UBB
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Economic perspectives

February 2020

Highlights

- For the euro area as a whole, the incoming data support our view of a gradual growth recovery in the course of this year. Consumption demand remains resilient and although it's too early to speak of a sharp recovery, industrial sentiment indicators are showing signs of stabilization. However, the euro area economy remains a mixed bag with upside and downside surprises in Q4 real GDP growth figures across countries.

- The US economy continues to perform well, and even slightly better than expected. Q4 GDP growth was pushed up by a marked decline in US imports, but consumption of domestic goods and in particular services is holding up well. Since the prospects for the US labour market are still favourable, private consumption will continue to be the main growth driver.

- The outbreak of the coronavirus means a new headwind for the Chinese economy, which seemed to be doing better at the start of this year. The magnitude of the economic impact of the epidemic is hard to estimate given that we don't know yet how quickly the virus will be contained. However, assuming that the peak of the virus will be reached before the end of the first quarter, the economic blow will likely be temporary and a normalisation after the dip is likely. Moreover, it will be mainly China that will suffer economically as the macro-economic distortion to the global economy remains limited under this scenario. This outcome is nevertheless prone to a high degree of uncertainty. The risk that the disease spreads much more across the globe is not negligible. In that case, the negative impact on global economic growth would be much more severe.

- The uptick in euro area inflation at the end of 2019, that has already partly been reversed, was mainly caused by volatile components. While there are some signs of rising wage growth translating into stronger inflationary dynamics – mainly in labour intensive services sectors with small weights in the overall inflation index – our overall scenario of very gradual inflation increases remains in place.

- Major central banks are expected to remain cautious going forward. However, the recent unexpected rate hike by the Czech National Bank signals that a gradual further normalisation of monetary policy in Central Europe is taking place.

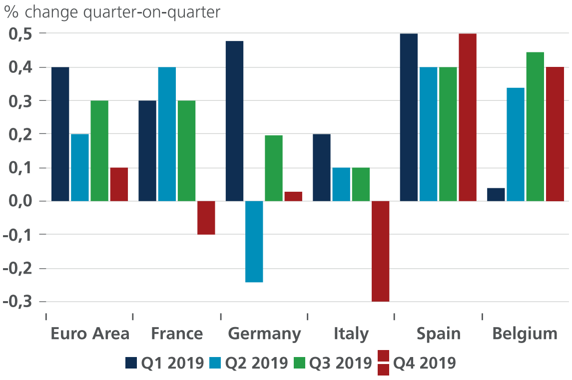
Global economy

Q4 surprised, scenario unchanged

Real GDP growth figures for Q4 2019 brought several upside as well as downside surprises in euro area countries. Disappointing results were released for Italy (-0.3% qoq) and France (-0.1% qoq) (figure 1). In Italy, there was a decrease in value added in agriculture and industry, while services stabilized. The combination of the significantly weaker-than-expected last quarter of 2019 and a slight downward adjustment of our Italian quarterly growth projection for Q1 2020 (from 0.1% qoq to 0.0% qoq), led to a downward adjustment of our 2020 annual average GDP growth forecast from 0.5% to 0.0%. In France, there was some negative impact from social unrest on growth, but also one-off factors were at work in Q4. The exceptionally mild winter weather caused less consumption demand for heating. Moreover, inventories contributed sharply negatively to GDP growth as a consequence of de-stocking of aeronautical and naval equipment production from earlier quarters. Nevertheless, the disappointing Q4 figure hides continued underlying strength of the French economy, which is why we don't think a major revision of our French growth projections is necessary.

On the other hand, real GDP growth in the fourth quarter was better than we anticipated for Spain (+0.5% qoq) as somewhat weaker domestic demand was compensated by stronger exports. Belgian (+0.4% qoq) and German (0.0% qoq) real GDP growth also surprised to the upside. Though somewhat better than we anticipated, German real GDP growth in Q4 was weaker than in Q3 (+0.2% qoq) as a result of a slowdown in both household and government expenditures according to preliminary figures. Net exports contributed negatively to GDP growth in Q4 as exports slightly decreased while German imports rose compared to the previous quarter. Investments showed a mixed picture, with a marked decrease for machinery and equipment – related to the weakness in German industrial sectors. Meanwhile, investment in construction increased. On balance, Q4 real GDP growth for the euro area as a whole was in line with our expectations (+0.1% qoq), resulting in an annual average growth rate of 1.2% for 2019.

Figure 1 - Gross domestic product
% change quarter-on-quarter



Source: KBC Economics based on Eurostat, DESTATIS

High-frequency indicators paint a broadly similar picture as in previous months. Sentiment indicators don't show any material change. There are persistent signs of stabilization of corporate sentiment, now not only in the PMI's but also better visible in European Commission's Indicator. Solid levels are still being reported in France, despite some weakening. Recent social unrest and public strikes hence don't seem to impact economic sentiment as sharply as was the case during the yellow vest protests at the end of 2018. An important point of weakness in the euro area remains Italy, where weakness in sentiment and activity data persists despite the favourable results of regional elections for the current government coalition. Industrial activity indicators are showing some improvement in the euro area, but it is too early to talk of a strong general recovery, particularly as Germany industrial production continued to shrink. Meanwhile, consumption demand remains resilient supported by strong labour market performance.

Therefore, despite some surprising Q4 GDP figures in the underlying country data, we did not change our annual average GDP growth forecasts for the euro area. Growth will remain rather muted this year, but will recover on a quarterly basis, resulting in an average annual growth of 1.0% this year and 1.3% next year. We assume that the negative impact of the coronavirus and associated measures on euro area growth will be mild and temporary, mainly concentrated in the first half of the year (also see below).

Steady US growth

The US economy reported slightly stronger-than-expected real GDP growth in Q4 2019 (+2.1% qoq annualised). This was a steady growth pace compared to the previous quarter, but underlying growth details showed some signs of weakness in investment and personal consumption. The headline growth figure was also boosted by the largest drop in imports since 2009, leading to a positive growth contribution of net exports. On balance, this means that US consumers are consuming less, which is mostly absorbed by lower imports, while consumption of domestic services remains strong. The slowdown in annual retail sales growth - to 3.5% in 2019 from 4.8% in 2018 - underscores this weakness in (foreign) goods consumption as well. One potential explanation for this are anticipatory imports of consumer goods into the US in earlier quarters. The likely trigger for this was the threat of new US import tariffs on imports from China that were partly implemented in September 2019. As a consequence, US inventories of Chinese consumer products were high at the start of Q4 and were drawn down in the course of the quarter. This also is consistent with the drawdown in inventories that we saw in Q4. Meanwhile, consumer sentiment remains solid despite some monthly choppiness. Therefore, despite the declining GDP growth contribution of private consumption, the underlying message about US consumers still remains positive.

Corporate confidence is improving again as the four main business sentiment indicators are now back in expansion territory. The latest uptick was likely also driven by the signing of the US-China trade deal (also see Box 1). However, there continue to be challenges ahead, in particular for the US industrial sector. Industrial production continues its year-on-year declines. Moreover, the Boeing production halt will weigh down on production as well. The negative impact of the coronavirus is expected to remain mild (also see below), but the risk of more severe economic damage increases the longer it takes to contain the virus outbreak.

To summarise, our real GDP forecasts for the US economy didn't change compared to last month. We still project annual growth to reach 1.7% in both this and next year. Private consumption is expected to remain the most important driver. It will be underpinned by favourable labour market dynamics since comments by the Federal Reserve suggest a willingness to ensure maximum employment.

Poor timing for China

Before the coronavirus outbreak became headline news, a string of positive Chinese data was suggesting that the government's previous stimulus efforts were having some effect. Business sentiment in the manufacturing industry has recovered to expansionary territory while sentiment in the services industry is still strong. Industrial production growth is showing signs of stabilization, as is fixed asset investment in the industrial sector. What's more, the signing of a phase one trade deal with the US, removes some of the headwinds that have been dragging on the Chinese economy. While the trade war was not the sole driver of the slowdown, it increased uncertainty, weighed on sentiment, and likely had some negative impact on China's manufacturing industry and foreign trade.

Unfortunately, that good news has now been overshadowed by the outbreak of the coronavirus. As seen with the SARS outbreak in 2003, the macroeconomic effects of an epidemic can be sizeable. The magnitude of the corona impact is hard to estimate given that we don't yet know how quickly the virus will be contained. But hits to tourism, transport, retail, and general consumer demand in areas directly affected by the virus are already being seen. Mild, second round effects on China's trade partners due to weaker Chinese demand are also possible. Hence, it is reasonable to assume that there will be some, at least temporary, drag on Chinese growth.

Consumption and travel will likely normalise once the outbreak of the virus is under control. However, given the current timing around the Chinese New Year celebrations, there will likely not be a compensating 'excess of spending' such as additional eating or travelling later in the year. Hence, once the shock has ended, the earlier losses won't be fully compensated. Though industrial production will also recover again after the temporary effects fade out, also firms are not very likely to go much further and compensate fully for earlier lost production. After all, the Chinese economy is going through a longer-term process of slower but better-quality growth. Moreover, global economic growth is expected to remain rather muted this year. Besides, a key issue is the extent to which Chinese fiscal policy is loosened and/or monetary measures boost demand. China is already facing elevated inflation driven by food prices and high indebtedness of both the corporate sector and households. Furthermore, the share of consumption in Chinese GDP growth has become much larger relative to the importance of investments (figure 2). Therefore, we don't expect the Chinese authorities to massively intervene to artificially ramp up growth via investments as was the case following the SARS outbreak in 2003.

Based on these arguments, we expect Chinese growth to slow down considerably in Q1, followed by a partial recovery in Q2 and an even stronger recovery in Q3. On an annual basis, we downwardly revise our outlook for Chinese real annual GDP growth in 2020 from 5.7% to 5.2%.

Our scenario assumes that the coronavirus remains largely contained within China in terms of mass cases and fatalities. The lockdown of the city of Wuhan, the Chinese city where the first cases of corona popped up, together with the lockdown of some other economically important cities in China, probably helped

Box 1 – Feasibility of Chinese import commitments in US-China trade deal is questionable

The “phase one” trade deal between the US and China that was signed mid-January will go into effect from this month on. One important element of the trade agreement is the set of import commitments China agreed to. US exports to China have been much smaller than US imports from the country. The difference between the two, the US-China bilateral trade balance, has hence been negative and this deficit has even been growing over time. In order to reverse that trend, China committed to increase its imports from the US by at least USD 200 billion, compared to total Chinese imports from the US in 2017, over the course of this and next year (figure B1.1). The phase one deal contains a more detailed plan to achieve this. In terms of subcategories it implies an increase of imports worth USD 77.7 billion for manufactured goods, USD 32.0 billion for agricultural goods, USD 52.4 billion for energy products and USD 37.9 billion for services, spread over two years’ time.

The commitments are sizable and the feasibility of them can be questioned for several reasons. For one, the mentioned import increases are benchmarked to 2017 data flows. According to US data, the US exported roughly USD 130 billion of goods and USD 57 billion of services to China in 2017. Comparing these figures to the Chinese import commitments in the phase one trade deal, this would imply that over the course of this and next year together, Chinese imports of goods and services from the US would have to more than double. Moreover, as a consequence of rising trade tensions between the US and China, export flows from the US to China have declined in the past few years (figure B1.2). This is in particular the case for trade in goods. Hence, compared to trade flows in 2019, the Chinese import commitments are even larger. Since most tariffs that were implemented in China and the US in recent years are – despite some minor rollback – not reversed by the US-China trade deal, such a sharp recovery of bilateral trade is not very likely.

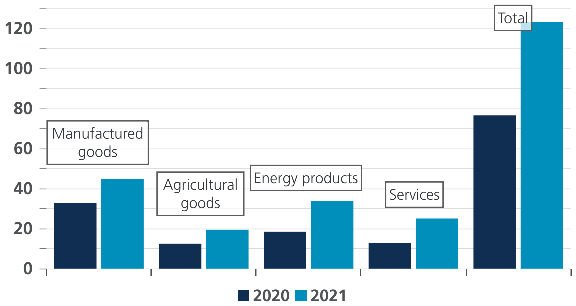
Furthermore, assuming that China did stick to its commitments, Chinese imports would very likely be directed away from its other trading partners. After all, the Chinese economy is going through a transition towards lower-quantity and higher-quality growth. Hence, a steep rise in its total demand and imports is unlikely. Significantly higher Chinese imports from the US would therefore likely result in lower imports from other countries.

It is also questionable whether US companies will be able to increase their production to export more to China. Given capacity constraints and the late-cyclical stage of the US economy, this might not be fully feasible. In that case, the US-China bilateral trade balance might become less negative, but bilateral trade balances with other US trading partners might worsen, meaning no major improvement in the US’s total trade balance.

In our view, the feasibility of the Chinese import commitments in the US-China trade deal is hence questionable. Especially in the short-term, the Chinese measures taken to contain the spread of the coronavirus might complicate the compliance further. Furthermore, the consequences might reach much further than only the US and Chinese economies. It remains to be seen how many of the promises made in the deal will be redeemed.

Figure B1.1 - US-China Phase 1 trade deal - Chinese import commitments

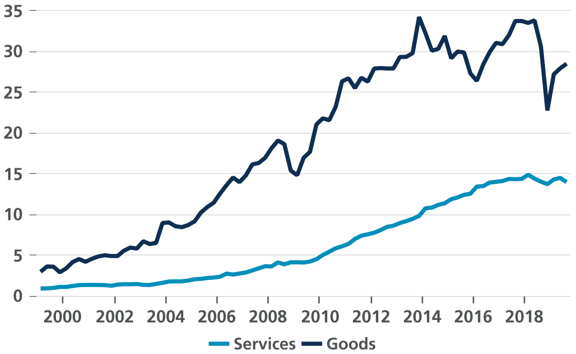
minimum additional purchases from US above the corresponding 2017 baseline amount; in billion USD



Source: KBC Economics based on USTR

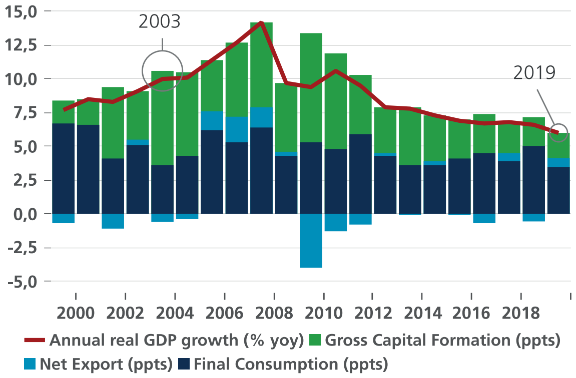
Figure B1.2 - US exports to China

seasonally adjusted, quarterly balance of payments data, in billion USD



Source: KBC Economics based on U.S. Census Bureau

Figure 2 - China: Contribution to GDP



Source: KBC Economics based on NBS

in limiting the spreading of the virus and hence underpins this view (also see Box 2). Of course, these projections are subject to a high degree of uncertainty. The risk that the disease spreads much more toward the US, Europe or other areas in the world is not negligible. In that case, the negative impact on economic growth across the globe would be much more severe. For now, we mildly change the quarterly growth dynamics for the euro area and US. However, these quarterly changes have no impact on our annual growth forecasts for the euro area and the US.

Volatile components driving Inflation

The upswing of headline and especially core inflation in the euro area at the end of 2019 raised the question whether euro area inflationary dynamics were finally rising. However, the end-2019 upswing of core (services) inflation was more of a "false alarm", mainly due to volatility, in particular coming from a change in the way German package holiday price inflation is calculated (figure 3). Indeed, core inflation already returned back towards its trend level (1.1% in January 2020). There are some signs of wage inflation feeding through in services inflation for labour intensive services though – e.g. for housing related services, recreation and personal care. However, these subsectors have a low weight in the overall inflation index. Moreover, productivity gains are tempering the impact of labour cost increases on inflation. Hence, overall, our scenario of only gradually increasing euro area inflation resulting from very gradually building wage pressures, with a moderating impact of energy prices in the short-term, remains intact.

Risks to headline inflation are tilted to the downside, especially in the context of the corona outbreak. In recent weeks, the negative demand impact from the corona epidemic on Chinese growth in Q1 2020 and the related (expected) fall in oil demand caused – aside from the unwinding of large speculative

Box 2 – Wuhan: much more than just the place where the coronavirus broke out

Wuhan and dorona. These two concepts have become inextricably linked over the past few weeks. The number of infections continues to rise daily and the number of deaths rose to more than 1000, making the coronavirus more deadly than the SARS epidemic that broke out in 2002-2003. For China, however, Wuhan - the capital of Hubei province - is much more than just the place where the virus broke out. Wuhan is a logistics hub, also known as "the Passage of China". The city with about as many inhabitants as Belgium contains crucial transport channels by road, air, water (Wuhan is located at the junction of the Yangtze and Han rivers) and rail. This extensive transport network makes Wuhan very attractive to companies. It is in particular popular among industrial firms (automotive, steel and chemical), although the metropolis has been welcoming more and more technology companies in recent years.

The city - and the province – have been able to benefit from its strategic location. Wuhan became an important economic engine. Economic growth reached 7.8% in 2019. In comparison, total Chinese gross domestic product (GDP) grew by 6.1% last year. The city accounts for more than 60% of Hubei province's foreign trade (244 billion yuan, some 32 billion euros). Hubei's economic importance in turn also increases year after year. The share of Chinese GDP is steadily increasing: from 3.2% in 2007 to 4.3% in 2019. The province is thus the seventh most important in China's total GDP. Expressed in terms of investments, the picture looks even more impressive. 7.5% of total Chinese capital expenditure is accounted for by Hubei, compared to approximately 3.5% in 2007.

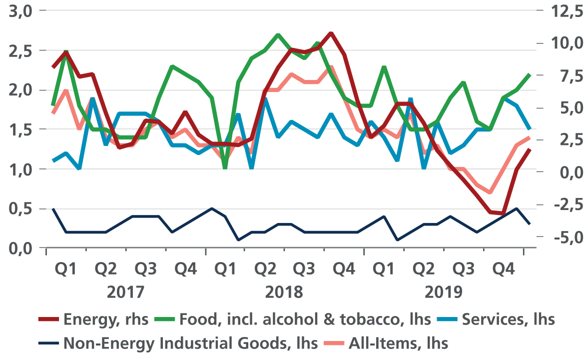
positions in Brent crude during the earlier upward price spike - a sharp drop in oil prices. If the epidemic turned out to be much more severe than currently assumed, the negative impact on oil demand and prices would be larger. As a consequence, this would drag down headline inflation across the globe further.

Long-term rates infected by corona, central banks on hold

Apart from declining oil prices, the coronavirus outbreak triggered a fall in long-term government bond rates too. The gradual global normalization path of long-term interest rates, that started late summer 2019, has been interrupted by the uncertainty and potential negative economic impact of the epidemic. However, we expect rates to continue their normalization path as soon as the virus outbreak gets under control.

Meanwhile, intra-EMU spreads remain very limited due to the ECB's Asset Purchasing Programme. There has been a striking further drop in the Italian-German spread as an immediate political crisis has been averted after recent local elections.

Figure 3 - Euro area headline inflation & main components
annual change in %



Source: KBC Economics based on Eurostat

The major central banks are expected to keep policy rates stable for the remainder of 2020. Only in case the coronavirus caused more international economic damage, central banks would likely intervene again.

Central and Eastern European Economies

Q4 growth generally surprised on the upside

From the point of view of the Central and Eastern European region, where most economies show a relatively high degree of openness (measured by the share of exports in GDP), the euro area is a key business partner. Despite that, the significant slowdown in the euro area's economic growth since the end of 2017 has been ambiguously reflected in the foreign trade balance of the region. The resilience contributes to the fact that the countries of Central and Eastern Europe can still boast solid growth dynamics that markedly surpasses economic growth in the euro area.

The flash estimates of regional real GDP growth for the last quarter of 2019 plainly confirm this argument. Notwithstanding the fact that economic activity is gradually slowing down in most of the Central and Eastern European economies, the headline growth figures generally surprised on the upside (figure CEE1). This is especially true for Romania, which saw a significant upswing from 0.5% qoq in Q3 to 1.5% qoq in Q4. On a year-on-year basis, this translates into a jump from 3.0% to 4.3%. A positive surprise combined with a pick-up in real GDP growth from 1.3% yoy in Q3 to 2.1% yoy in Q4 was also registered in Slovakia.

Meanwhile, both Hungary and Poland, traditional growth champions in the region, experienced a less severe slowdown than expected in the fourth quarter of 2019. While the Hungarian economy expanded by 1.0% qoq in Q4 from 1.1% qoq in Q3, the Polish economy eased more markedly from 1.3% qoq in Q3 to 0.2% qoq in Q4. Still, the Polish economy was able to avoid a contraction on a quarter-on-quarter basis (which had been expected based on the earlier publication of annual growth for 2019) and kept a solid growth dynamic of 3.1% on a year-on-year basis.

The Czech Republic registered a continued slowdown in economic activity that was broadly expected. Real GDP growth decelerated from 0.4% qoq in Q3 to 0.2% qoq in Q4, while on a year-on-year basis it eased from 2.5% in Q3 to 1.7% in Q4. Last but not the least, a mild slowdown was seen also in Bulgaria. The Balkan economy grew 0.7% qoq in Q4 from 0.8% qoq in the previous quarter, while year-on-year growth slowed to 3.5% in Q4 from 3.7% in Q3.

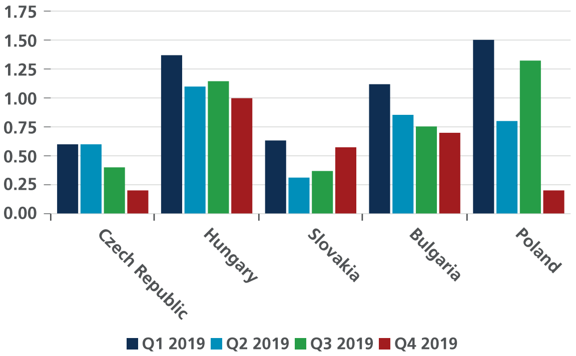
Trade balance dynamics mixed

The different CEE economies reported diverging dynamics in their respective trade balance over the past few years. With regard to the Czech Republic and Slovakia, their respective trade balances show a relatively stable development during the last quarters. (figure CEE2) While the balance of merchandise trade over the last two years worsened in Hungary and even more so in Romania, we can see improvement in Poland and particularly in Bulgaria.

To understand the above specified divergence better, the export and import sides of the trade balance need to be analysed separately. Regarding exports, in all six economies in the region except for one – Romania – the factors offsetting a drop in the eurozone's aggregate import demand had the upper hand

Figure CEE1 - Real GDP growth

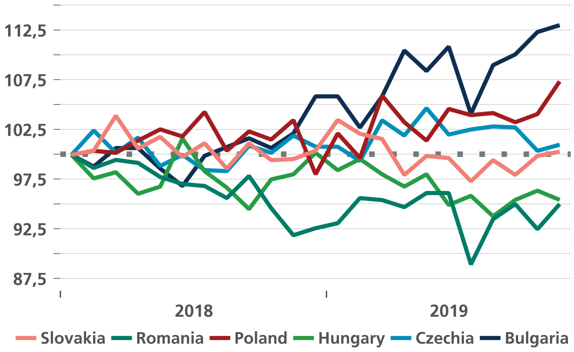
% change quarter-on-quarter



Source: KBC Economics based on Eurostat and national sources

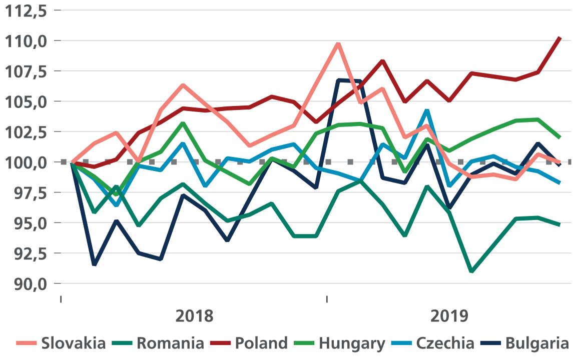
Figure CEE2 - Trade balance

trade in goods, volumes, index 01/2018 = 100, calender and seasonally adj.



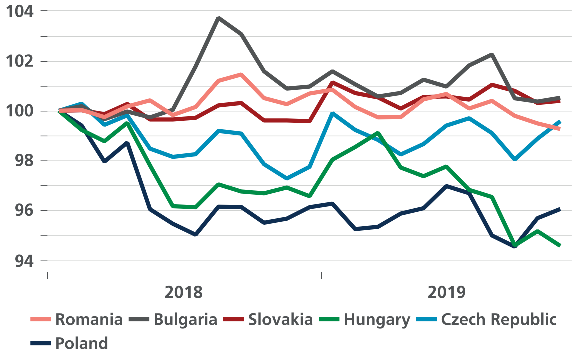
Source: KBC Economics based on Eurostat

Figure CEE3 - Goods exports volumes
index 01/2018 = 100, calender and seasonally adj.



Source: KBC Economics based on Eurostat

Figure CEE4 - Real effective exchange rate
relative to 42 trading partners, index 01/2018 = 100



Source: KBC Economics based on Eurostat

(figure CEE3). In Poland and Hungary, exports even registered an increase by 7% and 4% respectively between January 2018 and November 2019.

The growth of exports in Poland and Hungary was strongly supported by increased competitiveness which was in turn driven by real depreciation of the zloty and forint (figure CEE4). Moreover, real depreciation of a local currency supports the local trade balance from a different side too: it inhibits import growth as foreign goods become relatively more expensive. While in the case of Poland, the import contraction combined with export growth proved enough for improving the trade balance over the last two years, this was not the case in Hungary. The import absorption in the fastest-growing Central European economy was so strong that it trumped even the booming exports.

The development of the foreign trade balance in Bulgaria and Romania paints a more complicated picture. On the one side, the Bulgarian trade balance has seen the greatest improvement among the six CEE countries. The reason for the record improvement of the Bulgarian trade balance lies on the import side. While the aggregate volume of exports remained virtually unchanged in 2018-2019, imports in November 2019 lagged behind the level in January 2018 by ten percent. A change in the real exchange rate of the local currency was not the main driver, nor can we find an explanation in the development of economic growth (which has remained buoyant and above 3% yoy since the beginning of 2018). Evidently, Bulgaria saw a rare (and likely temporary) occurrence of two mostly asynchronous events: accelerating economic growth and decreasing import demand.

The above-mentioned has important implications. A temporary decline in the growth performance of the euro area within the range of 1-1.5 percentage points poses no immediate threat for the trade balance (and indirectly the growth of GDP) of the Central Eastern European countries. Moreover, helped by a real depreciation of exchange rates and the consequent export boost, regional trade balances can even improve despite a decrease in aggregate demand from the euro area. At the same time, real depreciation of a local currency efficiently dampens demand for imports, which helps maintain favourable dynamics for the trade balance, even in a relatively fast-growing economy.

Of course, this may hold true only within certain limits. When a drop in the GDP of the euro area or an increase in the growth differential between the euro area and a Central Eastern European country widens too much, this can worsen the latter´s trade balance and inevitably cause a negative impact on growth.

Surprising step by the CNB

At its first session this year, the Czech National Bank’s (CNB) Bank Board quite surprisingly decided to increase the base interest rate by a quarter of a percent. The primary interest rate (two-week repo) was thus raised to 2.25%, where it last was eleven years ago. It was an unexpected and, at the same time, a very tight decision (4:3). The CNB explained it by pointing to greater inflation pressures, which constitutes grounds to review the inflation prognosis upward. Nonetheless, the central bank expects inflation to return to its target level of 2% in the monetary policy horizon (1-1.5 years), which is likely from our viewpoint as well.

On the other hand, the CNB's prognosis of Czech GDP growth and the CZK exchange rate seems less likely to materialise. The central bank namely assumes that, after a short slowdown late last year, economic growth is now beginning to accelerate again, and GDP is expected to grow by 0.8% qoq in Q1 2020. Considering the negative signals coming from the Czech and other foreign economies, this outlook seems to be rather too optimistic. In the case of the Czech koruna, on the contrary, the CNB is a bit too pessimistic as it expects that the interest rate differential, extended to its twenty-year high (275 bps), will have virtually no effect on the currency, and foresees the exchange rate remaining around 25.30 EUR/CZK for the entire year.

The principal question to be answered is what the CNB is going to do after abandoning its interest rate smoothing approach and adopting an activist stance. Another interest rate increase seems to be the least probable variant at this time, which the central bank itself does not foresee in its current prognosis. On the contrary, the prognosis mentions that the CNB might even reduce the interest rates within half a year. Nonetheless, it is not at all clear whether the Bank Board will be that flexible as well; for this reason, we are inclined towards a stable scenario with a risk of the rates being reduced, which will be proportionate to the extent in which the optimistic prognosis does not get fulfilled.

Bulgaria and the euro

Following the fall of communism, Bulgaria experienced several episodes of hyperinflation and a sharp currency devaluation. As a reaction, in 1997, the Bulgarian lev was pegged to the German mark and Bulgaria started to operate under a currency board arrangement, meaning that all Bulgarian currency in circulation has been backed by foreign exchange reserves held by the Bulgarian National Bank. After the birth of the euro, the lev's peg effectively switched to the common European currency at the rate of 1.95583 BGN per EUR.

Bulgaria's authorities have expressed intention to join the euro area ever since the country became a member state of the European Union in 2007. Over the years, Bulgaria has achieved substantial progress in all aspects of its euro adoption plan. Most importantly, this progress is reflected in improved macroeconomic stability, underpinned by prudent fiscal policy, and one of the lowest government debt-to-GDP ratios in the European Union. Hence, attention has largely shifted to the stability of the financial system in Bulgaria. According to a recent finding by the European Central Bank, two locally owned Bulgarian banks have insufficient capital buffers, which requires follow-up actions to further strengthen their capital positions.

Provided the capital shortfalls are appropriately addressed, Bulgaria may receive an invitation to join the Banking Union and the Exchange Rate Mechanism (ERM II) as early as April 2020. Then, if Bulgaria meets all nominal convergence criteria (inflation, long-term interest rates, budget deficit and public debt) and participates in the ERM II without severe disruptions for at least two years, it qualifies to join the euro area. According to Bulgarian authorities, the euro adoption might take place on January 1st, 2023.

During the stay in the ERM II, Bulgaria intends to maintain both its current exchange rate regime and the central exchange rate of 1.95583 BGN per EUR. Some interpretations of legal amendments required by the ECB and the European Commission for compliance with the ERM II regulatory framework sparked fears among the population of forced devaluation of the lev before the euro adoption. These amendments are, however, technical in nature and do not call into question the current exchange rate regime. Still, in order to reassure citizens, the National Assembly passed a resolution, according to which Bulgaria would only adopt the euro at the current exchange rate.

Box CEE – 2020 Parliament elections in Slovakia

After four years of a coalition government consisting of Smer, SNS and Most-Híd, Slovakia will elect a new parliament on the last Saturday of February. The outcome will certainly depend on voter turnout and on how many parties will actually get into parliament by passing the necessary constitutional threshold of 5% (coalitions over 7%). Therefore, the NRSR (National Council of the Slovak Republic) may consist of 5 or even 11 political parties. There is still a significant portion of voters who are undecided.

This is why the governing parties proposed an increase in social benefits or to abolish certain fees before the election. These measures will affect a relatively large range of the population and, as a result, the public deficit may reach (depending on the specific extent approved by parliament at the last meeting) 2.5% - 3% of GDP.

Voter turnout, as mentioned, will be crucial. In the last four parliamentary elections, the turnout ranged from 54% to 59%. Public interest in the upcoming elections is evidenced by the fact that more than 55,000 people abroad want to vote this time, which would represent about 2% of the estimated turnout of 50%.

According to a recent AKO poll conducted in early February, nine political parties are likely to enter Parliament: Smer-SD (17.3%), OLaNO (13.5%), LSNS (11.8%), ZA LUDÍ (9.5%), Koalícia PS SPOLU (8.7%), SME RODINA (6.4%), SaS (5.8%), KDH (5.3%) and SNS (5.1%). This would mean the establishment of a broad six-member coalition of the current opposition parties ZA LUDÍ (19 seats) + PS SPOLU (17) + OLaNO (16) + SME RODINA (14) + KDH (10) + SaS (10). In this situation, the opposition parties would have a comfortable majority of 86 seats out of 150. However, such a broad coalition is usually less stable due to differences in their value issues. Alternatively, there is also the possibility of a coalition consisting of Smer-SD (32) + LSNS (23) + SME RODINA (14) + SNS (9). This represents an overall small majority of 78 seats out of 150.

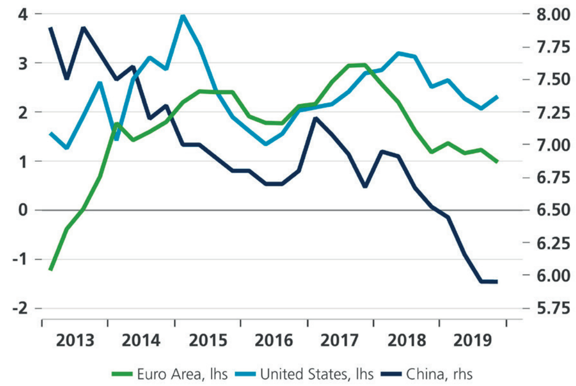
The president usually entrusts the winner with the task of putting together a government (constitutional habit). However, the president would probably not entrust this task to the extreme right party represented by LSNS.

The current government is likely to leave a larger than projected budget deficit. The new parliament will either have to accept it or look for ways to increase revenue or reduce spending. There is also increasing pressure in society to address systemic problems in health and education.

The broad coalition of the current opposition parties and their programmes would follow the necessary reforms. A coalition would also have to straighten public finances. On the other hand, coalition Smer-SD and some other parties, would probably "preserve" the current problems. In the area of public finances, this coalition would probably try to raise taxes on the wealthier even at the cost of legal disputes (e.g. bank tax). The economic policy of LSNS, should this party get a strong position within the coalition, would probably disrupt public finances. In addition, this party also proposes the withdrawal of Slovakia from NATO and the EU.

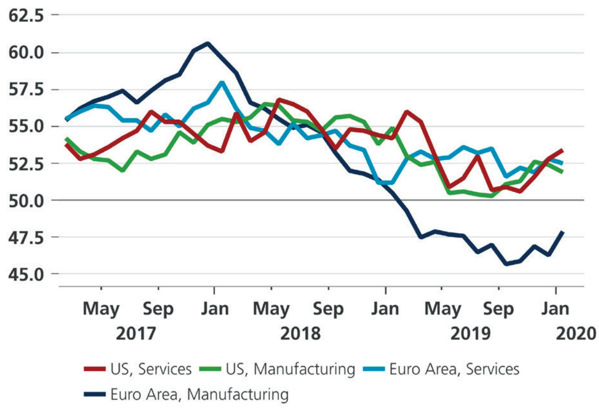
Figures

Real GDP
yearly change in %



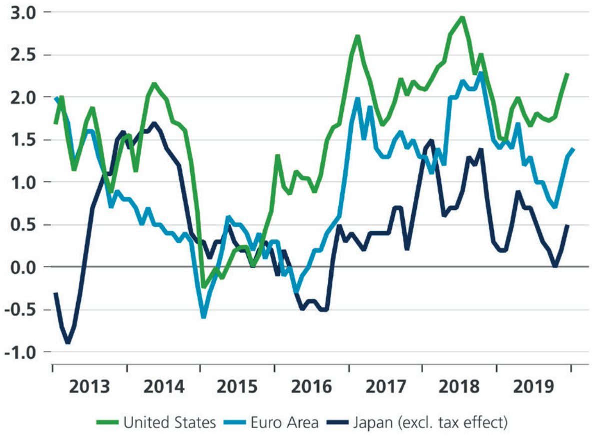
Source: KBC Economics based on Eurostat, BEA, NBS

Business confidence indicators
index, above 50 = expansion



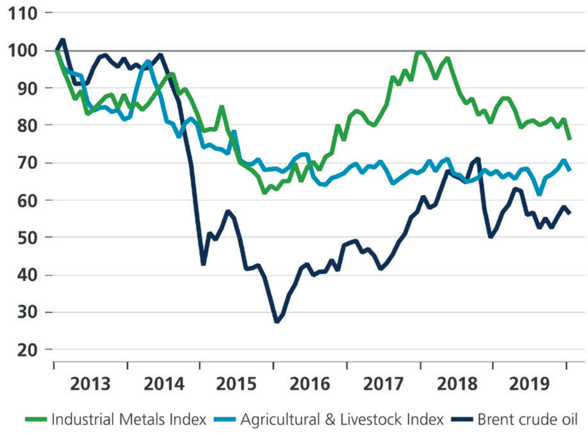
Source: KBC Economics based on IHS Markit

Headline inflation
yearly change consumer price index, in %



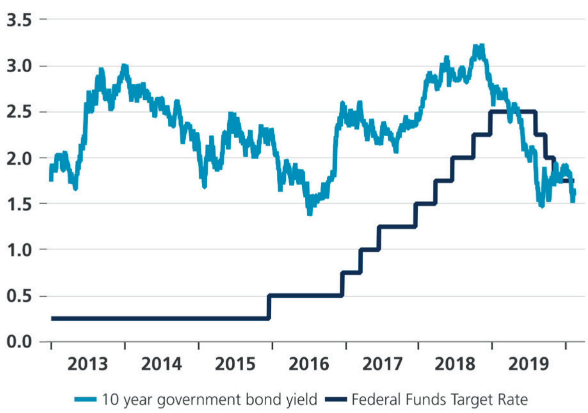
Source: KBC Economics based on Eurostat, Japanese Statistics Bureau, BLS

Commodity prices
index, January 2013=100, in USD



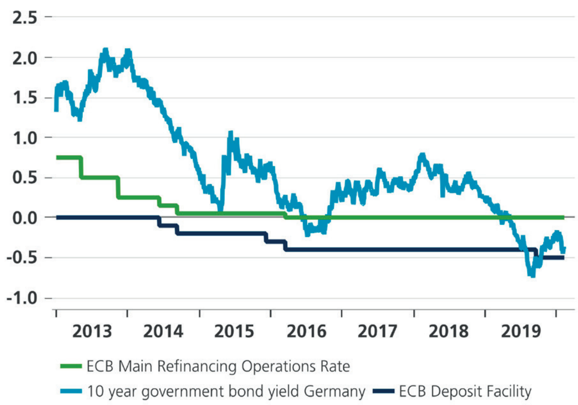
Source: KBC Economics based on World Bank, SPDJI

United States interest rates
in %



Source: KBC Economics based on Fed, Macrobond

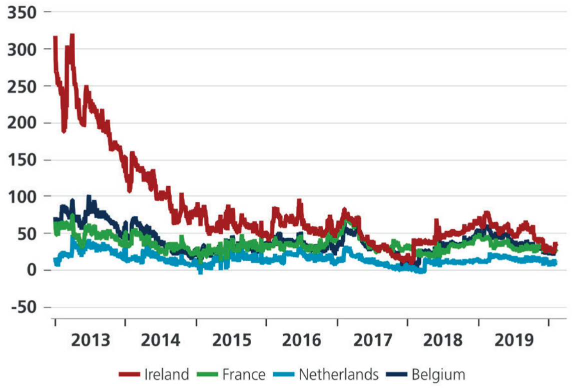
Euro area interest rates
in %



Source: KBC Economics based on Macrobond, ECB

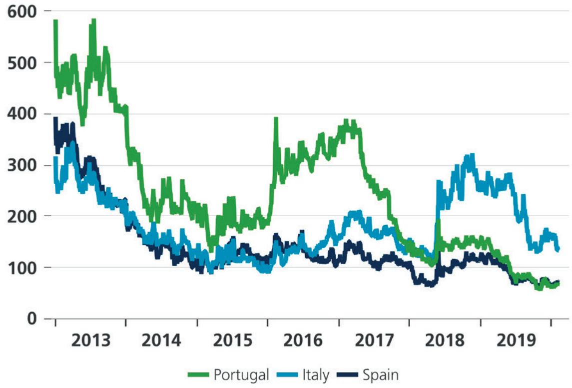
Figures

10 year government bond yield spreads to Germany
in basis points



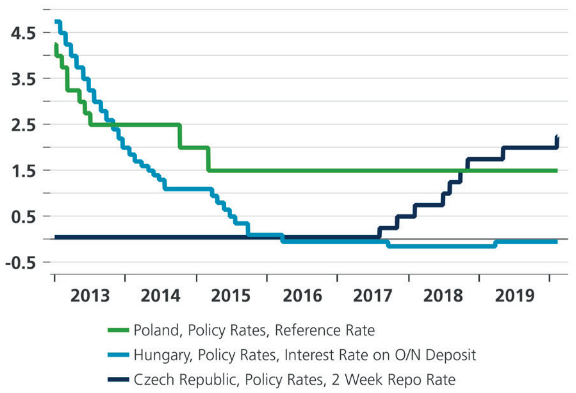
Source: KBC Economics based on Macrobond

10 year government bond yield spreads to Germany
in basis points



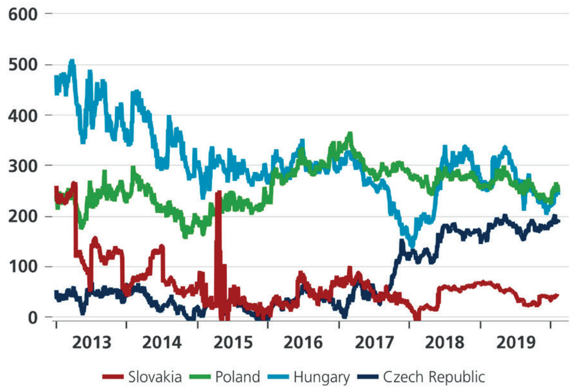
Source: KBC Economics based on Macrobond

Monetary policy rates Central Europe
in %



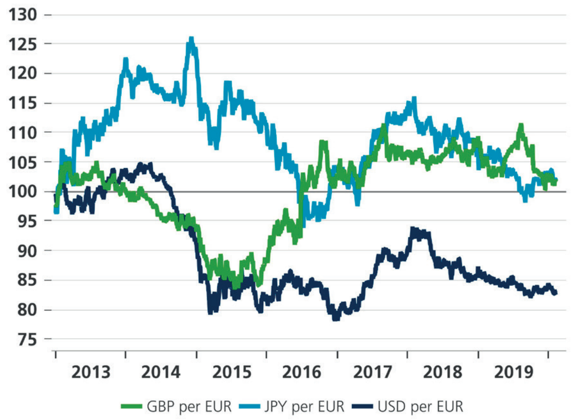
Source: KBC Economics based on CNB, MNB, NBP

10 year government bond yield spreads to Germany
in basis points



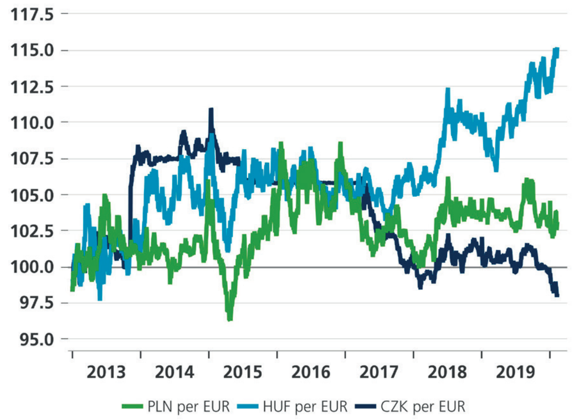
Source: KBC Economics based on Macrobond, AKK, Eurostat

Exchange rates
index, January 2013=100, increase = stronger EUR



Source: KBC Economics based on Macrobond

Exchange rates
index, January 2013=100, increase = stronger EUR



Source: KBC Economics based on Macrobond

Outlook main economies in the world

Real GDP growth and inflation (period average, in %)

		Real GDP growth 2019	2020	2021	Inflation 2019	2020	2021
Euro area	Euro Area	1,2	1,0	1,3	1,2	1,2	1,7
	Germany	0,5	0,6	1,3	1,4	1,5	1,7
	France	1,2	1,1	1,2	1,3	1,3	1,4
	Italy	0,1	0,0	0,5	0,6	0,9	1,1
	Spain	2,0	1,7	1,5	0,8	1,1	1,3
	Netherlands	1,7	1,5	1,6	2,7	1,5	1,8
	Belgium	1,4	1,0	1,2	1,3	1,3	1,5
	Ireland	6,0	4,0	2,2	0,9	1,5	1,9
	Slovakia	2,2	2,2	2,5	2,8	2,5	2,1
Central and Eastern Europe	Czech Republic	2,5	2,0	2,2	2,6	2,8	2,0
	Hungary	4,9	3,7	3,0	3,4	3,5	3,2
	Bulgaria	3,7	3,1	3,0	2,5	2,3	2,1
	Poland	4,0	3,8	3,5	2,1	3,0	2,5
	Romania	3,9	3,7	3,6	3,9	3,8	3,8
Rest of Europe	United Kingdom	1,4	1,1	1,1	1,8	1,6	2,0
	Sweden	1,1	1,1	1,5	1,8	1,6	1,7
	Norway	2,5	1,9	1,7	2,2	2,0	2,0
	Switzerland	0,8	1,3	1,3	0,4	0,3	0,7
Emerging markets	China	6,1	5,2	5,4	2,9	3,2	2,5
	India*	4,9	6,2	7,0	4,7	4,9	4,0
	South Africa	0,3	0,8	1,3	4,1	4,8	5,0
	Russia	1,3	1,8	1,8	4,5	3,1	4,0
	Turkey	0,1	2,5	3,0	15,5	11,0	10,0
	Brazil	1,1	2,1	2,3	3,7	3,8	4,0
Other advanced economies	United States	2,3	1,7	1,7	1,8	2,1	2,1
	Japan	1,0	0,4	0,8	0,5	0,6	0,6
	Australia	1,7	2,3	2,6	1,6	1,8	2,0
	New Zealand	2,5	2,7	2,6	1,4	1,9	2,0
	Canada	1,6	1,6	1,8	2,0	1,9	1,9

* Fiscal year from April-March

Policy rates (end of period, in %)

		12/02/2020	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Euro area	Euro Area (refi rate)	0,00	0,00	0,00	0,00	0,00
	Euro Area (deposit rate)	-0,50	-0,50	-0,50	-0,50	-0,50
Central and Eastern Europe	Czech Republic	2,25	2,25	2,25	2,25	2,25
	Hungary	-0,05	-0,05	0,05	0,05	0,05
	Bulgaria	-	-	-	-	-
	Poland	1,50	1,50	1,50	1,50	1,75
	Romania	2,50	2,75	2,75	2,75	2,75
Rest of Europe	United Kingdom	0,75	0,75	0,75	0,75	0,75
	Sweden	0,00	0,00	0,00	0,00	0,00
	Norway	1,50	1,50	1,50	1,50	1,50
	Switzerland	-0,75	-0,75	-0,75	-0,75	-0,75
Emerging markets	China	3,25	3,15	3,10	3,10	3,10
	India	5,15	5,15	4,90	4,90	4,90
	South Africa	6,25	6,25	6,25	6,25	6,25
	Russia	6,00	5,75	5,50	5,50	5,50
	Turkey	11,25	11,25	10,00	9,00	9,00
	Brazil	4,25	4,25	4,25	4,25	4,50
Other advanced economies	United States	1,75	1,75	1,75	1,75	1,75
	Japan	-0,10	-0,10	-0,10	-0,10	-0,10
	Australia	0,75	0,75	0,75	0,75	0,75
	New Zealand	1,00	1,00	1,00	1,00	1,00
	Canada	1,75	1,75	1,75	1,75	1,75

Outlook main economies in the world

10 year government bond yields (end of period, in %)

		12/02/2020	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Euro area	Germany	-0,37	-0,20	-0,15	-0,10	-0,05
	France	-0,13	0,10	0,15	0,20	0,25
	Italy	0,94	1,30	1,65	1,90	2,20
	Spain	0,31	0,55	0,60	0,65	0,70
	Netherlands	-0,28	-0,05	0,00	0,05	0,10
	Belgium	-0,06	0,10	0,15	0,25	0,35
	Ireland	-0,09	0,30	0,35	0,40	0,50
	Slovakia	0,06	0,10	0,15	0,25	0,35
Central and Eastern Europe	Czech Republic	1,55	1,54	1,56	1,58	1,60
	Hungary	2,07	2,00	2,10	2,20	2,20
	Bulgaria	0,30	0,30	0,40	0,50	0,40
	Poland	2,14	2,20	2,30	2,40	2,50
	Romania	4,11	4,30	4,36	4,46	4,57
Rest of Europe	United Kingdom	0,60	0,80	1,00	1,10	1,20
	Sweden	0,04	0,20	0,25	0,30	0,35
	Norway	1,46	1,60	1,65	1,70	1,75
	Switzerland	-0,69	-0,50	-0,45	-0,40	-0,35
Emerging markets	China	2,88	3,20	3,30	3,40	3,50
	India	6,48	6,70	6,80	6,90	7,00
	South Africa	8,90	8,90	8,90	9,00	9,10
	Russia	6,12	6,25	6,20	6,15	6,00
	Turkey	10,88	10,50	10,00	9,50	9,50
	Brazil	6,49	6,80	7,00	7,10	7,20
Other advanced economies	United States	1,62	1,90	2,00	2,10	2,20
	Japan	-0,04	0,00	0,00	0,00	0,00
	Australia	1,10	1,30	1,40	1,50	1,60
	New Zealand	1,42	1,60	1,70	1,80	1,90
	Canada	1,36	1,65	1,75	1,85	1,95

Exchange rates (end of period)

	12/02/2020	Q1 2020	Q2 2020	Q3 2020	Q4 2020
USD per EUR	1,09	1,12	1,14	1,16	1,17
CZK per EUR	24,92	25,30	25,30	25,20	25,10
HUF per EUR	338,63	334,00	332,00	338,00	340,00
PLN per EUR	4,26	4,28	4,30	4,32	4,25
BGN per EUR	1,96	1,96	1,96	1,96	1,96
RON per EUR	4,76	4,80	4,90	5,00	5,05
GBP per EUR	0,84	0,84	0,87	0,88	0,90
SEK per EUR	10,50	10,50	10,50	10,50	10,45
NOK per EUR	10,06	9,95	9,80	9,65	9,60
CHF per EUR	1,06	1,08	1,10	1,12	1,12
BRL per USD	4,33	4,25	4,20	4,20	4,00
INR per USD	71,33	71,00	71,00	71,00	71,00
ZAR per USD	14,79	14,80	14,70	14,70	14,70
RUB per USD	63,13	62,00	63,00	63,00	63,00
TRY per USD	6,03	6,00	6,10	6,20	6,30
RMB per USD	6,97	7,00	7,00	7,00	7,00
JPY per USD	109,98	109,00	109,00	109,00	109,00
USD per AUD	0,67	0,68	0,69	0,70	0,71
USD per NZD	0,65	0,65	0,66	0,67	0,67
CAD per USD	1,33	1,32	1,31	1,30	1,30

Outlook KBC home markets

	Belgium 2019	Belgium 2020	Belgium 2021	Ireland 2019	Ireland 2020	Ireland 2021
Real GDP (average yearly change, in %)	1,40	1,00	1,20	6,00	4,00	2,20
Inflation (average yearly change, harmonised CPI, in %)	1,30	1,30	1,50	0,90	1,50	1,90
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	5,20	5,40	5,40	4,80	4,80	5,10
Government budget balance (in % of GDP)	-1,90	-2,40	-2,80	0,70	1,00	1,00
Gross public debt (in % of GDP)	99,40	99,60	100,00	58,00	54,00	51,00
Current account balance (in % of GDP)	-1,40	-1,80	-2,00	-2,50	-2,00	4,00
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	3,50	2,10	2,00	2,50	2,50	2,00

	Czech Republic 2019	Czech Republic 2020	Czech Republic 2021	Slovakia 2019	Slovakia 2020	Slovakia 2021
Real GDP (average yearly change, in %)	2,50	2,00	2,20	2,20	2,20	2,50
Inflation (average yearly change, harmonised CPI, in %)	2,60	2,80	2,00	2,80	2,50	2,10
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	2,00	2,10	2,20	5,70	6,30	6,40
Government budget balance (in % of GDP)	0,00	-0,50	-0,80	-1,21	-1,50	-1,50
Gross public debt (in % of GDP)	31,00	30,30	30,00	48,00	47,50	47,50
Current account balance (in % of GDP)	3,40	0,20	0,20	-1,00	-4,00	-4,00
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	8,50	3,00	2,00	6,50	4,00	3,00

	Hungary 2019	Hungary 2020	Hungary 2021	Bulgaria 2019	Bulgaria 2020	Bulgaria 2021
Real GDP (average yearly change, in %)	4,90	3,70	3,00	3,70	3,10	3,00
Inflation (average yearly change, harmonised CPI, in %)	3,40	3,50	3,20	2,50	2,30	2,10
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	3,50	3,50	3,60	3,70	4,00	4,10
Government budget balance (in % of GDP)	-1,60	-1,00	-1,80	-1,00	0,40	0,20
Gross public debt (in % of GDP)	67,20	64,00	62,20	20,40	19,80	19,60
Current account balance (in % of GDP)	-0,70	-1,00	-1,20	4,70	4,00	2,00
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	12,00	10,00	5,00	5,00	4,00	3,00

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