

Fixed Income

CZGB Focus

Lower CZGB supply in second half of year



František Táborský
(420) 222 008 598
frantisek_taborsky@kb.cz

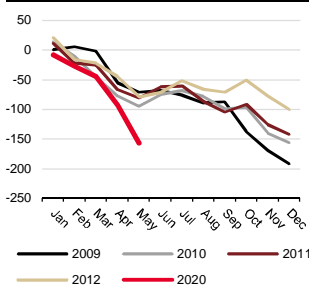
The government is proposing a further increase in the state budget deficit to CZK500bn. The main reason is the rise in spending to support the economy at this time of crisis. In our opinion, however, the government will continue to have problems implementing expenditure plans, which will lead to a deficit of only CZK400bn. This also implies less additional CZGB issuance, further reduced by using state financial assets and the drawdown of EUR loan programs. In our view, the MinFin has only CZK56.7bn left to issue by the end of the year, which shouldn't be a problem to place.

Government proposing further increase in budget to CZK500bn

This year, the MinFin has twice increased the planned state cash budget deficit from the original CZK40bn to the current CZK300bn to support the domestic economy during the crisis. Now, the government is proposing a further increase in the deficit to CZK500bn (9.2% of GDP). The proposal envisages a further downgrade in total revenues of CZK63.4bn (down by a total of CZK213.3bn compared to the original proposal). **This change is not based on the ministry's macroeconomic forecast**, as the new one will be published only in August. The new revenue estimate is nevertheless more in line with our expectations due to our more pessimistic outlook for this year's economic downturn and given the new measures to support the economy.

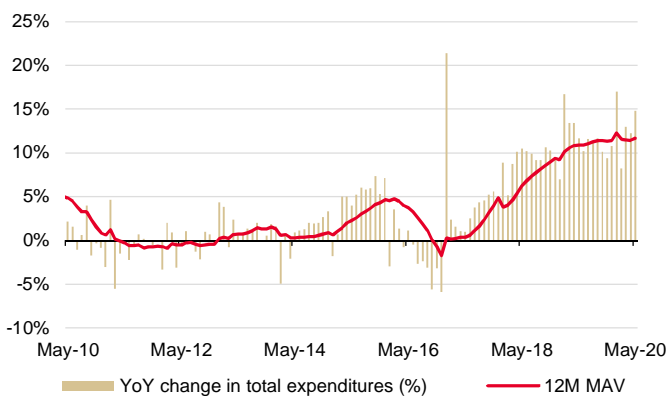
The biggest changes are in expenditure, which is to be boosted by another CZK136.6bn (up by a total of CZK246.7bn compared to the original proposal). The whole amount aims to increase the government budget reserve and thus has no specific purpose.

Development of state budget compared to previous crisis (CZKbn)



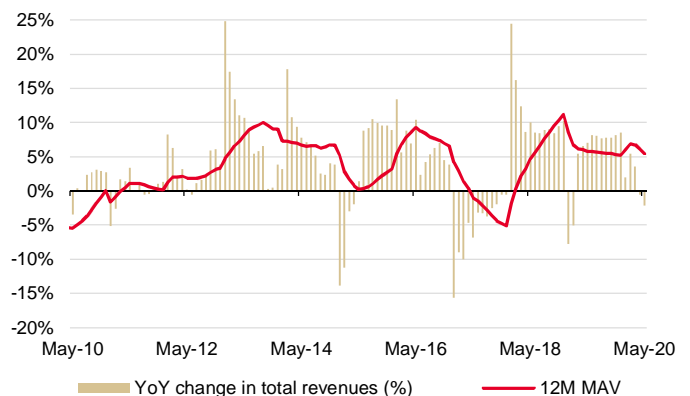
Source: MFCR, Economic & Strategy Research, Komerční banka

Budget expenditures not growing versus previous years



Source: MFCR, Economic & Strategy Research, Komerční banka

Revenue shortfall will be visible in the coming months

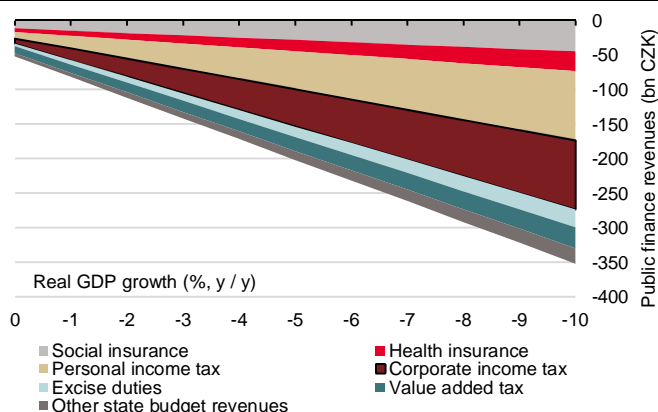


Source: MFCR, Economic & Strategy Research, Komerční banka

According to the MinFin, the current budget reserve of CZK78.8bn has already been fully allocated on crisis-related outlays and a further increase is therefore necessary. The new budget proposal doubles the reserve to CZK215.4bn, which in our view accommodates downside risk to the budget and the economy for the remainder of the year.

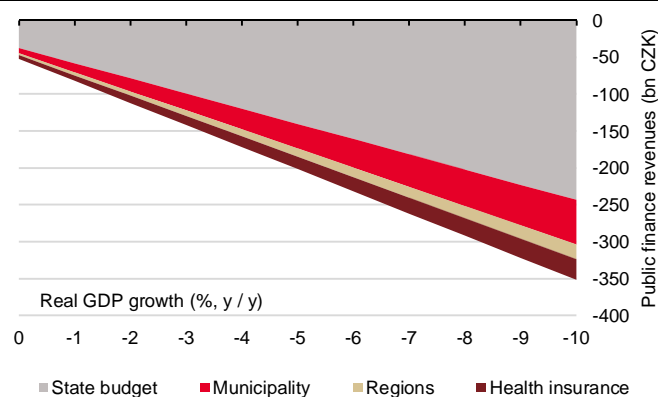
One of the government's main arguments for the increase in the state budget deficit is a presumed rise in financing for municipalities and to boost infrastructure investment. This year, a record amount of CZK140.5bn is to flow to investment, and in addition, the state budget has c.CZK33bn of unused expenditure from previous years (combined amount equals 3.3% of GDP). However, due to the two-month lockdown and the dispute between the municipalities and government over funding (local governments have been forced to co-finance part of the pandemic relief programmes), we assume that most investment projects at the regional level have been stopped or postponed and will be difficult to re-start this year. In addition, the recent shutdown of the economy has led to the departure of a large proportion of foreign workers, upon whom the domestic construction sector depended, and we do not expect a significant easing of the labour market (or the possibility of a reshuffle of employment) until the second half of the year. Consequently, we assume any additional increase in public investment above the currently planned level would exceed the capacity of the economy.

Public finance revenue scenarios by category compared to the MinFin's original budget (CZKbn)



Source: MFCR, Economic & Strategy Research, Komerční banka

Public finance revenue scenarios by recipient compared to the MinFin's original budget (CZKbn)



Source: MFCR, Economic & Strategy Research, Komerční banka

Due to the slow implementation of the already introduced measures to support the economy, and taking into account the expected decline in state budget revenues and the aforementioned changes, **we increase our expected deficit to CZK400bn from the previous CZK340bn, which would mean a total public finance deficit of 7.9% of GDP.** That compares to the new official plan of a CZK500bn shortfall.

The government wants the proposal to increase the state budget deficit be discussed as a legislative emergency. The proposal will likely be discussed by the Budget Committee of the Chamber of Deputies this week and subsequently should be discussed in the Chamber. So far, only the Communist Party, which supports the minority government in the Chamber of Deputies, will probably seek partial adjustments. We thus assume that the basic framework of the change in the state budget will go through the legislative process in June.

CZGB supply to be subdued in 2H20 nevertheless

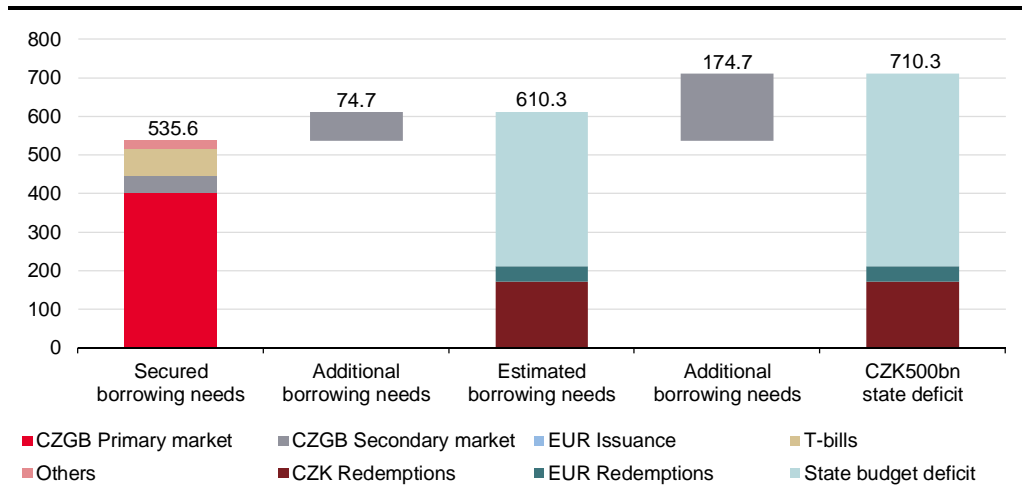
According to our calculations, the MinFin has already secured all its borrowing needs related to the CZK300bn budget deficit and other state liabilities through CZGB issuance and operations in the secondary market. However, the new proposal would imply significant additional borrowing needs of CZK174.7bn. On the other hand, as we expect the budget deficit to be lower than indicated in the new plan and as the government wants to use CZK18.9bn of reserves in financing, we estimate that **only CZK74.7bn of borrowing needs remain.**

In our opinion, potential additional CZGB issuance will also be reduced by the EUR loan programs of the European Commission and the Development Bank of the Council of Europe

to support the economy. In these, the government can borrow up to CZK18bn this year on very favourable terms, which can thus serve as EUR source to cover CZK40bn equivalent of euro-denominated short-term money market loans. EUR loans from supranational institutions could thus serve in part to replace the originally planned issuance of euro-denominated government bonds.

In nutshell, there is a room for an additional CZK56.7bn of CZGB issuance over the remainder of the year. If the ministry follows the already published calendar in the rest of June (max. CZK7bn to be sold indicatively), CZK8.3bn per month remains for 2H20, which in our view gives the MinFin a high degree of freedom and so previous flare ups of CZGB supply will likely not be repeated. If the state budget were eventually to move towards the planned CZK500bn, remaining CZGB issuance would increase to CZK156.7bn, i.e. CZK25bn per month, which is only slightly above last year's monthly average.

State borrowing needs and coverage (CZKbn)



Source: MFCR, Economic & Strategy Research, Komerční banka

For next year, the current maturity calendar offers a record CZK292.6bn, the most since 2013. To this we add our estimated state budget deficit of CZK300bn, which indicates at least as high borrowing needs as this year.

KB ECONOMIC & STRATEGY RESEARCH

Chief Economist and Head of Research



Jan Vejmelek, Ph.D., CFA
(420) 222 008 568
jan_vejmelek@kb.cz

Economists



Michal Brozka
(420) 222 008 569
michal_brozka@kb.cz



Jana Steckerová
(420) 222 008 524
jana_steckerova@kb.cz



Martin Gürtler
(420) 222 008 509
martin_gurtler@kb.cz



Strategist
František Táborský
(420) 222 008 598
frantisek_taborsky@kb.cz

Equity Analyst



Bohumil Trampota
(420) 222 008 560
bohumil_trampota@kb.cz

SG IN CENTRAL AND EASTERN EUROPE

Head of Research of Rosbank



Evgeny Koshelev
(7) 495 725 5637
evgeny.koshelev@rosbank.ru

Chief Economist of BRD-GSG

Florian Libocor
(40) 213 016 869
florian.libocor@brd.ro

Economist BRD-GSG



Ioan Mincu
(40) 213 014 472
george.mincu-radulescu@brd.ro



Equity Analyst
Laura Simion, CFA
(40) 213 014 370
laura.simion@brd.ro



Economist Rosbank
Anna Zaigrina
(7) 495 662 1300
anna.zaigrina@rosbank.ru

SG GLOBAL ECONOMICS RESEARCH

Head of Global Economics



Klaus Baader
(852) 2166 4095
klaus.baader@sgcib.com

Euro area



Michel Martinez
(33) 1 4213 3421
michel.martinez@sgcib.com



Anatoli Annenkov
(44) 20 7762 4676
anatoli.annenkov@sgcib.com



Yvan Mamalet
(44) 20 7762 5665
yvan.mamalet@sgcib.com



United Kingdom
Brian Hilliard
(44) 20 7676 7165
brian.hilliard@sgcib.com

North America



Stephen Gallagher
(212) 278 4496
stephen.gallagher@sgcib.com



Latin America
Dev Ashish
(91) 80 2802 4381
dev.ashish@socgen.com



India
Kunal Kumar Kundu
(91) 80 6716 8266
kunal.kundu@sgcib.cz



Korea
Suktae Oh
(82) 2195 7430
suktae.oh@sgcib.com

China



Wei Yao
(33) 1 57 29 69 60
wei.yao@sgcib.com



Greater China
Michelle Lam
(85) 2 21 66 57 21
michelle.lam@sgcib.com



Japan
Takuji Aida
(81) 3-6777-8063
takuji.aida@sgcib.com



Arata Oto
(81) 3 6777 8064
arata.oto@sgcib.com

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

Head of Rates Strategy



Adam Kurpiel
(33) 1 42 13 63 42
adam.kurpiel@sgcib.com



Head of Euro Area Rates Strategy
Ciaran O'Hagan
(33) 1 42 13 58 60
ciaran.ohagan@sgcib.com



Covered Bonds & SSA
Cristina Costa
(33) 1 58 98 51 71
cristina.costa@sgcib.com



Head of US Rates Strategy
Subadra Rajappa
(1) 212 278 5241
subadra.rajappa@sgcib.com



Jorge Garayo
(44) 20 7676 7404
jorge.garayo@sgcib.com



Jean-David Cirotteau
(33) 1 42 13 72 52
jean-david.cirotteau@sgcib.com



Shakeeb Hulikatti
(91) 80 2802 4380
shakeeb.hulikatti@sgcib.com



Kevin Ferret
(44) 20 7676 7073
kevin.ferret@sgcib.com



Rohit Gaurav
(91) 8067318958
rohit.gaurav@sgcib.com



Michael Chang
(1) 212 278 5307
michael.chang@sgcib.com

Chief Global FX Strategy



Kit Juckes
(44) 20 7676 7972
kit.juckes@sgcib.com



FX Derivatives Strategy
Olivier Korber
(33) 1 42 13 32 88
olivier.korber@sgcib.com

Head of Emerging Markets Strategy



Jason Daw
(65) 6326 7890
jason.daw@sgcib.com



Phoenix Kalen
(44) 20 7676 7305
phoenix.kalen@sgcib.com



Kiyong Seong
(852) 2166 4658
kiyong.seong@sgcib.com



Marek Drimal
(44) 20 7550 2395
marek.drimal@sgcib.com



Bertrand Delgado
(1) 212 278 6918
bertrand.delgado-calderon@sgcib.com

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 may from time to time have a position in or be holding any of the investments or related derivatives mentioned in this document. The authors of this document are not authorized to acquire the investment instruments mentioned in this document. This does not apply to cases when the investment recommendation mentioned in this document represents dissemination of an investment recommendation earlier produced by third parties according to Chapter III of regulation (EU) 2016/958. 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 an 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 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.