Global and regional trends

Focus on Central and Eastern Europe

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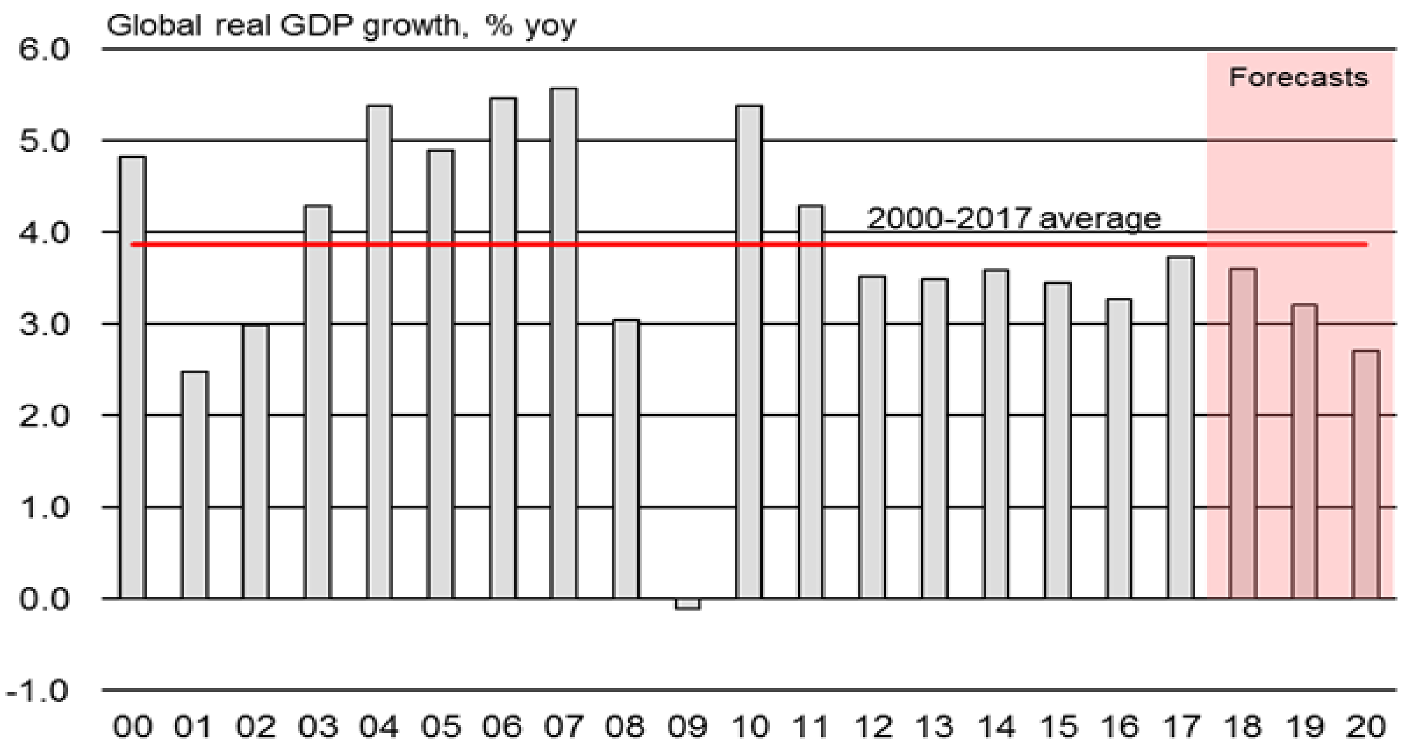
Zagreb, 25 September 2019

Banking that matters. | UniCredit

Main messages

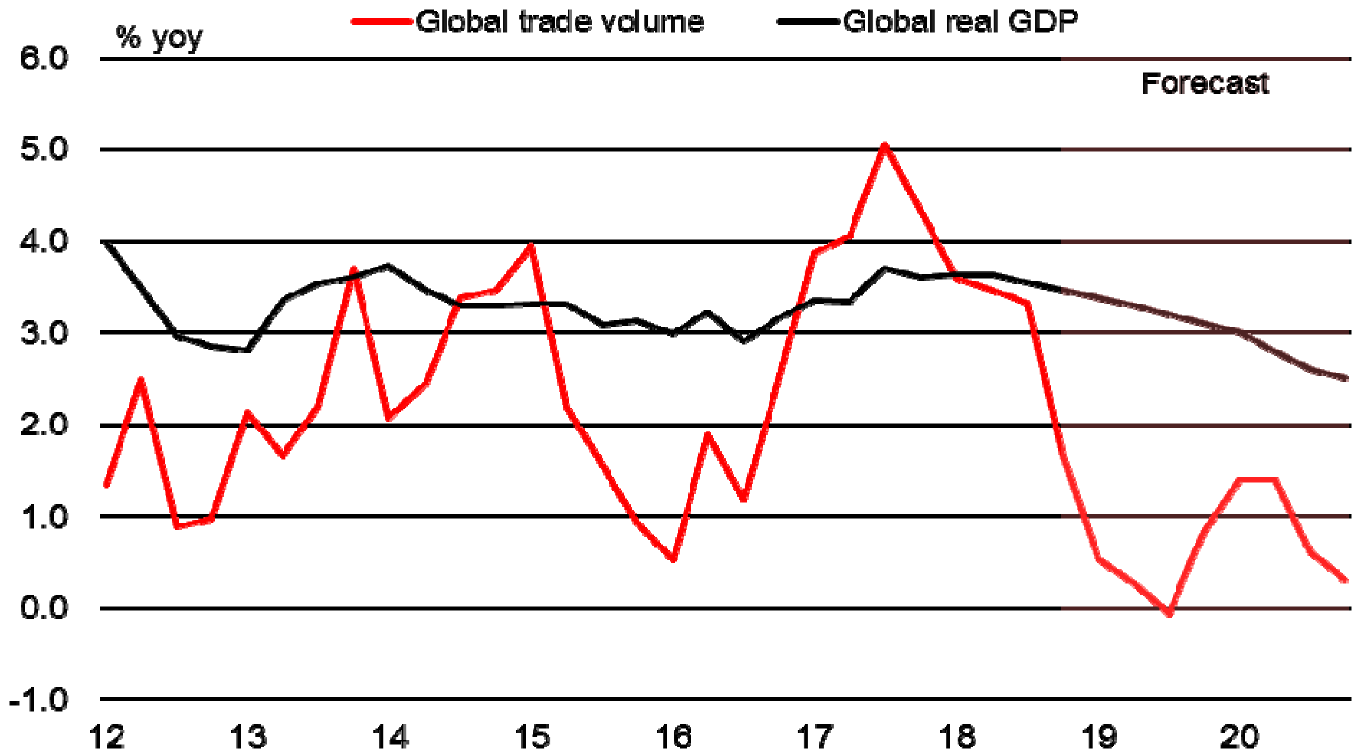
1. The business cycle is approaching its end
2. Growth will slow below potential in CEE but the region will outperform other EM
3. Quantitative easing in the eurozone cannot replace good public policies in CEE

1.1. We expect global growth to slow…



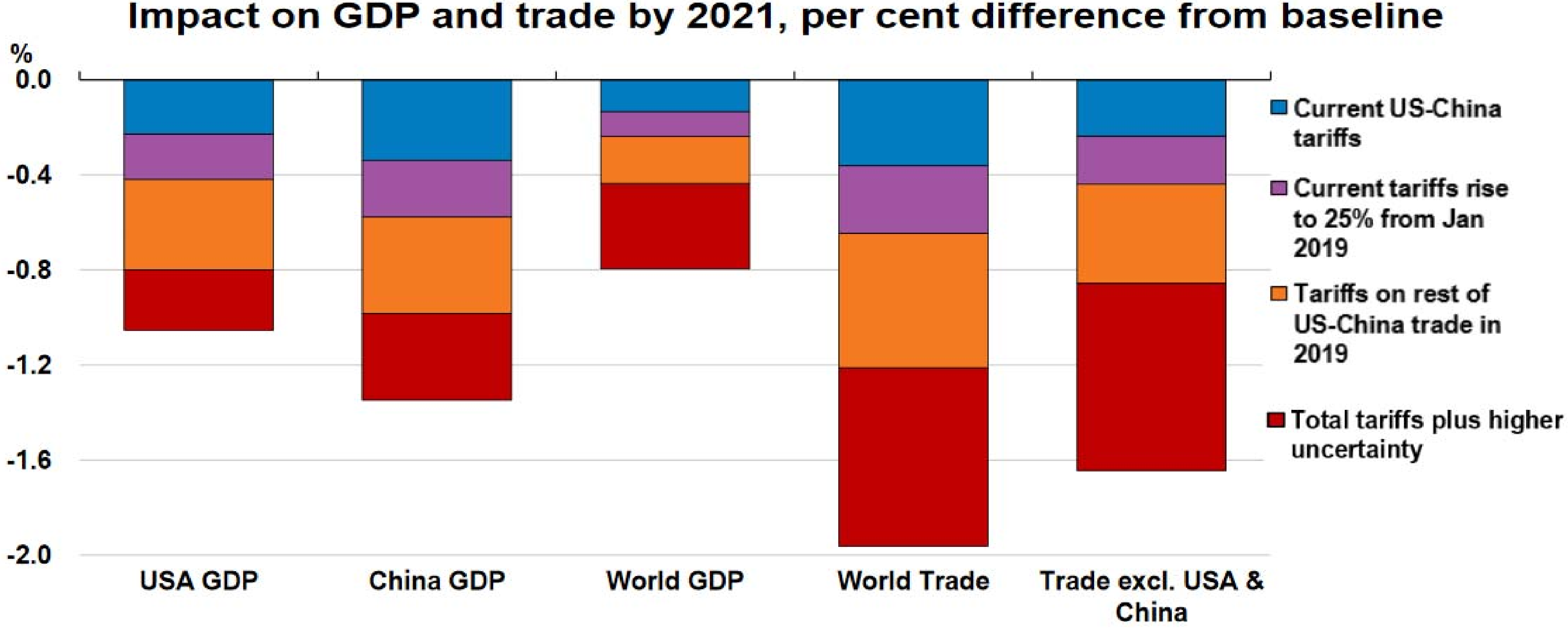
Source: IMF WEO, UniCredit Research

1.2. … due to weak global trade



Source: IMF, CPB Netherlands, UniCredit Research

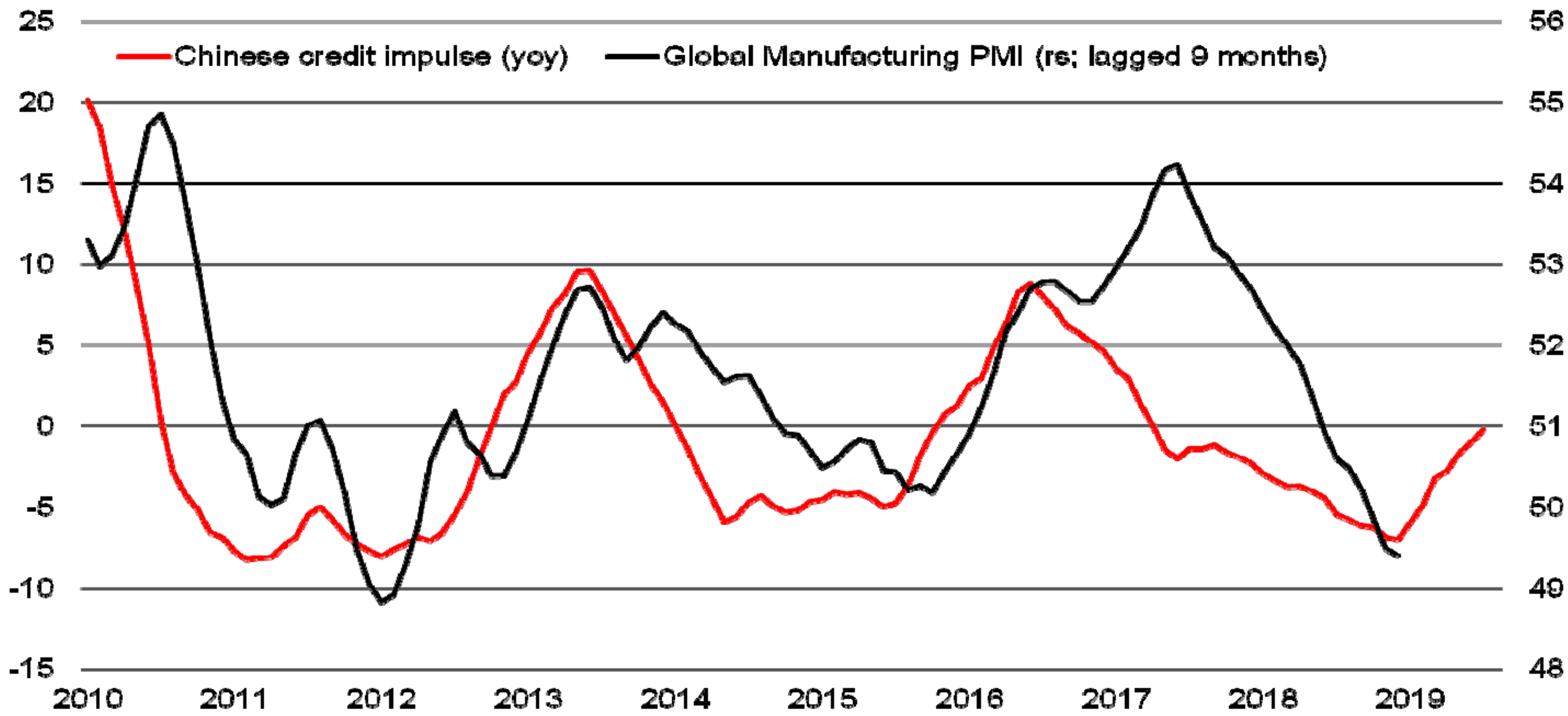
1.3. The cost of trade wars



OECD: Economic Outlook , November 20

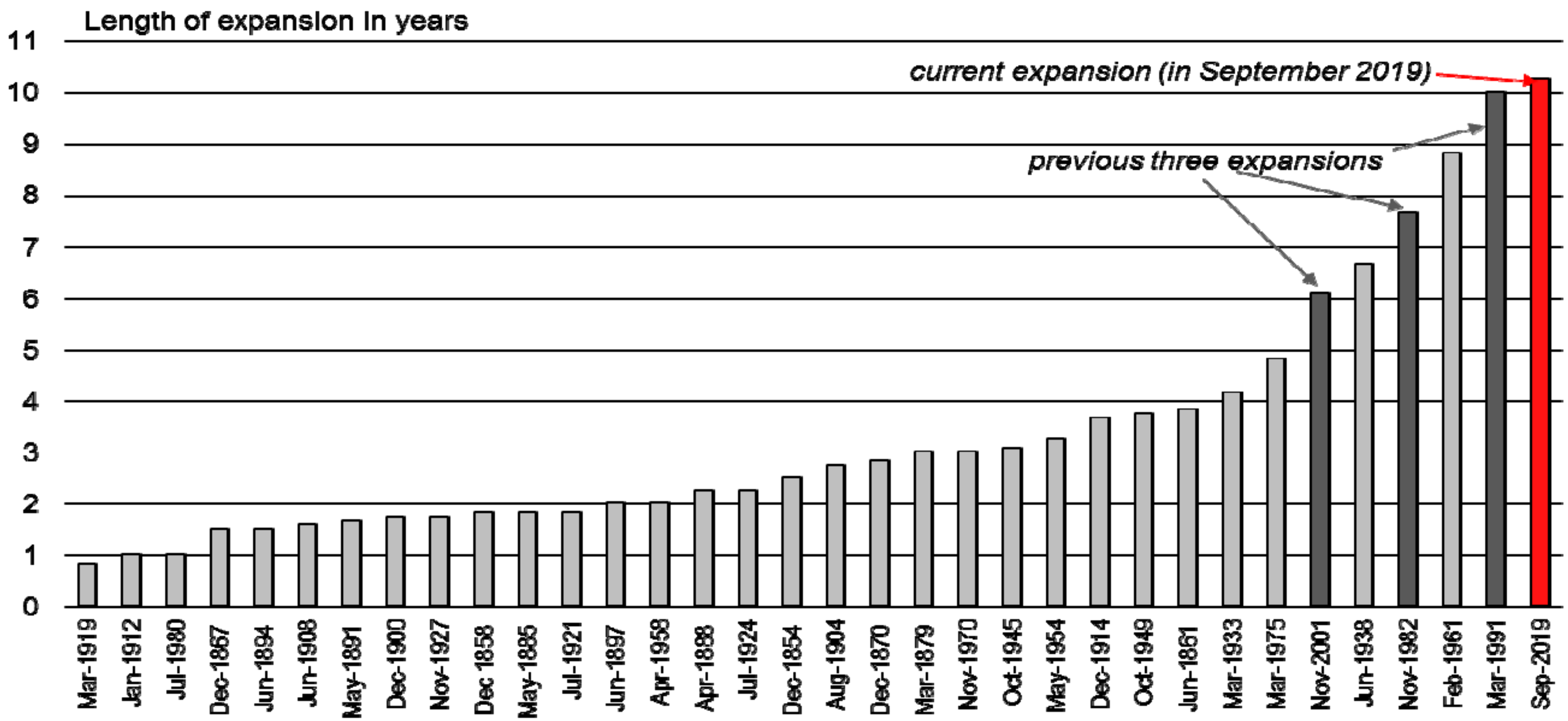
Note: Current tariffs include all tariffs imposed on bilateral US-China trade in 2018 up to the end of September. The purple scenario shows the additional impact of the United States raising tariffs on $200 billion of imports from China from 10% to 25% from January 2019 (with reciprocal action by China on $60 billion of imports from the United States). The orange scenario shows the additional impact if tariffs of 25% are imposed on all remaining bilateral non-commodity trade between China and the United States from July 2019. The red scenario shows the additional impact of related uncertainty resulting in a rise of 50bp in investment risk premia in all countries in 2019-2021.
Source: OECD calculations.

1.4. Global manufacturing:
Dancing to the tune of the Chinese credit cycle – and that looks up



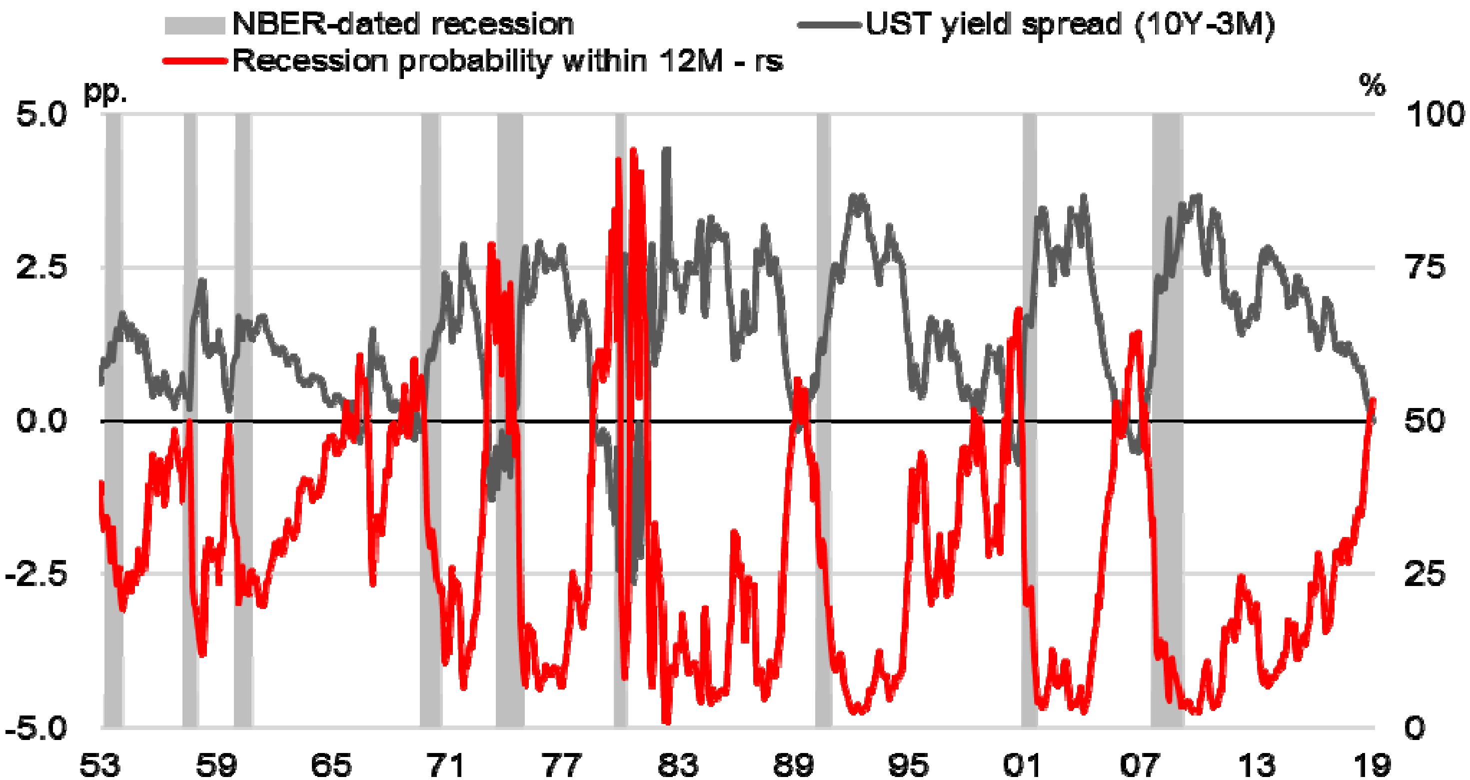
Source: BIS, UniCredit Research

1.5. US: Resilience will not last forever



Source: BEA, UniCredit Research

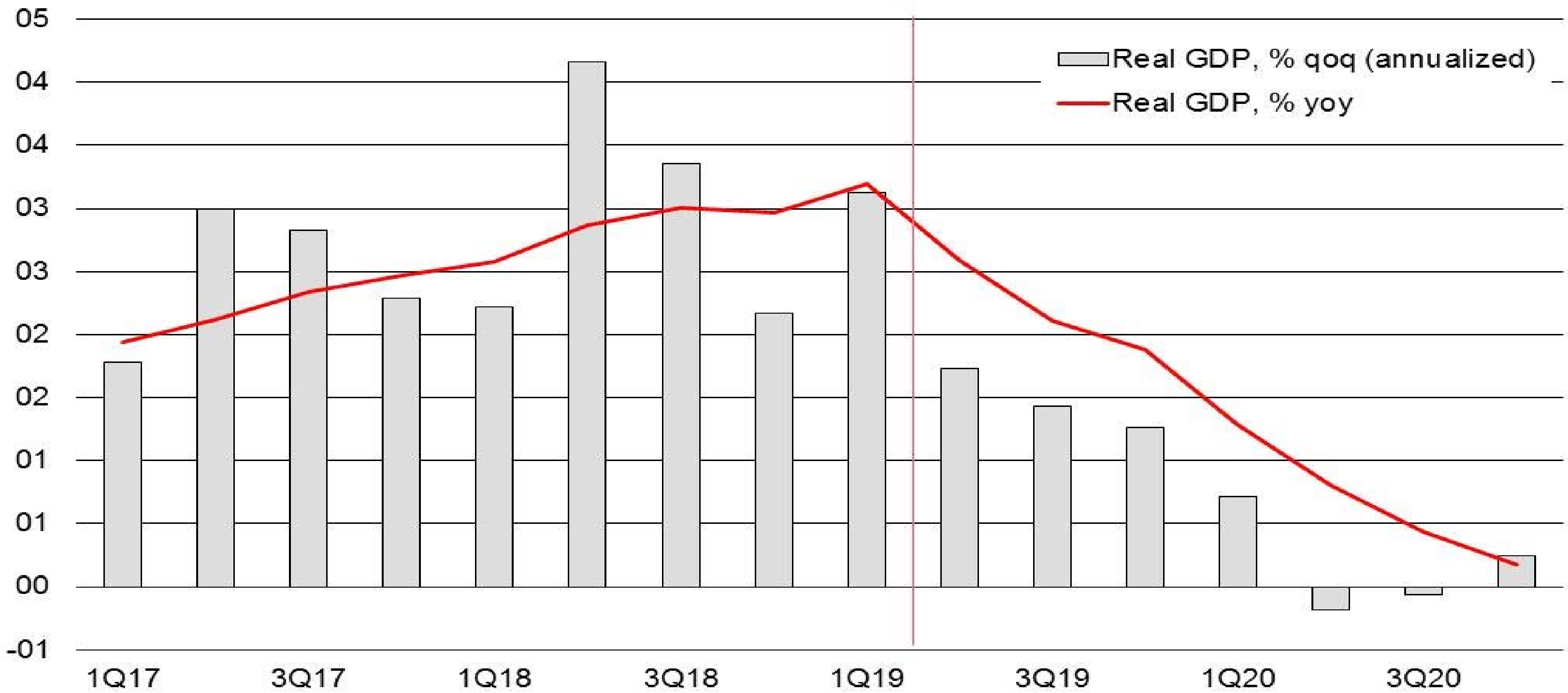
1.6. The probability of recession in the US remains high…



Source: statistical offices, UniCredit Research

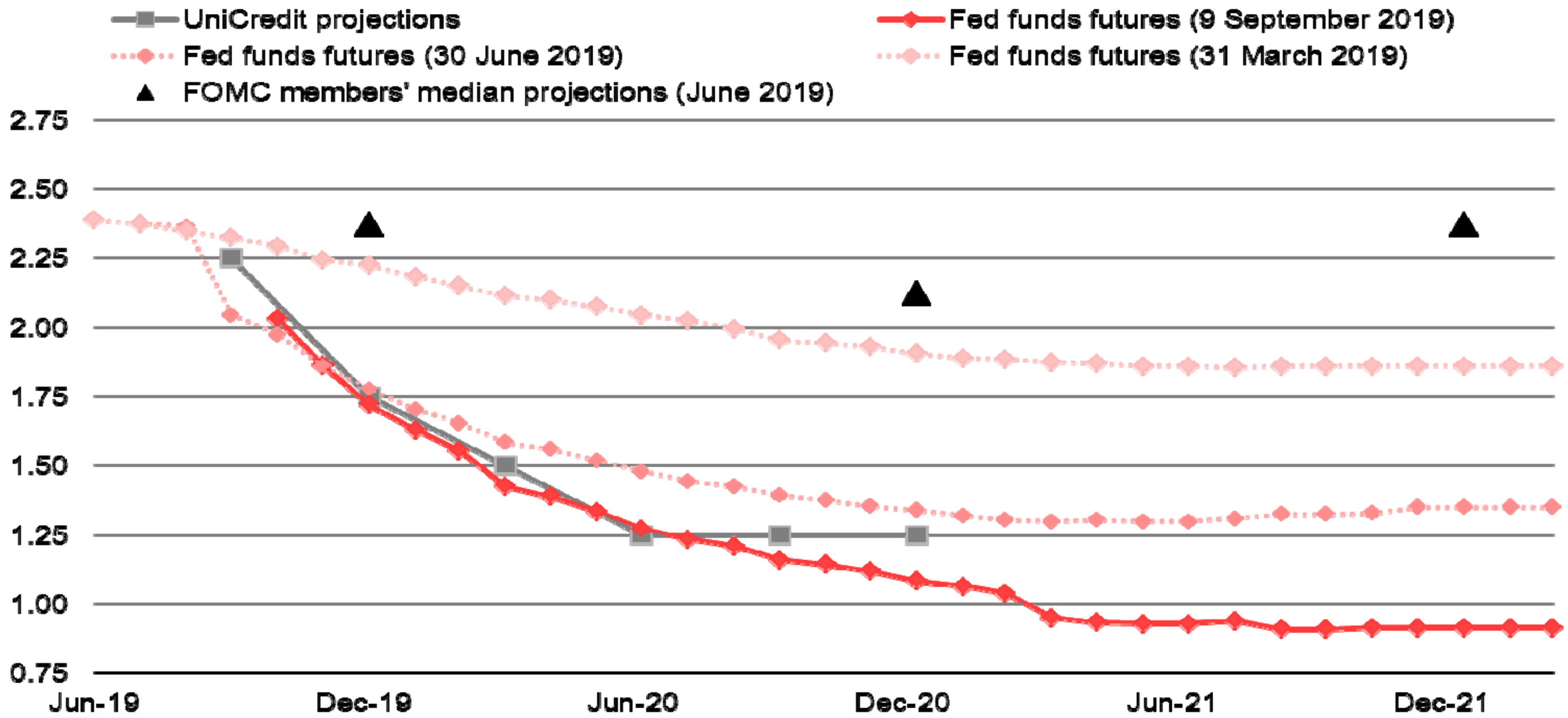
1.7. …with a downturn expected in 2020…

US growth: **2018: 2.9%** **2019: 2.4%** **2020: 0.7%**



Source: BEA, UniCredit Research

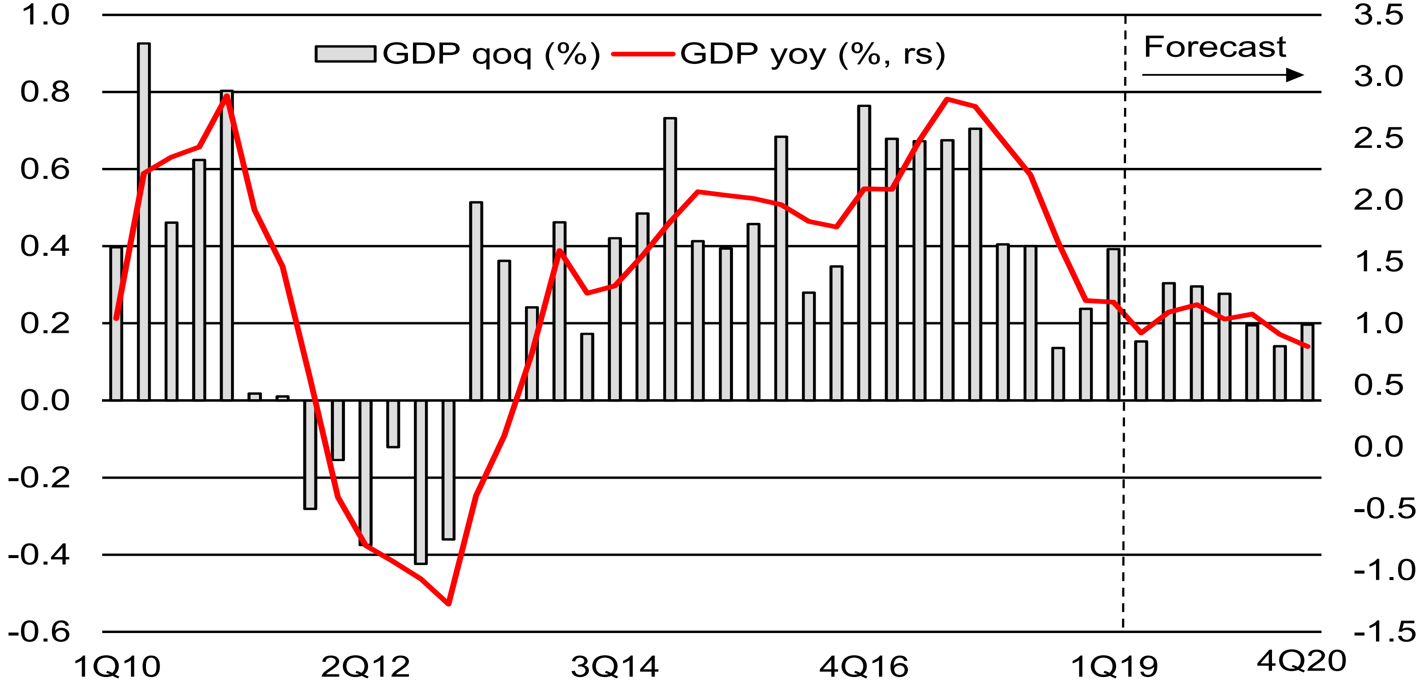
1.8. …triggering another rate cut from the Fed in 2019 and two in 2020



Source: Bloomberg , UniCredit Research

1.9. Eurozone: weak global trade to slow economic growth

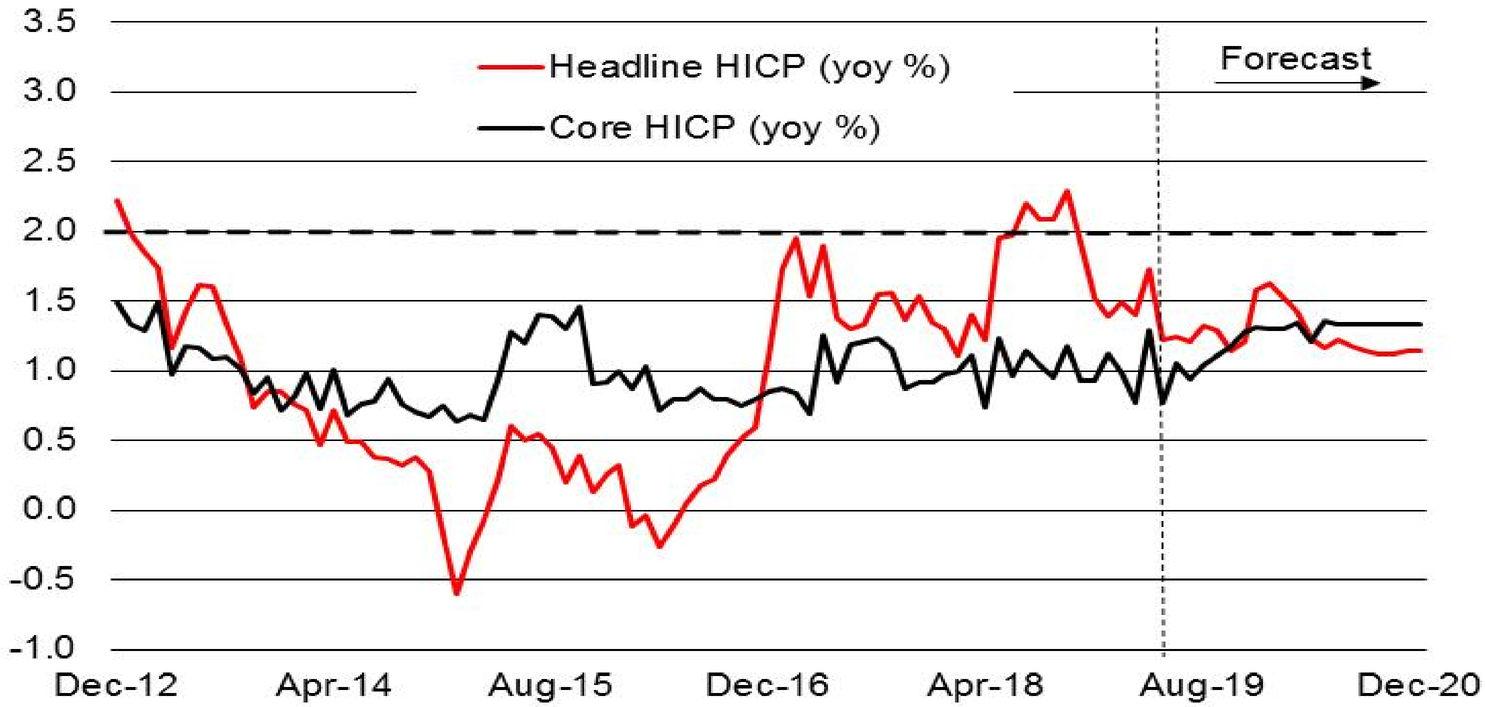
EMU growth: 2018: 1.9% 2019: 1.0% 2020: 1.0%



Source: Eurostat, UniCredit Research

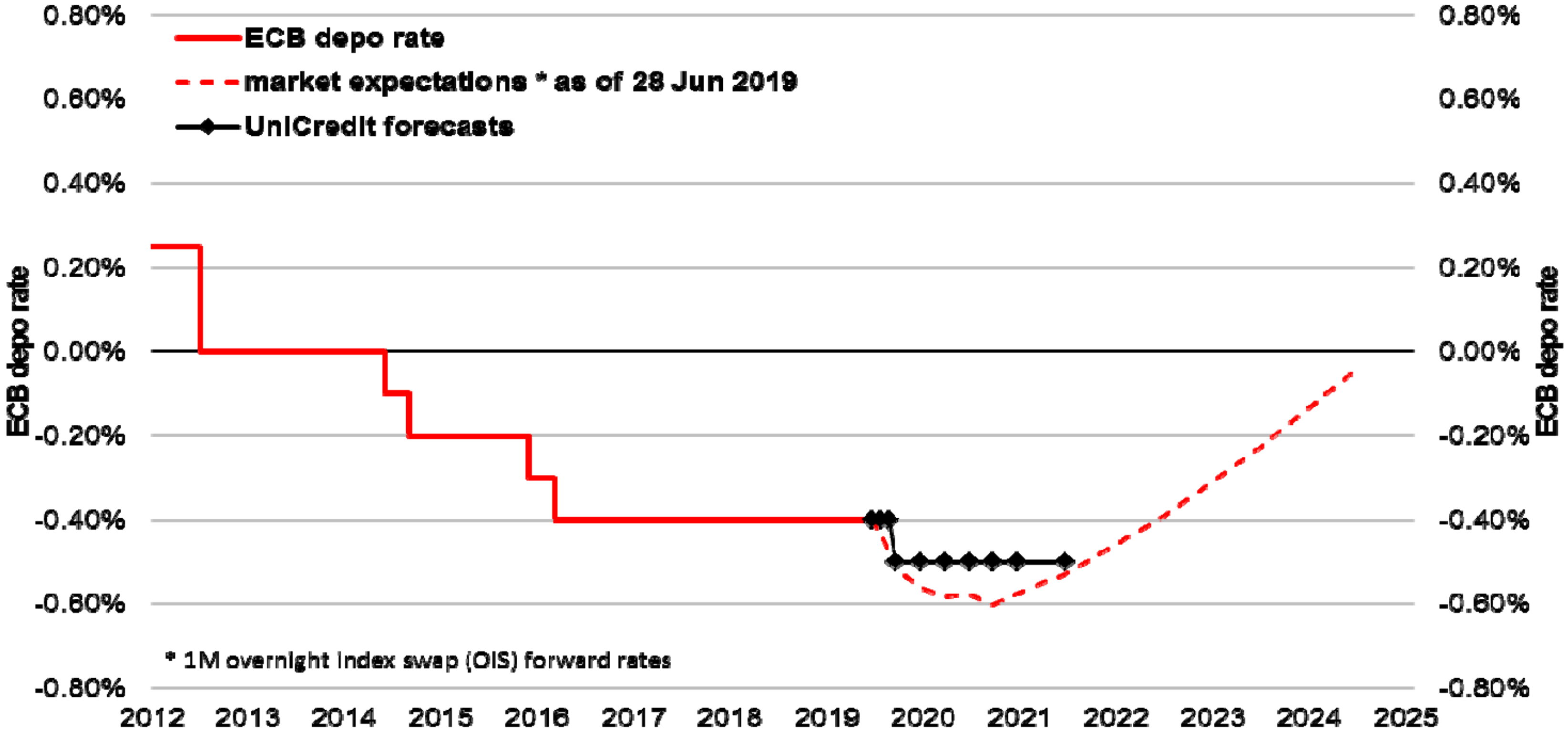
1.10. Eurozone: Headline and core inflation well below 2%

ECB: unchanged policy rates throughout 2020



Source: Eurostat, UniCredit Research

1.11. … prompted the ECB to ease monetary policy again



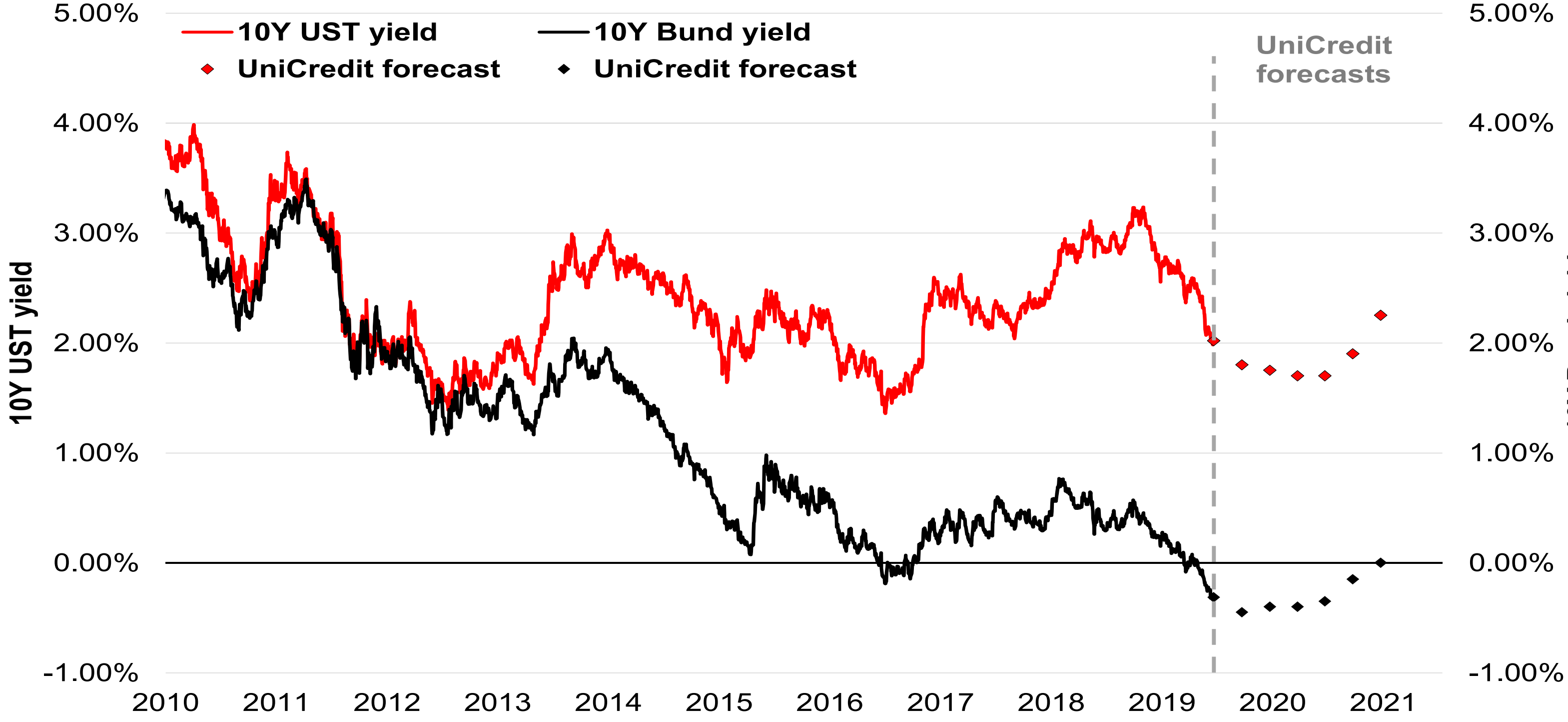
Source: Bloomberg, UniCredit Research

1.12. Exit from negative rates – don't hold your breath

Source: Bloomberg, UniCredit Research

1.13. UST yields on their way down, Bund yields to turn positive by 2021

10Y UST and Bund yield



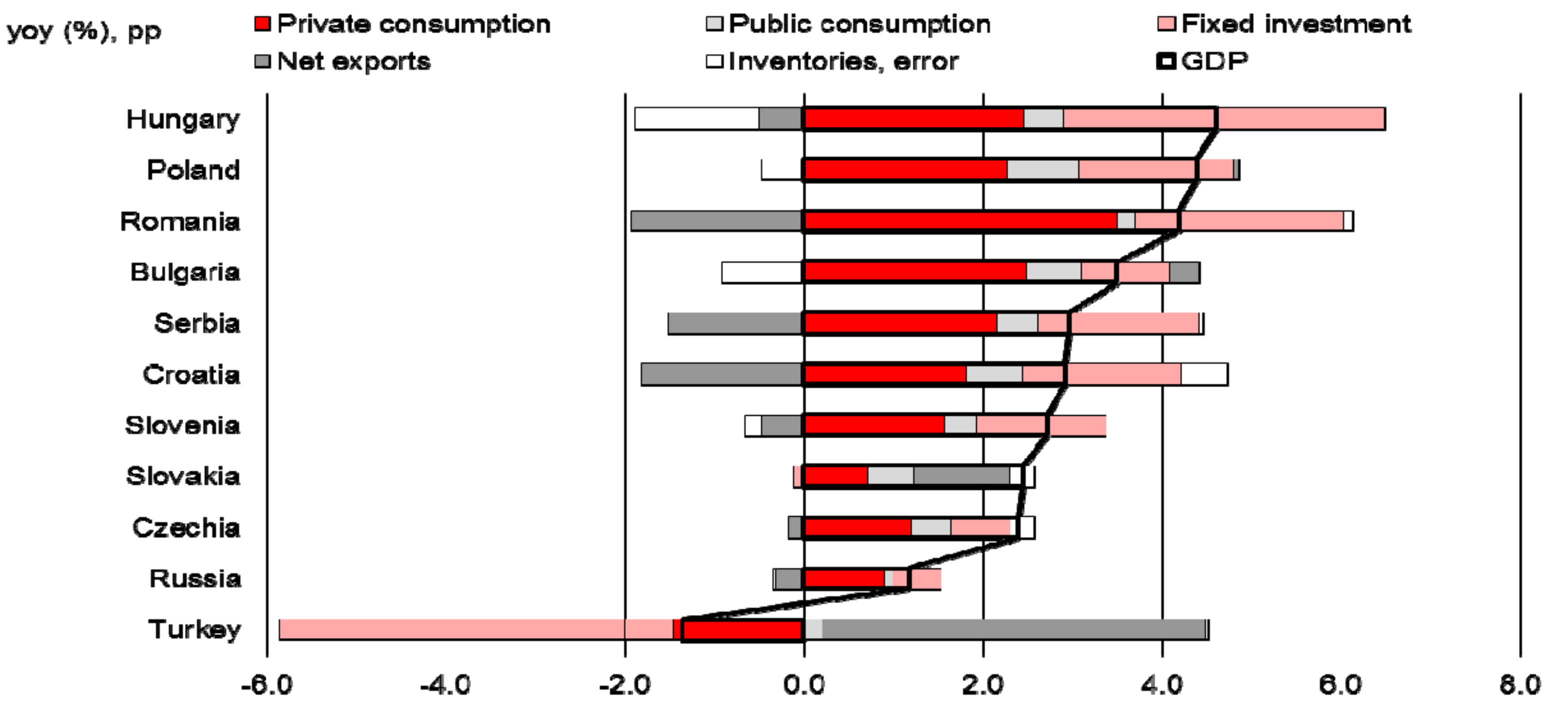
Source: Bloomberg, UniCredit Research

Main messages

1. The business cycle is approaching its end
2. **Growth will slow below potential in CEE but the region will outperform other EM**
3. Quantitative easing in the eurozone is not a cure-all solution

2. 1. 2019: the start of a cyclical slowdown

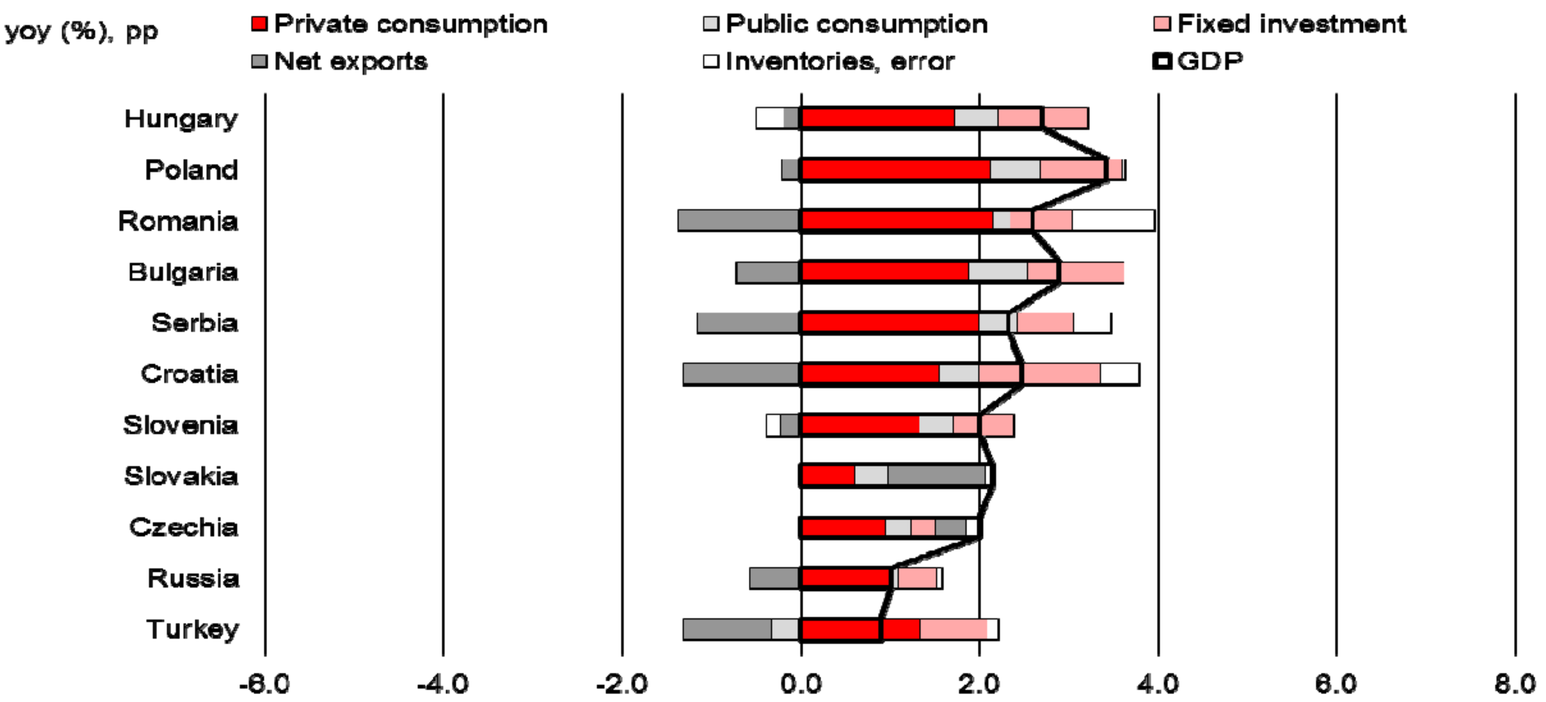
Growth still above potential in EU-CEE



Source: national statistical offices, UniCredit Research

2.2. 2020: GDP growth expected below potential in all CEE countries

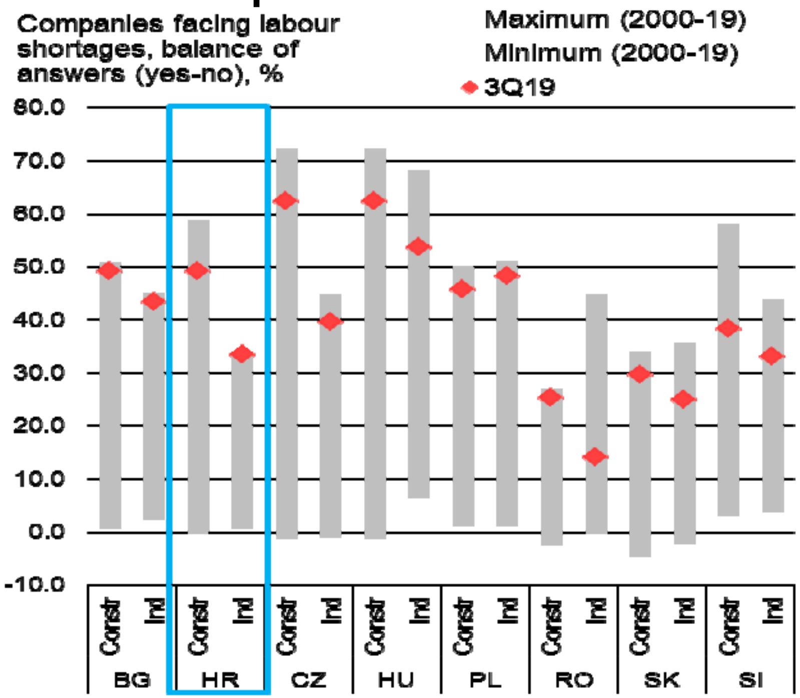
Growth below potential in all countries



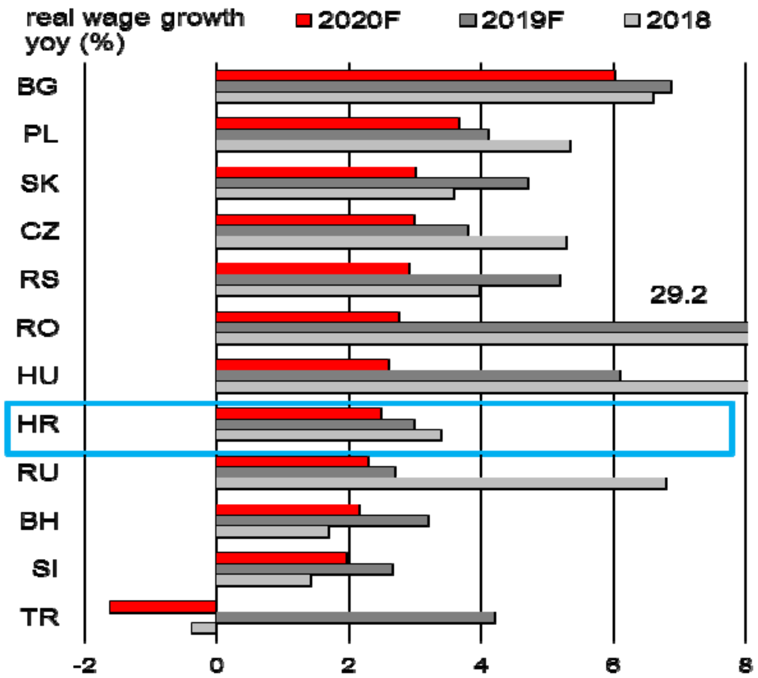
Source: national statistical offices, UniCredit Research

2.3. Labour market tensions have probably peaked in CEE…

Labour shortages probably peaked in central Europe…



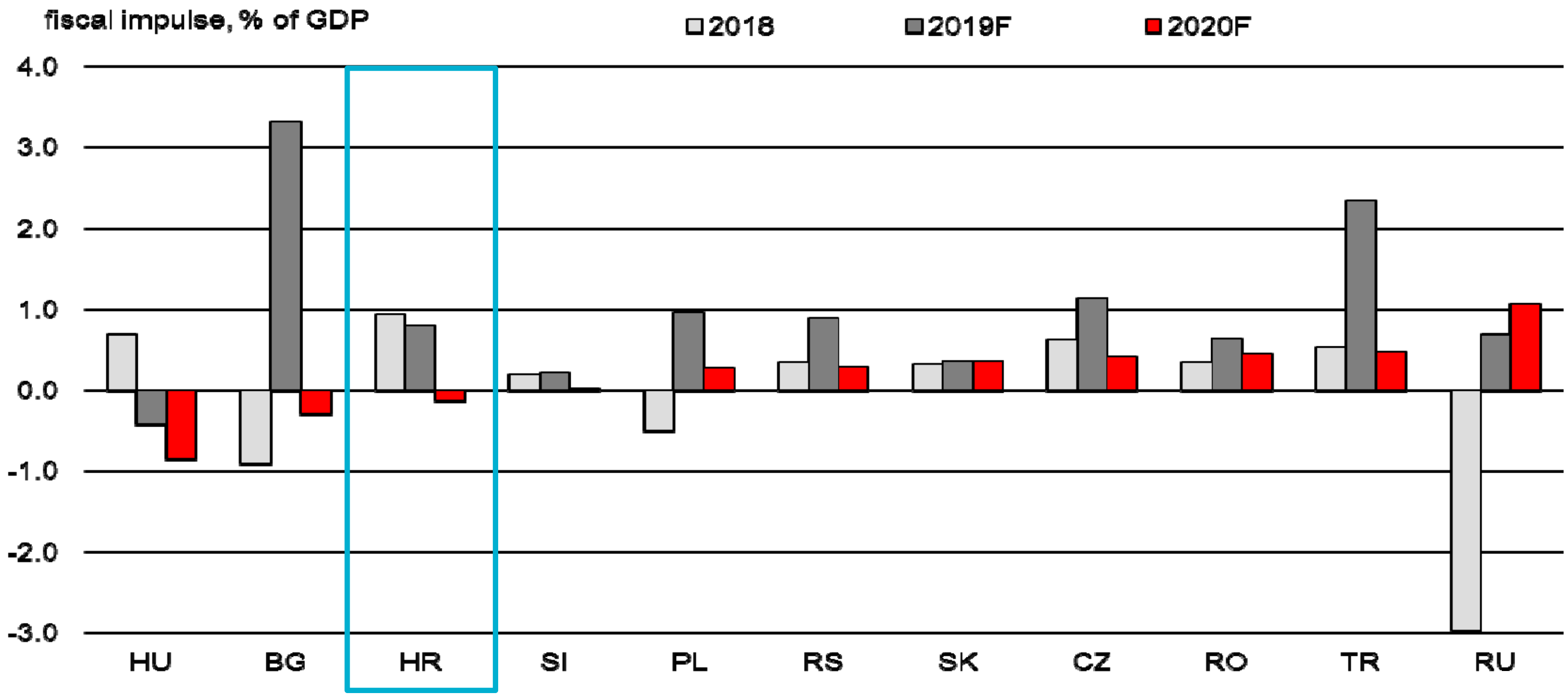
… and may help ease wage growth in 2020



Source: national statistical offices, UniCredit Research

2.4. … but governments are trying to smooth the cyclical slowdown

… probably too soon. Little scope for fiscal stimulus in 2020.



Source: Eurostat, central banks, statistical offices, ministry of finance, UniCredit Research

2.5. EM risk heatmap – CEE an outperforme

Legend
Low vulnerability
Moderate vulnerability
Significant vulnerability
High vulnerability

	BG	CZ	HR	HU	PL	RO	RS	RU	SK	TR	UA	MX	BR	CL	SA	ID	IN	CN	AG
External Liquidity																			
Current account (% of GDP)	7.6	0.7	2.0	-1.1	-0.1	-5.0	-5.6	6.8	-2.5	0.2	-3.2	-1.4	-0.8	-3.3	-3.6	-3.0	-2.4	1.0	-4.7
Extended Basic Balance (% of GDP)	11.1	2.5	4.6	4.0	3.8	-1.0	1.9	6.2	1.1	1.4	-1.2	0.5	0.3	-2.9	-1.6	-1.7	-1.3	1.6	-4.1
FX Reserves coverage (months of imports)	8.1	7.9	8.1	2.6	4.3	4.0	6.1	14.4	-	4.1	3.3	4.1	17.6	5.3	5.2	6.6	7.0	14.9	9.1
External Debt (excl.ICL, % of GDP)*	35.9	80.5	64.1	56.8	44.8	35.0	62.6	20.8	89.2	61.1	87.8	35.0	66.4	62.5	46.7	35.6	19.2	14.5	46.2
Short-term debt (% of GDP)	14.4	46.8	20.8	10.3	8.1	7.2	2.9	3.3	47.1	17.2	11.5	3.4	4.2	7.4	9.9	4.8	7.5	9.4	10.9
REER (Index, 2010=100)	102.0	98.7	97.3	88.4	90.2	97.3	123.6	84.1	-	62.9	91.4	84.9	106.5	90.6	84.0	90.3	106.7	120.8	118.9
Domestic Finances																			
Corporate debt (% of GDP)	48.6	52.1	58.0	57.3	45.9	38.5	42.2	55.2	54.9	98.3	72.5	37.6	39.4	77.2	55.6	36.5	44.8	151.6	15.2
Household Debt (% of GDP)	20.1	34.2	35.5	20.6	35.6	18.9	20.3	16.6	44.3	13.6	5.8	16.0	43.4	35.6	33.7	16.2	11.4	52.6	5.8
Nonresident holdings of gov.debt (% total)	0.9	40.9	-	23.6	24.9	18.6	31.3	39.4	51.8	11.4	-	31.0	11.7	-	39.2	37.7	-	8.4	-
Banking System																			
Credit Impulse (% of GDP)	0.3	0.5	4.3	1.8	0.8	0.2	1.2	4.7	-1.4	-8.3	-1.6	0.0	4.1	3.1	0.4	1.1	0.6	0.5	-2.3
Loans/deposit ratio (%)	73.1	68.3	80.7	68.7	98.2	75.0	92.6	103.5	103.0	110.1	188.1	103.2	97.6	109.7	106.4	102.9	113.1	72.2	150.8
NPL (% of total loans)	6.9	2.8	9.4	2.4	4.0	4.7	5.2	10.7	2.9	4.6	54.3	2.1	3.0	1.9	3.7	2.6	9.5	1.8	4.1
Domestic Banks CAR (%)	20.5	18.4	22.6	17.5	18.3	19.6	23.2	12.5	18.7	18.2	15.7	15.9	18.0	13.0	16.1	23.2	12.9	14.2	14.4
Domestic Banks RoE (%)	14.3	16.5	11.1	13.6	7.3	11.3	9.9	11.1	9.8	12.0	8.8	20.7	14.6	17.9	19.8	14.4	-0.2	11.7	-
Policy																			
Policy Rate, nominal (%)	-	2.00	-	0.90	1.50	2.50	2.50	7.00	-	16.50	17.50	8.25	6.50	3.00	6.75	6.00	6.00	4.35	70.73
Real policy rate (%)	-	-0.9	-	-2.1	-1.3	-1.3	1.2	2.5	-	1.3	7.2	3.8	1.8	0.6	2.3	2.3	2.8	1.6	8.5
Real Money market rate (%)	-	-0.8	-0.8	-2.8	-1.2	-0.9	0.7	2.9	-	2.3	6.0	3.9	0.6	0.5	2.1	3.5	3.8	0.5	-7.8
Headline inflation (% yoy)	2.9	2.9	1.1	3.1	2.9	3.9	1.3	4.3	2.8	15.0	9.6	4.3	4.7	2.3	4.4	3.6	3.1	2.7	57.3
Core Inflation (% yoy)	2.0	2.4	1.5	3.2	2.2	3.4	1.2	4.3	2.5	13.6	7.4	3.8	3.0	2.0	4.1	3.5	4.5	1.7	58.8
GG Fiscal balance (% of GDP)	1.2	0.8	0.2	-2.0	-1.1	-3.3	0.4	3.3	-0.7	-2.7	-2.3	-1.9	-7.0	-1.8	-4.9	-1.8	-3.8	-4.8	-4.3
GG Primary balance (% of GDP)	1.8	0.8	2.6	0.5	0.2	-1.8	2.6	2.1	-0.1	-0.4	-	0.7	1.4	-0.9	-1.3	-0.6	-0.3	-3.8	-1.7
Government Debt (% of GDP)	20.5	34.0	74.5	70.1	49.1	35.0	54.3	12.0	48.9	31.8	64.9	38.1	76.5	35.5	56.7	34.6	44.9	50.5	61.0
Markets																			
External Debt Spread (10Y, bp)**	72.6	38.3	102.2	78.2	52.2	195.5	159.6	164.9	52.5	515.3	518.7	160.4	185.6	59.9	288.9	141.5	127.2	42.4	1940.0
Local Currency Curve (5Y, %)***	0.0	1.0	0.8	0.9	1.8	3.9	3.8	6.8	-0.4	15.0	6.0	6.7	9.1	2.2	8.0	6.6	6.4	2.9	58.5
Local currency bond spread (2s10s)****	55.9	11.6	38.1	156.0	58.8	76.9	-35.8	41.0	34.3	-7.0	184.5	-10.0	177.2	270.0	206.1	90.2	95.8	41.9	-8131.5
CDS (5Y, bp)	90	49	94	85	74	97	97	83	17	386	454	113	134	38	188	89	79	46	3853
FX 3m implied volatility (%)	-	3.6	4.0	5.4	5.5	2.3	-	9.5	-	15.4	-	9.9	13.0	9.3	15.1	6.3	6.6	5.4	13.5
Structural*****																			
IBRD Doing Business	59	35	58	53	33	52	48	31	42	43	71	54	109	56	82	73	77	46	119
WEF Competitiveness Ranking	51	29	68	48	37	52	65	43	41	61	83	46	72	33	67	45	58	28	81
Unemployment (%)	4.5	2.2	8.1	3.3	3.2	5.3	10.8	4.5	5.7	13.9	8.6	3.3	11.6	6.8	27.5	5.3	7.0	4.8	9.1

*External debt incl ICL for CZ, RS, TR, MX, CL and SA ** Spread between 10Y EUR government bond yields and the corresponding German government bond yields for BG, HR, HU, PL, RO. For CZ, the spread refers to the 5Y yield. For the other countries, the spread is computed with respect to US government bond yields *** Data for UA refer to the generic USD bond. Data for HR refer to the 4Y bond **** Data for UA refer to the generic USD bond. Data for CL refer SA to the spread between 8Y and 2Y bond and 9Y and 2Y bond respectively. Data for HU refer to spread between 10Y and 3Y bond. *****IBRD and WEF indicators for 2019

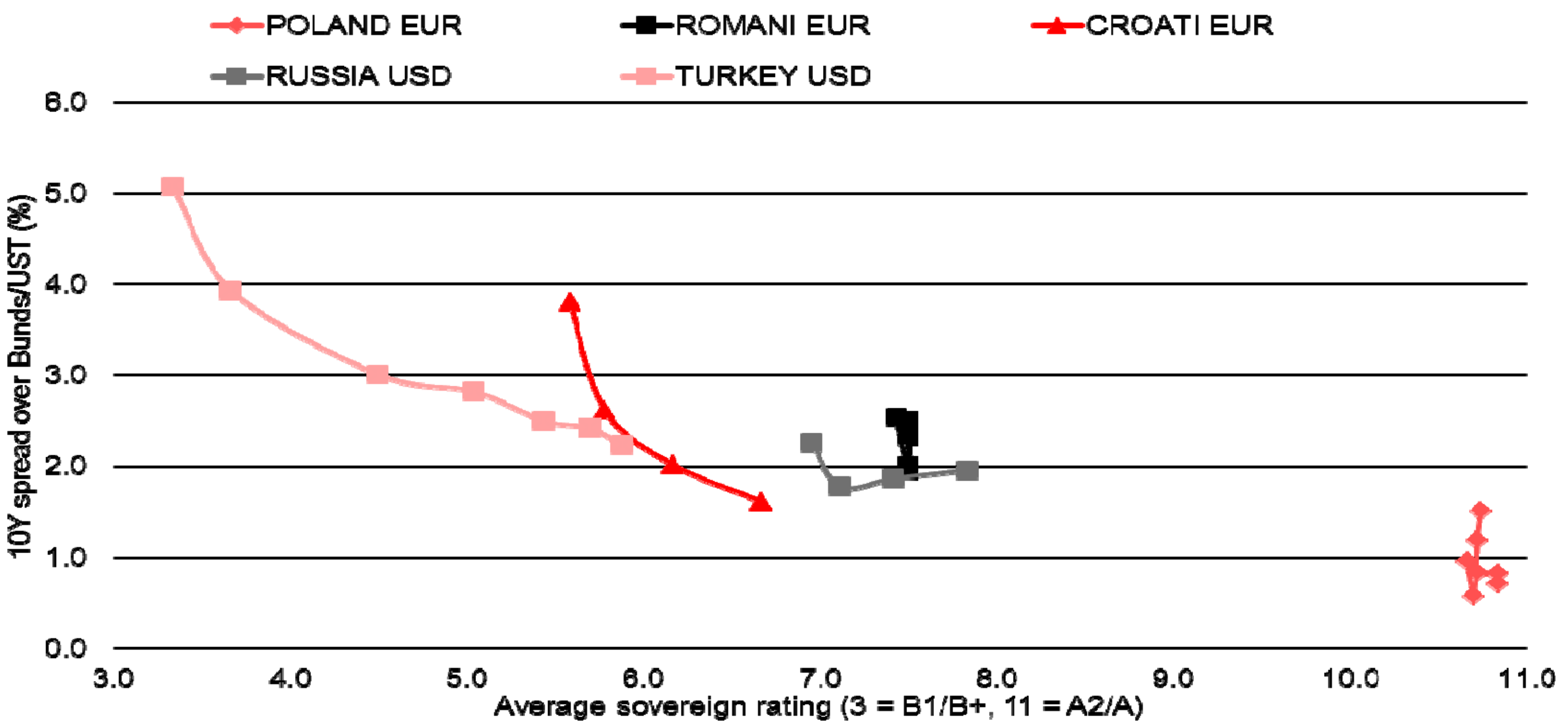
Source: central banks, ministries of finance, statistical offices, Bloomberg, UniCredit Research

Main messages

1. The business cycle is approaching its end
2. Growth will slow below potential in CEE but the region will outperform other EM
3. **Quantitative easing in the eurozone is not a cure-all solution**

3. Qualitative easing: credit spreads depend on domestic policies

Cautious public policies needed to avoid higher borrowing costs.



Source: Eurostat, central banks, statistical offices, ministry of finance, UniCredit Research

Main takeaways

1. **The global economy is slowing due to weaker global trade**
    1. Trade wars are affecting growth
    2. The fiscal stimulus is running out of steam in the US
    3. Eurozone countries hesitate to spend more on infrastructure (although they need to)
2. **Growth will fall in CEE but the region is likely to avoid recession**
    1. CEE is dependent on European demand (and especially on German demand)
    2. The quality and amount of fiscal and monetary stimulus is questionable
    3. CEE has fewer structural problems than other emerging markets
3. **Quantitative/ qualitative easing**
    1. The ECB cannot save countries with poor public policies
    2. Domestic policies very important to lower borrowing costs

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