UniCredit Bank

Weekly

N . o . t . e . s

English translation by an external party

HIGHLIGHTS OF THE WEEK

10/2016

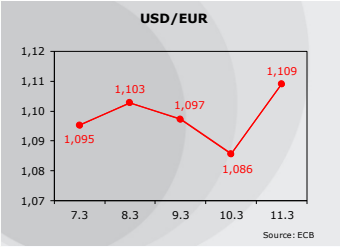
> Chart of the Week: Structure of economy growth was not a surprise, being driven mainly by public investments at the end of the year

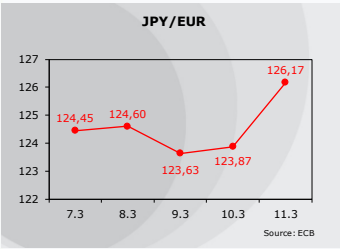
> Foreign trade returning to surpluses at the beginning of the year; however, growth of industry decelerates

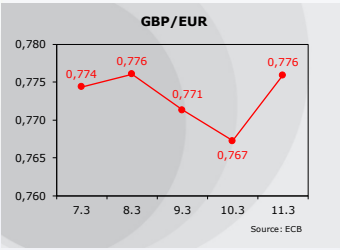
> Construction protected by recovering real estate market

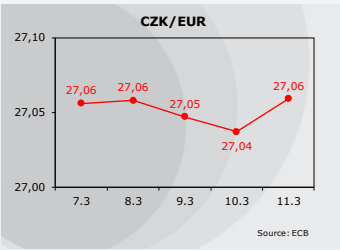
> Labour market remains positive: both wages and employment are on the rise

WEEK ON THE MARKETS









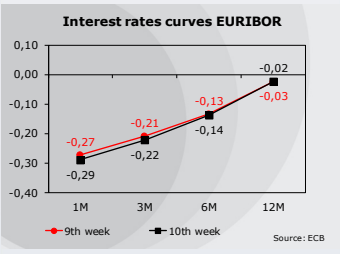
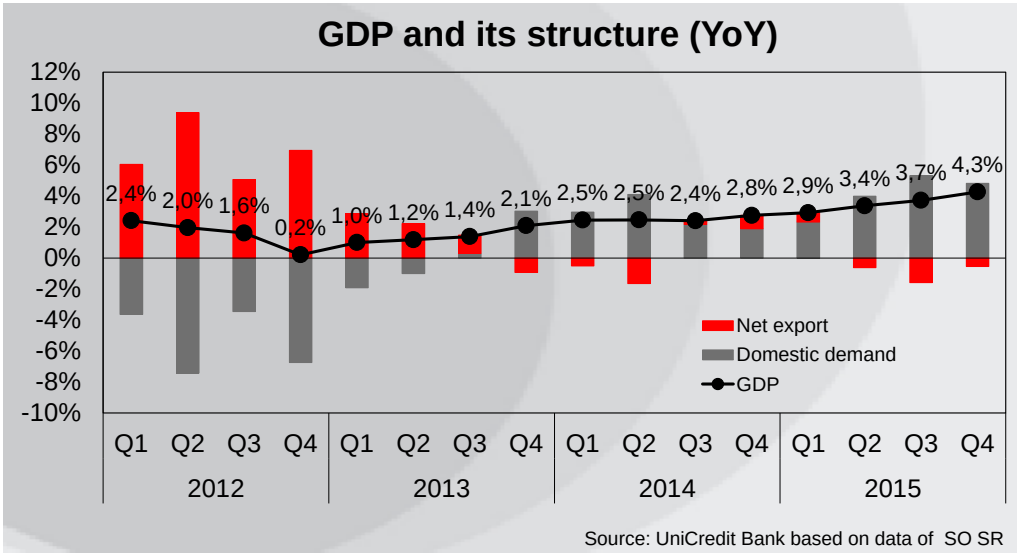


CHART OF THE WEEK



Source: UniCredit Bank based on data of SO SR

Based on updated data, the Statistical Office has revised the growth of Slovak economy in 4Q15 slightly upwards – from 4.2% to 4.3% yoy. Compared to the previous quarter, Slovak economy went up by 1.0% (seasonally adjusted). On the aggregate for the whole 2015, Slovakia's GDP at constant prices increased by 3.6%.

Structure of the economy growth was, in principle, no surprise. Economy was driven mainly by the domestic demand massively supported by public investments (EU funds) and the recovering foreign (mainly European) demand, which translated into acceleration of the dynamics of the growth of exports to a nearly two-year peak. However, the strong domestic demand was still translating also into the dynamic growth of imports, so the net contribution of abroad made the growth of GDP slightly lower also at the end of 2015; however, compared to 3Q, its negative contribution to the growth became lower.

Domestic demand was considerably supported mainly by the growing investments, which have gone up by as much as 19.4% yoy, rising faster in 2Q05. It was public investments massively supported by EU funds (increase in current prices by as much as 69.4%) that were the main source of growth of investments also at the end of the year. According to our calculations, public investments (prior to adjustment for induced imports) accounted for nearly ¾ of growth of the Slovak economy at the end of last year; after adjustment for imports, their net contribution to the growth of the economy could be at around one third. However, the dynamics of growth of public investments no longer accelerated; after termination of EU-funded projects from the preceding budgetary period, we expect a more considerable slump in public investments at the beginning of this year back to "standard" levels. The growth of investments was, however, supported also by private investments, reporting a relatively stable growth at around 4-5% yoy in the last 3 quarters.

The growth of domestic demand was supported also by its other components – household and government consumption. At the end of the year, the dynamics of growth of household consumption accelerated slightly once again from 2.7% to 2.9%; based on the monthly figures concerning retail sales it seems that households spend more mainly on durable goods (e.g. purchase of a new car).

From the supply (production) point of view on the structure of growth of the economy it is seen that the growth has come across sectors of the economy. Except agriculture (-1.8% yoy), value added increased yoy in all the main sectors of the economy, with the highest increase reported by IT and communication (13.8%), construction (8.3%) and industry (5.6%).

Slovak economy should retain the relatively strong economic growth also this year. However, due to lower public investment, which will be only gradually replaced by private investments (mainly in automotive industry), the dynamics of its growth should decelerate towards 3%. Based on the strong figures from the end of last year, we have decided to revise our estimate of growth of the Slovak economy in 2016 from 3.0% to 3.2%. This year, the growth of economy should be relatively balanced, with both domestic and net foreign demand contributing to the growth. Household consumption should continue to benefit from the positive development on the labour market (increasing wages and employment), absent inflation and low interest rates. Private investments and exports should profit from the relatively robust recovery of European economies supported by the relaxed monetary policy of the ECB and cheap oil.

On the other hand, also negative risks of our prognosis arising mainly from external environment accentuated at the beginning of the year. 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 turbulences on financial (stock) markets, if the sharp slump in stock indices is translated also in the sentiment of consumers and enterprises in Europe. Sentiment in Europe may be deteriorated also by the political issues in Europe – Brexit or dealing with the migration crisis. 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 translated into real economy so far. (lk)

ECONOMIC CALENDAR

Week	Indicator	Period	Market Consensus	UniCredit Bank Estimate	Reality
10.	GDP and its structure (March 8)	4Q 15	4.2% yoy	4.2% yoy	4.3% yoy
	Unemployment by LFS (March 8)	4Q 15	-	10.8%	11.0%
	Employment by LFS (March 8)	4Q 15	-	2.2% yoy	2.6% yoy
	Real wages (March 8)	4Q 15	-	3.7% yoy	4.6% yoy
	Foreign trade (March 8)	January	291 mil. EUR	373 mil. EUR	279 mil. EUR
	Industrial production (March 8)	January	-	6.1% yoy	1.6% yoy
	Construction production (March 8)	January	-	9.9% yoy	16.4% yoy
11.	Consumer prices (March 14)	February	-0.5% yoy	0.0% mom -0.5% yoy	-
	Harmonised index of consumer prices (March 17)	February	-0.5% yoy	0.0% mom -0.5% yoy	-
	Unemployment (March 15-20)	February	-	10.32%	-

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

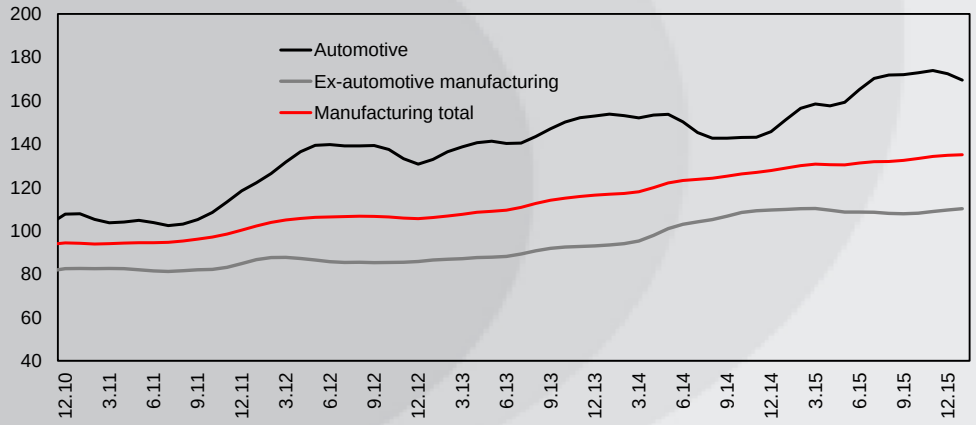
ECONOMY

Growth of industry decelerating more considerably in January

INDUSTRIAL AND CONSTRUCTION PRODUCTION

Slovak industry got into reverse in January. According to data of the Statistical Office, industrial production went down by -1.2% mom (after adjustment for season) in January, with the dynamics of its yoy growth decelerating from 6.0% to 1.6%. However, the yoy comparison at the beginning of the year was largely affected also by the relatively extensive revision of figures of the previous year. The Statistical Office has revised the yoy growth of industry last year upwards from 5.9% to 7.0%. The Office accelerated the growth of industry mainly at the beginning of the year - from the original 5.6% to as much as 12.5% yoy in 1Q; on the contrary, revision at the end of the year went in the opposite direction, with the growth of industry at the end of the year revised downwards from the original 8.1% to 5.1% yoy.

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



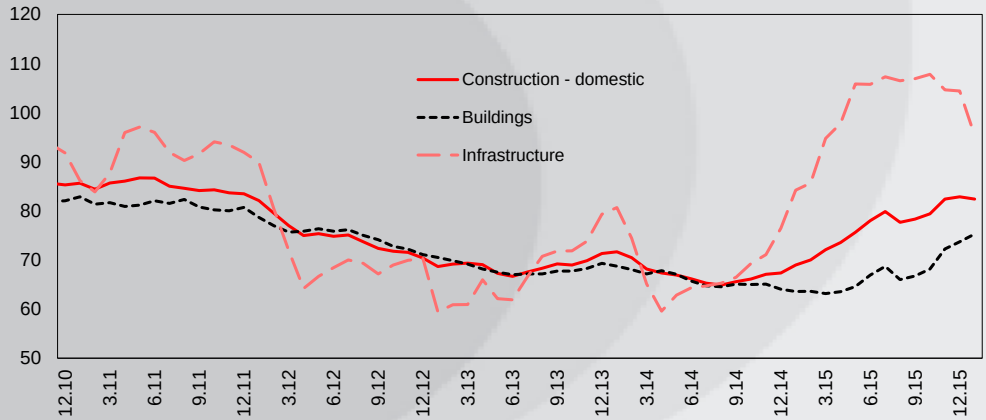
Source: UniCredit Bank based on data of SO SR

Revision of figures in the previous year does not change the fact that its driver is still the automotive industry. The situation remained basically the same also early this year, when production of transport equipment contributed to the yoy growth of industry with 2.2 pp, which means that without the growth of the automotive industry the Slovak industry would have reported a moderate yoy decline in production. However, compared to the end of the last year, also the automotive industry decelerated more considerably; compared to December, after adjustment for seasonal effects, its production decreased by around 5% and the dynamics of its yoy growth decelerated from 29.0% to 8.4%. In January, the position of a growth leader was thus assumed by the electrical engineering industry, when the production of electrical equipment increased by as much as 17.0% yoy; however, due to lower weight, its contribution to the growth of industry was “only” 0.7 pp. However, a growth well beyond average was reported also by the refinery industry (by 16.2% yoy) and, after 9 months of uninterrupted decline, producers of consumer electronics returned to positive figures, reporting a 7.2% yoy increase in production - after their production, after adjustment for traditional season, increased by considerable 10% mom. So it seems that Slovak producers of consumer electronics have dealt with the post-Christmas replenishment of retailers’ storehouses quite well.

In January, we expected that figures of the industry could have been negatively affected by metallurgy – U.S. Steel, the top corporation in the sector, announced in media shortening of the working week and production cuts because of the cheap Asian competition. However, the sector as a whole reported only a negligible decline in production (after adjustment for season), with its production even increasing by 3.7% yoy. Other sectors were an unpleasant surprise – a strong mom decline in production was reported mainly by machineries, making the once growth leader of the industry (with a yoy growth of machineries close to 20% at the end of the year) losing -3.0% of production yoy. It is this sector that could be affected more by the deterioration of corporate sentiment in Europe, for instance, due to turbulences on financial markets, which would discourage European companies from further investments. However, we do not expect that the January figures were already

affected by this factor and we rather assume that it was a short-term deviation. After the most recent revision of the industry figures it seems that also producers of rubber and plastic (a sector strongly connected mainly to the automotive and consumer electronics) started to get into trouble at the end of the year and this trend persisted also early this year, when the production in this sector reduced by as much as 12.2% yoy. High volatility during the last year was reported by the pharmaceutical industry and it did not change even in the new year; production of the sector remains volatile, slumping by as much as 31.2% yoy in January, while reporting a 20% yoy growth in November.

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



Source: UniCredit Bank based on data of SO SR

Recovery of real estate market protected construction from slump after the termination of EU funds

In January, a part of construction dealing with construction of infrastructure was, as expected, affected by the termination of EU-funded projects and, after adjustment for season, its production went down by about one fourth compared to the end of last year (calculation of UniCredit Bank based on SO SR data), with the production of the infrastructure segment reduced by -13.1% yoy. Despite this fact, construction as a whole has maintained a relatively dynamic yoy growth, with its production increased by 16.4% compared to January a year ago according to data of the Statistical Office (even despite the mom decline in production by 6.2%). A lifebelt was given to construction by the recovering economy, restarting both the real estate market and private investments. The segment of construction of buildings was perceptibly recovering already at the end of last year, continuing in this trend in January. After adjustment for the season, its production was growing slightly at the beginning of the year, translating into acceleration of its yoy growth from an already record 20.4% to as much as 25.3% - the last time a yoy growth that strong has been reported by the building construction segment was in June 2006.

OUTLOOK

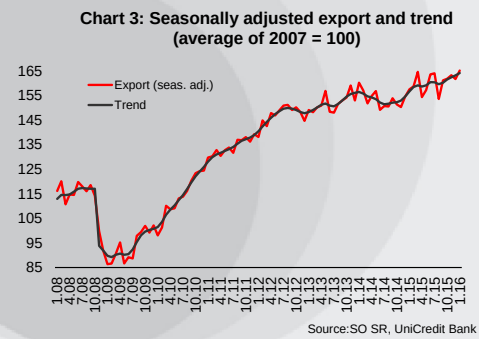
According to a survey by the Statistical Office, the sentiment in Slovak industry improved to as much as four-year peaks at the beginning of the year. The industry figures did not confirm this fact, at least not in January. Moreover, it seems that the yoy comparison base at the beginning of the year will not (after the current revision) make the yoy industry figures higher (as it seemed a month ago) in statistical terms but lower. In particular, in March, affected also by Easter, we may yet see a relatively considerable yoy decline in the industry in statistical terms. However, even despite several turbulences, the recovery of European economies supported by cheap oil and relaxed monetary stance seems relatively robust, which is also what the Slovak industry should be still benefiting from.

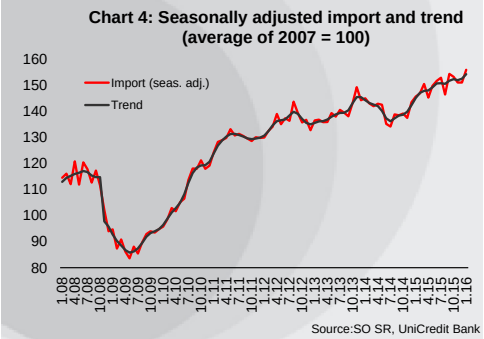
Our concerns that Slovak construction will again resume negative figures after the termination of EU-funded projects turned out to be unfounded for the time being, when it has been saved by the recovery of the real estate market. We should see a similar trend also in the coming months; however, the yoy growth of construction might be decelerating slightly in statistical terms due to the increasing base effect. (lk)

Foreign trade returning to surplus in January

FOREIGN TRADE

At the beginning of the year, foreign trade returned to surpluses as expected – according to data of the Statistical Office, the volume of exports in January exceeded the volume of imports by EUR 279 million. Compared to the same period a year ago, however, the foreign trade surplus moderated; at the same time, the Statistical Office revised, also based on updated data, the figures of foreign trade last year, reducing the total surplus by EUR 54 million. The 12-month foreign trade surplus kept moderating, from the revised 4.2% of the GDP in last year's December to 4.1% of the GDP in January.





Dynamics of the yoy growth of both exports and imports decelerated (exports from 6.5% to 3.0%, imports from 7.5% to 4.7% yoy) in January; however, compared to the end of the year, after adjustment for the season, there was quite a dynamic increase in volumes on both sides of the foreign trade balance (exports by 2.1% mom, imports by as much as 3.3% mom - calculation of UniCredit Bank).

The structure of January imports has not been known so far; but considering the surprisingly poor retail figures, we expect that imports were driven mainly by investment imports and imports of material for production. It indicates that the strong domestic demand should persist also at the beginning of the year, with absent public investments after the termination of EU-funded projects being gradually replaced by investments of the private sector. A stronger growth of materials and unfinished products for production may be marking increasing exports in the next month.

Similarly, it seems that turbulences on financial markets early this year have not yet affected real economies of European countries and the foreign (mainly European) demand continues to recover, which is reflected also in the ongoing growth of export performance of the Slovak economy. We expect that the automotive industry remained the driver of growth also at the beginning of the year.

OUTLOOK

Although January has not confirmed our original assumptions so far, we still expect that the pressure on the growth of investment imports will alleviate after the termination of EU-funded investments. Therefore, we expect that surpluses of the foreign-trade balance should no longer moderate in the coming months; 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)

WAGES

According to data of the Statistical Office of the SR, gross average nominal monthly wages were at EUR 956 in 4Q15, with the dynamics of their yoy growth accelerated from 2.9% to as much as 4.1%, when the yoy growth could be increased also by the relatively (compared to the previous quarters) lower last year's comparison base. With the inflation still absent, the growth of wages was 4.6% yoy in real terms (3.2% yoy in the previous quarter). The ongoing growth of real wages creates suitable preconditions for the growth of household consumption.

On the aggregate for the whole 2015, average wages increased by 2.9% yoy to EUR 883. In real terms, the wage growth last year decelerated from 4.2% to 3.2% yoy.

Wage growth accelerated again at the end of the year

Although the dynamics of growth of labour productivity was accelerating slightly at the end of the year, wages were again rising faster. The dynamic growth of unit labour costs persists, with the ULC uninterruptedly rising for 8 quarters in a row. Slovakia has thus been gradually losing its competitive advantage of the previous years – the extremely positive ratio of labour costs to productivity – and becoming, compared to its neighbours, an "expensive" country, in particular in industry, i.e. the key sector for foreign trade in goods.

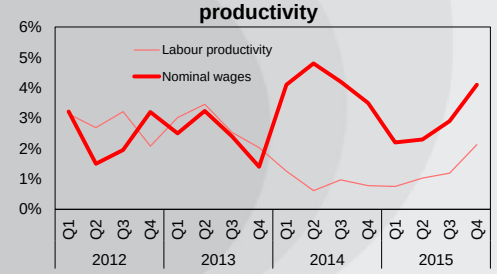
Once again, the growth of wages was distributed among the major economy sectors quite unequally. At the end of the year, the fastest growth of wages was reported by real estate (by as much as 14.3% yoy) and IT and communication (by 10.2% yoy). However, the growth of wages in construction (by 9.6% yoy), reporting record growth of production, and public administration (6.7% yoy) was accelerating, too. On the contrary, manufacturing reported a wage growth close to the average of the economy (by 4.2% yoy). On the other hand, there were also sectors reporting a yoy reduction in wages at the end of the year - compared to the last year, wages were lower mainly in professional, scientific and technical activities (by as much as -8.6% yoy), as well as in agriculture (-3.9% yoy), which was the only sector of the economy where value added has been falling yoy, or in energy supplies (-1.6% yoy) and administrative services (-0.7% yoy).

In terms of regions, the fastest yoy wage growth was reported by the regions of Žilina (by 6.9% yoy) and Nitra (by 5.1% yoy), with the slowest growth reported by Bratislava and vicinity (by 2.3% yoy). The region of Bratislava, also owing to the structure of economy of this region, does still report clearly the highest average wage (EUR 1,185); on the contrary, the lowest average wage is reported by the region of Prešov (only EUR 776).

OUTLOOK

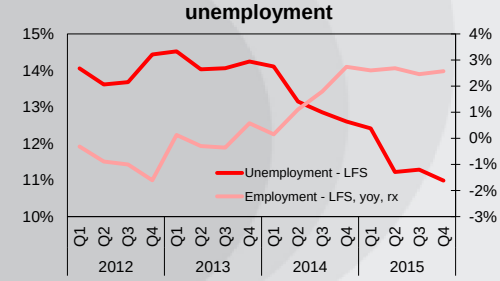
We assume that the nominal growth of wages in 2016 is subdued, also in wage negotiations, by the low inflation expectations. On the other hand, even despite the fact that unemployment in Slovakia still keeps its double-digit levels, its adverse structure creates pressure on the growth of wages, in particular in the case of some jobs and regions – this should result in a persistent growth of unit labour costs, i.e. the wage growth in 2016 should still outrun the growth of labour productivity. We expect that the dynamics of growth of average wages to be comparable to the last year, i.e. wages should grow by around 3%. (lk)

Chart 5: Nominal wages vs. labour productivity



Source: UniCredit Bank based on data of SO SR

Chart 6: Employment and unemployment



Source: UniCredit Bank based on data of SO SR

Labour market still with positive figures – employment is growing and unemployment is falling

EMPLOYMENT AND UNEMPLOYMENT

In 4Q15, employment in the Labour Force Survey (LFS) methodology of the Statistical Office of SR went up, compared to the previous quarter, by 0.9%, i.e. 21.7 thousand persons (seasonally adjusted, calculation of the Statistical Office of SR), being higher by 2.6% (i.e. 61.5 thousand) compared to the same period of the previous year and reaching 2,452 thousand of employed people. As in the previous quarters, the yoy growth of employment was supported also by the increasing outflow of workforce abroad. The number of persons working abroad for a short period (up to 1 year) increased by 17.9% (24.4 thousand) yoy to 160.6 thousand persons, with most of them being employed in the industry (23%) and construction (26%); in terms of countries, the most popular are the neighbouring countries - Austria (31%) and Czech Republic (25%). The main driver of the growth of employment is, however, still the domestic economy, when the number of persons working in domestic economy increased by 1.6% yoy (i.e. 37.1 thousand persons) in the last quarter of 2015. At the end of last year, employment was growing in all regions of Slovakia, with the fastest

growth of employed people reported by the regions of Žilina (by 5.2% yoy), Banská Bystrica (by 4.8% yoy) and Trnava (by 4.7% yoy).

The unemployment rate at the end of last year went down from 11.3 to 11.0%; after adjustment for traditional season, the number of unemployed people went down by 4.4% compared to the previous quarter. At the same time, also in 4Q the decline in unemployment was slowed down by the growing number of economically active persons – their number increased by 19 thousand yoy (0.7% yoy). The unemployment rate was lower by 1.6 pp compared to the same period a year ago.

OUTLOOK

Growth of economy should further create space also for growth of employment, or decline in unemployment. According to our calculations, unemployment in 2016 should fall, on average, from this year's 11.5% to 10.6%, approaching the magical 10% possibly at the beginning of 2017. (lk)

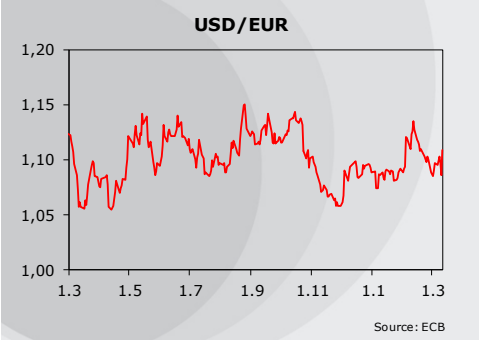
ECONOMIC OUTLOOK

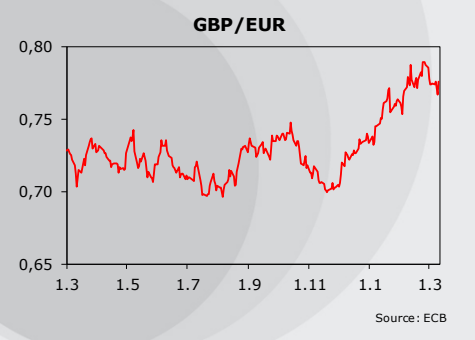
Slovakia	2011	2012	2013	2014	2015E	2016F	2017F
Real GDP growth	**2,8**	**1,5**	**1,4**	**2,5**	**3,6**	**3,2**	**3,2**
GDP per capita	13 052	13 398	13 643	13 947	14 287	14 860	15 383
Household consumption	**-0,6**	**-0,4**	**-0,8**	**2,4**	**2,4**	**2,9**	**2,6**
Government consumption	-1,7	-2,6	2,2	5,9	3,4	1,7	0,0
Gross investments	7,6	-14,0	1,5	2,6	13,1	-0,2	10,8
Exports	12,0	9,3	6,2	3,6	7,0	6,1	5,1
Imports	9,6	2,5	5,1	4,3	8,2	5,1	6,1
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**	**1,4**
CPI (Dec.)	4,4	3,2	0,4	-0,1	-0,5	0,5	1,6
Real Estate inflation	-3,0	-1,1	-0,9	-0,8	0,3	2,3	2,5
Average Wage level	786	805	824	858	883	911	941
Nominal Wage growth	**2,2**	**2,4**	**2,4**	**4,1**	**2,9**	**3,1**	**3,4**
Real Wage growth	-1,6	-1,2	1,0	4,2	3,2	3,3	2,0
Employment growth (LFS)	1,5	-1,0	0,0	1,5	2,6	1,0	1,3
Unemployment (average, LFS)	**13,5**	**14,0**	**14,2**	**13,2**	**11,5**	**10,6**	**9,4**
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	52,7	51,4
Foreign Direct investment (EURbn)	2,8	3,2	-0,3	0,2	0,7	2,5	3,5
ECB Refi rate (%, Dec.)	**1,00**	**0,75**	**0,25**	**0,05**	**0,05**	**0,00**	**0,00**
3M EURIBOR (%, Dec.)	1,2	0,2	0,3	0,1	-0,1	-0,3	-0,3
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

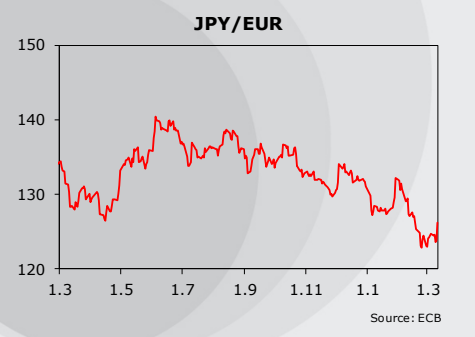
Abroad	2011	2012	2013	2014	2015	2016F	2017F
Eurozone GDP	**1,5**	**-0,6**	**-0,4**	**0,9**	**1,5**	**1,7**	**1,6**
German GDP	**3,1**	**0,9**	**0,5**	**1,6**	**1,7**	**1,8**	**1,4**
Czech R GDP	1,7	-1,0	-0,9	2,0	4,3	2,2	3,0
USA GDP	1,7	2,8	1,9	2,4	2,4	2,2	2,4
Eurozone Inflation	2,7	2,5	1,3	0,4	0	0,4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

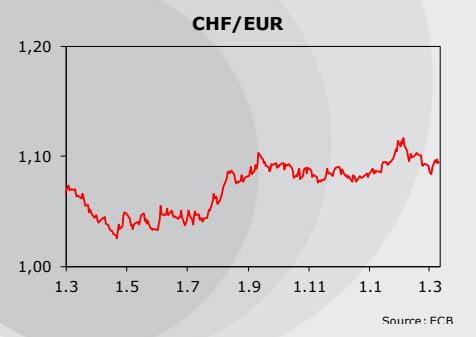
Source: NBS. SOSR. ÚPSVaR. MinFin SR. Eurostat. ECB
Forecasts: UniCredit Bank Slovakia – Slovakia. Eurozone. USA (EURIBOR. USDLIBOR. Brent. USD/EUR); UniCredit Group (CEE Economic Research. CIB) – Eurozone. USA

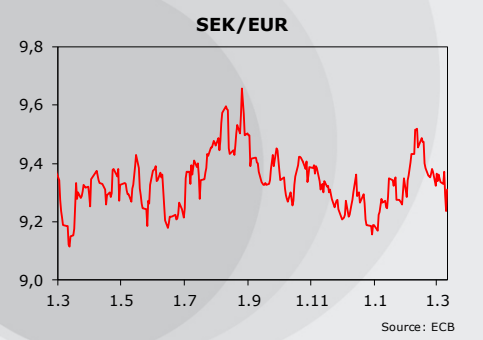
FOREIGN EXCHANGE

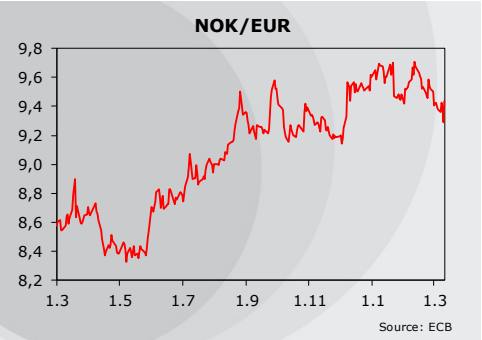


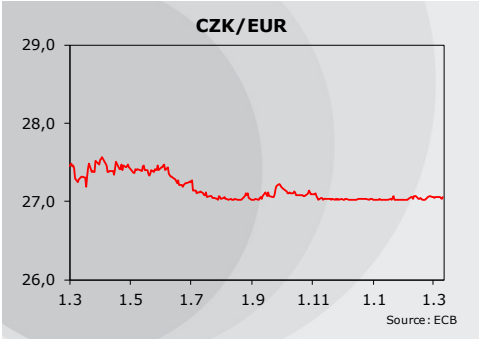


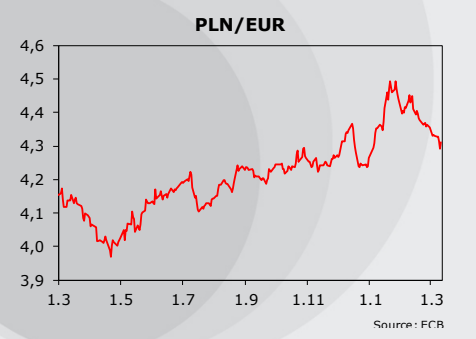


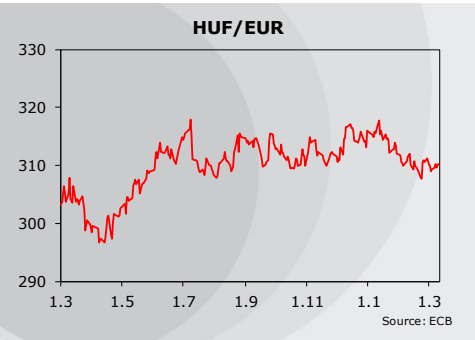


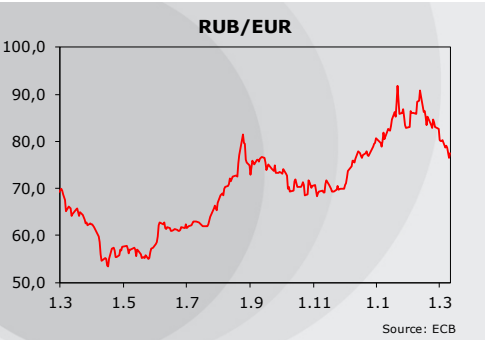












MONEY MARKET

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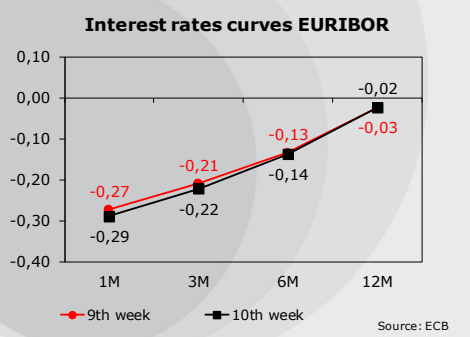
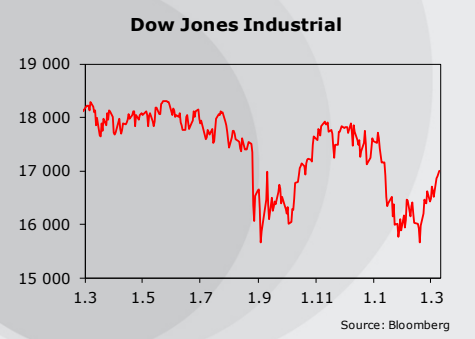
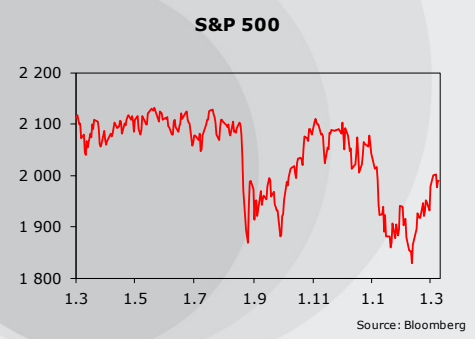
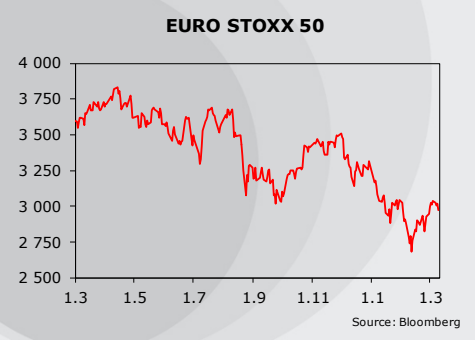
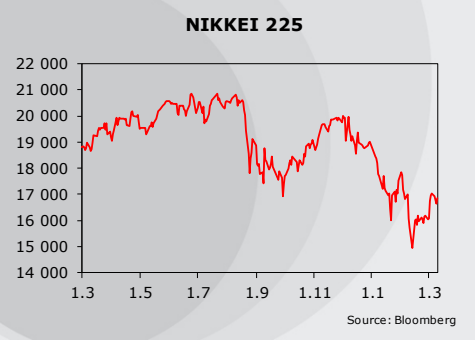


EQUITY









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