

January 14 | 2019

## Weekly | 2018 | Week 02

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## | CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	14-Jan-19	11:00	EMU	Industrial production, Nov'18, y/y (WDA)	1.9%	N/A
Tuesday	15-Jan-19	11:00	EMU	Trade Balance, Nov'18, EUR bn. (SA)	12.8	N/A
Wednesday	16-Jan-19	10:00	CZ	Industrial PPI, Dec'18, y/y	3.2%	N/A
Wednesday	16-Jan-19	10:00	CZ	Import prices, Nov'18, y/y	N/A	N/A
Thursday	17-Jan-19	11:00	EMU	Final HICP, Dec'18, y/y	1.6%	N/A
Friday	18-Jan-19	10:00	EMU	Current account, Nov'18, EUR bn. (SA)	N/A	N/A

\* LOCAL TIME IS CET

\*\* (REUTERS/ BLOOMBERG) POLL

## | JANUARY 2019 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
SPP 805*	3-Jan-19	4-Jan-19	4-Oct-19	CZK 5 bn. max	N/A
CZGB 2017-2027**	9-Jan-19	11-Jan-19	10-Feb-27	CZK 5 bn. max	0.25%
CZGB 2006-2036**	9-Jan-19	11-Jan-19	4-Dec-23	CZK 3 bn. max	4.20%
SPP 806*	17-Jan-19	18-Jan-19	19-Jul-19	CZK 5 bn. max	N/A
CZGB 2018-2021**	23-Jan-19	25-Jan-19	23-Feb-21	CZK 5 bn. max	0.75%
CZGB 2015-2026**	23-Jan-19	25-Jan-19	26-Jun-26	CZK 5 bn. max	2.40%
SPP 807	31-Jan-19	1-Feb-19	1-Nov-19	CZK 0-5 bn.	N/A

\* FOR T-BILLS, THIS IS MAXIMUM AMOUNT PER PRIMARY DEALER.

\*\* MINFIN CAN CHANGE THE ISSUE AT THE LATEST AT THE DAY OF THE AUCTION ANNOUNCEMENT FOR ONE WITH SIMILAR MATURITY.

## | THOUGHT OF THE WEEK

"I AM NOT A GRAMMAR NAZI, BUT I'D'VE ASKED THE WRITER TO USE "TRANCHES" INSTEAD OF "PARTS" IN THIS PARTICULAR HEADLINE... ↗?"

## WEEK AHEAD

**Not much by the way of data releases this week.**

**In here**, it is only import prices for November and PPI for December that will be released. And both will primarily reflect lower oil prices.

**In Eurozone**, final inflation data for December won't bring anything new while **November industrial production** will only confirm that weakness goes beyond Germany whose data we already have. ▶

## WEEK BEHIND

■ Czech inflation predominantly due to housing in 2018 ▶

■ Czech retail sales surprisingly strong in November ▶

■ German 11/18 industry data make (recession in 2H18 likely ▶

■ Eurozone consumers losing confidence, retail sales growth moribund ▶

## | FX

**EURCZK remained between...**

...25.55-25.65 last week, the mildly hawkish interview with the central bank Governor Rusnok ↗ notwithstanding.

## | FI

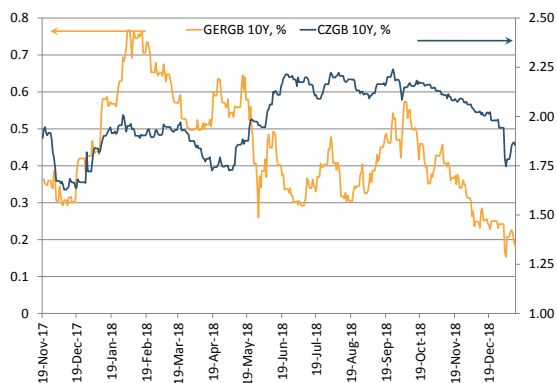
**German yields fell below 20 bps...**

...at 10 year maturity for the first time in almost 2 years. The release of account of the December 12-13 meeting ↗ of ECB (in which ECB said, inter alia, that “*situation remained fragile and fluid*” and that “*the balance of risks was moving to the downside*”) combined with weak global data (China, Germany) led to increased appetite for German government paper. Czech yields, on the other hand, rose a bit in last two weeks (10 bps. at 10Y) but still remain at their lowest since May of 2018.

### EURCZK REMAINS BETWEEN 25.55-25.65

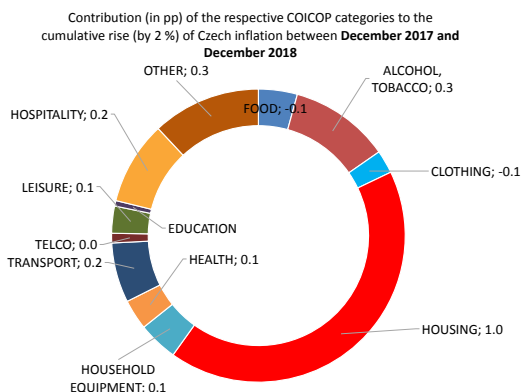


### GERMAN YIELDS FELL BELOW 20 BPS. ON ECB MINUTES, WEAK DATA

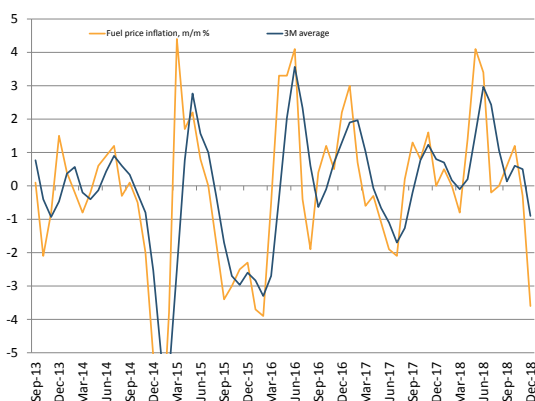


**CZECH ECONOMY**

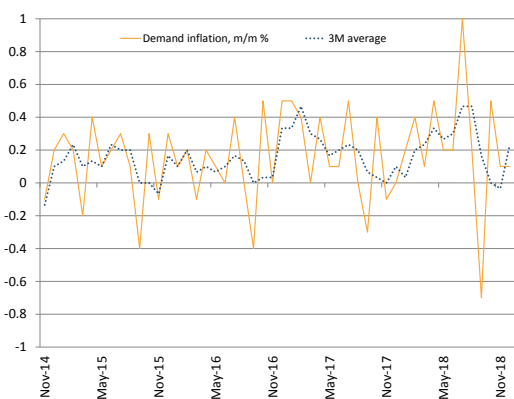
**CZECH INFLATION 50% DUE TO HOUSING**



**FUEL PRICES PLUMMETED IN DECEMBER, AS EXPECTED**



**MONTHLY DEMAND INFLATION WITH NO SIGN OF BEING RUNAWAY**



**Czech monetary-policy relevant inflation remains driven by housing...**

...with CNB clearly concerned, judging from the fact that half of the recent interview with CNB Governor Rusnok in daily ihned.cz was about real estate prices.

Anyway, the contribution of housing to 2% annual headline inflation (and 1.9% MPRI) was 1 pp, i.e. 50%. Nothing else comes even close to this contribution. Not all is due to real estate prices, but good part is – around half of the contribution of housing is due to rents (imputed), i.e. 0.5 pp of the total inflation. One could argue that no other category shows inflationary pressures because of five increases of repo rate in last year, but the problem with such an assertion is that

a) the CNB repo increases didn't show up in real economy interest rates one for one (rates on new consumer loans actually fell as CNB hiked...), and that

b) the time that's elapsed since CNB hikes is not long enough for the hikes to have affected the economy markedly (transmission takes longer).

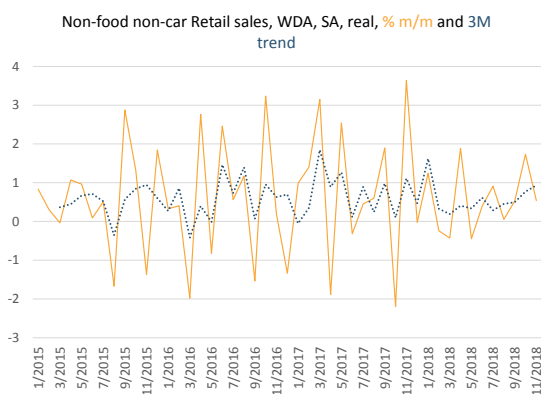
The truth is that, apart from the housing, the inflation (which was 2.1% for the entire 2018) is simply not a problem. When CNB tells you that it is and therefore that it needs to tighten, it basically tries to hide the fact that it wants to tame the real estate sector but lacks legally binding ways to do so (it cannot legally force banks to make fewer mortgages, it can merely "recommend" that they do so. Which it did in June 2018).

Demand inflation did rise to 2.6% y/y in December, but that is primarily a reflection of base effect (in November and December 2017 the demand inflation fell): the monthly dynamics doesn't show any signs of being runaway.

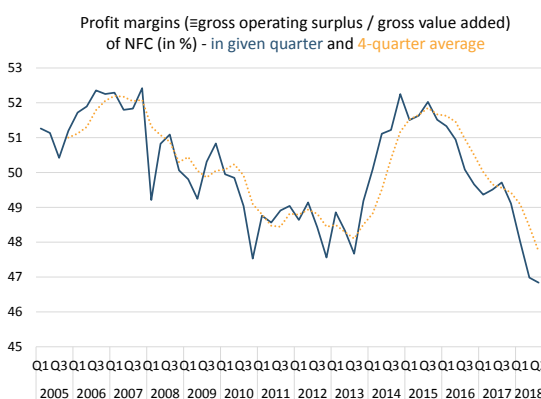
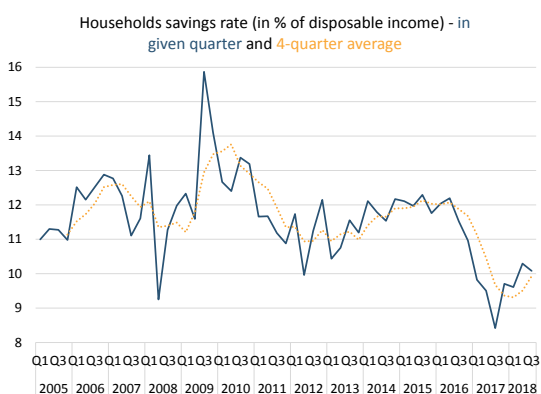
So, will CNB hike in February? It is not so clear: on the one hand there is strong CZK and weaker

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**CORE RETAIL SALES QUICKENED IN LAST THREE MONTHS**



**BUT HIGHER SAVINGS RATE AND LOWER PROFITABILITY OF CORPORATIONS MEAN 2019 GROWTH WILL BE MUCH SLOWER**



industry, on the other there is (nominally) high demand inflation and still solid demand of households... To me, it is clear what CNB should do (repo should stay unchanged) but with CNB, nobody knows.

**Retail sales remained solid in November, but slowdown in 2019 is very likely.**

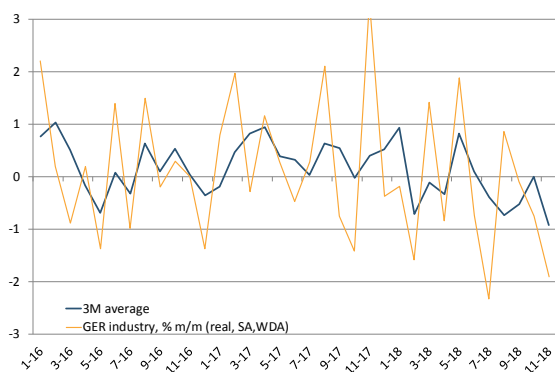
**Core retail sales (no food, fuel or cars) grew 0.5% m/m**, but what is more important is that the average in last three months was 1% m/m (the annual growth in November itself remained around 6%, just like it'd been throughout 2018). This is very strong growth indeed. But it is unlikely to hold: all signs point towards slowdown of momentum. Consumer confidence continues to decline, growth of wages peaked (firms profitability is lowest since at least 2005) and savings rate is 2 pp higher than a year ago.

And although **savings rate**, as **final 3Q18 GDP data** released last week showed, **declined** marginally against 2Q18 (10.3% in 2Q18 → 10.1% in 3Q18), it can reasonably be expected to rise higher once wage growth slows, as it must, and as economy slows. That wage growth must slow markedly this year is a foregone conclusion: profitability of companies is at all-time low and cold is coming in from the West that cannot but affect us. So, not only will the companies not have resources to sustain the growth of wages at rates seen in last years (or for that matter, even at one third of rates seen in that period), but the word “unemployment” will slowly come back into vocabulary of employees, taking “keeping the job” over “getting higher wage”.

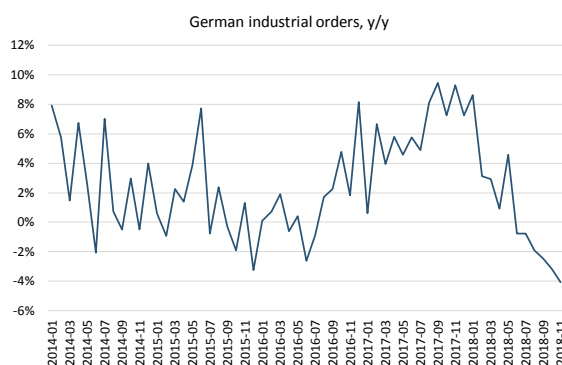
As relates the GDP growth in final 3Q18 release, there wasn't any change as against 2<sup>nd</sup> estimate ↗ released back in December: GDP grew 2.4% y/y and 0.6% q/q. in penultimate quarter of 2018. This is both below CNB / MINFIN expectation and below growth in Hungary or Poland (5%).

**EUROZONE ECONOMY**

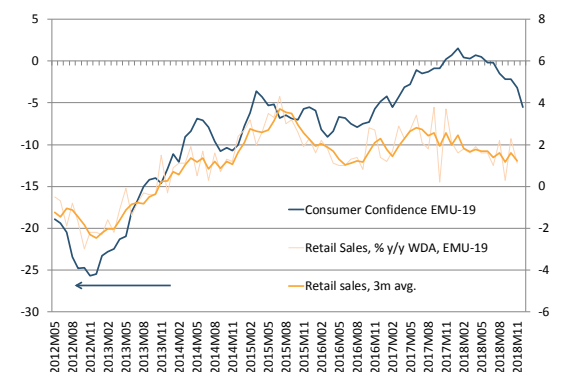
**GERMAN PRODUCTION DECLINES AGAIN IN NOVEMBER, RAISING FEARS OF 4Q18 GDP DECLINE.**



**ORDERS SHOW THE WEAKNESS IS LIKELY TO CONTINUE**



**HOUSEHOLDS LOSING OPTIMISM**



**German industry data make at least the moderate recession in 2H18 quite likely.**

Industrial production fell (1.9% m/m) for the third time in a row in November (and has fallen five times in last 6 months). Qualitatively the same was seen in manufacturing component thereof: the decline in November was 1.8% m/m, the cumulative decline over last 6 months was close to 5%. This is impossible to dismiss as one-off, transient etc. which was repeatedly mentioned by analysts last year. The structure also shows widespread weakness: every component of the production (capital goods, intermediate goods, consumer durables, non-durables etc.) showed the same pattern of weakness (and all of them fell in November).

And it doesn't look like it is going to get any better. **Orders fell 1% m/m in November and are now 4% lower y/y.** This was due to 12% decline of orders from Eurozone, which does smack of impact of French protests. But, even without this effect (if yellow vests caused this, which I don't know because country-by-country breakdown of orders is not available, and is questionable since protest only began in middle of November and that in only one country), the orders would be down y/y. Something is definitely up with German industry (and, hence, with world trade, of which it is an indicator), and it is only matter of (short) time before Czech industry shows the same symptoms.

Good times are over.

**And it is not only industry that says so.**

Eurozone consumers are becoming increasingly less optimistic: **the consumer confidence fell to lowest (-5.5 pts.) in December** since February 2017. This again closes the gap, wide open for 2 years, between verbal optimism (as seen in consumer confidence survey) and reality (as seen in actual spending of households, i.e. retail sales).

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And it is closing from only above: the **November retail sales**, also released last week, **grew at moribund 1.2% y/y**. This is clearly not something that would bring the core inflation up soon so that ECB could justify hiking the rates outright this year.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	2.010	2.070	2.135	1.870	1.784	1.750	
	-1M	2.010	2.070	2.290	2.330	2.295	2.270	
	-3M	1.740	1.810	2.330	2.560	2.564	2.580	
	-6M	1.170	1.250	1.700	1.900	1.926	1.970	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.439	-0.334	-0.263	-0.155	-0.034	0.033	
	-1M	-0.715	-0.716	-0.662	-0.551	-0.344	-0.239	
	-3M	-0.782	-0.822	-0.810	-0.718	-0.493	-0.432	
	-6M	-0.574	-0.611	-0.454	-0.305	-0.015	0.205	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.696	1.682	1.681	1.715	1.750	1.783	
	-1M	1.575	1.612	1.674	1.779	1.951	2.031	
	-3M	1.548	1.634	1.713	1.842	2.071	2.148	
	-6M	1.126	1.191	1.411	1.595	1.911	2.175	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.572	4.290	320.85	4.662	6.079	1.140	
	-1M	25.881	4.281	323.02	4.652	6.083	1.137	
	-3M	25.758	4.305	324.81	4.671	7.068	1.152	
	-6M	25.898	4.355	322.97	4.654	5.374	1.175	

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

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