

March 04 | 2019

Weekly | 2018 | Week 09

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**
Tuesday	5-Mar-19	10:00	EMU	(Final) Services PMI, Feb'19	52.30
	5-Mar-19	10:00	ITA	(Final) GDP, 4Q18, q/q	-0.2%
	5-Mar-19	11:00	EMU	Retail sales, Jan'19, y/y	2.1%
Thursday	7-Mar-19	11:00	EMU	(Final) GDP, 4Q18, q/q	0.2%
	7-Mar-19	13:45	EMU	ECB Monetary-policy meeting, Refinancing / Marginal Lending / Deposit rate	0%/0.25%/-0.4%
Friday	8-Mar-19	8:00	GER	Industrial orders, Jan'19, y/y (WDA)	-3.1%
	8-Mar-19	9:00	CZ	Average Real Monthly wage, 4Q18, y/y	5.9%
	8-Mar-19	9:00	SPA	Industrial production, Jan'19, y/y (WDA)	-1.6%
	8-Mar-19	10:00	ITA	Industrial production, Jan'19, y/y (WDA)	-3.2%

* LOCAL TIME IS CET

** (REUTERS/ BLOOMBERG) POLL

MARCH 2019 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2015-2026**	6-Mar-19	8-Mar-19	26-Jun-26	CZK 5 bn. max	1.00%
CZGB 2017-2033**	6-Mar-19	8-Mar-19	13-Oct-33	CZK 5 bn. max	2.00%
CZGB 2017-2027**	20-Mar-19	22-Mar-19	10-Feb-27	CZK 5 bn. max	0.25%
CZGB 2018-2029**	20-Mar-19	22-Mar-19	23-Jul-29	CZK 7 bn. max	2.75%
CZGB 2015-2030**	20-Mar-19	22-Mar-19	15-May-30	CZK 3 bn. max	0.95%

* 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

“THE LONG-AWAITED “WE-WANT-OUT-OF-THIS-S***T-LET-US-DUMP-IT-ONTO-THE –STUPID-PUBLIC” GAME ABOUT TO BEGIN ➤”.

WEEK AHEAD

Locally, there is not much in terms of releases scheduled for this week. Only the average wage growth for 4Q18 is to be released, and this will again show the double-digit growth in public sector and fast, but single-digit growth in the private one. I also expect government to keep looking for additional sources of revenues now that the big hole opened up in the budget. ➤

In Eurozone, ECB monetary policy meeting is by far the most important event of the week, and month. ECB recently became far less certain (see page 5 here ➤), to put it mildly, that the hike this year is still possible, but didn't take it entirely off the table just yet. It will do so now. The possibility of any tightening this year will officially go to zero.

Final 4Q18 GDP data will bring the structure for the entire Eurozone, but there will be nothing surprising in there, knowing as we do the structure of all big economies by now. Much more important for the immediate future is the release of January German industrial orders. The key question is this: did they already stop falling?

WEEK BEHIND

Neither structure of Czech 4Q18 GDP growth... ▶

...nor leading indicators give reason for not expecting slowdown in 1H19 ▶

CZ budget deficit much bigger in January-February than expected ▶

Eurozone core inflation still stuck at 1%... ▶

...and ESI / PMI strongly suggest this will not change soon ▶

FX

EURCZK remained in a tight range...

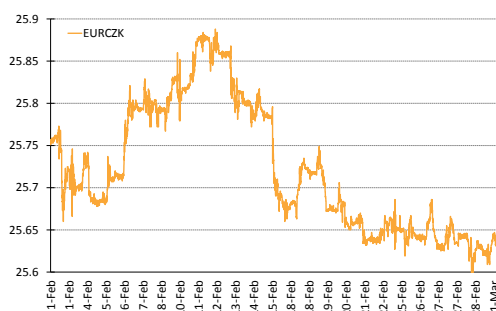
...of 25.60-25.65 throughout last week. No news to push the pair either way, just like the week before.

FI

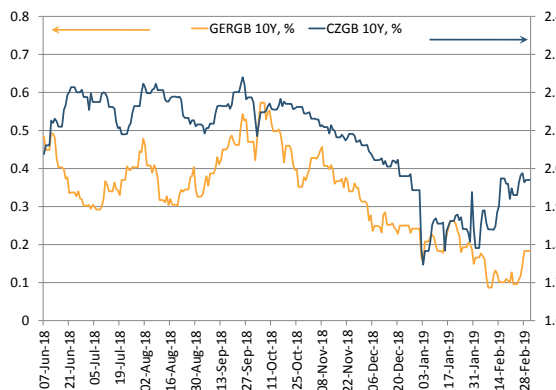
German long-dated yields jumped 10 bps...

...last week, their biggest weekly jump in almost a year. But that still means the yields only rose to 20 bps., which is highest in a month but otherwise very low. It is hard to attribute this rise to something specific, but maybe the fact that PMI seems to have stabilized, albeit at low level, played a role.

CZK IN A RANGE OF 25.60- 25.65.

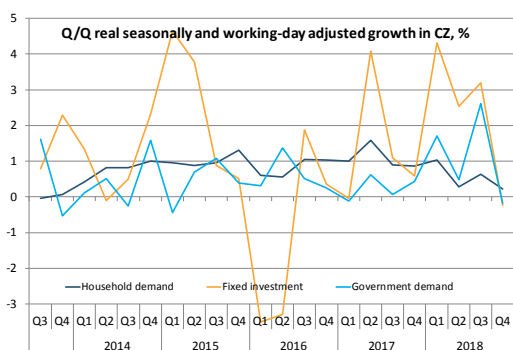


GERMAN 10Y YIELDS IN LARGEST WEEKLY RISE IN A YEAR.

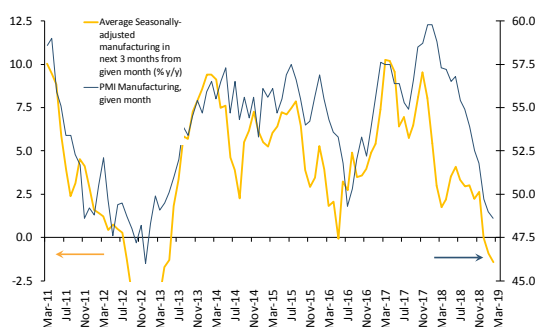


| CZECH ECONOMY

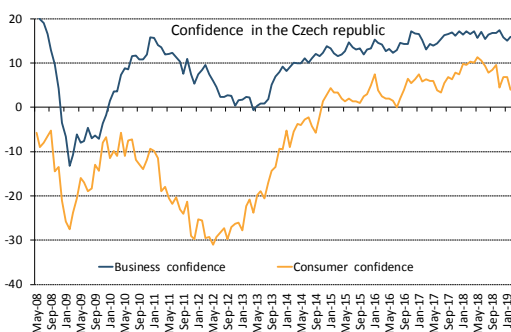
CZECH 4Q18 GDP GROWTH DRIVEN ONLY BY EXPORTS AMID DECELERATING DOMESTIC DEMAND.



EXPORTS ARE, IF PMI IS ANYTHING TO GO BY, BOUND TO SLOW MARKEDLY IN 1H19.



CONSUMER CONFIDENCE WORSENE TOO



■ Nor the structure of 4Q18 GDP growth neither the leading indicators give reasons not to expect substantial slowdown in 1H19.

Growth in the final quarter of last year was revised slightly down from the first estimate, but it still remained extraordinarily strong: at 0.9% q/q, it was the fastest quarterly expansion since 2Q17, and one that was faster than in Poland (0.5% q/q) and almost as fast as growth in 4Q18 in Hungary (1% q/q).

The structure of the quarterly expansion was, however, much less optimistic than the headline figure might lead casual observer to believe. All of the components of the domestic demand slowed substantially, a bad omen for the 2019. Household demand grew at the slowest (0.2% q/q) since 4Q13, government demand and fixed investments *contracted* q/q. So, the only component of the demand that grew (and thus the one that was behind strong showing of economy in 4Q18) were net exports.

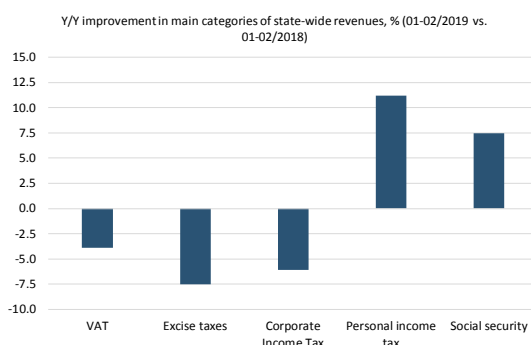
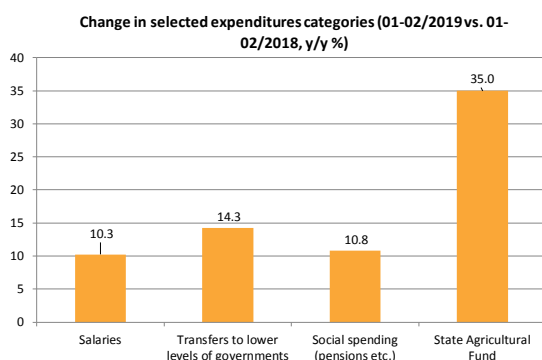
But, this is clearly not how the 1H19 will look like: German slowdown is already being felt in the local industry, as **manufacturing PMI for February (48.6 pts.)**, released last week, illustrated. The weakening of the conditions in Czech manufacturing was fastest in 6 years, and since new orders fell at the fastest rate since October 2012 and confidence remained subdued, exports will certainly be a drag on growth in (at least) 1H19.

Worsening of the confidence was shown to be broader than just in the industry. **Czech statistical office in its own Feb'19 confidence survey** showed confidence in trade had also fallen and it did so to the lowest since November 2014. The same survey also showed that even confidence of consumers, while still high by historical standards, fell to the lowest since summer 2017.

For the entire 2019, the growth of 3% that we saw in 2018 is thus highly unlikely to be

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CZECH BUDGET SWINGS TO LARGE DEFICIT IN 1Q19 AS EXPENDITURES CONTINUE TO RISE STRONGLY



repeated. It will very likely be much, much slower.

And Ministry of Finance sees it the same way. That is why it panicked.

After February budget numbers, we now know what was / is behind the recent surge of government's activity regarding taxes and savings (see here ↗ or here ↗). The problem is this: this government that came into the office on the promise to run the country like a firm squandered all the growth-related revenues of last three years on higher wages and social spending. And now that the slowdown in revenues opened a huge hole in the budget, they're looking for money to pay for this profligacy of the past.

And the hole it is. February budget data released last week showed the budget worsening by whopping CZK 45.7 bn. y/y to almost 20 bn. deficit for the first two months of 2019. Even adjusting for the effect of EU money on the both side of the budget (in-)equality, the resulting deficit of CZK 22 bn. is a massive deterioration from 2018 when EU-adjusted budget was balanced over its first 2 months.

No wonder: whereas **tax revenues rose just CZK 4.5 bn.** (i.e., 2.5% y/y) and - without social security contributions - actually fell (by 1.5%), the **current expenditures** kept on increasing at the tremendous rate. In the first two months, they **rose 15.4% (!)**, i.e. by **CZK 31 bn.!** How so? Well, CZK 10 bn. more is for pensioners, CZK 1 bn. for higher salaries, CZK 18 bn. for higher transfers (to lower levels of government for salaries of their employees, i.e. teachers etc.).

So, brace for higher taxes, higher deficits or both. Government is already exploring what / who to tax more to pay for the spending it already did. Exactly like an alcoholic who's promised everyone everything during last night's bender and now realizes that it will cost a lot. The problem with this approach is this: most of the taxes are already quite high, especially the direct ones.

EUROZONE ECONOMY

Eurozone core inflation is still stuck at 1%, nothing suggests this will change soon.

Headline inflation was 1.5% in February, core inflation was 1%. Thus, still not going anywhere – it was 1% in January 2018 as well. For the reference and forecast accuracy check, let me just state here what ECB’s minutes said in January 2018 (i.e., 14 months ago):

*“...the steady absorption of economic slack gave grounds for **increased confidence that price pressures would gradually take hold**. This was reflected in the December [2017] staff projections, which showed a gradual convergence of inflation towards the Governing Council’s inflation aim. The strong cyclical momentum and the associated significant reduction of economic slack **provided increasing confidence that inflation would converge to the Governing Council’s aim.**”*

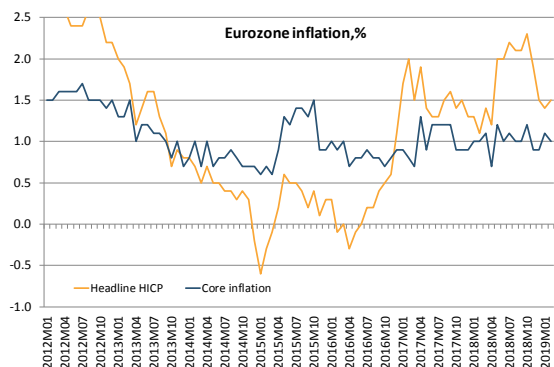
True, it didn’t say when it will happen...Just that they were confident...So it still could happen..., But, other data released last week gave little hope that this ECB’s long-awaited convergence will happen soon.

Leading / soft indicators worsened and labor market improvement slowed in recent months.

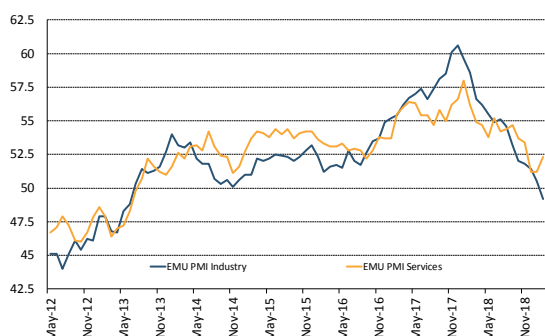
Final manufacturing PMI confirmed the preliminary findings: that industry is in contraction and that it doesn’t look like it will improve soon. See, manufacturing PMI was 49.3 in February and there were concurrent declines in both current output and in new orders (which fell to lowest in over 6 years), the latter meaning that the actual output will fall further in the coming months.

Country-wise, **74-month low was seen in Germany, 72-month low in Italy**. Spain dipped below 50 for the first since November 2013. Weakness in all of the countries was driven by

EUROZONE INFLATION STILL LOW

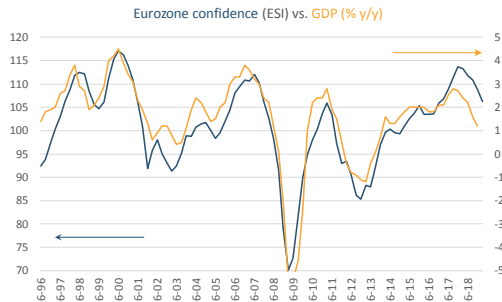


EUROZONE PMI BELOW 50 IN FEBRUARY



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ESI ALSO WORSENE



investment goods, another proof that this weakness is due to weaker environment outside the EMU.

February European Sentiment Indicator (ESI), also released last week, confirmed all of what I said above as it worsened to lowest (106.1) since November 2016. The fact that the **seasonally adjusted unemployment** remained unchanged at 7.8%, with y/y improvement of only 0.8 pp., also doesn't make sudden or impending increase in core inflation very likely.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	2.000	2.060	2.195	1.960	1.868	1.880	
	-1M	2.010	2.070	2.100	1.790	1.715	1.730	
	-3M	2.000	2.060	2.415	2.540	2.525	2.515	
	-6M	1.460	1.550	1.935	2.135	2.178	2.210	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.329	-0.312	-0.280	-0.219	-0.056	0.094	
	-1M	-0.327	-0.298	-0.159	-0.085	0.015	0.054	
	-3M	-0.927	-0.853	-0.814	-0.714	-0.512	-0.416	
	-6M	-0.655	-0.740	-0.636	-0.461	-0.222	-0.034	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.866	1.793	1.740	1.741	1.812	1.974	
	-1M	1.773	1.682	1.716	1.705	1.730	1.784	
	-3M	1.488	1.638	1.708	1.826	2.013	2.099	
	-6M	1.280	1.290	1.457	1.674	1.956	2.176	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.678	4.334	318.28	4.741	5.969	1.130	
	-1M	25.545	4.293	323.08	4.681	6.221	1.141	
	-3M	26.005	4.289	321.97	4.663	6.075	1.133	
	-6M	25.768	4.322	324.44	4.666	6.748	1.135	

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

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