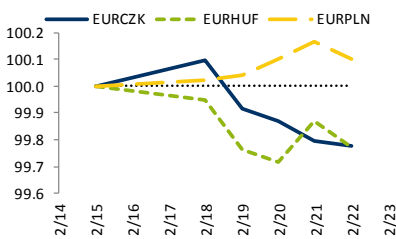




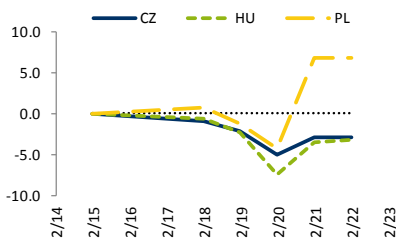
Friday, 22 February 2019

Forex markets (index)



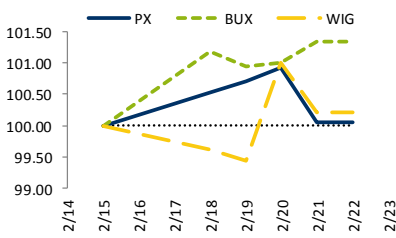
	LAST	PREVIOUS	CHANGE (%)
EURCZK	25.64	25.64	-0.02
EURHUF	317.4	317.7	-0.10
EURPLN	4.334	4.336	-0.06

Gov. bonds 10 Y (bps change)



	LAST	PREVIOUS	CHANGE (bps)
CZGB 10Y	1.901	1.901	0.0
HUGB 10Y	2.71	2.71	0.1
PLGB 10Y	2.75	2.75	0.0

Equity indices (index)



	LAST	PREVIOUS	CHANGE (%)
PX	1058.9	1058.9	0.00
BUX	40721	40721	0.00
WIG	59938	59938	0.00

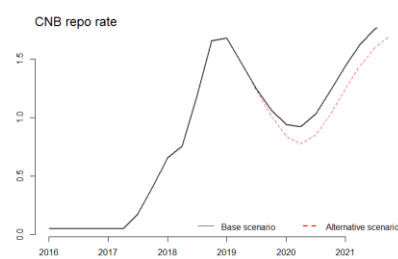
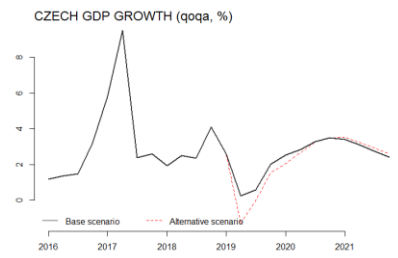
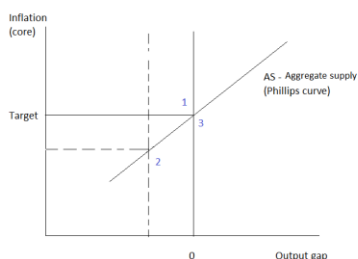
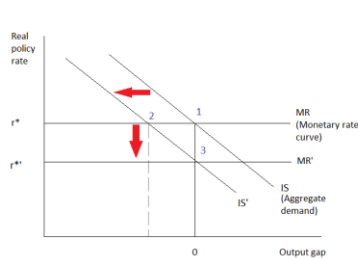
Regional insights

CNB's staff projection & hard Brexit: a rate hike?!

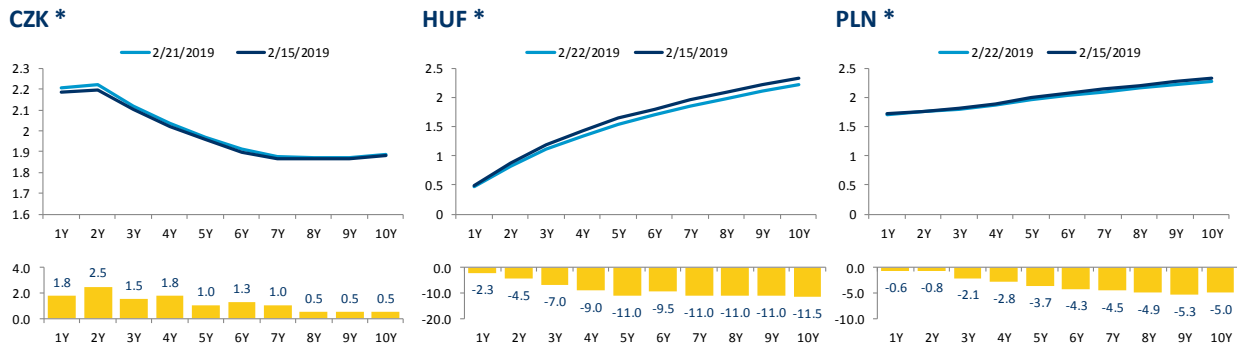
While Brexit negotiations have been in their final stage, markets have to assess not only disruptions coming from this process, but also policy-makers' reaction to different Brexit scenarios. In this respect it is interesting to read the last CNB staff projection, where a disorderly Brexit scenario was presented. Recall what the CNB projection exactly says about model-derived implications of a disorderly Brexit for the Czech economy: *'...the drop in demand for Czech exports from the UK and especially from the euro area, which is substantial overall, is reflected in a weaker koruna. Coupled with higher foreign prices, the weaker koruna increases the inflation pressures stemming from import prices. This results in a distinctly higher path of domestic interest rates relative to the baseline scenario of the forecast...'*. Hence, put it bluntly – in the CNB model world a hard Brexit leads to a rate hike!

This CNB's (staff not the Board) conclusion sounds strange to us, because in our 'model' world a hard Brexit would mean a negative demand shock and only a very negligible supply shock for the Eurozone and the Czech economy. Hence, an implied policy reaction from the CNB should be rather a rate cut. This should suggest not only a simple theoretical macro IS-AS model (see below), but also our alternative scenario drawn from our (BVAR) empirical model for the Czech economy. In the latter case we have defined a hard Brexit shock as a 25% drop in final demand for EU imports to the UK coupled with tightening of financial conditions in the EMU to a level of 2013 highs (exclusively through the widening of credit spreads). This – in our model - clearly translates into weaker GDP (growth) trajectory and sooner and deeper CNB's rate cuts in 2020 (see below on the right).

Hard Brexit & our model view (theoretical and empirical) for the Czech economy



Interest-rate Swap Curves



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

Calendar

Country	Date	Time	Indicator	Period	Forecast		Actual		Consensus		Previous	
					m/m	y/y	m/m	y/y	m/m	y/y	m/m	y/y
PL	02/22	14:00	Money supply M3	%					-0.9	9.4	2.6	9.2

Contacts

Brussels Research (KBC)			Global Sales Force		
Mathias van der Jeugt	+32 2 417 51 94		Brussels		
Peter Wuyts	+32 2 417 32 35		Corporate Desk		+32 2 417 45 82
Mathias Janssens	+32 2 417 51 95		Institutional Desk		+32 2 417 46 25
Dieter Lapeire	+32 2 417 25 47		France		+32 2 417 32 65
Dublin Research			London		+44 207 256 4848
Austin Hughes	+353 1 664 6889		Singapore		+65 533 34 10
Shawn Britton	+353 1 664 6892				
Prague Research (CSOB)			Prague		
Jan Čermák	+420 2 6135 3578		Prague (Equities)		+420 2 2142 4216
Petr Dufek	+420 2 6135 3560				
Bratislava Research (CSOB)			Bratislava		
Marek Gabris	+421 2 5966 8809				+421 2 5966 8820
Budapest Research			Budapest		
David Nemeth	+36 1 328 9989				+36 1 328 99 85

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