UniCredit Bank

Weekly

N . o . t . e . s

English translation by an external party

HIGHLIGHTS OF THE WEEK

06/2016

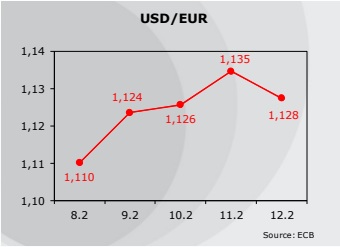
> Chart of the Week: Economic growth of Slovakia accelerating at the end of the year

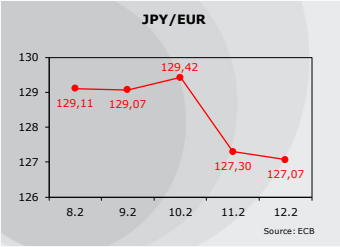
> Industry a pleasant surprise in December, even despite the issues of basic metals

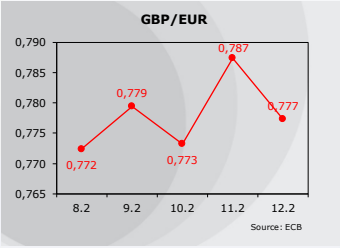
> Construction reporting a strong growth again in December; dynamic growth reported also by the building construction segment

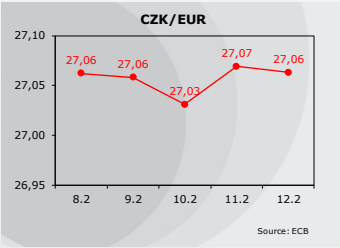
> As expected, foreign trade reporting no surplus in December

WEEK ON THE MARKETS









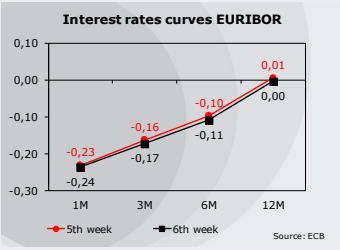
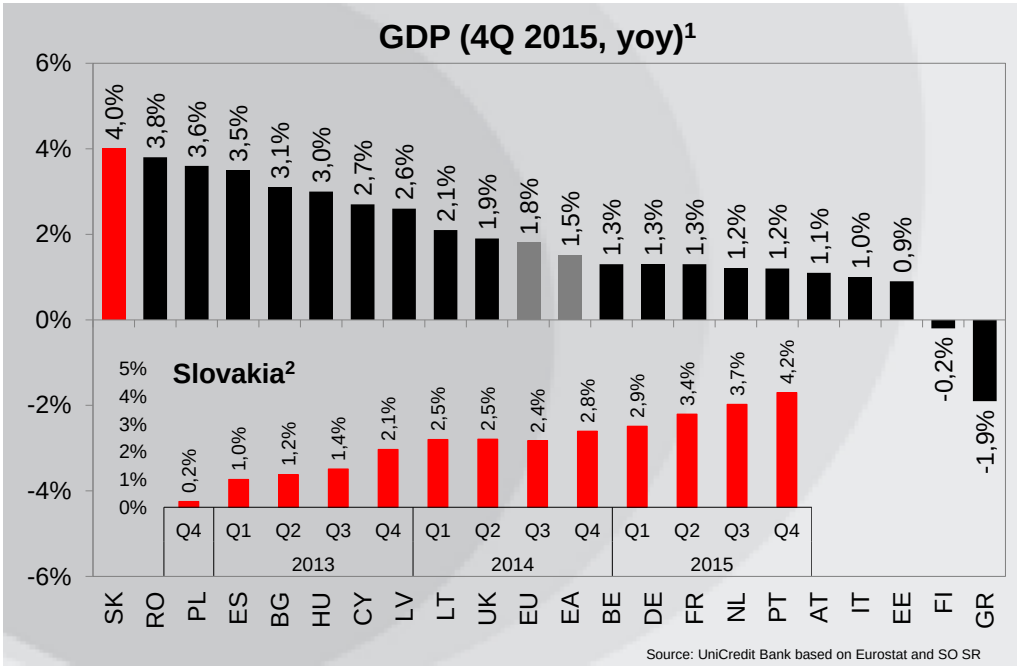


CHART OF THE WEEK



Note: 1. seasonally adjusted; 2. non-seasonally adjusted

As already indicated by the published monthly figures, the GDP growth at the end of the year has significantly exceeded our original and the average market expectations. According to a flash estimate of the Statistical Office of the SR, the growth of Slovak economy accelerated from 3.7% to as much as 4.2% in the last quarter of the previous year - i.e. the fastest growth since the end of 2010. Compared to the previous quarter, the GDP growth increased by 1.0% (seasonally adjusted). On average, the performance of Slovak economy went up by 3.6% last year (compared to 2.5% in 2014).

Out of the EU countries that have published data for the last quarter of the previous year so far, Slovak economy reported the fastest yoy growth. However, several countries that were growing dynamically in the previous quarters have not published data yet, and it is assumed that they maintained a relatively dynamic growth also at the end of the year (Czech Republic, Ireland, Luxembourg, Sweden). On average, economies of the eurozone grew by 0.3% compared to the previous quarter, with the dynamics of their yoy growth decelerating from 1.6% to 1.5%. Thus, the growth of the eurozone has slightly lagged behind our original expectations, being no surprise though in the light of recent figures. After publishing the last monthly figures, a more-or-less expected slowdown in economic growth was reported also by the largest European economy – Germany (from 1.7% to 1.3% yoy). On the contrary, a relatively dynamic growth was reported, besides Slovakia, also by other CEE economies, also

strongly supported by EU funds – Romania (3.8%), Poland (3.6%), Bulgaria (3.1%), and Hungary (3.0%). A relatively strong growth is still maintained by Spain (3.5%)

Also owing to the EU funds that have supported the growth of CEE economies, Slovakia managed to smoothly overcome the slight slowdown in growth of the key German economy. At the end of the year, our conservative expectation that the economic growth of Slovakia will decelerate with the completion EU-funded projects was not confirmed, either. It seems that EU-funded projects were completed until the very last moment – it is confirmed also by data of construction, indicating only a moderate slowdown in infrastructure construction (a part of economy likely to be stimulated by EU funds the most). Moreover, further recovery was reported also by other sectors of the economy not stimulated by EU funds. Mainly the Slovak automotive industry was doing well, becoming again the driver of growth of Slovak industry and exports. Even despite the VW affair, the Slovak automotive sector was pushing its production towards new record peaks. So it seems that if the affair had any effect on the Slovak VW plant, other plants were able to fully make up for this loss. At the end of the year, Slovak car plants benefited from the strongly rising sales on the "domestic" market in Europe. A strong recovery was reported also by the real estate market, which has been reflected also in the record growth of construction in the building construction segment. Real estate market is massively supported by the relax ECB monetary stance - interest rates at record lows in combination with growing wages are pushing the affordability of housing financed by bank loans to new record peaks. Recovery in the real estate market can be seem mainly in the capital city - Bratislava and its vicinity.

In terms of demand, the GDP growth structure should be slightly more balanced at the end of the year than as in the previous quarters. Although the GDP growth was still driven almost exclusively by domestic demand, it seems that the negative contribution of abroad has moderated considerably at the end of the year. It would be indicated also by the development of foreign trade, when its surpluses finally stabilised. On the one hand, the dynamics of growth of exports was accelerated mainly by the good condition of the automotive industry; on the other hand, investment imports induced by EU-funded investment decelerated more considerably probably right at the end of the year (imports outpacing actual investment). Domestic demand was still dominated by investment, driven mainly by public EU-funded investment, which however is increasingly supplemented by private investment – besides the above-mentioned investment in building construction, probably also investment of private companies, which would be indicated also by the look at loans of the banking sector – loans to non-financial companies in the 2H were making the growth dynamics considerably faster and their yoy growth approached the highest levels since 2009 in December. Household consumption is still slightly lagging behind the expectations arising from the strong economic growth, which is positively reflected also in the labour market. The growth of retail sales reported no major acceleration even at the end of the year, with the dynamics of their yoy growth being less than one half of the one of, let's say, the Czech Republic. However, improved household sentiment is reflected at least in the growing courage of households to make higher purchases/investment (buying cars or real estate). In any case, the growth of household consumption remains subdued; however, it is likely that it also reported a moderate acceleration at the end of the year.

According to a flash estimate of the Statistical Office, employment (domestic concept – ESA2010 methodology) was rising also at the end of the year; however, the dynamics of its growth is slightly decelerating - compared to the previous quarter, it went up by 0.4% (seasonally adjusted), with the dynamics of its yoy growth decelerating from 2.2% to 2.0%. The slightly decelerating labour market could indicate also a moderate slowdown in the economic growth this year. On the other hand, slower growth of employment increased the growth of labour productivity, which went up by 2.1% yoy in the last quarter of the previous year; at constant prices, the dynamics of its growth nearly doubled compared to the previous quarter, reporting the fastest growth in the last two years. A faster growth in labour productivity creates room also for a sound growth of wages. However, we still expect that the dynamics of the wage growth outpaced the growth of labour productivity in the last quarter of the previous year. Unit labour costs were thus most likely rising uninterruptedly for eight quarters in a row.

This year, we expect that economic growth in Slovakia will be slowing down towards 3%. We will review our current estimate (3.0%) once the Statistical Office publishes the last year's GDP growth structure at the beginning of March. Slowdown of economic growth should be attributable mainly to lower public investment due to termination of the previous budgetary period of EU funds and the usually slower start of absorption of the funds at the beginning of the new budgetary period. This loss will be gradually compensated by high private investment (mainly in automotive industry) later this year.

The faster economic growth at the end of the last year accentuates the positive risks of our forecast for this year, in particular if the growth structure confirms that also other sectors of the economy contributed to the acceleration of growth besides the absorption of EU funds. Further decline in oil prices at the turn of the years could have positive impact on the growth of Slovak (and most European) economies, as well. On the other hand, negative risks arising mainly from external environment have been accentuated recently. Besides the threat of a more significant slowdown of economies of emerging markets (including China), the economic growth in Europe could be decelerated also by the current turbulences on financial (stock) markets, if the sharp slump in stock indices is translated also in the sentiment of consumers and enterprises in Europe. Lower consumption and investment in Europe would considerably affect also Slovak exporters (including Slovak car plants). However, so far it seems that turbulences on financial markets are based on the deteriorated sentiment of financial investors rather than on the fundamentals of European economies, and they have not been reflected in deterioration of sentiment of industrial enterprises and consumers in Europe so far. A longer-term decline of markets could be translated in deterioration of corporate and consumer sentiment in Europe, contributing to the slowdown in recovery of European economies, including the Slovak one. (lk)

ECONOMIC CALENDAR

Week	Indicator	Period	Market Consensus	UniCredit Bank Estimate	Reality
6.	Foreign trade (February 8)	December	30 mil. EUR	-5 mil. EUR	-16 mil. EUR
	Industrial production (February 11)	December	-	6.9% yoy	8.2% yoy
	Construction production (February 11)	December	-	13.1% yoy	25.7% yoy
	GDP flash (February 12)	4Q	3.7% yoy	3.4% yoy	4.2% yoy
	Employment flash (February 12)	4Q	-	2.0% yoy	2.0% yoy
7.	Consumer prices (February 15)	January	-0.5% yoy	-0.2% mom -0.6% yoy	-
	Unemployment (February 15-20)	January	-	10.75%	-

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

ECONOMY

Industry a pleasant surprise in December, with growth reported mainly by car plants

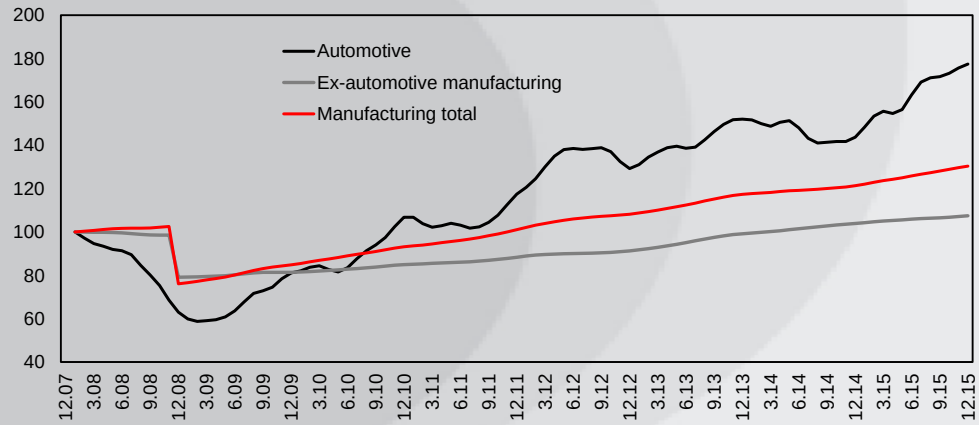
INDUSTRIAL AND CONSTRUCTION PRODUCTION

Slovak industry was a pleasant surprise in December, not following the prevailing line in Europe, when the industry figures gradually published during the week in several countries (including Germany and the Czech Republic) did not met the expectations at all. After a record strong November, we expected a considerable correction of industry production also in Slovakia, which was indicated also by a considerable deterioration of sentiment in industry both in November and December. It actually occurred, but the decline in production by -0.6% mom (after adjustment for season) was roughly only one half of the one expected by us, and the dynamics of the yoy growth of the industry thus remained quite strong, decelerating, according to data of the Statistical Office, from 11.8% to only 8.2% - even despite serious issues of one of the key sectors of the industry – basic metals.

In terms of yoy growth, the automotive industry remained the key sector also in December, generating a new momentum at the end of the year and pushing its

production towards new record peaks despite the turbulences caused by the VW affair. With a growth of production by 30.3% yoy, the automotive industry accounted for as much as 88% of total growth of the industry (contributing with 7.3 pp to the growth of the industry). However, a strong double-digit yoy growth was reported also by other major export sectors – engineering (19.2%) and production of electric equipment (10.6%), as well as sectors of chemical industry - refinery (12.0%) and production of chemicals (32.1%).

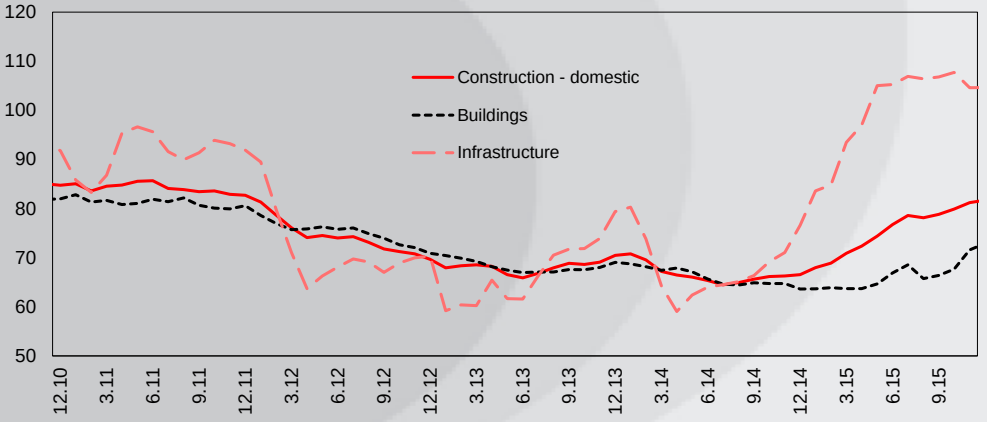
Chart 1: Industrial production
(Jan 2008 = 100, seasonally adjusted, trend)



Source: UniCredit Bank based on data of SO SR

On the other hand, producers of consumer electronics are not doing well in the long run (a decline in production by -11.9% yoy), which are still affected by the shift of a part of TV production from the UMC plant to Poland in a yoy comparison. A negligible yoy decline in production was reported also by the food industry (-0.6%) and the recently extremely volatile sector of pharmacy (-0.5%), which is once again trying to find its new balance after changes in the ownership structure and subsequent sharp slump in production in previous years. The growth of the industry was reduced also by the non-processing sectors of the industry in December – mining (-8.7%) and production and distribution of energy (-1.1%). However, the decreasing production of basic metals accounted for the highest (as much as -2.0 pp) reduction of the yoy growth of the industry in December. This sector struggled with cheap Chinese competition, which is flooding also the European steel market, with the largest Slovak metallurgy plant in Košice reporting major issues concerning the sales of its production at the end of the last year. After adjustment for traditional season, production in the sector dropped by considerable -8.0% compared to November, with the production falling by as much as -13.4% yoy.

Chart 2: Construction production - domestic
(12/2008 = 100, seasonally adjusted, 3M MA)



Source: UniCredit Bank based on data of SO SR

The construction figures of December were a pleasant surprise, too. According to data of the Statistical Office, its production was growing by considerable 4.6%

Construction accelerating its growth dynamics in December

(seasonally adjusted) compared to November, with the dynamics of its yoy growth returning to its record levels (25.7%). Strong growth was reported by both segments of construction – construction of infrastructure (36% yoy) as well as construction of buildings (20% yoy - the fastest growth in the last 7 years). At the end of the year, the infrastructure segment reported a final hike in EU-funds, the building construction segment confirmed a massive recovery of the previous months, indicating a potential to compensate the loss in infrastructure construction at the beginning of the year.

Slovak industry was a pleasant surprise at the end of the year, reporting a relatively strong resilience and confirming a robust growth. It was mainly the automotive industry that was doing well, assuming the place of the growth leader of the industry. Industry as a whole has thus maintained its dynamic growth, rising by another 2.1% (seasonally adjusted, calculation of UniCredit Bank) compared to the previous quarter, with the dynamics of its yoy growth accelerating from 6.6% in 3Q to as much as 8.0% in 4Q of the last year – thus, industry has reported the fastest yoy growth since the turn of 2013/2014. Strong growth supported by the completion of EU-funded projects of infrastructure construction as well as by the quickly recovering residential property market were maintained also by construction at the end of the year. Compared to the previous quarter, construction production went up by another 4.1% (seasonally adjusted, calculation of UniCredit Bank), with the dynamics of its yoy growth accelerating from 19.8% in 3Q to as much as 23.0% in 4Q of the last year. This has not confirmed our expectations that the activity of construction will gradually slow down at the end of the year and with completion of EU-funded projects, so it seems that we will see a sharp decline in production in January. December figures of the industry and construction have thus accentuated the positive risks of our GDP forecast, which was confirmed by flash estimate published later this week.

OUTLOOK

After a temporary deterioration in sentiment of Slovak industry at the end of the last year, which however were not translated in worse production figures, expectations of the industry became significantly better at the end of this year again. Even despite the ongoing issues of one of the key sectors of the industry – basic metals, we expect that Slovak industry should retain its growth trajectory also at the beginning of the year. Development in the next months will depend mainly on the development of consumer sentiment in Europe. If the current turbulences on financial (stock) markets in Europe are reflected also in the consumer confidence of European households and slowdown of the market selling new cars, it would probably affect also the Slovak automotive industry, endangering further growth of its production.

It seems that the strong growth of construction in December was the last trembling before the completion of EU-funded projects of the preceding budgetary period. The loss in infrastructure construction will be probably partially offset at the beginning of this year by the recovering building construction segment, which has already indicated its strong potential at the end of the last year. Even despite this fact, it cannot be excluded that the beginning of this year will see red growth figures after the strong growth of construction last year. However, the decline in construction production should be short-term, when the gradual start of new construction of highways during the year (completion of tenders shifted to the start of 2016) or the expected growth of private investment (driven mainly by the Jaguar-Land Rover investment) should restart also the infrastructure construction segment, which should supplement the growing building construction segment, returning construction back to its growth trajectory during the year - however, the dynamics of growth of construction should not reach the last year's record levels at all. (lk)

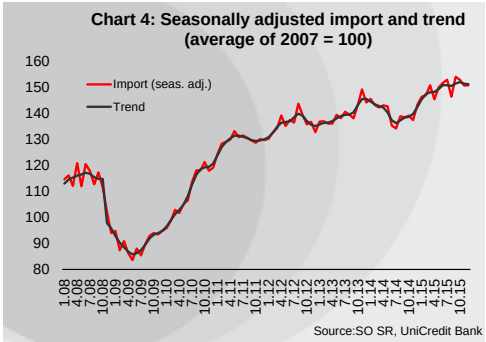
Foreign trade in December with expected moderate deficit

FOREIGN TRADE

Lower activity of companies and higher demands for consumer imports due to Christmas traditionally lead to "poorer" results of the foreign-trade balance in the last month of the year. It was also the case of the previous year - as we expected, foreign trade reported a moderate monthly deficit for the first time during the year – according to the preliminary data of the Statistical Office, in the volume of EUR -16 million. At the same time, based on updated figures, statisticians have revised the figures for the previous months of the year, reducing the foreign trade surplus in the first 11 months of the year by EUR 125 million. As we have already indicated a month ago, SO SR has once again increased the turnover in foreign trade more considerably over the

last month (November) - thus, November export figures correspond more to the significant hike in production of export-oriented sectors in November. The 12-month foreign trade surplus did not change in December, maintaining the revised 4.3% of the GDP.

After adjustment for traditional season, turnover in foreign trade remained nearly the same in December compared to the previous month. In a yoy comparison, the dynamics of growth of both exports and imports decelerated from double-digit levels identically to 7.7%. Interim export figures indicate that, as we have expected, the yoy growth of industry (to be published by the Statistical Office on Thursday) could decelerate as well in December - however, the Statistical Office has been making quite extensive reviews of interim figures in the recent months.



In the last year, we could see slowdown in the longer-term trend of moderating of foreign trade surpluses. Even despite the VW emission affair, Slovak car plants were doing well at the end of the year; mainly owing to their increasing exports, we could see again acceleration of the dynamics of growth in exports in the last quarter - after adjustment for traditional season (calculation of UniCredit Bank), exports went up by 1.9% compared to the previous quarter, with the dynamics of their yoy growth accelerating from 5.8% to 7.6%. On the other hand, the growth of imports did no longer accelerate further; compared to the previous quarter, the volume of imports (after adjustment for season – calculation of UniCredit Bank), increased by negligible 0.2%, with the dynamics of their yoy growth decelerating from 11.2% to 9.0%. We expect that completion of EU-funded projects has played an important part here, gradually reducing also the demands for investment imports induced by public investment. Slowdown in the decline of foreign trade surpluses also indicates that the GDP growth structure could really be more balanced in the last quarter of the last year – although we expect that the economy continued to be driven mainly by domestic demand, the negative contribution of net export to the GDP growth was likely to have moderated significantly (we expect it to be close to zero).

OUTLOOK

After completion of EU-funded investment, we expect moderation of the pressure on the growth of investment imports. Therefore, we expect that surpluses of the foreign-trade balance should no longer moderate at the beginning of the year; just the opposite, their moderate recovery (also owing to further decline in oil prices) and subsequent stabilisation at around 4.7-4.8% of the GDP are expected. Although imports will be pulled up by the increasing household consumption and recovering private investment, this growth should already be fully compensated by the growing exports driven by the cyclical recovery of European economies. (lk)

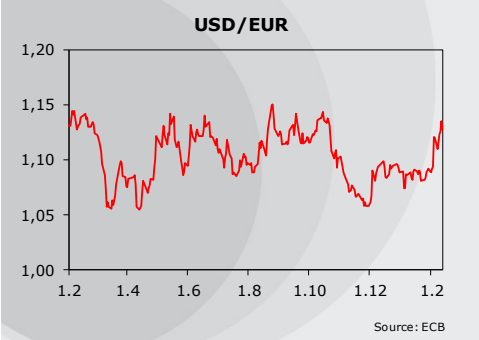
ECONOMIC OUTLOOK

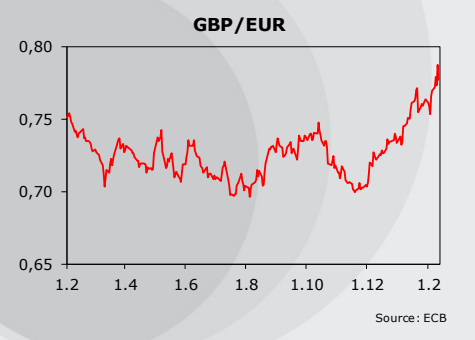
Slovakia	2011	2012	2013	2014	2015E	2016F	2017F
Real GDP growth	**2,8**	**1,5**	**1,4**	**2,5**	**3,6**	**3,0**	**3,0**
GDP per capita	13 052	13 398	13 643	13 947	14 287	14 788	15 291
Household consumption	**-0,6**	**-0,4**	**-0,8**	**2,4**	**2,5**	**2,9**	**2,6**
Government consumption	-1,7	-2,6	2,2	5,9	3,8	1,7	0,5
Gross investments	7,6	-14,0	1,5	2,6	11,4	-2,5	6,8
Exports	12,0	9,3	6,2	3,6	6,4	5,6	4,1
Imports	9,6	2,5	5,1	4,3	8,1	4,1	4,5
Industrial Production	**6,9**	**13,4**	**5,3**	**3,7**	**5,8**	**5,5**	**6,5**
Construction	-1,7	-12,5	-5,3	-4,2	15,1	2,7	6,5
Retail Sales	-2,8	-1,0	0,1	3,6	1,7	2,3	2,5
CPI (average)	**3,9**	**3,6**	**1,4**	**-0,1**	**-0,3**	**0,3**	**1,5**
CPI (Dec.)	4,4	3,2	0,4	-0,1	-0,2	0,9	1,6
Real Estate inflation	-3,0	-1,1	-0,9	-0,8	0,3	2,3	2,4
Average Wage level	786	805	824	858	880	904	930
Nominal Wage growth	**2,2**	**2,4**	**2,4**	**4,1**	**2,5**	**2,8**	**2,9**
Real Wage growth	-1,6	-1,2	1,0	4,2	2,8	2,5	1,4
Employment growth (LFS)	1,5	-1,0	0,0	1,5	2,2	1,0	1,0
Unemployment (average, LFS)	**13,5**	**14,0**	**14,2**	**13,2**	**11,6**	**10,8**	**9,9**
Fiscal deficit (% of GDP)	-4,1	-4,2	-2,7	-2,8	-2,7	-2,0	-1,0
Public Debt (% of GDP)	43,3	51,9	54,6	53,5	53,0	52,9	51,7
Foreign Direct investment (EURbn)	2,8	3,2	-0,3	0,2	2,0	2,5	3,3
ECB Refi rate (%, Dec.)	**1,00**	**0,75**	**0,25**	**0,05**	**0,05**	**0,05**	**0,50**
3M EURIBOR (%, Dec.)	1,2	0,2	0,3	0,1	-0,2	-0,2	0,5
3Y SK gov't bonds(%,Dec.)	2,7	0,3	0,7	-0,1	-0,6	0,0	1,5
10Y SK gov't bonds(%,Dec.)	5,2	3,9	2,7	1,2	0,7	1,0	2,0

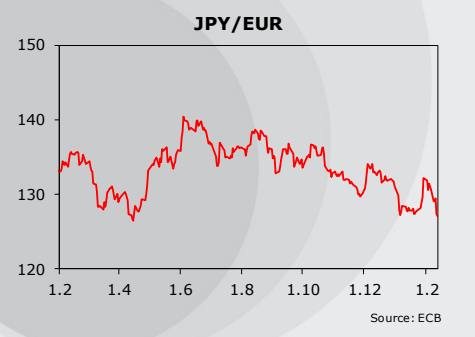
Abroad	2011	2012	2013	2014	2015E	2016F	2017F
Eurozone GDP	**1,5**	**-0,6**	**-0,4**	**0,9**	**1,5**	**1,9**	**1,6**
German GDP	**3,1**	**0,9**	**0,5**	**1,6**	**1,5**	**2,1**	**1,4**
Czech R GDP	1,7	-1,0	-0,9	2,0	4,3	2,3	3,0
USA GDP	1,7	2,8	1,9	2,4	2,5	2,6	2,4
Eurozone Inflation	2,7	2,5	1,3	0,4	0	0,9	1,4
EUR/USD (average)	**1,39**	**1,28**	**1,33**	**1,33**	**1,11**	**1,08**	**1,16**
EUR/USD (Dec)	1,32	1,31	1,37	1,21	1,09	1,12	1,18
EUR/CZK (Dec)	25,8	25,1	27,5	27,7	27,0	27,0	26,5
EUR/HUF (Dec)	304,2	285,8	300,2	315,5	314,0	320,0	325,0
EUR/PLN (Dec)	4,5	4,1	4,2	4,3	4,3	4,2	4,2

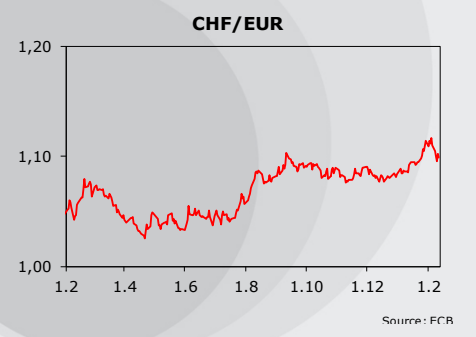
Source: NBS. SOSR. ÚPSVaR. MinFin SR. Eurostat. ECB
Forecasts: UniCredit Bank Slovakia – Slovakia. Eurozone. USA (EURIBOR. USDLIBOR. Brent. USD/EUR); UniCredit Group (CEE Economic Research. CIB) – Eurozone. USA

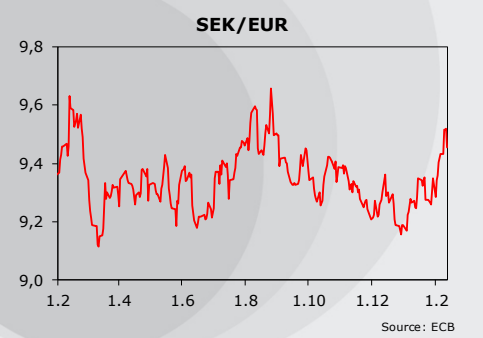
FOREIGN EXCHANGE

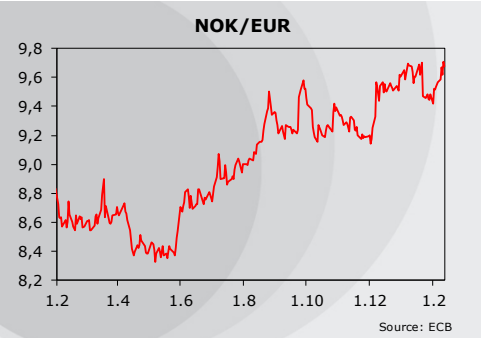


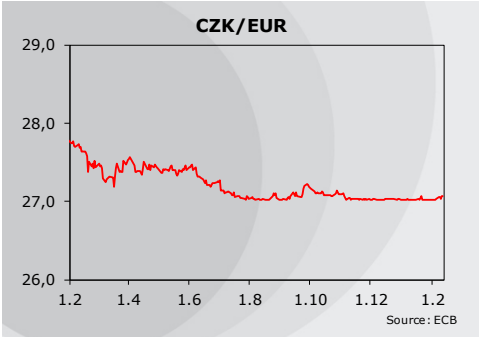


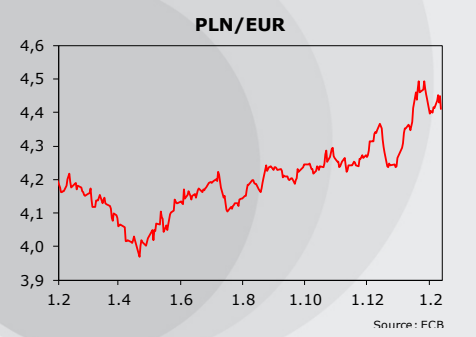


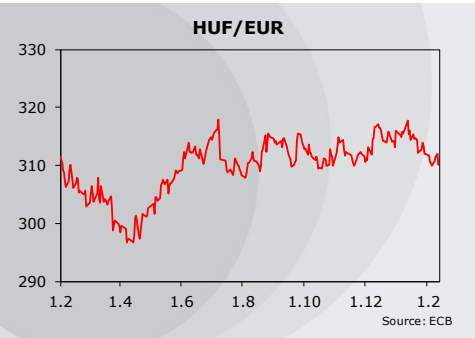


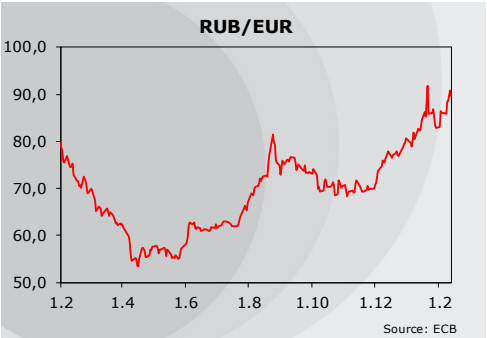












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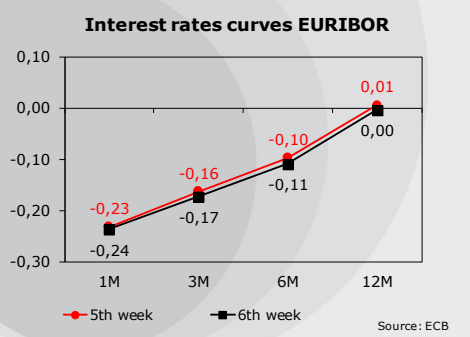

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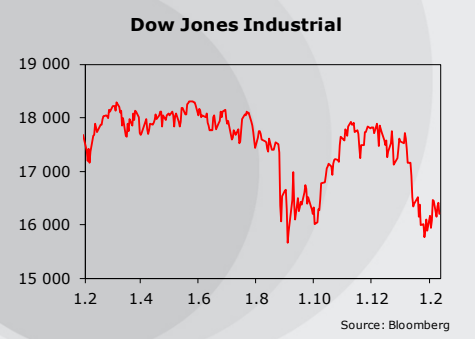

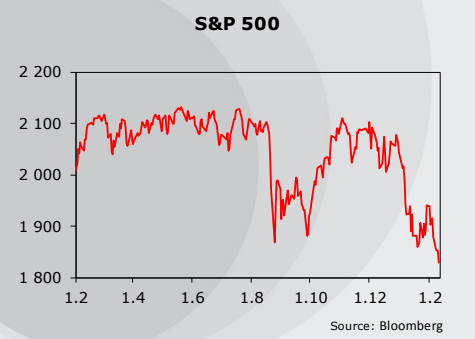

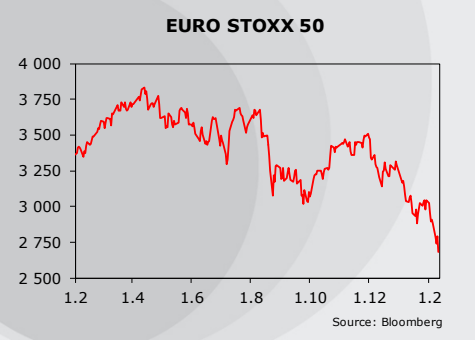

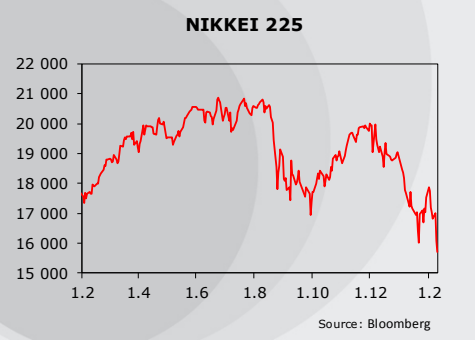

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