

February 12 | 2018

Weekly | 2018 | Week 06

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Tuesday	13-Feb	10:00	CZ	Current account, Dec'17, CZK bn.	-6.5	-8.0
Wednesday	14-Feb	8:00	GER	(1st est.) GDP 4Q17, q/q (SA)	0.6%	N/A
	14-Feb	8:00	GER	(Final) HICP, Jan'18, y/y	1.4%	N/A
	14-Feb	9:00	CZ	CPI, Jan'18, y/y	2.2%	2.0%
	14-Feb	10:00	ITA	(Final) HICP, Jan'18, y/y	0.4%	N/A
	14-Feb	11:00	EMU	Industrial output, Dec'17, y/y	4.2%	N/A
	14-Feb	11:00	EMU	(1st est.) GDP 4Q17, q/q (SA)	0.6%	N/A
Thursday	15-Feb	9:00	SPA	(Final) HICP, Jan'18, y/y	0.7%	N/A
	15-Feb	11:00	EMU	Trade balance, Dec'17, EUR bn.	22.3	N/A
Friday	16-Feb	9:00	CZ	(1st est.) GDP 4Q17, q/q (SA)	0.6%	0.7%
	16-Feb	9:00	CZ	Export / Import Prices, Dec'17, y/y	N/A	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

“(TWITTER) IT'S AMAZING HOW EMBEDDED THE EQUITY MARKETS ARE IN AMERICAN DAILY LIFE. EUROPEAN INDICES COULD GAIN OR SHED 5% IN A DAY, AND IT WOULD BARELY REGISTER. IS THIS BECAUSE AMERICAN SPORTS ARE TERRIBLE AND THE STOCK MARKET SERVES AS A PROXY?”

WEEK AHEAD

In the Czech Republic, January inflation is of utmost importance, followed by 4Q17 GDP data.

January inflation is the most important release this week in that it should bring another evidence that the inflationary threat was exaggerated by the market and CNB. Hence, if inflation falls further, market might finally have to revise its expectation that CNB monetary policy will continue to diverge strongly from that of ECB. In January 2017, the increase of monthly inflation was driven by imputed rents (higher weight of prices of new apartments in the computation thereof + fast growth of real estate prices) and some additional effect of EET (most of it happened in December 2016). This year, imputed rents shouldn't have such a big effect on monthly price level increase and the only thing that should increase the monthly inflation is 4% increase in fuel prices and hike in tobacco prices. **In other words, annual inflation rate should moderate further.**

First estimate of 4Q17 GDP growth should confirm strong end to 2017, with household demand the primary driver.

WEEK BEHIND

Czech households remained on the shopping spree in December ▶

Czech industry remains in strong, almost double-digit growth ▶

Eurozone households aren't walking the talk ▶

Eurozone industry finally catching up with leading indicators ▶

FX

EURCZK strengthened to 25.40 amid the turmoil in the financial markets.

The stock sell-off that began at the beginning of February continued last week, with analysts, observers, commentators' coming up with all kinds of explanations, mostly blaming volatility traders ↗ that got too complacent and short volatility bets going awry.

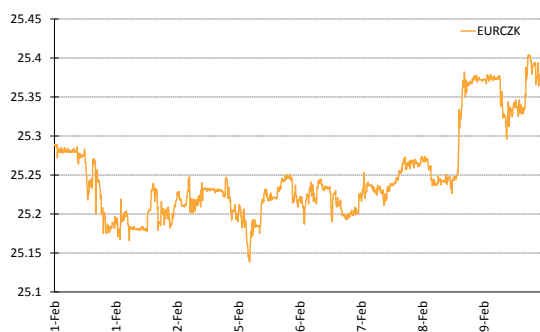
Although I don't really know – or care – why the sell-off happened, it is welcome that the stocks returned, as someone said recently, *'if not to Earth, then to the outer stratosphere'*.

Amid the turmoil, EURUSD market finally realized that 1.25 is too high and fell to 1.225. And EURCZK rose to 25.40, first meaningful weakening this year. Frankly, more of the same should come before both those rates in line with fundamentals.

FI

Bonds remained unmoved by stock market correction.

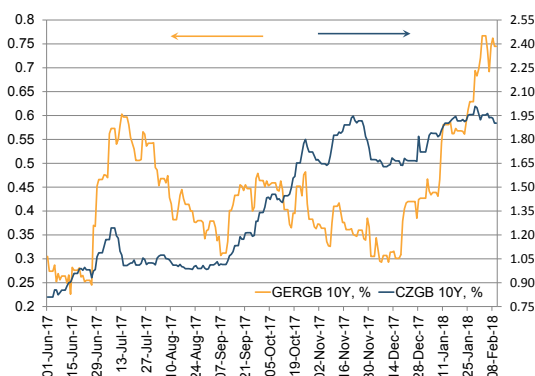
EURCZK RETURNS TO 25.40 AS...



...MARKET TURMOIL TAKES ITS TOLL ON EURO.

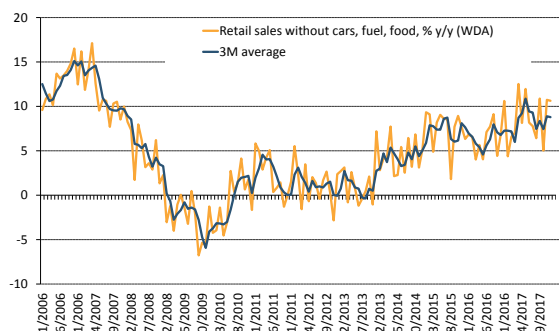


CALM WEEK IN THE BOND MARKETS

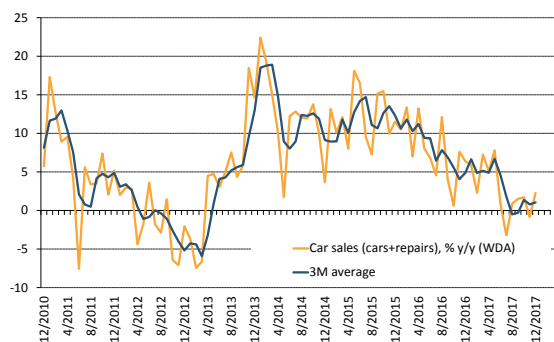


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RETAIL SALES REMAIN STRONG...



...WHILE CAR SALES PUZZLINGLY LOW.



CZECH ECONOMY

Czech households remained on the shopping spree at the end of 2017, December retail data showed.

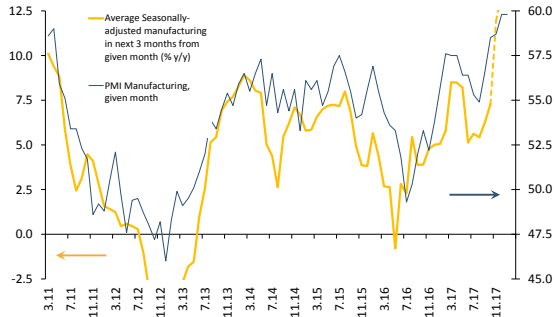
Although the headline figure was affected by two fewer working days last December as compared to December 2016, adjusting for this effect the growth remained very strong. See, the core retail sales (i.e. sales of items other than cars, fuel and food) posted another double-digit growth, grew 10.6% (real, WDA), almost the same as in November (10.7%), for the average annual growth in 4Q17 of almost 9%. It may seem almost greedy to say more should be expected, but only until one realizes that consumer confidence is at all-time high, i.e. levels that, with extrapolation, should be associated growth of 12-13% y/y.

The sales outside the core category remained the same as in previous few months: fuel sales continued to grow at 6.5% y/y, food sales at slightly over 2% while car sales, puzzlingly, and registered growth that was barely above zero. This doesn't make sense considering the general macro picture: extremely low unemployment (according to CSO it remained, in January, at 3.9%), extremely high consumer optimism etc.

Anyway, the pace of growth remains strong but, as said in our recent outlook ↗, there are reasons why this year's growth of household demand should be somewhat slower than in 2017 (though by no means weak).

For CNB December retail data shouldn't change anything but it might: 'shouldn't' since CNB *should* only target inflation and inflation is showing no signs of demand pressures, but 'might' because CNB might take continuing strong growth of household demand as heralding future inflation and hence as a pretext to hike, although Czech republic is far more likely to see worse trade balance than higher inflation in situations where household demand growth is excessive. Which, by the way I don't think the current one is.

INDUSTRY GROWTH 8% IN DECEMBER, STRONG 1Q18 AHEAD

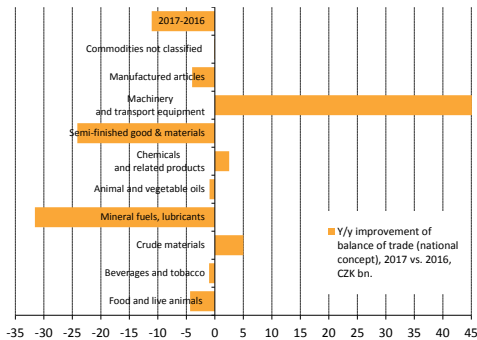


In the December industry, soft indicators didn't lie.

Adjusting for working days (and recall that in industry, this effect is stronger than in retail), the industrial production grew 8% y/y in December and the manufacturing component thereof 9%. Very good, indeed, as befits the industry where PMI hovers at 60. The coming quarter should see double-digit y/y growth. Let's see whether that happens.

One interesting news from the release: the average wage in industry was 6.5% higher in December 2017 than in December 2016. Considering that inflation was above 2% and that employment in industry rose 2%, it is far from being growth that anyone should call 'excessive', i.e. inflationary.

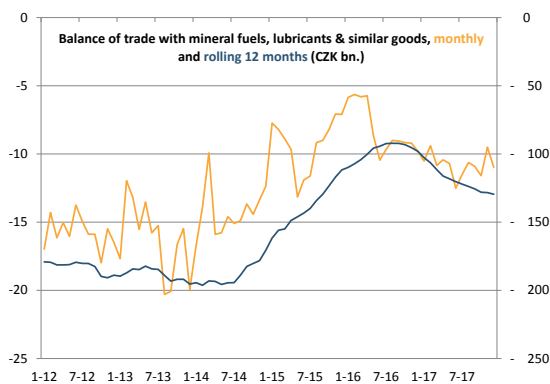
TRADE BALANCE SURPLUS SLIGHTLY WORSE IN 2017 ON HIGHER IMPORTS,...



(National concept) trade balance surplus in 2017 was CZK 152 bn., some CZK 11 bn. lower than in 2016.

Exports rose CZK 185.5 bn., mainly due to CZK 122 bn. rise of exports of machinery and transport equipment. Imports rose even more, with CZK 196.5 bn. increase being due to machinery / vehicles (+75 bn.), mineral fuels (+32.5 bn.), semi-finished goods / material (+45 bn.) and manufactured goods (+23 bn.). This predominantly reflects strong domestic demand; the worsening of the balance of trade with mineral fuels also reflects pricier oil: the average Brent price in CZK per barrel was 15% higher in 2017 than in 2016.

... AND ALSO PRICIER OIL.



All in all, strong performance and one of the largest surpluses of Czech economy. All fundamentally supportive of CZK.

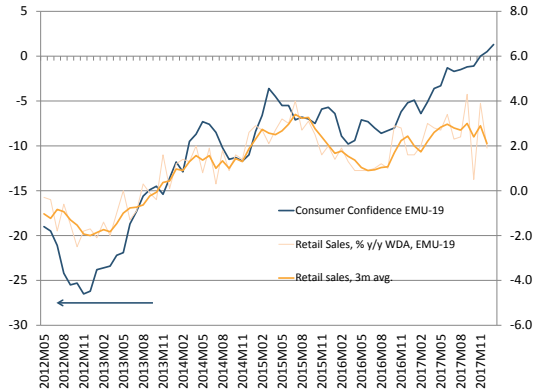
EUROZONE ECONOMY

Eurozone households remain somewhat schizophrenic: on the one hand, there's unbridled optimism, on the other hand there's weak actual spending.

December retail sales increased by meagre 2% y/y

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EUROZONE HOUSEHOLDS AREN'T WALKING THE TALK.

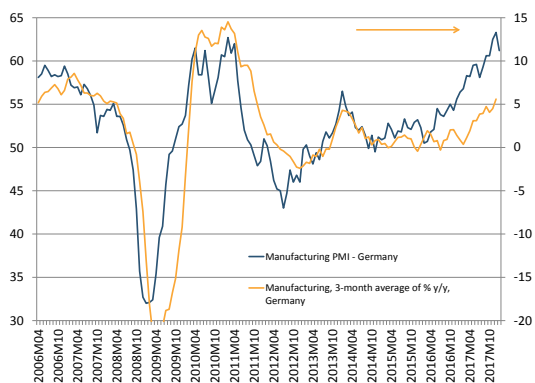


in a month in which consumer confidence was highest in 17 years. I mean, really? Is this consistent? One reason for this may be that economy is buoyant and people see that, but it doesn't translate into the wage growth, which remains subdued, and unemployment rate has only been falling slowly (1 pp / year).

But if so, I would expect people to be a bit less optimistic: unless I don't have 5% more cash in hand y/y, I am not going to say this is the best time in close to two decades. But that is just me...

Anyway, for the ECB this is another sign that inflation increase is further than it might want it to be, strong soft indicators, hawkish comments of hawkish bankers and whatnot nonetheless.

EUROZONE INDUSTRY IMPROVES FURTHER, BUT GERMAN ONE STILL LAGS PMI



Eurozone industrial data are finally catching up with the leading indicators.

According to local statistical offices' data (i.e., not Eurostat data), German industrial production quickened to 6.5% y/y in December (November: 5.6%), Spanish one to 6.1% (4.2%), French one to 4.5% (2.5%) and Italian one to 4.9% (2.2%). The Eurostat data, due out this week, will be slightly different due to different methodology, but the general story will remain unchanged.

Hence, after December, Italian industry growth is now in line with PMI, French one is still somewhat behind and German one still lags massively: German PMI above 60 points at solidly double digit growth.

THE ORDERS SUGGEST THIS GAP WILL CLOSE MORE LIKELY FROM PMI SIDE



That it probably won't happen in 1Q18 either and that the gap between PMI and actual production will close from PMI side is seen in **German industrial orders for December**. Although they grew, driven by foreign orders from both Eurozone and outside the Eurozone, by solid 6.8% y/y in December, the average for 4Q17 is 'just' 7.7%. And that can hardly bring 12% growth called for by PMI.

That said, 1Q18 should be strongest quarter for German industry in a long time. And it actually

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might translate into some real wage growth. IG Metall clearly smelled the chance and succeeded ↗, other might follow. Though, personally, I thought IG Metall would not settle for less than 6% and I certainly wouldn't call the deal as '*heralding the end of wage restraint*' in Germany (like Reuters did...). Demand-pull inflation is still far away, even in Germany with unemployment rate at all-time lows.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	0.709	0.969	1.325	1.740	1.835	1.940	
	-1M	0.709	0.969	1.290	1.580	1.656	1.770	
	-3M	0.709	0.969	1.205	1.553	1.669	1.800	
	-6M	0.709	0.969	0.770	1.060	1.205	1.330	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.709	-0.824	-0.676	-0.669	-0.548	-0.038	
	-1M	-0.807	-0.751	-0.620	-0.655	-0.456	0.089	
	-3M	-0.833	-0.735	-0.699	-0.690	-0.550	0.026	
	-6M	-1.004	-0.925	-0.912	-0.950	-0.970	-0.303	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	0.616	0.691	0.969	1.071	1.287	1.902	
	-1M	0.483	0.678	0.901	0.925	1.200	1.859	
	-3M	0.372	0.627	0.771	0.863	1.119	1.826	
	-6M	-0.234	-0.037	0.062	0.110	0.235	1.027	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.396	4.187	312.11	4.651	4.680	1.225	
	-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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