

February 26 | 2018

Weekly | 2018 | Week 08

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

CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	26-Feb	9:00	CZ	Consumer / Business Confidence, Feb'18	N/A	N/A
Tuesday	27-Feb	10:00	SPA	(Preliminary) HICP, Feb'18 .y/y	0.9%	N/A
	27-Feb	11:00	EMU	(Final) Consumer confidence / ESI, Feb'18	0.1/114	N/A
	27-Feb	14:00	GER	(Preliminary) HICP, Feb'18 .y/y	1.3%	N/A
Wednesday	28-Feb	8:45	FRA	(2nd est.) GDP 4Q17, q/q (SA)	0.6%	N/A
	28-Feb	8:45	FRA	(Preliminary) HICP, Feb'18 .y/y	N/A	N/A
	28-Feb	9:00	CZ	PPI, Jan'18, y/y	0.4%	0.3%
	28-Feb	11:00	EMU	(Preliminary) HICP, Feb'18 .y/y	1.2%	N/A
	28-Feb	11:00	ITA	(Preliminary) HICP, Feb'18 .y/y	1.0%	N/A
Thursday	1-Mar	9:00	SPA	(Final) GDP 4Q17, q/q (SA)	0.7%	N/A
	1-Mar	9:30	CZ	Manufacturing PMI, Feb'18	59.0	58.8
	1-Mar	11:00	EMU	Unemployment rate, Jan'18	8.6%	N/A
	1-Mar	14:00	CZ	Budget balance, Feb'18, CZK bn.	N/A	N/A
Friday	2-Mar	9:00	CZ	(2nd est.) GDP 4Q17, q/q (SA)	0.5%	0.5%
	2-Mar	10:00	ITA	(Final) GDP 4Q17, q/q (SA)	1.6%	N/A
	2-Mar	11:00	ITA	PPI, Jan'18, y/y	1.6%	N/A

* LOCAL TIME IS CET

** (REUTERS/ BLOOMBERG) POLL

MARCH 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
SPP 784	1-Mar	2-Feb	31-Aug-18	CZK 0-5 bn.	N/A
CZGB 2015-2023**	7-Mar	9-Mar	25-Oct-23	CZK 4 bn. max	0.45%
CZGB 2013-2028**	7-Mar	9-Mar	25-Aug-28	CZK 4 bn. max	2.50%
CZGB 2017-2033**	7-Mar	9-Mar	13-Oct-33	CZK 4 bn. max	2.00%
SPP 785	8-Mar	9-Mar	7-Sep-18	CZK 0-5 bn.	N/A
SPP 786	15-Mar	16-Mar	14-Sep-18	CZK 0-5 bn.	N/A
CZGB 2018-2021**	21-Mar	23-Mar	23-Feb-21	CZK 4 bn. max	0.75%
CZGB 2014-2025**	21-Mar	23-Mar	17-Sep-25	CZK 4 bn. max	2.40%
CZGB 2018-2029**	21-Mar	23-Mar	23-Jul-29	CZK 4 bn. max	2.75%
SPP 787	22-Mar	23-Mar	21-Sep-18	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

“ NOW THAT EVERY ANALYST OUT THERE FORMULATED HIS WEAK DOLLAR NARRATIVE, IT'S PROBABLY A GOOD TIME FOR THE USD TO STRENGTHEN. ”

WEEK AHEAD

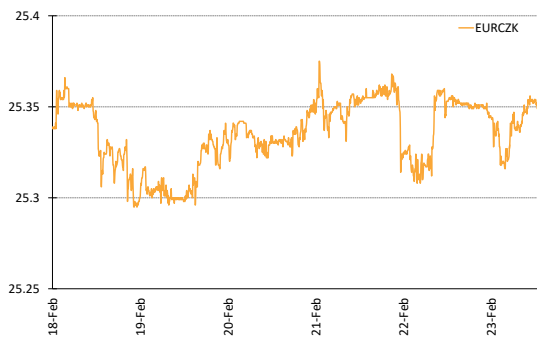
Czech data to be released this week include, in the order of decreasing importance, **structure of 4Q17 GDP growth**, February **soft indicators** (PMI and confidence), January **PPI** and February **budget**. None of these will have any impact on markets, though structure of the growth is important in that I'd like to see how much of growth was due to (potentially inflationary) household demand.

In Eurozone, most important release is obviously that of **preliminary February inflation**. Considering the structure of 4Q17 growth ► in Germany, somewhat weaker leading indicators of late ►, stronger euro and, as this week's unemployment data shall show again, continuing, but only slow improvement of the labor market, **I don't see reason why inflation shouldn't stay just like last week's final January data confirmed ►** – low.

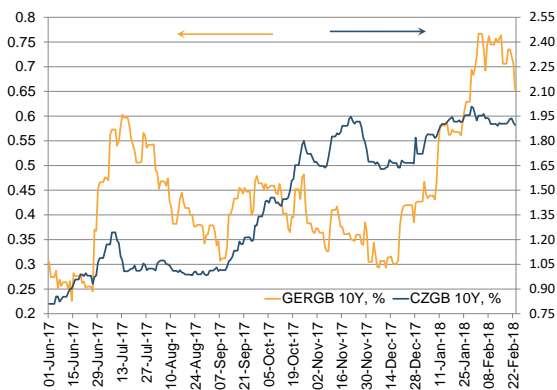
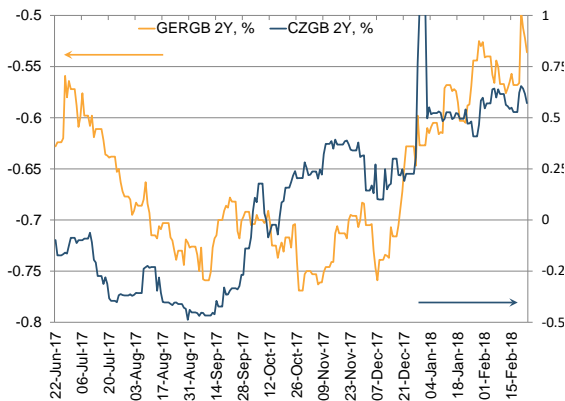
WEEK BEHIND

- █ Hawkish FOMC minutes... ▶
- █ ...and dovish ECB account of the January meetings, combined with... ▶
- █ ...decline of Euro area PMI and... ▶
- █ ...of German IFO, sent EURUSD below 1.23 ▶
- █ German 2H17 GDP growth completely devoid of household demand boost ▶
- █ No wonder, then, that Eurozone / German inflation remains low ▶

EURCZK TRADES RANGE-BOUND.



ANOTHER CALM WEEK IN THE BOND MARKETS



| FX

EURCZK traded uneventfully around 25.30-25.35 last week.

There were two comments from Governor Rusnok and Vice-governor Hampl. Both men said previous hikes had been necessary (what else...) and both made reference to real estate prices which, according to them, are 10-15% above fundamental levels. They thus made it fairly clear that the No.1 reason why the hikes have been happening is price of the real estate. Trying to arrest the price growth via repo rate, however, is like using cannon to shoot pigeons...

| FI

German yields fell on dovish ECB minutes and on fall of leading indicators ▶.

10Y Bunds returned to end-of-January levels of 65 bps. Czech ones didn't move.

February 26 | 2018

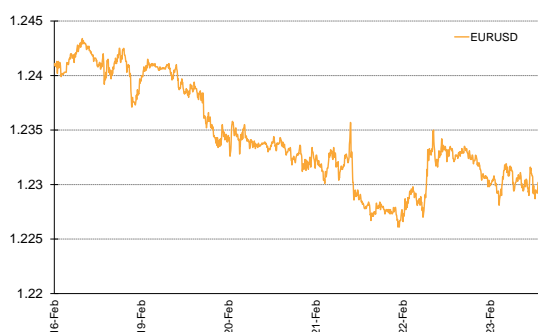
| CZECH ECONOMY / POLITICS

Nothing important in the Czech Republic except for the fact that President Zeman announced that he'd become the first President since 1986 to speak at assembly of the Communist Party in April...

This is part of his attempt to form the government of ANO (which won last year's elections), Social Democrats (at which assembly he spoke 8 days ago) and Communists.

One repugnant government this would be, to be honest, with insult added to the injury considering that Sunday marked the 70th anniversary of the Communist coup in 1948.

February 26 | 2018

DOLLAR UP ON HAWKISH FOMC / DOVISH ECB MINUTES**EUROZONE ECONOMY & FED****FOMC minutes were a notably hawkish affair, helping send the EURUSD below 1.23.**

Minutes from the FED's end-of-January meeting said that a number of FOMC members thought both the global economy and local factors, esp. the tax cuts of USD 1500 bn. voted in few weeks before that meeting, will provide additional boost to US economic growth and, consequently, to inflation (which, most of the same FOMC members admitted, is still subpar). Although the tax cuts are going to create a big hole in the US public finances (no, these reforms never pay for themselves), this is beyond FOMC's horizon and, somewhat sadly, also behind markets' horizons, so there is little impact of this darker side of the 'reform' on the FOMC thinking.

Next meeting is held on March 20-21 and the FOMC will have to weigh the market turbulence that hit the US financial markets shortly after the January meeting against the increase ↗ in early February of stimulus by another USD 290 bn. or so in domestic and defense spending, and also against somewhat higher inflation in the meantime. **To me it looks like March hike is almost a done deal** – I don't believe stock market gyrations will stop Fed from hiking. And so the dollar should head higher.

That ECB, on the other hand, will tread very carefully when it starts to tighten was corroborated by minutes from the January 24-25 monetary-policy meeting.

It was essentially the same text as the one from December 13-14 meeting, released on January 11 and commented on by me here ↗. So, the same sentence was in the recent account as was in the previous one, i.e. one about the possibility to revisit "the language pertaining to the monetary policy stance (...) early this year as part of the regular reassessment." There was nothing to indicate

when this should happen or

how it should happen.

That said, 'when' should most likely mean March since

- there will be new forecast released in March and
- April or June hardly qualify as 'early this year'.

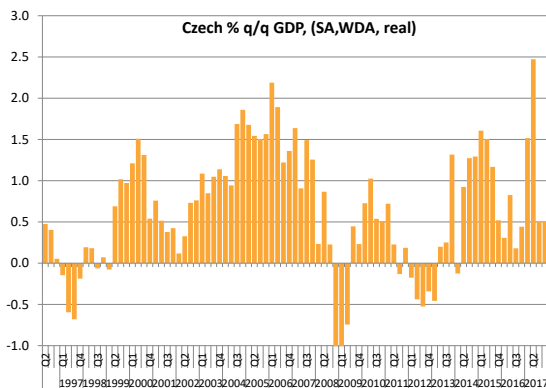
Regarding 'how' I think that there will be some tweaking to language pertaining to asset purchase program (APP), likely via removal of easing bias ("Governing Council stands ready to increase the APP in terms of size and/or duration") and, possibly, via saying that when APP ends, it will occur via tapering (rather than via sudden stop) and that it is likely that the taper process will start 'this year'. This cosmetic tightening will be offset by reiteration of the promise that rates will remain low for long.

In the account from the meeting there were also comments on euro couched in terms of 'volatility' (not 'strength') of the common currency – Board said this volatility is a "source of uncertainty" that requires "monitoring". It also said that so far "the past appreciation of the euro had no significant negative impact on euro area external demand". So unless EURUSD breaks above 1.25, I think **ECB will have no problem taking some minuscule steps away from extra loose policy in March.**

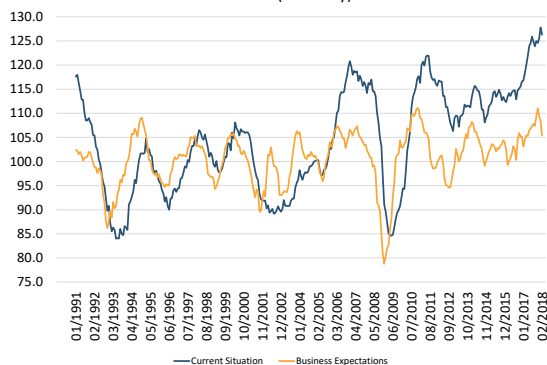
Eurozone PMI eased off the recent highs in February, indicating that the 1% quarterly growth its January level forecast is not going to happen.

Not that the rate of expansion is slow, but February composite PMI level of 57.5, especially if confirmed in March, points at approximately 0.8% q/q GDP growth in 1Q18, a more realistic forecast in my eyes than 1% PMI called for in January. Manufacturing fell to 4-month low of 59.5 (vs 61.1 in January) while service PMIS decreased to 2-month low of 56.7 (vs. 58 in January). All the sub-indices obviously remained very high, though in all cases

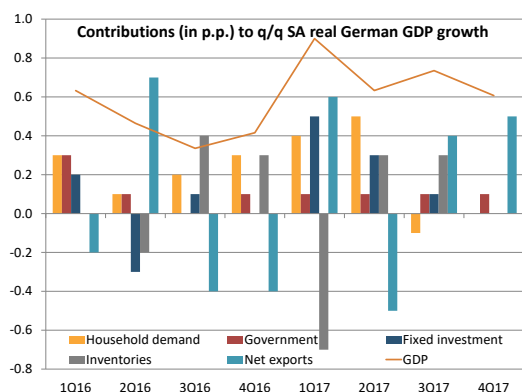
EASING OFF OF PMI...



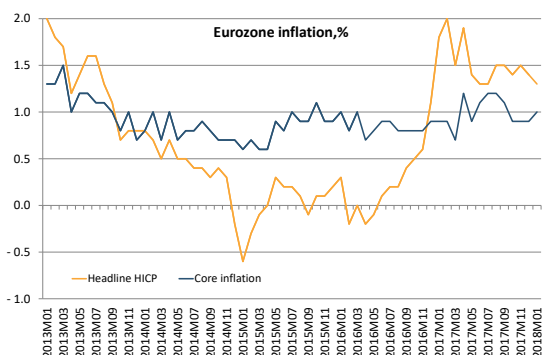
...AND OF IFO, ...
IFO Index (Germany)



... TOGETHER WITH NON-INFLATIONARY
STRUCTURE OF GROWTH IN GERMANY,



...SUGGESTS EURO AREA INFLATION WILL STAY
LOW IN AT LEAST NEXT 2 QUARTERS.



eased off of recent, often multi-decade, highs.

For ECB, thus, nothing changes: the policy will stay loose for long, and the first hike is for 2020.

Same pull-back as in PMI was seen in German IFO as well, though IFO remained at its second highest in the entire history, i.e. since 1991.

The decrease, which now points at much-more-realistic German GDP growth of about 0.7-0.8% q/q in 1Q18, was driven by worsening of expectations component, esp. in manufacturing and construction. The expectations' sub-index, which as recently as in November 2017 hit 111, fell in February 2018 to 105 pts., the lowest since April 2017. The optimism about the future thus cooled, and did so across the board – the assessment of the future worsened in retail, wholesale, manufacturing and construction, the biggest one having been observed in last two.

This worsening thus echoes what we saw in PMI and indicates only marginally faster growth in 1Q18 than in 4Q17.

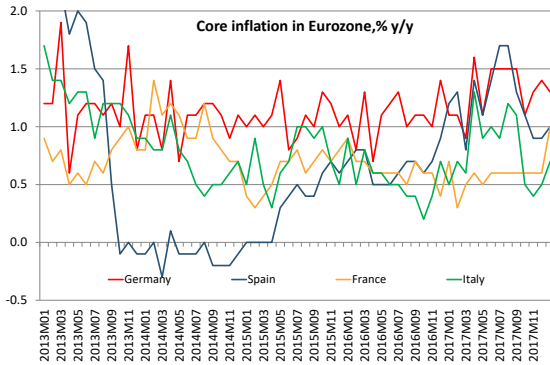
Together with structure of the German GDP growth in 4Q17, it looks like inflation will have a hard time quickening soon in the Eurozone.

The structure of the 4Q17 GDP growth showed that household demand, despite the low unemployment and hence the potential for wage increases, didn't translate into any growth of household demand in 2H17. Just the contrary was true: contribution of household demand to quarterly GDP growth in 3Q17 was actually negative and was zero in 4Q17.

4Q17 GDP growth of 0.6% was thus pretty much only driven by net exports (having added 0.5 pp).

This is hardly the economy where inflation, hitherto very subdued, should now be dangerously close to coming unhinged.

CORE INFLATION REMAINS LOW IN BIG-THREE, FRENCH ONE SHOT UP TO HIGHEST SINCE SEP'14.



It so far surely has not come unhinged – final January 2018 inflation data confirmed Eurozone inflation at join-lowest (1.3%) in 12 months...

...with core inflation at 1%, only 0.1 pp higher than in January of 2017. Core inflation in big economies is thus the same as or lower than 12 months ago, the exception being France.

In France, core inflation shot up to 1.5% in January, highest since September 2014. This was due to rise of annual inflation in three sectors: clothing, household equipment and communications. It could theoretically be the reflection of demand pressures, though I find it unlikely since nothing like that is seen elsewhere and the abrupt rise is suspicious. We will know more three months from now.

February 26 | 2018

MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	0.709	0.969	1.290	1.675	1.785	1.910	
	-1M	0.709	0.969	1.340	1.715	1.801	1.905	
	-3M	0.709	0.969	1.335	1.660	1.761	1.890	
	-6M	0.709	0.969	0.815	1.115	1.238	1.371	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.719	-0.715	-0.646	-0.632	-0.541	-0.015	
	-1M	-0.869	-0.838	-0.681	-0.722	-0.559	0.007	
	-3M	-0.991	-0.839	-0.765	-0.709	-0.540	0.014	
	-6M	-1.219	-0.967	-1.036	-1.081	-0.988	-0.369	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	0.571	0.746	0.923	1.043	1.244	1.895	
	-1M	0.471	0.686	0.961	0.993	1.242	1.912	
	-3M	0.344	0.647	0.821	0.951	1.221	1.904	
	-6M	-0.404	-0.034	-0.006	0.034	0.250	1.002	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.350	4.172	313.13	4.655	4.658	1.229	
	-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

RESEARCH

Research@42fs.com

AVAILABLE AT THOMSON REUTERS EIKON MESSENGER

PREVIOUS ISSUES OF WEEKLY AND OTHER REPORTS ARE AVAILABLE HERE ↗

February 26 | 2018

| 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.

Copyright: 42 Financial Services Czech Republic, 2018.

All rights reserved.