# Weekly | 2018 | Week 02

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## CALENDAR

| DAY | DATE | TIME (CET)* | MARKET | RELEASE | CONSENSUS** | 42FS |
|---|---|---|---|---|---|---|
| Monday | 15-Jan | 10:00 | CZ | Current account, Nov17, CZK bn. | 1.0 | 3.0 |
| | 15-Jan | 11:00 | EMU | Trade Balance, Nov17, EUR bn. (SA) | 22.3 | N/A |
| Tuesday | 16-Jan | 9:00 | CZ | PPI Industrial, Dec'17, % y/y | 0.5% | 0.4% |
| | 16-Jan | 9:00 | CZ | Export and Import Prices, Nov17, y/y | N/A | N/A |
| Wednesday | 17-Jan | 11:00 | EMU | (Final) HICP, Dec'17, y/y | 1.4% | N/A |
| Friday | 19-Jan | 10:00 | EMU | Current account, Nov17, EUR bn. | 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

"JUDGING FROM THE PRESIDENT'S RESPONSE TO TWO NIPPLES, I CAN'T IMAGINE WHAT'D HAVE HAPPENED HAD SHE BEEN AU NATUREL."

## WEEK AHEAD

**Czech Republic will see producer and import prices for November.** Another proof that inflation threat was massively exaggerated by CNB and by most of the analysts will thus be provided.

**In Eurozone,** final December inflation will do nothing but confirm there are no inflation pressures to speak of.

# WEEK BEHIND

**December inflation debunks inflation threat myth of CNB ▶**

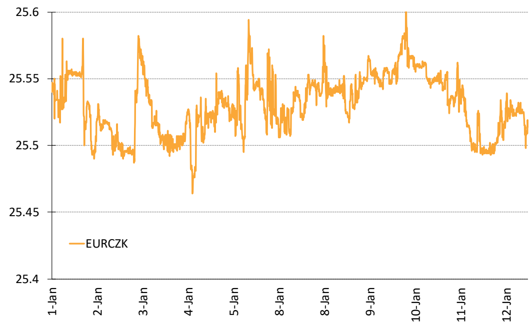
**Retail sales still strong except for cars ▶**

**Eurozone industry in strong growth in December as Germany surges ▶**

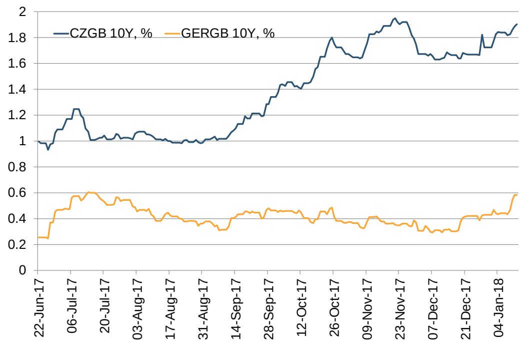
**Eurozone labor market improvement quickens in December ▶**

**ECB promises to revisit forward guidance soon ▶**

**EURCZK STILL STUCK TO 25.50-25.55**




**EUROZONE YIELDS RISE ON ECB MINUTES,…**




**…AND SO DOES EURO.**


## | FX

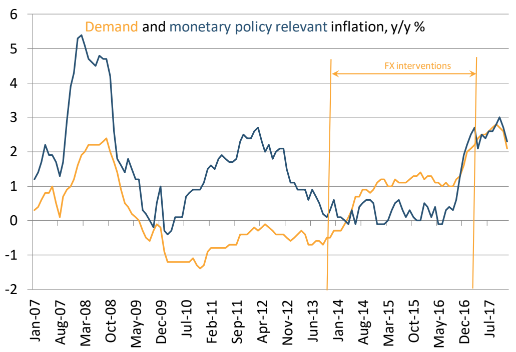
**EURCZK still stuck to the 25.50-25.55 range.**

## | FI

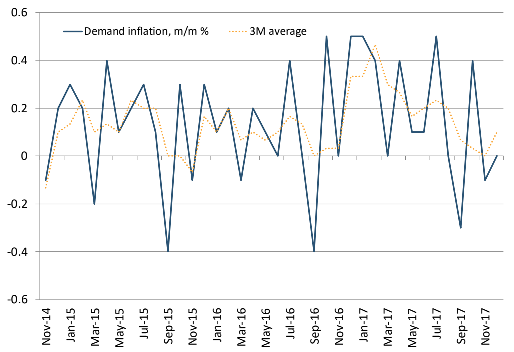
**German yields rose after ECB minutes, pulling Czech ones alongside.**

The minutes weren't anything hawkish, just the contrary, but the mention that there might be a 'revisiting' of the forward guidance early next year took market by surprise. Not only did the bonds rise (as the 'revisiting' is likely to take the form of removal of doubt that the asset purchases may not end in September), but euro climbed to highest (1.22) since the end of October 2014. This is exaggerated and if anyone is going to the U.S. this year, I'd consider buying dollars now.

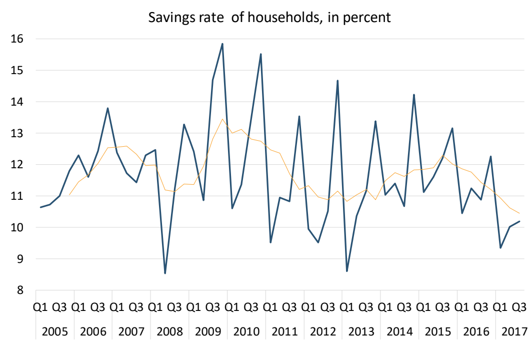
## CZECH REPUBLIC IN A STRONG DISINFLATION…




## …AS DEMAND INFLATION DYNAMICS SLACKENS SUBSTANTIALLY.




## NO QUICKENING OF DEMAND AND DEMAND INFLATION EXPECTED FOR 2018 AS SAVINGS RATE REMAINS NEAR ALL-TIME LOW…




# | CZECH ECONOMY

**December inflation was another debunking of the inflation threat myth perpetuated by (some in) CNB and (most of) analysts.**

Monetary-policy inflation fell to 2.3% and demand one fell to 2.1%, both thus now being 0.7pp below the local maxima of late Fall. This is the result of much slower monthly dynamics of the inflation at the end of last year than a year before: while demand inflation rose 1% in the last quarter of 2016, it rose just one third of a percent during the last quarter of 2017. And although some observers (bank analysts…) were “surprised” by the slower dynamics of the demand inflation (and although even CNB admitted that demand inflation was the reason for slight undershooting in December of its November inflation forecast), nothing else but this was to be expected.

**First, EET was bound to vanish from the numbers.** Recall that it was in December 2016 when implementation of the electronic record of sales system caused massive increase of prices in restaurants, prices subsumed under ‘demand inflation’. **Second**, **the real estate price** dynamics has been slowing and so has the imputed rent component of the consumer prices inflation. **Third**, **the openness of the economy simply doesn’t permit high locally generated demand inflation**: in Czech economy, high demand will find its reflection in worsening current account much sooner than in increasing price level. **Fourth**, stronger currency combined with still low inflation abroad precluded import of inflation. How could you not expect much slower demand inflation is beyond me.

**And this is not over yet.** First two/three months of 2018 will see further deceleration of both monetary-policy relevant and demand inflation. The former will be impacted by deceleration of the annual growth of food prices, the latter by the base effect of imputed rents: last year in January, the weight of imputed rents within CPI doubled which, combined with growth of real estate prices, led to massive increase of contribution of imputed rents to demand inflation.

Also, **last week's final 3Q17 GDP data,** although not bringing any change to previous release (0.5% q/q, 5% y/y), suggest 2018 household demand growth will be somewhat weaker than in 2017: savings rate is near all-time low while profitability of non-financial corporations has been worsening, limiting the space for strong wage growth.

Hence, the only thing that could now cause CNB to deliver what market expects (3-4 hikes next year) is substantial weakening of the CZK. Otherwise, it is going to be one hike at most - and only in February and only because that is the only time when CNB can still somewhat plausibly claim inflation outlook demands it.

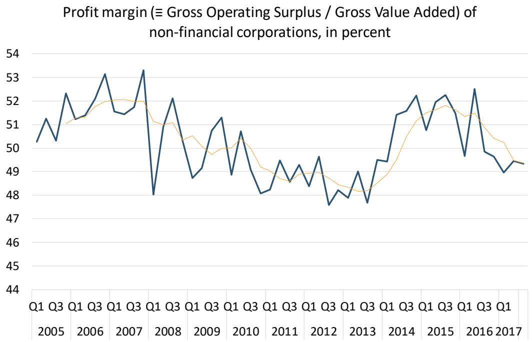
**Retail sales remained strong in November, confirming strong household appetite at the end of 2017.**

Core retail sales (i.e., without cars, fuel and food) posted a double-digit growth of almost 11%, with average over September-November being almost 9%, a clear testament to the healthy household demand.

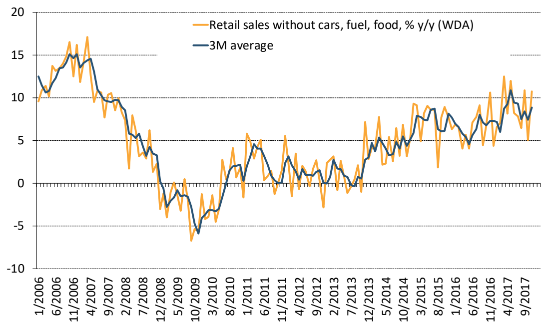
Food and fuel prices grew at the rate similar to the one seen in previous months (approx. 3% and 7% y/y, respectively) while car sales dipped below 0% again, extending the surprising weakness for the 6th month. I don't know what to make of this: elsewhere, the consumer exuberance is in full display, but not in car sales.

Whatever the reason, should CNB want to justify another hike in February (which isn't necessary from the pure inflation-targeting perspective), it will find sufficient ammunition for doing so in retail sales.

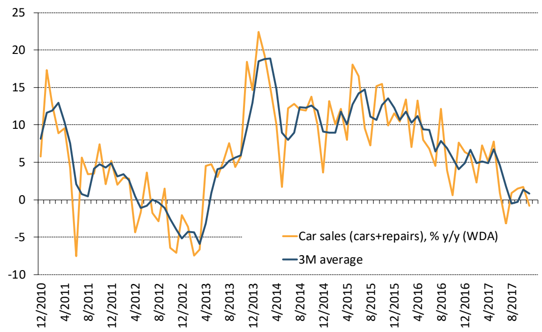
**…AND PROFITABILITY OF FIRMS CONTINUES TO WORSEN, LIMITING WAGE GROWTH POTENTIAL.**




**CORE RETAIL SALES STRONG…**




**…WHILE CAR SALES REMAIN SURPRISINGLY WEAK FOR THE 6TH MONTH IN A ROW.**



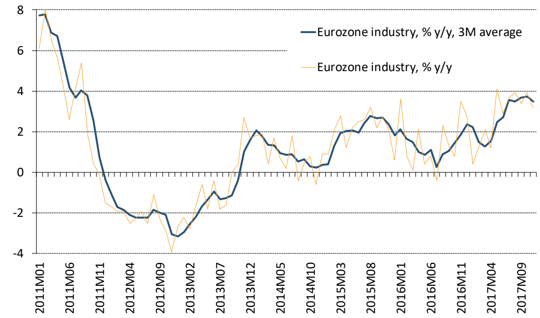
**Industrial production rose strongly after two weak months, with y/y growth finally being closer to what PMI suggested.**

The October and September saw cumulative decline of over 2%, so the 3.7% increase in November was a welcome development and more or less in line with the increase of PMI seen in the Fall, as well as with German growth in November. The annual growth was 8.5%, much closer to what PMI called for.

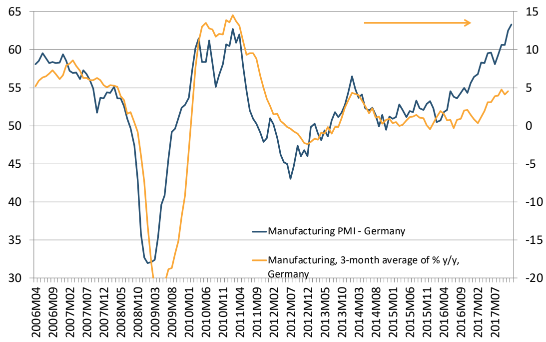
As was mentioned in Weekly 01 last, the levels at which PMI is now (59.8) have historically been associated with double-digit growth of the manufacturing over the subsequent three months. Although I don't think we'll see quite that, that 1Q18 will be stronger than previous quarters of 2017 seems now to be almost certain.

## | EUROZONE ECONOMY

**EUROZONE INDUSTRY POSTS 1% MONTHLY GAIN AS GERMANY SURGES 3.6%.**




**THAT SAID, GERMAN GROWTH IS STILL WELL BELOW WHAT PMI CALLS FOR.**



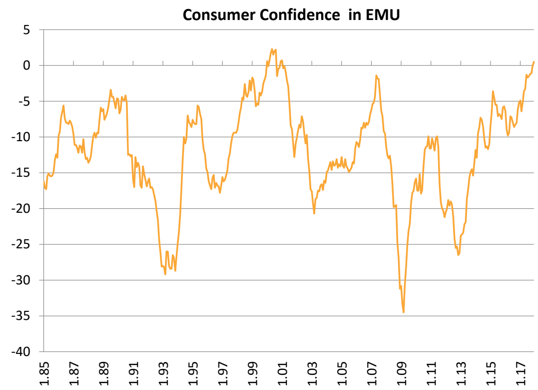

**Eurozone industry rose strongly in November, mainly on the back of strong German performance.**

Owing to the 3.6% monthly increase in Germany and partially due to 1% increase in Spain, both of which offset November stagnation in Italy and the outright fall (of 0.5% m/m) in France, the overall Eurozone industrial production growth was 1%. Together with 0.4% monthly gain in October, November growth means that even if Eurozone industry only stagnated in December, the growth was faster in 4Q17 than in 3Q17 (though only marginally so in this particular case). Structure was pretty boring, with both capital and consumer good productions up and energy one down.

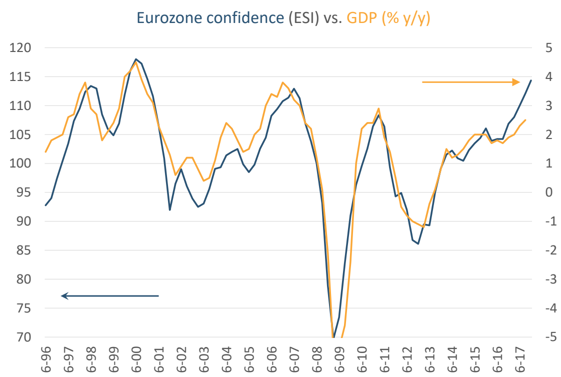
**The 1% m/m gain translated into the annual growth of 3.2%,** still only so-so considering where the leading indicators are. Same is still true for Germany: even if German November growth of industrial production shot to 5.7% y/y, fastest rate since August 2011, the PMI is so high that even 5.7% is still too low. The good thing, however, is

### THE RATE AT WHICH EUROZONE LABOR MARKET IMPROVES QUICKENED IN NOVEMBER


### CONSUMER CONFIDENCE IS CLOSE TO ALL-TIME HIGH…




### …WHILE OVERALL SENTIMENT IS HIGHEST SINCE EURO.




that the gap between PMI and the actual industrial production growth closed somewhat in November.

**Case for economic optimism for the 1st half of 2017 remains, unemployment and confidence data showed last week.**

Unemployment in Eurozone fell to 8.7% after it improved (by 0.1 pp) in all big economies expect for Spain. In Spain, the unemployment rate levelled off at 16.7% and hasn't improved much in recent months. German unemployment fell to a new all-time low of 3.6% and hence for all practical purposes this channel of support to household demand is exhausted. Now, the wages should rise.

The good news is that the rate of improvement of the unemployment rate, though still slow, quickened in November. Whereas in previous 2 years the unemployment rate had been improving at the rate of 0.8-1 pp per year, the improvement in November 2017 as against November 2016 was 1.1 pp.

**Together with consumer confidence which in December was confirmed at one of the highest levels in last 30+ years and with overall economic sentiment having been shown to be highest since euro, this bodes well for the consumer demand in early 2018**.

This I believe. But I don't think it will have tangible impact on the inflation anytime soon…

**ECB generally thinks so too, according to the minutes from December meeting. But there was one surprise.**

Minutes from December meeting were generally unchanged from previous months, with commitment "*to adjust the size or duration of the QE if necessary*". Forward guidance remained unchanged as well in both its elements: that asset purchases will not stop before September and that rates will remain low for long.
So far dovish through and through.
However, against the backdrop of stronger-than-

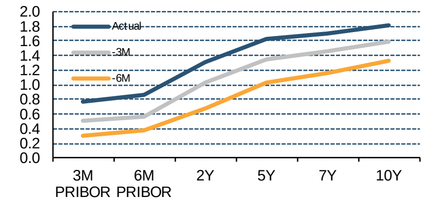
expected economic (though not inflation!) data, ECB came with one hawkish drop in the dovish sea when it said that *“the language pertaining to various dimensions of the monetary policy stance and forward guidance could be revisited early in the coming year.*” (without prejudice to sequencing established earlier, so ECB still believes QE will stop first, then rates will rise after a delay).

In other words, at one of next few meetings – possibly already in January – ECB will adjust the wording of the forward guidance. The most innocuous way to do so is to keep the promise to keep interest rates low for long but at the same time to say asset purchases will, with very high probability, stop in September.

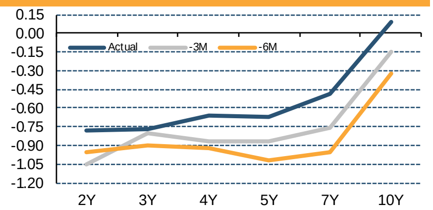
This would be relatively minor as nobody really expects the noticeable extension of the program, let alone increase of size anyway. **And it changes nothing in my view that inflation will remain depressed for long enough to not enable ECB to hike before 1H20.**

## | Markets ‡

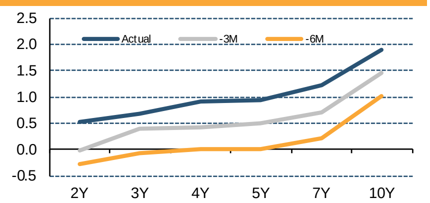
| MM / IRS | | 3M PRIBOR | 6M PRIBOR | 2Y | 5Y | 7Y | 10Y |
|---|---|---|---|---|---|---|---|
| % | Actual | 0.760 | 0.860 | 1.310 | 1.623 | 1.700 | 1.813 |
| | -1M | 0.760 | 0.850 | 1.340 | 1.645 | 1.740 | 1.870 |
| | -3M | 0.500 | 0.560 | 1.030 | 1.355 | 1.465 | 1.595 |
| | -6M | 0.300 | 0.380 | 0.680 | 1.023 | 1.164 | 1.326 |



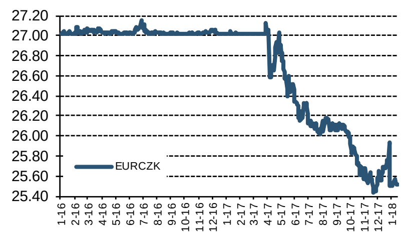

| ASW spread* | | 2Y | 3Y | 4Y | 5Y | 7Y | 10Y |
|---|---|---|---|---|---|---|---|
| bps. | Actual | -0.783 | -0.775 | -0.658 | -0.675 | -0.490 | 0.090 |
| | -1M | -1.040 | -0.883 | -1.032 | -0.859 | -0.732 | -0.205 |
| | -3M | -1.053 | -0.797 | -0.867 | -0.866 | -0.755 | -0.149 |
| | -6M | -0.954 | -0.906 | -0.918 | -1.024 | -0.955 | -0.318 |




| CZGB** | | 2Y | 3Y | 4Y | 5Y | 7Y | 10Y |
|---|---|---|---|---|---|---|---|
| % | Actual | 0.527 | 0.686 | 0.902 | 0.948 | 1.210 | 1.902 |
| | -1M | 0.300 | 0.601 | 0.547 | 0.786 | 1.008 | 1.665 |
| | -3M | -0.023 | 0.380 | 0.411 | 0.489 | 0.710 | 1.446 |
| | -6M | -0.274 | -0.083 | 0.012 | -0.001 | 0.209 | 1.008 |




| FX | | EURCZK | EURPLN | EURHUF | EURRON | EURTRY | EURUSD |
|---|---|---|---|---|---|---|---|
| | Actual | 25.513 | 4.171 | 308.77 | 4.632 | 4.571 | 1.220 |
| | -1M | 25.686 | 4.207 | 314.13 | 4.622 | 4.540 | 1.175 |
| | -3M | 25.807 | 4.246 | 308.15 | 4.586 | 4.297 | 1.182 |
| | -6M | 26.075 | 4.205 | 305.95 | 4.564 | 4.059 | 1.147 |




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

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