Weekly | 2018 | Week 04

MARTIN LOBOTKA, (+420) 777 027 165, MLobotka@42fs.com, Research@42fs.com

| CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Wednesday	30-Jan-19	7:30	FRA	(Preliminary) GDP growth, 4Q18, q/q	0.2%	N/A
	30-Jan-19	9:00	SPA	Retail sales, Dec'18, y/y	1.8%	N/A
	30-Jan-19	11:00	EMU	Economic Confidence, Dec'18	106.8	N/A
	30-Jan-19	14:00	GER	(Flash) HICP, Jan'19, y/y	1.7%	N/A
Thursday	31-Jan-19	8:00	GER	Retail sales, Dec'18, y/y	1.5%	N/A
	31-Jan-19	9:00	SPA	(Preliminary) GDP growth, 4Q18, q/q	0.6%	N/A
	31-Jan-19	11:00	EMU	Unemployment, Dec'18	7.9%	N/A
	31-Jan-19	11:00	EMU	(Preliminary) GDP growth, 4Q18, q/q	0.2%	N/A
	31-Jan-19	11:00	ITA	(Preliminary) GDP growth, 4Q18, q/q	-0.1%	N/A
Friday	1-Feb-19	9:30	CZ	Manufacturing PMI, Jan'19	49.5	N/A
	1-Feb-19	10:00	EMU	Manufacturing PMI, Jan'19	50.5	N/A
	1-Feb-19	11:00	EMU	(Flash) HICP, Jan'19, y/y	1.4%	N/A
	1-Feb-19	14:00	CZ	Budget balance, Jan'19, CZK bn.	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

“ IN THE FINE TRADITION OF BRITISH PEOPLE INTERACTING WITH FOREIGNERS, THERESA MAY’S “PLAN B” WAS TO SAY PLAN A AGAIN BUT LOUDER AND S L O W E R.”

WEEK AHEAD

Czech data are in the backseat this week as Eurozone releases the 4Q18 GDP growth estimates.

In Czech Republic, only manufacturing PMI for January is interesting. The forecast is for PMI to worsen marginally against December (49.7) and thus remain under 50. In light of weak soft indicators from Eurozone ► this is understandable. And realistic.

Eurozone is where the show is this week. First estimates of 4Q18 GDP growth for the Eurozone as a whole as well as for three out of four big economies (Italy, Spain and France, this one with structure) will be released. The expectation is at 0.2% q/q but recent data would lead me to expect something like 0-0.1% q/q. Nothing to give support to ECB’s claim from the last week’s meeting that economic expansion continues ►.

And the **preliminary January 2019 inflation** will further undermine the ECB’s story that inflation is about to converge to the target. Core inflation will be shown to have remained unchanged at 1%, just like in last two years.

WEEK BEHIND

Confidence in industry lowest in 5 years...

...and even MinFin (!) noticed something is up.

ECB made a dovish turn…

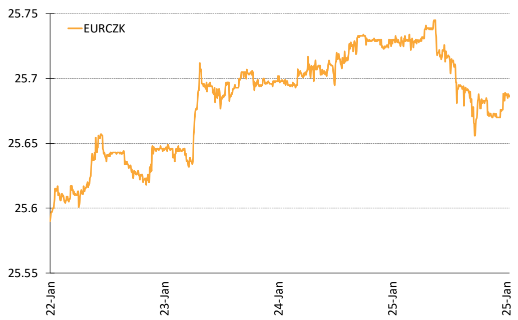
…as leading indicators softened further

| FX

EURCZK rose above 25.70,…

…as former de-facto chief economist Holub, since December a full Board member, said ↗ that the pause in the tightening from December may last longer and that the next hike may come “in spring or in summer”. Or, I would add, even later than that. With Germany teetering on the brink of recession, I don’t think even weaker CZK will cause CNB to tighten this year. We’re headed into much weaker times economically, but central bankers are for some reason unwilling or unable to see (or admit) that. For Holub, the problem is his obsession with models: if you’d spent 20 years looking at DSGE models, you might hesitate to look out of the window, so to speak. Not that I countenance it.

EURCZK ROSE ABOVE 25.70 AS HOLUB ADMITTED PAUSE IN TIGHTENING

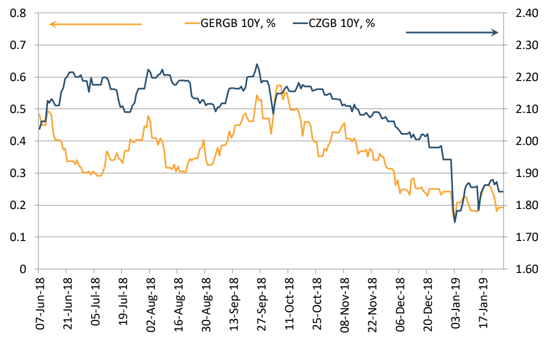


| FI

German 10Y fell below 20 bps. again…

…as ECB made a cautious dovish turn at its meeting last week. Weak soft indicators certainly contributed too.

GERMAN 10YS BACK BELOW 20 BPS. AS ECB TURNED CAUTIOUSLY DOVISH



| CZECH ECONOMY

MinFin finally – though, unfortunately, belatedly – noticed that something is up with the economy. And that good times don't last forever.

MinFin Schillerova (lawyer by training, so bear with her…) said last week ↗ that Minfin now "*expects* [economy to] *decline*" and that "*we must start saving*". Kid you not. This from the minister of the government whose Prime Minister ran all the electoral campaigns to date on the promise to "run country like a firm" …You know, like, as everyone knows, that it is the best time to start saving when going gets tough. God forbid to do it in years of abundance, of which we've just had three.

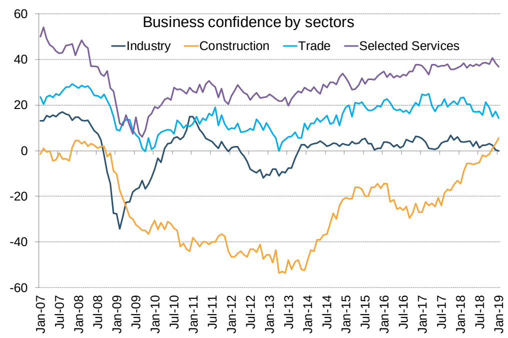
I don't know about you but I wouldn't let anyone with this level of economic thinking run a small shop, let alone a Ministry.

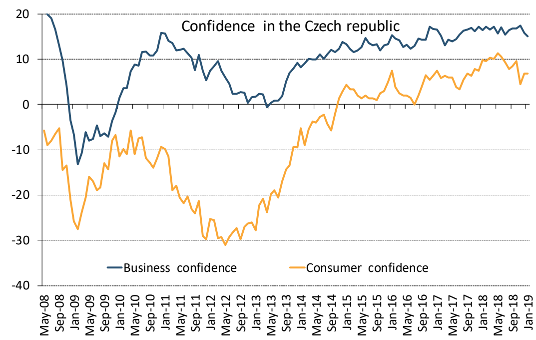
Confidence in construction now higher than that in industry.

Confidence in industry declined further (0 pts.) to lowest since October 2013, mainly due to further worsening of the expectations. Of course, one cannot speak of anything dramatic just yet, but the gradual worsening clearly continues. Declines were also seen in two other segments (in trade and in services) with the confidence in the former now lowest since November 2014.

The only sector where confidence continues to improve is thus construction. No wonder, with boom in the residential construction (that CNB tries to bring to a smooth halt with its 'recommendations' ↗) still going strong and with government investments still high. However, this will not last long. Economic slowdown + growing financial constraints of the government will cool the sector down soon.

CONFIDENCE IN CONSTRUCTION ABOVE THAT IN INDUSTRY,…





| EUROZONE ECONOMY

Leading indicators point to stagnation of growth in 1Q19.

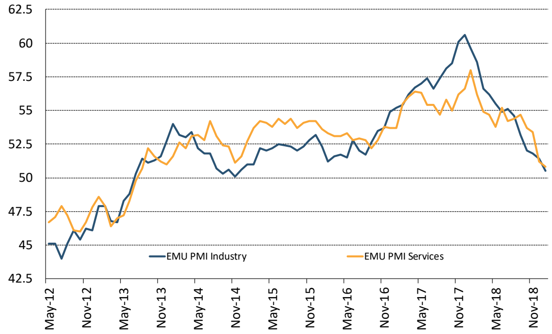
January flash PMI fell further in both services and industry, and both indices got close to 50, i.e. close to the level that's historically separated contraction from the expansion. Manufacturing PMI fell to 50.5, lowest in little over 4 years whereas service PMI was lowest (50.8) in almost 5 ½ years. And since the total new orders fell for the first time since November 2014, it doesn't look like this will improve soon. The weakness was primarily due to France where dominant service sector fell to lowest (47.5) in 59 months mainly on quickening rate of decline of new orders; service sector in France is now thus clearly in the contractionary territory.

Germany did slightly better overall compared with December: while manufacturing PMI was lowest in 50 months (49.9 vs 51.4 in December 2018), services improved to 53.1 (51.8 in December). Nonetheless, the overall PMI is second-slowest since the end of 2014. And with new orders in first outright decline since December 2014, this too is unlikely to improve soon. Also, level of pessimism about future as evidenced in the relevant subindex of PMI will prolong the economic weakness via cutbacks in investment and hiring. **If the Eurozone economy didn't contract outright in 1Q19, it will in 2Q19.**

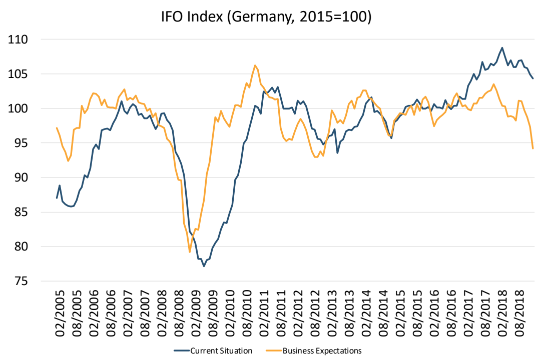
Other soft data confirm the weakness. German IFO fell to lowest in January (99.1 pts.) since February 2016, driven mainly by the deteriorating expectations. Actually, the expectations turned pessimistic for the first time in 6 years. The worsening was concentrated in manufacturing, but services worsened too. Germany very likely will have contracted in 1Q19.

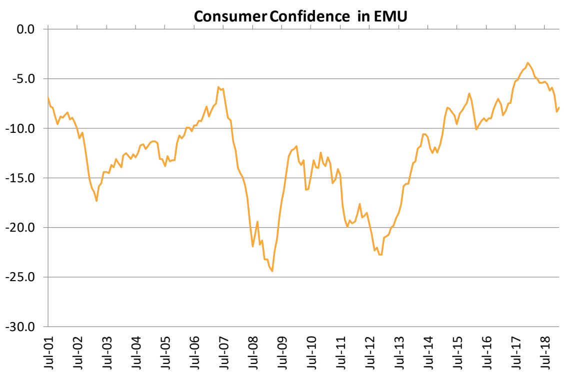
The only soft indicator release that didn't heighten the concern about the future was January flash consumer confidence for the entire Eurozone. Although close to lowest in over

PMIs HINT AT GDP STAGNATION AT BEST IN 1Q19



GERMAN BUSINESS EXPECTATIONS TURN NEGATIVE FOR THE FIRST TIME IN 6 YEARS





2 years, it remained above the long-term average. But, then again, consumers usually lag other sectors, such as the industry in spotting problems. Their confidence will worsen once employment does.

In short: **economy is going south.** No way will the ECB hike this year.

ECB is slowly beginning to acknowledge this, though it is taking as much time as it would to turn around a tanker…

ECB, at its January 24 meeting, admitted (unanimously, as Draghi said at the press conference) that "*the risks* [Brexit, trade war, market volatility, end of fiscal package in US] *surrounding the euro area growth outlook have moved to the downside on account of the persistence of uncertainties related to geopolitical factors and the threat of protectionism, vulnerabilities in emerging markets and financial market volatility.*" That's Brexit, trade war, market volatility, end of fiscal package in US, if you need translation from the ECB-ese.

But, if you thought that this, together with PMI in contraction territory, moribund retail sales and core inflation that hasn't gone anywhere in last five years would lead ECB to reconsider its monetary policy outlook, think again. ECB "*continues to expect*", just like in previous 6 months, that rates shall "*remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.*" This even when everyone sees that "at least through summer 2019" should've been changed to "at least through spring 2020".

Analysts at the press conference did ask why there weren't any changes to the outlook, to which Draghi said that this meeting was about "*assessment*" of the situation and that no "*implications were discussed*"…

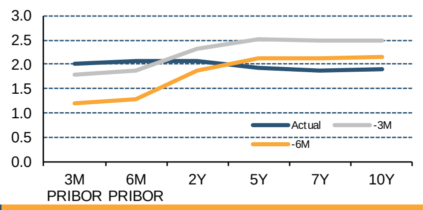
But, reticent as he usually is, he did at last hint at coming change: asked whether the market is pricing the interest hike of ECB correctly ("first hike in 2020") Draghi responded that "*we have to assess the developments and if this persistence* [of weak data, ML.] *will continue, we'll have to validate this indication". In other words, next meeting will likely exclude any tightening this year.

The journalist also asked why the core inflation hasn't moved vigorously up as ECB predicted. ECB admitted that "*it [core inflation] has been muted, has been moving sideways*" but that it would eventually move up… The confidence of ECB that inflation will converge sustainably to 2% is based on the "*continuation of the economic expansion*", on *"supportive financing conditions, favorable labor market dynamics and rising wage growth."* Well, economic expansion is dying as we speak, that is for the former. As for the latter, yes, the total labor costs rose 2.5% y/y in 3Q18, which indeed qualifies as "rising growth", but only because ten years since GFC saw annual growth of between 1% and 2% only. So, 2.5% y/y is at best normalization, not even a complete one, and one likely to stop now that industry (and the overall economy) are headed for stagnation, or worse.
Importantly in this respect, although Draghi did say that probability of recession was "*low*", the fact that he mentioned word "recession" nine times during the conference is itself quite a change from the December meeting.

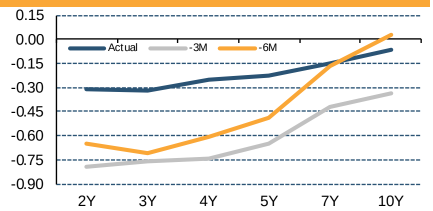
So, while nothing substantial came from the meeting, it is very likely that dovish changes in the outlook will be made at the next meeting, alongside the new, more pessimistic, forecast.

| Markets ‡

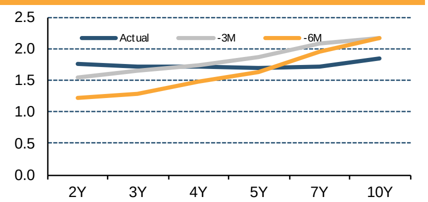
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	2.000	2.070	2.065	1.918	1.875	1.908
	-1M	2.010	2.060	2.040	1.870	1.802	1.815
	-3M	1.790	1.880	2.325	2.507	2.499	2.500
	-6M	1.200	1.290	1.875	2.120	2.122	2.140



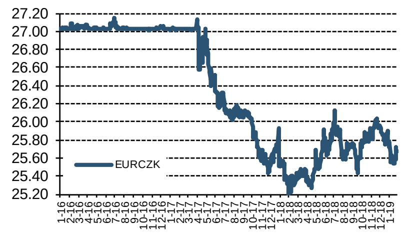
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.308	-0.316	-0.256	-0.225	-0.152	-0.067
	-1M	-0.548	-0.410	-0.266	-0.079	0.128	0.170
	-3M	-0.790	-0.763	-0.744	-0.650	-0.425	-0.338
	-6M	-0.649	-0.711	-0.610	-0.491	-0.172	0.024



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	1.757	1.709	1.712	1.693	1.723	1.841
	-1M	1.492	1.584	1.661	1.791	1.930	1.985
	-3M	1.535	1.657	1.735	1.857	2.074	2.162
	-6M	1.226	1.287	1.468	1.629	1.950	2.164



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.675	4.287	317.63	4.762	6.021	1.141
	-1M	25.833	4.290	321.07	4.660	6.050	1.143
	-3M	25.816	4.311	324.19	4.661	6.378	1.140
	-6M	25.635	4.286	322.45	4.624	5.656	1.166



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

| Contacts

Martin Lobotka, Analyst (+420) 777 027 165, MLobotka@42fs.com

Research Research@42fs.com

Available at Thomson Reuters Eikon Messenger

Previous issues of Weekly and other reports are available here ↗

| Disclaimer

This publication has been prepared by 42 Financial Services Czech Republic (hereafter referred to as '42 Financial Services' only). This report is for information purposes only.

Publications in the United Kingdom are available only to investment professionals, not private customers, as defined by the rules of the Financial Services Authority. Individuals who do not have professional experience in matters relating to investments should not rely on it.

The information contained herein has been obtained from public sources believed by 42 Financial Services to be reliable, but which may not have been independently justified. No guarantees, representations or warranties are made as to its accuracy, completeness or suitability for any purpose.

This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument or any other action and will not form the basis or a part of any contract.

Neither 42 Financial Services nor any of its affiliates, its respective directors, officers or employers accepts any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith. Any opinion, estimate or projection expressed in this publication reflects the current judgment of the author(s) on the date of this report. They do not necessarily reflect the opinions of 42 Financial Services and are subject to change without notice. 42 Financial Services has no obligation to update, modify or amend this report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favorable investment results.

42 Financial Services, its affiliates, principals or employees may have a long or short position or may transact in the financial instrument(s) referred to herein or may trade in such financial instruments with other customers on a principal basis. 42 Financial Services may act as a market maker in the financial instruments or companies discussed herein and may also perform or seek to perform investment banking services for those companies. 42 Financial Services may act upon or use the information or conclusion contained in this report before it is distributed to other persons.

This report is subject to the copyright of 42 Financial Services. No part of this publication may be copied or redistributed to persons or firms other than the authorized recipient without the prior written consent of 42 Financial Services.

By accepting this report, a recipient hereof agrees to be bound by the foregoing limitations.