

January 08 | 2018

## Weekly | 2018 | Week 01

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## CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	8-Jan	8:00	GER	Industrial orders, Nov'17, y/y	7.8%	N/A
	8-Jan	9:00	CZ	Industrial production, Nov'17, y/y	5.7%	6.5%
	8-Jan	9:00	CZ	Trade balance, Nov'17, CZK bn.	5.3	8.0
	8-Jan	11:00	EMU	(Final) consumer confidence, Dec'17	0.5	N/A
	8-Jan	11:00	FRA	Retail sales, Nov'17, y/y	2.4%	N/A
Tuesday	9-Jan	8:00	GER	Industrial production, Nov'17, y/y	4.0%	N/A
	9-Jan	11:00	EMU	Unemployment rate, Nov'17	8.7%	N/A
Wednesday	10-Jan	9:00	CZ	CPI, Dec'17, y/y	2.4%	2.3%
	10-Jan	9:00	CZ	(Final) GDP growth, 3Q17, q/q	0.5%	0.5%
Thursday	11-Jan	9:00	CZ	Retail sales, Nov'17, y/y	3.8%	4.4%
	11-Jan	11:00	EMU	Industrial production, Nov'17, y/y	3.0%	N/A
	11-Jan	14:30	EMU	Account of the Dec 14, 2017 monetary policy meeting	N/A	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

“NO 2018 RESOLUTIONS FOR ME: NOBODY LIKES THE SKINNY SOBER B\*\*\*\*\*S ANYWAY (JANUARY 01, 2018 TEXT FROM MY FRIEND)”

## WEEK AHEAD

Finally a week that is not (data-) weak.

**Czech Republic will see all of the important November macro data plus December inflation.**

The latter is most important as it will help determine whether CNB delivers in 2018 in line with its November dovish forecast or whether market, predicting far more aggressive repo trajectory, will be the one to be right. I am of the former view (that CNB will hike very moderately this year, if at all) and expect December inflation to slow further against November's 2.6%, justifying my view (and maybe eroding little that of the market). Other Czech data shouldn't be much of a surprise – **industrial production will be shown to have grown 6.5 %** in November which, with one fewer working days in 2017 vs. 2016, translates to almost double-digit growth. At least, that is what manufacturing PMI sloe to 60 leads me to expect ► Retail sales also likely grew strongly in November, the consumer confidence being sky-high and inflation having begun to ease.

**In Eurozone**, the key releases are the **account of the December 14, 2017 meeting of ECB** and **November industrial production**. The former will probably reveal little new, it being from the December meeting when ECB did nothing, the latter is interesting especially as regards Germany. German manufacturing PMI is at all-time high while manufacturing growth is at paltry 4%. The gap should now close.

WEEK BEHIND

Czech budget 2017: healthy on the outside, putrid on the inside ▶

Czech PMI attacks 60 ▶

Eurozone Dec'17 inflation still far below ECB target ▶

4Q17 Eurozone PMI points at 0.8% q/q growth ▶

FX

EURCZK stuck to the 25.50-25.55 range.

Once EURCZK fell at the very end of 2017 as Resolution fund effect disappeared, market had little to trade in the first week of the new year.

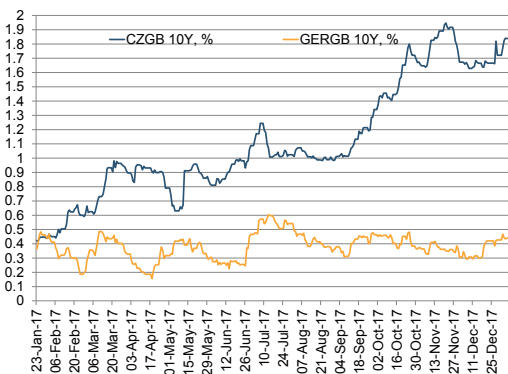
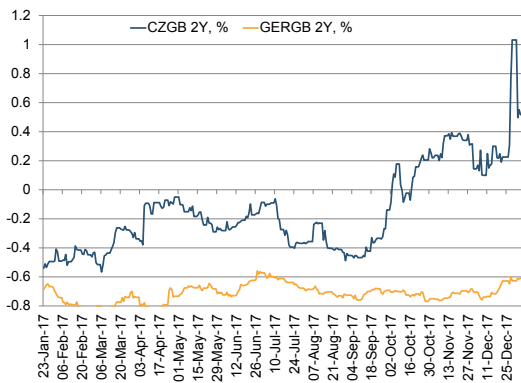
FI

As with CZK, market was calm one Resolution fund effect faded.

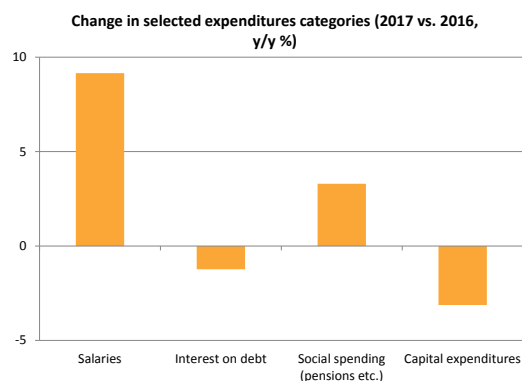
EURCZK STUCK TO 25.50-25.55



SHORT YIELDS RETURN LOWER AFTER RESOLUTION EFFECT VANISHES



### CZECH 2017 BUDGET IN A COMPLETE WRONG DIRECTION, DESPITE BEING ALMOST BALANCED



## | CZECH ECONOMY

### ■ Czech budget ended in a small cash deficit last year. A great success?

Not really. The CZK 8 bn. deficit (or CZK 1.3 bn. one if the EU money is omitted on either side of the budget) looks like a success only if one slept throughout the year, didn't read our Weekly ☺ and jumped to Ministry of Finance presentation the first thing after waking up in semi-alcoholic stupor in January ☺. So, what is wrong with budget that is almost balanced?

**First, exactly the fact that it is only balanced: had the economy grown at 1.5%, not 4%, balanced budget would be a success, but with strongest growth in a long time, it is hardly so.** With tax revenues (incl. social security) up 7.7% y/y at the central government level (and almost 7% at the level of general government, i.e. incl. municipalities), the budget should have been much, much better. And it would have been so had the government not squandered the windfall gain of faster economy: tax revenues' growth of CZK 82.4 bn. (7.7% mentioned above) was from three-fourths immediately spent on current expenditures!

**Hence, second, the structure of the budget was dismal.** Things that should have been kept in check rose massively whereas areas where spending should've increased were neglected.

By former I mean the current expenditures which increased CZK 62.6 bn., with CZK 10 bn. going towards higher salaries of public sector workers at central government, CZK 16.4 bn. going (mostly) to higher salaries of public sector employees at lower levels of administration (teachers etc.) and another CZK 17 bn. towards higher social allowances. By latter I allude to the fact that capital expenditures fell 3.1%.

**Third, the increase of current expenditures equals the increase of mandatory spending:** there is no going back on higher social allowances

or salaries. The inflexibility of the budget thus increased further.

To sum, the balanced budget of 2017 is dangerous in that it enables the government to treat fiscal issues with insouciance where nothing really was done to improve the precarious foundations on which public finances of Czech Republic rest. And all it will take to expose this is one mild recession.

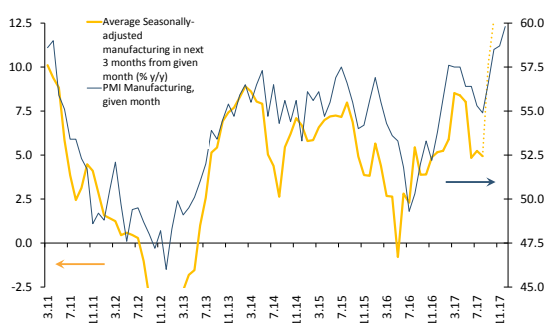
By the way, recall that the cash deficit was just CZK 20 bn. in 2008, and CZK 193 bn. the following year...

**Manufacturing PMI rose to almost 60 at the end of 2017.**

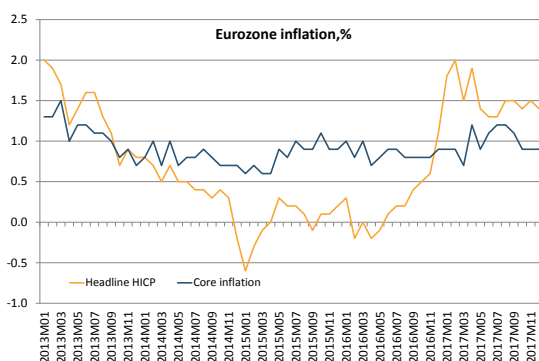
This is the highest in almost 7 years and due to the strong growth of actual production as well as of new orders, mainly from abroad. Since labor market is already tight, the backlogs of work increased – to a 7-year high as well.

Now, the levels at which PMI is now (59.8) is historically associated with double-digit growth of the manufacturing over the next three months. Although I don't think we'll see quite that, that 1Q18 will be stronger than previous quarters seems now like a certainty.

**PMI POINTS AT DOUBLE-DIGIT MANUFACTURING GROWTH IN 1Q18**



**EUROZONE INFLATION REMAINS LOW AND WITHOUT A TREND...**

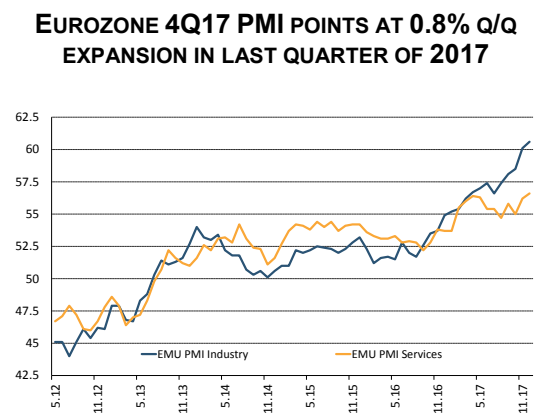
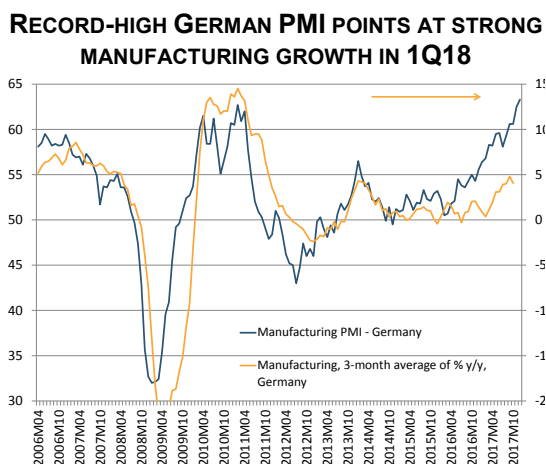
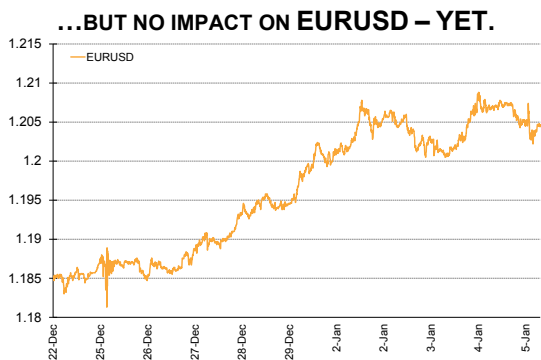


**EUROZONE ECONOMY**

**Preliminary inflation should have been a cold shower for the EURUSD bulls.**

As the Spanish / German data prefigured the week before last, inflation remained weak just as ECB was about to cut the monthly purchases of assets in half. December headline inflation returned to October's 1.4% and hence remained without a trend; core inflation defied market expectations for a rise to 1% and remained at 0.9% for the 3<sup>rd</sup> month in arrow, again without any trend.

For ECB, December inflation thus reinforces the view that the economy has not even begun to



generate inflation sustainably, and that therefore very loose monetary stance is justified.

For EURUSD, (December) inflation together with hawkish FED should bring EURUSD lower. It has not happened yet, but I think we'll see 1.15 sooner than 1.25.

**Final December PMI in Eurozone confirms EMU growth is strongest in close to 7 years.**

Final Services PMI was 56.6 (preliminary estimate 56.5), up 0.4 pts. from November, while manufacturing PMI remained unchanged from preliminary estimate at 60.6, up 0.5 pts. on November.

**In manufacturing,** PMI readings in Austria (64.3), Germany (63.3), Ireland (59.1) were all at all-time highs, with French PMI being at 17 year-high. This thus clearly shows how good the situation in the Eurozone manufacturing is. What we need to see now, especially in Germany, is that this translates into actual growth figures. So far, we've seen actual data in Germany lag massively behind the soft leading indicators.

**In services,** the index was strongest in 80 months, propelled by strongest increase of new orders in little over 10 years. This bodes well for the 1Q18.

**Altogether, Eurozone looks set to have grown 0.8% q/q in 4Q17** and momentum only got better towards the end of last year. This is certainly positive for ECB, as is the fact that, though slightly lower than in November, the increase of output prices reported by PMI respondents remained above long-term trend. Whether or when this will actually show up in HICP inflation is a different matter, though...

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MARKETS ‡

MM / IRS	3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y		
%	Actual	0.760	0.850	1.310	1.610	1.689	1.805	
	-1M	0.740	0.830	1.245	1.540	1.642	1.780	
	-3M	0.490	0.550	1.020	1.350	1.479	1.615	
	-6M	0.300	0.380	0.675	0.975	1.100	1.275	
ASW spread*	2Y	3Y	4Y	5Y	7Y	10Y		
bps.	Actual	-0.787	-0.802	-0.661	-0.732	-0.523	0.033	
	-1M	-0.973	-0.803	-0.908	-0.725	-0.646	-0.110	
	-3M	-0.842	-0.776	-0.869	-0.832	-0.749	-0.160	
	-6M	-0.774	-0.783	-0.842	-0.875	-0.789	-0.104	
CZGB**	2Y	3Y	4Y	5Y	7Y	10Y		
%	Actual	0.523	0.652	0.888	0.878	1.166	1.838	
	-1M	0.272	0.575	0.562	0.815	0.996	1.670	
	-3M	0.178	0.385	0.394	0.518	0.730	1.455	
	-6M	-0.099	0.017	0.063	0.100	0.311	1.171	
FX	EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD		
	Actual	25.540	4.153	308.44	4.631	4.495	1.203	
	-1M	25.618	4.213	314.27	4.631	4.543	1.180	
	-3M	25.888	4.311	312.20	4.577	4.241	1.173	
	-6M	26.145	4.238	308.28	4.592	4.140	1.142	

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

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