UniCredit Bank

Weekly

N . o . t . e . s

English translation by an external party

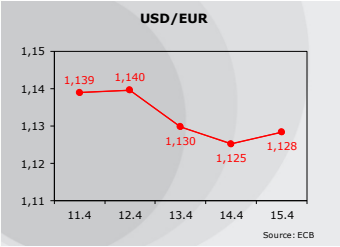
HIGHLIGHTS OF THE WEEK 15/2016

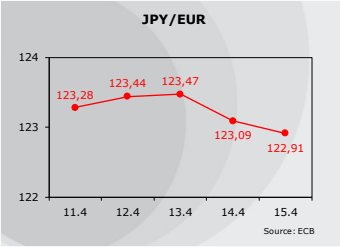
> Chart of the Week: More than million cars were produced in Slovakia last year

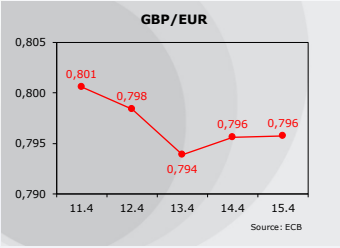
> Industry was a pleasant surprise in February, construction continues to show dynamic growth

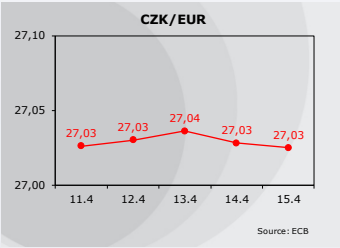
> Deflation deepens slightly in March

WEEK ON THE MARKETS









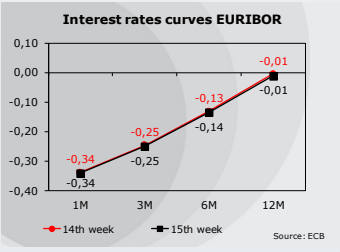
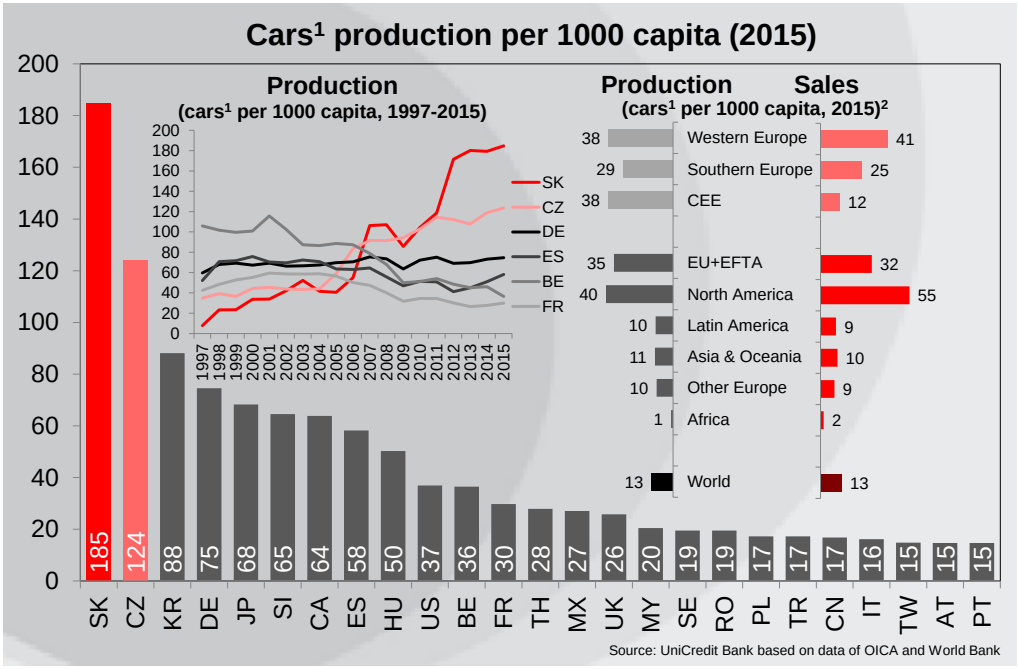


CHART OF THE WEEK



Note: 1. production and sales of passenger cars and light-commercial vehicles (LCVs)
2. SVE – CZ, SK, PL, HU, RO, SI, BG, HR, EE, LV, LT; Western Europe: AT, BE, DK, FI, FR, DE, IC, IE, LU, NL, NO, SE, CH, UK; Southern Europe: GR, IT, ES, PT, CY, MT; Rest of Europe including Turkey; Northern America: USA and Canada: Mexico included in Latin America

Both Slovakia and the Czech Republic retained their position of unrivalled global automotive powers also in 2015. According to preliminary data of OICA (International Organization of Motor Vehicle Manufacturers), both countries continue to rank first in car production per capita - Slovakia ranks first with production of 185 cars per 1,000 people, and the Czech Republic is a runner-up with 124 cars per 1,000 people. However, both countries are also in the ranking of car production in absolute terms - the Czech Republic ranks 16th with production of more than 1.3 million cars a year (1.5% share in the global car production), and Slovakia ranks 18th with production just above 1 million cars a year (1.1% share in the global production). In the next years, car production in both countries could rise further, in particular in Slovakia - with the reported investments in extension of production capacities and in a new (fourth) car plant - post-2018 production should attack one and a quarter million of cars a year, i.e. it should exceed the line of 200 cars per 1,000 people more significantly.

The position of the biggest global producer of passenger cars and LCVs of 2015 was retained by China – roughly one fourth car in the world was produced here. Despite this fact, in terms of production per capita, China ranks 21st in global terms. China is followed by the USA with a 13% share in the global car production, Japan (10%), Germany (7%), and South Korea (5%). In car production, EU as a whole would be a

runner-up, following China and preceding the USA, with a 21 per cent share in the global production of passenger cars and light-commercial vehicles.

Last year, around 13 cars per 1,000 people was produced and sold, with global production (and sales) rising by roughly 2% yoy. It was mainly developed countries that were growing – Europe and North America. On the contrary, both sales and production were falling in several emerging markets - mainly in Russia and Ukraine, or in many Latin America countries, led by Brazil. In general, trends in production in individual countries more-or-less only reflected the trends in sales in the relevant region. The exception was only Africa, which reported a relatively dynamics growth of production (underdeveloped automotive sector) with a decline in sales.

As for Europe, it was mainly the countries to the south of Europe that were doing well; they had been recovering from a crisis lasting several years and reported a rapid growth in sales from the crisis lows. This was positively reflected also in the car production in this region. Production in Italy increased by almost one half, however, an above-average yoy growth of 14% was reported also by Spain. On average, both car sales and production in the countries to the south of Europe increased by 19-20%. However, as for the sale of new cars, the Central and Eastern Europe region did not lag behind (14%) but the production here rose "only" by 6%. Both in Slovakia and the Czech Republic, production of new cars went up by roughly 3-4% yoy. Sales in the countries of western Europe grew by 7% yoy and production by almost 3%.

Car sales and production in most global regions are at comparable levels. The only exception is Europe and North America. While, in recent years, more cars in Europe is produced than sold (mainly thanks to the CEE region), countries of North America (USA and Canada) are, on the contrary, pure car importers as well as a market where the most passenger cars and light-commercial vehicles per capita is sold. Over the last 20 years, Europe has seen a trend of shifting production from western and southern European countries to the east. It was mainly the countries of Central Europe that benefited from this trend; a strong automotive cluster has been gradually formed there, led by Slovakia and the Czech Republic. A strong decline in production over the last years has been reported mainly by Belgium, which was, in the first half of the last decade, a western European country with the highest car production per capita; currently, with a production of 36 cars per 1,000 people, it is even below the average of western European countries. However, a significant decline in production was reported also by France, with production falling also in Italy, Great Britain, and Spain in the years of crisis. The only major automotive power of western Europe maintaining a relatively stable production level is still Germany. (lk)

ECONOMIC CALENDAR

Week	Indicator	Period	Market Consensus	UniCredit Bank Estimate	Reality
15.	Industrial production (April 11)	February	-	2.7% yoy	7.4% yoy
	Construction production (April 11)	February	-	13.6% yoy	18.8% yoy
	Consumer prices (April 14)	March	-0.4% yoy	0.1% mom -0.4% yoy	0.0% mom -0.5% yoy
	Harmonised index of consumer prices (April 14)	March	-0.3% yoy	0.1% mom -0.4% yoy	0.0% mom -0.5% yoy
16.	Unemployment (April 15-20)	March	-	9.91%	-

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

ECONOMY

INDUSTRIAL AND CONSTRUCTION PRODUCTION

Industry confirmed the positive figures of foreign trade published last week, reporting a relatively dynamic growth in February - rising by 1.8% (seasonally adjusted, calculation of UniCredit Bank). After a weaker turn of the years, Slovak industry restarted and the dynamics of its growth accelerated from 1.7% in January to 7.4% yoy in February, despite the adverse base effect. Thus, in February, Slovak industry reported the fastest yoy growth from among all EU countries (which have published

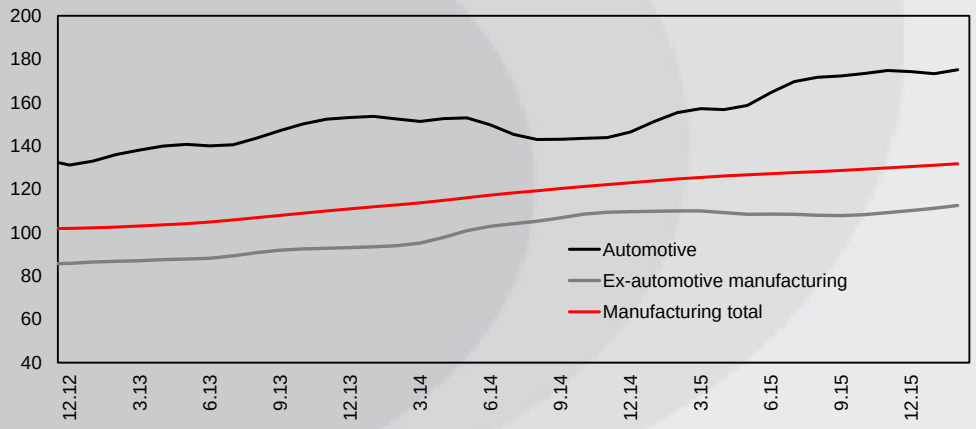
their data so far). On average, industrial production of the euro area and EU countries went up identically only by 0.8% yoy.

February saw a restart of Slovak industry

The automotive sector remains the driver of growth of Slovak industry, accounting for more than one half of the growth in the industry (the contribution to the industry's yoy growth reached 4.09 pp). In February, production of transport equipment reported a relatively strong mom (6.8% - seasonally adjusted, calculation of UniCredit Bank) as well as yoy growth in production (13.9%), setting off the all-time production peaks of last year's November following a mild deceleration at the turn of the years. However, other export-oriented sectors were doing well, too. After a surprising decline in January, Slovak engineering rebounded in February – this has completely offset the decline in January, resuming a strong 9.9% yoy growth in production. This has confirmed our expectations that the decline of engineering in January had been only a short-term deviation, most likely associated with the extension of Christmas stoppages. In February, a surprisingly strong growth in production was reported also by metallurgy - even despite the cheap Asian competition, they were able to increase their production by as much as 14.1% yoy. The electrical engineering sectors were doing not so great, both reporting a moderate mom decline in production, which in both cases was reflected also in deceleration of the yoy growth dynamics – from 7.2% to 1.0% in the case of consumer electronics and from 17.9% to 8.1% in the case of production of electrical equipment. Chemical sectors were not doing well in February either; a mom increase in production (after adjustment for the season) was reported only by the volatile pharmacy; on the contrary, production of the refinery industry, production of chemicals and rubber, plastic, and glass goods, and construction materials was falling slightly on a mom basis. Compared to the previous year, a considerable decline was reported mainly by production of chemicals and rubber, plastic, and glass goods, and construction materials (by as much as -6.8%); on the contrary, refineries continued to report a relatively dynamic yoy growth (by 7.2%) even despite a mom decline.

Low-tech industry sectors reported mixed results in February. Compared to January, production was falling in none of them, however, compared to last year's February, the food industry reported an as much as -13% decline in production (base effect); on the contrary, the wood industry reported double-digit dynamics of the yoy growth (wood processing and paper production by 14.1%, furniture production by 16.8%).

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



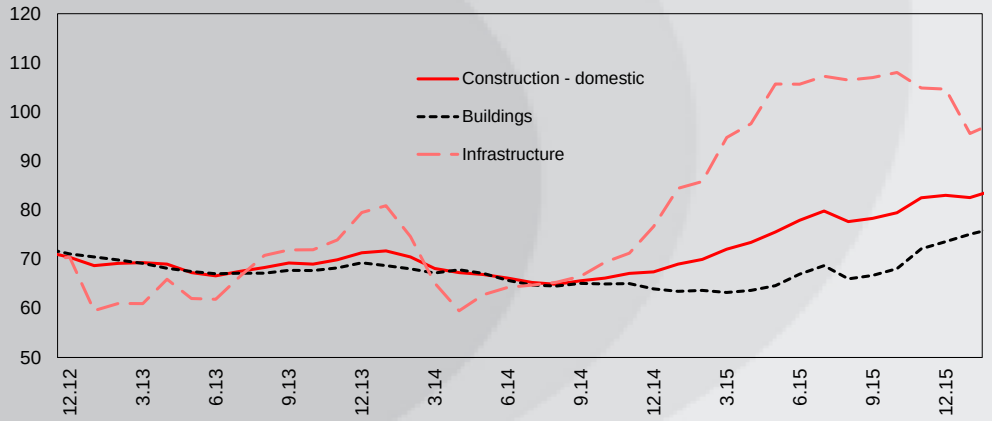
Source: UniCredit Bank based on data of SO SR

Construction surprises with a strong growth

Also construction was a pleasant surprise in February - its production increased by 2.0% mom (seasonally adjusted), with the dynamics of its yoy growth accelerated from 16.4% to 18.8%. A surprisingly strong growth was reported mainly by the infrastructure segment – by as much as 21.8% yoy. So, even after the termination of EU Funds, it seems that construction did not take their foot off the accelerator in this segment, being able to replace the EU-funded projects with other ones (financed from the national budget or private investments). Construction could benefit also from the relatively warm winter in February. However, a dynamic growth is still maintained by the segment of building construction. Although it did not maintain its all-time production levels from January and, after adjustment for the season, its production

went down slightly on a mom basis, it still reported a 17.5% yoy increase in performance.

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



Source: UniCredit Bank based on data of SO SR

OUTLOOK

According to a survey by the Statistical Office, the sentiment in Slovak industry is close to its 4-year peaks. It seems that Slovak industry has been so far relatively resistant to the turbulences in financial markets, it should still be supported mainly by the growing demand in the domestic European market - recovery of European economies supported by cheap oil and relaxed monetary stance is quite robust. However, despite this fact, March could see a more considerable deceleration of the yoy growth of the industry due to the base effect supported by the Easter effect (a part of companies cuts production during the Easter holidays).

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. The beginning of the year showed that Slovak construction was able to smoothly replace the EU-funded projects, benefiting from recovery in the real estate market as well as from restart of private investments. 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)

CONSUMER PRICES

Deflation deepens slightly in March

According to data of the Statistical Office, consumer prices in Slovakia remained unchanged on average in March, however, the dynamics of their yoy decline accelerated once again from -0.4% to -0.5%. Although Slovakia is in deflation for more than 2 years, the rate of deflation is still relatively moderate, driven solely by supply-side factors. In principle, such form of deflation is not harmful to the economy; just the opposite, it supports household consumption, when the falling energy and food prices increase the available resources of households for other expenses.

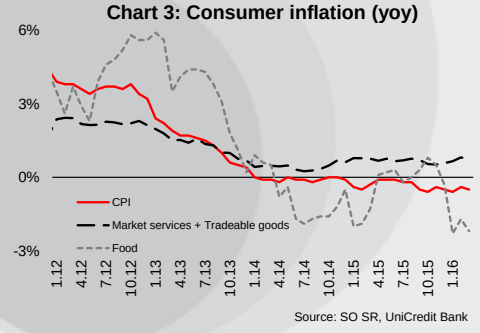
In March, the yoy deflation accelerated also due to the falling food prices, the slower-than-last-year increase in fuel prices in March, as well as the deceleration of the demand-pull inflation. At the turn of the years, the demand-pull inflation (measured by the index of tradable goods (excl. fuels) and market services (excl. imputed rent), UniCredit Bank calculation) was slightly rising, reaching its more than 2-year peak in February. However, March saw no such trend, the demand-pull inflation fell by -0.1% mom, with the dynamics of its yoy growth decelerating from 0.8% to 0.7%. Deceleration of the demand-pull inflation is mainly attributable to tradable goods (probably also due to the secondary effects of low oil prices); on the contrary, a yoy growth of prices of market services accelerated also in March to a new 30-month peak (probably reflecting mainly the dynamically growing wages in the economy).

Food prices dropped by -0.1% mom in March and the dynamics of their yoy drop increased from -1.7% to -2.2%. It was mainly the prices of oil and fats or pastry that were falling in March. On the contrary, a seasonal hike in prices was reported by the

prices of fruit and vegetables, however, the extent of the seasonal effect was milder than usually. Even the traditional pre-Easter hike in prices of milk, cheese and eggs was not translated into prices – their prices remained unchanged this year on a mom basis, being lower by more than 7% yoy. Prices of milk are pushed down mainly by its surplus in the European market after cancellation of quotas in last year's April, however, in the next months, this effect should start to wear off gradually (statistical effect of lower benchmark in a yoy comparison).

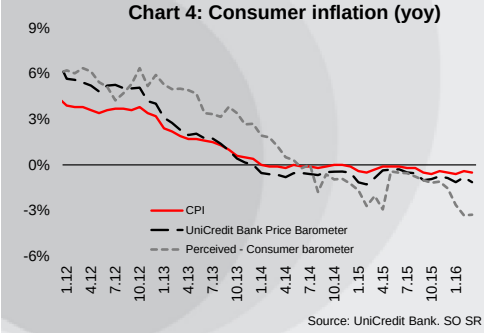
World market oil prices continued to recover in March - the average Brent oil prices in EUR was rising by 18.5% mom. Due to the traditional time delay between the oil prices and fuel prices in Slovakia, only a part of the hike in oil prices in February and March has been translated in the prices at Slovak petrol stations so far. In March, prices of fuels increased "only" by 2.5%, reporting a slower growth than in the same period a year ago. Dynamics of the yoy decline in fuel prices deepened slightly once again. Fuel prices in March accounted for around one half of the yoy deflation, reducing the total yoy increase in prices by 0.25 pp. The growth of fuel prices should continue also in April.

Chart 3: Consumer inflation (yoy)



Source: SO SR, UniCredit Bank

Chart 4: Consumer inflation (yoy)



Source: UniCredit Bank. SO SR

The UniCredit Bank Price Barometer (i.e. the perceived inflation measured through frequently bought goods and services) did not change in March, with its decline deepening from -0.8% to -1.1% compared to the same period of the previous year. Even despite the moderate acceleration of the yoy decline in prices or deepening of the decline in prices of frequently bought goods and services, it seems that deflation perception by consumers did not change in March – according to the consumer barometer of the Statistical Office, consumers perceived (as in February) a yoy decline in prices by -3.3% (calculation of UniCredit Bank from the balance of answers). Inflation expectations accelerated further, however, in the next 12 months, consumers still expect a moderate decline in prices – by -0.5% (compared to -1.5% in February, calculation of UniCredit Bank from the balance of answers).

Chart 5: Harmonised index of consumer prices (02/16, YoY)

*02/2016

Source: UniCredit Bank based on data of Eurostat

In the harmonised Eurostat methodology, prices in Slovakia did not change in March either, with the dynamics of their yoy decline increasing from -0.3% to -0.5%. On average, consumer prices increased by 1.2% in the euro area countries, stagnating yoy in March after a short one-month resuming of deflation in the euro area. The strong mom increase in prices in the euro area in March is due to the traditional seasonal hike in prices of clothing and shoes in several countries after the end of

post-Christmas sales as well as hike in the energy prices (fuels), which have already responded to the corrected oil prices in global markets in many countries. However, a more considerable recovery of inflation in the euro area (and Europe) is still prevented by cheap oil. In March, fuel prices were falling by as much as 12.7% yoy on average in the euro area, reducing inflation of the euro area by as much as 0.6 pp, and the decline in prices of heating oil accounted for another two tenths of the inflation's reduction, with gas accounting for one tenth of the same.

Dynamics of the yoy growth of core inflation (i.e. inflation adjusted for the change in food and energy prices) accelerated from 0.8% to 1.0% in March. It continues to oscillate in a relatively narrow space, not going beyond the interval of 0.8% to 1.1% in the last 11 months. In March, a yoy decline in core prices was reported by no euro area country (only Bulgaria out of the non-euro area countries).

In March, the number of euro area countries with deflation went down from 11 to 10 (with Germany and Finland no longer reporting mild deflation and Greece resuming the price decline) - with the fastest price decline being again reported by Cyprus (by as much as -2.2%), Spain (-1.0%) and Slovenia (-0.9%). Out of the 9 EU countries that are not yet members of the euro area, more than one half of them (five) reported a yoy price decline, with the highest decline being reported by Romania (by as much as -2.4%) and Bulgaria (by -1.9%). On the contrary, the fastest price growth was reported by Belgium (1.6%) and Malta (1.0%); as for the non-euro area EU countries, by Sweden (by 1.2%).

OUTLOOK

There is still no stronger inflation driver and this situation should persist also for most of 2016. Low prices of oil and other energy commodities, besides the direct impact through prices of fuels and regulated energy prices, decelerate also the recovery of demand-pull inflation. Return of food prices to the positive is hindered also by tax cut (reduction of VAT on selected food). Therefore, inflation could return to positive territory no earlier than at the end of this year (after nearly three years), when the effect of low oil prices starts to gradually wear off. (lk)

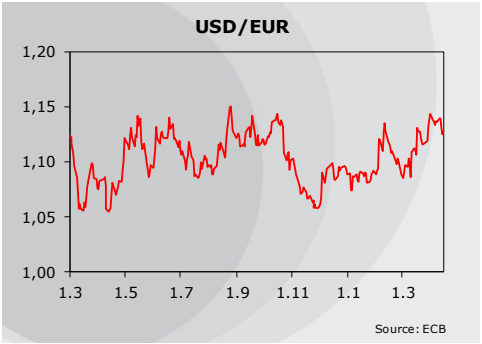
ECONOMIC OUTLOOK

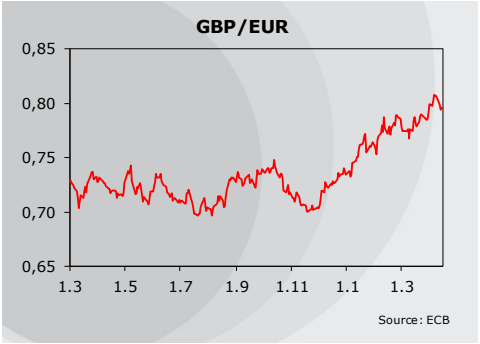
Slovakia	2011	2012	2013	2014	2015E	2016F	2017F
Real GDP growth	**2,8**	**1,5**	**1,4**	**2,5**	**3,6**	**3,2**	**3,2**
GDP per capita	13 052	13 398	13 643	13 947	14 287	14 860	15 383
Household consumption	**-0,6**	**-0,4**	**-0,8**	**2,4**	**2,4**	**2,9**	**2,6**
Government consumption	-1,7	-2,6	2,2	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**	**7,0**	**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

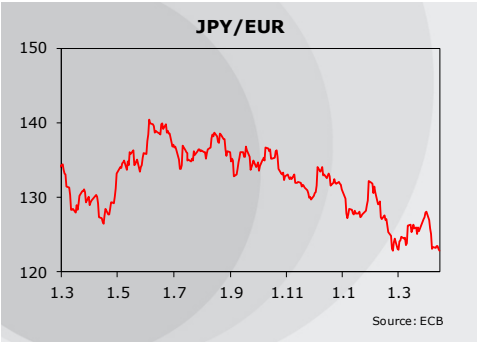
Abroad	2011	2012	2013	2014	2015	2016F	2017F
Eurozone GDP	**1,5**	**-0,6**	**-0,4**	**0,9**	**1,5**	**1,7**	**1,6**
German GDP	**3,1**	**0,9**	**0,5**	**1,6**	**1,7**	**1,8**	**1,4**
Czech R GDP	1,7	-1,0	-0,9	2,0	4,3	2,2	3,0
USA GDP	1,7	2,8	1,9	2,4	2,4	2,2	2,4
Eurozone Inflation	2,7	2,5	1,3	0,4	0	0,4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

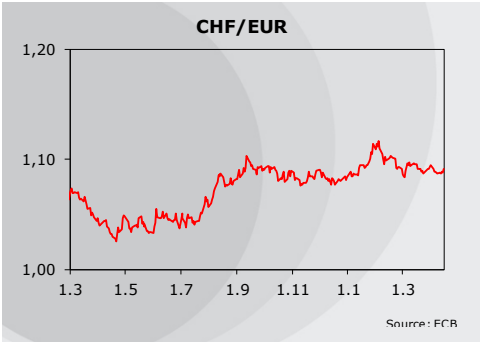
Source: NBS. SOSR. ÚPSVaR. MinFin SR. Eurostat. ECB
Forecasts: UniCredit Bank Slovakia – Slovakia. Eurozone. USA (EURIBOR. USDLIBOR. Brent. USD/EUR); UniCredit Group (CEE Economic Research. CIB) – Eurozone. USA

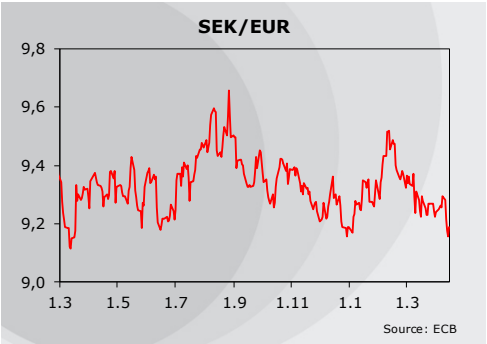
FOREIGN EXCHANGE

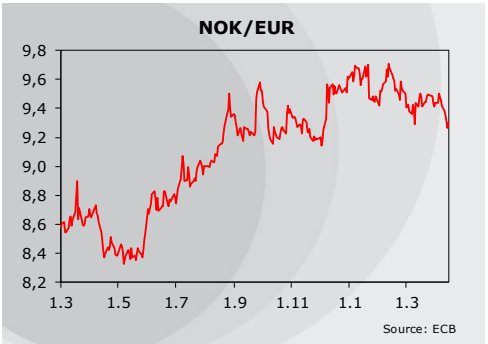


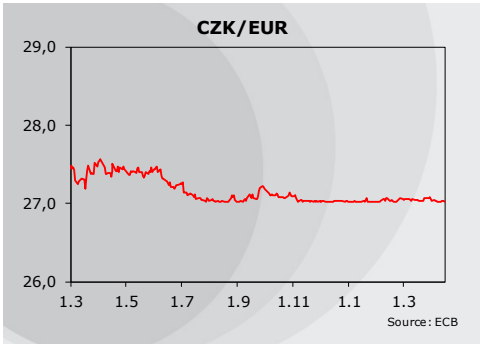


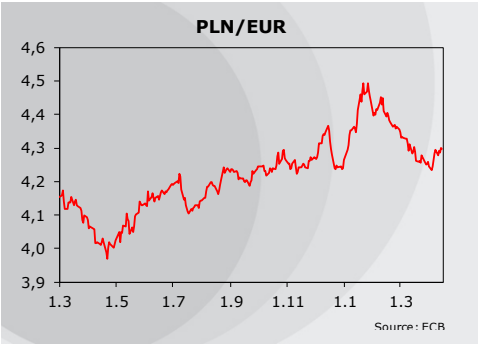


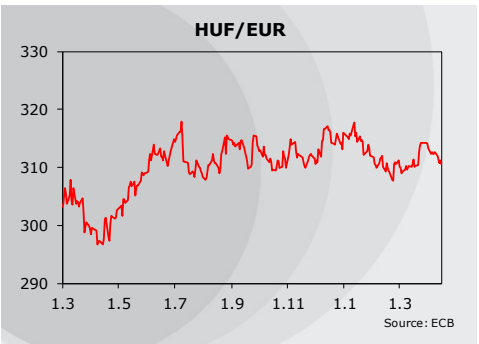


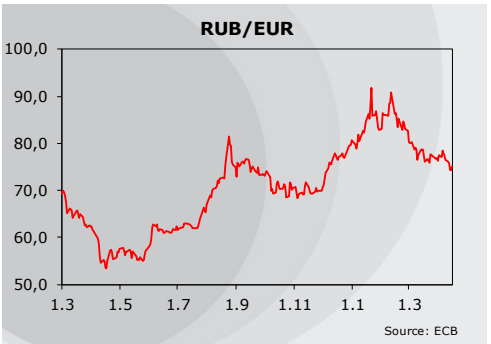












MONEY MARKET

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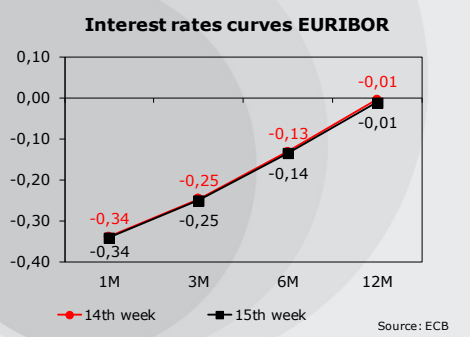
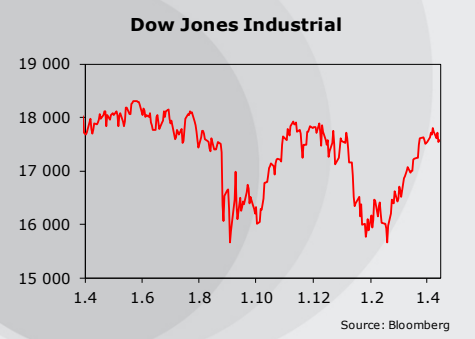
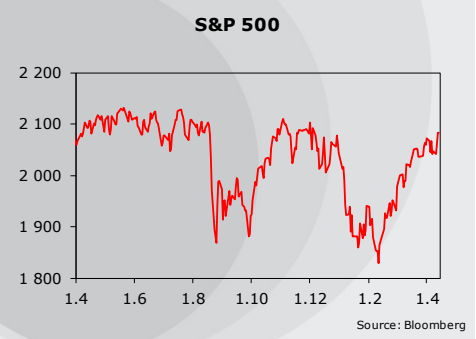
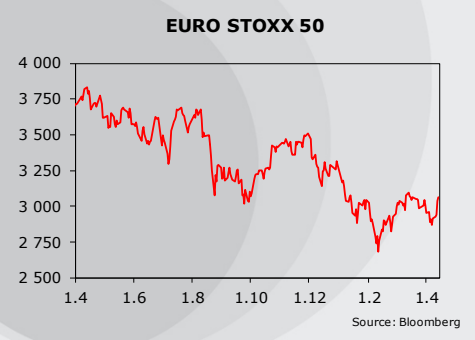
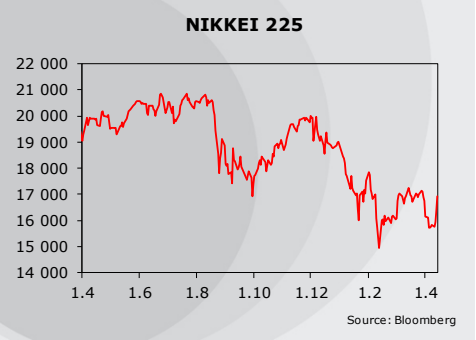


EQUITY









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

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