

| Foreign Exchange |

# Special Report

## EUR/CZK call revised higher as major stress hits markets



**Marek Dřimal**  
(420) 222 008 598  
marek\_dřimal@kb.cz

**On the back of the recent market turmoil and the increase in political stress, we have revised our EUR/CZK call higher for the coming months. However, the medium-term forecasts remain virtually unchanged.**

### Sharp koruna depreciation in May



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Since early May, global FX markets have seen a significant increase in volatility and flight-to-quality moves as several risk-off events have emerged. Notably Argentina's debt issues, North Korea tensions, the Turkish lira's plunge, disappointing macroeconomic data and, most recently, the political crisis in Italy have slashed investors' confidence. As a result, market players have been selling EM currencies, returning to EUR and – to the greatest extent – USD assets. **What differentiates May's developments from previous periods of stress is the uniformity of EM sell-offs.**

### Correlations with EUR/PLN and EUR/USD highest in years



Source: Bloomberg, Economic & Strategy Research, Komerční banka

In the past, the koruna has proved resilient against EM-wide losses. The Czech currency provided a straightforward story of long-term undervaluation, nominal convergence and rising interest rates (and the IR differential against EUR). However, we have long argued that the sharp increase in CZK liquidity due in the final months of the Czech National Bank's interventions can result in the koruna's losses if markets are hit by a major stress event. On a relatively small scale, the recent depreciation of the currency has confirmed this risk. The EUR/CZK exchange rate increased to the proximity of the 26 level in May. Importantly, there has been a major increase to multi-year maximums in a positive correlation between EUR/CZK and other CEE currencies and in a negative correlation with EUR/USD. **Apparently, global investors have stopped differentiating between CZK and other EM assets and have been pulling funds to USD.**

### New FX forecasts (EOP)

	3Q18	4Q18	1Q19	2Q19
EUR/CZK	25.20	24.80	24.50	24.50
USD/CZK	21.9	20.3	19.3	18.6
EUR/USD	1.15	1.22	1.27	1.32
EUR/PLN	4.30	4.25	4.20	4.16
EUR/HUF	319.0	321.0	325.0	333.0

Source: Economic & Strategy Research, Komerční banka, SG Cross Asset Research

This week, markets were frightened by the political crisis in Italy. In our view, the stream of risk-off news is not likely to subside in the coming months: We expect snap elections in September, and the M5S and Northern League parties might present the poll as a referendum on euro area membership. That said, we do not believe Italy will leave the euro area, and the situation will calm in 4Q18. **Still, the elevated risk will likely continue to hamper any fast CZK recovery in the coming months.** As a result, we have revised the expected path of EUR/CZK in the remainder of 2018. Due to the risk-off mood on the markets, we have shifted EUR/CZK higher in 2Q and 3Q, but calmer developments in late 2018 and the expected CNB hike are set to drive the currency below 25.

The new SG forecasts for EUR/USD and CEE currencies reflecting the elevated stress are shown in the table on the left-hand side.

If market sentiment significantly worsens and the EUR/USD exchange rate plunges substantially below 1.150, **then it is possible EUR/CZK will test and breach the 26 level.** That would further confirm the risk scenario as per our latest *Czech Economic Outlook*: <http://bit.ly/2JKkaJz>

**KB ECONOMIC & STRATEGY RESEARCH**

**Chief Economist and Head of Research**  
**Jan Vejmelek, Ph.D., CFA**  
 (420) 222 008 568  
 jan\_vejmelek@kb.cz

<p><b>Economists</b>  <b>Viktor Zeisel</b>                  (420) 222 008 523                  viktor_zeisel@kb.cz</p>	<p><b>Marek Dřimal</b>                  (420) 222 008 598                  marek_drimal@kb.cz</p>	<p><b>Monika Junicke</b>                  (420) 222 008 509                  monika_junicke@kb.cz</p>	<p><b>Jana Steckerová</b>                  (440) 222 008 524                  jana_steckerova@kb.cz</p>
<p><b>Equity Analysts</b>  <b>Miroslav Frayer</b>                  (420) 222 008 567                  miroslav_frayer@kb.cz</p>	<p><b>Jiří Kostka</b>                  (420) 222 008 560                  jiri_kostka@kb.cz</p>	<p><b>Sectors</b>  <b>David Kocourek</b>                  (420) 222 008 569                  david_kocourek@kb.cz</p>	

**SG IN CENTRAL AND EASTERN EUROPE**

<p><b>Chief Economist of SG Poland</b>  <b>Jaroslav Janecki</b>                  (48) 225 284 162                  jaroslav.janecki@sgcib.com</p>	<p><b>Head of Research of Rosbank</b>  <b>Yury Tulinov, CFA</b>                  (7) 495 662 13 00 (ext. 14836)                  yury.tulinov@rosbank.ru</p>	<p><b>Chief Economist of BRD-GSG</b>  <b>Florian Libocor</b>                  (40) 213 016 869                  florian.libocor@brd.ro</p>
---	--	--

<p><b>Head of Fin. Markets Research BRD-GSG</b>  <b>Carmen Lipara</b>                  (40) 213 014 370                  carmen.lipara@brd.ro</p>	<p><b>Economist</b>  <b>Ioan Mincu</b>                  (40) 213 014 472                  george.mincu-radulescu@brd.ro</p>	<p><b>Equity Analyst</b>  <b>Laura Simion, CFA</b>                  (40) 213 014 370                  laura.simion@brd.ro</p>
---	---	---

**SG GLOBAL ECONOMICS RESEARCH**

**Head of Global Economics**  
**Klaus Baader**  
 (852) 2166 4095  
 klaus.baader@sgcib.com

<p><b>Euro area</b>  <b>Anatoli Annenkov</b>                  (44) 20 7762 4676                  anatoli.annenkov@sgcib.com</p>	<p><b>Michel Martinez</b>                  (33) 1 4213 3421                  michel.martinez@sgcib.com</p>	<p><b>Yvan Mamalet</b>                  (44) 20 7762 5665                  yvan.mamalet@sgcib.com</p>	<p><b>United Kingdom</b>  <b>Brian Hilliard</b>                  (44) 20 7676 7165                  brian.hilliard@sgcib.com</p>
<p><b>North America</b>  <b>Stephen Gallagher</b>                  (212) 278 4496                  stephen.gallagher@sgcib.com</p>	<p><b>Omair Sharif</b>                  (1) 212 278 48 29                  omair.sharif@sgcib.com</p>	<p><b>Latin America</b>  <b>Dev Ashish</b>                  (91) 80 2802 4381                  dev.ashish@socgen.com</p>	<p><b>Ankur Shukla</b>                  (91) 80 6731 4432                  ankur.shukla@sgcib.com</p>
<p><b>China</b>  <b>Wei Yao</b>                  (852) 2166 5437                  wei.yao@sgcib.com</p>	<p><b>Japan</b>  <b>Takuji Aida</b>                  (81) 3 5549 5187                  takuji.aida@sgcib.com</p>	<p><b>Kiyoko Katahira</b>                  (81) 3 5549 5190                  kiyoko.katahira@sgcib.com</p>	<p><b>Arata Oto</b>                  (81) 3 6777 8064                  arata.oto@sgcib.com</p>
<p><b>Korea</b>  <b>Suktae Oh</b>                  (82) 2195 7430                  suktae.oh@sgcib.com</p>	<p><b>India</b>  <b>Kunal Kumar Kundu</b>                  (91) 80 6716 8266                  kunal.kundu@sgcib.cz</p>	<p><b>Inflation</b>  <b>Vaibhav Tandon</b>                  (91) 80 6731 9449                  vaibhav.tandon@sgcib.com</p>	

**SG CROSS ASSET RESEARCH - FIXED INCOME & FOREX GROUPS**

**Global Head of Research**  
**Brigitte Richard-Hidden**  
 (33) 1 42 13 78 46  
 brigitte.richard-hidden@sgcib.com

**Head of Fixed Income & Forex Strategy**  
**Guy Stear**  
 (33) 1 41 13 63 99  
 guy.stear@sgcib.com

<p><b>Fixed Income</b>  <b>Bruno Braizinha</b>                  (1) 212 278 5296                  bruno.braizinha@sgcib.com</p>	<p><b>Jean-David Crotteau</b>                  (33) 1 42 13 72 52                  jean-david.crotteau@sgcib.com</p>	<p><b>Cristina Costa</b>                  (33) 1 58 98 51 71                  cristina.costa@sgcib.com</p>	<p><b>Jorge Garayo</b>                  (44) 20 7676 7404                  jorge.garayo@sgcib.com</p>
<p><b>Head of Euro Area Rates Strategy</b>  <b>Ciaran O'Hagan</b>                  (33) 1 42 13 58 60                  ciaran.ohagan@sgcib.com</p>	<p><b>Shakeeb Hulikatti</b>                  (91) 80 2802 4380                  shakeeb.hulikatti@sgcib.com</p>	<p><b>Rates Derivative Strategy</b>  <b>Adam Kurpiel</b>                  (33) 1 42 13 63 42                  adam.kurpiel@sgcib.com</p>	
<p><b>Head of US Rates Strategy</b>  <b>Subadra Rajappa</b>                  (1) 212 278 5241                  subadra.rajappa@sgcib.com</p>	<p><b>Jason Simpson</b>                  (44) 20 7676 7580                  jason.simpson@sgcib.com</p>	<p><b>Marc-Henri Thoumin</b>                  (44) 20 7676 7770                  marc-henri.thoumin@sgcib.com</p>	

<p><b>Foreign Exchange</b>  <b>Kit Juckes</b>                  (44) 20 7676 7972                  kit.juckes@sgcib.com</p>	<p><b>FX Derivatives Strategy</b>  <b>Olivier Korber</b>                  (33) 1 42 13 32 88                  olivier.korber@sgcib.com</p>	<p><b>Alvin T. Tan</b>                  (44) 20 7676 7971                  alvin-t.tan@sgcib.com</p>
--	--	--

**Head of Emerging Markets Strategy**  
**Jason Daw**  
 (65) 6326 7890  
 jason.daw@sgcib.com

<p><b>Amit Agrawal</b>                  (91) 80 6758 4096                  amit.agrawal@sgcib.com</p>	<p><b>Régis Chatellier</b>                  (44) 20 7676 7354                  regis.chatellier@sgcib.com</p>	<p><b>Phoenix Kalen</b>                  (44) 20 7676 7305                  phoenix.kalen@sgcib.com</p>
---	---	---

## Disclaimer

The information herein is not intended to be an offer to buy or sell, or a solicitation of an offer to buy or sell any securities. All information and opinions have been obtained from or are based on sources believed to be reliable, but their completeness and accuracy are not guaranteed by Komerční banka, a.s., even though Komerční banka, a.s. believes them to be fair and not misleading or deceptive. The views of Komerční banka, a.s. reflected in this document may change without notice.

Komerční banka, a.s. and its affiliated companies may from time to time deal in, profit from the trading of, hold or act as market makers of securities, or act as advisers, brokers or bankers in relation to securities or derivatives thereof emitted by persons, firms or entities mentioned in this document.

Employees of Komerční banka, a.s. and its affiliated companies, or individuals connected to them including the authors of this report, may from time to time have a position in or be holding any of the investments or related derivatives mentioned in this document. Komerční banka, a.s. and its affiliated companies are under no obligation to provide any services to their clients on the basis of this document.

Komerční banka, a.s. does not accept any liability whatsoever arising from the use of the material or information contained herein beyond what is required by law. This research document is primarily intended for professional and qualified investors. Should a private customer obtain a copy of this report, they should not base their investment decisions solely on the basis of this document and should seek independent financial advice. The investors must make their own informed decisions regarding the appropriateness of their investments because the securities discussed in this report may not be suitable for all investors.

The performance attained by investment instruments in the past may not under any circumstance serve as a guarantee of future performance. The estimates of future performance are based on assumptions that may not be realized. Investment instruments and investments are connected with different investment risks, the value of any investment can rise and fall and there is no guarantee for the return of the initial invested amount. Investment instruments denominated in foreign currencies are also subject to fluctuations caused by changes in exchange rates, which can have both positive and negative influences particularly on the prices of the investment instrument and consequently on the investment return.

This publication is issued by Komerční banka, a.s. which is a bank/stockbroker according to the applicable legislation and thus regulated by the Czech National Bank. Komerční banka, a.s. applies various measures to prevent conflict of interests in the process of creating investment recommendations, such as the implementation of an appropriate internal separation including information barriers between different departments of Komerční banka, a.s. in compliance with the requirements imposed by applicable regulation. The employees of Komerční banka, a.s. proceed in accordance with the internal regulations governing conflict of interest.

The evaluation of employees creating investment recommendations is never by any means tied with the volume or profit of the trades with instruments mentioned in this document done by Komerční banka, a.s., or the trades of Komerční banka, a.s. with the issuers of such instruments. However, the evaluation of the authors of this document is linked to the profits of Komerční banka, a.s. which also partially include the results of trading with investment instruments.

The recommendations mentioned in this document are intended for the public and the document before its publication is not available to persons not involved in the creation of this document. As per our practice, the issuers usually do not receive a copy of research reports prior to their publication. Each author of this research report hereby states that (i) the views expressed in the research report accurately reflect his or her personal views about any and all of the securities or issuers at stake.

This document and its contents is not designed for persons with permanent residence or seat in the United States of America and to persons who are deemed as "U.S. persons", as defined in Regulation S under the US Securities Act of 1933, as amended.

This document is not an investment recommendation according to Regulation (EU) No 596/2014 of the European Parliament and of the Council on market abuse and does not constitute investment advisory according to Act no 256/2004 Coll., on Capital market undertakings as amended.

Please refer to our website <http://www.trading.kb.cz> for more details.