

Weekly | 2018 | Week 05

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**
Tuesday	5-Feb-19	9:00	CZ	Retail sales, Dec'18, y/y	0.8%
	5-Feb-19	10:00	EMU	(Final) Service PMI, Jan'19	50.8
	5-Feb-19	11:00	EMU	Retail sales, Dec'18, y/y	0.8%
Wednesday	6-Feb-19	8:00	GER	Industrial orders, Dec'18, y/y	-6.7%
	6-Feb-19	9:00	CZ	Industrial production, Dec'18, y/y	0.0%
	6-Feb-19	9:00	CZ	Trade balance, Dec'18, CZK bn.	-5.5
Thursday	7-Feb-19	8:00	GER	Industrial production, Dec'18, y/y	-3.3%
	7-Feb-19	13:00	CZ	CNB rate-setting meeting, 2-week repo rate	1.75%
Friday	8-Feb-19	9:00	CZ	Unemployment 15-65, Jan'19	3.2%
	8-Feb-19	8:45	FRA	Industrial production, Dec'18, y/y	-1.4%
	8-Feb-19	10:00	ITA	Industrial production, Dec'18, y/y (WDA)	-2.7%

* LOCAL TIME IS CET

** (REUTERS/ BLOOMBERG) POLL

FEBRUARY 2019 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2014-2025**	6-Feb-19	8-Feb-19	17-Sep-25	CZK 5 bn. max	2.40%
CZGB 2017-2027**	6-Feb-19	8-Feb-19	10-Feb-27	CZK 5 bn. max	0.25%
SPP 808*	14-Feb-19	15-Feb-19	16-Aug-19	CZK 5 bn. max	N/A
CZGB 2019-XXXX EURO***	20-Feb-19	22-Feb-19	22.2.21/22.2.22	EUR 100 mn. max	0.00%
CZGB 2018-2029**	27-Feb-19	1-Mar-19	23-Jul-29	CZK 5 bn. max	2.75%
CZGB 2015-2030**	27-Feb-19	1-Mar-19	15-May-30	CZK 5 bn. max	0.95%
CZGB 2006-2036**	27-Feb-19	1-Mar-19	15-May-36	CZK 2 bn. max	4.20%
SPP 809*	28-Feb-19	1-Mar-19	29-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.

*** TO BE DETERMINED ACCORDING TO THE ACTUAL MARKET SITUATION.

THOUGHT OF THE WEEK

“BLANKFEIN MAY TAKE THE PAY-CUT OVER 1MDB. NOT THAT I BELIEVE IT. ↗”

WEEK AHEAD

The biggest event locally is CNB meeting.

New forecast will be released, so this could be the time for CNB to hike again, especially in light of how convinced CNB was not long time ago that the growth would continue pretty much as before, and that, consequently, so would the tightening. Recall that as recently as at December meeting, two Board members (V. Benda, A. Michl) voted for a hike.

This should change now, though. Having seen the decline in PMI to lowest in 6 years last week and string of weak data from Germany should produce 7/0 result in favor of no change in rates. Although, with Michl especially, there's no telling whether the weak data will make him change the stance.

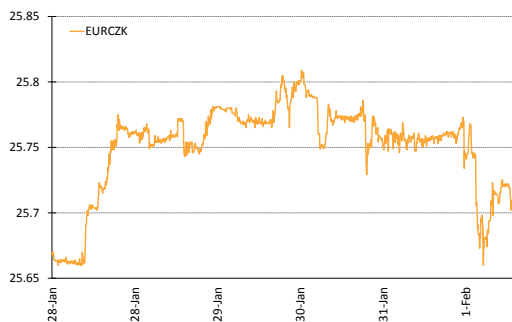
Anyway, the forecast should lower down the growth as well as the inflation while keeping EURCZK higher throughout the forecasting period.

In Eurozone, most of the monthly data to be released this week are for the December 2018, so are not that important (considering that we now have 4Q18 GDP data for Spain, France and Italy, as well as for the whole of Eurozone). The only release with potentially useful information about the future are thus December German industrial orders: another weak reading and we all can all but price in contraction in 1Q19.

WEEK BEHIND

- CZ Manufacturing PMI at 6 year low ▶
- Budget so far so good, but government begins to grapple with new reality ▶
- Eurozone 4Q18 growth held up at 3Q18 rate, surprisingly so ▶
- Eurozone core inflation still not going anywhere ▶

EURCZK TRADES AROUND 25.75 IN THE RUN-UP TO THE CNB MEETING

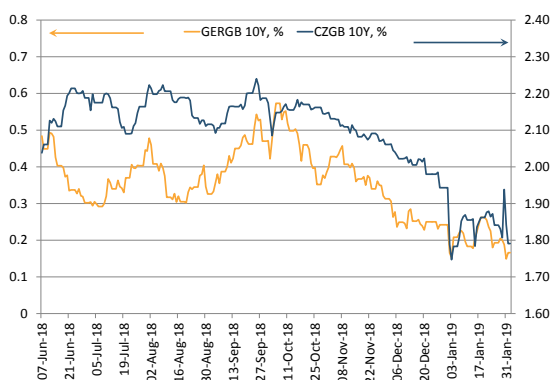


| FX

EURCZK traded sideways,...

...around 25.75, as market waited for this week's CNB meeting.

GERMAN 10YS AT 15 BPS. LAST WEEK



| FI

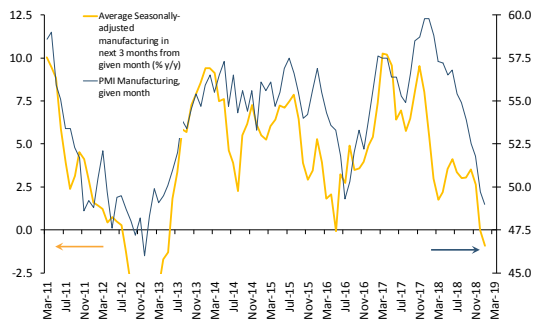
German bonds continued to get pricier,...

...with 10Y falling to just 15 bps. at one point last year. This was the lowest since November 2016. Weak data (see below) were the reason for this continuing flight to safety.

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| CZECH ECONOMY

CZECH MANUFACTURING PMI AT 6-YEAR LOW



| Manufacturing PMI fell to 6 year low in January.

At 49 pts., January was 0.7 pts. below December's reading and thus indicative of mild contraction in manufacturing in 1Q19.

New orders continued to decline, with most respondents blaming "ongoing trade tensions" and some respondents saying that the reason was that they'd "lost competitiveness". If true, the wage growth in private sector that was forced upon it by relentless increases in the public sector probably took its toll.

Importantly, the **employment** also fell for the first time in 6 years, indicative of slowdown beginning to affect labor market as well.

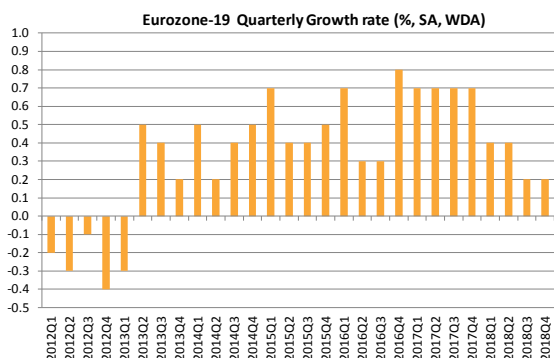
The January release was thus no surprise: German leading indicators foretold it. And it means that industry will likely contract y/y in next three months. This Thursday, this should be one reason why CNB should remain on hold: the (part of the) economy is clearly much weaker than previously thought.

| And government is beginning to grapple with reality as well.

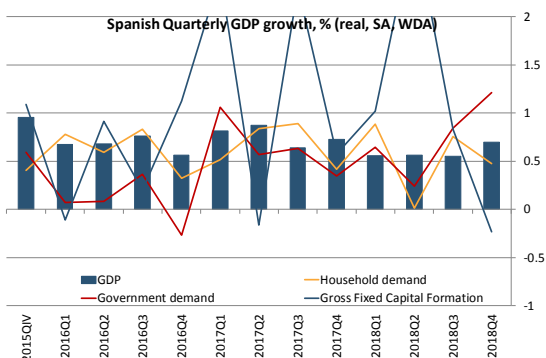
After MinFin Schillerova spoke two weeks ago ↗ about the general need to start saving (after years of relentless spending increases that saw mandatory spending increase by CZK approx. 200 bn.), last week she said how she wants to achieve that: by reducing the number of central government workers by 10%... Yes, those same employees whose wages government lifted by 25% over last three years, having thus spent good part of the additional taxes it collected during the boom times.

She was joined by her boss, PM Babis, ↗ who also realized, belatedly again, that the times of easy governing and plentiful money are over. He resurrected the idea of "increased efficiency" from its electoral campaigns, with IT costs now being singled out as those where most of the fat to be cut

EUROZONE GROWTH SAME IN 4Q18 AS IN 3Q18,...



..AS SPANISH GROWTH SURPRISES ON THE UPSIDE IN 4Q18



should be. Somehow he failed to explain why, with his party having been in power for five years and his alleged business acumen, this hasn't been done yet...

I'll help you. Hard truth is, even if there are savings to be made in IT (big if), these will be order of magnitude smaller than, say, CZK 83 bn. that government raised the mandatory spending by last year alone ↗. And order of magnitude smaller revenues will be raised by other ideas he floated: higher hard alcohol excise tax, higher taxation of gambling. No, any meaningful savings would require rolling back spending increases from previous years, something that's not going to happen.

So far, the budget looks good – January surplus (without EU money) was CZK 4.1 bn., as against CZK 5 bn. surplus in January 2018 – but it naturally takes some time before weaker economy shows up in budget data.

I am willing to bet that CZK 40 bn. deficit that government promised will not be met this year.

| EUROZONE ECONOMY

█ Eurozone 4Q18 growth surprisingly held up at 3Q18 rate, i.e. at 0.2% q/q. This brought the annual growth to 1.2%, half of what it was a year ago.

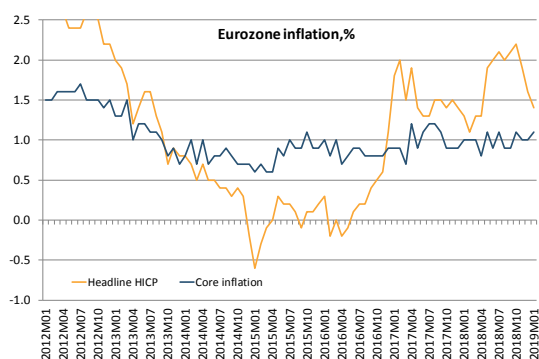
The first big economy to report the preliminary 4Q18 growth was, as is usual, **France**. Its quarterly growth of 0.3% q/q surpassed the expectations (0.2% q/q) and was thus the same as in 3Q18. Annual growth slowed down to 1.5% y/y. Structure, however, indicated that the growth at this rate is unlikely to last (which is what PMIs show as well). See, the domestic demand slowed down in both components (households, firms), contributing just 0.1 pp to the q/q growth in 4Q18 as against 0.5 pp in 3Q18. The inventories remained a drag on growth as well (-0.1 pp vs. -0.5 pp in 3Q18), leaving the exports as main contributor to growth. Their strong rebound (+2.4% q/q after 3Q18 +0.2% q/q) meant that, the rebound (+1.6% q/q) of imports

notwithstanding, net exports were the primary contributor to growth (+0.2 pp). However, with external environment getting weaker, this is unlikely to last.

As Spanish retail sales presaged (down, according to data released last week, by 0.6% m/m in December, but up about 0.6% q/q for the whole of 4Q18) **the growth of Spanish economy in 4Q18 was stronger (0.7% q/q) than in 3Q18 (0.6% q/q)**. Household demand indeed played a role, having grown 0.5% q/q. The biggest contributor to growth was, however, and like in France, export that added almost 2% q/q. somewhat surprisingly, government demand grew at 1.2% q/q, strongest rate in 4 years.

Unlike France and Spain, Italy disappointed. Instead of contracting 0.1% q/q, as was forecast, it declined 0.2% q/q, bringing the annual growth to almost a standstill (0.1% y/y). No structure was released just yet.

EUROZONE INFLATION UNCHANGED IN JANUARY.

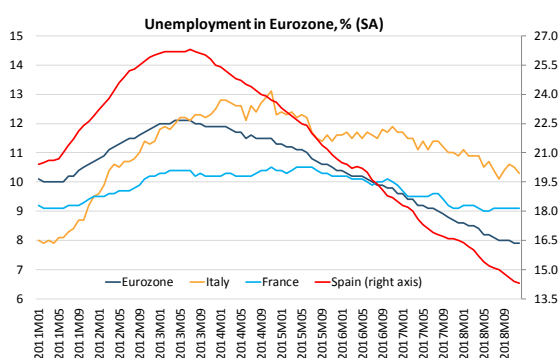


All in all, Eurozone held up in 4Q18, but further worsening of the leading indicators at the end of 4Q18 is a bad omen for 1Q19 and beyond. And recession certainly cannot be ruled out.

Eurozone core inflation is still around 1%, and unlikely to rise any time soon.

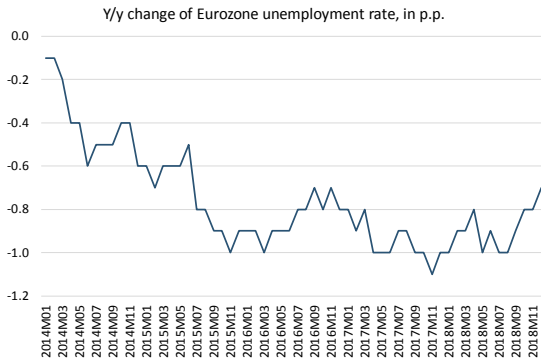
Eurozone core inflation (71% of the total inflation) was 1.1% in January, staying in the tight range of 0.8-1.1% where it's been non-stop since September 2017. Headline fell further to lowest (1.4%) since April 2018, but this was exclusively due to slowdown of energy price growth from 5.4% y/y in December 2018 to 2.6% in January 2019.

UNEMPLOYMENT SLIGHTLY BELOW 8%, BUT...



And it doesn't look like core inflation's about to start rising to 2%. **Unemployment remained unchanged at 7.9% in December, but the rate of improvement slowed to just 0.7 pp / year, far below 1 pp / year rate seen as recently as in August 2018.** This suggests cooling of the labor market (which is still at least 2 pp away from the full

...RATE OF IMPROVEMENT SLOWED NOTICEABLY IN 4Q18.



employment and, thus, from any hopes of self-sustaining inflationary pressures), and would be in line with recent indicators such as PMI. The “convergence of inflation to the target in a sustained fashion”, as ECB puts it, is in my eyes still far away. And so is the first ECB hike.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	1.990	2.060	2.053	1.785	1.708	1.720	
	-1M	2.010	2.070	1.985	1.730	1.670	1.668	
	-3M	1.960	2.030	2.393	2.565	2.542	2.525	
	-6M	1.240	1.320	1.890	2.155	2.176	2.203	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.245	-0.247	-0.237	-0.205	-0.026	0.071	
	-1M	-0.440	-0.300	-0.180	-0.058	0.060	0.121	
	-3M	-0.880	-0.828	-0.822	-0.725	-0.491	-0.394	
	-6M	-0.662	-0.757	-0.641	-0.420	-0.205	0.011	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.808	1.698	1.626	1.580	1.682	1.791	
	-1M	1.545	1.568	1.610	1.672	1.730	1.788	
	-3M	1.513	1.658	1.718	1.840	2.051	2.131	
	-6M	1.228	1.265	1.464	1.735	1.971	2.214	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.717	4.290	317.55	4.754	5.971	1.146	
	-1M	25.773	4.293	322.28	4.658	6.129	1.134	
	-3M	25.808	4.309	321.70	4.659	6.187	1.139	
	-6M	25.668	4.275	321.22	4.622	5.879	1.159	

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

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