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EM: Inflation the most crucial aspect

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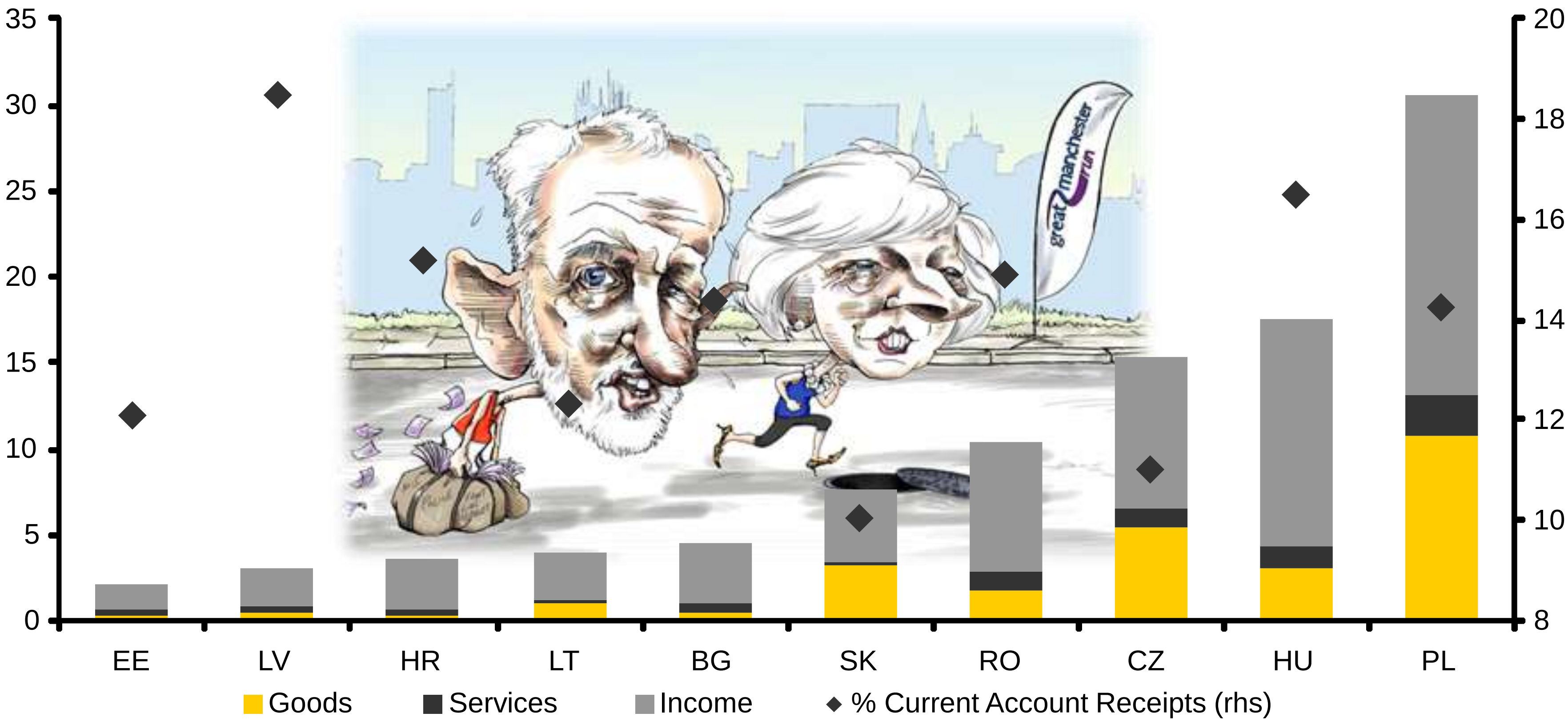
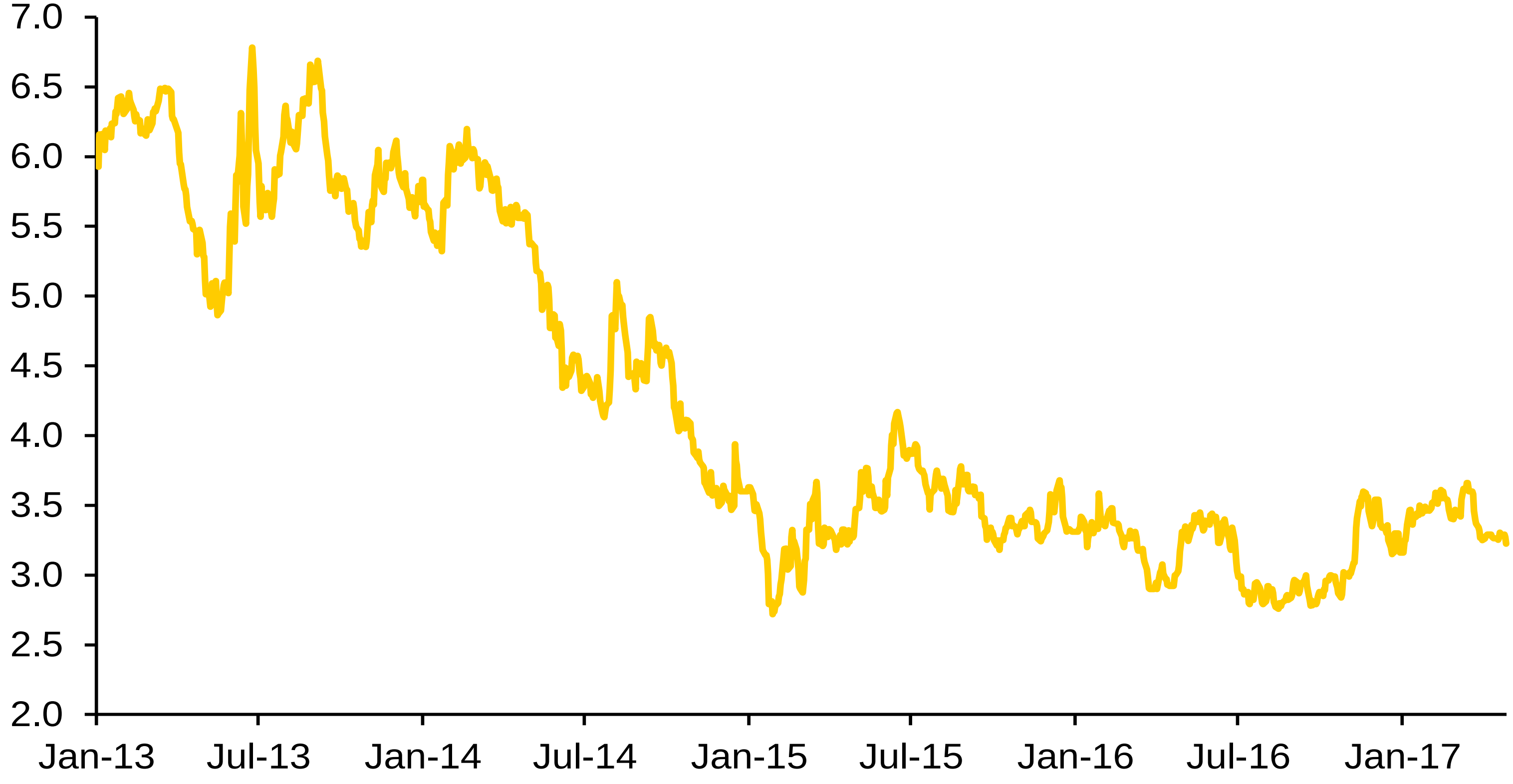
Current Account exposure to the UK



- Poland, Hungary and Romania have significant income and trade receipts from the UK
- A weaker GBP will ultimately affect the current a/c of these countries

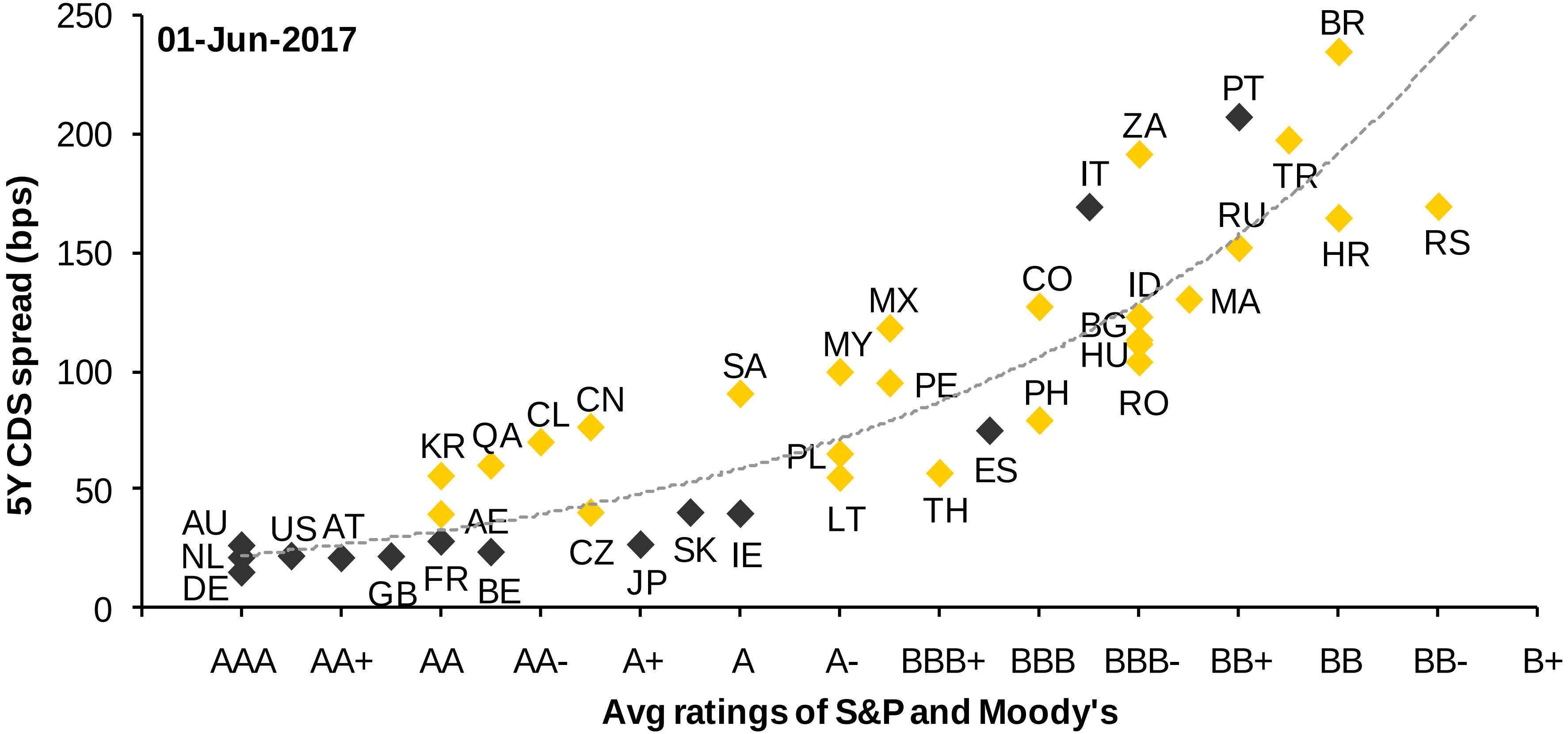
Source: Eurostat, Commerzbank Research

Last promise? Hungarian 10-year yield %



Source: Bloomberg

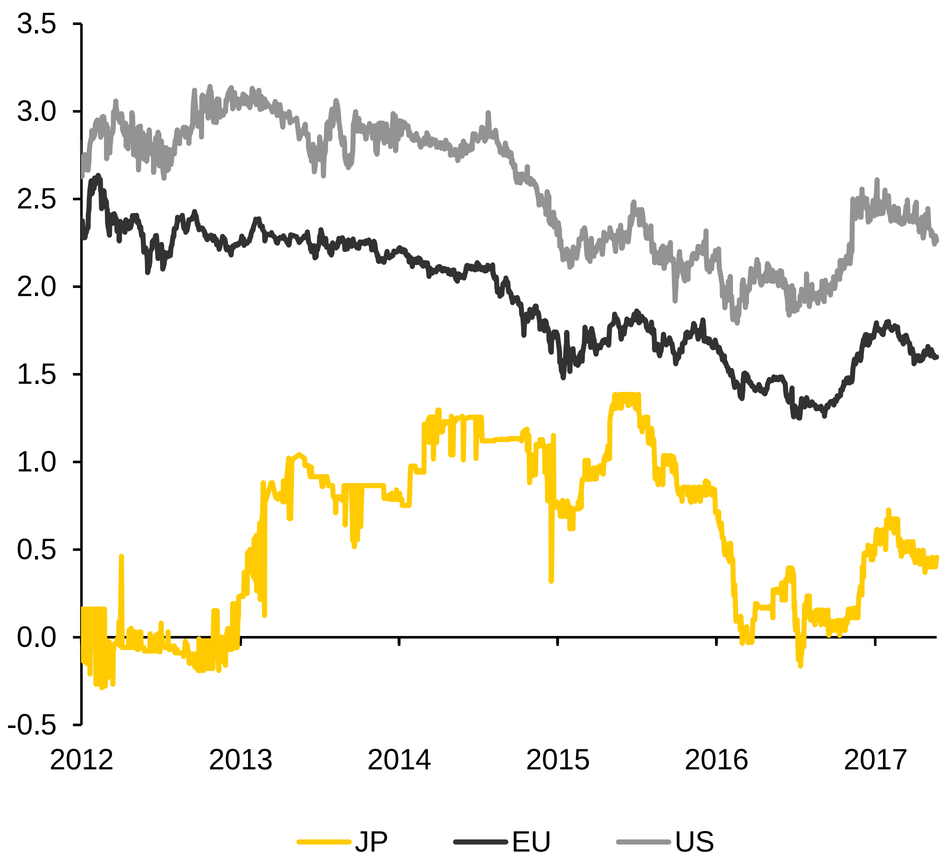
Ratings vs. CDS spreads: No glaring opportunities



Source: Bloomberg, Commerzbank Research

Japanification… but, ECB getting ready for tapering …

No sustained recovery of inflation expectations
Five-year inflation-indexed forward swap rate in five years' time

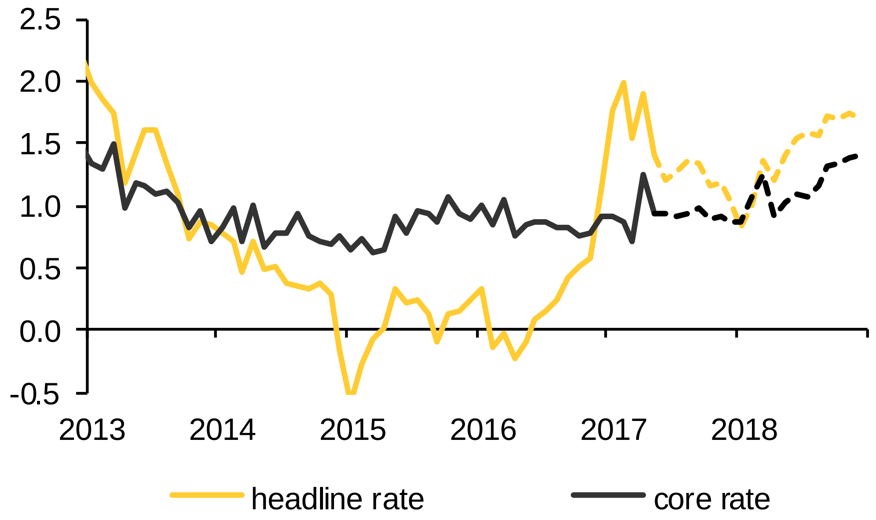


- Whilst economic growth may be robust in the near-term, inflation looks set to be well below the ECB's expectations from May onwards.
- Nor are inflation expectations likely to move on a sustained recovery path (chart).
- At the same time, the ECB is under pressure to gradually reduce its bond purchases in the course of 2018, as it would otherwise infringe upon the 33% issuer limit agreed at the beginning of the programme.
- Against this backdrop, the central bank looks set to taper the purchases from January 2018 onwards, though the exit should be gradual over a period of probably twelve months, due to the unsatisfactory inflation trend. Thanks to robust growth, however, the ECB should be able to sell the tapering of its bond purchases as fundamentally justified.
- To prepare the market, the ECB would have to give several months notice prior to the exit from its purchases. We continue to stick to our view that the announcement will be made at its meeting in September.

Source: Bloomberg

Euro zone: Inflation rate on the retreat again

Inflation rate will fall again later this year
Consumer price index (HICP), core rate: HICP ex energy, food, alcohol and tobacco, percentage change on year. Forecast: dashed lines.



Source: Eurostat, ECB, Commerzbank Research

- In April, headline inflation soared to 1.9% (chart left), largely led by the relatively late date of Easter. Unlike in 2016, the holiday-related price increase in package tours and hotel accommodation was not in March, but in April.
- In May, prices for package tours and hotel accommodation normalised, and consequently, the core rate fell to 0.9% and should remain at that level until year-end.
- Headline inflation, on the other hand, is on a downward trend, due to energy prices. Unlike in 2016, crude oil prices are, in our view, unlikely to inch up and should be flat until year-end 2017.
- We expect an increase of 1.4% in average annual consumer price inflation. The index excluding energy, food, alcohol and tobacco looks set to rise by 0.9%, like in 2016.

Source: Bloomberg, Commerzbank Research

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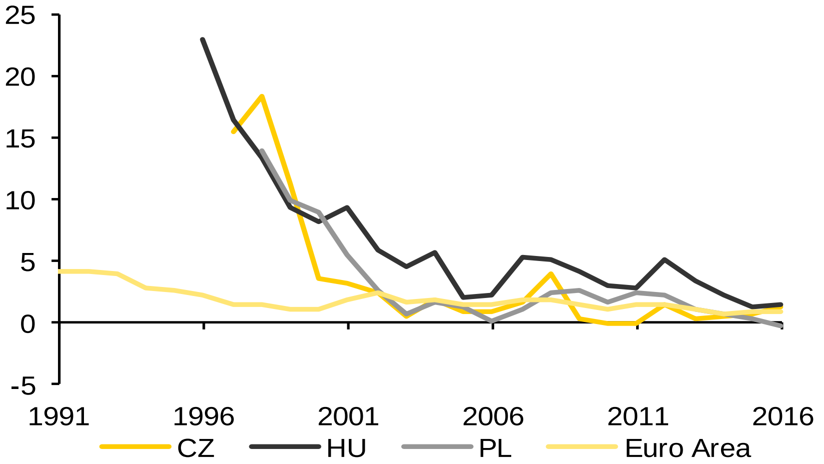
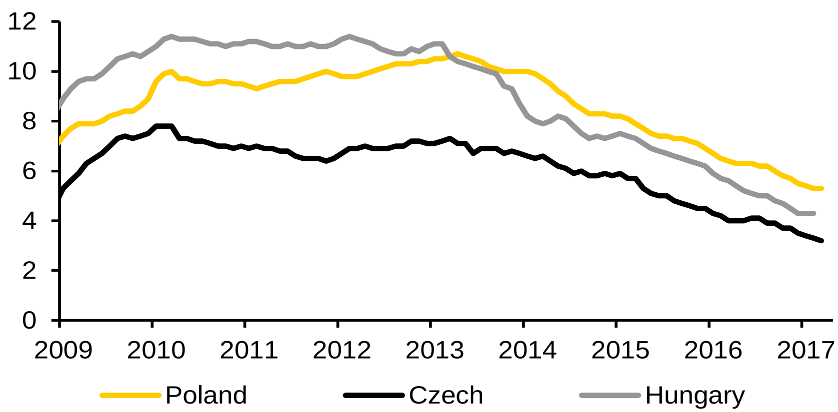
CE3 inflation: Converged with EU average

CE3 vs. Eurozone core HICP



CE3 unemployment rates, %

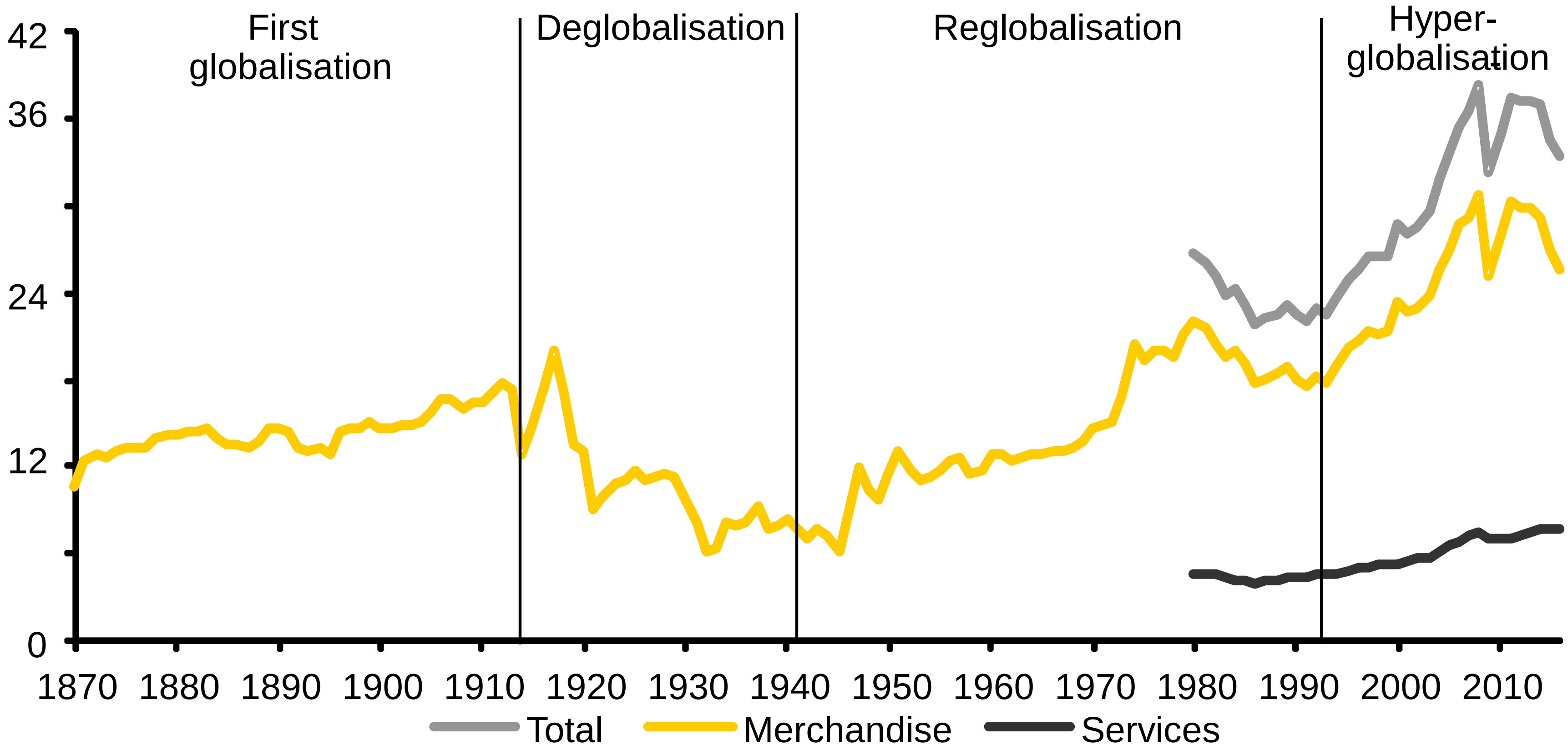


- ➢ CEE inflation virtually disappeared since 2014, except where there had been sharp FX depreciation (Turkey, Russia, S Africa).
- ➢ Where inflation went down, it happened despite steadily falling unemployment rates and steady wage growth.
- ➢ This is why there are question marks around the narrative that inflation is ‘finally’ picking up because of tightening labour markets.
- ➢ Also, the timing of upturn coincides across disparate economies and disparate regions.

Source: Bloomberg, Commerzbank Research

Hyperglobalisation

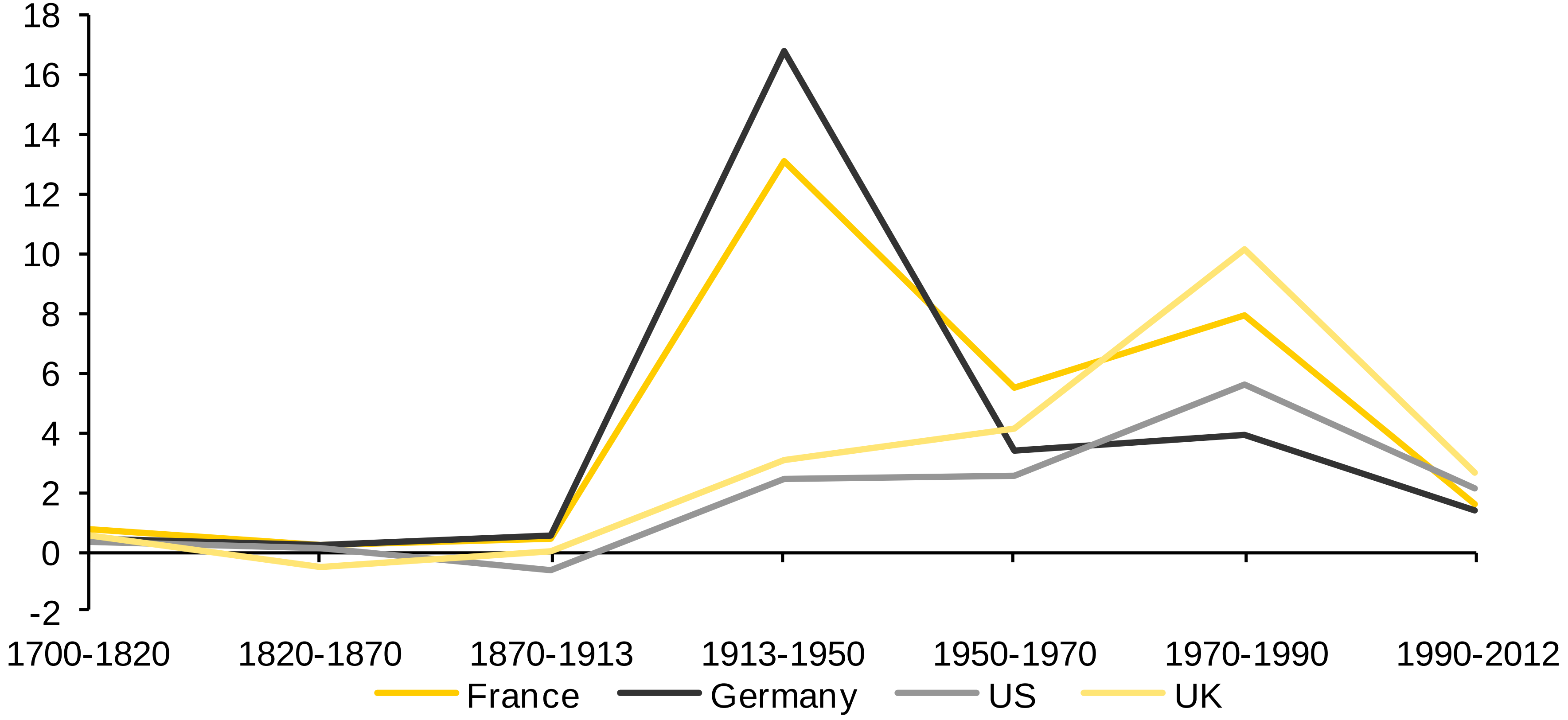
Exports in US$ trn (constant dollars)



- Supply-chain indivisibilities, and globalisation, could be wiping out price arbitrage

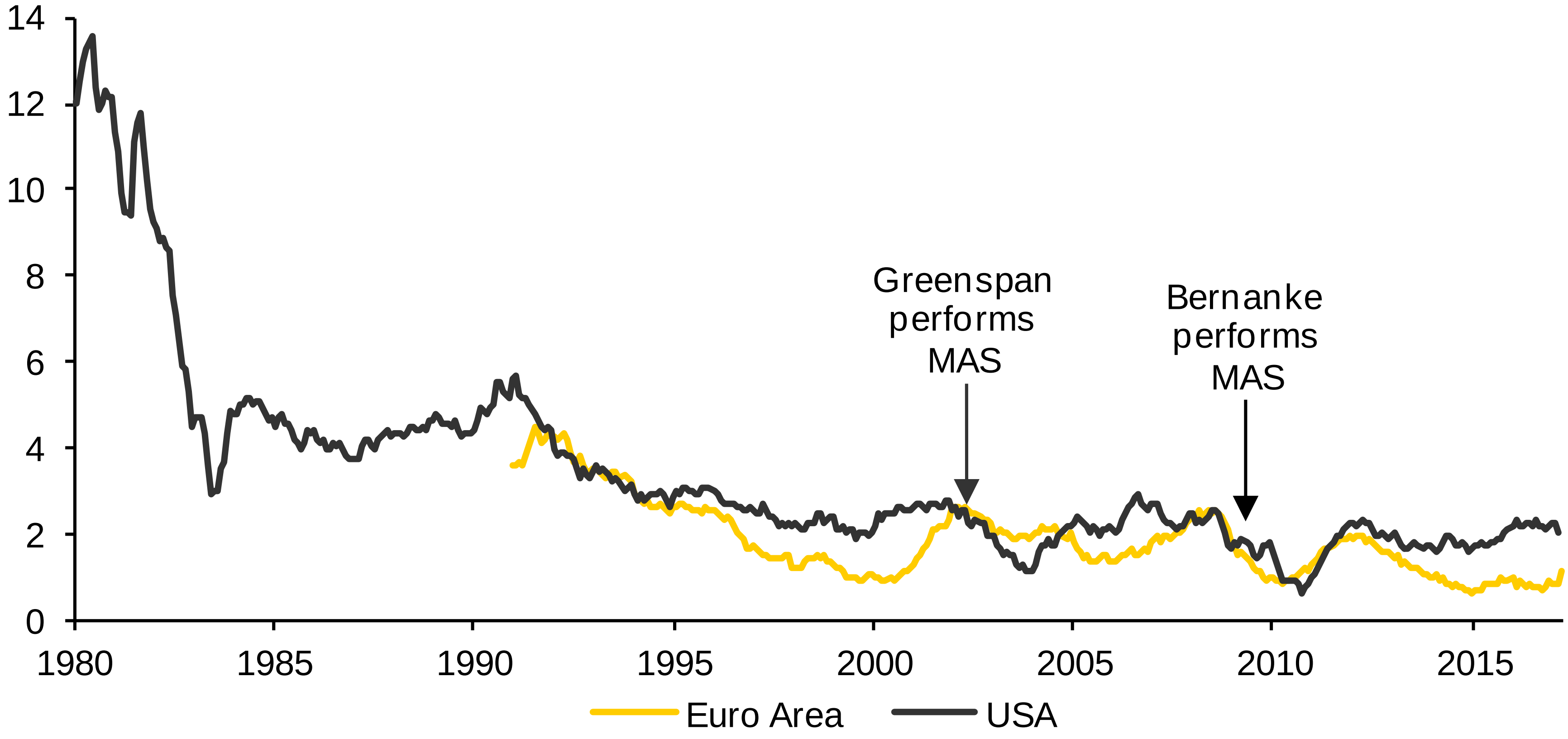
Source: Peterson Institute for International Economics, WTO, Commerzbank Research

Inflation since the Industrial Revolution



Source: Thomas Picketty: Capital in the Twenty-First Century

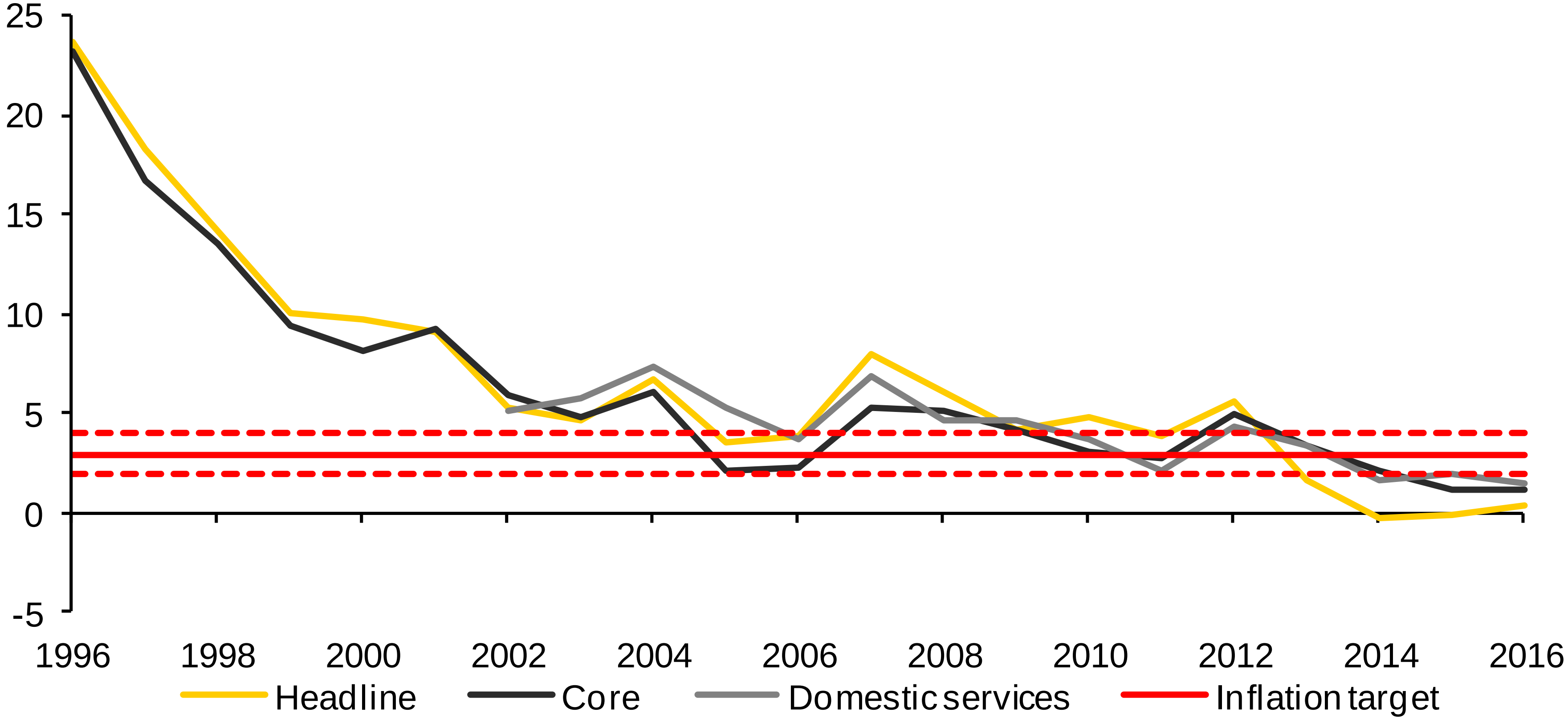
US and Euro Area Core CPI – the long view



Source: Bloomberg, EuroStat, Commerzbank Research

Did Central Banks really win the fight against inflation?

Hungarian CPI: headline, core and domestic services, y/y %

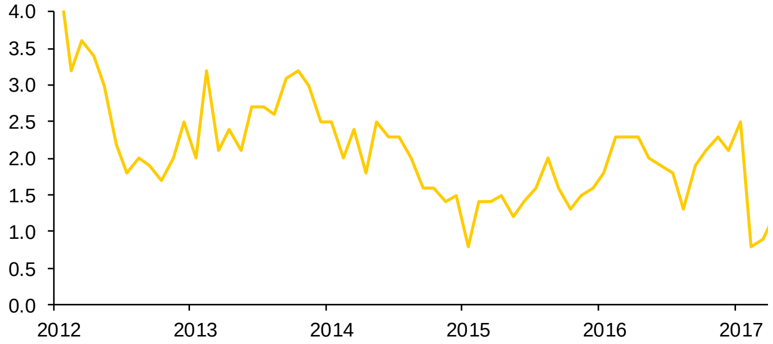


- Hungarian inflation has proceeded from far above inflation target in the early-2000’s, to within target since 2010, to now below target. This is not about headline drivers such as commodity prices or utility tariffs – core categories and non-tradables, such as domestic services, show the same disinflation trend.

Source: Bloomberg, CEIC, Commerzbank Research

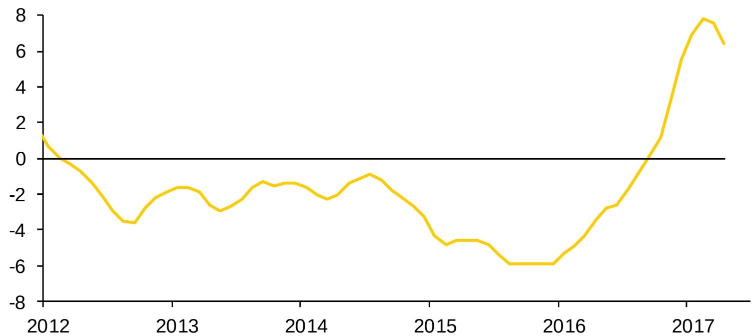
Chinese/Indian inflation also on downtrend

China: Inflation rate has fallen to 8-years low
Consumer Price Index, year-on-year change in per cent



Sources: Bloomberg, Commerzbank Research

China: Producer price rose sharply until a quarter ago
Producer Price Index, year-on-year change in %

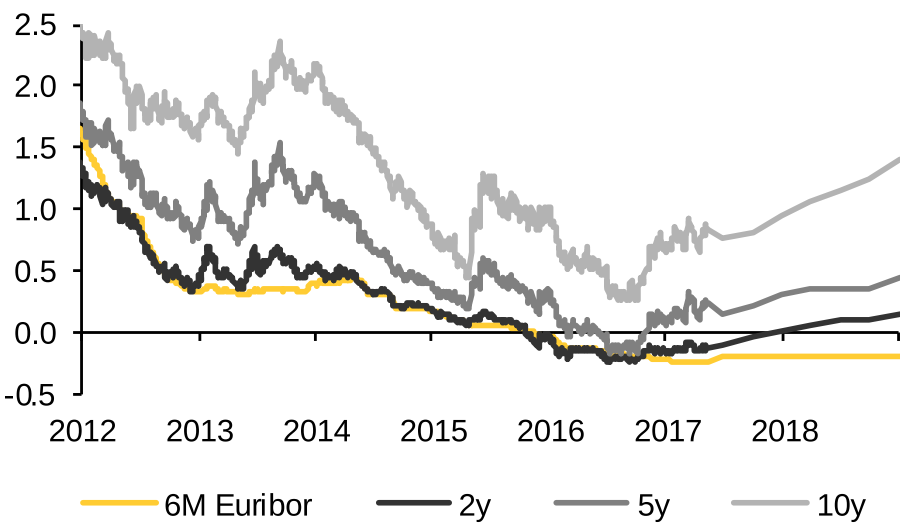


Sources: Bloomberg, Commerzbank Research

- In February, the inflation rate fell to xx%. The downward trend in inflation is thus continuing. In the medium term, the inflation rate should settle below 2%.
- The price slump in February was not limited to individual goods. Consequently, we do not believe the sharp rise in producer prices will be lasting.
- The weak inflation could be a warning sign, indicating a drop in domestic demand.
- The inflation rate will continue to fluctuate strongly from month to month.

Consequences of ECB policies: steeper yield curves

Swap curve moderately steepening from long end
Six-month Euribor, two-, five-, ten-year swap rates
in percent. Forecasts as of May 2017.

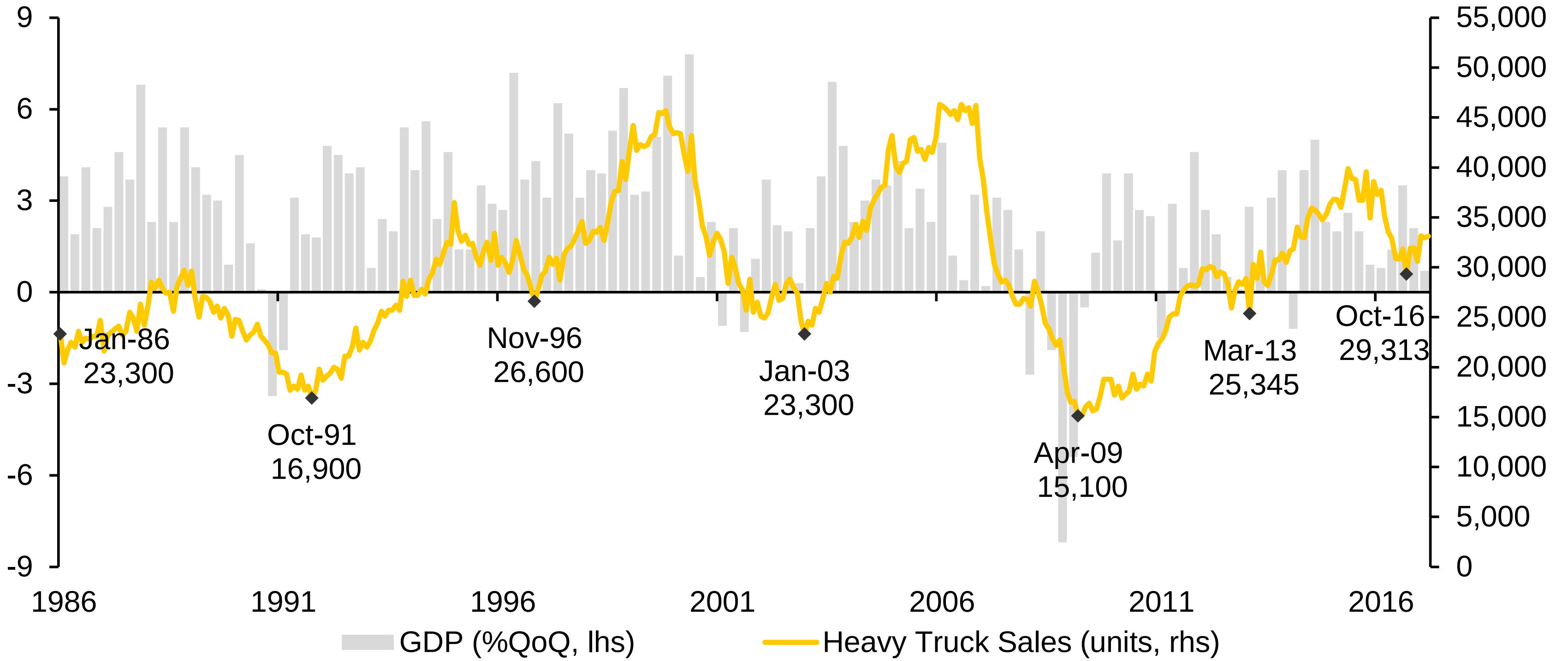


Soruce: Bloomberg, Commerzbank Research

- Swap rates should rise moderately in the medium term given the prospect of fewer bond purchases by the ECB next year.
- At the same time, the liquidity of German securities in particular remains tight and there is still a shortage of Bunds, which can be used as collateral for general repo transactions.
- Increased Bundesbank purchases in the short maturity segment since the beginning of the year have strengthened this trend. As a result, swap spreads have widened significantly while nominal yields have remained low.
- We expect the imbalance between supply and demand to improve only marginally in the foreseeable future.
- Bund-asset swap spreads thus remain structurally wide. A renewed strong fall of swap rates has become less likely, especially as other central banks – more than the ECB - are considering a possible exit from their loose monetary policy.

What about growth itself? The US has enjoyed a long upswing

US truck sales vs. GDP growth

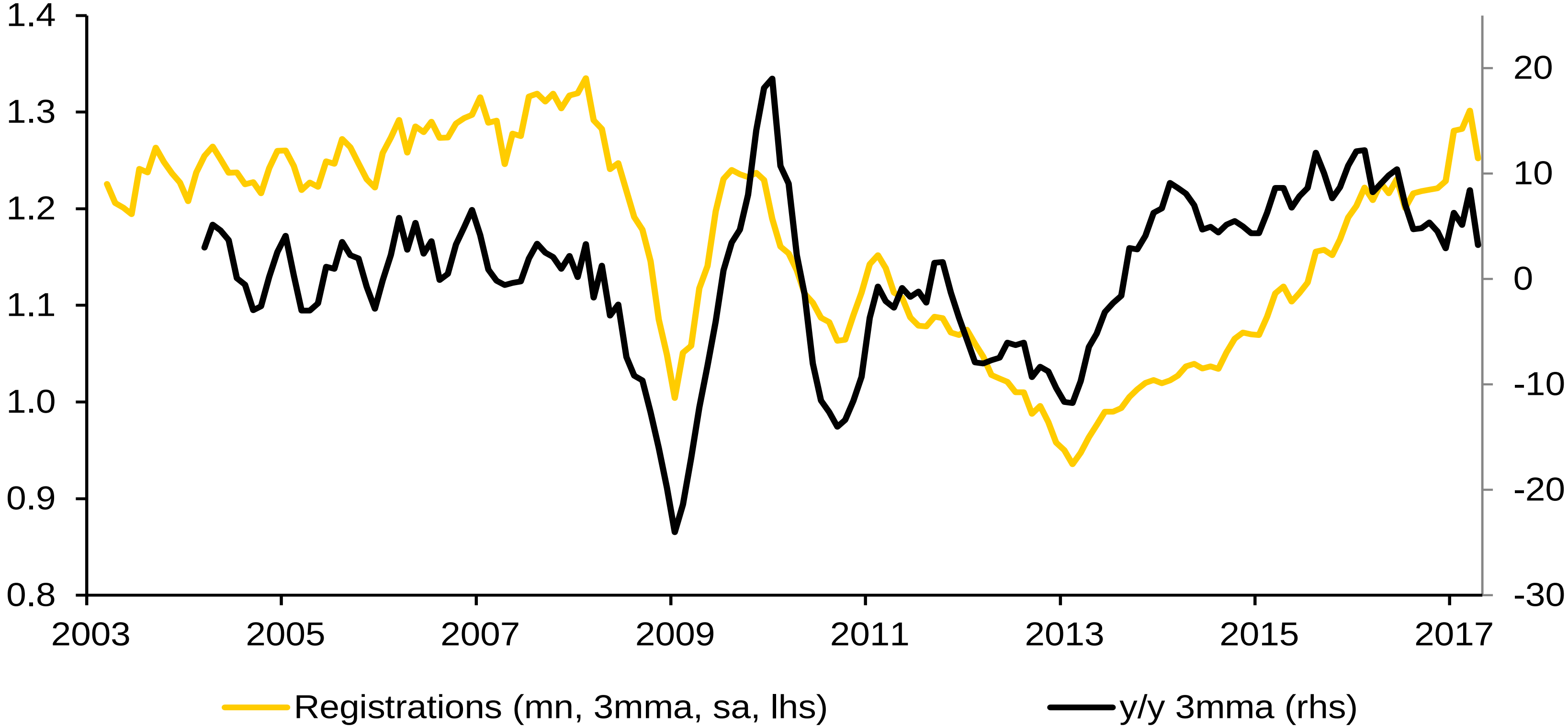


➢ …but this is an atypical expansion, hence normal rules may not apply.

Source: CEIC, Commerzbank Research

…so has the European auto industry since the EZ debt crisis

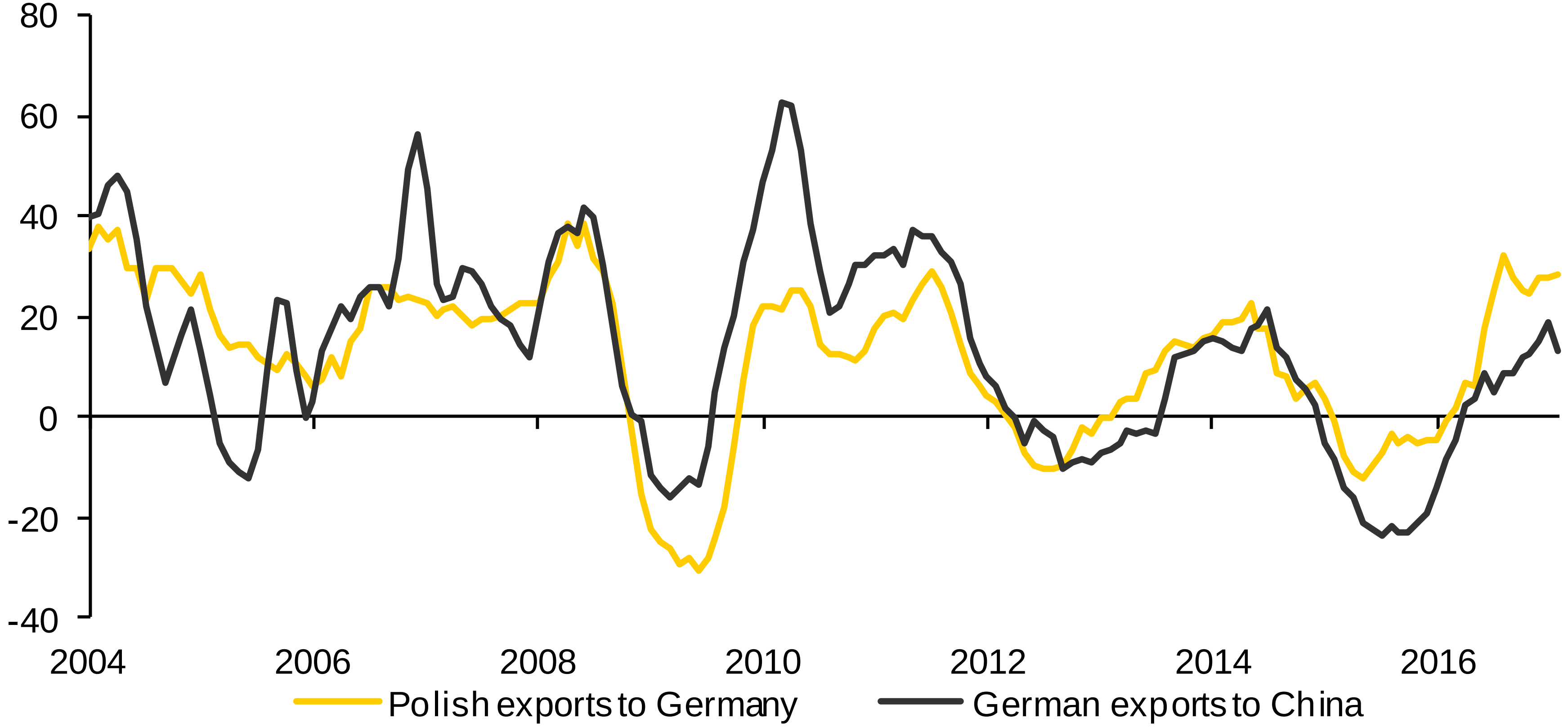
EU27 new car registrations



- The EU auto industry has been going strong since 2013 after the economy pulled out of the debt crisis shock.
- Now, demand has normalised back at pre-Lehman levels; year-on-year growth appears to be peaking.

Source: Bloomberg, Commerzbank Research

CEE quite exposed to China



- CEE is significantly exposed to China and the global cycle via “indirect” exports.
- Breakdown of the German recovery confirms significant tailwind from external demand, esp. China.

Source: CEIC, Commerzbank Research

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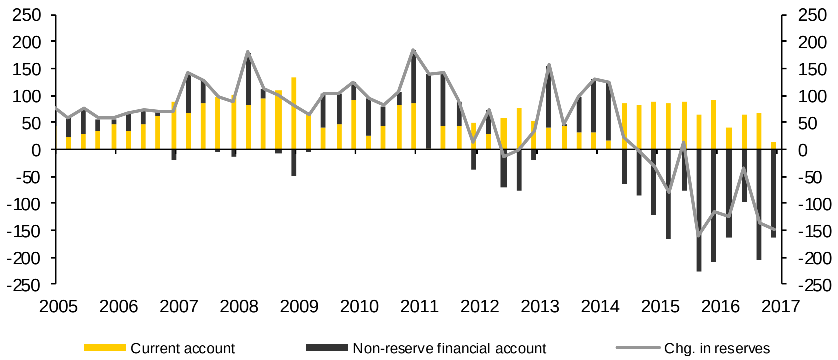
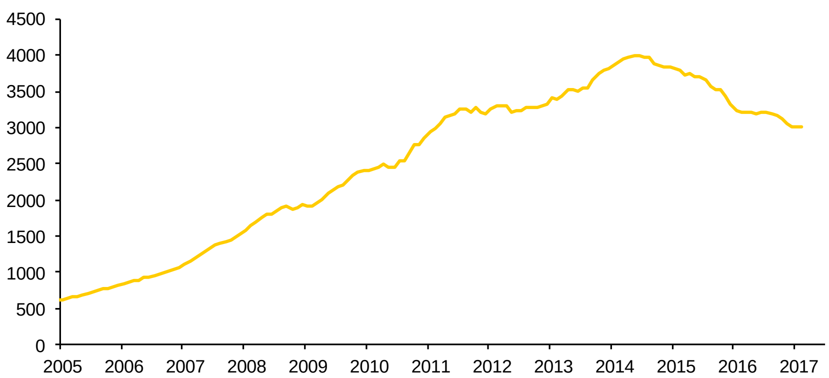
China: Capital flight stopped, but at what price?

Capital outflow was higher than current account surplus...
in $bn.



Source: Bloomberg, Commerzbank Research

... FX reserves stabilising of late
In $bn.



Source: Bloomberg, Commerzbank Research

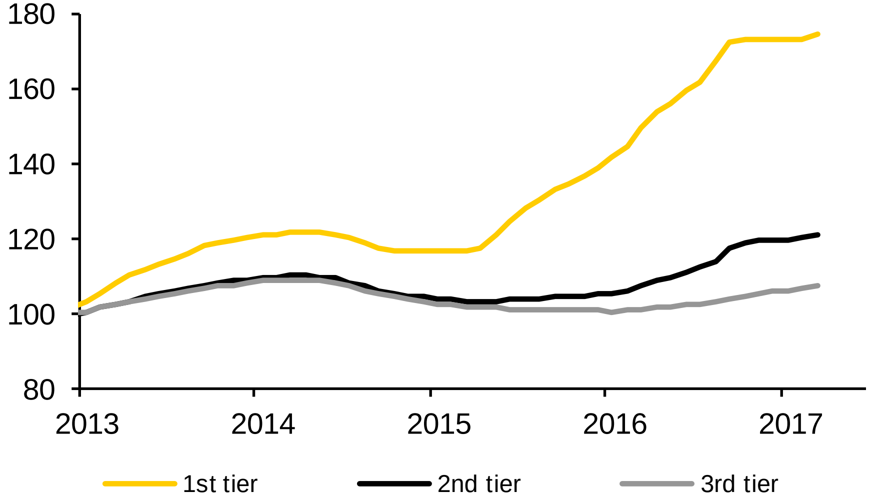
- Since 2014 China has seen an accelerated flight of capital. The deficit in the capital account could not longer be financed by surpluses in the current account and has lead to a melting of the currency reserves of the central bank (PBoC).
- In the meantime, the measures decided by the government to prevent capital exports is having an effect. The outflow of PBoC currency reserves has stopped.
- However, this policy has its price:

  (1) The administrative prevention of capital outflows has shaken the prospect of further liberalisation of capital movement in the medium term and could undermine the willingness of the rest of the world to invest in China in the long term.

  (2) The problem of domestic overinvestment and its consequences (overcapacities, bubble-like circumstances on the housing market, excessive debt levels) are being cemented; surplus savings cannot be invested abroad so easily.

China: House price boom ends and now critical phase lies ahead!

House prices have recently decelerated
New home prices, December 2011=100.

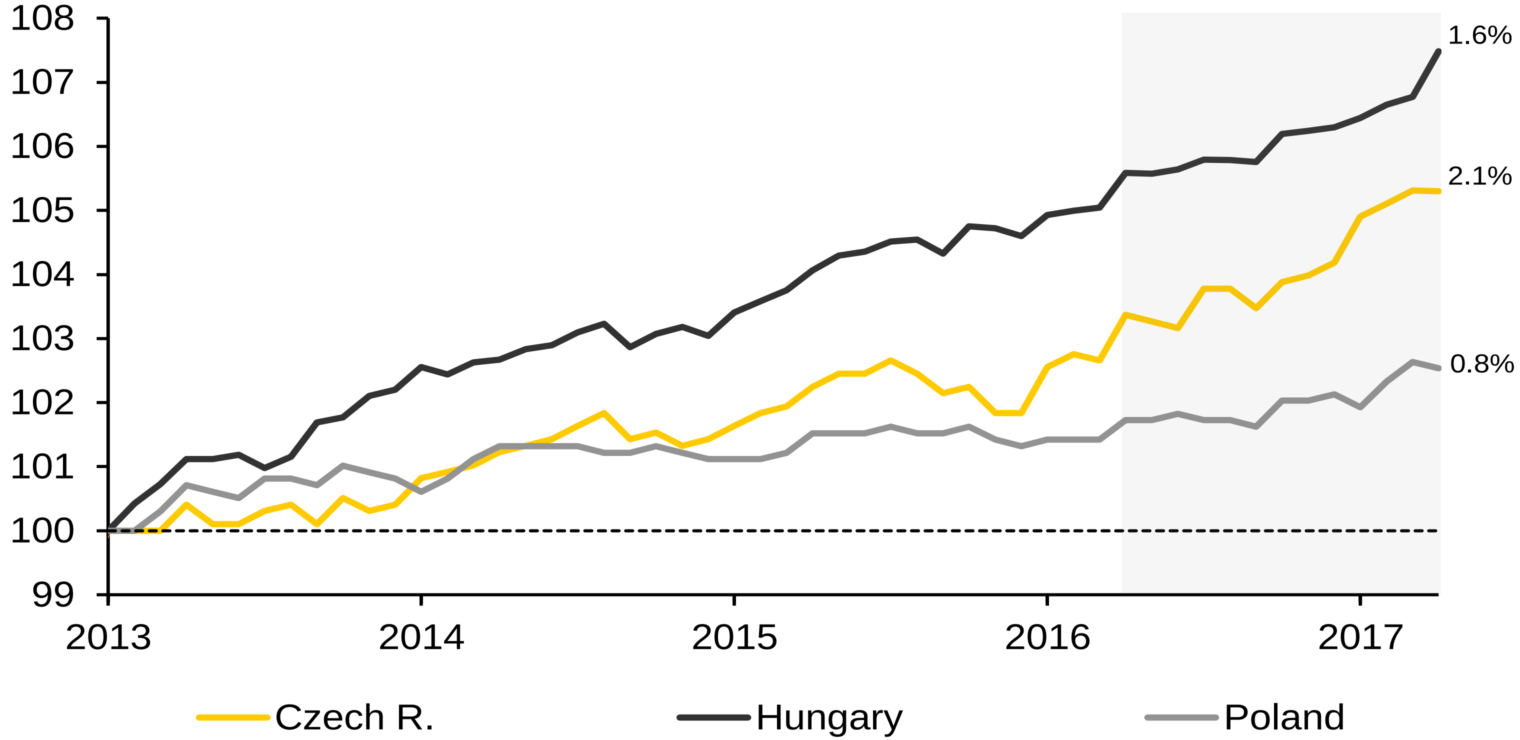


Source: National Bureau of Statistics, Commerzbank Research

- The measures decided by the government in October 2016 to slow the housing market are having a visible impact. Housing prices in the first-tier cities have stabilised at a high level, prices in the second and third-tier cities are rising only moderately. The systemically dangerous housing boom has been stopped for now.
- However, the most dangerous phase is now beginning. A dip in housing prices (like in 2014) would presumably be tolerable but a sharp fall could lead to a self-reinforcing housing crisis, but could imply systemic risk for China‘s banking system.
- We do not expect such extreme scenarios but to avoid this, China‘s government will be forced to continue its strong regulation of capital outflows.

EM inflation outlook

HICP excl. energy and unprocessed food, indexed (Jan 2013=100)

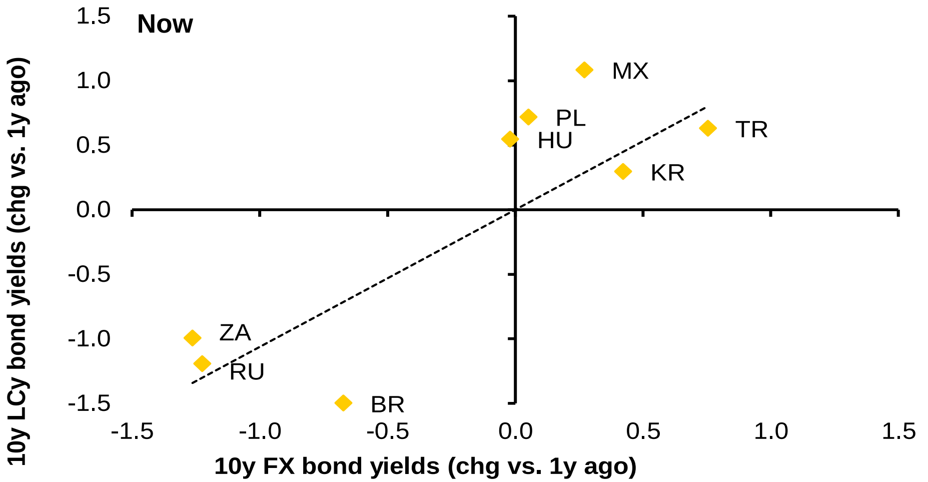


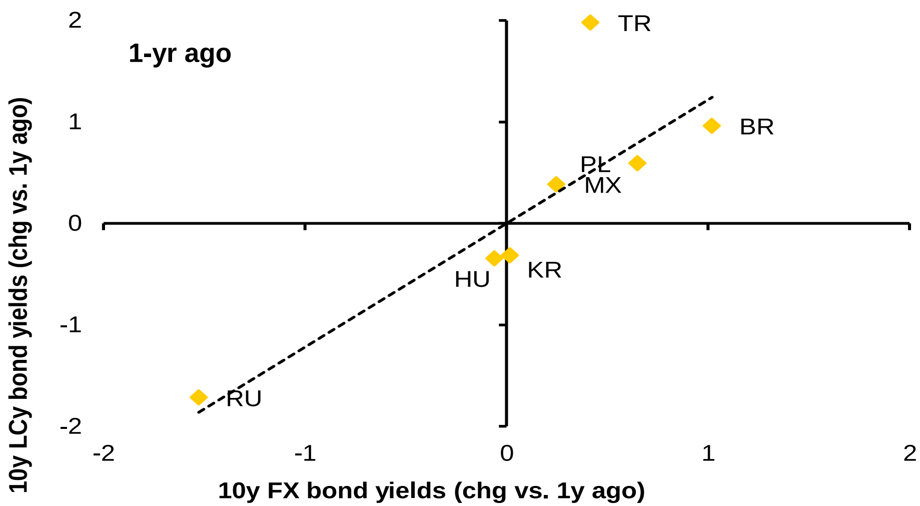
- There are question marks around the narrative that inflation is “finally” picking up because of tightening labour markets.
- Year-on-year readings of the past 6 months are not a reliable guide.
- Core HICP *level* is a better indicator: when we fit trends to the past year’s data, it does not appear that CE3 countries are necessarily heading back towards inflation targets.

Source: EuroStat, Commerzbank Research

The movement of yields during the years of spread compression

Hard ccy (x-axis) vs. local ccy (y-axis) 10-yr yields, chg from yr ago

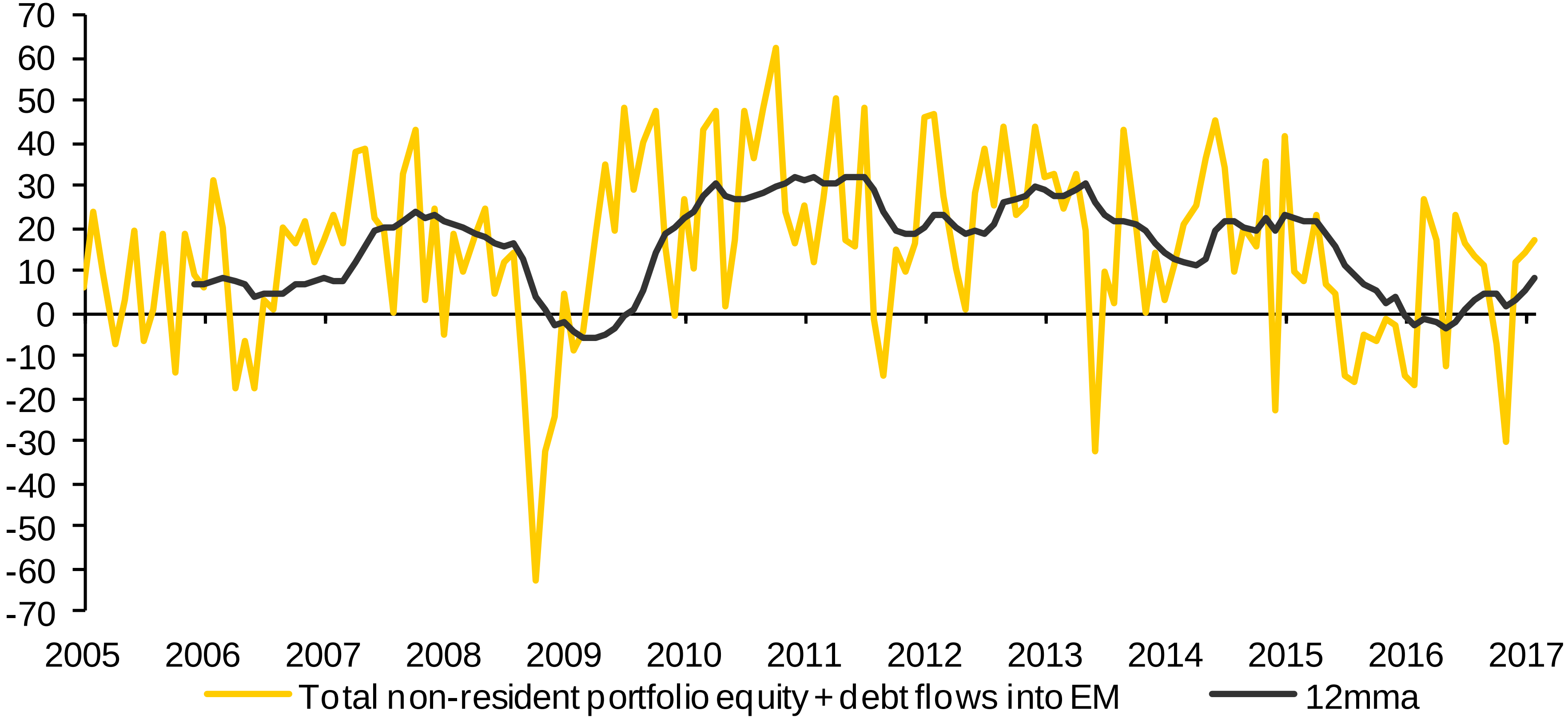




- Strong one for one movement of local bond yields in correspondence with hard currency bond yields.
- Charts show now vs. a year ago and a year ago vs. 2-years ago. Not much changed, except with Turkey and Brazil.
- This hints at global disinflation as a probable root cause.
- In a perverse way then, its not so much central bank liquidity amount, but the *failure* of CB's to stop disinflation, which has been key for EM performance.

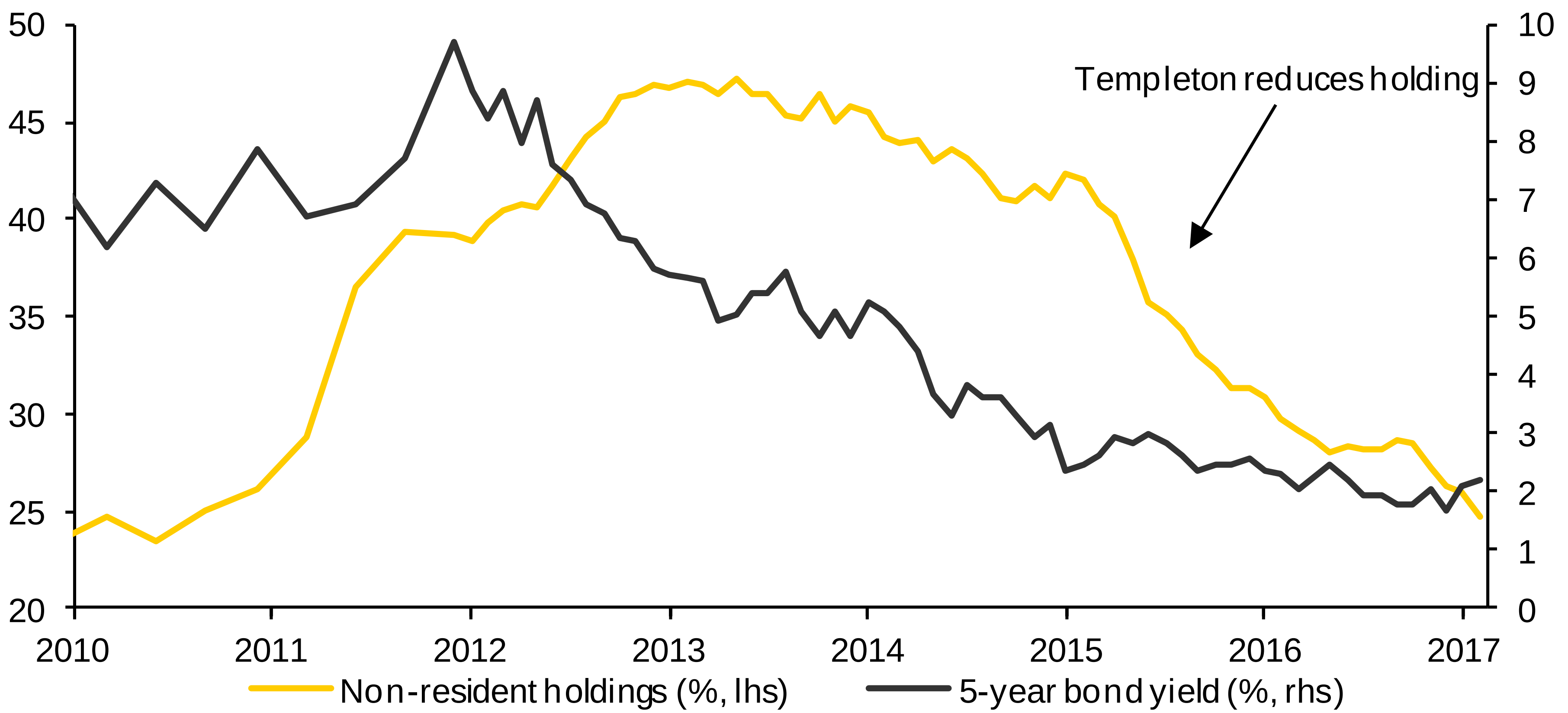
Source: Bloomberg, Commerzbank Research

Capital inflows into EM – huge wall of money?



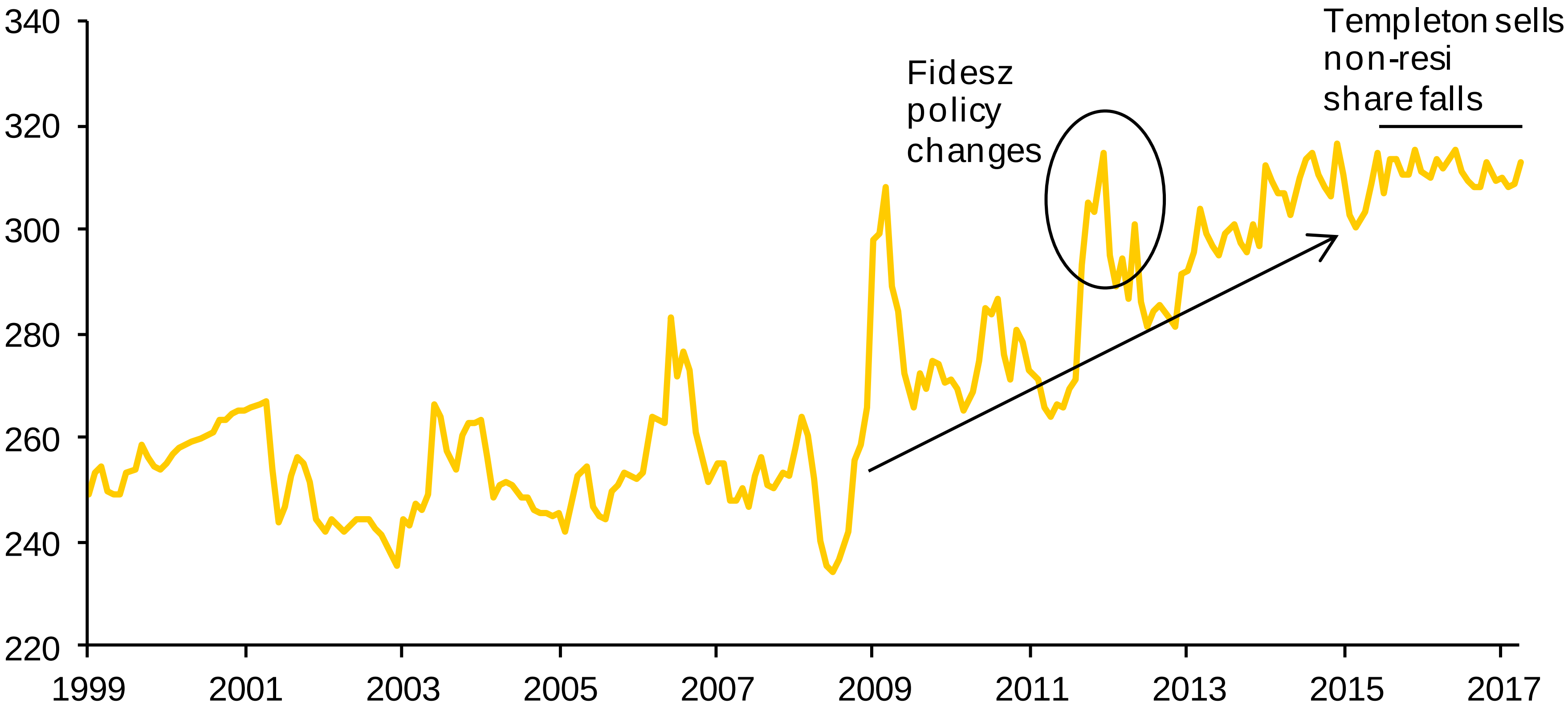
Source: IIF, Commerzbank Research

Hungary: Do big buyers/sellers matter?



Source: Government Debt Management Agency, Commerzbank Research

Longer-term trend in EUR-HUF – rising since debt began to fall

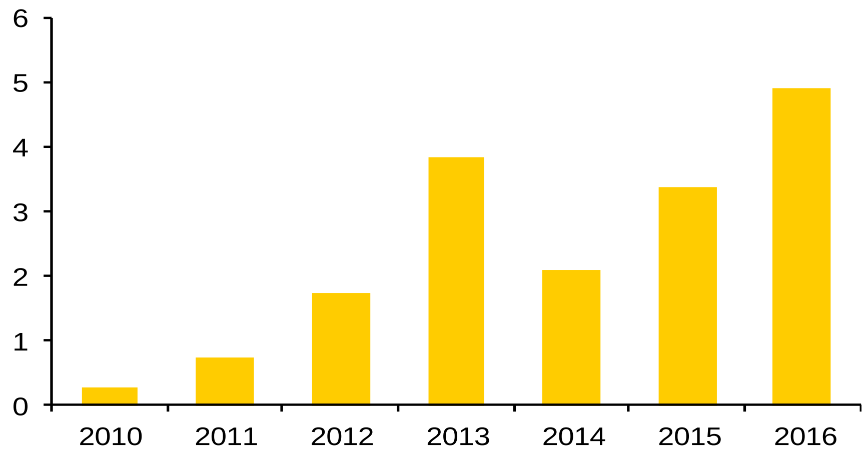


- HUF has continuously weakened even as fundamentals improved. Rates better reflect the improvement in credit quality.
- EUR-HUF had to move in a manner that the current account could widen to counter/cover external liabilities.

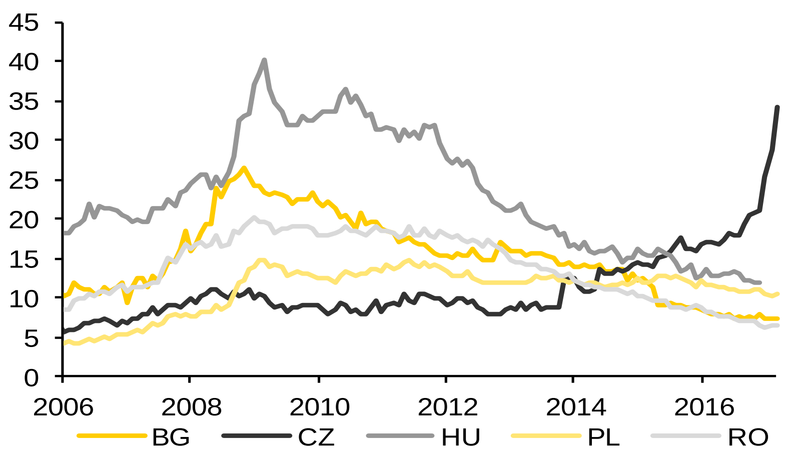
Source: Bloomberg, Commerzbank Research

Hungary: Structural factors improved leading to upgrade

Current Account (%/GDP)



Financial sector's FX liabilities (%/GDP)

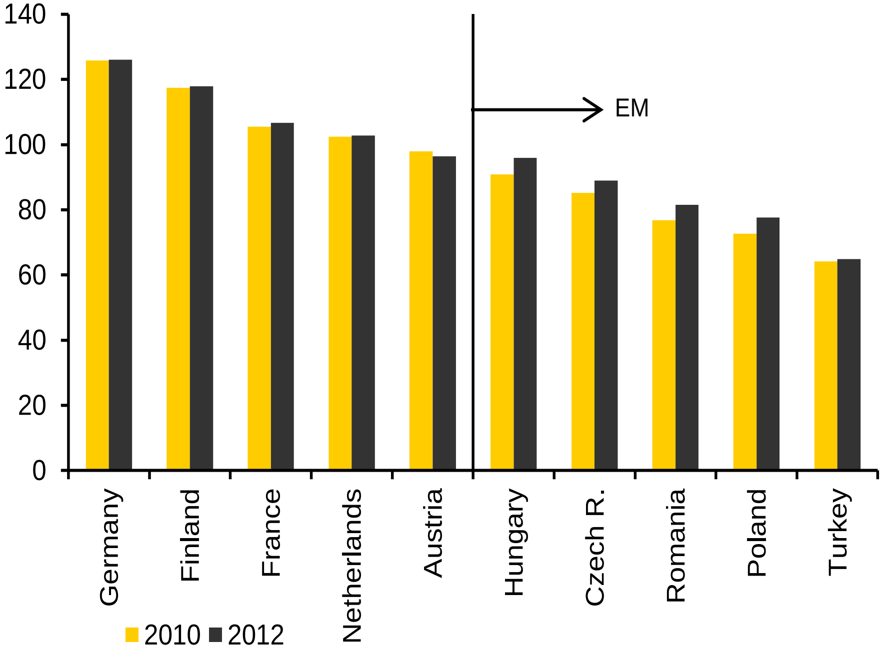


- Hungary managed to reduce its external debt from 140% of GDP to 100% in gross terms and 45% in net terms
- NBH's policy of cutting rates during a supportive risk environment managed to lower rates and weaken the HUF to competitive levels despite high external debt
- Now, the Current Account has buffers (5% of GDP, forecast to average 4% surplus over 2017-18), which is forint positive
- Hungarian financial sector FX liabilities down from USD 47bn in 2009 to USD 11bn now.
- We expect NBH to hold easiest monetary stance within CEE
- The jump in Czech liabilities is because of speculation ahead of exit from FX cap.

Source: CEIC, Commerzbank Research

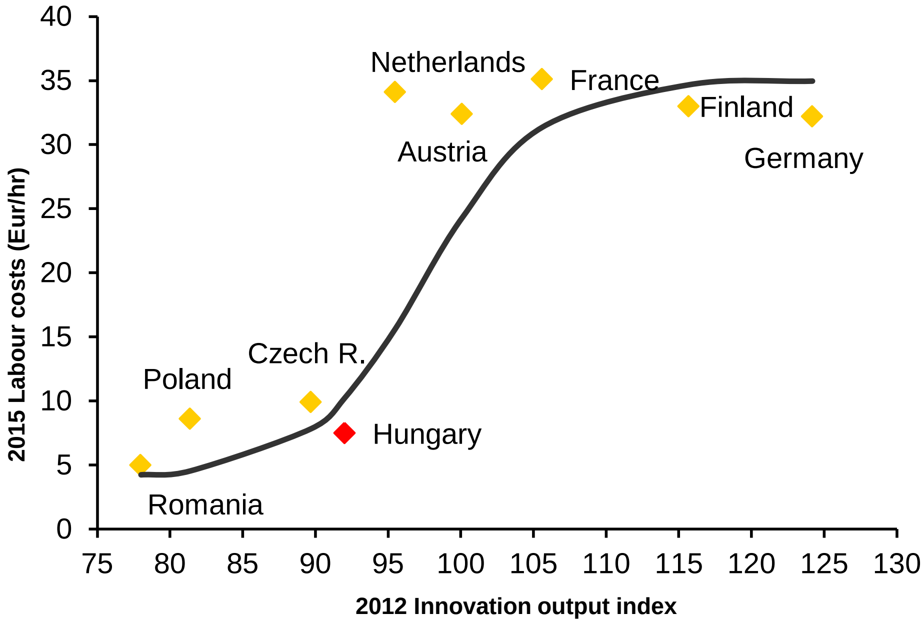
Hungary: the most innovative in CEE

Hungary most innovative in EM group



Source: EC, Commerzbank Research

Wages and innovation output score correlated

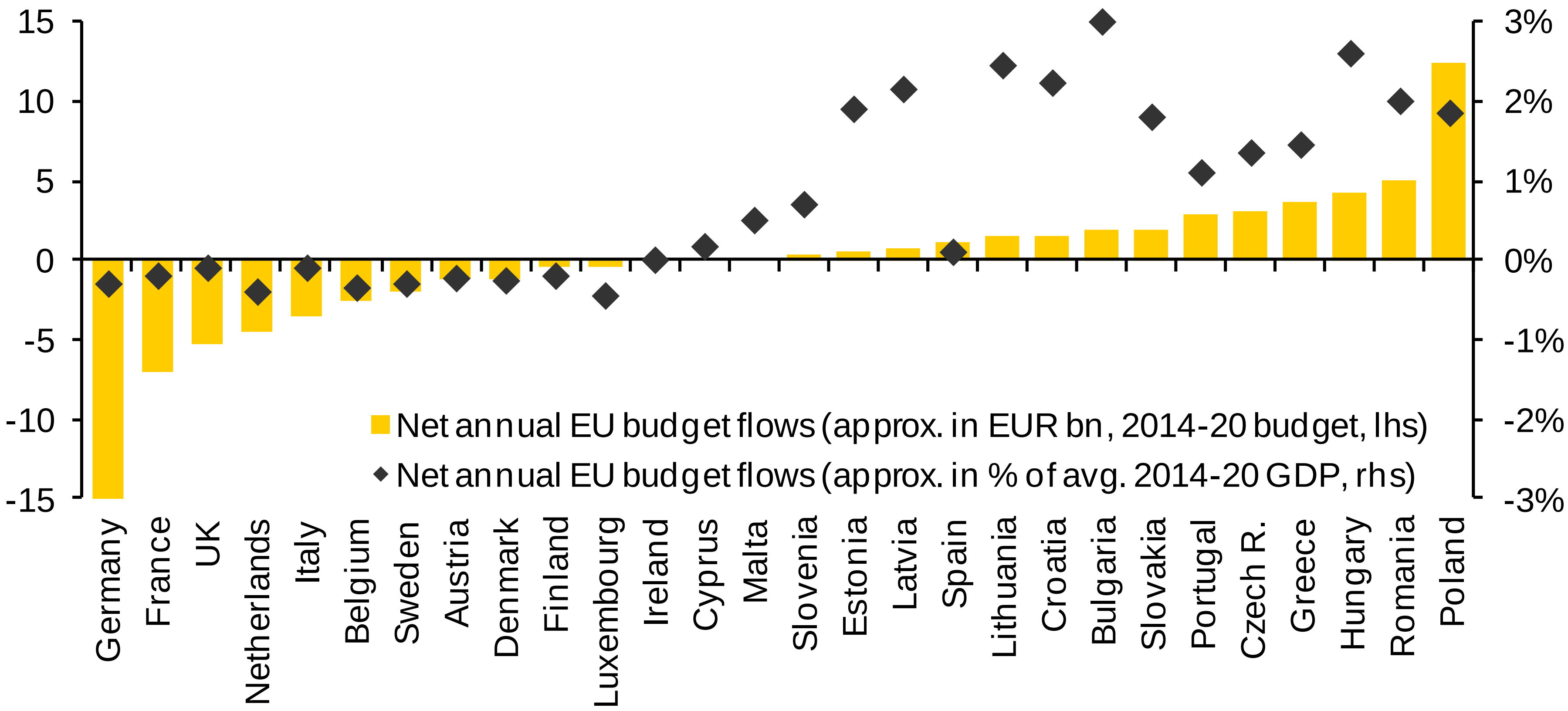


Source: Eurostat, Commerzbank Research

- Hungary's sizeable pool of highly-skilled qualified engineers distinguishes the labour force: this ultimately reflects in innovation capability (relative to wages, which are still low) – corporates across the board highlight this as their main competitive advantage when operating from Hungary. We also find independent corroboration at the macro level through the EC's "innovation output scores": this index is calculated by aggregating components such as the patent-intensity of knowledge sectors, employment generation in knowledge-intensive and innovative sectors, plus the sectoral trade balances of high-tech and higher value-added industries. Is Hungary on the 'cusp' of wage take-off?

Additional charts

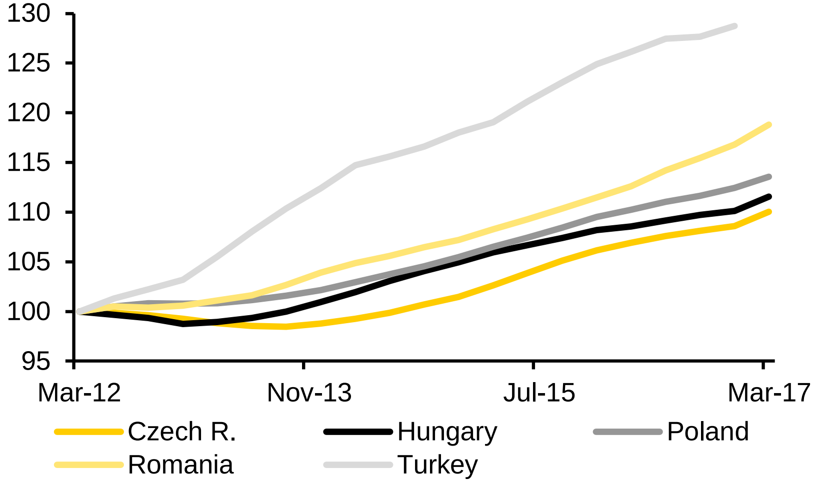
EU funding exposure: proxy for Brexit exposure



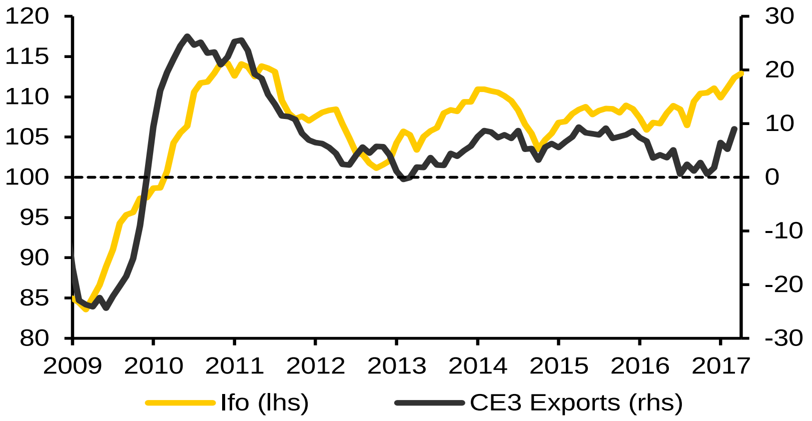
Source: European Commission, Commerzbank Research

CEE: Growth picked up strongly in Q1

Real GDP levels (sa, 2012Q1=100)



German ifo vs. CE3 aggregate exports y/y



- PMIs improving since Q4 driven by better German orders.
- The upswing gained momentum in Q1; Hungary a particular beneficiary.
- But Q1 enjoyed technical boosts from easter timing : correlated upswing seen across the region, including in Russia and Turkey.
- The auto industry was a major driver. Car registrations spiked in late Q1.
- Auto industry capacity expansion plans are a crucial ingredient for 2017.

Source: Bloomberg, CEIC, Commerzbank Research

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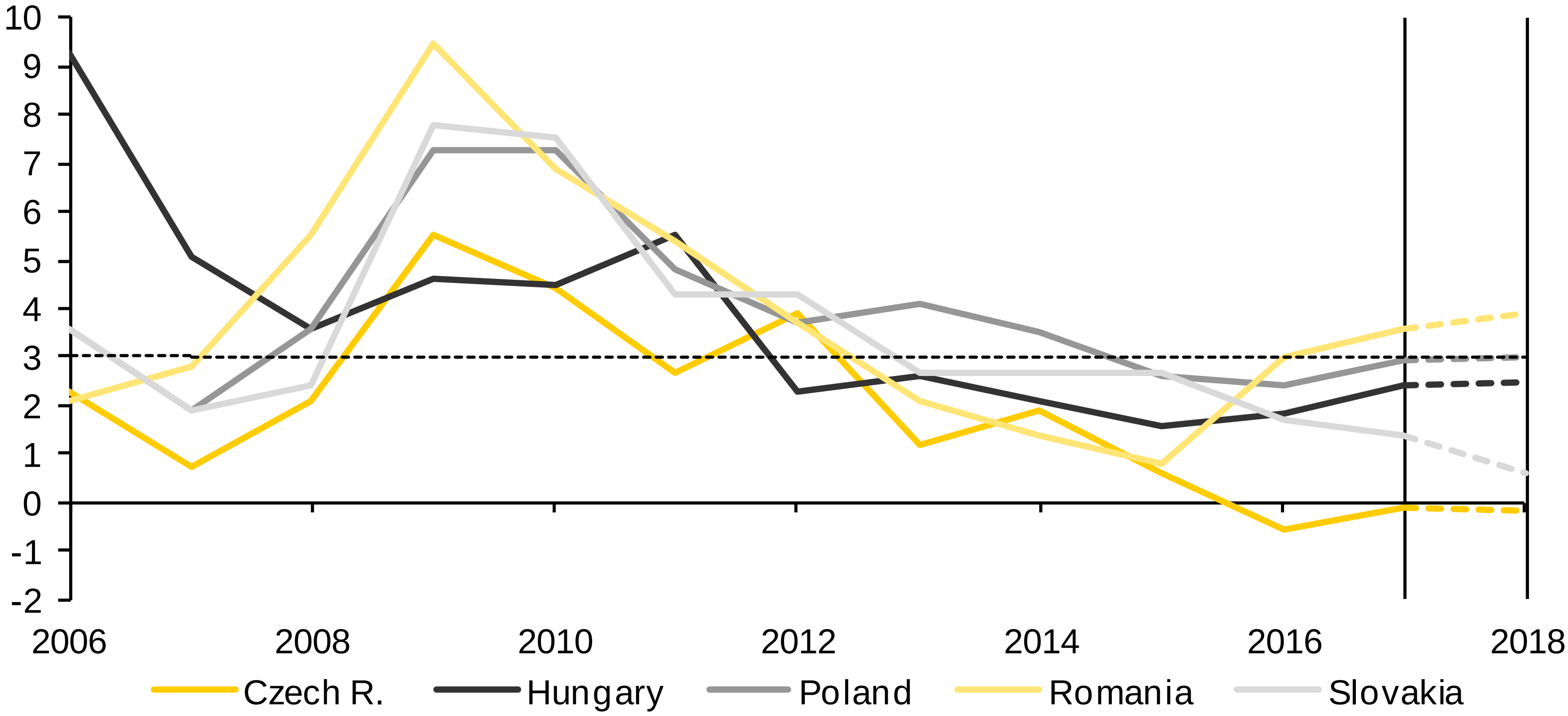
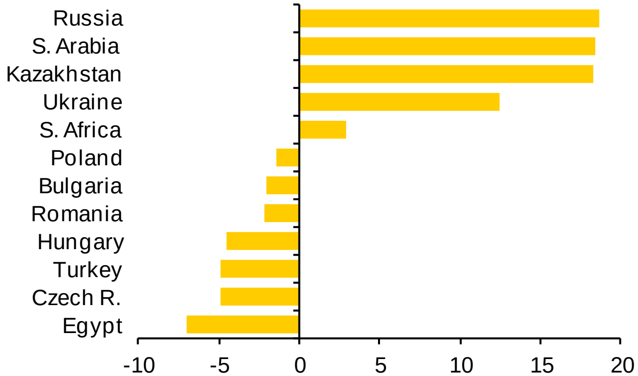
CEE: Fiscal deficits have all narrowed within 3%



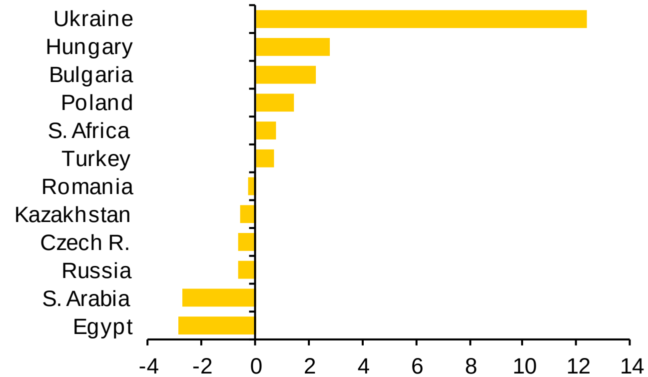
Source: European Commission, Commerzbank Research

2015 net trade balance in key commodities

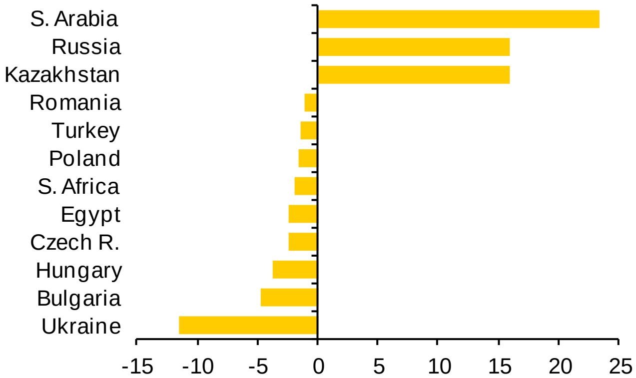
All major raw commodities (%/GDP)



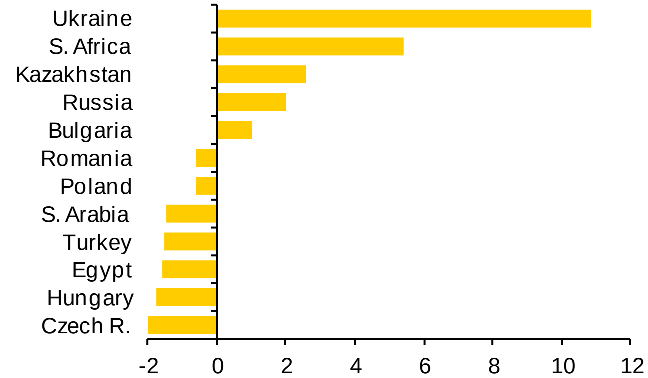
Agricultural soft commodities (%/GDP)



Energy: oil, gas, and coal (%/GDP)



Metals incl. finished iron and steel (%/GDP)



Source: Bloomberg, UN ComTrade, Commerzbank Research

EUR-USD: Temporary high

EUR-USD
Forecast: dotted line.

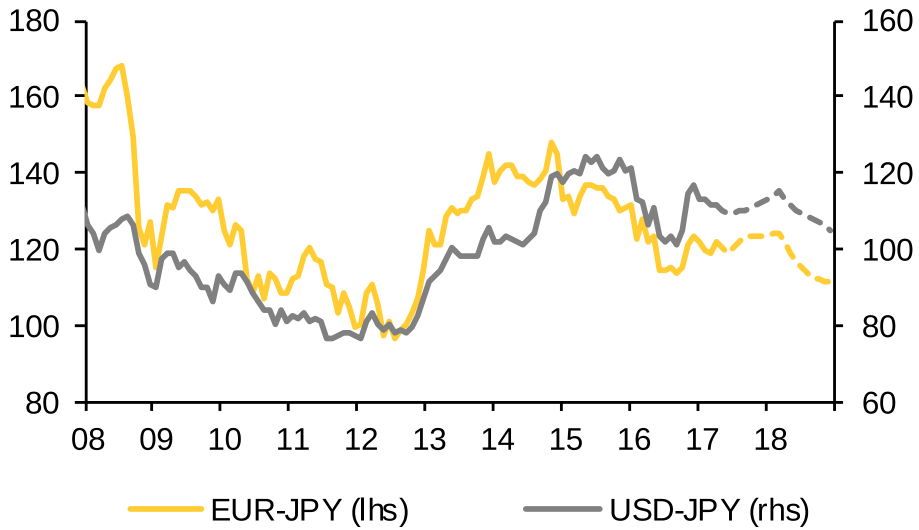
Sources: Bloomberg, Commerzbank Research

	forecast (end of month)				
	Sep-17	Dec-17	Mar-18	Jun-18	Dec-18
EUR-USD	1.12	1.10	1.08	1.06	1.08

- The EUR was able to rise versus the USD as the inevitable further tapering of the monthly bond purchases and good economic data revived rate hike fantasies in the euro zone.
- Hopes for an increased political cooperation in the euro zone supported the euro as well.
- However, the EUR will have to give up its gains again once the FX market has to recognise that in view of disappointingly slow increases in inflation rates the ECB will raise interest rates later than hitherto assumed.
- The EUR will only rise on a sustainable basis again when the first ECB rate hikes are clearly seen on the horizon towards the end of 2018.
- Overall, the USD will see only a modest appreciation versus the EUR. Major fiscal policy surprises that could make the USD appreciate sharply appear unlikely.
- The Fed will probably adhere to a slow rate hiking cycle, which will also cause the USD to appreciate only slowly.
- After a temporary EUR high, EUR-USD will be able to resume its slow downtrend.

Yen: Unsuccessful Bank of Japan

EUR-JPY and USD-JPY
Forecasts: dotted lines.



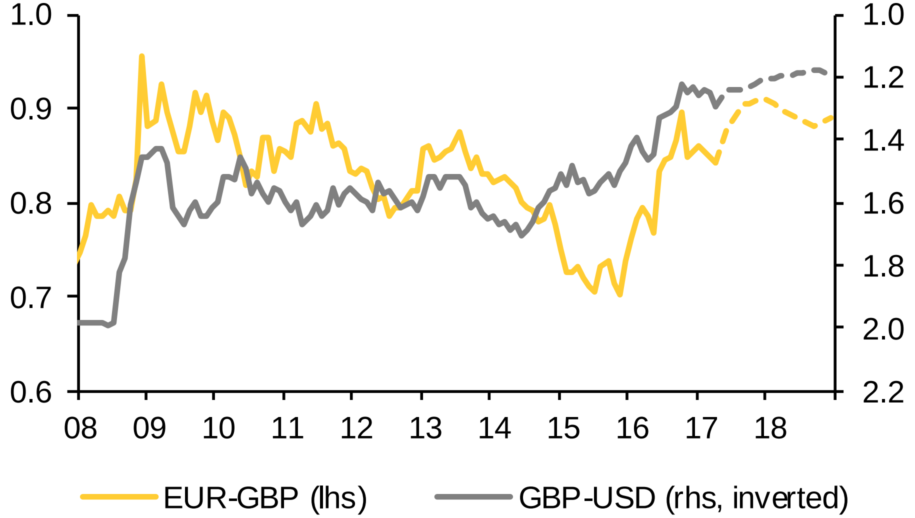
Sources: Bloomberg, Commerzbank Research

	forecast (end of month)				
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
EUR-JPY	119	123	123	124	117
USD-JPY	109	110	112	115	110

- Doubts about the Bank of Japan's ability to combat the notoriously low inflation have repeatedly caused appreciation pressure on the JPY, because a currency tends to benefit from rising purchasing power when the central bank is unable to offset low inflation through an even more expansionary monetary policy.
- BoJ monetary policy since September 2016 has focused on yield curve control, halting the decline in the USD-JPY rate.
- The appreciation of the US dollar amid the US election has reversed the downtrend in USD-JPY. For now, hopes of tighter monetary policy in the USA and unattractive real interest rates in Japan are providing a lift to USD-JPY.
- But new upside risks for the JPY are on the cards, once it becomes clear that even the current monetary strategy may not suffice to achieve a sustained rise in Japanese inflation and anchor it at 2%, in which case the BoJ would again be under pressure to act.

Sterling: Brexit remains the major risk

EUR-GBP and GBP-USD
Forecasts: dotted lines.



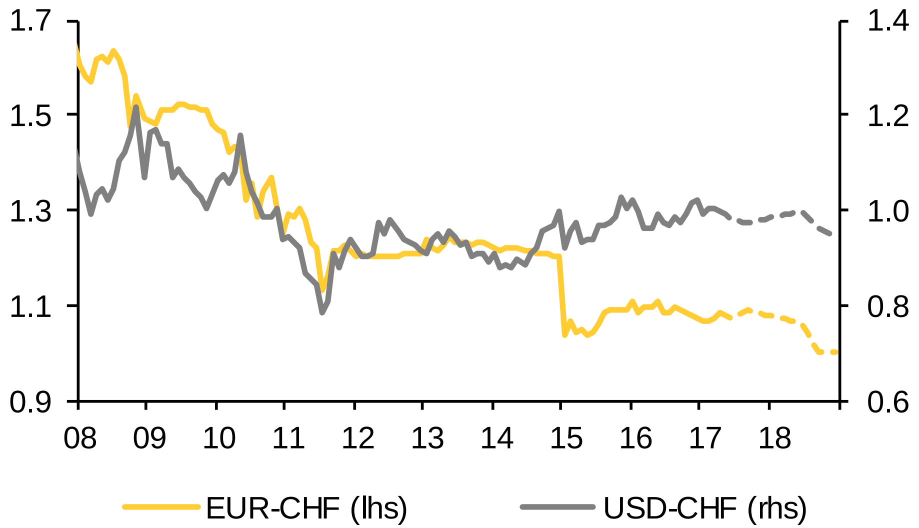
Sources: Bloomberg, Commerzbank Research

	forecast (end of month)				
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
EUR-GBP	0.88	0.90	0.91	0.90	0.89
GBP-USD	1.24	1.24	1.21	1.20	1.19

- On 29 March, the government declared its intention to leave the EU pursuant to Article 50 TEU, which started the two-year deadline for the exit negotiations.
- After Prime Minister Theresa May surprisingly announced early general elections on 8 June, the pound sterling appreciated.
- Apparently, FX markets see May‘s Brexit plan as positive for GBP and believe in the polls that suggest May will get a strong mandate from the early election for “her” Brexit plan, which would keep the advocates of a softer or much harder Brexit on the sidelines.
- Hopes probably are that May will be less restricted by domestic political disputes in the negotiations with the EU, if she has a broad majority behind her (and more time until the next election, then due in 2022).
- We, however, argue that May’s Brexit agenda and the upcoming challenging negotiations are likely to weigh on the pound sterling in the near term. Despite the early elections, we therefore stick to our fundamentally pessimistic GBP outlook.

Swiss francs: Intervention strategy is not sustainable

EUR-CHF and USD-CHF
Forecasts: dotted lines.



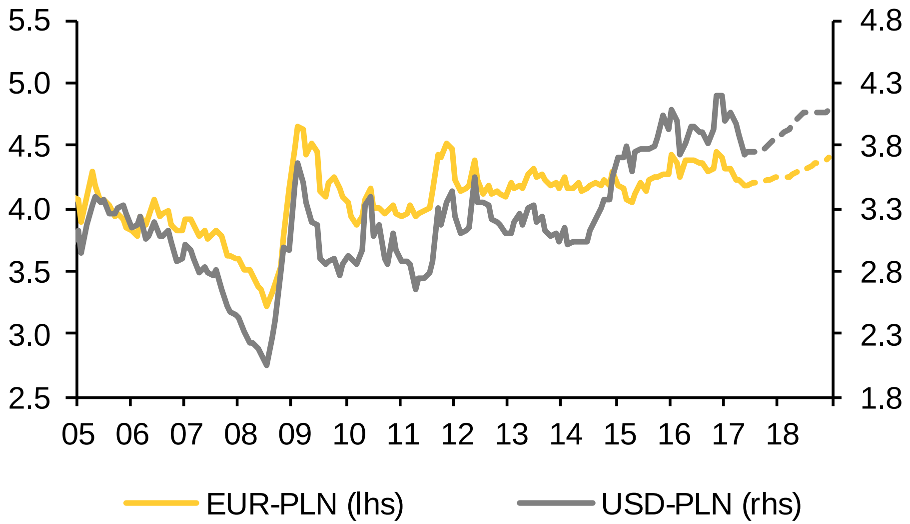
Sources: Bloomberg, Commerzbank Research

	forecast (end of month)				
	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
EUR-CHF	1.07	1.09	1.08	1.07	1.06
USD-CHF	0.98	0.97	0.98	0.99	1.00

- The SNB still hopes for a depreciation of the franc, but lacks the tools to weaken the currency. It has already cut its deposit rate to -0.75% and further rate cuts would only fuel holdings of cash.
- Instead, it is actually being forced to continue its intervention on the FX market to prevent a further appreciation of the franc. This can be seen from the expanding currency reserves of the SNB.
- The SNB views a large increase in foreign-exchange reserves as a risk. Hence we doubt that the SNB would resist franc appreciation pressure over the longer term.
- Our expectation is that the SNB – as it did in abandoning the exchange-rate floor early in 2015 – will tolerate an appreciation of the franc in order to limit its interventions. When exactly the SNB will take this decision is difficult to predict, however.
- Near term, upward pressure on the CHF ought to ease, as political risk in the eurozone has decreased following the French election and the ECB will support the euro, if – as we expect – it continues to reduce its bond purchases.

Polish zloty: Likely to weaken due to neutral monetary policy

EUR-PLN and USD-PLN
Forecasts: dotted lines.



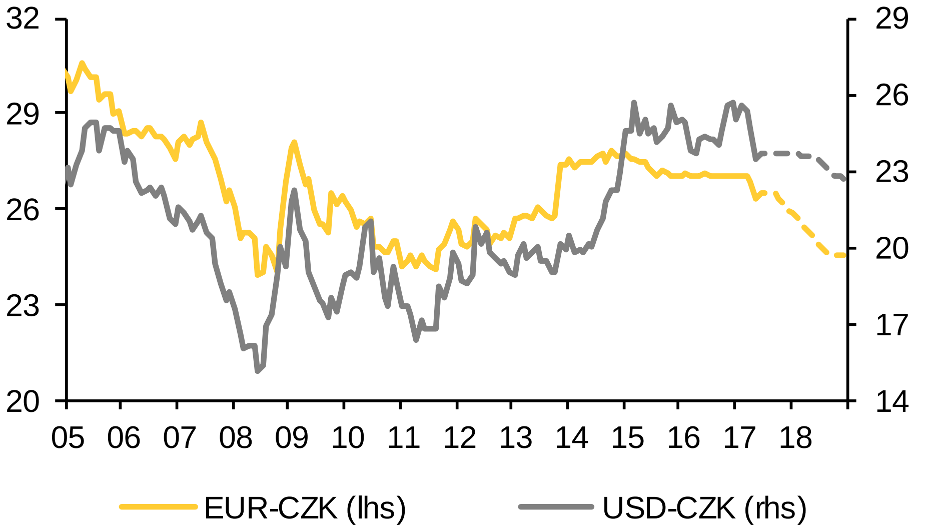
Sources: Bloomberg, Commerzbank Research

	forecast (end of month)				
	Sep-17	Dec-17	Mar-18	Jun-18	Dec-18
EUR-PLN	4.20	4.25	4.25	4.30	4.40
USD-PLN	3.75	3.86	3.94	4.06	4.07

- Poland's economy could gain significantly in the last quarter of 2016. However, in the course of the year growth should lose steam somewhat. Our forecast is for growth of 3.3% in 2017 and 2.8% in 2018.
- The country's close trade relations with the UK should have a negative effect, as revenues (trade, transfers) will decline due to the weak pound and the current account deficit should widen out.
- The inflation rate has risen sharply amid the energy price effect in the first quarter. In the current year, inflation should climb to 2% on average. However, core inflation should only be slightly positive.
- At the same time, the inflation rate should remain below the central bank's 2.5% target, ruling out the need for interest-rate hikes.
- Due to neutral monetary policy in Poland and expectations that the ECB will announce the exit from its ultra-expansionary policy in the second half of the year, the zloty looks set to decline further versus the euro this year and the next.

Czech koruna: Central bank abandons exchange rate floor

EUR-CZK and USD-CZK
Forecasts: dotted lines.



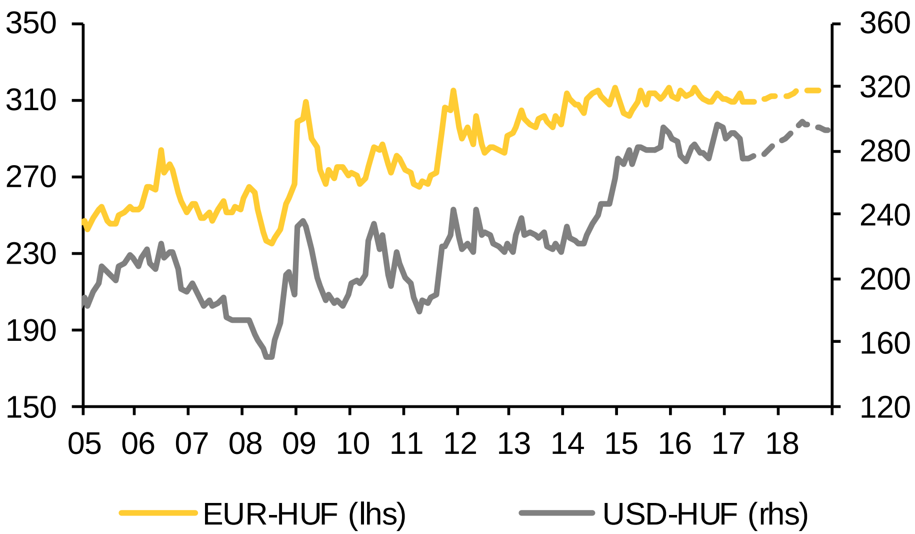
Sources: Bloomberg, Commerzbank Research

	forecast (end of month)				
	Sep-17	Dec-17	Mar-18	Jun-18	Dec-18
EUR-CZK	26.5	26.0	25.5	25.0	24.5
USD-CZK	23.7	23.6	23.6	23.6	22.7

- At an extraordinary meeting on 6 April, the Czech central bank (CNB) ended the exchange rate floor for EUR-CZK, which it had fixed at 27 in 2013. It said this move marked the start of a gradual normalisation of monetary policy.
- The reaction of EUR-CZK was surprisingly muted. The CNB has promised to intervene in case of excessive volatility. Return to a minimum exchange rate cannot be excluded.
- Czech growth is solid. For this year and the next, we expect expansion rates of 2.6% and 2,5%, respectively.
- Inflation has picked up of late. In the first half of the year, it should exceed the central bank‘s inflation target of 2%, but looks set to drift back towards the target rate afterwards.
- The CNB has promised to react with unconventional monetary measures, if inflation were to decline.
- In our view, EUR-CZK ought to remain around 27.00 in the months ahead. By year-end, however, a decline to below 26 is to be expected.

Hungarian forint: Central bank to remain expansionary

EUR-HUF and USD-HUF
Forecasts: dotted lines.



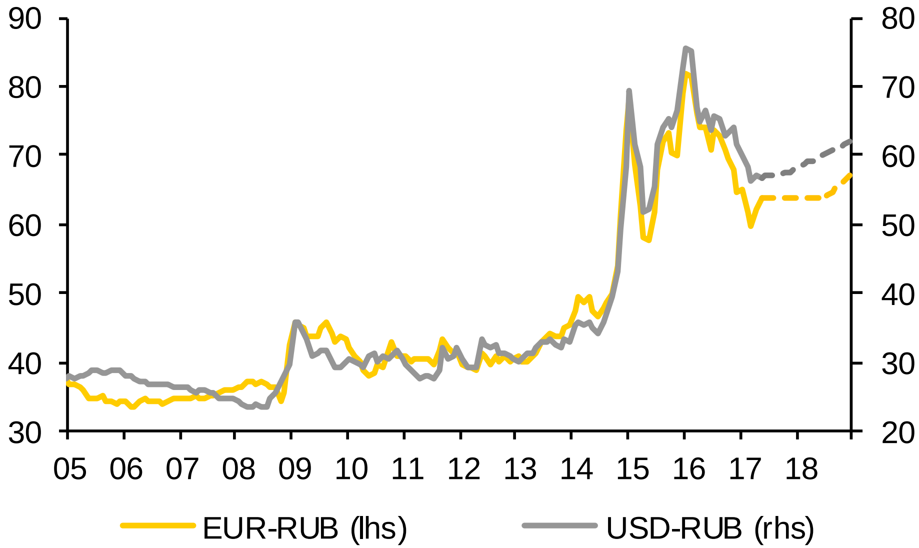
Sources: Bloomberg, Commerzbank Research

forecast (end of month)	Sep-17	Dec-17	Mar-18	Jun-18	Dec-18
EUR-HUF	310	312	312	315	315
USD-HUF	277	284	289	297	292

- In 2016, the Hungarian economy grew at a modest rate of only 1.9%. Thanks to EU fund inflows and planned investments in the automotive industry, the economy should post slightly stronger growth of 2.4% in both 2017 and 2018.
- The Hungarian central bank (MNB) sees the core rate of inflation at 2.9% in 2017. We think this is too high and do not expect core inflation to exceed 2% lastingly.
- Despite its inflation forecasts, the central bank adheres to its expansionary stance. While no further rate cuts are to be expected, the MNB should ease monetary policy further via unconventional measures.
- Whereas the ECB will likely signal a reduction of its bond purchases towards the end of the year, the MNB will remain very dovish. EUR-HUF should therefore rise moderately in the course of the year.
- However, a current account surplus of 4-5% of GDP should mitigate depreciation pressure on the HUF. We see EUR-HUF at 315 at the end of 2017.

Russian rouble: Further rate cuts ahead

EUR-RUB and USD-RUB
Forecasts: dotted lines.



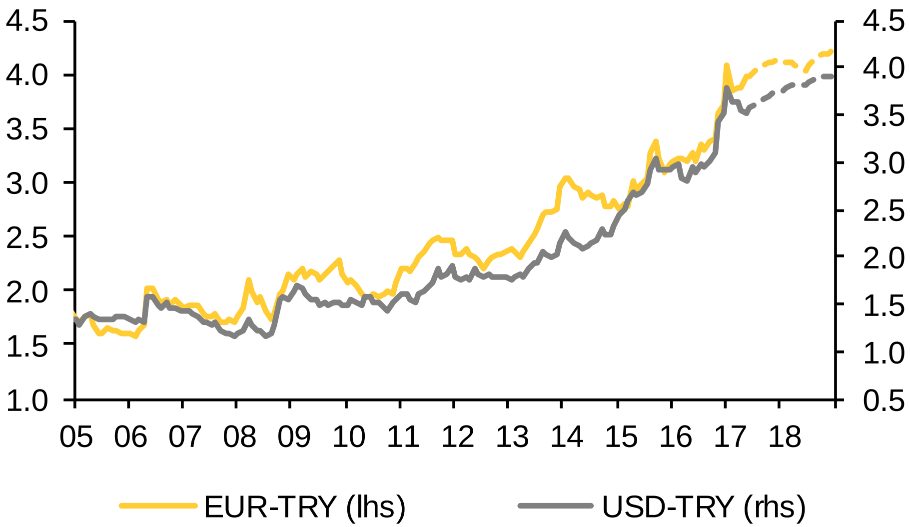
Sources: Bloomberg, Commerzbank Research

	forecast (end of month)				
	Sep-17	Dec-17	Mar-18	Jun-18	Dec-18
EUR-RUB	63.8	63.8	63.7	63.6	67.0
USD-RUB	57.0	58.0	59.0	60.0	62.0

- After having contracted massively by 2.8% in 2015, the minus in 2016 amounted to only 0.2%. The economy looks set to recover this year and the next. But especially in view of Russia's heavy dependence on the oil price, we are cautious and forecast only moderate growth rates of 1.3% and 2.0% for this year and the next.
- The inflation rate has fallen sharply in past months due to statistical base effects and is now moving only just above the central bank's inflation target of 4%.
- In line with declining inflation, the central bank trimmed the key rate in late April, by 50 basis points to 9.25%. But in view of earlier exchange rate comments from President Putin, the move leaves an "unsavoury aftertaste" as regards the independence of the central bank.
- The central bank looks set to adhere to its rate cutting cycle. This year, further cuts of 50 basis points are likely to be on the cards. Lower interest rates in Russia and tightening in the USA argue for a moderately weaker RUB in the months ahead.

Turkish lira: Stabilisation is only temporary in nature

EUR-TRY and USD-TRY
Forecasts: dotted lines.



Sources: Bloomberg, Commerzbank Research

	forecast (end of month)				
	Sep-17	Dec-17	Mar-18	Jun-18	Dec-18
EUR-TRY	4.09	4.13	4.10	4.03	4.21
USD-TRY	3.65	3.75	3.80	3.80	3.90

› After the attempted coup of 15/07/2016 and post-coup purges by the Erdogan administration, the economy slipped into recession.

› One argument supporting this view is monthly data. Revenues from tourism are down markedly, the trade deficit has widened and unemployment is soaring.

› But official GDP data are painting a different picture, suggesting that quarter-over-quarter growth in the final quarter of 2016 came to nearly 4%.

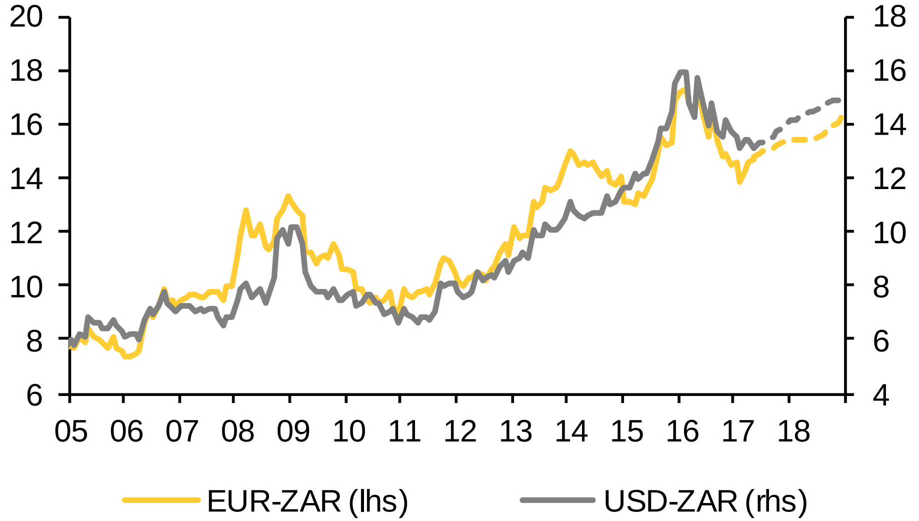
› Based on the official figures, we expect growth of 3.3% for 2017.

› Led by the lira depreciation since the end of 2016, headline inflation is up to just under 12%, the core rate stands at 9.4%. Real interest rates hence remain near zero. Price pressure should continue to be high this year.

› Over the past months, the lira has gained some ground, helped by the weak dollar and increasing risk appetite. Following the narrow “yes” vote in the referendum on constitutional amendments, the lira appreciated further. If this trend continues, the central bank is likely to ease monetary reins somewhat. This should weigh on the TRY.

South African rand: Incalculable policy continues to be a risk

EUR-ZAR and USD-ZAR
Forecasts: dotted lines.



Sources: Bloomberg, Commerzbank Research

	forecast (end of month)				
	Sep-17	Dec-17	Mar-18	Jun-18	Dec-18
EUR-ZAR	15.1	15.4	15.4	15.4	16.2
USD-ZAR	13.5	14.0	14.3	14.5	15.0

- The South African economy is facing persistent headwinds. We expect growth of just 0.8% for 2017 and an only moderate acceleration to 1.5% for 2018.
- The inflation trend is favourable, though. Recently, central bank governor Kganyago therefore signalled the end of the rate hike cycle, but stressed that speculation about rate cuts would be premature.
- Ultimately, the effect of the incalculable policy is the key risk. Due to the cabinet reshuffle at the end of March, the already tense fiscal situation in South Africa ought to deteriorate further, as President Jacob Zuma has practically been given a carte blanche.
- Against this backdrop, the rating agencies Standard & Poor`s and Fitch have already downgraded South Africa‘s credit rating to junk status. Moody`s could follow.
- Whilst this is weighing on the rand, the overall positive market environment for the emerging markets has prevented a crash. However, incalculable policy and volatile commodity prices argue for further rand weakness.

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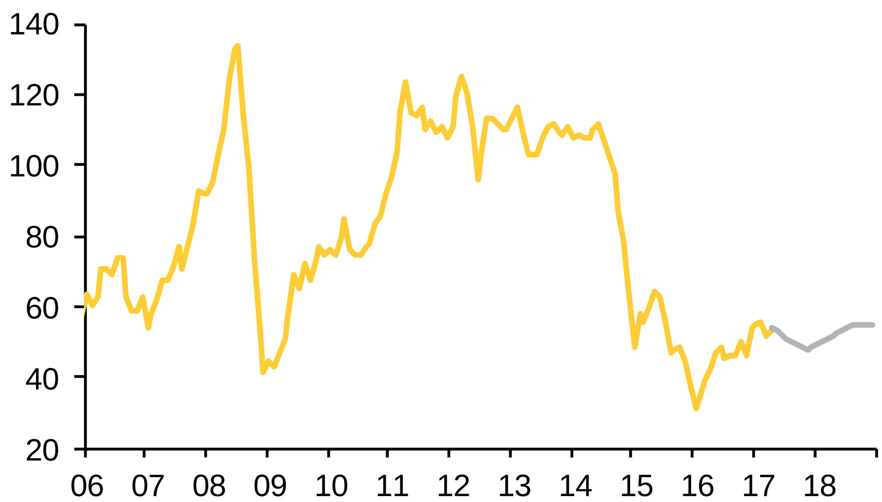
Commodities: Oil prices under pressure despite production cuts

Brent oil price in USD
Per barrel, forecast: grey line.



- In early May, Brent oil prices were down to a 5-month low of less than USD 50 per barrel and have thus lost nearly their entire gains since OPEC agreed in late November to trim back production.
- OPEC and Russia are almost entirely following through on the agreed cuts, but this did not prevent the decline.
- Doubtful as to whether the production cuts will be effective in view of persistent high inventories, many market participants are disappointed and are withdrawing from the oil market.
- At its upcoming meeting in late May, OPEC looks set to extend the cuts to year-end or beyond, in order to reach its goal of a visible reduction in inventories.
- In this case the OPEC countries would risk losing market shares to non-OPEC countries, as US oil production should increase significantly in the course of the year. Russia should also expand its oil production in H2. Compliance with the OPEC production cuts should therefore crumble.
- We adhere to our forecast that the price for Brent oil will fall below $50 a barrel by the end of 2017.

EM Macro Forecasts Summary

		Real GDP (%)			Inflation rate (%)		
		2016	2017	2018	2016	2017	2018
Asia	China	6.7	6.5	6.3	2.0	1.6	2.2
	India	7.9	6.1	7.4	5.0	5.3	5.1
	South Korea	2.8	2.9	2.8	1.3	1.9	2.0
	Indonesia	5.0	5.3	5.6	3.5	3.7	3.9
	Thailand	3.2	3.4	3.6	0.2	1.6	1.8
	Malaysia	4.2	4.2	4.6	2.1	2.4	2.7
EMEA	Poland	2.7	3.5	2.8	-0.6	2.2	1.6
	Czech	2.5	2.9	2.5	0.7	2.2	1.8
	Hungary	1.9	3.0	2.2	0.4	2.2	1.8
	Romania	4.9	4.7	4.0	-1.5	1.1	2.6
	Turkey	2.9	3.3	2.0	7.8	10.0	7.4
	Russia	-0.2	1.3	2.0	7.1	4.5	4.5
	South Africa	0.3	0.8	1.5	6.3	6.2	6.0
LatAm	Brazil	-3.6	0.7	2.0	8.8	4.3	4.5
	Mexico	2.3	1.9	1.0	2.8	5.1	3.5

		Q3 2017	Q4 2017	Quarter End Q1 2018	Q2 2018	Q3 2018
China	Policy Rate	4.35	4.35	4.35	4.35	4.35
	3M	4.40	4.30	4.20	4.10	4.00
	10Y	3.50	3.50	3.60	3.70	3.80
	USD-CNY	7.00	7.10	7.15	7.20	7.25
India	Policy Rate	6.25	6.25	6.25	6.25	6.25
	3M	6.50	6.60	6.60	6.70	6.80
	10Y	6.70	6.80	6.80	6.90	6.90
	USD-INR	66.50	67.50	67.00	67.50	67.00
Poland	Policy Rate	1.50	1.50	1.50	1.50	1.50
	3M	1.65	1.70	1.70	1.70	1.70
	10Y	3.25	3.25	3.25	3.30	3.30
	EUR-PLN	4.20	4.25	4.25	4.30	4.35
Czech Republic	Policy Rate	0.05	0.05	0.25	0.25	0.25
	3M	0.25	0.25	0.30	0.35	0.40
	10Y	1.00	1.00	1.10	1.20	1.30
	EUR-CZK	26.50	26.00	25.50	25.00	24.50
Hungary	Policy Rate	0.90	0.90	0.90	0.90	0.90
	3M	0.25	0.30	0.40	0.50	0.75
	10Y	3.00	3.00	3.00	3.00	3.00
	EUR-HUF	310.00	312.00	312.00	315.00	315.00
Romania	Policy Rate	1.75	1.75	1.75	1.75	1.75
	3M	0.63	0.63	0.63	0.63	0.63
	10Y	2.93	3.03	3.13	3.13	3.13
	EUR-RON	4.53	4.53	4.54	4.55	4.55
Turkey	Policy Rate	10.50	10.00	9.50	9.50	9.50
	3M	12.00	11.50	10.00	10.00	10.00
	10Y	10.50	10.00	10.00	10.50	11.00
	USD-TRY	3.65	3.75	3.80	3.80	3.90
Russia	Policy Rate	9.00	8.75	8.75	8.50	8.50
	3M	8.85	8.60	8.60	8.35	8.35
	10Y	7.10	6.85	6.85	6.60	6.60
	USD-RUB	57.00	58.00	59.00	60.00	61.00
South Africa	Policy Rate	7.00	7.25	7.50	7.50	7.50
	3M	7.40	7.60	7.90	7.90	7.90
	10Y	9.10	9.30	9.70	9.70	9.80
	USD-ZAR	13.50	14.00	14.25	14.50	14.75
Brazil	Policy Rate	9.00	9.00	9.00	9.00	9.00
	3M	8.75	8.75	8.00	8.00	8.00
	10Y	8.75	8.75	8.00	8.00	8.00
	USD-BRL	3.30	3.40	3.40	3.45	3.50
Mexico	Policy Rate	6.75	7.00	7.00	7.25	7.50
	3M	7.05	7.30	7.30	7.55	7.80
	10Y	7.75	8.00	8.00	8.25	8.50
	USD-MXN	19.50	20.00	20.25	20.50	20.75

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Source: Bloomberg, Commerzbank Research