

## Market Expectations for Central-Eastern Europe: What's Next?

Attila Juhász and Ádám Kóbor<sup>1</sup>

We present and review market expectations by the end of 2007 and 2008 for some selected Central-Eastern European countries, namely Hungary, Slovakia, Czech Republic and Poland. We surveyed nine<sup>2</sup> major international investment banks on their view on some representative macroeconomic and market indicators, namely GDP, CPI, unemployment, as well as central bank base rates, 2-year and 10-year yields and the exchange rate versus the euro. All of the participants are active players in the related markets, with significant influence on investors' views.

**Table 1.** Year end data as of 12/31/2006

2006	Hungary	Slovakia	Czech	Poland
GDP	3.20	9.60	5.80	6.40
CPI	6.50	4.20	1.70	1.40
UL	7.50	9.40	7.70	14.90
Base rate	8.00	4.75	2.50	4.00
Currency	251.39	34.45	27.52	3.83
2Y yield	7.80	4.44	3.14	4.60
10Y yiled	6.71	4.23	3.72	5.22

Source: Bloomberg

**Table 2.** Market Expectations for year end 2007

2007	Hungary	Slovakia	Czech	Poland
GDP	2.29	8.22	5.09	5.66
CPI	5.92	2.38	2.82	2.40
UL	8.13	9.58	7.17	13.17
Base rate	7.01	4.11	2.94	4.38
Currency	248.70	34.04	28.16	3.69
2Y yield	5.99	4.12	3.67	5.12
10Y yiled	6.48	4.27	4.18	5.33

**Table 3.** Market Expectations for year end 2008

<sup>1</sup> Investment Management Department and Quantitative Strategies, Risk and Analytics Department of the World Bank, respectively. The findings, interpretations, and conclusions are those of the authors and should not be attributed to the World Bank, their Executive Boards of Directors, or the governments they represent.

<sup>2</sup> Participants are: ABN Amro, Citigroup Global Markets, Deutsche Bank, Dresdner Bank, HVB, HSBC, ING, Ixis Corporate and Investment Bank, Royal Bank of Scotland

2008	Hungary	Slovakia	Czech	Poland
GDP	3.06	6.70	4.77	5.09
CPI	3.56	2.52	2.82	2.56
UL	7.93	8.84	6.93	11.83
Base rate	6.08	4.08	3.29	4.66
Currency	253.59	33.97	27.29	3.63
2Y yield	5.62	4.12	3.75	5.18
10Y yiled	6.53	4.19	4.22	5.31

### The so-called peer group

Although traditionally the sampled countries have been broadly viewed and treated as a peer group for investors, they do face radically diverse macroeconomic challenges, and thus the expectations predict contradictory outcomes. Market expects monetary easing cycle in Hungary and Slovakia, meantime forecasts rate hikes in the Czech Republic and Poland. The investor community anticipates modest growth in Hungary, and somewhat slower but still relatively high growth rate in the other countries. The consumer price index is expected to improve in Hungary, remain relatively stable in the other sampled countries during 2007 and 2008.

### Hungary: the sick man of the region

The second point reflected by the survey results is that Hungary is viewed as a laggard behind the other countries. Analysts on average expect higher consumer price inflation and significantly lower growth in Hungary compared to the other CEE countries. While the economic prospects are expected to turn brighter as a result of the austerity package, Hungary is expected to stay behind the others over the next two years.

**Table 4.** Expectations for Hungary for 2007

2007	Mean	Stand Dev	Min	Max
GDP	2.29	0.45	1.80	3.20
CPI	5.92	1.39	3.90	7.50
UL	8.13	0.47	7.70	9.00
Base rate	7.01	0.48	6.50	8.00
Currency	248.70	12.07	232	267
2Y yield	5.99	1.27	4.10	6.85
10Y yiled	6.48	0.52	5.90	7.10

Ambiguity of the future is well reflected by the high standard deviations and the uneven distribution of the analysts' responses in the case of Hungary. Note that one of the market participants expects the current currency band to be removed, as the end-of-2007 currency level is positioned well below the strong side the band.

**Table 5.** Expectations for Hungary for 2008

2008	Mean	Stand Dev	Min	Max
GDP	3.06	0.33	2.50	3.50
CPI	3.56	0.57	2.50	4.60
UL	7.93	0.57	7.30	8.80
Base rate	6.08	0.72	5.00	7.25
Currency	253.59	15.88	240	290
2Y yield	5.62	1.10	4.09	6.70
10Y yiled	6.53	0.78	5.60	7.75

Not surprisingly, as the market anticipates rate cut from the central bank, we may see strong bull steepening of the yield curve. For bond investors, it may offer the best roll down and carry advantage compared to the other countries in the region. Regarding the currency, the market participants expect slight weakening versus the euro.

*Slovakia: what might bring the future?*

Slovakia's performance has brought investors attention already. The stable growth, low inflation, investor friendly economic policy and the employment potential (high unemployment rate plus the cheap labor force) offered a solid base ground for multinational companies (mainly from the auto industry) and also offered momentum for bond investors.

**Table 6.** Expectations for Slovakia for 2007

2007	Mean	Stand Dev	Min	Max
GDP	8.22	0.58	7.50	9.20
CPI	2.38	0.45	1.80	3.20
UL	9.58	1.10	8.50	11.20
Base rate	4.11	0.32	3.75	4.50
Currency	34.04	2.15	32.30	37.79
2Y yield	4.12	0.13	4.00	4.25
10Y yiled	4.27	0.26	4.00	4.60

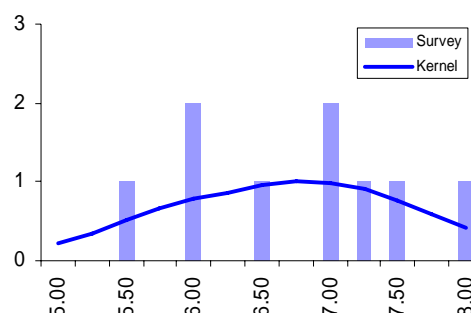
Although the numbers are still positive for the next year, the expectations are unevenly distributed. We may find the highest standard deviation for the growth among the countries, which predicts potential threat. Even though market assumes risk regarding the growth, the market rate levels are expected to be

intact and the positive yield curve will be even flatter, with unchanged base rate and short-end levels. The currency is expected to be stronger versus Euro.

**Table 7.** Expectations for Slovakia for 2008

2008	Mean	Stand Dev	Min	Max
GDP	6.70	0.81	5.40	8.00
CPI	2.52	0.44	2.00	3.50
UL	8.84	1.11	7.50	10.20
Base rate	4.08	0.35	3.50	4.50
Currency	33.97	1.56	31.90	36.82
2Y yield	4.12	0.13	4.00	4.25
10Y yiled	4.19	0.30	3.90	4.60

**Figure 1.** Distribution of the Slovakia's 2008 GDP expectations



*Czech Republic and Poland: the stable performers*

The performance of these two countries could follow similar paths, with relatively minor discrepancies. Solid growth, falling consumer price index, declining unemployment rate (still high in Poland), monetary tightening, yield curve flattening, stronger or stable currency, with no anticipated major shift in economic policy on the horizon.

**Table 8.** Expectations for the Czech Republic for 2007

2007	Mean	Stand Dev	Min	Max
GDP	5.09	0.55	4.50	6.00
CPI	2.82	0.38	2.20	3.50
UL	7.17	0.61	6.50	8.00
Base rate	2.94	0.22	2.70	3.25
Currency	28.16	0.97	27.20	29.75
2Y yield	3.67	0.15	3.50	3.80
10Y yiled	4.18	0.14	3.90	4.30

**Table 9.** Expectations for the Czech Republic for 2008

2008	Mean	Stand Dev	Min	Max
GDP	4.77	0.53	4.20	5.50
CPI	2.82	0.32	2.50	3.50
UL	6.93	0.68	6.00	7.80
Base rate	3.29	0.34	2.90	3.75
Currency	27.29	0.70	26.50	28.34
2Y yield	3.75	0.25	3.50	4.00
10Y yield	4.22	0.21	3.90	4.50

**Table 10.** Expectations for Poland for 2007

2007	Mean	Stand Dev	Min	Max
GDP	5.66	0.55	5.00	6.60
CPI	2.40	0.40	2.00	3.30
Unemployment rat	13.17	1.75	10.00	14.90
Base rate	4.38	0.19	4.00	4.50
Currency	3.69	0.18	3.37	4.02
2Y yield	5.12	0.10	5.00	5.20
10Y yield	5.33	0.24	5.10	5.80

**Table 11.** Expectations for Poland for 2008

2008	Mean	Stand Dev	Min	Max
GDP	5.09	0.55	4.20	5.80
CPI	2.56	0.45	1.80	3.20
Unemployment rat	11.83	2.44	8.00	14.70
Base rate	4.66	0.25	4.30	5.00
Currency	3.63	0.20	3.38	4.03
2Y yield	5.18	0.16	5.00	5.30
10Y yield	5.31	0.14	5.10	5.50

### EMU Entry: When, when, when?

As one of the most dominant question arising from the investor community, we also examined the potential EMU entry date expectations. The result was in line with the above mentioned observations: Hungary may be the last to introduce the common currency, and Slovakia would be the first one. The Czech Republic might be the second country in the group. Although the expectations for Poland are unevenly distributed, and the range is relatively wider, market still expects an earlier EMU entry compared to the case of Hungary.

**Table 12** EMU entry date expectations (the star represents the expected date)

	Hungary	Slovakia	Czech	Polad
2008				
2009		*		
2010		*		
2011			*	
2012			*	*
2013				*
2014	*			*
2015	*			*
2016	*			*

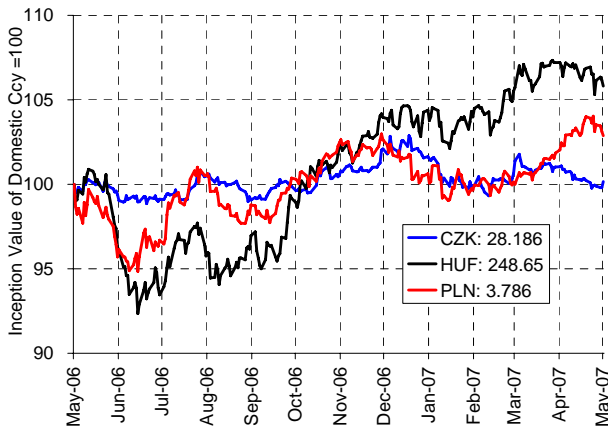
The Quarterly Letter is a forum for members of the HunEx-Econ Group to share their preliminary research results or opinions. The findings, interpretations, and conclusions are solely those of the authors. With questions or comments please contact the authors directly — [ajuhasz@worldbank.org](mailto:ajuhasz@worldbank.org) and [akobor@worldbank.org](mailto:akobor@worldbank.org) respectively for this issue.

To sign up to the HunEx-Econ e-mail list, or to become a member, please visit our website: <http://www.hungarianamerica.com/hunex-econ/>

<http://www.hungarianamerica.com/hunex-econ/>

## Currency Markets

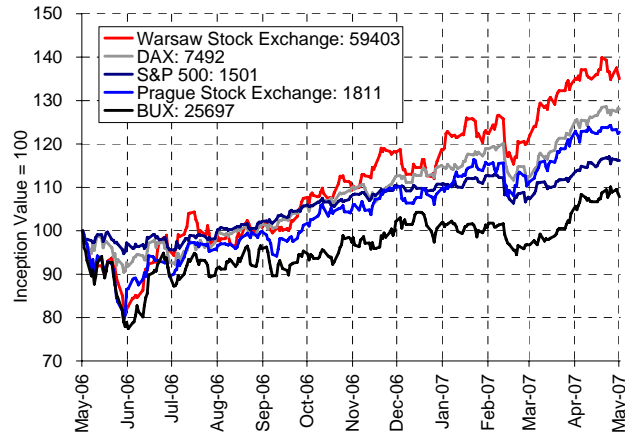
Value of Domestic Currency vs. Euro



Source: Bloomberg

## Equity Markets

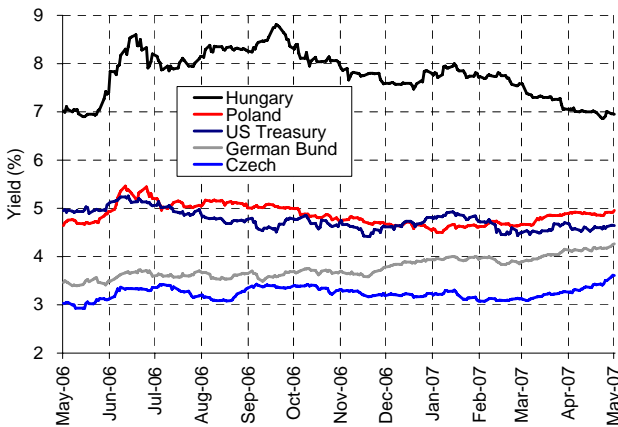
Representative Stock Indices



Source: Bloomberg

## Domestic Bond Markets

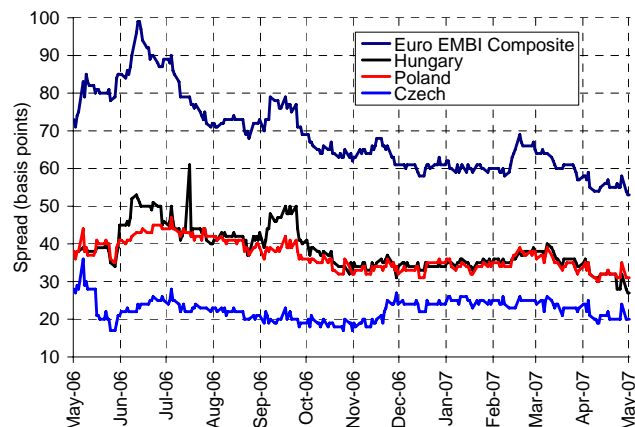
3-Year Government Bonds



Source: Bloomberg

## Euro-Denominated Sovereign Bonds

Government Spreads



Source: J.P. Morgan, Bloomberg

## Latest Economic Releases: Hungary

Indicator	Last Release	Actual Value	Next Release	Survey Median
NBH Base Rate	4/24/07	8.00	5/21/07	7.75
CPI Monthly	5/11/07	0.50	6/12/07	
CPI Yearly	5/11/07	8.80	6/12/07	
PPI Monthly	4/27/07	-0.60	5/30/07	
PPI Yearly	4/27/07	2.00	5/30/07	
Avg Gross Wages Y/Y	2/28/07	5.70	5/17/07	6.00
GDP YoY (Constant Prices)	5/15/07	2.90	6/8/07	
Industrial Production M/M	5/15/07	-0.60	6/7/07	
Industrial Production Y/Y	5/15/07	6.80	6/7/07	
Current Account Q/Q (EUR Mn)	12/31/06	-1,117.00	7/2/07	
Foreign Trade Bal. M/M (EUR Mn)	5/10/07	16.90	6/1/07	
Consolidated Govt Budg (HUF Bn)	5/7/07	-745.40	6/5/07	
Unemployment Rate	4/26/07	7.50	5/31/07	
PMI SA	5/2/07	57.70	6/1/07	
Retail Trade Yearly (%)	4/23/07	0.10	5/24/07	

Sources: Bloomberg Economic Releases