Weekly | 2018 | Week 04

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	29-Jan	9:00	**SPA**	Retail sales, Dec'17, y/y	2.2%	**N/A**
Tuesday	30-Jan	7:30	**FRA**	(1st estimate) GDP 4Q17, q/q (SA)	0.5%	**N/A**
	30-Jan	9:00	**SPA**	(1st estimate) GDP 4Q17, q/q (SA)	0.7%	**N/A**
	30-Jan	11:00	**EMU**	(1st estimate) GDP 4Q17, q/q (SA)	0.6%	**N/A**
	30-Jan	14:00	**GER**	(Preliminary) HICP, Jan'18, y/y	1.6%	**N/A**
Wednesday	31-Jan	8:00	**GER**	Retail sales, Dec'17, y/y	2.8%	**N/A**
	31-Jan	8:45	**FRA**	(Preliminary) HICP, Jan'18, y/y	0.9%	**N/A**
	31-Jan	9:00	**SPA**	(Preliminary) HICP, Jan'18, y/y	2.4%	**N/A**
	31-Jan	11:00	**EMU**	(Preliminary) Headline/Core HICP, Jan'18, y/y	1.3%/1%	**N/A**
Thursday	1-Feb	9:30	**CZ**	Manufacturing PMI, Jan'18	59.0	**N/A**
	1-Feb	13:00	**CZ**	Rate-setting meeting of CNB	0.75%	**0.75%**
	1-Feb	14:00	**CZ**	Budget balance, Jan'18, CZK bn.	N/A	**N/A**
Friday	2-Feb	11:00	**ITA**	(Preliminary) HICP, Jan'18, y/y	0.8%	**N/A**

* LOCAL TIME IS CET
** (REUTERS/ BLOOMBERG) POLL

FEBRUARY 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
SPP 780	1-Feb	2-Feb	4-May-18	CZK 0-5 bn.	N/A
CZGB 2007-2022**	7-Feb	9-Feb	12-Sep-22	CZK 3 bn. max	4,70%
CZGB 2017-2027**	7-Feb	9-Feb	10-Feb-27	CZK 4 bn. max	0,25%
CZGB 2015-2030**	7-Feb	9-Feb	15-May-30	CZK 4 bn. max	0.95%
SPP 781	8-Feb	9-Feb	11-May-18	CZK 0-5 bn.	N/A
SPP 781	15-Feb	16-Feb	18-May-18	CZK 0-5 bn.	N/A
CZGB 2018-2021**	21-Feb	23-Feb	23-Feb-21	CZK 4 bn. max	N/A
CZGB 2015-2026**	21-Feb	23-Feb	26-Jun-26	CZK 4 bn. max	1,00%
CZGB 2018-2029**	21-Feb	23-Feb	23-Jul-29	CZK 4 bn. max	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.

THOUGHT OF THE WEEK

"(HEARD IN A BAR BEFORE PRESIDENTIAL ELECTIONS): TALKING TO HIS VOTER FEELS LIKE PLAYING CHESS WITH PIGEON. HE THROWS THE CHESS PIECES AROUND, TAKE A S**T ON THE CHESSBOARD ONLY TO WALK ON IT PROUDLY MOMENTS AFTER."

WEEK AHEAD

The major event is of course the CNB rate-setting meeting, the first one in 2018.

Although as I said repeatedly ↗ ↗ there's no need to tighten policy from the purely inflationary perspective, I think **it is likely that another hike will come this Thursday**. First, **inflation** (last release we have is from December) is **still high** enough to sustain the CBV-perpetuated myth of deflationary pressures (monthly dynamics of demand inflation itself shows something else). January and February should see another strong disinflation, 5% increase of oil prices in CZK since November nonetheless. **Second, soft indicators from Eurozone** strengthened ▶ in January, giving ammunition to those that see inflation pressure lurking everywhere (stronger EURUSD nonetheless). **Third, new forecast will be released** and changes in repo rate tend to happen in those months. What could theoretically work against the hike is that only 5 out 7 Board members will be present and one of the missing members will be Mojmir Hampl who, together with Vojtech Benda, voted for hike in December. Since Marek Mora also sounded hawkish recently (see below) while Tomsik is fairly dovish, the decision will depend on Governor's Rusnok stance. But Rusnok said last year he wants to see rates normalized (at 3%) in two years, so he needs to move quickly, and also said last week that there is 'solid probability' of rates rising in February. Finally, his words that there is a bubble in real estate prices also point at hike. **Hence, hike is more likely than not, inflation slowdown nonetheless.**

In Eurozone, **key releases are first estimate of GDP for 4Q17 and flash January inflation**. As said elsewhere, ESI points at 1% q/q GDP expansion while 4Q17 PMI hints at 0.7-0.8% q/q. The analysts' expectations are for more moderate growth of 0.6% q/q, so any surprise is likely to pour more gasoline on the USD vs. EUR pyre. **Jan'18 HICP will've remained low and w/o trend**. This should counter euro enthusiasm, though market now seems more inclined to see EUR positive than EUR negative news.

WEEK BEHIND

▌ Czech consumer confidence breaks another record ▶

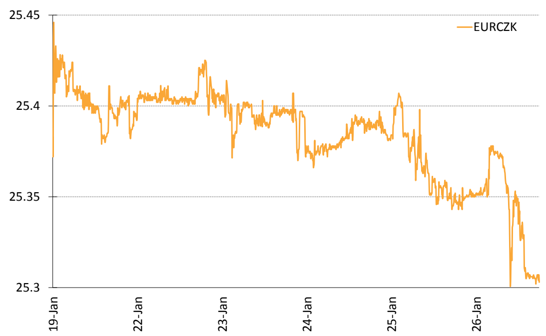
▌ Presidential elections won by incumbent President Zeman, no market impact foreseen ▶

▌ Eurozone PMI joins IFO, ESI in pointing at 1% q/q growth ▶

▌ ECB dovish meeting did nothing to stop EURUSD from rising to a three-year high ▶

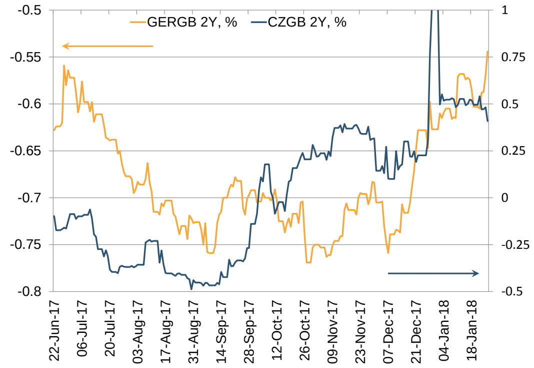
| FX

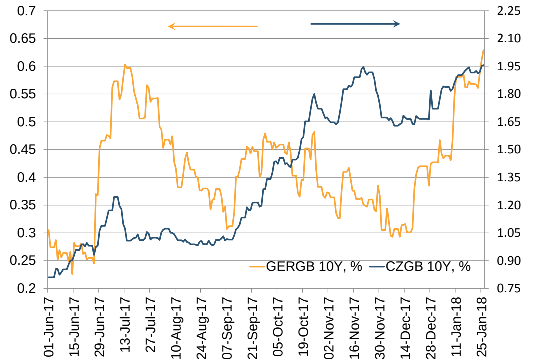
EURCZK ATTACKS 25.30 AMID CBANKER'S HAWKISH COMMENT



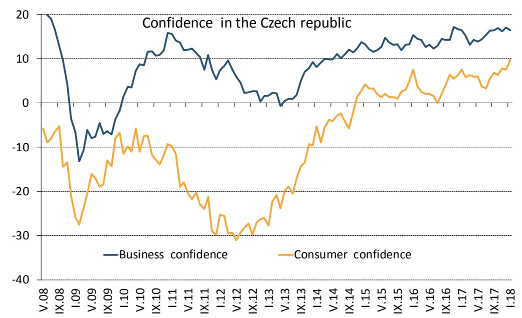
EURCZK strengthened to 25.30 in the run-up to the first 2018 meeting of CNB.
Board member Mora ↗ was hawkish when he said he'd vote for the hike at this week's CNB meeting, arguing that surprisingly stronger growth indicators in Eurozone are pro-inflationary risk to the latest (and soon-to-be-revised) November forecast. Although he admitted that wage growth isn't excessive and although he forgot to mention that the monthly inflationary dynamics remains weak, he made it sound like that February vote for the hike is almost certain and that he might vote for more hikes down the road.

ALTHOUGH GERMAN YIELDS ROSE ON STRONG SOFT INDICATORS, CZECH ONES STAGNATED OR FELL

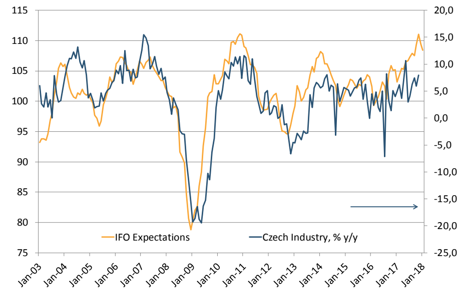




CZECH CONSUMER CONFIDENCE BREAKS ANOTHER RECORD IN JANUARY



CLOSE RELATIONSHIP BETWEEN CZECH INDUSTRY AND IFO CALLS FOR QUICKER CZECH IP GROWTH AHEAD



| FI

German yields rose on strong soft indicators and despite the dovish ECB.

Czech yields remained stable or, in case of short-end of the curve, declined moderately.

| CZECH ECONOMY

Czech (consumer) confidence rose further at the beginning of 2018.

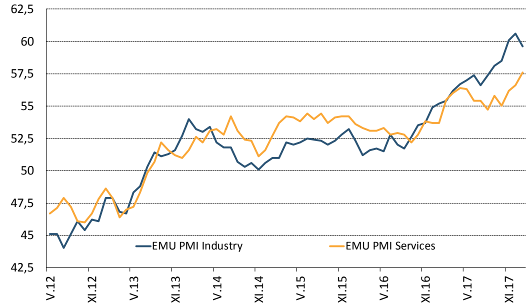
In January, consumers' morale, measured by Czech Statistical Office (CSO), shot to +10 pts., the highest ever. This shows that as far as household demand is concerned, there is no reason to worry that it will not be powerful growth driver this year just like it was in 2017.

In business, the situation is not that optimistic – business confidence remains close to the post-crisis highs but well below the pre-crisis peaks. This is a bit strange as in Eurozone, as will be seen below, the confidence of both consumers and business improved a lot in last three months. However, looking at, for example, German IFO and its close historical relationship with the Czech industry (current levels of German IFO point at 10%, the fact that confidence is not higher does not mean the industry will not quicken in 1Q18.

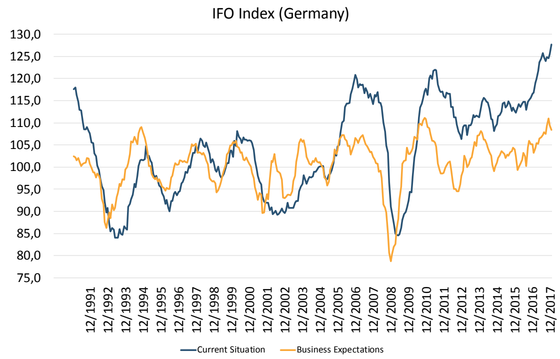
The 2nd round of the presidential elections was won by the incumbent President Zeman, though only by a small margin of approx. 150 000 votes.

This, however, is of no consequence for the Czech Republic and the markets shouldn't react. See, Czech Republic hasn't had a proper government since October of 2017 (the current one of PM Babis was always bound to not get confidence and has now resigned) and nothing happened: if anything, CZK is stronger than 2 months back. Hence, who cares about the President… The overall campaign

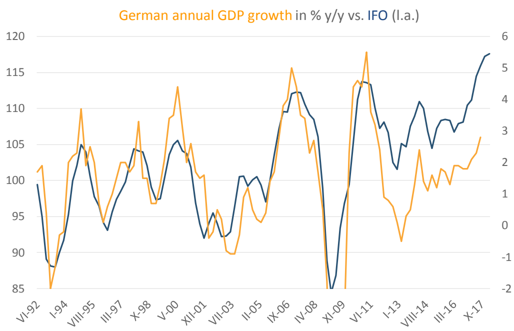
EUROZONE PMI POINTS TO 1% Q/Q GROWTH IN 1Q18, MIMICKING EUROZONE SENTIMENT INDICATOR (ESI)



GERMAN IFO AT NEW HIGH…



…POINTS AT QUICKER GERMAN GROWTH AHEAD.



EURUSD CONTINUES TO RISE DESPITE DOVISH ECB

frenzy didn't correspond with the influence of the President in the Czech political system, which, symbolism aside, is fairly small.

| EUROZONE ECONOMY

Eurozone growth indicators improved further in January, pointing at 1% q/q growth in this quarter.

At least that is what PMI hints at. Although the manufacturing component fell slightly from the December high, it remains well above the long-term average and only slightly (0.4 pts.) below 60. Service component continues to climb higher, though, with PMI at 57.6 in January. Put together, the **composite PMI is at levels unseen in 12 years and at levels consistent with growth of 1% q/q**.
Which, by the way, if you recall, is the same growth that consumer confidence, European Sentiment Indicator (ESI) or ….

…German IFO have been forecasting for some time. After a small pull-back in December, **IFO rose again in January, reaching the joint all-time high of November 2016** (117.6). This was due to assessment of the current situation having risen to the new all-time high (the expectation component worsened, but this one has recently been more volatile than assessment of current situation).

To sum, **all the leading indicators now point at much faster 1Q18 than 4Q17** which, in turn, should be faster than 3Q17. Let us see whether real data really confirm this.

Although ECB meeting was anti-euro dovish affair, euro continued to rise.

Right off the bat, Draghi made it clear that there was no change in the forward guidance at the meeting and then, in Q&A session, made it clear that the minutes from the December meeting were misconstrued. Draghi said that what was meant by the (allegedly misconstrued) sentence ("*the language pertaining to various dimensions of the monetary policy stance and forward guidance could be revisited early in the coming year*") meant only that there will be a discussion starting in early 2018, not a decision on that. To send even more dovish message, Draghi added that the "*discussion hasn't really started yet"* and the only thing that happened at the meeting was bankers went "*through the events since October to now*" trying to see what changed. He also said that the risks to ECB forecasts are balanced, that there can be no "*declaration of victory*" yet, that price pressures are muted (to say the least, ML.), that there no signs of convincing upward movement of underlying inflation, that wages aren't growing etc. In other words, a bonfire of dovishness even without the comments on EURUSD exchange rate.

And comment on EURUSD he did, betraying the displeasure at the recent EURUSD movements. He asked himself the rhetorical question of whether the EURUSD strengthening of late (1.25) was produced endogenously and thus justifiably, or not. He said that there were three reasons for the improvement of the EURUSD:

- *improvement of the economy* (ML: true, but so far only at the level of soft indicators);
- "*heightened market sensitivity to perceived changes in ECB communication*" (ML: probably a complaint of ECB to market response to minutes…);
- *the verbal interventions of US representatives* (in Draghi's words the "*use of language … that doesn't reflect the terms of reference that have been agreed lastly on October 14th 2017 in the IMFC in Washington").*

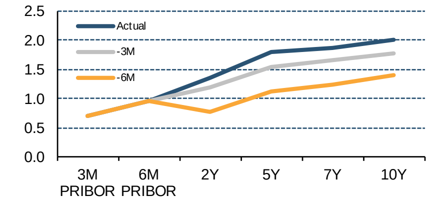
This last comment was a reference to Treasury Secretary Mnuchin's comments in Davos that weak dollar was good for US trade and that the dollar fluctuations don't concern him, a stark departure from the long-time mantra of "strong dollar" (mantra that began, if I am not mistaken, with Robert Rubin under Clinton). Trump's five-grader-like response ("*We are doing so well. Our country is becoming so economically strong again that the dollar is going to get stronger and stronger, and ultimately I want to see a strong dollar."*) did little to tame the sell-off.

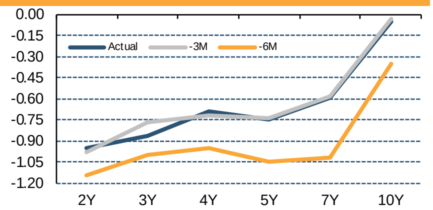
In my eyes, **nothing justifies the current strength of the euro**, but the market still can have a lot of fuel to run on: while from US there will hardly be any surprise that market considers hawkish (market being ready for three hikes there), from Eurozone there can apparently hardly be a dovish surprise.

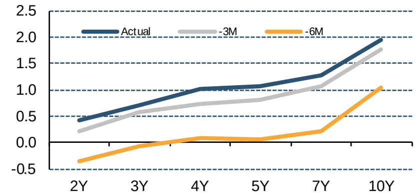
Still: Fundamentally, EURUSD should be below 1.20.

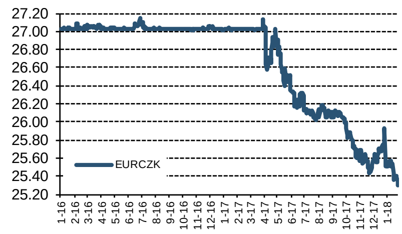
| MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.709	0.969	1.365	1.805	1.877	2.010
	-1M	0.709	0.969	1.307	1.619	1.710	1.839
	-3M	0.709	0.969	1.190	1.540	1.654	1.785
	-6M	0.709	0.969	0.780	1.115	1.240	1.400
ASW spread*		**2Y**	**3Y**	**4Y**	**5Y**	**7Y**	**10Y**
bps.	Actual	-0.956	-0.865	-0.691	-0.752	-0.593	-0.054
	-1M	-1.081	-0.825	-0.933	-0.832	-0.648	-0.173
	-3M	-0.986	-0.767	-0.726	-0.745	-0.589	-0.032
	-6M	-1.142	-1.004	-0.955	-1.052	-1.019	-0.354
CZGB**		**2Y**	**3Y**	**4Y**	**5Y**	**7Y**	**10Y**
%	Actual	0.409	0.701	1.003	1.053	1.284	1.956
	-1M	0.226	0.623	0.615	0.787	1.062	1.666
	-3M	0.204	0.584	0.733	0.795	1.065	1.753
	-6M	-0.362	-0.081	0.073	0.063	0.221	1.046
FX		**EURCZK**	**EURPLN**	**EURHUF**	**EURRON**	**EURTRY**	**EURUSD**
	Actual	25.300	4.135	309.37	4.662	4.659	1.242
	-1M	1.750	1.562	1.38	1.681	1.790	1.821
	-3M	1.750	1.562	1.38	1.681	1.790	1.821
	-6M	1.750	1.562	1.38	1.681	1.790	1.821









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

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