Weekly | 2018 | Week 01

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Tuesday	2-Jan	9:30	CZ	Manufacturing PMI, Dec'17	N/A	N/A
	2-Jan	10:00	EMU	(Final) manufacturing PMI, Dec'17	60.6	N/A
Wednesday	3-Jan	14:00	CZ	Budget Balance, Dec'17, CZK bn.	N/A	N/A
Thursday	4-Jan	10:00	EMU	(Final) services PMI, Dec'17	56.5	N/A
Friday	5-Jan	8:45	FRA	(Preliminary) HICP, Dec'17, y/y	1.3%	N/A
	5-Jan	11:00	EMU	(Preliminary) HICP, Dec'17, y/y	1.4%	N/A
	5-Jan	11:00	ITA	(Preliminary) HICP, Dec'17, y/y	1.1%	N/A

* LOCAL TIME IS CET
** (REUTERS/ BLOOMBERG) POLL

JANUARY 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2014-2025	3-Jan	5-Jan	17-Sep-25	CZK 2bn. max	2.40%
CZGB 2017-2025	3-Jan	5-Jan	10-Feb-27	CZK 2bn. max	0.25%
CZGB 2006-2036	3-Jan	5-Jan	4-Dec-36	CZK 1bn. max	4.20%
SPP 776	4-Jan	5-Jan	6-Apr-18	CZK 0-5 bn.	N/A
SPP 777	11-Jan	12-Jan	13-Apr-18	CZK 0-5 bn.	N/A
CZGB 2015-2023	17-Jan	19-Jan	25-Oct-23	CZK 2 bn. max	0.45%
CZGB 2013-2028	17-Jan	19-Jan	25-Aug-28	CZK 2 bn. max	2.50%
CZGB 2017-2033	17-Jan	19-Jan	13-Oct-33	CZK 2 bn. max	2.00%
SPP 778	18-Jan	19-Jan	20-Apr-18	CZK 0-5 bn.	N/A
SPP 779	25-Jan	26-Jan	27-Apr-18	CZK 0-5 bn.	N/A

* FOR T-BILLS, THIS IS MAXIMUM AMOUNT PER PRIMARY DEALER.
** DEPENDING ON MARKET CONDITIONS.

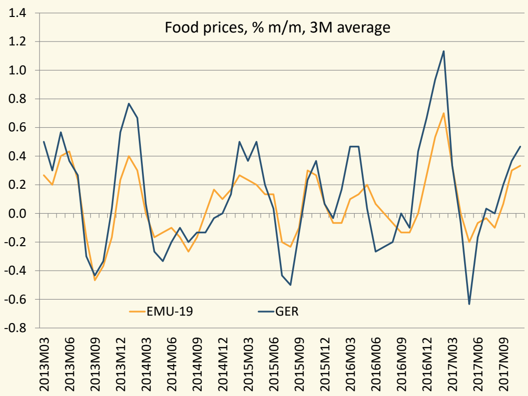
THOUGHT OF THE WEEK

"HAPPY NEW YEAR!"

WEEK AHEAD

Another light week ahead.

In Eurozone, December preliminary inflation data will not be anything surprising: lack of inflation pressures, some base effect from food prices. At least that is what previous week's release of German / Spanish inflation suggest.



In Czech Republic, December manufacturing PMI and budget for the whole of 2017 will be released. PMI will probably have remained high while budget will have shown deficit, a true shame considering the 2017 growth of GDP. But, then again, it was election year so no miracles were to be expected even from someone claiming to run the country as a firm…

WEEK BEHIND

Czech confidence data confirm businesses and consumer are sanguine ▶

German / Spanish preliminary inflation show Eurozone still devoid of inflationary pressures ▶

Spanish retail sales rebound after October referendum drop ▶

| FX

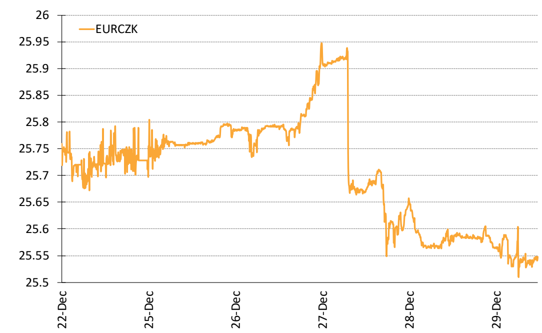
EURCZK strengthened back below 25.60.

My idea that weakening in previous weeks may have been due to market slowly coming to realize that CNB will not hike as fast as it thought was apparently a wrong one: in light of snap-back to 25.50 last week, it is now certain the weakening we saw in the previous couple of weeks was due to technical reasons ahead of the end of the year. The effect of the Resolution fund (contributions to which are, inanely, determined based on the size of the balance sheet at the end of December, so banks are incentivized to shrink BS before end of the year) was thus very likely what drove investors to sell CZK for EUR and take profit (thus evading the charge on excess deposits all big commercial banks in Czech Republic implemented for deposits at the end of the year).

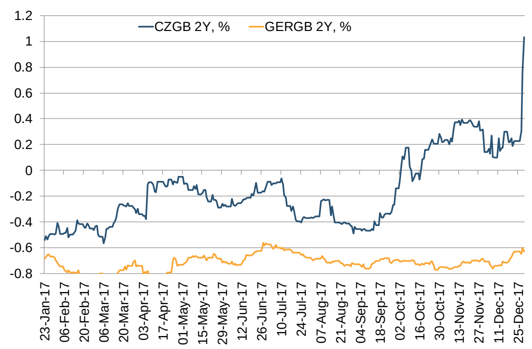
Since spot transactions settle t+2, this would be consistent with the plunge of EURCZK in last 2 working days of last week – the charge doesn't apply from Thursday.

BTW, the CZK became the most successful currency against EUR last year, strengthening about 5.5% last year.

EURCZK RETURNS BELOW 25.60 AS RESOLUTION FUND EFFECT DISAPPEARS



CZECH YIELDS STABLE DESPITE BUNDS' SELL-OFF

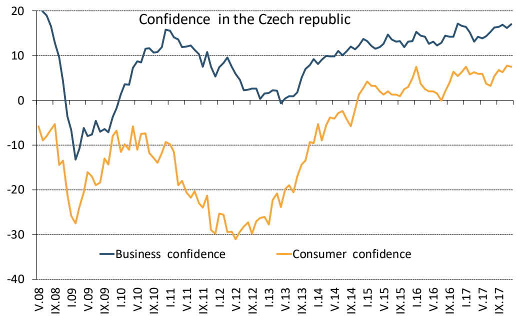


| FI

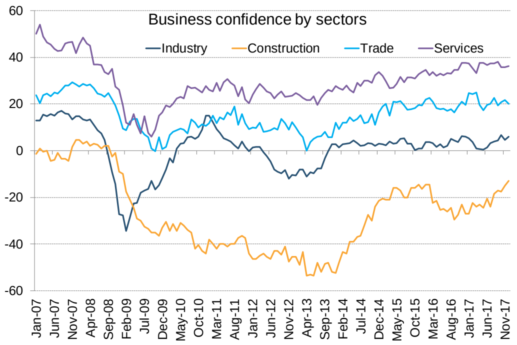
Czech short yields jumped to over 1%.

The size of the jump and the fact that German yields didn't move suggests local factors at play. I don't

CZECH CONFIDENCE REMAINS HIGH, WITH BUSINESS ONE IMPROVING TO WITHIN REACH OF POST-CRISIS HIGH.



THAT SAID, BUSINESS CONFIDENCE ONLY IMPROVED BECAUSE OF CONSTRUCTION.



know what it is, though Resolution fund effect may have played the role: everyone wanted to have bonds, not cash before the year-end so as not to pay the charge on large deposits, so yields were kept artificially low in previous weeks.

Late last week, with year-end so close, bonds could be sold (settlement being next year), a decision that probably met with very low liquidity, producing the spike seen in the picture.

| CZECH ECONOMY

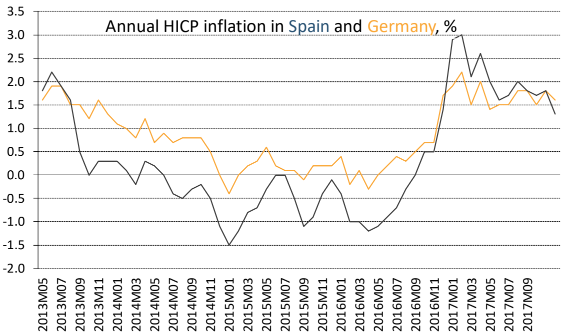
Czech confidence data remained unchanged – and thus high, especially for consumers.

Consumer confidence retreated to 7.5, second highest ever (after November's 7.8). There is not really much to say to this except that consumers are *uber*-optimistic – and that should show up in household demand in the 4Q17, and beyond.

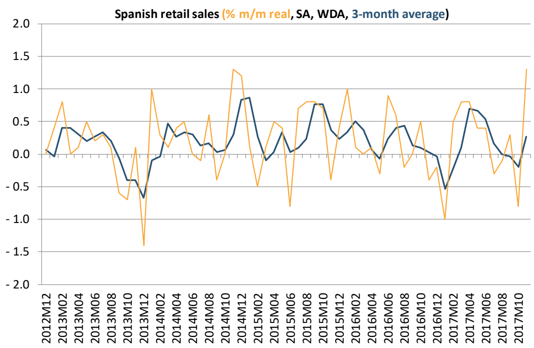
The business confidence rose to 17.1, just a tenth of a point below the post-crisis high of November 2016, and hence very high. The improvement, however, was solely driven by construction sector where confidence rose 2 points to -13, the highest since January 2009. The other components – industry, services, trade – didn't move much. For industry, this may be understandable considering the CZK strengthening (though is inconsistent with other indicators like PMI), but for services and trade, we should've seen large improvement this year.

Nonetheless, the confidence suggests this boom has some way to go still.

German/Spanish Preliminary Inflation confirms ease policy of ECB to stay



Spanish retail rebounds after referendum drop in October…



…But annual growth remains sluggish.

| EUROZONE ECONOMY

Eurozone inflation remained low in December, the final month before ECB starts buying half the assets each month than hitherto.

That is what the Spanish / German December preliminary inflation data suggest. Spanish HICP fell to 1.3%, the lowest since November 2016 while German HICP was 1.6%, almost the same as in December 2016 (1.7%). With food prices having grown massively at the beginning of 2017, we are very likely to see further disinflation in January and February. As regards core inflation, there weren't any new data in the preliminary release, but from the headline figure it seems the core rate remained unchanged in Germany and fell in Spain.

For ECB just about to cut the monthly rate of asset purchases in half, December inflation in Germany / Spain changes nothing: the economy is still not generating inflation sustainably, so very loose monetary stance is justified.

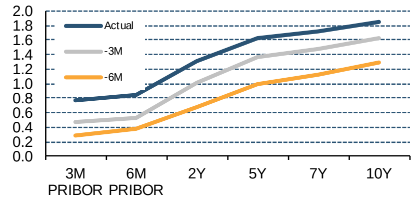
Spanish retail sales rebounded in November after what apparently was referendum-induced drop in October.

The November rise of 1.3% m/m was joint highest in three years, confirming my belief that October decline was just a one off due to Catalonian independence referendum.

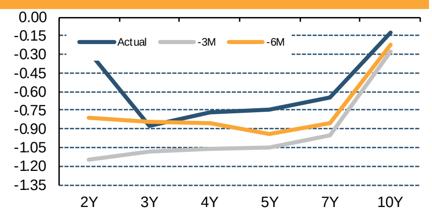
That said, the annual growth of just 2% is weak and is significantly slower than the growth seen over 2014-2016. The primary explanation (apart from a less expansionary fiscal policy) is of course the rise of inflation in 2017 which wasn't followed by the nominal wage growth (so real wage growth suffered) and which the fall of unemployment only dampened. The 2018 inflation should be lower on average than in 2017, so that should help household demand this year.

| MARKETS ‡

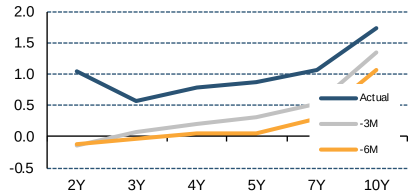
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.760	0.850	1.315	1.620	1.713	1.845
	-1M	0.740	0.830	1.315	1.650	1.750	1.880
	-3M	0.470	0.530	1.010	1.360	1.480	1.619
	-6M	0.290	0.370	0.683	0.994	1.130	1.289



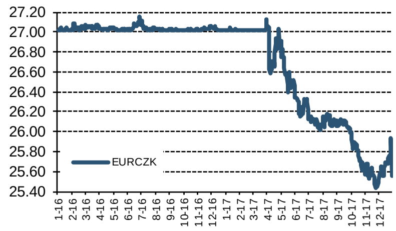
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.283	-0.878	-0.770	-0.745	-0.648	-0.124
	-1M	-1.001	-0.857	-0.915	-0.743	-0.620	-0.088
	-3M	-1.149	-1.083	-1.064	-1.047	-0.957	-0.278
	-6M	-0.808	-0.840	-0.854	-0.945	-0.854	-0.227



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	1.032	0.572	0.779	0.875	1.065	1.721
	-1M	0.314	0.615	0.661	0.907	1.130	1.792
	-3M	-0.139	0.080	0.210	0.313	0.523	1.341
	-6M	-0.125	-0.045	0.047	0.049	0.276	1.062



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.549	4.175	310.73	4.665	4.551	1.200
	-1M	25.490	4.204	312.04	4.644	4.694	1.185
	-3M	25.992	4.313	311.63	4.595	4.211	1.181
	-6M	26.216	4.241	309.80	4.570	4.038	1.144



‡ As of Sunday night
* Spreads to generic bonds
** Generic bond

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