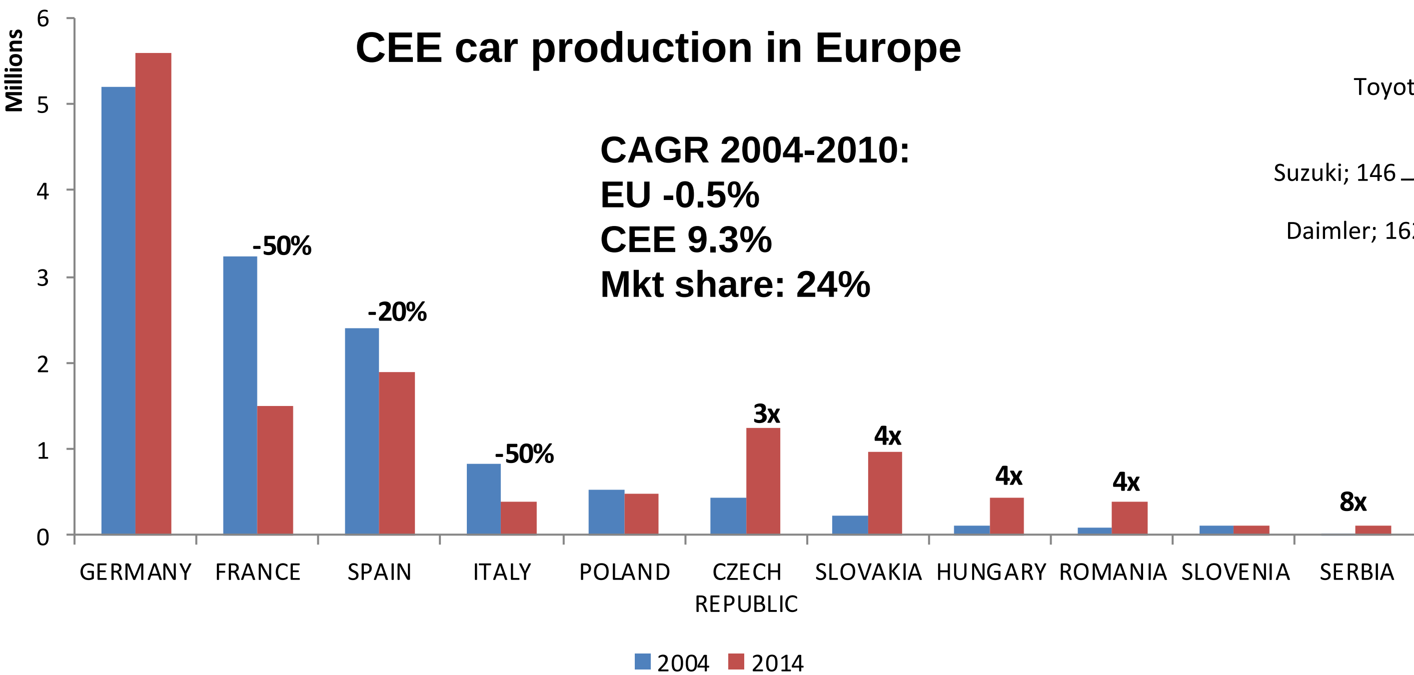
ERSTE Group

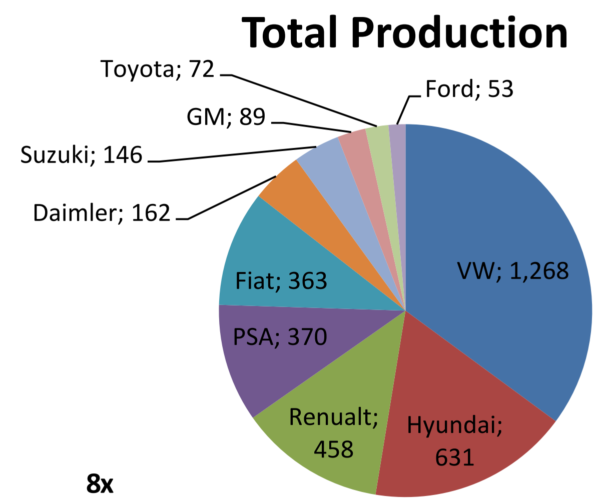
GDP growth is expected mildly to slow down on average in CEE next year



Source: Erste Group Research, Eurostat

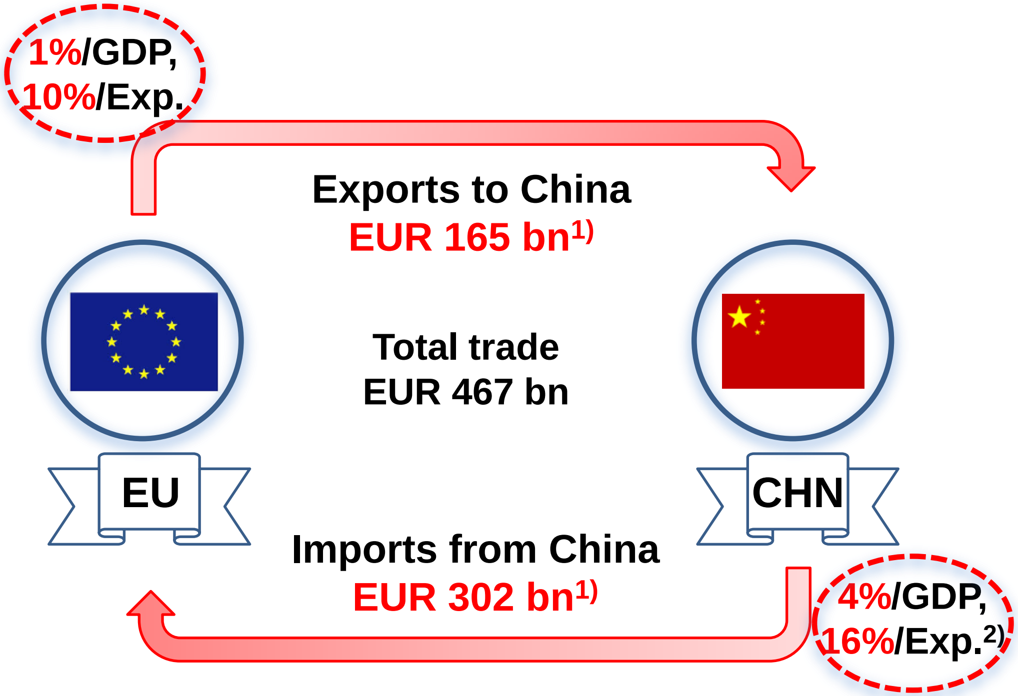
Car manufacturing is still in the forefront but not linked to German manufactures solely





Source: Erste Group Research, OICA

Mutual trade flows EU vs. China



EU exports

28% Transport Equip.
26% Other machinery
12% Chemicals
7% Agricultural products
4% Scientific instruments

China exports

29% Office & Telecom. Equip.
17% Other machinery
10% Clothing
5% Chemicals
2% Agricultural products

1) for 2014, 2) second after US
Source: European Commission, own calculations Erste Group Research

- **Weakening of China's economy and devaluation of yuan increase risk of imported deflation to Eurozone (in segment of consumer goods)**
- **Secondary effects – falling commodity prices (crude oil prices dropped about 20% YTD) may reinforce the risk that inflation will stay well below the target**
- **The ECB might revise its inflation forecast down in March and discuss further easing measures**
- **Given that the volume of foreign trade with China is relative low (exports at 1% of GDP, imports from China about twice as high), overall impact on EU economy should be muted.**

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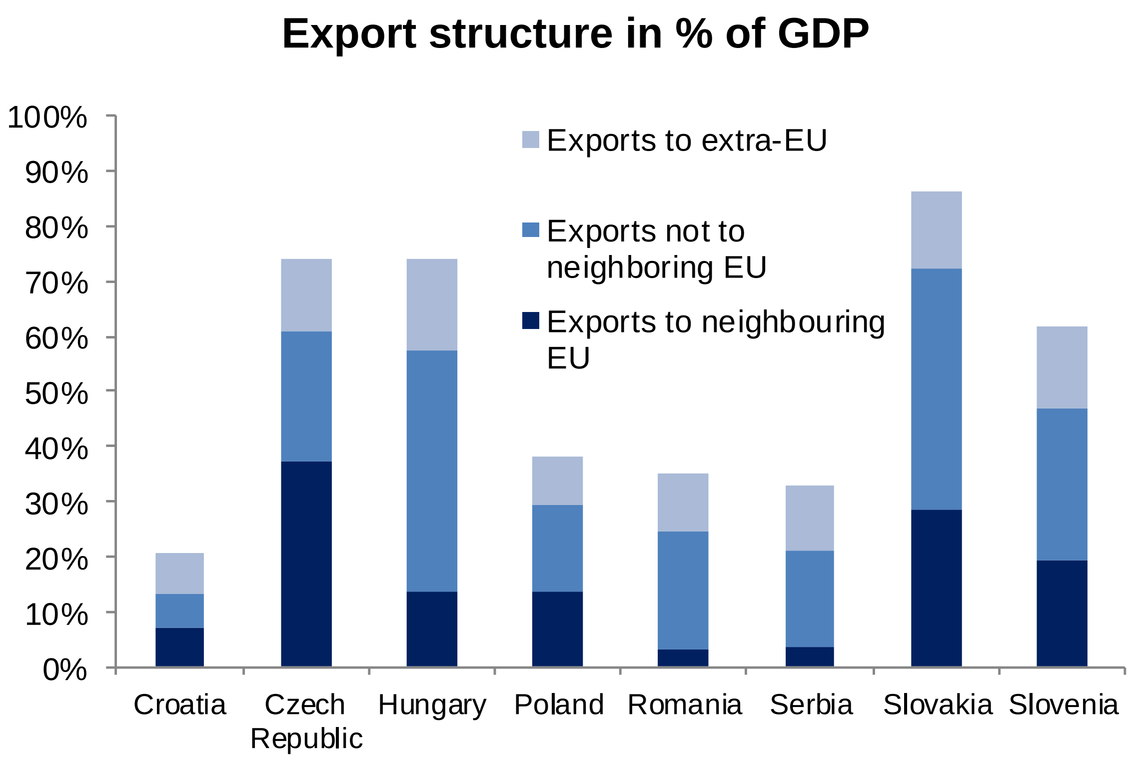
Schengen area is being openly questioned

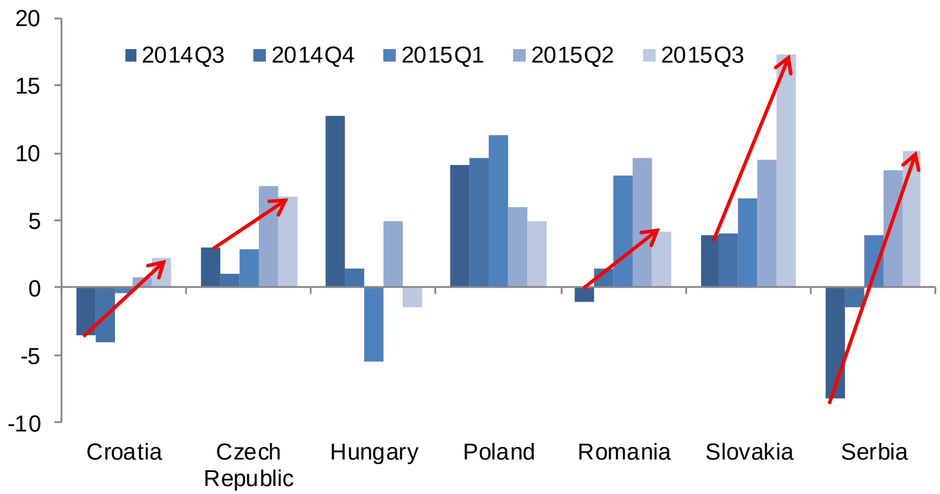


- **It is in vital interest to keep the Schengen and avoid fragmentation of EU**
- **Czech Republic, Hungary and Slovakia are the most open economies in the EU (exports to GDP are at about 80% of GDP)**
- **Hungary would be the most affected if internal boarders were rebuilt in the EU - about ¾ of its intra-EU trade would need to cross at least 2 boarders - potential problems with logistics**

Source: Erste Group Research, Eurostat

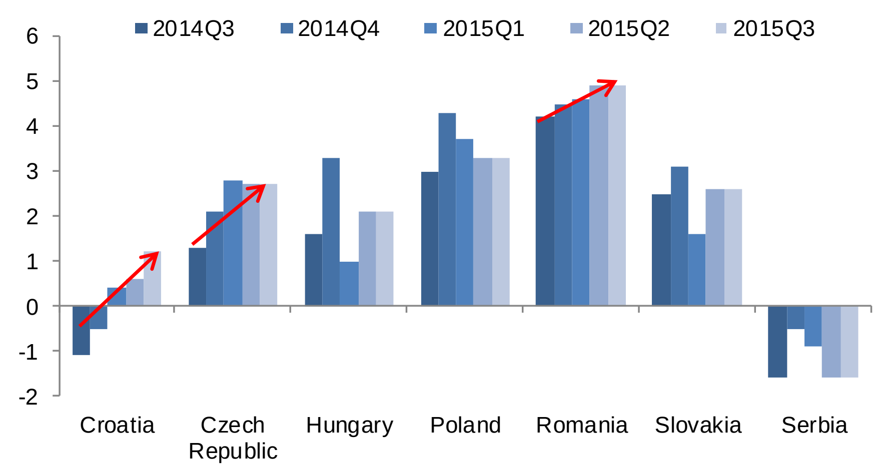
Detailed GDP numbers show more home-grown growth in CEE…

Gross fixed capital formation (y/y)



Source: Erste Group Research, Eurostat

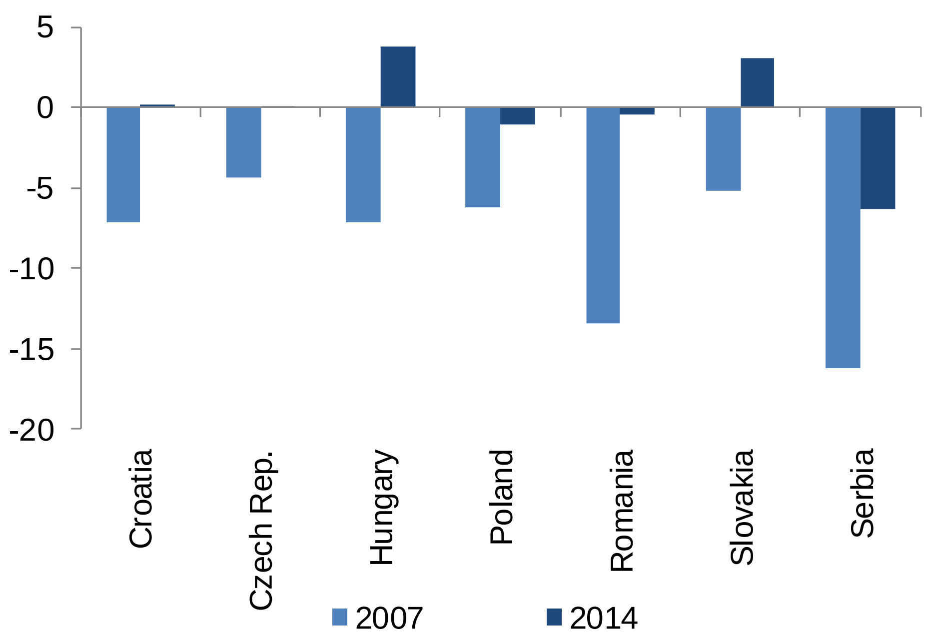
Final consumption (y/y)



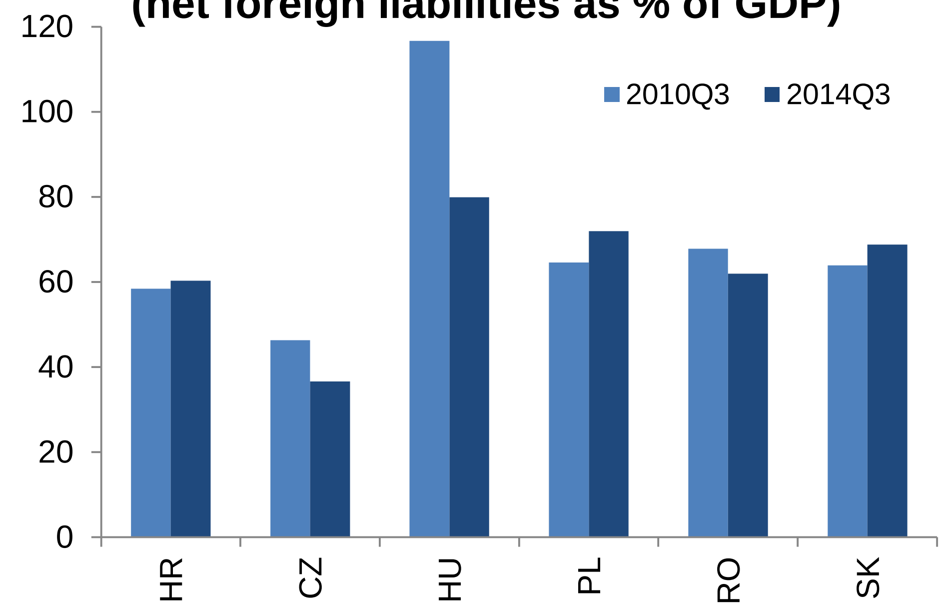
Source: Erste Group Research, Eurostat

… which is less dependent on new foreign funding

Current account balance (% of GDP)

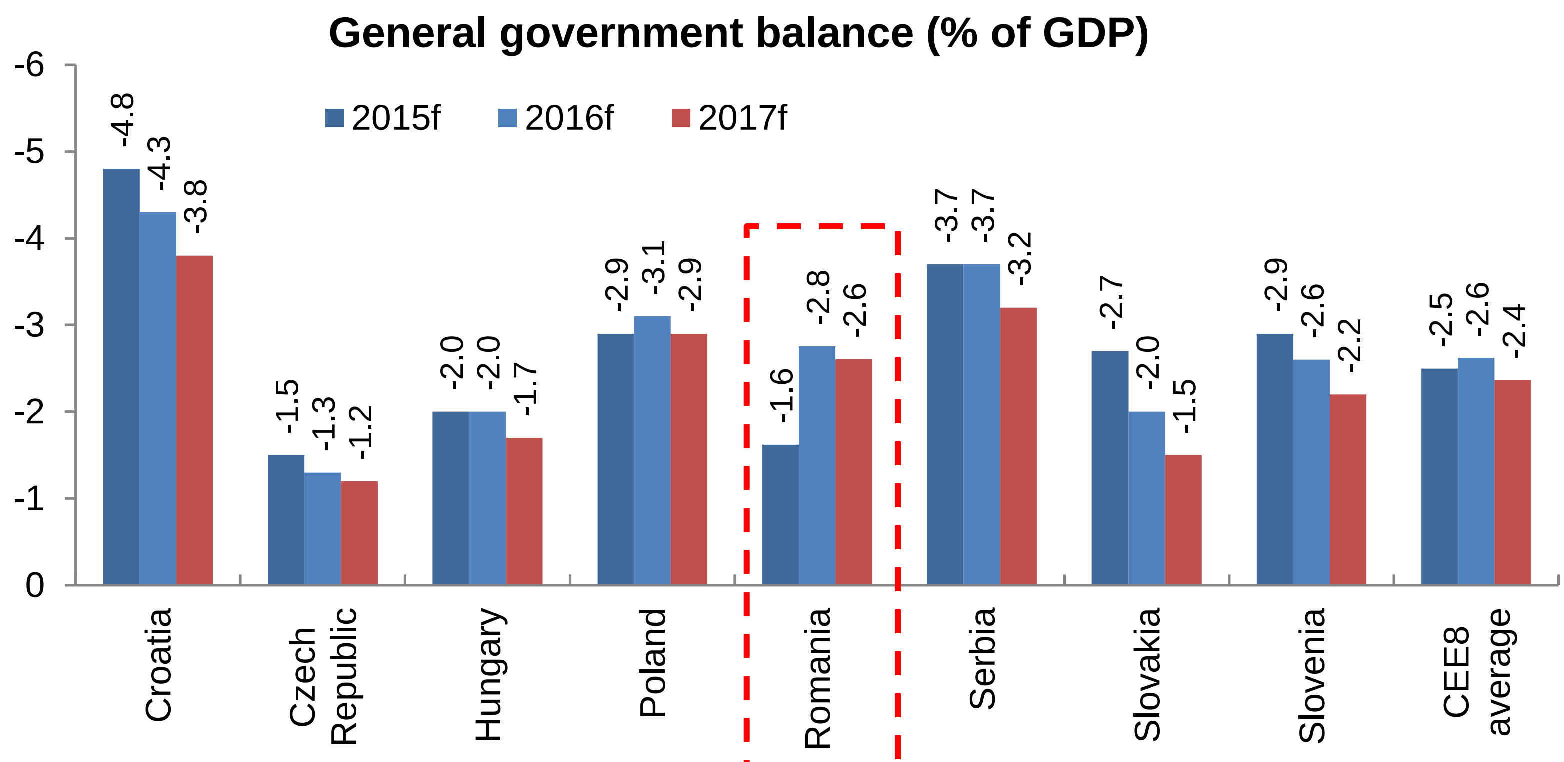


Net iternational investment position (net foreign liabilities as % of GDP)



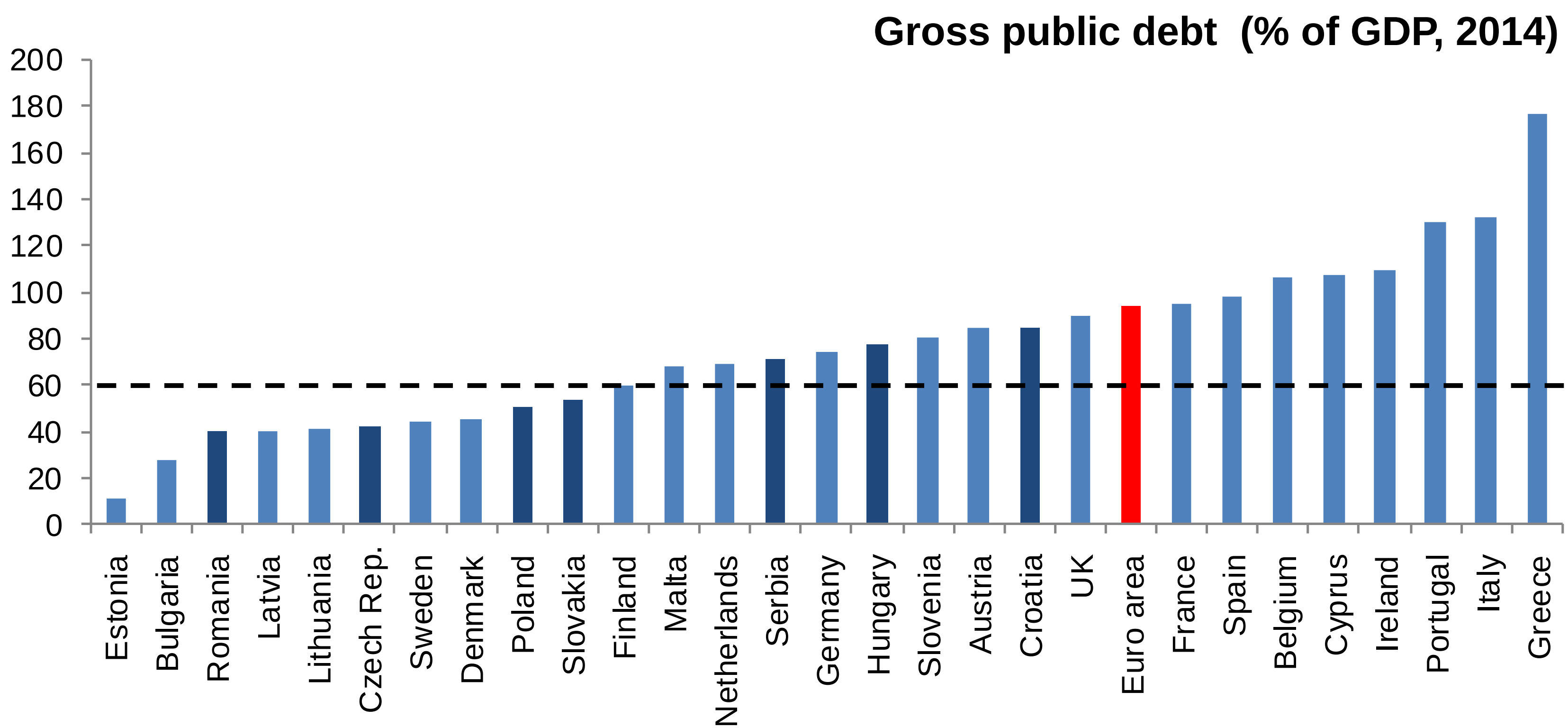
Source: Erste Group Research, Eurostat

Fiscal consolidation is to moderate next year in CEE and even to reverse in Romania



Source: Eurostat, Erste Group Research

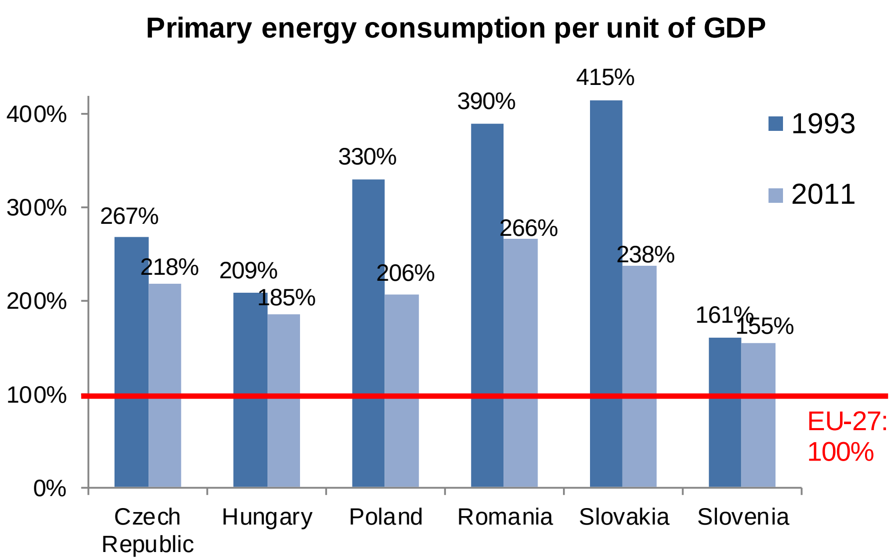
Public debt ratios remain below the EA level in CEE; in Czech Republic, Poland, Romania and Slovakia have stayed below 60% of GDP



Source: Erste Group Research, AMECO

Investments into energy security, energy efficiency and defence will be a priority

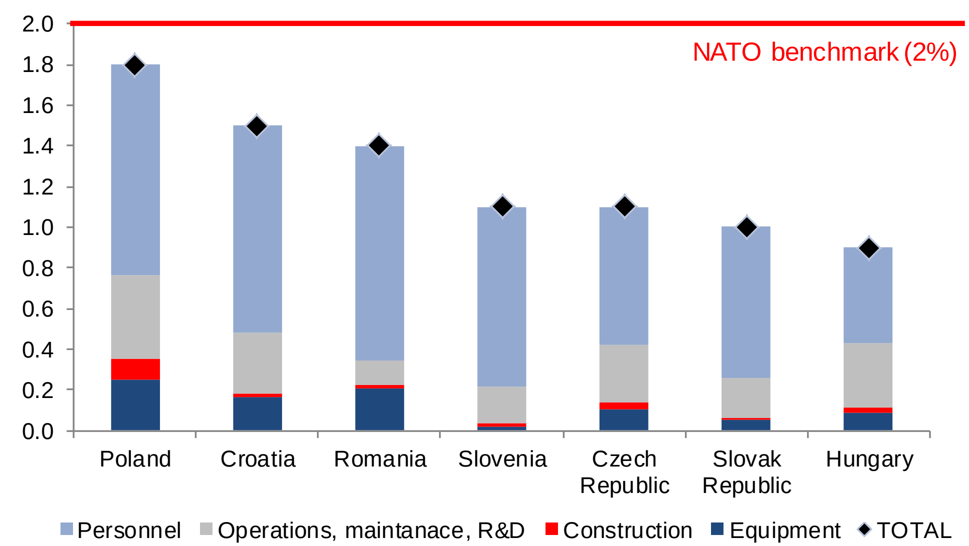
Decreasing energy intensity and investments into cross-border energy infrastructure is key



Source: IEA, Erste Group Research

Investment in and purchase of military equipment squeezed in CEE so far

% of GDP



Source: NATO

Interconnectors and reverse flow

Figure 1: Central Eastern Europe Reverse Flow Points (2015)

REVERSE FLOWS TO CZECH REPUBLIC

1	Germany: Waidhaus	15.6 BCM/Y
2	Germany: Brandov	36.0 BCM/Y
	Germany: Brandov	INTERR unlimited
3	Germany: Hora sv. Kateriny	9.1 BCM/Y
10	Poland: Cieszyn	0.5 BCM/Y

REVERSE FLOWS TO HUNGARY

4	Slovakia: Balassagyarmat	1.8 BCM/Y
5	Romania: Csanadpalota	0.1 BCM/Y
6	Austria: Mosonmagyarovar	4.5 BCM/Y
7	Croatia: Dravaszerdahely	6.9 BCM/Y

REVERSE FLOWS TO POLAND

8	Germany: Malnow	5.5 BCM/Y
	Germany: Malnow	2.7 BCM/Y INTERR
9	Germany: Laszow	1.6 BCM/Y INTERR
10	Czech Republic: Cieszyn	5.7 BCM/Y

REVERSE FLOWS TO SLOVAKIA

11	Czech Republic: Lanzhot	14.6 BCM/Y
12	Hungary: Velke Zlievce	4.5 BCM/Y

REVERSE FLOWS TO UKRAINE

13	Poland: Hermanvice	1.5 BCM/Y
14	Slovakia: Budince	14.6 BCM/Y
15	Hungary: Beregdaroc	6.1 BCM/Y

- The total CEE reverse flow capacity now stands at about 147 bcm/year
- 42 bcm/year of new interconnection capacity has been added within Eastern Europe and between Central and Western Europe over the last five years
- Gas prices in the Czech Republic and Slovakia have already converged to German gas hub

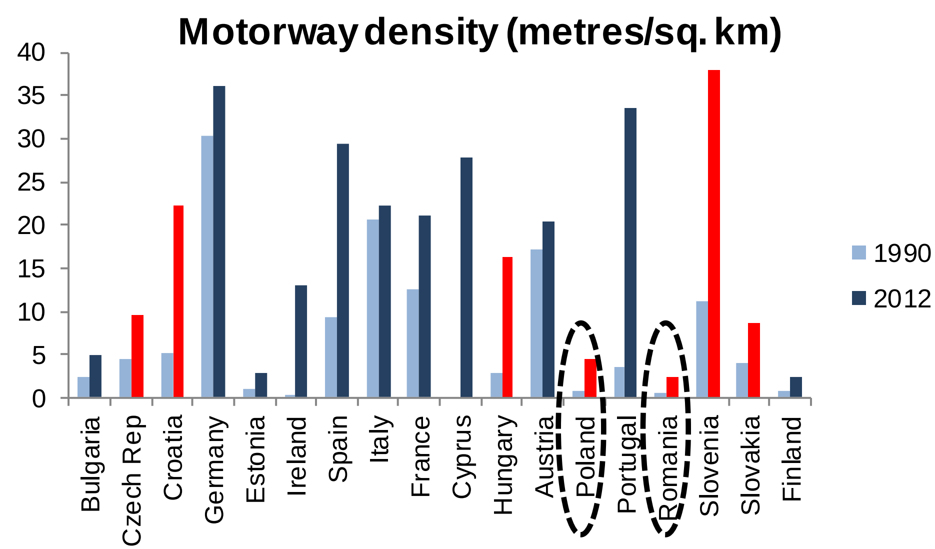
Source: IPA Industry Insight

Room for investments into hard infrastructure is still very much there

For funding investments, EU funds could be excessively used

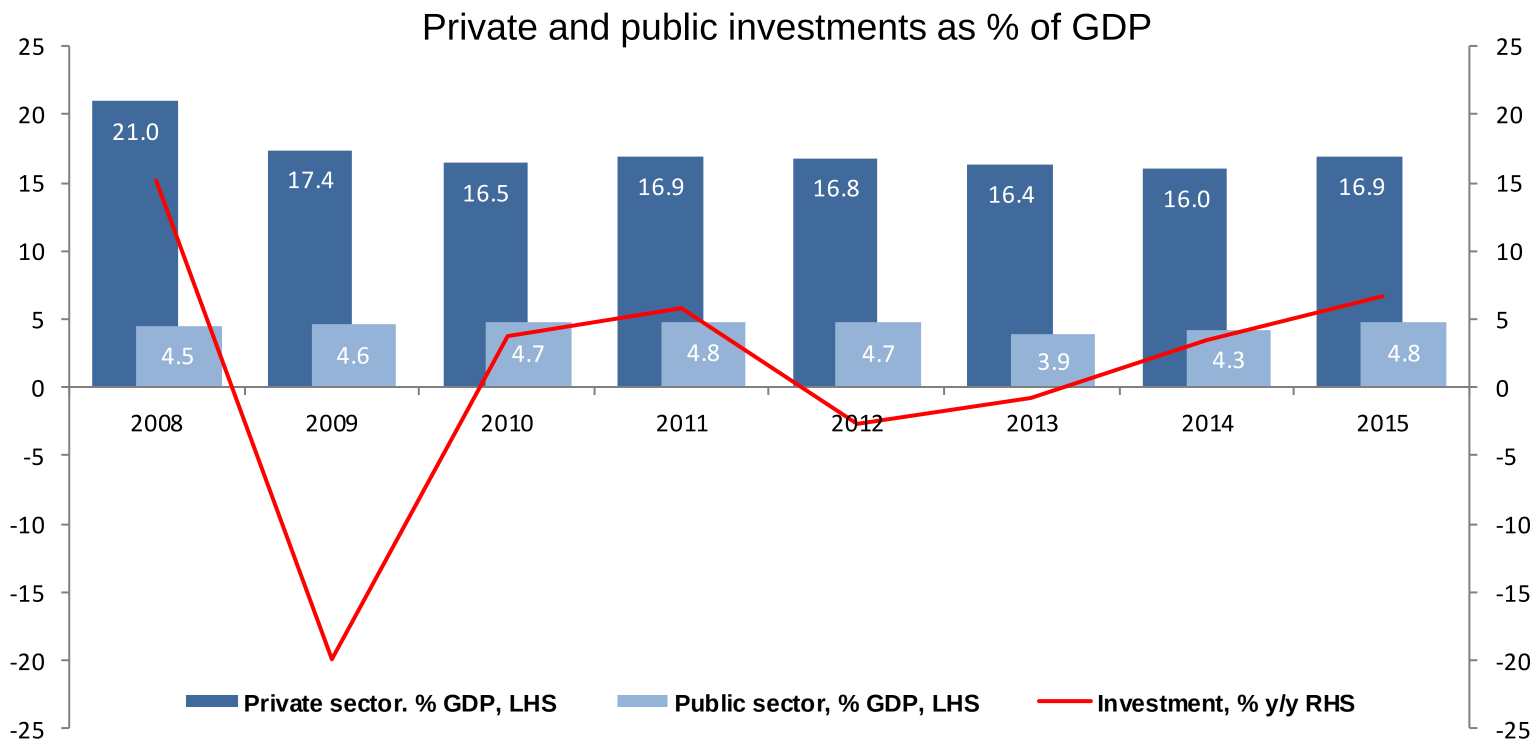
- EUR 167bn in Cohesion Funds (2014-2020) + EUR 33bn Connecting Europe Facility Program
- Romania: up to EUR 24bn can be invested in the road network by 2030
- Poland: EUR 27.5bn for infrastructure projects (part of Infrastructure and Environment Program)
- Czech Republic: expected launch of a bulk of infrastructure investment worth almost EUR 9bn

Motorway density is still low in a number of CEE countries



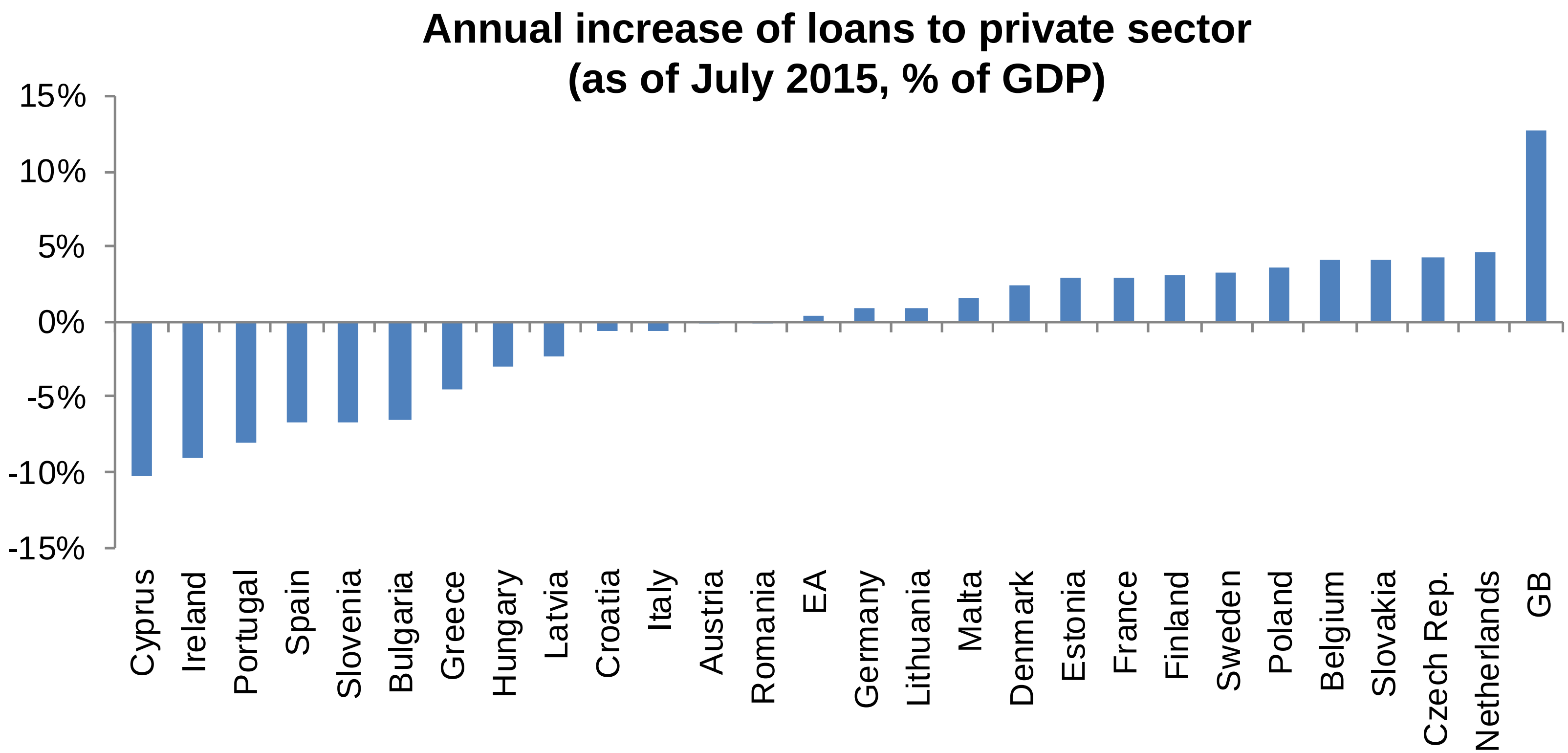
Source: Eurostat, Erste Group Research

Size-wise, private investments are much more relevant for boosting the growth potential



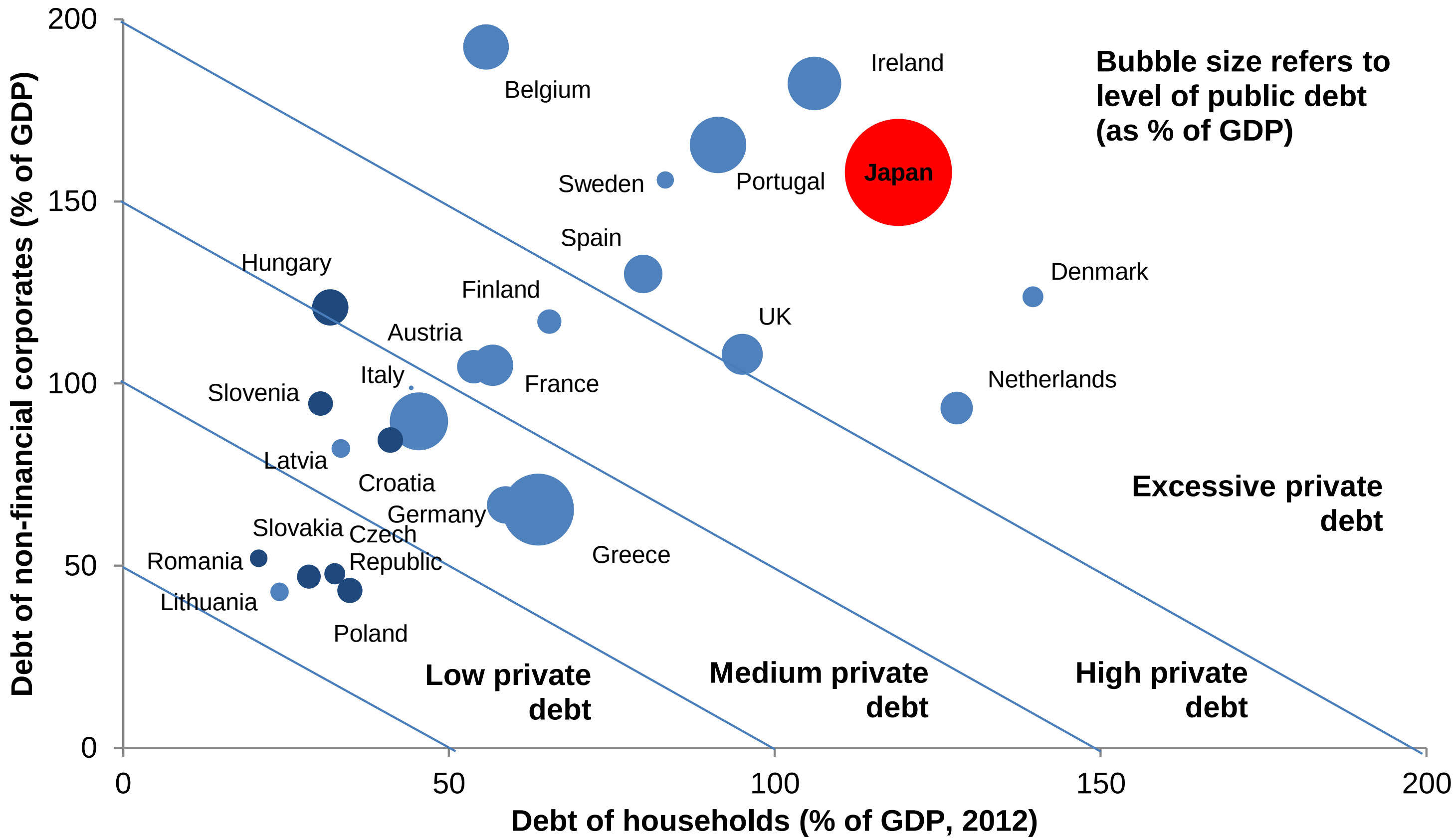
Source: European Comission, AMECO, Erste Group Research

Loan growth has finally picked up in several CEE countries



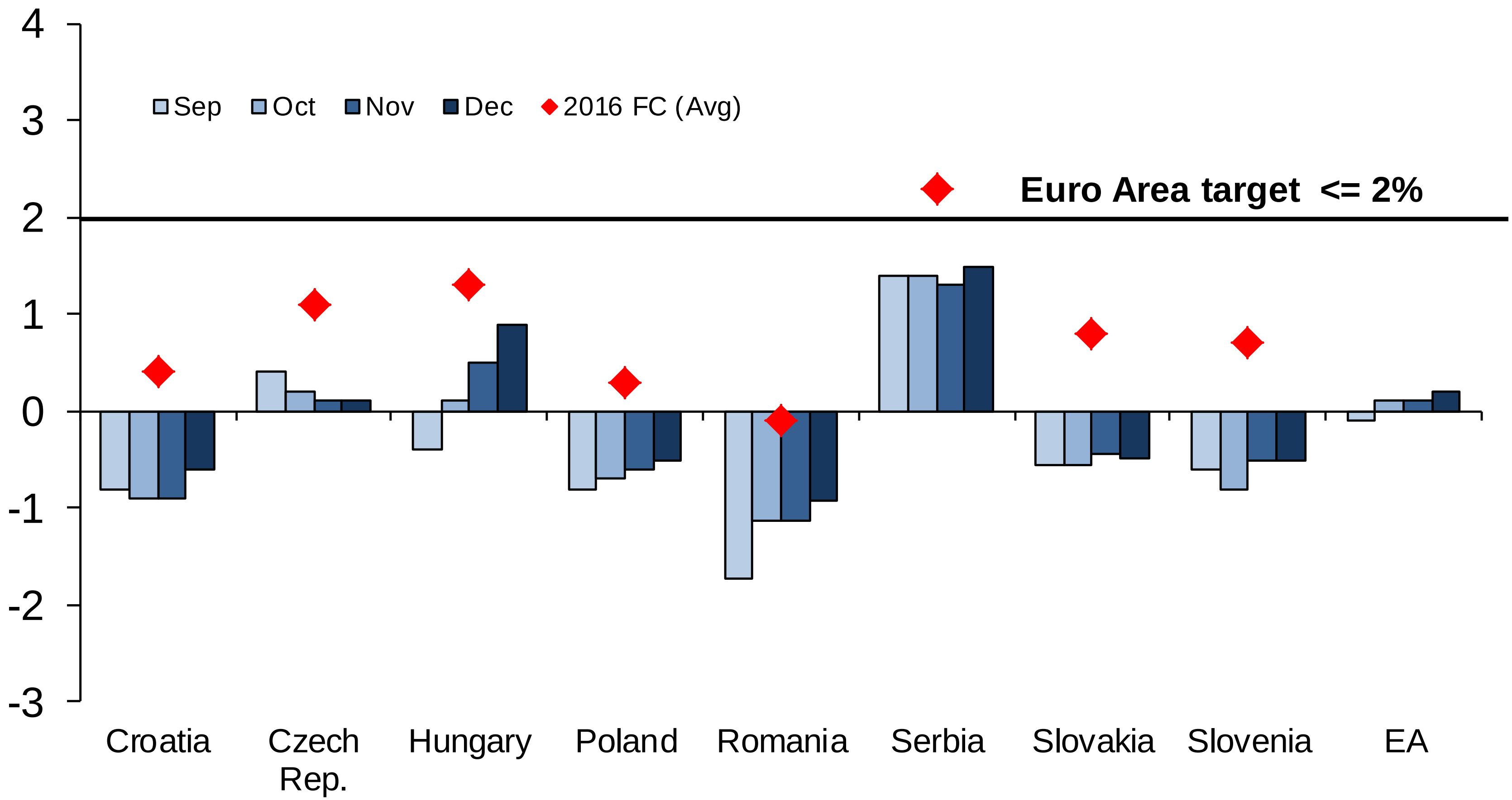
Source: ECB, Erste Group Research

CEE countries have much bigger potential for organic credit growth



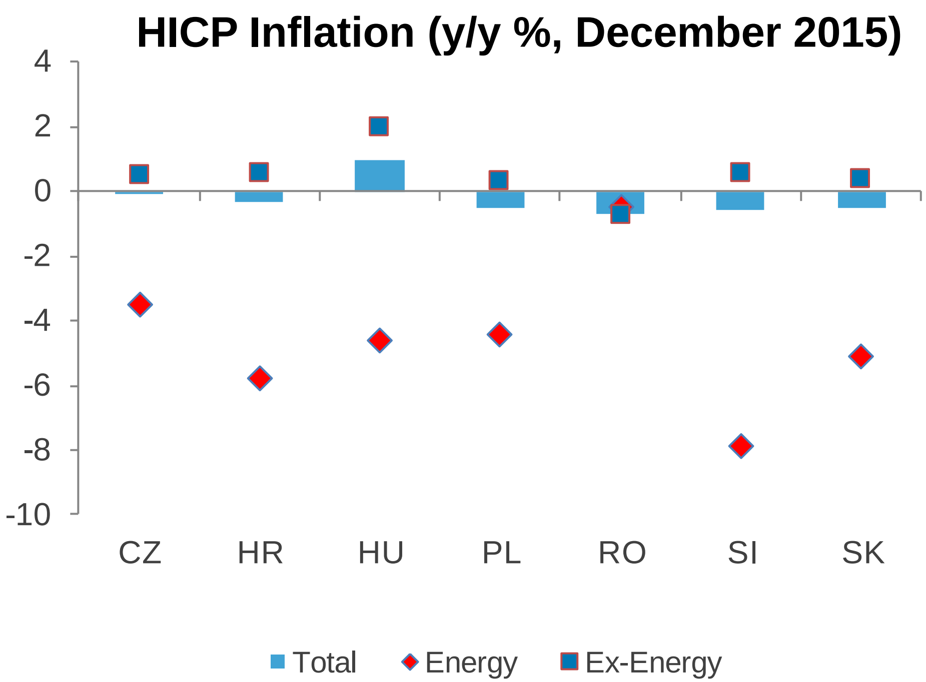
Source: ECB, Erste Group Research

Inflation has remained depressed…



Source: Bloomberg

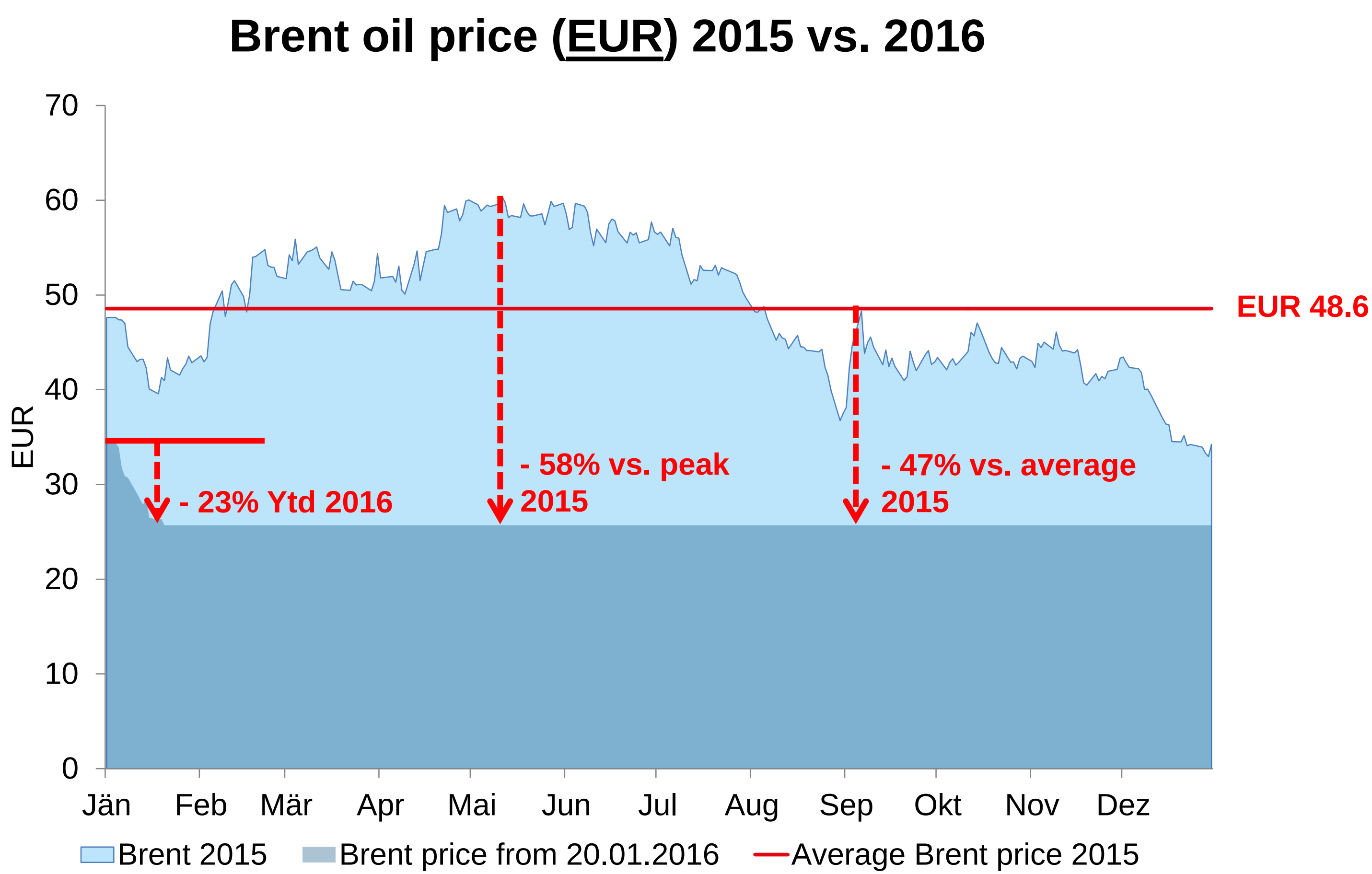
...but not just because of energy, also core inflation is low



- Falling energy prices (-4-10%) keep the inflation close to zero
- Low imported inflation from trading partners
- Romanian inflation depressed by cut of the VAT rate for food
- Some central banks in CEE might react to low inflation
- Inflation is to pick up next year in CEE due to base effect but staying still below inflation target

Source: Erste Group Research, Eurostat

Current oil price clearly below average 2015



Source: Bloomberg, Erste Group Research

Factors which temporary supported demand for government bonds but are not supposed to stay forever

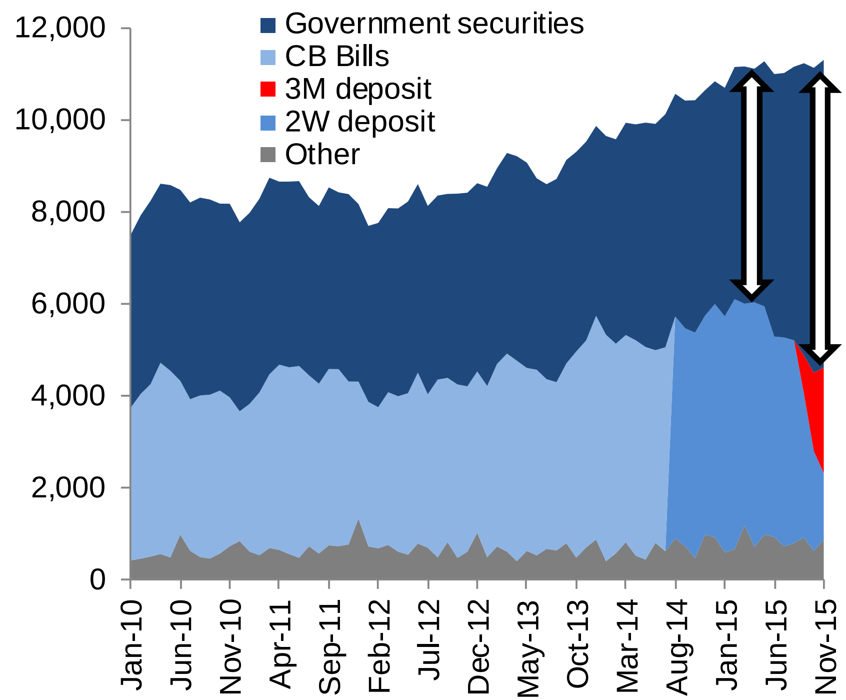
- deleveraging of the private sector
- low inflation
- FED‘s ultra-low interest rate policy
- ECB‘s purchase program
- favourable treatment of government bond holdings in balance sheet on banks

Are we heading to financial repression?

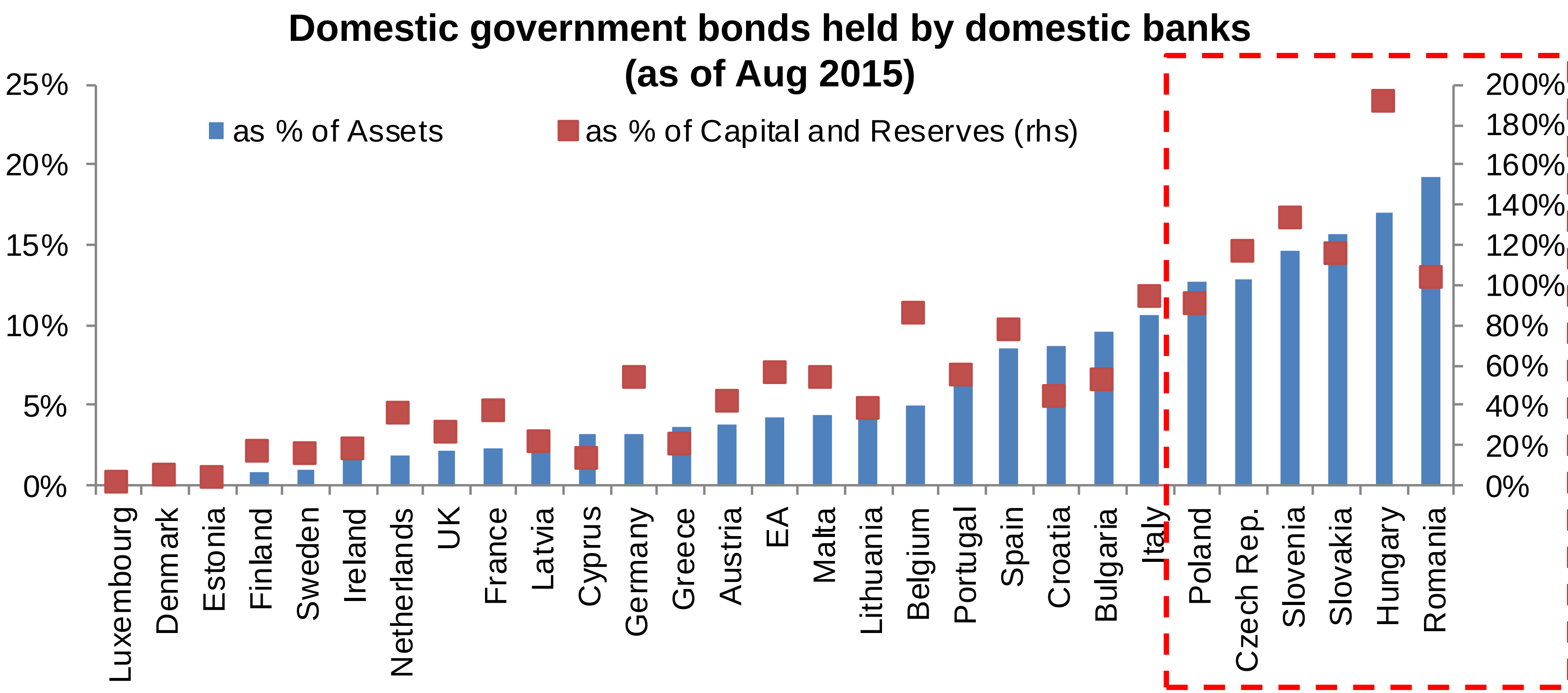
The bond market becomes more a more distorted

- **Hungary: abolished 2w deposit facility and increased volume of IRS with the central bank incentivise banks to buy more sovereign debt**
- **Poland: introduction of the new banking tax (0.44%) and exempting government securities from the tax base incentivise banks to buy sovereign**
- **Czech Republic: Excess liquidity related to FX interventions increase demand for CZK cash instruments**
- **Romania: Cut of reserve requirement ahead of issuance of FX debt will help to stimulate demand**
- **Slovakia: ECB‘s asset purchase program moves the prices where the demand is not exisiting any more**
- **Liquidity has been drying on the bond market**

Shift in the structure of highly liquid assets of Hungarian banks (HUFbn)



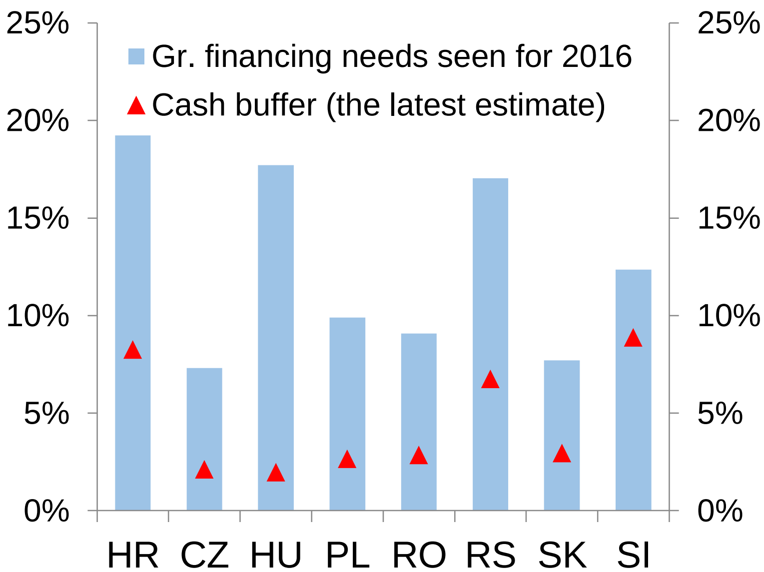
CEE banks are already heavily loaded with domestic bonds; regulation may make them more expensive to hold (capital-wise)



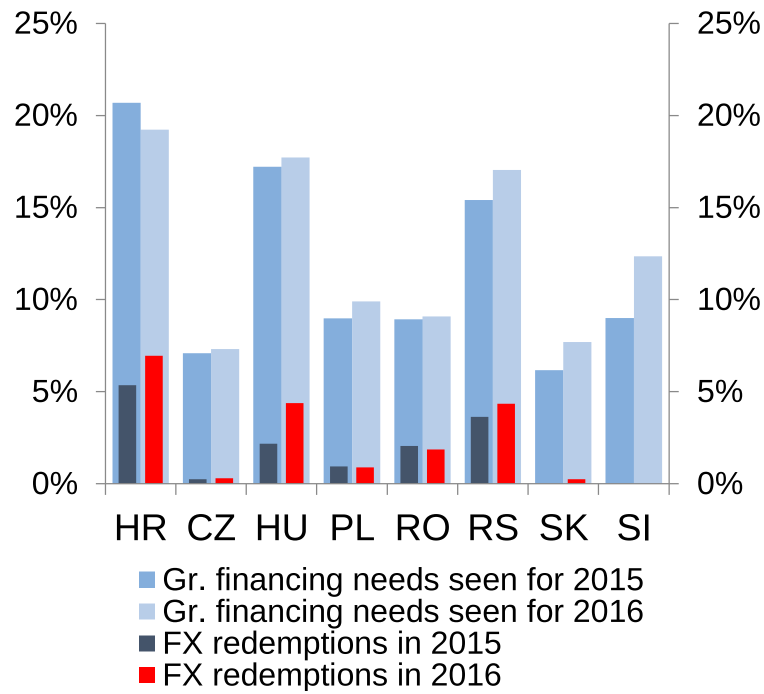
Source: ECB, Erste Group Research

Debt issuance will increase in CEE in 2016

Gross financing needs in 2016 and cash reserve (% of GDP)



Gross financing needs and FX redemptions (% of GDP)



- **After 2 years of absence, Hungary will tap international markets**
- **Romania will need to frontload the issuance to avoid getting under pressure ahead of elections**

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FX and bond yield forecasts – downward risks at some yield forecasts

Government bond yields	current	2016Q1	2016Q2	2016Q3	2016Q4
Croatia 10Y	3.81	3.90	3.80	3.90	4.00
Czech Rep. 10Y	0.53	0.49	0.52	0.55	0.57
Hungary 10Y	3.35	3.40	3.47	3.53	3.60
Poland 10Y	3.18	3.12	3.19	3.25	3.29
Romania 5Y	2.04	2.40	2.50	2.80	3.00
Slovakia 10Y	0.59	0.90	0.95	1.00	1.05
Slovenia 10Y	1.54	1.50	1.60	1.70	1.70
Serbia 7Y	7.82	7.50	7.00	7.00	7.00

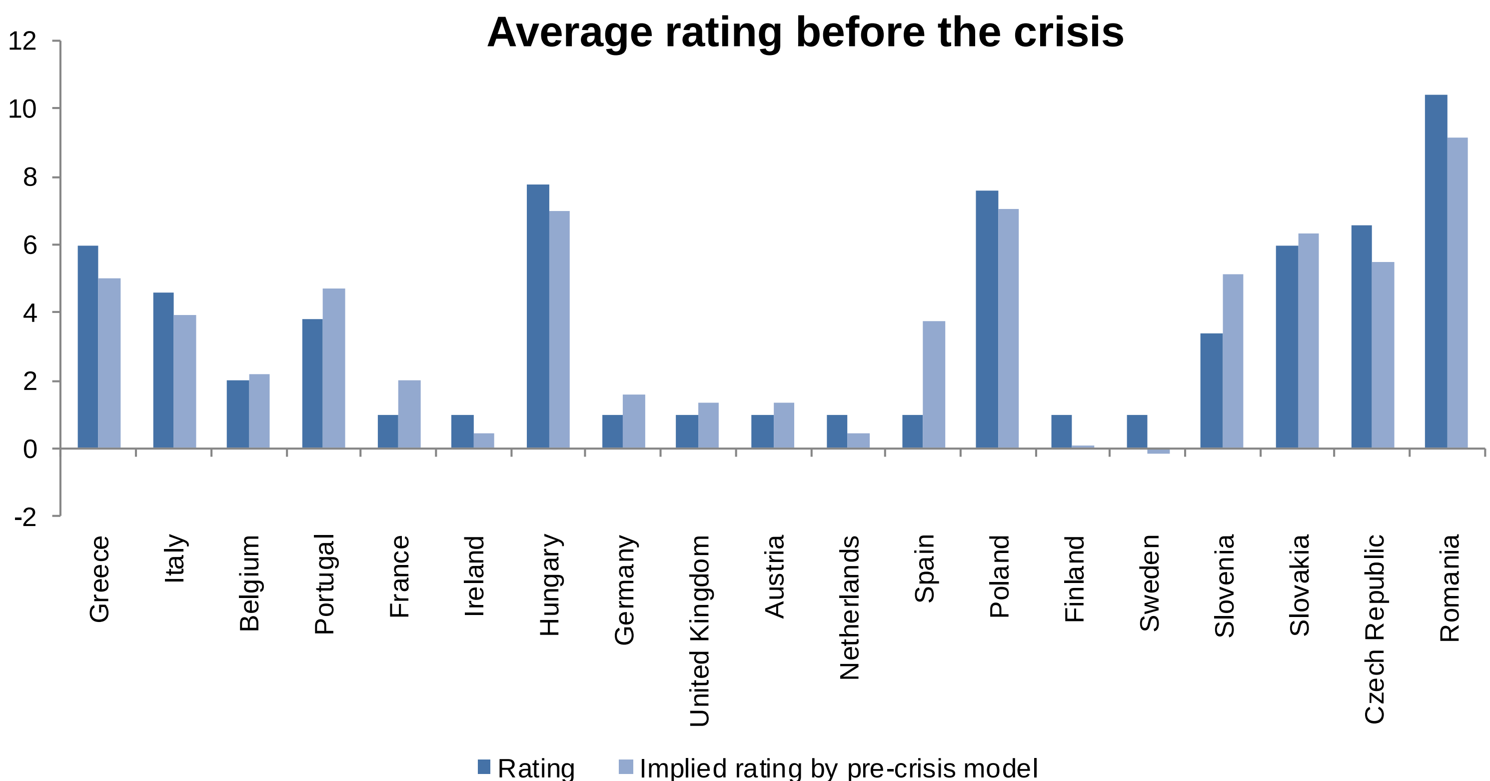
3M Money Market Rate	current	2016Q1	2016Q2	2016Q3	2016Q4
Croatia	0.92	0.90	0.80	0.80	0.80
3M forwards		-	-	-	-
Czech Republic	0.29	0.30	0.30	0.30	0.30
3M forwards		0.30	0.21	0.16	0.14
Hungary	1.35	1.35	1.35	1.35	1.35
3M forwards		1.36	1.28	1.26	1.27
Poland	1.70	1.38	1.23	1.24	1.24
3M forwards		1.62	1.51	1.47	1.46
Romania	0.83	1.00	1.20	1.30	1.40
3M forwards		0.48	0.90	1.40	1.33
Serbia	3.46	3.40	3.00	3.00	3.00
3M forwards		-	-	-	-
Eurozone	-0.16	-0.25	-0.25	-0.25	-0.25

Source: Erste Group Research, Bloomberg

FX	current	2016Q1	2016Q2	2016Q3	2016Q4
EURHRK	7.67	7.70	7.60	7.65	7.70
forwards		7.68	7.69	7.71	7.72
EURCZK	27.02	27.02	27.02	27.03	27.04
forwards		27.07	26.97	26.79	26.37
EURHUF	310.6	314.0	315.0	315.0	315.0
forwards		311.4	312.4	313.6	314.8
EURPLN	4.41	4.45	4.39	4.43	4.47
forwards		4.42	4.44	4.45	4.47
EURRON	4.51	4.48	4.47	4.45	4.45
forwards		4.52	4.53	4.54	4.55
EURRSD	122.7	122.0	122.5	122.5	122.5
forwards		-	-	-	-
EURUSD	1.10	1.06	1.07	1.08	1.10

Key Interest Rate	current	2016Q1	2016Q2	2016Q3	2016Q4
Croatia	0.50	0.50	0.50	0.50	0.50
Czech Republic	0.05	0.05	0.05	0.05	0.05
Hungary	1.35	1.35	1.35	1.35	1.35
Poland	1.50	1.25	1.00	1.00	1.00
Romania	1.75	1.75	1.75	1.75	2.00
Serbia	4.50	4.25	4.00	4.00	4.00
Eurozone	0.05	0.05	0.05	0.05	0.05

Before the crisis, ratings had been well explained by differences in GDP per capita, inflation and competitiveness index



Source: Erste Group Research, Bloomberg

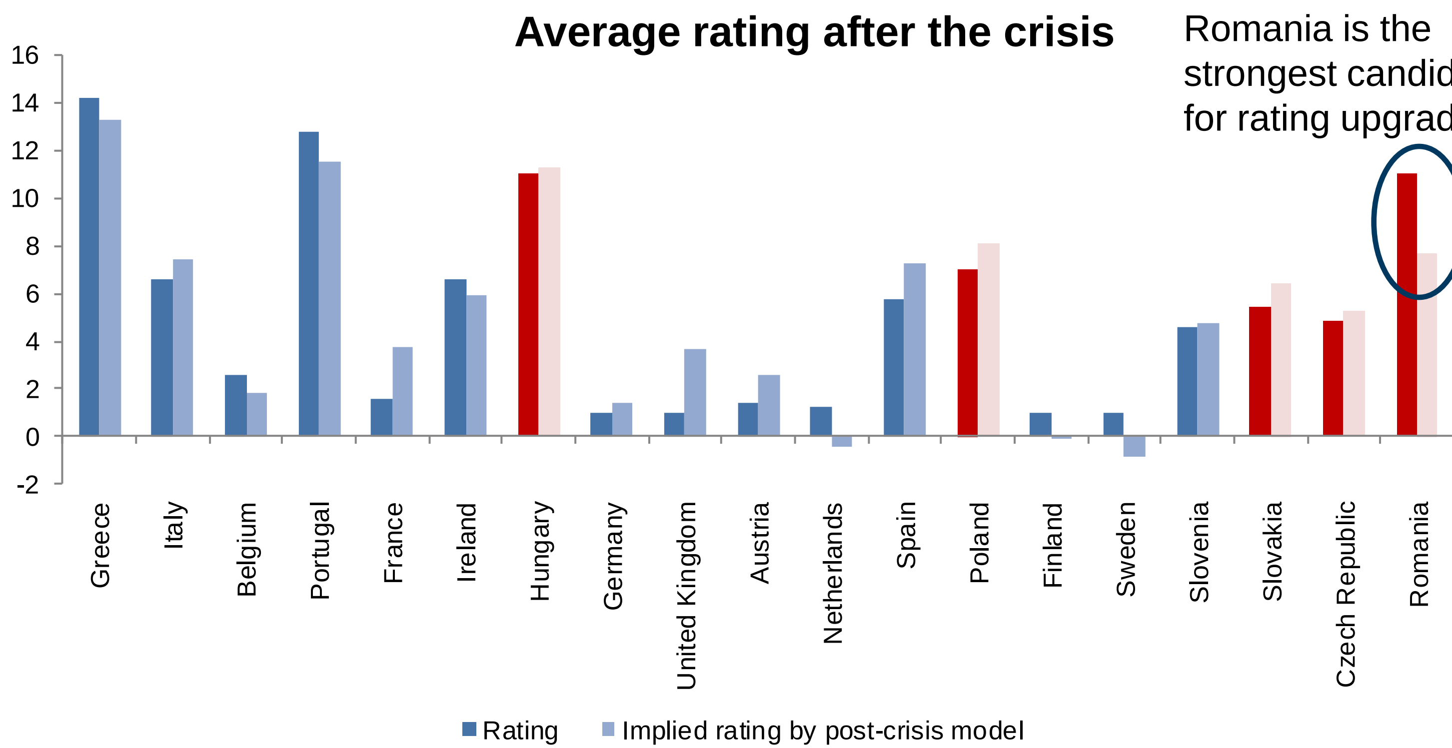
Implied rating:

-0.15*gdppercapita
-1.88*comp
+0.26*infl
+constant

Insignificant:

Deficit
Public Debt
International Investment Position

After the crisis, external imbalances and public debt levels have gained on significance



Romania is the strongest candidate for rating upgrade

Implied rating:

-0.16*gdppercapita
0.13*deficit
0.06*debt
-4.12*iip

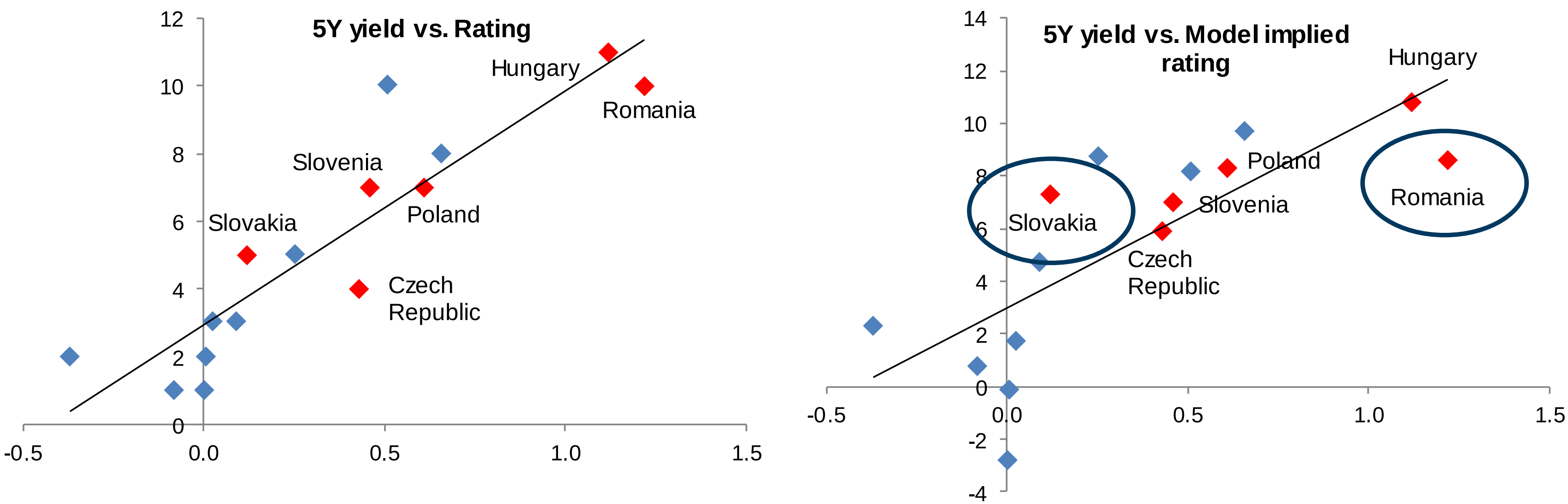
Insignificant:

Inflation
Competitiveness
Index

Source: Erste Group Research, Bloomberg

In cash instruments, Romania is still relatively cheap, Slovakia expensive

5Y yields on Eurobonds vs. Rating



Source: Erste Group Research, Bloomberg

Summary

- Car production in CEE is getting more diversified (it is not only VW)
- We will see more home-grown growth in CEE next year
- Investments in infrastructure, energy efficiency & security will stimulate the growth and enhance growth potential
- Credit to the private sector is picking up
- Inflation remains low – more monetary easing in the sight
- Bonds are getting extremely expensive – Romania's Eurobonds look as a good relative value trade

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