UniCredit Bank

Weekly

N . o . t . e . s

English translation by an external party

HIGHLIGHTS OF THE WEEK

08/2016

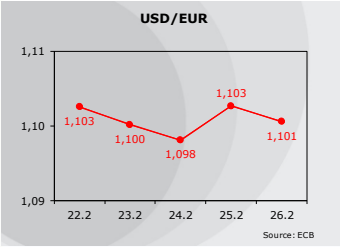
> Chart of the Week: Stock markets falling earlier this year, with the Slovak market swimming against the tide though

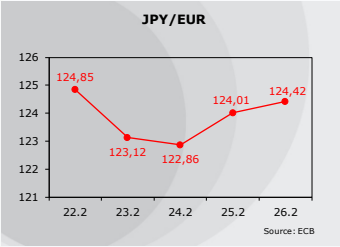
> Unemployment falling unexpectedly in January; even despite termination of seasonal works

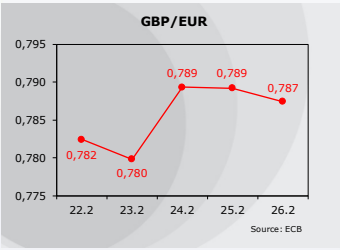
> Producer prices falling again in January, due to cheap oil

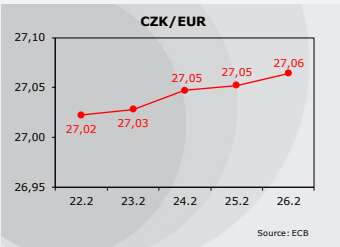
> Cheap oil prevents inflation from recovering in most European countries

WEEK ON THE MARKETS









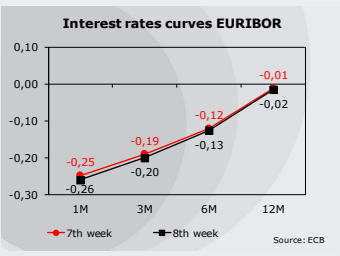
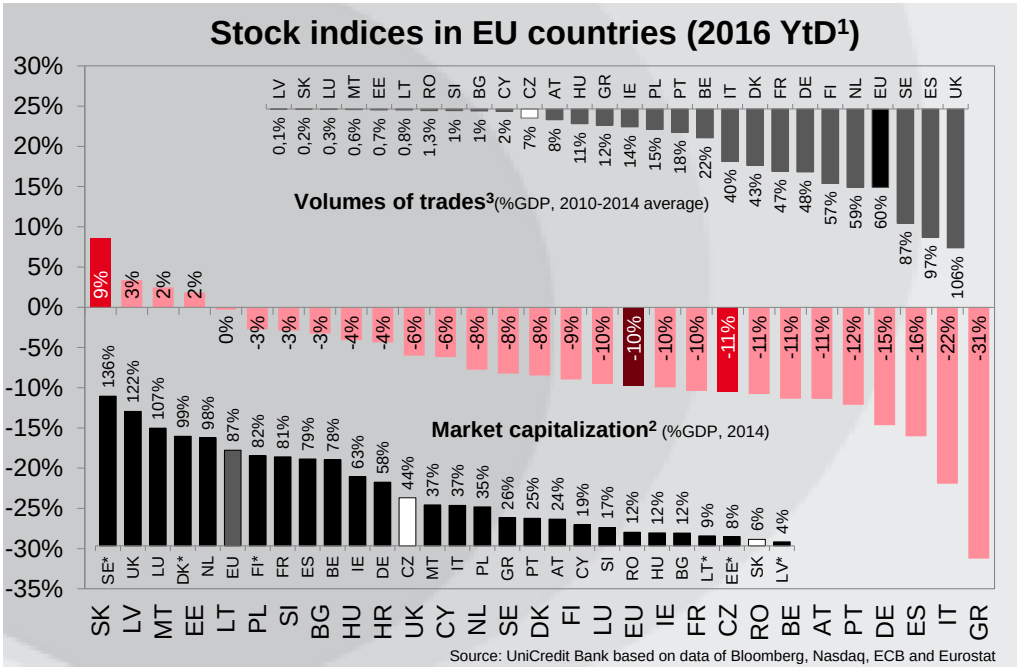


CHART OF THE WEEK



Note: 1. The change in stock indices as of 24 February 2016 (compared to 31 December 2015). AT – ATX; BE – BEL20; BG – SOFIX; CY – CYSE General; CZ – PX; DE – DAX; DK – OMX Copenhagen 20; EE – OMXT; ES – IBEX35; FI – OMX Helsinki 25; FR – CAC40; GR – Athex20; HR – CROBEX; HU – BUX; IE – ISEQ; IT - FTSE MIB; LT – OMX Vilnius; LU – LuxX; LV – OMX Riga; MT – MALTEX; NL – AEX; PL – WIG; PT – PSI20; RO – BET10; SE – OMX Stockholm 30; SI – SBI TOP; SK – SAX; UK – FTSE100; EU – weighted average (based on market capitalisation) of EU countries' indices

2. The market capitalisation of domestic companies (excl. investment funds) listed on domestic stock markets (source: ECB), except SE, FI, DK, LV, LT, and EE, where market capitalisation of the entire market, including foreign companies listed on local stock exchanges, is considered (source: NASDAQ).

3. The volume of all transactions made on the stock markets of the country (except the shares of investment funds)

Stock markets reported considerable slump almost all over the world earlier this year. This was also the case of Europe, where most stock indices headed south. However, there were some exceptions, with mainly the Slovak stock index SAX standing out, increasing its value by considerable 9% since the beginning of the year. The *Chart of the Week* brings an insight into the development of European stock indices as well as into the size of stock markets in EU countries, which largely explain the non-standard behaviour of some European stock indices.

In less than two months of this year, European stock indices have plummeted by nearly -10% on average, with the highest slump being reported by the Athens stock index Athex20 with a value lower by as much as 31% compared to the end of the last year. However, stock exchanges in other Southern European countries reported a major decline too – in Italy, Spain or Portugal (by 12% to 22%), as well as the German stock index DAX (by -15%). Earlier this year, a bit milder decline was

reported by stock markets in the CEE region - by "only" -5% on average. As for the CEE markets, the highest slump was reported by the Romanian and Czech stock index (both by -11%). On the contrary, as for major stock exchanges in the region, it was mainly the Polish (-3%) and Budapest (-4%) stock exchange that reported a relatively mild decline. As many as 3 countries (Slovakia, Latvia, and Estonia) of the region have reported increased value of their stock indices earlier this year. However, the development of stock indices in many CEE countries is distorted by the extremely low liquidity on local markets, which is the case of the mentioned 3 countries. With a small number of instruments and transactions on the market, the value of the index varies more or less randomly, not following the general economic or regional trends. On the face of it, these markets may seem to be a good opportunity for investors looking assets "swimming against the tide" in an attempt to diversify their portfolio as much as possible, however, with the low liquidity of these markets, any considerable transaction means a major shift in the value of stock (to the detriment of the potential investor), making the implementation of such strategy impossible.

The market value of domestic companies listed on European stock markets is at almost 90% of the GDP of EU countries. As for the size of economy, the strongest market capitalisation can be found in northern European countries – in Sweden, Great Britain, Denmark or Luxembourg. Market capitalisation of stock exchanges in the largest European economy, in Germany, is at 58% of the performance of its economy. According to the data of ECB, as for CEE countries, the relatively strongest market capitalisation is reported by Czech stock exchanges (44% of the GDP, of which the Prague Stock Exchange accounts for 15% of the GDP and the RM system for 29% of the GDP), however, the largest stock exchange is clearly the Warsaw Stock Exchange (35% of the GDP). However, the stock markets of most European countries are still poorly developed, with their market capitalisation usually not exceeding 20% of the performance of their economy. Given the size of the economy, the smallest stock exchanges can be found in Latvia (4% of the GDP) and in Slovakia (6% of the GDP). There are only 7 companies listed on the stock market at the Bratislava Stock Exchange, with only three of them executing actual deals (more than 80% of the volume of transactions), reporting a daily volume of closed transactions of only around EUR 11 thousand (the 2015 average).

The low number of stock instruments is reflected in the low market liquidity - the annual volume of transactions closed is beyond 1% of the GDP in Slovakia; the same applies also to the Baltic states, Malta and Luxembourg. Stock markets of the surrounding countries are a bit better off – the annual volume of transactions closed at local stock exchanges in the Czech Republic accounts for 7% of the GDP (96% of the transactions is closed at the Prague Stock Exchange), 8% of the GDP in Austria, 11% of the GDP in Hungary and as much as 15% of the GDP in Poland; however, they are not by far the most liquid stock markets in Europe. On average, the annual volume of transactions closed at stock exchanges in EU countries accounts for as much as 60% of the performance of EU economies, in particular owing to the intensive dealing at stock exchanges in Great Britain, Spain and Sweden. (lk)

ECONOMIC CALENDAR

Week	Indicator	Period	Market Consensus	UniCredit Bank Estimate	Reality
8.	Harmonised index of consumer prices (February 25)	January	-	-0.2% mom -0.5% yoy	-0.3% mom -0.6% yoy
	Producer prices (February 26)	January	-3.9% yoy	-4.7% yoy	-5.2% yoy
9.	State budget (March 1)	January	-	-750 mil. EUR	-
	Retail sales (March 3)	January	-	3.1% yoy	-

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

ECONOMY

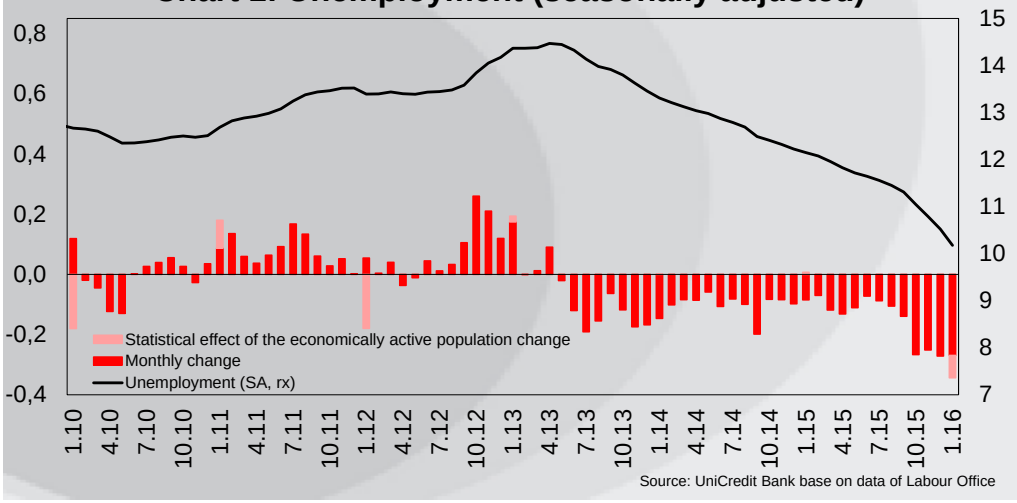
UNEMPLOYMENT

The labour market continues is still a positive surprise. According to the Central Office of Labour, Social Affairs and Family methodology, (disposable) unemployment

Unemployment once again a surprise in January – falling at the beginning of this year for the first time in history

continued to report an unexpected decline also earlier this year. In January, it went down by -0.24 pp to 10.39%. Due to completion of seasonal works in agriculture and, mainly, construction, unemployment is usually rising at the start of the year. Compared to last year's December, a lower unemployment rate in January could be seen for the first time in history (or since 1998, when the statistics of labour offices have been available); in 1998-2014, the average growth of unemployment in January was by as much as 0.5 pp. Seasonally adjusted unemployment (calculation of UniCredit Bank) fell in January by considerable -0.34 pp (the most since June 2004) to 10.18%. Unemployment was lower by 2.0 pp, i.e. by almost 52 thousand unemployed, compared to the same period a year ago.

Chart 1: Unemployment (seasonally adjusted)



Source: UniCredit Bank base on data of Labour Office

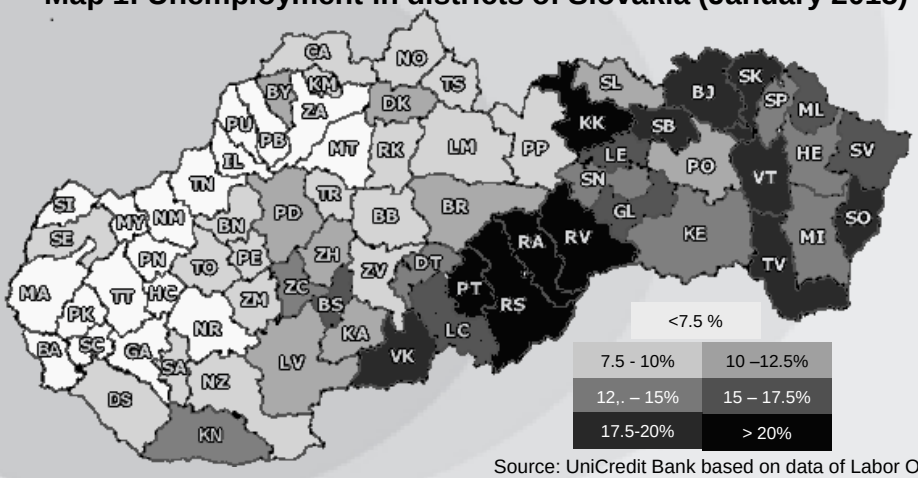
There are several reasons for the unexpected January decline in unemployment – from good condition of the economy up to statistical effects. The Central Office of Labour, Social Affairs and Family methodology changes the number of economically active population (denominator of the unemployment rate) only once a year, always in the first month of the year. It was the same this year, and, while this change had no considerable influence on the rate of unemployment in previous years, it made it go down by 0.08 pp this year (accounting for about one third of the January mom decline in unemployment). According to the statistics used by the Central Office of Labour, Social Affairs and Family, the economically active population has gone up by nearly 20 thousand people over the last year, even despite the fact that the number of people in productive age in Slovakia has already been falling. Last year, the rate of economic activity was rising, i.e. a portion of the economically inactive population (for instance, people with disabilities, students, voluntarily unemployed, etc.) moved to the economically active population. However, the demographic trend indicates that such development (increase in the number of economically active population) should be rather rare in the following years, with the change in economically active population making, in statistical terms, the unemployment rate poorer rather than better in the future. Disposable unemployment was still reduced also by various administrative factors – the rate of incapacity for work, municipal works, re-skilling, etc.; however, their impact was visible only in a yoy comparison, with no major effect on a mom comparison.

The core of the decline in unemployment is, also in January, owing mainly to the better labour market reflecting a relatively good condition of domestic (and European) economy. A relatively successful placement of the unemployed on labour market could still be seen. As many as 19 thousand unemployed people got a new job in January, which has been the best January outcome since 2007. Although, after adjustment for traditional season (calculation of UniCredit Bank), the number of people placed on the labour market declined slightly compared to the extremely strong November and December, it is still well above the average of previous months. A robust labour market is confirmed also by the figures regarding vacant positions, with their number growing to more than 31 thousand in January; at the same time, there were three-times more vacant positions than in last year's January. The still relatively high number of vacant positions indicates that the decline in unemployment could continue also in the next months. On the other hand, a suitable workforce on

the labour market is depleting quite fast; in some regions, employers can often not find adequate candidates at labour offices for their vacancies, due to an inadequate structure of the unemployed - a high portion of low-skilled long-term unemployed with no working habits or strong regional disparities. Slovak companies have thus been increasingly hiring employees from abroad; the number of foreigners working in Slovakia has gone up by nearly 2 thousand yoy, however, only about 25 thousand of them is working in Slovakia, i.e. around 1% of the employed population. If there are no major structural changes in the near term which would increase the employability of the long-term unemployed, we can expect that the growth of employment in Slovakia will be less and less visible in the unemployment figures, being increasingly subsidised by import of workforce from abroad.

However, it was not so much the outflow of the unemployed from the records of labour offices in January than the influx of them that was so surprising. Only 22 thousand new job applicants were registered with labour offices in January, even despite the completion of seasonal works. In the past, around twice as much new unemployed used to register in the first month of the year on average and, although seasonal deviations became slightly quenched in the previous years, this year it is the historically lowest number of newly registered unemployed in January. The cause lies partially in Slovak construction. Despite the fact that after the completion of EU-funded projects we expected that construction could provide a bit more of new unemployed this year than the traditional season, precisely the reverse has happened. In January, construction delivered a bit more than one thousand new unemployed to the records of labour offices - the lowest number in the history.

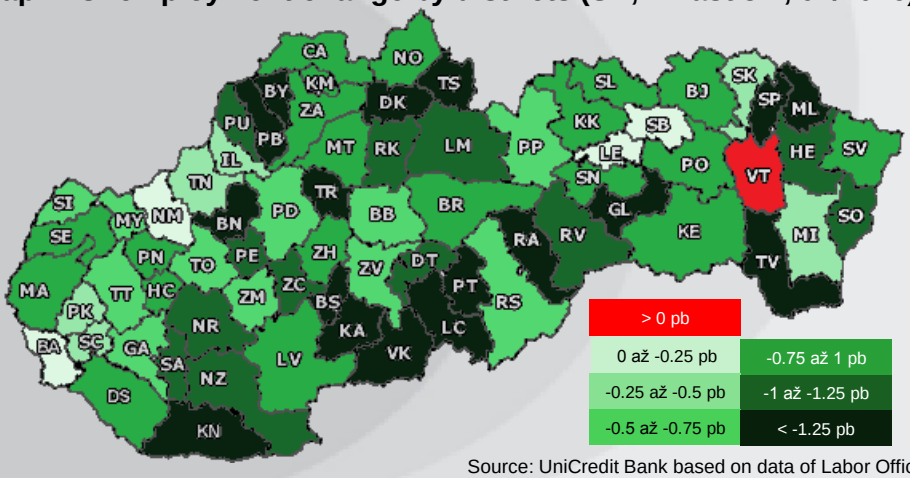
Map 1: Unemployment in districts of Slovakia (January 2015)



Source: UniCredit Bank based on data of Labor Office

After adjustment for traditional season, unemployment was falling in all Slovak regions earlier this year, with the highest decline being reported by regions of Žilina, Nitra, and Prešov. In terms of districts, unemployment went up only negligibly (after adjustment for the season) only in 3 out of 79 districts - Bratislava IV, Nové Mesto nad Váhom, and Levoča. In the remaining 76 districts, unemployment was falling in January, with the strongest decline being reported by the districts of Banská Štiavnica, Sobrance, and Svidník. Unemployment higher than 15% was reported only by 19 out of 79 Slovak districts in January (1 less than in December), with only 5 of them reporting unemployment higher than 20% - Rimavská Sobota (27.4%), Kežmarok (23.1%), Rožňava (21.9%), Revúca (21.4%), and Poltár (21.1%). The lowest unemployment rate is still reported by the vicinity of the capital – districts of Bratislava (from 4.6% to 5.5%), Galanta (4.8%), Trnava (5.3%), Senec (5.4%), Pezinok (5.5%) and Malacky (5.6%), followed by some districts in the area of Považie – Púchov (5.2%), Piešťany (5.4%). Unemployment below 10% was reported in January by more than one half of Slovak districts - as much as 44 out of 79 Slovak districts (3 more than in December), with unemployment falling below 7% in 20 Slovak districts.

Map 2: Unemployment change by districts (SA, in last 3M, 01/2016)



Source: UniCredit Bank based on data of Labor Office

OUTLOOK

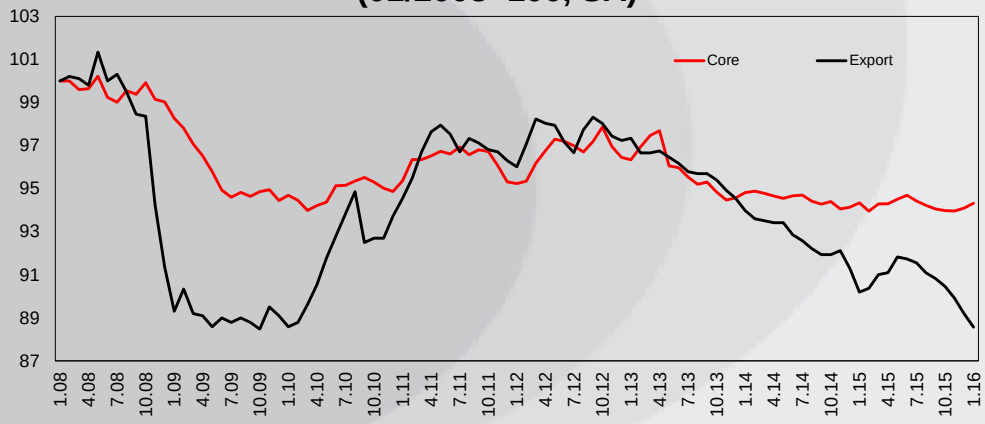
Unemployment should continue to fall gradually also in the following months. The absent seasonal increase in unemployment at the turn of the years (and mainly the lower influx of seasonal workers in the records of labour offices) diminish, however, the potential of a major seasonal decline in unemployment in the spring months. (lk)

PRODUCER PRICES

Producer prices falling in January due to cheap oil

According to the data of the Statistical Office of the SR, domestic producer prices went down by as much as -1.3% mom in January, with the dynamics of their yoy decline accelerating from -4.5% to -5.2%, and the yoy decline has offset the nearly 6-year low of last year's September.

Chart 2: Producer prices - core and export (01/2008=100, SA)

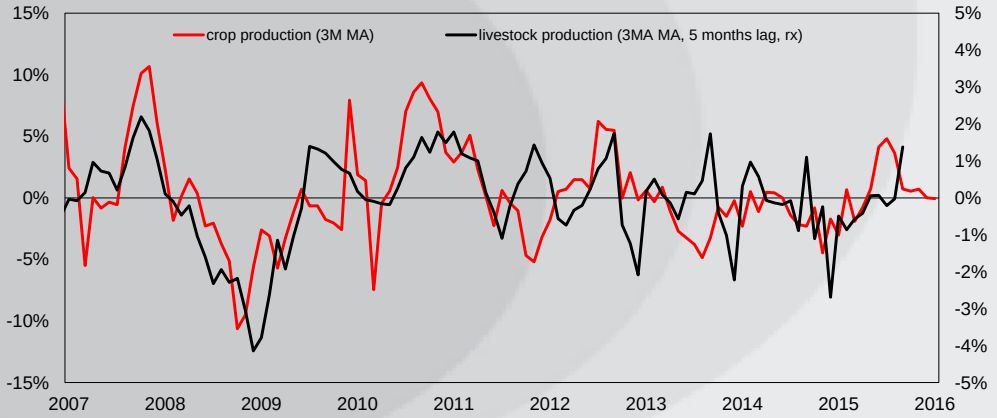


Source: UniCredit Bank based on data of SO SR

As in December, the decline in producer prices in January was due to further slump in oil prices at the turn of the years – prices of refinery products went down by another 16.6% mom, being lower by as much as -36.1% yoy. This year, a traditional change in prices in January was reported also by the prices of energy supplies (electricity, gas, heating), with the scope of this year's decline being identical to the last year, and the dynamics of their yoy decline remained unchanged (-6.7% yoy). Energy have thus been the main driver of the decline in domestic producer prices. On the contrary, core prices in the industry (prices in manufacturing adjusted for the change in prices of oil and food – calculation of UniCredit Bank) were rising very slightly in January - compared to the previous month, they were rising by 0.2%, being unchanged on average compared to January a year ago. A yoy growth in prices was reported by machinery (4.5%), woodworking industry and production of chemicals (both by 4.4%), with decline in prices being reported by basic metals (-4.7%), in particular due to cheap surplus from Asia.

In January, there was a considerable decline in export prices – by -0.7% mom. Dynamics of their yoy fall moderated from -2.4% to -1.9%. Compared to the last year, as for export prices, decline was reported mainly by prices of refinery products (-27.7%) and basic metals (-8.7%); on the contrary, growth was reported by prices of wood and paper (by 4.9%), machinery (by 3.9%), as well as, unlike domestic prices, by prices of consumer electronics (4.0%), or clothes and textile (3.7%).

Chart 3: Prices of vegetable and animal production (MoM, SA)



Zdroj: UniCredit Bank na základe údajov ŠÚ SR

Prices of agricultural commodities went up in January - by 2.9% mom (after adjustment for traditional season - calculation of UniCredit Bank), with the dynamics of their yoy growth decelerating from 2.7% to 1.6%. Compared to the end of the year, mainly the prices in animal production increased in January (by as much as 3.7% - seasonally adjusted, calculation of UniCredit Bank), following the hike in plant production prices in the summer with around a half-year delay. Nevertheless, dynamics of their yoy decline accelerated from -3.3% to -5.2%, with mainly the prices of milk and slaughter pigs falling further. A bit milder mom increase in prices could be seen in plant production in January - "only" by 1.8% (seasonally adjusted, calculation of UniCredit Bank), however, the dynamics of their yoy growth accelerated from 8.5% to 13.6%.

OUTLOOK

At the turn of the years, the oil price went down more considerably, affecting the producer prices in Slovakia. The subsequent stabilisation of oil prices should contribute to the stabilisation of producer prices as well. On the other hand, lower prices of oil (and energy) should prevent core prices in the industry from recovering more considerably this year too (secondary effects). (lk)

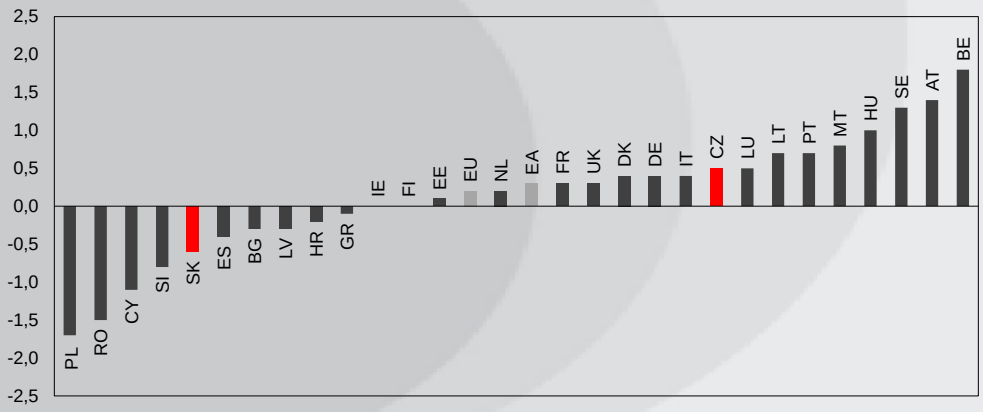
Falling oil prices preventing inflation in Europe from recovering

HARMONISED INDEX OF CONSUMER PRICES

In the harmonised Eurostat methodology, prices fell by -0.3% mom in Slovakia in January, with the dynamics of their yoy decline deepening from -0.5% to -0.6%. On average in the euro area countries, the consumer prices dropped by as much as -1.3% mom, with the dynamics of their yoy growth accelerating slightly from 0.2% to 0.3%. Mainly the low oil prices on global markets were still the main factor hampering the price growth in Europe. Their further decline at the turn of the years has considerably moderated the expected influence of the base effect on the yoy inflation in European countries. Although the negative contribution of fuel prices had moderated in several countries, the fuel prices were falling by -5.9% yoy in the euro area, reducing overall inflation by considerable 0.28 pp.

Core inflation (i.e. inflation adjusted for the modification in food and energy prices) is still subdued by the secondary effects of cheap energy, however, it remained relatively stable in most countries also in January – although it dropped by -1.7% on average in the euro area earlier this year, mainly thanks to the traditional seasonal effects (post-Christmas sales), the dynamics of its yoy growth accelerated slightly from 0.9% to 1.0%. Dynamics of the yoy growth of core prices in Slovakia accelerated slightly from 0.7% to 0.8% in January, reaching its 29-month peak.

Chart 4: Harmonised index of consumer prices (01/16, YoY)



Source: UniCredit Bank based on data of Eurostat

The number of euro area countries with deflation went down from 7 to 5 in January (with Estonia, Lithuania and Finland no longer reporting deflation and Latvia returning to the negative) - with the fastest price decline being reported by Cyprus (-1.1%) and Slovenia (by -0.8%). Out of the 9 EU countries that are not yet members of the euro area, nearly one half of them (four) reported a yoy price decline, with the highest decline being reported by the neighbouring Poland (-1.7%) and Romania (by -1.5%). On the contrary, the fastest price growth was reported by Belgium (1.8%) and Austria (1.4%); as for the non-euro area EU countries, by Sweden (by 1.3%) and Hungary (by 1.0%).

OUTLOOK

There is still no stronger inflation driver in Europe (in Slovakia either) and this situation should persist during most of 2015. Decline in oil prices on global markets of the turn of the years has only postponed the recovery of inflation in European countries.

The supply-side nature of absent inflation in Europe supports the consumption of European households - with low energy prices, households have more available funds to purchase other goods and services. The risks of occurrence of the harmful deflationary spiral still seems to be relatively low. Although the secondary effects of low energy prices prevent the substantial recovery of demand-pull inflation (even with an increasing demand); however, it is still relatively stable at about 1%. (lk)

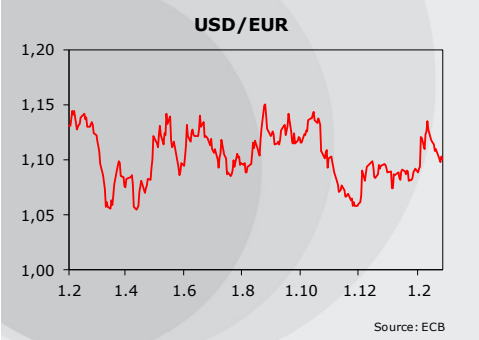
ECONOMIC OUTLOOK

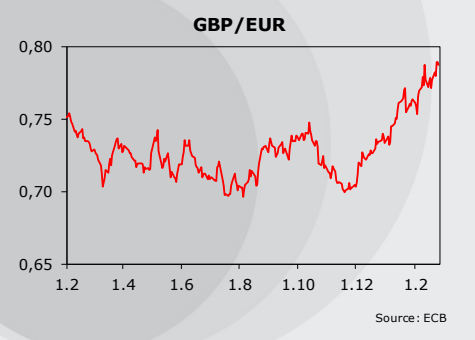
Slovakia	2011	2012	2013	2014	2015E	2016F	2017F
Real GDP growth	**2,8**	**1,5**	**1,4**	**2,5**	**3,6**	**3,0**	**3,0**
GDP per capita	13 052	13 398	13 643	13 947	14 287	14 788	15 291
Household consumption	**-0,6**	**-0,4**	**-0,8**	**2,4**	**2,5**	**2,9**	**2,6**
Government consumption	-1,7	-2,6	2,2	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**	**5,9**	**5,5**	**6,5**
Construction	-1,7	-12,5	-5,3	-4,2	16,3	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

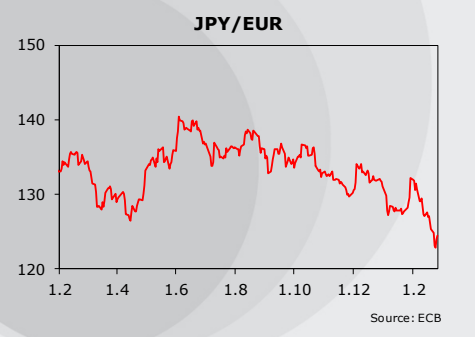
Abroad	2011	2012	2013	2014	2015E	2016F	2017F
Eurozone GDP	**1,5**	**-0,6**	**-0,4**	**0,9**	**1,5**	**1,9**	**1,6**
German GDP	**3,1**	**0,9**	**0,5**	**1,6**	**1,5**	**2,1**	**1,4**
Czech R GDP	1,7	-1,0	-0,9	2,0	4,3	2,3	3,0
USA GDP	1,7	2,8	1,9	2,4	2,5	2,6	2,4
Eurozone Inflation	2,7	2,5	1,3	0,4	0	0,9	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

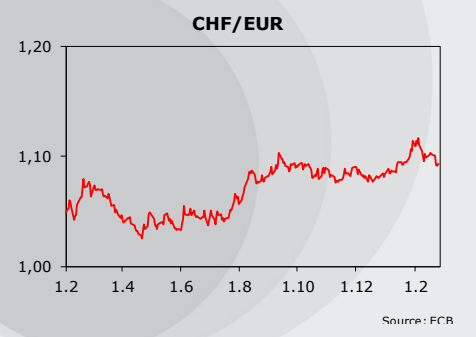
Source: NBS. SOSR. ÚPSVaR. MinFin SR. Eurostat. ECB
Forecasts: UniCredit Bank Slovakia – Slovakia. Eurozone. USA (EURIBOR. USDLIBOR. Brent. USD/EUR); UniCredit Group (CEE Economic Research. CIB) – Eurozone. USA

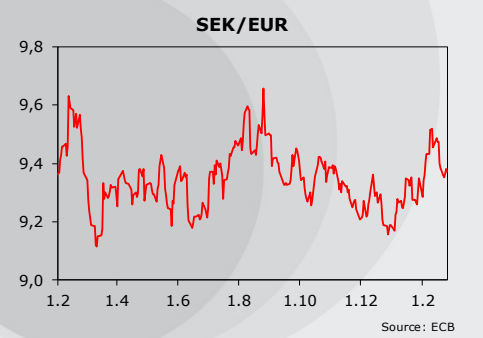
FOREIGN EXCHANGE

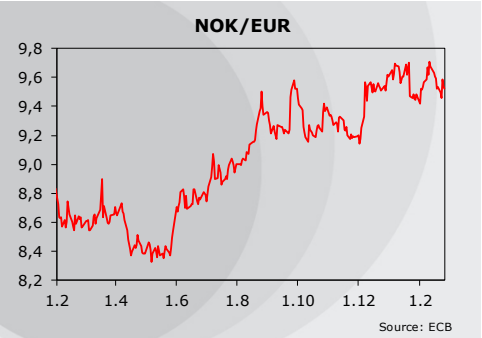


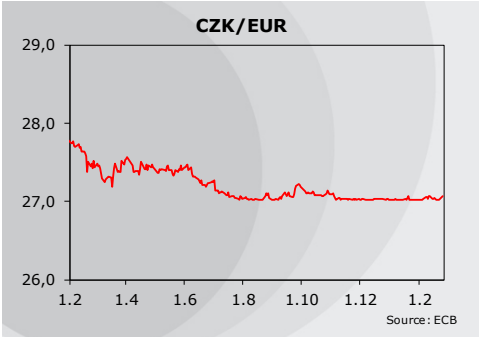


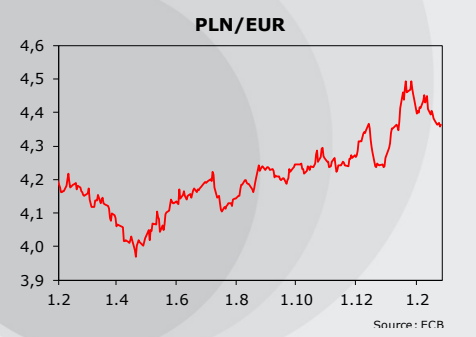


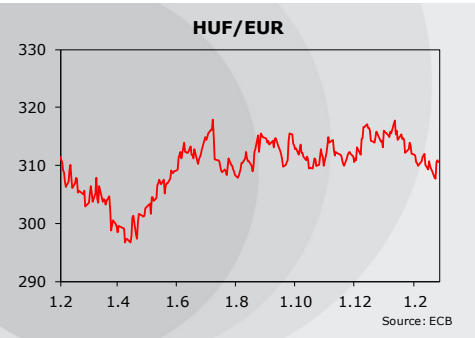


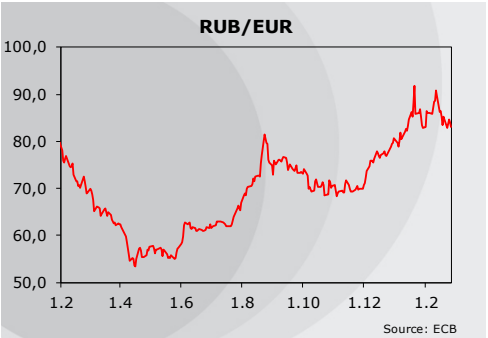






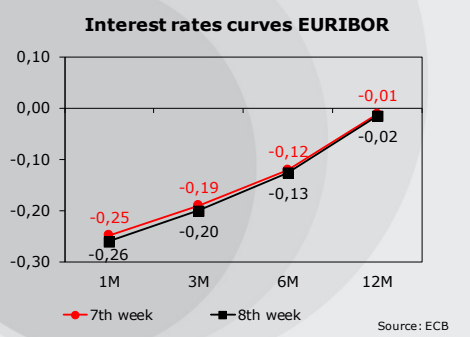




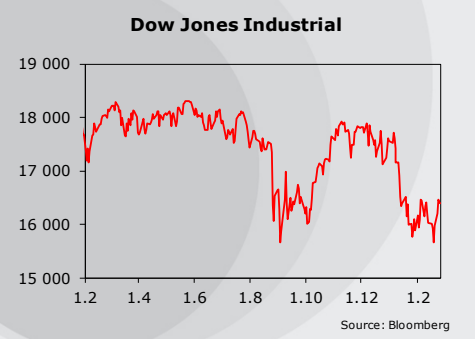


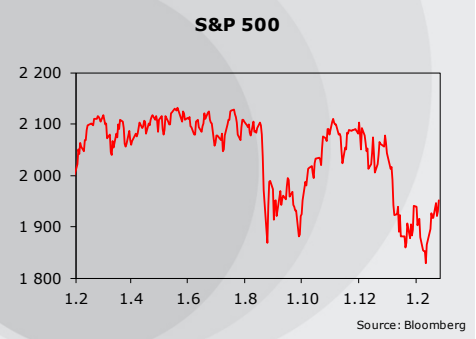
MONEY MARKET

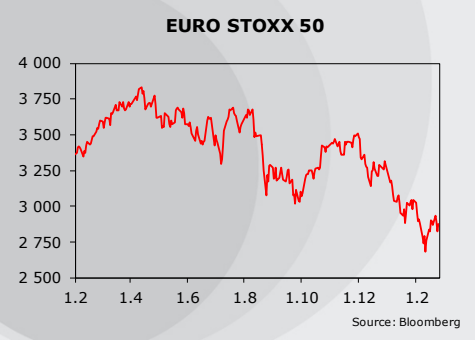
MONEY MARKET

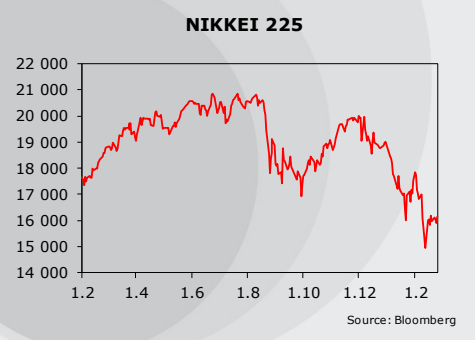


EQUITY









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

Ľubomír Koršňák,
+421 2 4950 2427; Lubomir.Korsnak@unicreditgroup.sk

CONTACTS:

Jaroslav Habo, Large Corporates and Multinationals
+421 2 4950 4319; Jaroslav.Habo@unicreditgroup.sk

František Doležal, MID Corporates
+421 2 4950 4229; Frantisek.Dolezal@unicreditgroup.sk

Raymond Kopka, Retail and SB
+421 2 4950 3212; Raymond.Kopka@unicreditgroup.sk

Roman Hajduk, Private
+421 2 5942 8022; Roman.Hajduk@unicreditgroup.sk

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