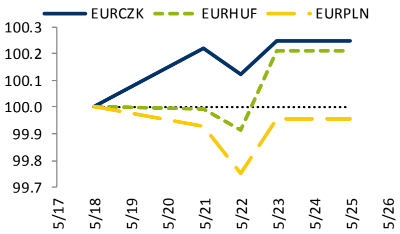
Written by ČSOB Prague and K&H Budapest

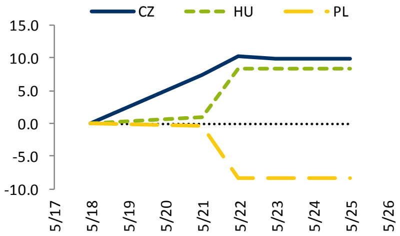
Friday, 25 May 2018

Forex markets (index)



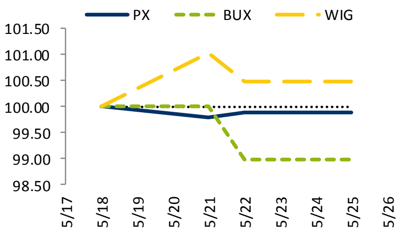
	LAST	PREVIOUS	CHANGE (%)
EURCZK	25.73	25.73	0.00
EURHUF	319.0	319.0	0.00
EURPLN	4.295	4.295	0.00

Gov. bonds 10 Y (bps change)



	LAST	PREVIOUS	CHANGE (bps)
CZGB 10Y	1.939	1.939	0.0
HUGB 10Y	3.19	3.19	0.0
PLGB 10Y	3.24	3.24	0.0

Equity indices (index)



	LAST	PREVIOUS	CHANGE (%)
PX	1103.3	1103.3	0.00
BUX	36401	36401	0.00
WIG	59015	59015	0.00

Regional insights

Turkish contagion in Central Europe lacks fundamentals

Central European currencies have faced negative spill-over effects from emerging markets when the dramatic depreciation of the Turkish lira caused a weakening of the regional currencies. Generally speaking, the Turkish economy is fundamentally very different and so it is hard to find reasons why investors should put the koruna, zloty and forint in one basket with the Turkish lira as it is evident from sharply higher correlations between CE currencies and the TRY (see the chart below).

Let's recall that the theory of financial contagion says there are two macroeconomic channels that can spread across the affected economies: trade and financial channels.

As far as the trade links of Central Europe with Turkey are concerned, the collapse of the lira could theoretically represent a relatively small threat**. The share of Czech or Polish exports of total exports to Turkey is about 0.8% and it is even less for Hungary (the ratio of exports to Turkey to GDP for the Central European countries is naturally even lower). In other words, only a very small part of the foreign trade of Central European countries can be actually affected by the dramatic depreciation of the lira or by capital controls applied in Ankara.**

If we focus on the possible financial channels of the contagion, there are more possibilities here. For example, it is considered dangerous if the economy that spreads the contagion has the same creditors as the country negatively affected by financial spill-overs. The data on who and how much has been borrowed in Turkey is not easy to find, but the Bank for International Settlements (BIS) statistics actually show that the most exposed are Spanish banks in Turkey. Only followed at a great distance by banks from France and the UK. This should not be a big reason for contagion to Central Europe, which does not need Spanish or French savings.

If we look at another financial channel of the contagion, which can also be dangerous – it could be the situation if banks that are owned by the Turkish financial sector are also owned by Central European banks. Here, too, there is no rational reason for the infection, because it is impossible to find an example of a large bank that at the same time owns banks both in Turkey and Central Europe.

Hence, to sum-up: ***we can hardly find serious fundamental reasons, why CE currencies should react to the contagion particularly generated by the Turkish lira, (which is extremely vulnerable currency from macroeconomic and political point of view). On the we can still imagine that the whole Central Europe will face significant sell-off, if there is sharp increase in global risk aversion and serious threat of another Eurozone's recession. But it should be another story.***

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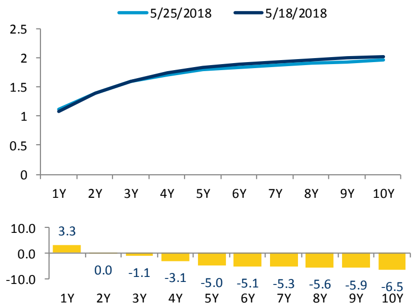
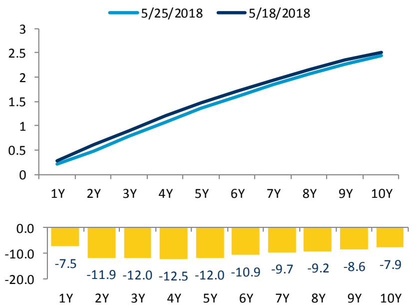
Interest-rate Swap Curves

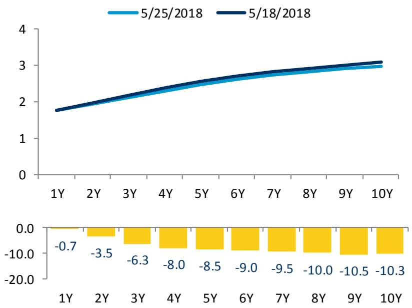
CZK *



HUF *



PLN *



* upper plot in each panel shows interest swap curve (%), lower plot shows change in interest rates in basis points (against previous Friday).

Calendar

Country	Time	Indicator		Period	Forecast m/m	Forecast y/y	Actual m/m	Actual y/y	Consensus m/m	Consensus y/y	Previous m/m	Previous y/y
PL	10:00	Unemployment rate	%	04/01/2018			6.3		6.3		6.6	

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