

Macroeconomic and Strategic Analysis

UniCredit Weekly Report



Annual inflation likely to have accelerated further in June

July 9, 2018

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Data spotlight: 2 – 6 July

CURRENCIES - MAJORS

Currencies	Last	1D ch (%)	1M ch (%)
EURUSD	1,1788	0,35%	0,13%
EURCHF	1,1628	0,06%	0,62%
USDJPY	110,43	-0,01%	0,22%
GBPUSD	1,3345	0,41%	-0,51%

CURRENCIES - CEE

Currencies	Last	1D ch (%)	1M ch (%)
EURPLN	4,3149	-0,94%	1,15%
EURHUF	322,66	-0,18%	1,53%
EURCZK	25,85	-0,20%	0,71%

CURRENCIES - NBR REFERENCE

Currencies	EUR	USD	SDR	XAU (1g)
09.iul	4.6590	3.9604	160.85	0.1195

CURRENCIES - RON

	EURRON	USD RON
09.iul	4,659	3,952
06.iul	4,658	3,969
05.iul	4,662	3,988

FIXED INCOME MARKET YIELDS - LOCAL

Mid-rate	1Y	3Y	5Y	10Y
09.iul	3,5	4,3	4,7	5,1
06.iul	3,4	4,3	4,8	5,1
05.iul	3,4	4,3	4,7	5,2

MONEY MARKET RATES - LOCAL

ROBOR	ON	1M	3M
09.iul	3,26	3,35	3,35
06.iul	2,60	3,59	3,56
05.iul	3,46	3,59	3,50

MONEY MARKET RATES - MAJORS

Euribor	1M	3M	6M
06.iul	-0,37	-0,32	-0,27
05.iul	-0,37	-0,32	-0,27
04.iul	-0,37	-0,32	-0,27
USD Libor	1M	3M	6M
06.iul	2,09	2,33	2,51
05.iul	2,10	2,34	2,52
04.iul	2,09	2,34	2,51

STOCK MARKETS

Index	Last	1D ch (%)	1M ch (%)
S&P 500	2.759,8	0,85%	0,40%
Dow Jones	24.456,5	0,41%	-1,39%
FTSE	7.635,7	0,24%	-0,59%
DAX	12.494,7	-0,01%	-2,47%
Hang Seng	28.688,5	1,32%	-8,22%
Bucharest BET	7.861,7	0,34%	-4,74%

Romanian Economy

- In its meeting on 4 July, the Board of the National Bank of Romania decided: i) to keep the monetary policy rate at 2.50%; ii) to leave unchanged the deposit facility rate at 1.50% and the lending facility rate at 3.50%; and iii) to maintain the existing levels of minimum reserve requirement ratios on both LCY and FCY denominated liabilities of credit institutions. The decision was against the consensus expectations, with around 60% of the analysts expecting a hike.

— In the press release following the meeting, the NBR acknowledged that the annual inflation rate is currently above its latest projection included to the May 2018 Inflation Report, but expects it to decline toward the upper bound of the variation band (1.50% – 3.50%) at the end of 2018. At the same time, it insisted on the fact that the CORE2 inflation rate (inflation excluding prices on which monetary policy has limited or no influence) is much lower and fell to 2.95% in May from 3.09% in April.

— NBR also mentioned that the recent rise in interbank rates is sufficient to tighten monetary conditions and that it does not want to offer a high interest rate differential in comparison to regional peers.

— Given the sharper than anticipated loss of momentum in GDP growth in 1Q2018, the NBR aims at “ensuring an adequate dosage and pace of adjustment of the monetary policy stance”. However, it notes that “the uncertainties and risks surrounding the medium-term inflation outlook are significant”: 1) labour market conditions; 2) developments in administered prices and in oil prices; 3) international financial market volatility; and 4) the economic growth pace in the euro area and globally, which could be impacted by escalating trade protectionism.

- Although our projection envisages a similar path for inflation, we anticipate inflation constantly above NBR’s May 2018 estimate, with an endpoint for 2018 significantly above the target range (4.1%yoy in December 2018 vs. 3.6% forecasted by NBR). Food and fuel prices could remain the most important sources of inflationary pressure in the coming months due to a weaker harvest and higher oil prices compared to last year. Given the tighter monetary conditions than suggested by the current key rate, we

Data spotlight: 2 – 6 July

Romanian Economy (continued)

- continue to believe that market participants would welcome a higher key rate; hence our call for a 25bp hike entering into the monetary policy meeting, to accommodate market preference. We continue to expect two hikes by year-end. The first hike might come in August, when the NBR could revise upwards its inflation forecast for 2018-20, followed by another 25bp increase in 4Q18. The next inflation release will be on 11 July, when the NBR also publishes the minutes of July's meeting.
- Retail sales registered a monthly increase of 2.1% (swda) in May, supported by the continued double-digit annual expansion of the average net wage. However, the annual growth pace decelerated to 6.6% (from 8.2% in April) due to a large negative base effect. All components contributed to the monthly expansion, with food sales up 1.4%mom, non-food sales +0.9%mom and fuels adding 0.8%mom. We expect these more tempered growth rates of retail sales to be maintained during 2018 due to a lower fiscal impulse.
- Producer prices (PPI) increased by 0.8%mom in May 2018, sending the annual growth rate to 5.3%, the fastest pace since February 2013. Producer prices in the energy sector grew strongly in May (+3.6%mom), reflecting the surge in oil prices expressed in RON (+11.6%mom). Prices for capital goods also added 0.4mom% for the month, while prices in other sectors were rather balanced: +0.1mom for durable consumer goods, -0.1mom for intermediate goods and -0.2%mom in the non-durable consumer goods industry.
- NBR's international reserves were EUR 35.3bn at the end of June 2018, lower by EUR 1.5bn in comparison to the end of the previous month. Total outflows for the month stood at EUR 3.9bn, out of which EUR 1.6bn were represented by EUR denominated debt principal repayment and interest payments. Inflows totaled EUR 2.5bn in June, including USD 950mn resulting from the issuance and the partial early redemption of some USD denominated Eurobonds by the Ministry of Public Finance. The stock of gold was unchanged at 103.7 tones, while its value decreased to EUR 3.6bn, due to the change in the international price of gold.

International and Romanian Markets

- Major bond markets had a rather quiet week despite a de-escalation of German political tension that might have improved risk appetite, as the grand coalition reached an agreement on the refugees' debate. The 10Y Bund yield was unchanged at 0.30%. US Treasuries also had a lackluster week with no directional momentum and only the curve flattening continuing. Spreads across the complete curve continued to flatten with 2-10s hitting 28bp, the lowest level since August 2007. Apart from fine-tuning aspects with regard to monetary policy, the major impulse driving major bond markets these days is the global trade friction fueled by US President Donald Trump. Since the topic gained traction in March, US Treasuries and Bunds have benefitted from a renewed demand for safe assets.
- After having increased sharply during June (+66bp at the short end of the curve and +36bp at the long end), Romanian yields reversed part of the move during the previous week, with the belly of the curve benefitting the most. Consequently, the 1Y and 10Y yields dropped 4bp and 3bp, respectively, while the 3Y and 5Y dropped by 9bp and 7bp, respectively. The MinFin placed last week RON 380mn in T-bonds with residual maturity of 2.3 years and RON 0.4bn in T-bonds with residual maturity of 5 years. The amount placed was by around 26-27% above the plan for both auctions as they enjoyed good demand, with bid-to-cover ratios of 1.64x and 2.08x, respectively. However, the above-expectations placement came at higher costs, with MinFin accommodating the market's preference for higher yields. Consequently, the average accepted yield for the first auction was 4.40% (up from 3.42% at the end of April), while the one for the second auction was 4.90% (up from 4.80% on 11 June).

Data spotlight: 2 – 6 July

International and Romanian Markets (continued)

- ROBOR rates on the O/N – 1W segment dropped up to 19bp during the previous week, marking the return to an upward sloping curve. This is likely the effect of lower liquidity needs as we progress into the current minimum reserve holding period, although excess liquidity has not returned into the market for the time being, as suggested by NBR's depo operations organized in July which failed to attract any demand. The remainder of the ROBOR curve added up to 19bp during the previous week, with half of the move before NBR's decision and half after. This is likely the consequence of higher inflationary expectations, in spite of the recent tightening of monetary conditions. Given the uncertain inflation outlook and prolonged domestic and external uncertainties, we expect money market conditions to remain volatile and ROBOR rates subject to upside pressure.
- The EURRON traded in the 4.6500 – 4.6685 range over the past week, with the pair closing Friday's trading session only 0.1% below the levels prevailing at the beginning of the week. This relatively stable evolution was in contrast to a pronounced appreciation of the regional currencies against the EUR, by up to 2.2% for the HUF. The EURUSD approached again 1.17, exceeding for a while its end-of-June peak of 1.1720 due to stronger German economic data, talks that an ECB rate hike could come sooner than current expectations and rumors of a de-escalation between the US and EU on the car tariffs. Consequently, due to the weaker dollar, the USDRON followed a downtrend from levels close to 3.99 at the beginning of last week and is currently quoted close to 3.9600.

European Economy

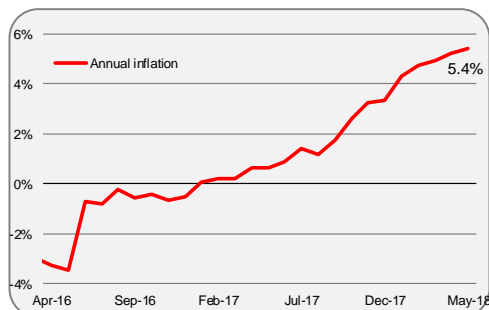
- German industrial production rose sharply in May, expanding by 2.6%mom, while April's reading was revised slightly down to -1.3%mom from -1.0%mom. The increase was driven by construction output and consumer goods, which increased over the month by 3.1% and 6.5%, respectively. Energy production was up by 0.8%mom in May, a substantial change from April's 4.7%mom decrease, amid unusually warm weather.

US Economy

- The Federal Reserve released on Thursday the minutes of the June 12-13 FOMC meeting, when the Committee decided to raise the target rate by another 25bp. The minutes struck a very positive and confident tone on the economy. In particular, labor market developments were repeatedly described as "strong", while shortages of labor were highlighted. Moreover, the minutes acknowledged that inflation readings have moved close to 2% (since then, the core PCE deflator actually hit 2%). The main risk to the outlook is the growing uncertainty around trade tensions. At this point, however, trade tensions are seen by the majority of FOMC members only as a risk to a very optimistic baseline scenario, that includes strong growth, for another several quarters, fueled by a fiscal stimulus, a further tightening of the labor market and inflation at the 2% target. Considering the strong outlook, UniCredit Research continues to expect two more 25bp monetary policy rate hikes in 2018, a total of four hikes for this year.
- US tariffs (25%) on USD 34bn of Chinese imports went into effect, with retaliatory measures by China to the same extent immediately kicking in afterwards. Already before, US President Donald Trump had threatened to extend tariffs to all Chinese imports, worth about USD 500bn. However, credit markets responded positively to unconfirmed reports suggesting that both the US and the EU are considering ways and means of de-escalating the conflict on car tariffs.

Focus Ahead: 9 – 13 July

Annual inflation

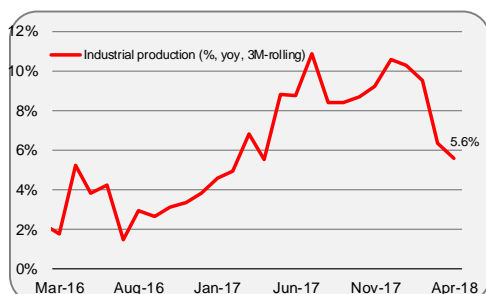


Data Source: NIS

Date	Indicator/Event	Period	UniCredit forecast	Consensus (Reuters)	Previous
Wed, 11 Jul	CPI (% yoy)	Jun	5.6		5.4

- We expect annual inflation to accelerate further, to 5.6% in June 2018 (from 5.4% in May).
- Although food prices could show a slight decrease from May in line with the seasonal pattern witnessed in the summer months, the drop could be lower than in the past years due to a weaker harvest and strong consumer demand. At the same time, we expect prices of nonfood products and services to edge higher, reflecting the rising producer prices and strong demand.

Industrial output

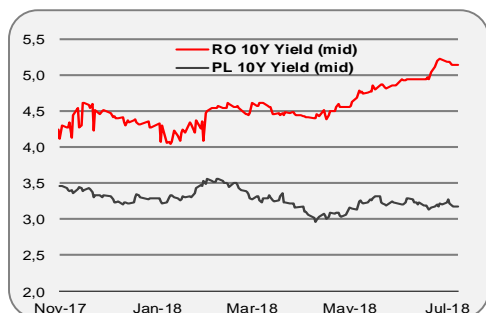


Data Source: NIS

Date	Indicator/Event	Period	UniCredit forecast	Consensus (Reuters)	Previous
Thu, 12 Jul	Industrial Output (% yoy, swda)	May	4.2		5.7

- We expect industrial production to continue the positive evolution with a further expansion in May, although at a lower pace than the +2.1% mom growth in April. This is supported by a 2.6% mom rise in German industrial production during the month.
- In spite of this monthly expansion, the annual growth pace is prone to decelerate due to the very strong 2% monthly expansion of May 2017 which is now leaving the base and is being replaced by the May 2018 figure.

MinFin Issues



Data Source: Thonsom Reuters

- The Ministry of Finance intends to place this week: RON 0.3bn in T-bonds with residual maturity of 1 year on Monday and RON 0.4bn in T-bonds with residual maturity of 3.7 years on Thursday.
- The current week is rich in events with the potential to move the market, the most important being: i) President Iohannis' announcement that the chief anti-corruption prosecutor was dismissed as of today to implement a ruling by Romania's Constitutional Court; ii) the minutes of NBR's 4 July monetary policy decision and the June inflation to be released on Wednesday. We expect MinFin's auctions this week to reflect the market's unease in light of the heightened uncertainty, either through high requested yields or impaired demand.

Focus Ahead: 9 – 13 July

BOND ISSUES - JULY

ISIN Code	Auction Date	Maturity Date	Months	Planned Amount	Currency	Total Applications	Total Allocated	Yield (avg)
RO1620DBN017	26-Jul-18	26-Feb-20	19	300 lei				
RO1821DBN052	23-Jul-18	27-Oct-21	40	400 lei				
RO1624DBN027	19-Jul-18	29-Apr-24	70	400 lei				
RO1631DBN055	16-Jul-18	24-Sep-31	161	200 lei				
RO1722DBN045	12-Jul-18	8-Mar-22	45	400 lei				
RO1419DBN014	9-Jul-18	24-Jun-19	12	300 lei				
RO1823DBN025	5-Jul-18	28-Jun-23	61	400 lei		1,048	503	4.9
RO1720DBN072	2-Jul-18	26-Oct-20	28	300 lei		623	381	4.4

Data Calendar

	Country	Indicator/Event	Period	UniCredit forecast	Consensus (Reuters)	Previous
9-Jul-2018	United States	United States-Consumer Credit - Consumer Credit	May. 2018		12	9,26
	Eurozone	Euro Zone-Sentix Index - Sentix Index	Jul. 2018		8,2	9,3
	Germany	Germany-Trade - Trade Balance, EUR, SA	May. 2018		20	19,4
	Romania	Romania-Wages Net (% , YY)	May. 2018	14,4 (actual)		14,7
10-Jul-2018	Germany	Germany-ZEW - ZEW Current Conditions	Jul. 2018		78	80,6
	Germany	Germany-ZEW - ZEW Economic Sentiment	Jul. 2018	-20	-18,2	-16,1
	Romania	Romania-Trade deficit - Trade Balance (EUR, bn)	May. 2018	-1,13		-1,01
11-Jul-2018	United States	United States-PPI demand - PPI ex Food/Energy/Trade MM	Jun. 2018			0,1
	Romania	Romania-CPI - Consumer Price Index	Jun. 2018	5,6	5,5	5,4
12-Jul-2018	United States	United States-Jobless - Initial Jobless Claims	w/o Jul. 2, 2018		230	231
	United States	United States-CPI - CPI MM, SA	Jun. 2018	0,2	0,2	0,2
	Eurozone	Euro Zone-Industrial production - Industrial Production MM	May. 2018	1,2	1,1	-0,9
	Germany	Germany-Inflation Final - CPI Final YY	Jun. 2018		2,1	2,2
	Germany	Germany-Inflation Final - CPI Final MM	Jun. 2018		0,1	0,5
	Romania	Romania-Industrial Output (% , YY)	May. 2018	4,2		5,7

Economic Forecasts

Please note that our macroeconomic scenario is currently under revision and the new one will be published soon, based on the 3Q 2018 CEE Quarterly Report.

MACROECONOMIC DATA AND FORECASTS

	2015	2016	2017E	2018F	2019F		
GDP (EUR bn)	160,3	169,8	187,5	201,2	213,7		
Population (mn)	19,9	19,8	19,6	19,6	19,5		
GDP per capita (EUR)	8067	8591	9546	10275	10946		
Real economy yoy (%)							
GDP	4,0	4,8	7,0	4,4	3,6		
Household Consumption	5,9	7,6	10,2	5,4	4,0		
Fixed Investment	7,4	-2,0	5,4	1,3	3,4		
Collective Public Consumption	0,2	3,1	1,6	1,6	0,9		
Exports	4,6	8,7	9,5	7,5	5,9		
Imports	8,0	9,8	11,1	8,8	7,1		
Monthly wage, nominal (EUR)	576	643	724	939	981		
Unemployment rate (%); ILO avg	6,8	5,9	4,9	4,5	4,4		
Fiscal accounts (% of GDP)							
Budget balance	-0,8	-3,0	-2,7	-3,4	-3,6		
Primary balance	0,5	-1,7	-1,5	-2,0	-2,1		
Public debt	37,9	37,6	36,8	36,9	37,7		
External accounts							
Current account balance (EUR bn)	-2,0	-3,5	-6,5	-8,2	-8,6		
Current account balance/GDP (%)	-1,2	-2,1	-3,4	-4,1	-4,0		
Net FDI (% of GDP)	1,8	2,7	2,4	2,4	2,3		
Gross foreign debt (% of GDP)	57,4	54,7	50,1	46,7	43,9		
Fx reserves (EUR bn)	32,2	34,2	33,5	32,1	30,7		
Inflation/Monetary /FX							
CPI (pav g)	-0,6	-1,5	1,3	4,6	3,4		
CPI (eop)	-0,9	-0,5	3,3	3,5	3,5		
Central bank inflation target	2,5	2,5	2,5	2,5	2,5		
Central bank key rate (eop)	1,75	1,75	1,75	3,00	3,00		
3M money market rate (eop)	1,03	0,83	2,13	3,17	3,11		
RON/USD (eop)	4,15	4,30	3,89	3,92	3,80		
RON/EUR (eop)	4,52	4,54	4,66	4,70	4,75		
RON/USD (pav g)	4,01	4,06	4,05	3,89	3,80		
RON/EUR (pav g)	4,44	4,49	4,57	4,66	4,68		
UniCredit Forecast, eop	Current	sep.18	dec.18	mar.19	iun.19	sep.19	dec.19
EURRON	4,659	4,650	4,700	4,678	4,700	4,650	4,750
EURUSD	1,178	1,190	1,200	1,210	1,230	1,240	1,250
EURCHF	1,155	1,170	1,180	1,190	1,200	1,190	1,180
USDRON	3,954	3,908	3,917	3,866	3,821	3,750	3,800
CHFRON	4,034	3,974	3,983	3,931	3,917	3,908	4,025
EURIBOR 3M	-0,32	-0,32	-0,32	-0,30	-0,30	-0,10	-0,10
ROBOR 3M	3,36	3,10	3,17	3,12	3,07	3,07	3,11

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