UniCredit Bank

Weekly

N . o . t . e . s

English translation by an external party

HIGHLIGHTS OF THE WEEK

01/2016

> Chart of the Week: Slovak economy to retain growth of around 3% this year

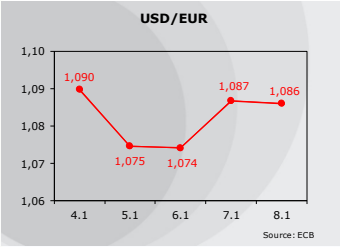
> Ongoing dynamic decline in unemployment in November

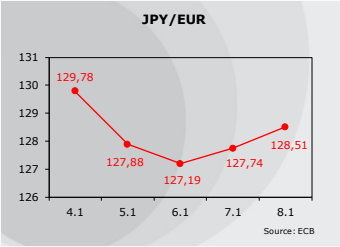
> 2015 government budget cash deficit well below the plan - supported by improved tax collection rates, EU funds and lower transfers to the Social Insurance Agency

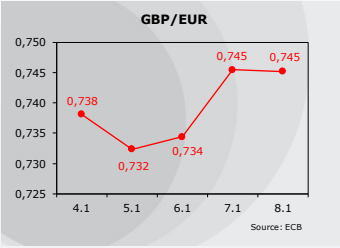
> Household consumption continues to increase, affecting the sales of merchants

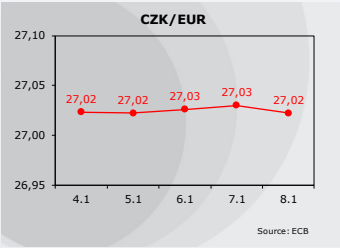
> Foreign trade once again with considerable surplus in November

WEEK ON THE MARKETS









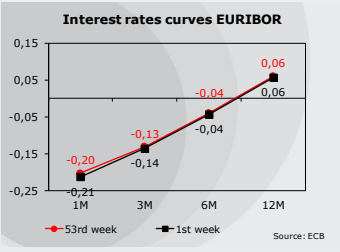
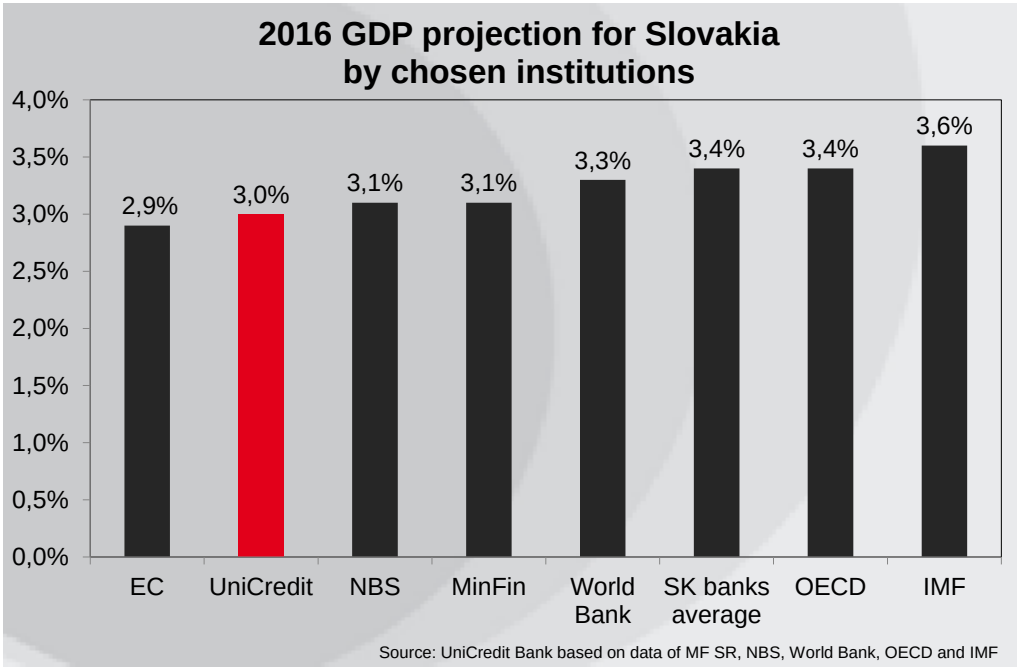


CHART OF THE WEEK



Note: EC - Autumn 2015 European Economic Forecast November 2015; NBS - Medium-Term Forecast P4Q-2015 of December 2015; MinFin – Macroeconomic Forecast September 2015; World Bank - Global Economic Prospects January 2016; OECD – Economic Outlook November 2015; IMF - World Economic Outlook October 2015; Average of Slovak Banks based on NBS Survey of December 2015 (4 participating banks); UniCredit – current forecast

The year of 2015 was a year of accelerated economic growth in Slovakia - from 2.5% to 3.4% according to our estimate based on the data of the first three quarters. Economic growth was driven mainly by domestic demand, positively translating into the labour market, which reported quite a dynamic growth of employment and real wages. Like most economies of euro area countries, Slovakia benefited mainly from cheap energy (oil) and relaxed ECB monetary policy (and weaker euro). Moreover, Central European countries (including Slovakia) were given another growth momentum in the form of dynamic growth of public investments due to higher absorption of EU funds from the preceding budgetary period.

And what awaits Slovak economy this year? Slovak GDP growth estimates by economic analysts of various domestic and international institutions range from 2.9% (European Commission) to 3.6% (IMF). Our estimate (3.0%) is rather on the conservative side of the range of estimates, with the mild pessimism following mainly from the expected decline of public investments (termination of the EU funds-driven investments), which, according to our estimates, will be only partially compensated by private investments (supported by the Jaguar-Land Rover investment in 2H).

The recovery in Europe seems quite robust, also owing to its structure. A growth driven by the cyclical consumption recovery is usually more persistent than a growth driven by inventories and exports as in the previous years. Moreover, economies of the euro area will be able to enjoy the relaxed monetary conditions further - ECB has prolonged and extended the QE and, with the inflation still absent, the cycle of relaxed monetary conditions seems to have no end so far. European exports could leverage also on the normalisation of elasticities in global foreign trade, with the foreign trade turnover, surprisingly, lagging well behind the growth of global economy this year. Another growth momentum could be given to the European economies again by the current decline of oil prices on global markets; however, the price of USD 30 for oil will probably be no longer sustainable in the long run (extraction at this price is becoming economically unviable in many areas) and it is not excluded that the oil price resumes USD 50 per barrel already in 1H. Thus, Europe should maintain its current upward trend, also benefiting the Slovak economy (and its exports). Moreover, the factors pulling domestic demand in Europe upwards (relaxed monetary policy (and low interest rates), cheap oil (and absent inflation), positive consumer confidence and persistence of domestic consumption recovery) will affect the domestic consumption in Slovakia in a positive manner. On the other hand, the growth of economy will be negatively affected by the decline of public investments, which will be gradually compensated by the recovering private investments, however, on the aggregate, we still expect a moderate decline of fixed investments.

Slovakia will report no considerable increase in consumer prices this year too. Just the opposite, the current decline of oil prices on global markets in combination with reduced VAT rates on certain food has only delayed the return from moderate deflation, with the yoy price growth being supposed to resume its positive levels some time around half-year at the earliest. However, the form of moderate deflation which has been reported by Slovakia for two years already is not, in principle, detrimental to the economy; rather the opposite, its supply-side nature supports the growth of household consumption (households have more available funds for purchases of other goods and services owing to the lower energy prices). At the same time, for 2016 we expect that prices will be pushed down mainly by supply-side factors and the risk of occurrence of a deflation spiral still seems to be relatively low.

The risks of our forecast of the growth of Slovak economy this year come once again mainly from the external environment, whether from Europe (Brexit, escalation of the migrant crisis, settlement of government debts on the euro area periphery, mainly in Greece) or from other parts of the world (deceleration of emerging markets - including China, although we do not consider the current panic on Chinese stock markets justified and substantiated by real economic fundamentals). One also should not neglect the "black swans", similar to the one from the last year's autumn in the form of the VW case. Slovakia awaits elections at the start of March. However, we assume that their result will not change the economic direction of the country in a substantial manner - opinion polls indicate the elections should be almost certainly won by the governing SMER-SD party, but the question is whether it will govern alone or will have to find a coalition partner. Forming a new government without SMER seems extremely unlikely at present. (lk)

ECONOMIC CALENDAR

Week	Indicator	Period	Market Consensus	UniCredit Bank Estimate	Reality
52.	Unemployment (December 21)	November	-	10.90%	10.77%
1.	State budget (January 4)	December	-	-2 400 mil. EUR	-1 933 mil. EUR
	Retail sales (January 7)	November	-	2.3% yoy	3.2% yoy
	Foreign trade (January 8)	November	-	331 mil. EUR	404 mil. EUR
2.	Industrial production (January 11)	November	-	3.5% yoy	-
	Construction production (January 12)	November	-	23.1% yoy	-
	Consumer prices (January 15)	December	-0.2% yoy	-0.1% mom -0.3% yoy	-

Source: Bloomberg, Reuters, NBS, SOSR, UPSVaR, MinFin SR, UniCredit Bank Slovakia

ECONOMY

UNEMPLOYMENT

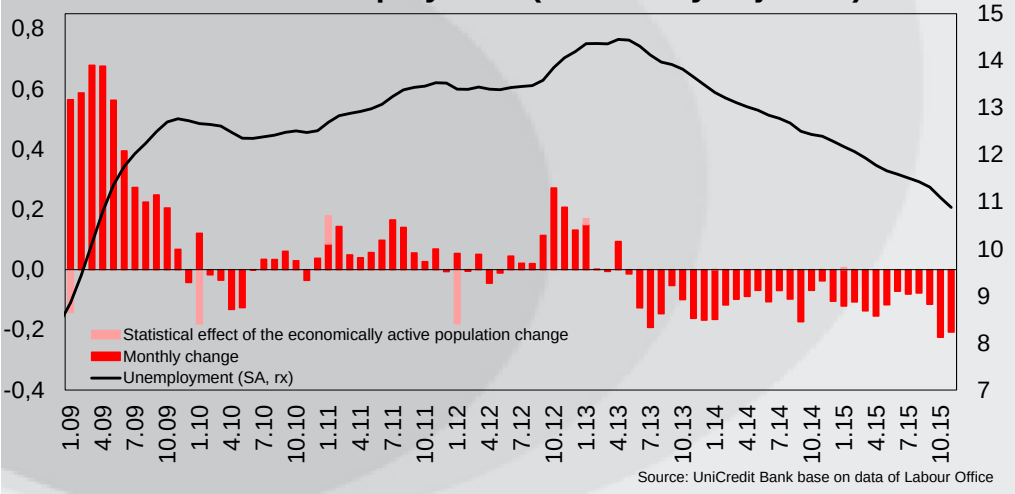
Ongoing sharp decline in unemployment in November

Once again, according to the Central Office of Labour, Social Affairs and Family methodology, (disposable) unemployment fell more considerably in November - by -0.21 pp to 10.77%. Thus, the seasonally adjusted unemployment (calculation of UniCredit Bank) went down by -0.21 pp to 10.88% in November. Compared to last year's November, unemployment went down by 1.48 pp, i.e. by 40 thousand unemployed.

The considerable decline in unemployment in October and November is a combination of the economy's sound condition, which generates new jobs and reduces the numbers of unemployed people, and several administrative factors. After the summer break, when the number of people placed on the labour market decelerated, we could see quite a strong recovery on the labour market again in October and this trend was confirmed in November. After adjustment for the season, the number of job seekers placed on the labour market increased again in November, reaching a new post-crisis peak (18 thousand job seekers found a job in November). Even despite a higher outflow of the unemployed absorbed by the increasing labour marker, the number of vacant jobs continued to rise slightly (reaching more than 35 thousand in November, i.e. more than three-times the number of the last year's November), making the further positive trend (in absorption of the unemployed by the labour market) quite likely also in the next months.

Besides the higher number of unemployed people placed on the labour market, (disposable) unemployment was reduced by administrative and statistical factors in November again. The trend of the previous months in the form of increase in sick leaves continued in November - the sick leave rate (reducing the disposable unemployment) went up (after adjustment for the season – calculation of UniCredit Bank), reaching its 3 years peak, i.e. as much as 7.3%. Control of the unemployed by offices has probably intensified again over the recent months, with as much as 3,773 unemployed people being forced to deregister with labour offices due to non-cooperation – more job seekers were deregistered by labour offices due to non-cooperation over the last two years only in the previous month (on average, only around 2,250 unemployed people were deregistered due to non-cooperation by labour offices in the first 9 months of the year). Compared to the previous year, the number of unemployed people involved in municipal and voluntary jobs increased too (by almost 2 thousand to nearly 16 thousand).

Chart 1: Unemployment (seasonally adjusted)

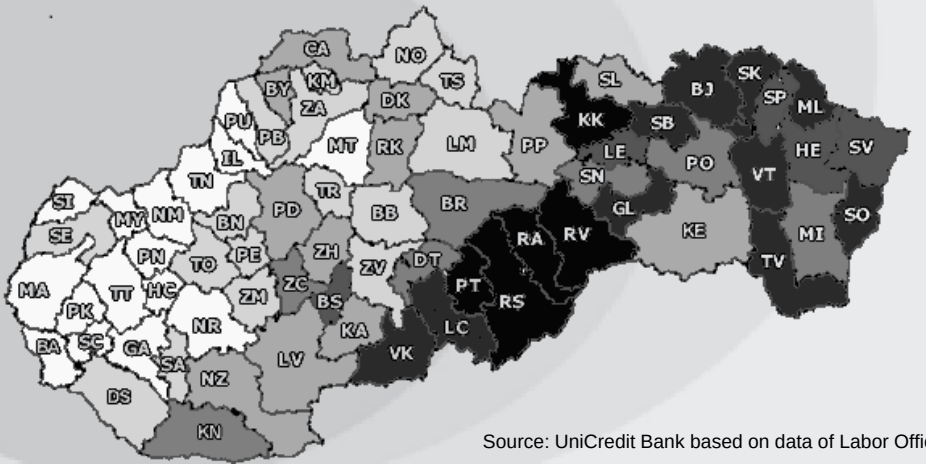


Source: UniCredit Bank base on data of Labour Office

After adjustment for traditional season, unemployment was falling in all Slovak regions in November, with the strongest decline being reported by the regions of Košice and Banská Bystrica. In terms of districts, unemployment went up (after adjustment for the season) only in 10 out of 79 districts compared to the previous month, with the strongest increase being reported by the districts of Vranov nad Topľou and Sabinov. In the remaining 69 districts, unemployment was falling in November, with the strongest decline being reported by the districts of Veľký Krtíš

and Revúca. The highest unemployment is still in the districts in the south of the central Slovakia - Rimavská Sobota (27.5%), Poltár (21.7%) and Revúca (21.2%), rivalled, in the negative sense of the word, by the districts of Kežmarok (24.1%) and Rožňava (22.0%). In November, unemployment higher than 15% was reported by 21 out of 79 districts of Slovakia (the same as in October), with unemployment higher than 20% being reported by only the 5 districts mentioned above. The lowest unemployment rate is still reported by the vicinity of the capital – districts of Bratislava (from 4.7% to 5.7%), Galanta (4.9%), Senec and Trnava (identically 5.6%), Pezinok (5.7%), followed by some districts in the area of Považie and Záhorie – Púchov (5.8%), Skalica and Piešťany (identically 5.9%), Myjava (6.0%), Malacky (6.1%), Ilava and Nové Mesto nad Váhom (identically 6.3%). Unemployment below 10% was reported by as much as 40 out of 79 districts of Slovakia in November (the same as in October).

Map 1: Unemployment in districts of Slovakia (November 2015)



Source: UniCredit Bank based on data of Labor Office

OUTLOOK

Although unemployment in October and November was reduced also by administrative effects, the main driver of its decline was the improving labour market, which was able to absorb a considerable portion of the unemployed. The growing economy is likely to retain this trend also in the next months and the seasonally adjusted unemployment will keep falling gradually. However, its decline may be decelerated by the structure of unemployed people with the prevalence of the long-term unemployed with no experience and qualification, or an unequal regional distribution of unemployment and low mobility of the unemployed in some regions. In certain regions, employers can face more often the issue of not finding suitable candidates for the job positions to be occupied from among the unemployed today.

Despite this fact, due to traditional season (end of seasonal works in agriculture and construction), we expect a moderate increase in the unemployment rate at the turn of the years (in December and January). Due to completion of the "EU projects", construction could deliver a bit more unemployed persons than usually. (lk)

RETAIL SALES

Retail sales slightly rising in November

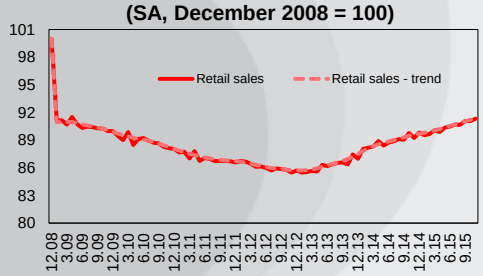
Retail sales (without car sales) increased slightly once again in November - by 0.3% compared to the previous month (adjusted for the season, calculation of UniCredit Bank on the basis of data of the Statistical Office of the SR). Dynamics of their yoy growth accelerated from 1.9% to 3.2%. Mainly the recovering economy, positively affecting the labour market (growth of employment and wages), relaxed monetary policy of ECB (record low interest rates) or absent inflation are still providing room for the growth of sales of domestic merchants.

A yoy growth of sales may be seen in most retail sectors. A moderate yoy decline in sales was reported only by sellers of household goods (furniture, glass, textile, carpets, hardware, etc.) – by -3.4% and market stall traders – by -1.4%. Mainly the sellers of typical Christmas goods were doing well as Christmas was approaching – a considerable increase in sales was reported mainly by sellers of ICT equipment (by

16.6% yoy), goods for culture and leisure (toys, books, sports gear, etc. – by 7.1%), or by specialised shops with other goods (textile, shoes, drugstores, etc. – by 7.7%).

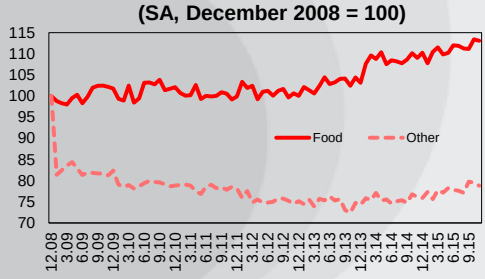
In the food segment, a relatively strong growth is maintained in the longer term mainly by small food shops benefiting from the current trends in the behaviour of consumers, who start putting more emphasis on the freshness of foods and closeness of the shop. However, sales in November were rising also in shops with predominance of food (mainly various chain stores), although this growth was slower than in the case of the small specialised shops.

Chart 2: Retail sales (SA, December 2008 = 100)



Source: UniCredit Bank based on data of SO SR

Chart 3: Retail sales (SA, December 2008 = 100)



Source: UniCredit Bank based on data of SO SR

The recent improved situation of Slovak households and the courage to make larger investments are still confirmed by the sales from sale and maintenance of cars – the dynamics of their yoy growth accelerated from 15.1% to 24.1% in November – the fastest growth since November 2010 (sales from the sale of cars itself were higher by as much as one third compared to the last year's November).

OUTLOOK

The positive development on the labour market and increasing disposable income of households, low interest rates and absent inflation should be beneficial to the growth of household consumption also at the turn of the years and at the start of this year.

(lk)

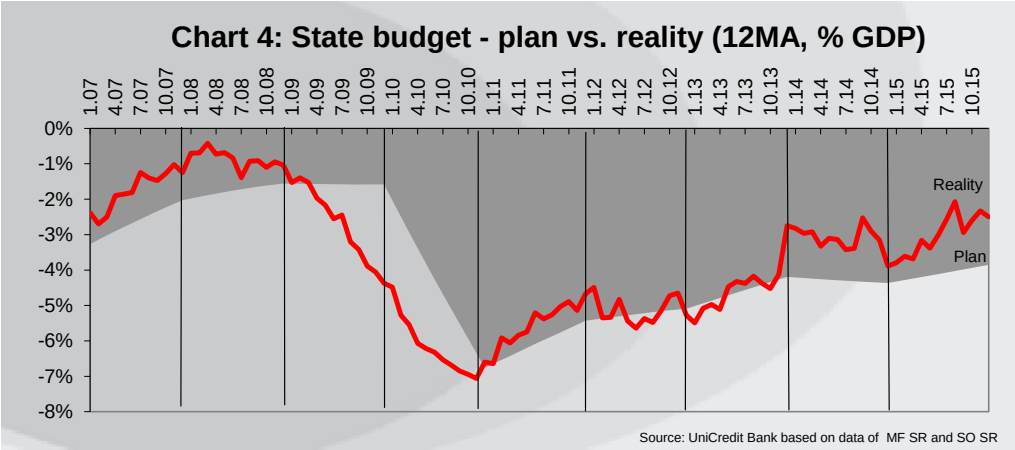
STATE BUDGET

Government budget deficit well below the plan

In 2015, the government budget reported a cash deficit of EUR -1,933 mil., i.e. around 1 billion less than planned by the state, as well as nearly 1 billion less than in the previous year. Thus, the government budget cash deficit went down from -3.9% in 2014 to -2.5%/GDP in 2015, mainly owing to a higher tax revenue, improved absorption of EU funds before the end of the budgetary period, lower costs of the government debt service and lower transfers to the Social Insurance Agency.

Last year, the government budget revenues went up by considerable 29.9% to EUR 16.2 bn., exceeding the budgeted volume by 12%. This was largely due to the higher absorption of EU funds before the end of the budgetary period – the income from the EU more than tripled on a yoy basis, reaching EUR 4.3 bn. However, higher absorption of EU funds was also reflected in the expenditure side of the budget – EU-related expenditure including co-funding of the EU funds almost doubled. In total, the higher absorption of EU funds reduced the deficit by EUR 339 mil., accounting roughly for one third of the improvement of the budget cash deficit.

After adjustment for EU funds, the government budget income increased by 6.4% to EUR 12.0 bn. (exceeding the plan by 6.5%), mainly owing to the 14.2% yoy increase of tax revenue which reached EUR 10.6 bn., exceeding the budgeted volume by 5.7%. The budgeted volumes exceeded all tax revenue components, save for the excise duty, which reported collection in line with the budget. Positive development was reported mainly by corporate tax revenue, increasing by 36% yoy and exceeding the plan by 13.1%. The dynamic growth of corporate tax revenue was mainly due to the stronger economic growth, newly implemented tax licences, and enhanced pressure on more efficient tax collection (measures against tax evasion). A faster-than-expected growth of economy and an ongoing pressure on improving the efficiency of collection supported the higher VAT receipts, which went up by 12.0% yoy and exceeded the budgeted volume by 4.9%. At the same time, VAT receipts are the main component of tax revenue, accounting for 52% of all tax revenue of the government budget in 2015.



Last year, the government budget expenditure went up by 17.8% to EUR 18.2 bn., exceeding the budgeted volume by 3.9%. After adjustment for expenditure related to the EU funds and expenditure on EU budget (including reserve), the government budget expenditure went up by 1.2% to EUR 12.5 bn., being lower by -2.0% compared to the approved 2015 budget, mainly due to lower transfers to the Social Insurance Agency. Based on higher actual income of the Social Insurance Agency, benefiting also from the improvement on the labour market, the need for transfers from the government budget halved (compared to both the budget and the transfers in 2014). Lower transfers to the Social Insurance Agency thus accounted for nearly one half of the yoy reduction of the government budget deficit. However, the state's management was improved also by the lower interest rates on the government debt, translating into the reduction of costs of the government debt service roughly by 10% (compared to both the budget and the previous year).

OUTLOOK

Government budget is only one of the public finance components, however, it indicates that the public finance deficit could be better this year than the 2.7% of the GDP forecast by the Ministry of Finance. (lk)

FOREIGN TRADE

Foreign trade once again with considerable surplus in November

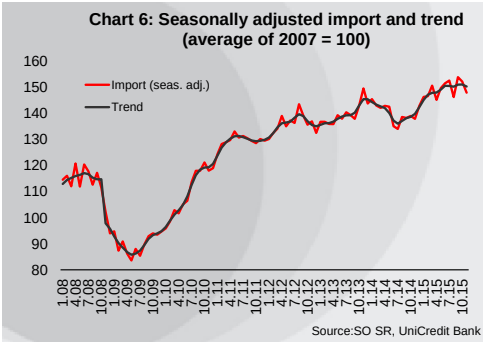
According to data of the Statistical Office, foreign trade reported a surplus of EUR 404 mil. in November, which was slightly more than our expectations and average market expectations. On the other hand, based on the up-to-date figures the SO SR revised the foreign trade surplus in the first ten months of this year downward by EUR 83 mil. The 12-month foreign trade surplus did not change in November, maintaining the revised 4.5% of the GDP.

Turnover in foreign trade brought more controversial news than the balance sheet. Compared to October, reduction in the turnover of foreign trade could be seen on both sides of the balance sheet. However, the dynamics of the yoy growth of exports and imports accelerated due to lower last year's comparison basis.

Compared to October, exports dropped by -0.9% (seasonally adjusted, calculation of UniCredit Bank), with the dynamics of their yoy growth accelerating from 5.5% to 8.7%. The structure of exports will be published by the Statistical Office in one month, however, it seems that also November confirmed that the VW affair had only a negligible effect on Slovak exports (and industry). At the same time, industry figures from the recent months indicate that deceleration was reported rather by other export-oriented sectors of Slovak industry, mainly by the electrotechnical industry.

The main reason for deepening of the foreign trade surplus is on the part of imports. They were falling for two months in a row on a mom basis, being lower by as much as -2.8% compared to October (seasonally adjusted, calculation of UniCredit Bank). However, as in the case of exports, the dynamics of their yoy growth accelerated slightly from 7.0 to 9.5% due to lower last year's comparison basis. The structure of November imports is not yet known. Given the relatively stable growth of retail sales, we expect that the deceleration of imports would be due to investment imports and imports of intermediate goods. Deceleration of the growth of investment imports should be related to the gradual completion of projects funded from the preceding

budgetary period. The growth of imports in November decelerated also due to the decline in oil prices on global markets.



OUTLOOK

At the end of the year, surpluses of the foreign trade balance usually moderate, when imports are pushed up by growing retail Christmas sales and, on the contrary, traditional Christmas closures of a part of the industry use to reduce exports - Slovakia could thus, as usually, report a moderate monthly deficit of foreign trade in December.

With a gradual fading of investments induced by the EU funds absorption, we expect alleviation of pressure on the growth of investment imports (which could be partially seen in the last 2 months). Therefore, at the turn of the years, we expect that the longer-term trend of moderation of surpluses of the foreign trade balance comes to a halt, stabilising at around 4.5-5.0% of the GDP this year. Although imports will be pulled up by the increasing household consumption, this growth could be fully compensated by the growing exports driven by the cyclical recovery of European economies. (lk)

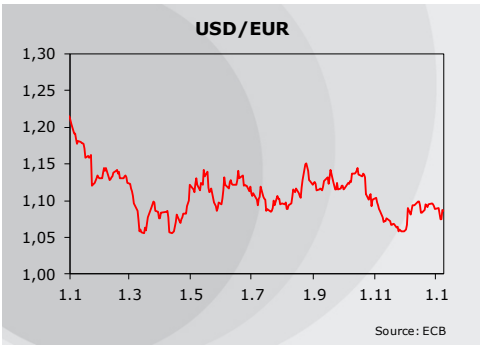
ECONOMIC OUTLOOK

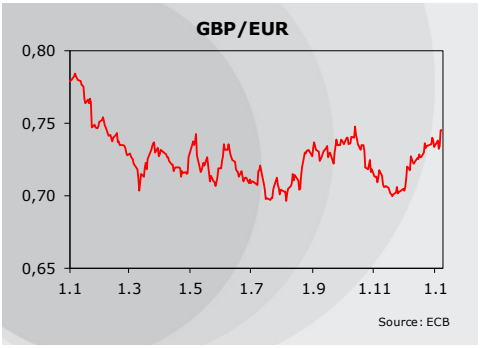
Slovakia	2010	2011	2012	2013	2014	2015F	2016F
Real GDP growth	**5,1**	**2,8**	**1,5**	**1,4**	**2,5**	**3,4**	**3,0**
GDP per capita	12 411	13 052	13 398	13 643	13 947	14 372	14 788
Household consumption	**0,4**	**-0,6**	**-0,4**	**-0,8**	**2,4**	**2,5**	**2,9**
Government consumption	1,8	-1,7	-2,6	2,2	5,9	3,8	1,7
Gross investments	18,8	7,6	-14,0	1,5	2,6	11,4	-2,5
Exports	15,7	12,0	9,3	6,2	3,6	6,4	5,6
Imports	14,7	9,6	2,5	5,1	4,3	8,1	4,1
Industrial Production	**18,9**	**6,9**	**13,4**	**5,3**	**3,7**	**5,3**	**5,1**
Construction	-4,6	-1,7	-12,5	-5,3	-4,2	15,1	2,7
Retail Sales	-2,2	-2,8	-1,0	0,1	3,6	1,5	2,3
CPI (average)	**1,0**	**3,9**	**3,6**	**1,4**	**-0,1**	**-0,3**	**0,3**
CPI (Dec.)	1,3	4,4	3,2	0,4	-0,1	-0,2	0,9
Real Estate inflation	-3,9	-3,0	-1,1	-0,9	-0,8	0,9	2,3
Average Wage level	769	786	805	824	858	880	904
Nominal Wage growth	**3,2**	**2,2**	**2,4**	**2,4**	**4,1**	**2,5**	**2,8**
Real Wage growth	2,3	-1,6	-1,2	1,0	4,2	2,8	2,5
Employment growth (LFS)	-2,2	1,5	-1,0	0,0	1,5	2,2	1,0
Unemployment (average, LFS)	**14,4**	**13,5**	**14,0**	**14,2**	**13,2**	**11,6**	**10,8**
Fiscal deficit (% of GDP)	-7,5	-4,1	-4,2	-2,7	-2,8	-2,7	-2,0
Public Debt (% of GDP)	40,8	43,3	51,9	54,6	53,5	53,1	52,9
Foreign Direct investment (EURbn)	0,9	2,8	3,2	-0,3	0,2	2,0	2,5
ECB Refi rate (%, Dec.)	**1,00**	**1,00**	**0,75**	**0,25**	**0,05**	**0,05**	**0,05**
3M EURIBOR (%, Dec.)	1,0	1,2	0,2	0,3	0,1	-0,2	-0,2
3Y SK gov't bonds(%,Dec.)	1,0	1,1	0,3	0,7	0,5	-0,1	0,0
10Y SK gov't bonds(%,Dec.)	2,9	4,8	2,2	2,6	1,3	0,5	0,9

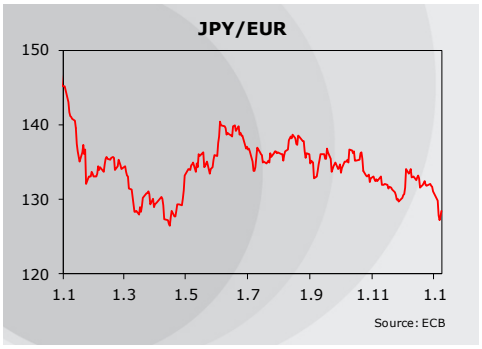
Abroad	2010	2011	2012	2013	2014	2015F	2016F
Eurozone GDP	**1,7**	**1,5**	**-0,6**	**-0,4**	**0,9**	**1,5**	**1,9**
German GDP	**3,6**	**3,1**	**0,9**	**0,5**	**1,6**	**1,7**	**2,1**
Czech R GDP	2,7	1,7	-1,0	-0,9	2,0	4,3	2,3
USA GDP	3,0	1,7	2,8	1,9	2,4	2,5	2,6
Eurozone Inflation	1,6	2,7	2,5	1,3	0,4	0,1	1
EUR/USD (average)	**1,33**	**1,39**	**1,28**	**1,33**	**1,33**	**1,11**	**1,08**
EUR/USD (Dec)	1,32	1,32	1,31	1,37	1,21	1,05	1,12
EUR/CZK (Dec)	25,1	25,8	25,1	27,5	27,7	27,1	27,0
EUR/HUF (Dec)	277,6	304,2	285,8	300,2	315,5	313,0	320,0
EUR/PLN (Dec)	4,0	4,5	4,1	4,2	4,3	4,2	4,0

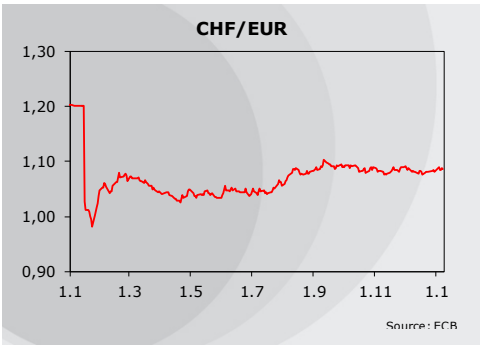
Source: NBS. SOSR. ÚPSVaR. MinFin SR. Eurostat. ECB
Forecasts: UniCredit Bank Slovakia – Slovakia. Eurozone. USA (EURIBOR. USDLIBOR. Brent. USD/EUR); UniCredit Group (CEE Economic Research. CIB) – Eurozone. USA

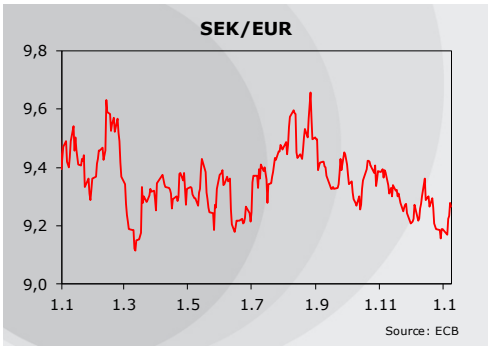
FOREIGN EXCHANGE

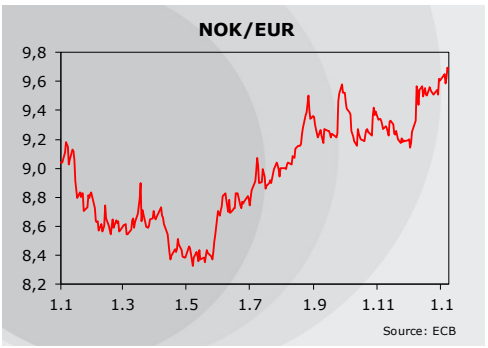


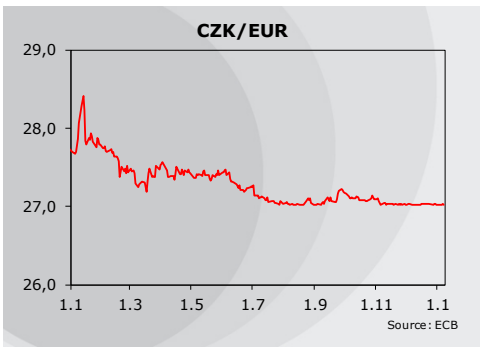


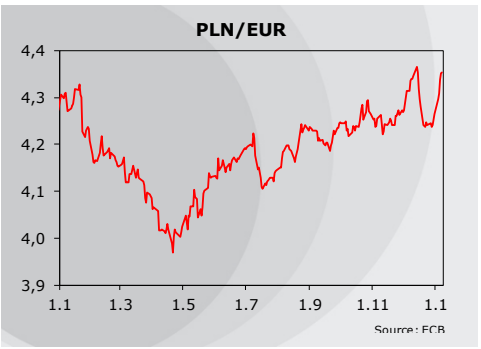


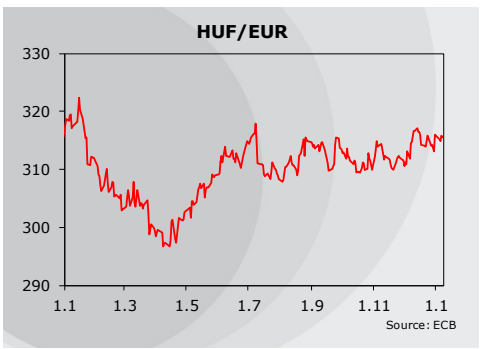


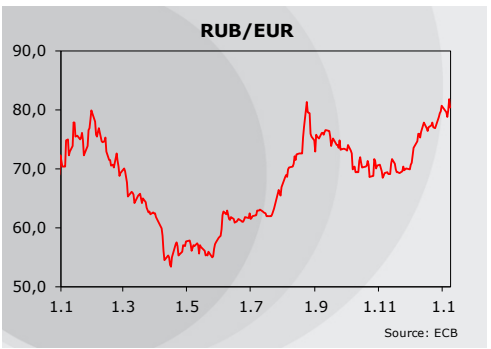






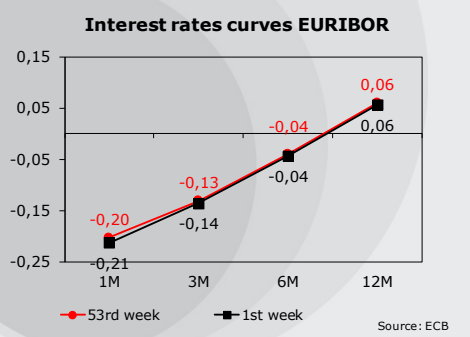




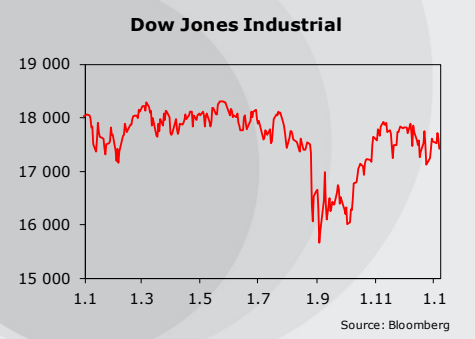


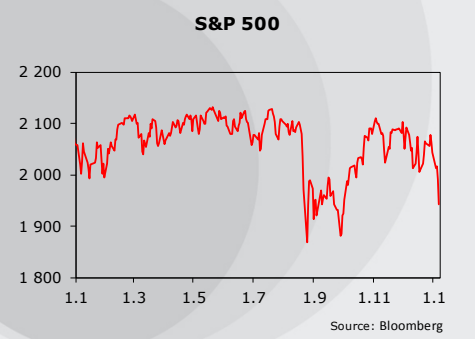
MONEY MARKET

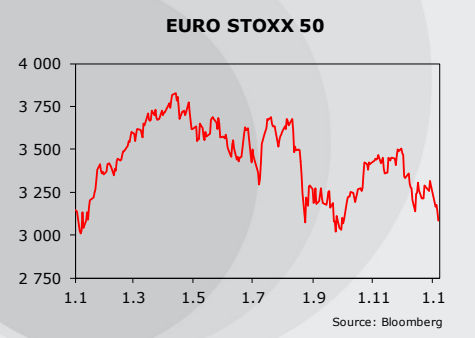
MONEY MARKET

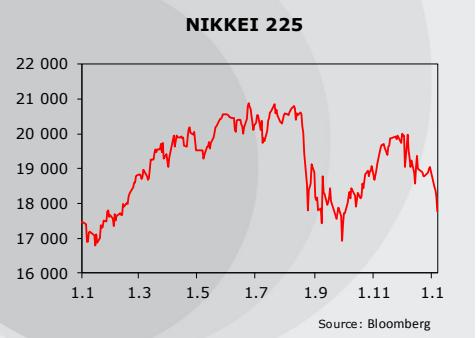


EQUITY









UniCredit Bank Weekly N.o.t.e.s has been prepared by Macroeconomic Analysis

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