

January 21 | 2019

Weekly | 2018 | Week 03

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Wednesday	23-Jan-19	16:00	EMU	(Preliminary) Consumer confidence, Jan'19	-6.5	N/A
Thursday	24-Jan-19	9:00	CZ	Consumer & Business confidence, Jan'19	N/A	N/A
	24-Jan-19	10:00	EMU	(Preliminary) Service/Manufacturing PMI, Jan'19	51.5/51.3	N/A
	24-Jan-19	13:45	EMU	ECB Monetary-policy meeting, Refinancing / Marginal Lending / Deposit rate	0/0.25/-0.4%	N/A
Friday	25-Jan-19	10:00	GER	IFO Business Climate, Jan'19	100.6	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

“WHENEVER YOU THINK LOCAL POLITICS SUCK, REMEMBER THAT THERESA MAY LOST BY THE BIGGEST MARGIN EVER ↗ ON MOST IMPORTANT LEGISLATION IN DECADES AND SHE IS STILL A PM.”

WEEK AHEAD

Not much by the way of data releases this week in CZ. Only consumer and business confidence for January 2019 will be released, and it is reasonable, in light of development to the West of us, to expect further deterioration of both.

In Eurozone, ECB's meeting is the top event. Here, it's going to be very interesting to see how Draghi & Co. view the recent numbers from Eurozone which can easily be described as 'recessionary'. Previous meetings, under the influence of and motivated by the desire to extricate ECB from the QE, were overblown in their positivity, but I suspect that now Draghi will turn decidedly in the dovish direction. EURUSD may fall.

Almost equally as important are **two releases of January leading indicators:** German IFO and Eurozone PMI. If they worsen further against December, recession in Eurozone in 1Q19 will be almost assured.

WEEK BEHIND

Neither Czech import prices nor producer prices show higher inflation ahead.

Eurozone Nov'18 industry shatters hope of 4Q18 rebound

Eurozone Dec'18 inflation all but excludes 2019 hike

| FX

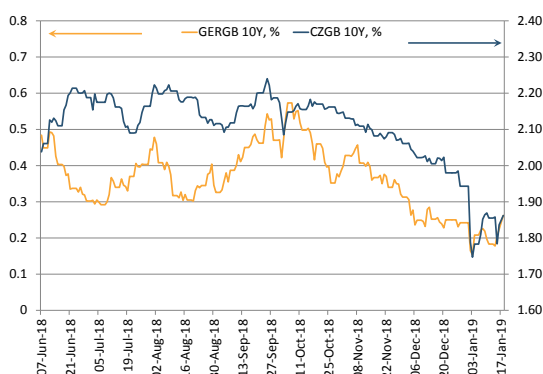
EURCZK continued to oscillate between 25.55 and...

EURCZK REMAINED BETWEEN 25.55-25.65



...25.65 last week, just like the week before. Governor Rusnok told the local radio that rates' increases would be slower this year than in 2018. He still made it sound like some increases would be made, but reading between the lines he created space for there not being any: "signals from the world are such that our estimate of growth (from November forecast) will be lowered in next forecast" or "it remains a question of how many increases will be necessary this year". CZK didn't respond to what's clearly a turn toward dovishness.

GERMAN YIELDS UP, ALLEGEDLY ON RISING HOPES OF SOFT BREXIT.



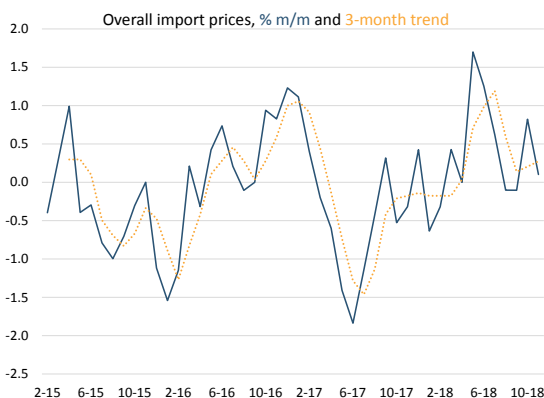
| FI

German 10Y yields rose to a month high,...

...a move ascribed to rising probability "of soft Brexit". I don't know whether this really is the cause, though, even if the 2.5% strengthening of pound vs. euro does indicate market being more optimistic on soft Brexit. What I don't understand is where market gets the confidence that hard Brexit is now less likely from: although majority of MPs in UK says that hard exit is what they DO NOT want, their inability to agree on anything makes the default option (=hard Brexit on WTO terms) at least as likely as before the vote on withdrawal agreement that government lost by largest margin ever.

CZECH ECONOMY

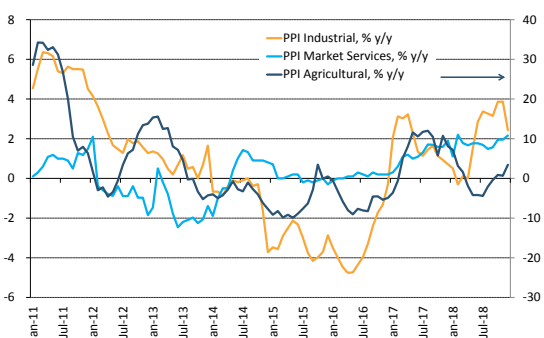
IMPORT PRICES ROSE MARGINALLY AS WEAKER CZK OUTWEIGHED LOWER OIL PRICE



Import prices rose marginally in November as weaker CZK outweighed the decline of oil price.

The import prices of mineral fuels fell 5.7% m/m, but still were almost 22% higher in November 2018 than what they were at the end of 2017. Against that effect, somewhat weaker CZK showed up in other segments, except for food (where import prices fell another 0.5%): the biggest m/m increase was in raw materials (+1.6% m/m), in chemicals (+0.8%) and in consumer goods (+0.75%). With CZK stronger now, this will not continue and there will be (moderate) downward pressure on import prices starting from February.

GROWTH OF INDUSTRIAL PRODUCER PRICES DECELERATED ON LOWER OIL PRICE

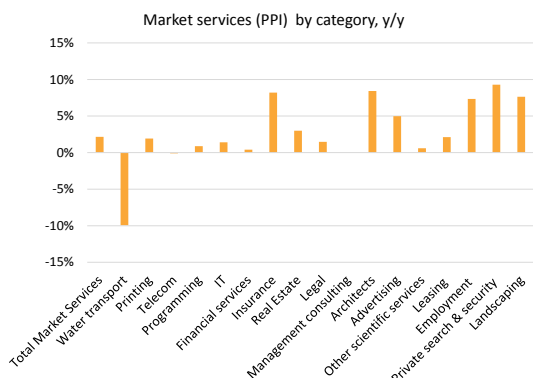


Producer prices diverged in December.

The growth of prices of industrial producers expectedly slowed in December as lower oil price filtered in: whereas in November the PPI grew 3.9% y/y, it was just 2.4% y/y in December. The monthly decline of 1% here was largest in almost three years and will bring the annual growth further still in coming months.

In agriculture and in market services, the results were different.

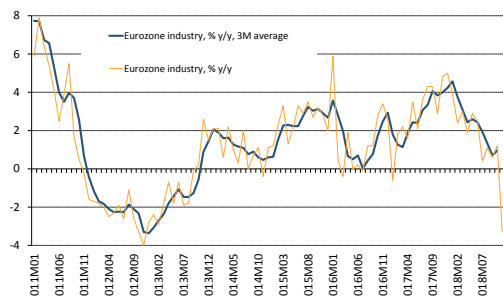
MARKET SERVICES' GROWTH OF 2.2% PREDOMINANTLY DUE TO CONSTRUCTION BOOM



Agricultural producer prices rose 3.4% y/y, fastest growth since January 2018, but their monthly growth of 2.2%, second fastest since September 2017, wasn't due to belated effect of weaker 2018 harvest: most of the monthly growth was due to higher prices of milk and eggs, i.e. items unlikely to have been affected by harvest. Considering the decline of agricultural producers' prices in 1H18, one should expect strong upward base effect in 1H19, with agricultural PPI being pushed above 7% in 1H19.

Market services' annual growth climbed back above 2% for the first time since February 2018, but the monthly dynamics don't show any acceleration that could lead one to believe that the annual

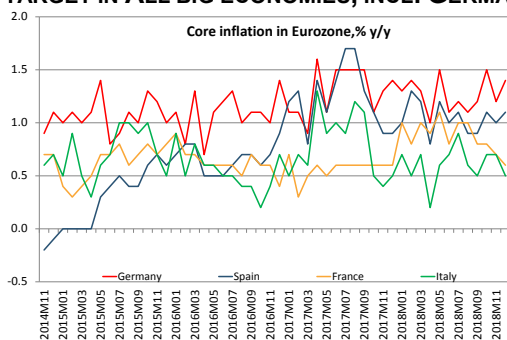
EUROZONE INDUSTRY IN DEEPEST ANNUAL DECLINE IN 6 YEARS



WEAKNESS UNIFORM GEOGRAPHICALLY AND PRODUCT-WISE



CORE INFLATION IN EUROZONE BELOW ECB TARGET IN ALL BIG ECONOMIES, INCL. GERMANY



growth will accelerate further. Moreover, looking at the structure, good amount of the annual increase of market services is due to construction (architects + 8.4% y/y) and employment (+7.4%) - and in both sectors the boom is about to end.

All in all, neither in the import prices nor in the producer prices can one see the origins of future higher inflation.

EUROZONE ECONOMY

Something is rotten in the industry of Eurozone.

November 2018 release of industry shattered the hopes of some analysts and central bankers that there'd be a quick rebound after 0.2% quarterly GDP crawl in 3Q18. If I'd only been given 10 CZK each time a weak German industrial data was dismissed as one-off last year, or when Draghi said "not to worry, inflation will climb to 2% soon", I'd be driving Ferrari now...

Well, the truth is that industry plummeted most in November (on a y/y in basis) in 6 years, falling 3.3% y/y (and 3.1% in manufacturing). The monthly decline of 1.7% was uniform: Germany -1.9% m/m, Spain -1.6% m/m, France -1.3% m/m, Italy -1.6% m/m. And so was the decline on goods' basis.

In short: if ECB hikes this year, it'll have outdone its most stupid previous move a.k.a. two hikes in April-May 2011, amid ongoing debt crisis and against the backdrop of streets in Athens full of protesters.

Final inflation for December confirmed there is absolutely no need to tighten policy anywhere in Eurozone.

Core inflation remained at 1% in December, just like in November, and hence far from the ECB's target of 'close to but below' 2%. I know, I know, ECB targets headline inflation (which slowed, due to energy prices, to 1.6%), but since what ECB is

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after is *sustainable* return of inflation to the target, it ultimately must target core inflation – as only that inflation can be self-sustaining.

Of all big economies, highest core inflation was in Germany (1.4%), but even there it was well below the ECB's target. In France it was 0.6%, in Italy 0.5%, in Spain 1.1%. And nowhere was there any positive trend to be seen. So much for sustainable convergence of inflation to the target that Draghi's been promising for at least a year now.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	2.010	2.070	2.175	1.980	1.915	1.920	
	-1M	2.020	2.080	2.285	2.280	2.239	2.210	
	-3M	1.760	1.860	2.385	2.640	2.650	2.670	
	-6M	1.180	1.270	1.750	1.990	2.007	2.065	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.397	-0.391	-0.263	-0.211	-0.115	-0.058	
	-1M	-0.688	-0.660	-0.591	-0.482	-0.290	-0.190	
	-3M	-0.813	-0.832	-0.846	-0.784	-0.568	-0.494	
	-6M	-0.660	-0.728	-0.591	-0.462	-0.166	0.041	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.778	1.730	1.782	1.769	1.800	1.862	
	-1M	1.597	1.629	1.695	1.798	1.949	2.020	
	-3M	1.572	1.673	1.743	1.856	2.082	2.176	
	-6M	1.090	1.138	1.355	1.528	1.841	2.106	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.582	4.288	317.73	4.705	6.046	1.136	
	-1M	25.746	4.285	322.21	4.645	6.077	1.136	
	-3M	25.871	4.305	323.46	4.672	6.461	1.145	
	-6M	25.840	4.307	324.04	4.655	5.583	1.164	

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

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