

February 19 | 2018

## Weekly | 2018 | Week 07

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

## CALENDAR

| DAY       | DATE   | TIME (CET)* | MARKET | RELEASE                                      | CONSENSUS** | 42FS |
|-----------|--------|-------------|--------|----------------------------------------------|-------------|------|
| Wednesday | 21-Feb | 10:00       | EMU    | (Flash) Manufacturing / Services PMI, Feb'18 | 59.2 / 57.6 | N/A  |
|           | 21-Feb | 21:00       | USA    | FOMC minutes                                 | N/A         | N/A  |
| Thursday  | 22-Feb | 8:45        | FRA    | (Final) HICP, Jan'18, y/y                    | 1.5%        | N/A  |
|           | 22-Feb | 10:00       | GER    | IFO Business Climate, Feb'18                 | 117.0       | N/A  |
|           | 22-Feb | 11:00       | ITA    | (Final) HICP, Jan'18, y/y                    | 1.1%        | N/A  |
|           | 22-Feb | 8:00        | GER    | (2nd est.) GDP 4Q17, q/q (SA)                | 0.6%        | N/A  |
| Friday    | 23-Feb | 11:00       | EMU    | (Final) Headline / Core HICP, Jan'18, y/y    | 1.3% / 1%   | 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

“(UBER) Q: WHY ARE YOU STILL DRIVING? DIDN'T PM BABIS SAID YOU SHOULD STOP? A: NAAH, I AM CARETAKER UBER DRIVER.”

## WEEK AHEAD

**Leading indicators and the structure of 4Q17 GDP growth in Germany are the main releases this week.**

Both IFO and PMI are expected to come off the recent highs a bit, and seeing how they both overstated the 4Q17 GDP growth in Eurozone, I would expect to see that too.

German 4Q17 GDP structure won't bring anything new to ECB as it will “only” confirm that the household demand hasn't quickened and thus that the growth was non-inflationary in nature.

Finally, final January Eurozone inflation data will merely confirm what we already know: the lack of demand pressures in all big Eurozone economies and, thus, by extension, in Eurozone in general.

WEEK BEHIND

Czech growth confirms the annualized growth slowed to 2% in 2H17

Czech inflation rises more than I expected in January, but only due to non-demand factors

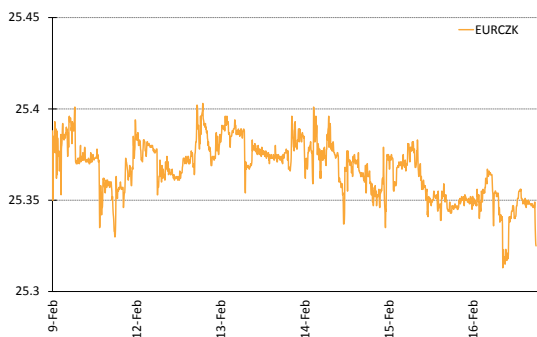
Czech export prices confirm no external inflation threat whatsoever

Eurozone 4Q17 growth confirmed at 0.6% q/q, with non-inflationary structure

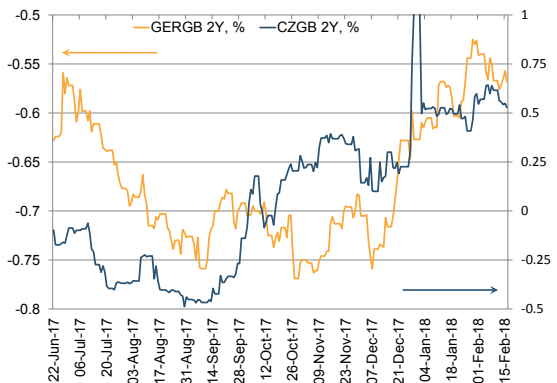
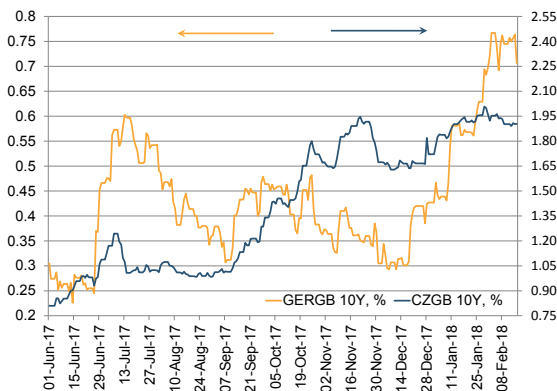
Eurozone industry in strongest growth since August 2011

Inflation in Germany & Spain confirmed at low levels, but EURUSD doesn't seem to have noticed

EURCZK RETURNS DRIFTS BELOW 25.35 IN AN UNEVENTFUL TRADING.



ANOTHER CALM WEEK IN THE BOND MARKETS



FX

EURCZK traded uneventfully last week, drifting from 25.40 to 25.35.

Czech data or Eurozone data had exactly zero impact on EURCZK.

FI

Bond market was as uneventful as the EURCZK one.

**CZECH ECONOMY**

**Czech inflation continues to decelerate, reinforcing my view that further tightening of the monetary policy will be much harder sell this year.**

**Czech inflation rose 0.6% m/m in January**, taking the annual inflation down to 2.2%, i.e. lowest since April 2017. Although this is a bit more than I expected (0.4% m/m, 2% y/y), it is in the same direction (i.e., slowdown of inflation) and the structure of the inflation shows there are still very few demand pressures to speak of.

See, monthly increase of 0.6% was caused only by alcoholic beverages, tobacco prices (courtesy of increase of tobacco excise tax again, as is January tradition by now) and by prices of utilities (electricity, natural gas, water, sewage). **Which of these price increases do you think happened because of strong domestic demand?**

Yep, what I thought...It is only administrative and regulatory factors that keep inflation close to 2% now. Without there, we'd be looking at CPI rates closer to 1% than to 2%.

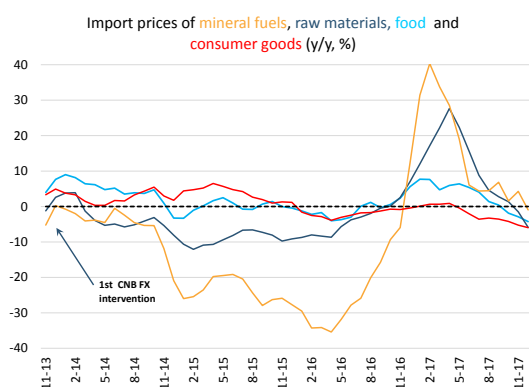
**On top of lack of domestic demand pressures comes another proof of lack of external ones as well – subdued import prices.**

Yes, the import prices did rise in December (0.4% m/m), but that is not a reflection of Eurozone inflationary pressures finding their way into the Czech prices. See, the increase of import prices was due to

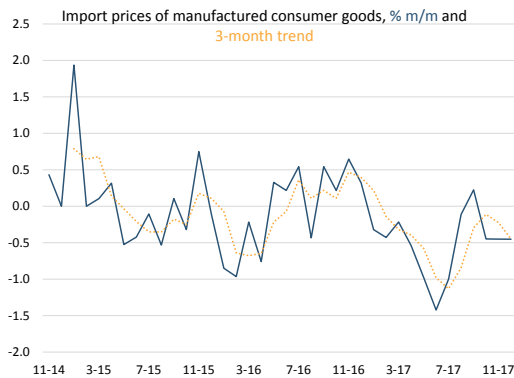
- the **prices of mineral fuels** (+1.7% m/m), a reflection of somewhat pricier oil (even in local currency), and to
- the **prices of food** (+1% m/m).

On the contrary, prices of other materials fell and so did (-0.4% m/m) the import prices of manufactured consumer goods, the same decline

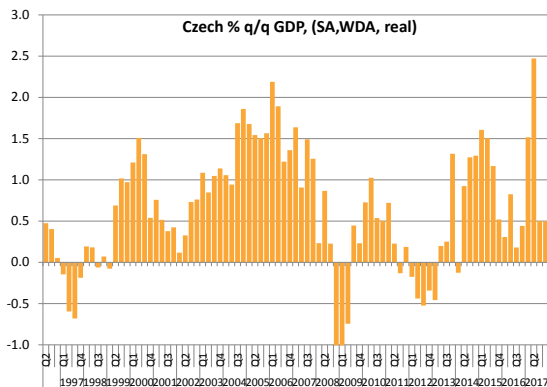
**IMPORT PRICES DOWN ACROSS THE BOARD,...**



**...WITH CONTINUING PRONOUNCED WEAKNESS IN MANUFACTURED CONSUMER GOODS.**



**GROWTH IN 4Q17 AT SOLID, BUT NOT AWESOME 0.5% Q/Q.**



as in October and November. Manufactured consumer goods thus fell in every month of 2017 except for September.

On an annual basis, all components of the import prices decelerated: all are markedly lower than in December 2016. With import prices of consumer goods down 6% y/y and the non-demand structure of domestic inflation, it beats me where exactly do people see the threat of inflation in Czech Republic.

The hard truth is that, just like in Germany, the fact that economy is booming and that labor market is tight do not mean acceleration of inflation.

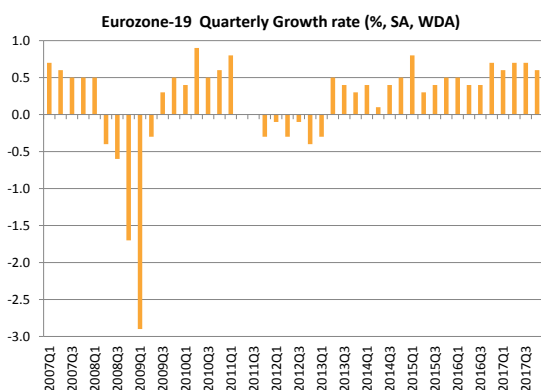
**Czech GDP rose 0.5% q/q in last quarter of 2017, in line with expectations.**

This meant that the total growth in 2017 was 4.5% and that it was 5.1% y/y in last quarter.

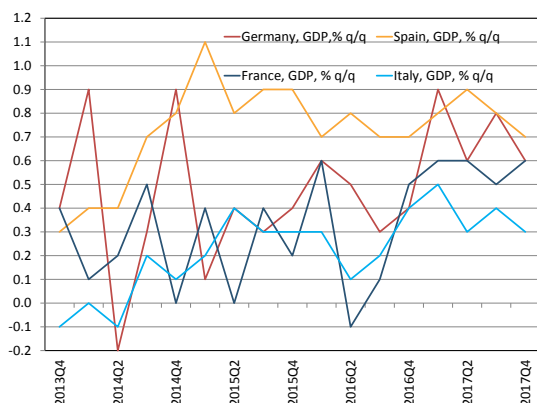
This is by no means weak but is also nothing spectacular – the economy slowed to 2% annualized growth in 2H17, a far cry from 1.5% and 2.5% *quarterly* expansions in 1Q and 2Q17, respectively. It is thus in line with my view that 2017 growth was unusual and that 2018 will be considerably slower.

Structure-wise, not much new was released. Statistical office only said that all of the aggregate demand components contributed evenly to the growth in 4Q17. Next release is on March 02, 2018, so that is when we will know more, but the 0.5% growth rate and the “even contribution” line in the Statistical office release do not sound like higher inflation is around the corner.

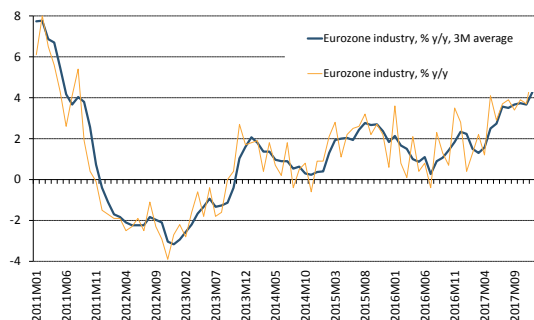
**EUROZONE GROWTH SLOWS TO 0.6% Q/Q IN 4Q17 AS...**



**... ALL BIG ECONOMIES EXCEPT FOR FRENCH ONE EDGE DOWN.**



**INDUSTRIAL PRODUCTION IN FASTEST ANNUAL GROWTH SINCE SUMMER 2011...**



**EUROZONE ECONOMY**

**Eurozone growth was confirmed at 0.6% q/q in the last quarter of last year, with German, Spanish and Italian growth all slower than in 3Q17.**

Although 4Q17 growth was somewhat faster than the average (0.5%) quarterly expansion since 2Q13 (when Eurozone economy returned to growth after the debt crisis) and although there is no breakdown of the data yet, it looks unlikely that 4Q17 GDP data will change the ECB's stance. See, national monthly data suggest that household demand slowed against 3Q17 and that the growth was supported by net exports and investments. This is a structure that is not inflationary. It is true that leading indicators point to 0.9%-1% quarterly growth in 1Q18, but some of these indicators have been overstating the actual growth for some time (consumer confidence, ESI, IFO) and some (PMI) did so at least recently (like PMI in 4Q17).

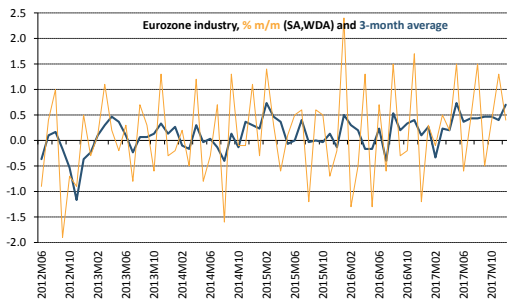
As regard big economies, all of them slowed except for France. In Germany, local statistical office not only revised the 3Q17 down to 0.7% q/q, but said that consumer spending was unchanged in 4Q17. Hence, ECB will have a hard time arguing that tighter policy is need if for nothing else than for the need to contain inflation in the North: the truth is that there is none, the fact that some German politicians and hawks in the monetary policy circles have been forecasting the inflation apocalypse for years nevertheless.

**Industrial production ended last year on a very strong footing, with annual growth fastest since August 2011.**

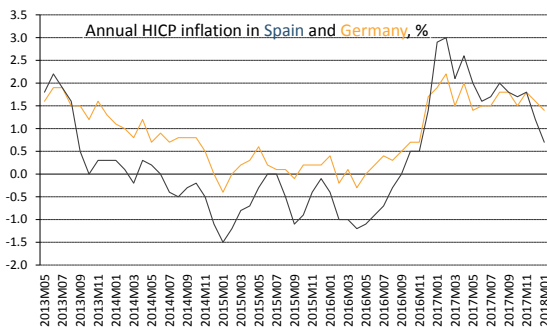
Industrial production rose 5.2% y/y in December, with monthly December growth of 0.4% and (upwardly revised) November growth of 1.3% meaning that the quarterly expansion in 4Q17 was faster than in 3Q17. The quickening of the growth of production made the gap between what PMI calls for and what the actual production is a bit narrower,

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**...AS MONTHLY DYNAMICS NOW SHOWS CONVINCING SIGNS OF HAVING IMPROVED IN 2H17.**



**GERMAN, SPANISH INFLATION CONFIRMED LOW IN JANUARY...**



**...BUT EURUSD DOESN'T SEEM TO CARE.**



though – especially in case of Germany– the gap still remains sizable.

**The monthly dynamics clearly quickened in 2H17:** the three-month average monthly gain has been around 1% since May of last year. And with PMI very high, it looks like this will continue.

**Persistently low inflation in Eurozone & the non-inflationary implications of 4Q17 Eurozone GDP data should re-energize the dollar bulls soon.**

So far, just the opposite is true. Take last week: higher CPI print in US, non-inflationary Eurozone GDP numbers and low final January inflation data nonetheless, EURUSD headed up towards 1.25 again (and only reversed the rise a bit on Friday). Beats me why...

**Anyway, last week German inflation was confirmed at 1.4% in January, with core inflation at 1.3%.** Yes, that is the economy which, because of all the ECB money printing, rampant inflation was by now supposedly be ravaging ↗...

**Spanish inflation was also confirmed, a day later after the German one, at just 0.7% y/y in January, a significant slowdown from almost 3% in January 2017 and another confirmation that the increase we saw last year was just one-off.**

In other words, EURUSD bulls should think twice whether 'ECB will soon start catching up with FED' narrative is indeed a correct one...



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MARKETS ‡

| MM / IRS    |        | 3M PRIBOR | 6M PRIBOR | 2Y     | 5Y     | 7Y     | 10Y    |  |
|-------------|--------|-----------|-----------|--------|--------|--------|--------|--|
| %           | Actual | 0.709     | 0.969     | 1.275  | 1.695  | 1.795  | 1.915  |  |
|             | -1M    | 0.709     | 0.969     | 1.340  | 1.665  | 1.737  | 1.843  |  |
|             | -3M    | 0.709     | 0.969     | 1.270  | 1.575  | 1.682  | 1.815  |  |
|             | -6M    | 0.709     | 0.969     | 0.833  | 1.130  | 1.238  | 1.386  |  |
| ASW spread* |        | 2Y        | 3Y        | 4Y     | 5Y     | 7Y     | 10Y    |  |
| bps.        | Actual | -0.747    | -0.733    | -0.669 | -0.634 | -0.551 | -0.011 |  |
|             | -1M    | -0.840    | -0.800    | -0.648 | -0.688 | -0.483 | 0.085  |  |
|             | -3M    | -0.901    | -0.749    | -0.706 | -0.677 | -0.513 | 0.076  |  |
|             | -6M    | -1.189    | -0.979    | -0.995 | -1.039 | -1.006 | -0.385 |  |
| CZGB**      |        | 2Y        | 3Y        | 4Y     | 5Y     | 7Y     | 10Y    |  |
| %           | Actual | 0.528     | 0.722     | 0.926  | 1.061  | 1.244  | 1.904  |  |
|             | -1M    | 0.500     | 0.698     | 0.954  | 0.977  | 1.254  | 1.927  |  |
|             | -3M    | 0.369     | 0.660     | 0.797  | 0.898  | 1.169  | 1.891  |  |
|             | -6M    | -0.356    | -0.029    | 0.055  | 0.091  | 0.232  | 1.001  |  |
| FX          |        | EURCZK    | EURPLN    | EURHUF | EURRON | EURTRY | EURUSD |  |
|             | Actual | 25.324    | 4.157     | 311.32 | 4.661  | 4.649  | 1.241  |  |
|             | -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

CONTACTS

MARTIN LOBOTKA, ANALYST

(+420) 777 027 165, [MLobotka@42fs.com](mailto:MLobotka@42fs.com)

RESEARCH

[Research@42fs.com](mailto:Research@42fs.com)

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