Weekly | 2018 | Week 09

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

| CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	5-Mar	10:00	EMU	(Final) Composite PMI, Feb'18	57.5	N/A
	5-Mar	11:00	EMU	Retail sales, Jan'18, y/y	2.0%	N/A
Wednesday	7-Mar	11:00	EMU	(Final) GDP 4Q17, q/q (SA)	0.6%	N/A
Thursday	8-Mar	8:00	GER	Industrial orders, Jan'18, y/y (WDA)	11.4%	N/A
	8-Mar	9:00	CZ	Unemployment rate (15-64 years), Feb'18	3.8%	N/A
	8-Mar	13:45	EMU	ECB monetary policy meeting	no change	no change
Friday	9-Mar	8:00	GER	Industrial production, Jan'18, y/y	6.0%	N/A
	9-Mar	9:00	CZ	CPI, Feb'18, y/y	2.0%	1.9%
	9-Mar	9:00	SPA	Industrial production, Jan'18 y/y	5.0%	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

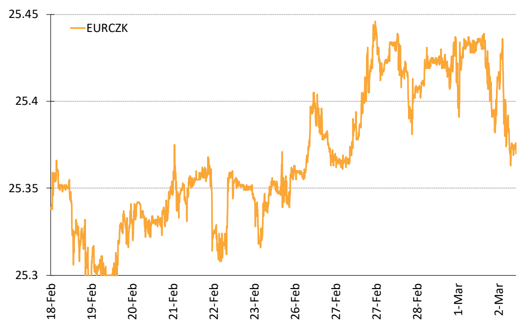
" THE HEART OF THE UK-EU MISUNDERSTANDING IS THAT MAY WANTS TO SHOP FOR POST-BREXIT DEAL ON SAVILE ROW WHILE BARNIER KEEPS TELLING HER SHE SHOULD REALLY HEAD TO MARKS & SPENCER."

WEEK AHEAD

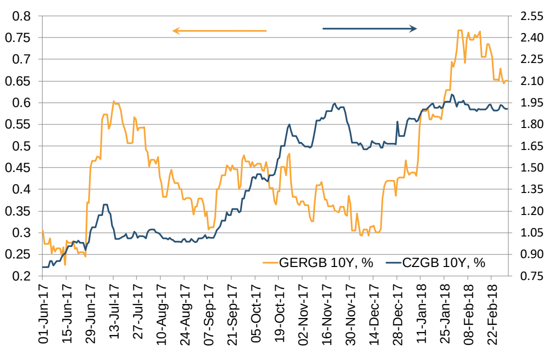
Number one event is obviously ECB meeting. There certainly will not be any change in the 'hard' monetary policy itself (i.e. rates, amounts purchased under PSPP program shall stay the same), but there will likely be adjustment of the forward guidance, and that via – most probably – removal of the ECB commitment to step up the QE purchases if necessary. That the adjustment to forward guidance is likely follows from two facts: first, in last two accounts (from December and January meeting) ECB said adjustment of the wording is likely to happen „early in 2018" and I think March still qualifies as "early" (April and May less so). Second, there will be a new forecast released in March (which only occurs four times a year) and this one could / should be a bit more optimistic on growth (if not inflation). Hence, this should support cosmetic adjustment of the overall monetary policy stance alluded to above. EURUSD should not respond as this is priced in fully.

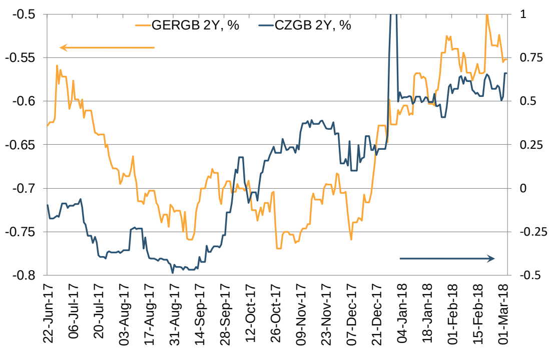
In CZ, the biggest thing is inflation for February. Here, we should see another deceleration of the y/y inflation as food prices, imputed rents did not contribute as much in February 2018 to price growth as they did in February 2017 – hence, the base effect. I think inflation will fall slightly below 2%, with MPRI and demand inflation falling even lower, and the monthly dynamics of both subdued. This should thus keep the CNB from hiking anytime soon.

EURCZK WEAKENS MARGINALLY.



ANOTHER CALM WEEK IN THE BOND MARKETS





WEEK BEHIND

▌ Czech 4Q17 GDP growth broad-based, but much slower than in 1H17 ▶

▌ Czech confidence remains high ▶

▌ Producer prices continue to decelerate ▶

▌ Eurozone inflation remained low in February… ▶

▌ … which, together with pull-back in confidence, … ▶

▌ …and continuing slack in labor market reinforces the view ECB policy will stay loose for long ▶

| FX

EURCZK weakened a bit to 25.40, but that was about it.

There was comment from Board member Benda in which he retreated from his previous hawkish (see for example his October 13 interview ↗). Back then, he said he can imagine rates 50-75 bps. higher by Christmas than what they were in August, i.e. repo at 0.75-1%, and that he wouldn't mind one-off 50 bps. hike. This didn't happen - repo was at 0.5% last Christmas and only was increased in February; CNB also says next hike is at the end of 2018. He now ↗ says that hikes aren't that necessary any more, pointing to strengthening of the CZK - which is all of 1.6% stronger now than on October 13 … – as an explanation for why his hawkishness was tempered…What I think happened was that a] inflation fell and b] his friend, Governor Rusnok, who brought him to CNB Board, is significantly less hawkish…

| FI

Nothing happening in the bond markets.

| CZECH ECONOMY

Czech GDP growth in 4Q17 confirmed marked slowdown of dynamics as against 1H17, but also the broad-based nature thereof.

Q/q growth was confirmed at 0.5% q/q, translating into 5.2% y/y growth in last quarter and making the 2017 growth a very strong 4.5%. The structure of the growth was very broad-based, both qualitatively and quantitatively.

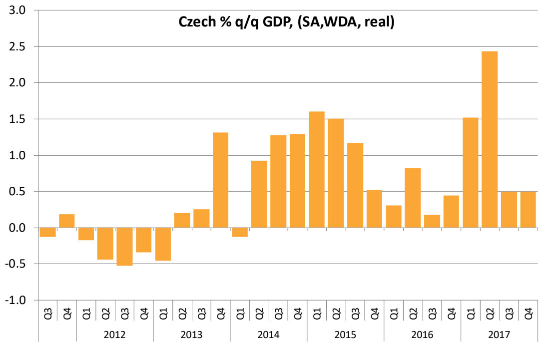
On the demand side, government demand and household demand both expanded by 0.6% q/q in last quarter of last year while fixed investments grew by only slightly less (0.5% q/q). Taking the whole of 2017, the picture is the same: strong growth of fixed investments in 2Q17 (a record-breaking 5.6% *quarterly* expansion) translated into 1.4 pp contribution to overall (4.5%) growth, while growth of household demand added another 1.9 pp and that of net exports added 1 pp. Very even, it is easily seen.

On the supply side, manufacturing obviously dominated (2.1 pp contribution to the 2017 growth of value added growth of 4.5%), with rest of the growth accounted for pretty much evenly by sectors (trade & transport contributed 0.6 pp and was second largest contributor).

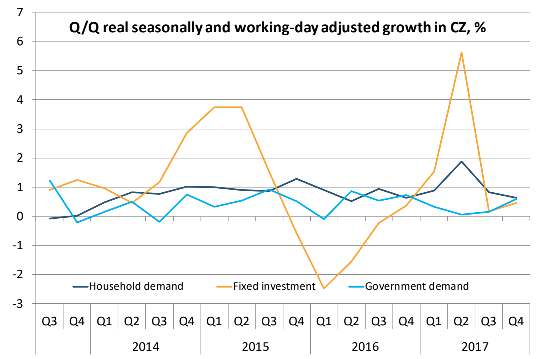
Looking forward, there are two implications of last week's GDP data. First, growth will be slower this year – the 2H17 brought the annualized growth to 2% and I expect approx. 1 pp. faster growth this year. Second, the nature of the growth together with the openness of Czech economy suggests demand inflation will not be much of a threat – demand is "only" responsible for half the growth, and it will not change significantly going forward. Hence, CNB policy will remain fairly loose.

Czech overall confidence remained essentially unchanged from January, and, hence, high.

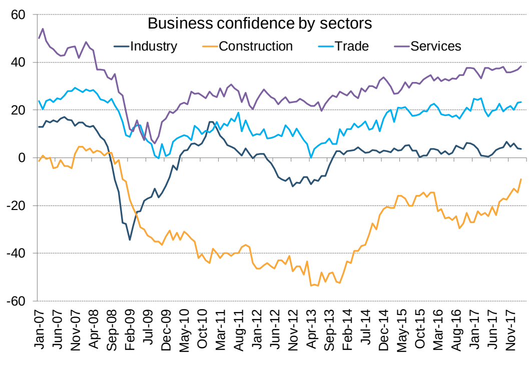
CZECH GDP GROWTH SLOWED MARKEDLY IN 2H17…



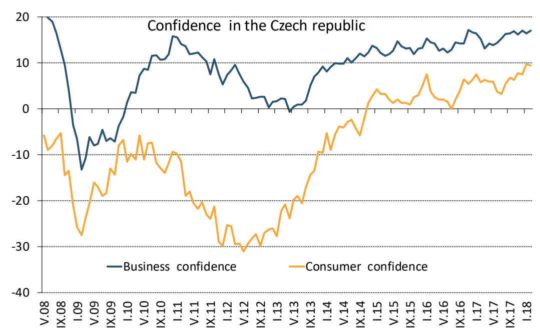
…WHILE STRUCTURE OF GROWTH WAS VERY EVENLY BASED IN 2H17.



CONFIDENCE JUMPS IN CONSTRUCTION, DRIFTS HIGHER IN SERVICES



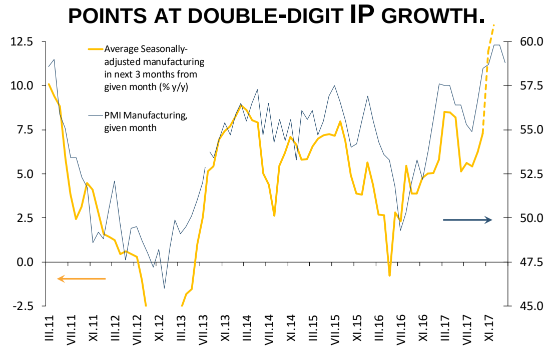
CONSUMER CONFIDENCE REMAINS CLOSE TO ALL-TIME HIGH



In February, business confidence returned to December 2017 level (17.1), a modest improvement vs. January 2018 (16.4) but essentially the same as is January of 2017 (16.5). The structure-wise, the biggest improvement against January 2018 (-14.5) but also against January 2017 (-27) was in construction, where confidence in February rose to a level (-9) unseen since December 2008. On the less optimistic note, last four months saw worsening of confidence in industry, undoubtedly a strange occurrence considering the strength of PMI here and elsewhere in the region. **The confidence in services, the majority of the economy, continues to creep up, reflection of the strong household demand – February level of 38.3 is highest since April 2008.**

Consumer confidence in February saw small decrease against January (9.5 vs. 9.8), but this is still the second-highest level ever. Hence, it is still very positive for household demand going forward.

DESPITE FEBRUARY SLOWDOWN, PMI STILL POINTS AT DOUBLE-DIGIT IP GROWTH.

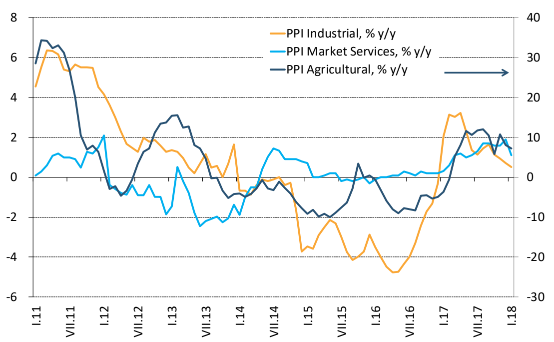


As expected, Czech PMI retreated in February, mirroring what happened elsewhere in the region.

February PMI was thus full point lower (58.8) than January 2018 level, but it still is very high – in fact, since April 2011, only January 2018 and December 2017 saw higher PMI readings. Current levels are still so high as to be consistent with forecast of double-digit growth of industrial production in 1Q18. I am not sure this will be so, but some acceleration of industry growth in 1Q18 is certain.

What CNB should like about the release is the news that output price sub-index rose to highest since April 2011. That said, the link between this index and the consumer price one has been tenuous historically…

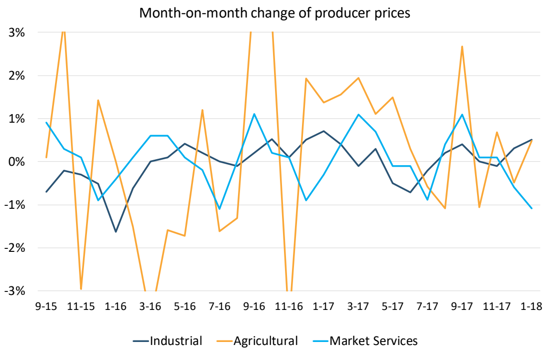
PRODUCER PRICES' GROWTH DECELERATES MAINLY ON BASE EFFECT…



Annual growth of Czech producer prices continued to decelerate in January, and not only because of the base effect.

The **growth of prices of agricultural producers**

…BUT MONTHLY DYNAMICS REMAINS SUBDUED AS WELL.



slowed to **7.2%** and this deceleration will continue in the coming months as the strong growth of these prices seen in 1Q17 vanishes from the annual comparison. The monthly dynamics is also subdued, with m/m growth of prices oscillating around 0%in last half a year.

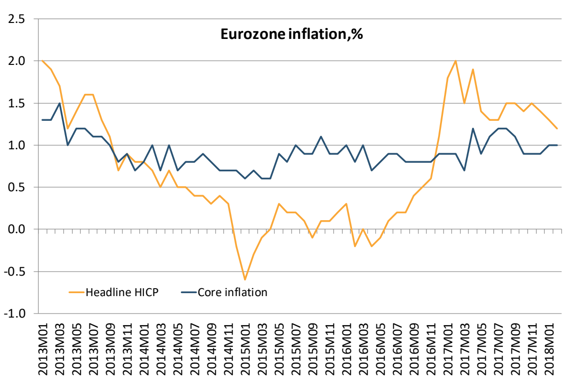
Prices of industrial producers also decelerated to 0.5% y/y, weakest growth since December 2016. Here, however, we are bound to see some re-acceleration in April-June as that is when oil price base effect kicks in. See, in those months of 2017 the USD oil prices were still low but CZK had already been strengthening. Currently, the USD prices are higher and CZK stopped strengthening, so there will be a base effect there. That said, monthly dynamics shows no signs of accelerating inflation pressures.

Prices of market services fell 1% m/m, mainly due to fall of prices in advertising. This is seasonal occurrence (going from December when advertising is heavy to January when it is not) but this year the drop was larger than in the same month of previous year. The annual growth of market services thus decelerated from 1.9% to 1.1%.

Put together, there is nothing that would suggest cost pressures are getting out of control.

| EUROZONE ECONOMY

EUROZONE INFLATION REMAINS LOW



Eurozone inflation remained low in February, confirming my view that ECB is long way from tightening the policy.

With inflation in France (1.3%), Germany (1.2%) and Italy (0.7%) undershooting the expectations (1.5%, 1.5% and 1.0%), it is almost a surprise that the Euro-area inflation only slowed from 1.3% in January to 1.2% in February (which, by the way, is the lowest inflation rate since December 2016). The apparent surprise is due to inflation in Spain overshooting the expectation (0.9%) by 0.3 pp, and due to increases in smaller countries.

The demand pressures continue to be non-existent: core inflation remained at 1% vfor th whole of Eurozone.

For ECB, nothing changes – very loose policy should stay with us for quite some time. In other words, I don't think Draghi will see hike in his term…

And the retreat of soft indicators in February reinforces that view.

Last week, I wrote about the pull-back of both PMI and German IFO, and the final February confidence data for Eurozone showed the same.

Consumer confidence returned to 0 pts., still one of the highest level ever, but notable correction from January 1.4 pts. The same pullback was seen in the overall economic sentiment (ESI). All the components thereof fell, except the service one, bringing the overall ESI to 114.1, i.e. to November 2017 level.

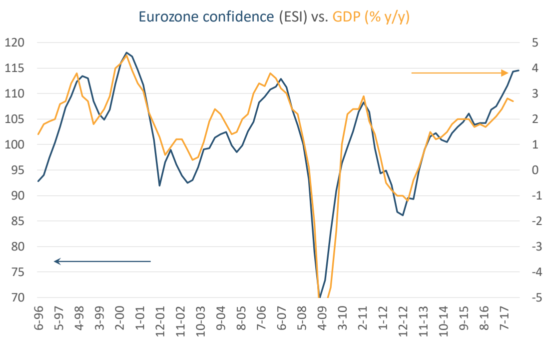
Although lower than previously, this is still consistent with about 4% annual growth in 1Q18, but that is unlikely given the recent softening of PMI and IFO. I think the growth will be around 3%, strong by Eurozone standard but unlikely to produce demand inflation any time soon…

Considering the slack in the labor market, confirmed by January unemployment data.

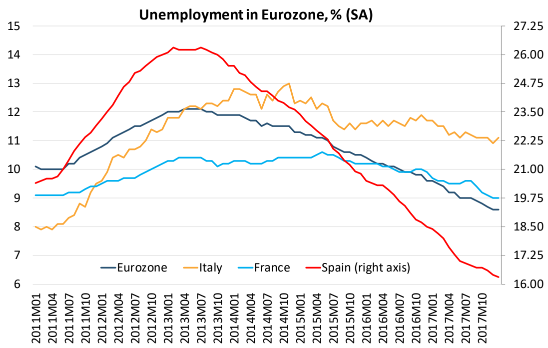
Unemployment rate remained at 8.6%, the same as in December and just 1 pp lower than in January 2017, i.e. the rate of improvement is still rather sluggish: at this rate, it will take 2-3 years before unemployment drops to levels that'd allow one to say 'full employment, here we are'.

The January unemployment evolved heterogeneously in big economies – it obviously stagnated in Germany (where full employment has been around for at least 18 months) and the same was seen in France (9% vs. 9.7% a year ago). Spanish one continued to fall (16.3% vs. 18.4% in

EUROZONE ESI STOPS GROWING, STILL POINTS AT STRONG GROWTH IN 1Q18

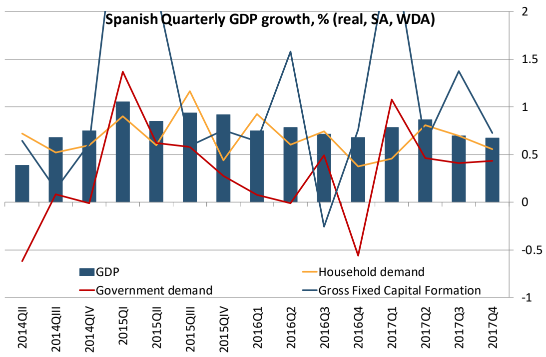


EMU UNEMPLOYMENT CONTINUES TO IMPROVE…

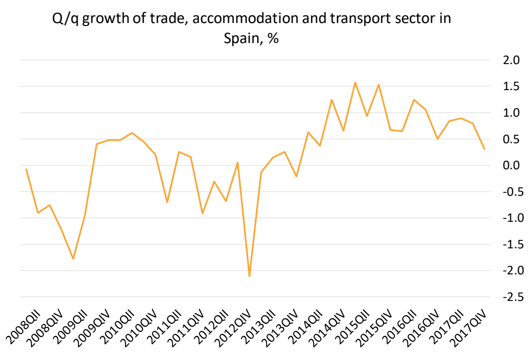


…BUT AT A SLUGGISH RATE.

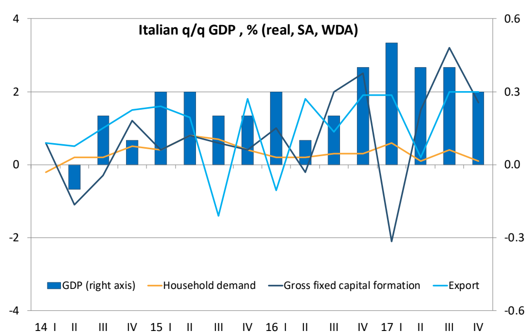
SPANISH 4Q17 GROWTH WAS BROAD-BASED AND SOLID,…



…THOUGH IT WOULD HAVE / COULD HAVE BEEN BETTER HAD IT NOT BEEN FOR POLITICAL CHAOS.



ITALY REMAINED A LAGGARD



January 2017) whereas Italian one surprisingly edged back up above 11% (11.1% vs. 11.7% in January 2017).

All in all, while progress continues on this front, it is very, very slow, especially in Italy, but also in France and, given the sheer number of unemployed, in Spain as well.

Spanish and Italian GDP 4Q17 GDP data showed these economies did not quicken, despite what (some) soft indicators suggested.

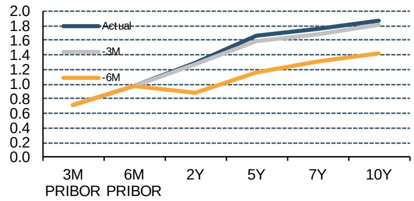
Spanish q/q growth grew 0.7% q/q, same as in 3Q17, and slower than 0.8 and 0.9% q/q growth seen in 1Q and 2Q of 2017, respectively. This is however still very **respectable outcome** – not only is it **fastest growth among big Euro area economies**, but it came in a quarter plagued by political instability (referendum on independence in Catalonia in early October) which did translate into some weakness / drag on growth. This was not only seen in October retail sales data, but is now clearly reflected in the weakness of important tourist sector – **in 4Q17, growth of trade, transport and accommodation sector slowed to lowest in 4 years.** Political situations must have contributed to this. Structure-wise, domestic demand was the major contributor. Investments and household demand rose almost the same, 0.7 and 0.6% q/q, respectively, both slower than in 3Q17, while net exports added (0.1 pp) something to q/q growth. **Looking forward, PMI points at the same GDP growth in 1Q18 as seen in 3Q-4Q17.**

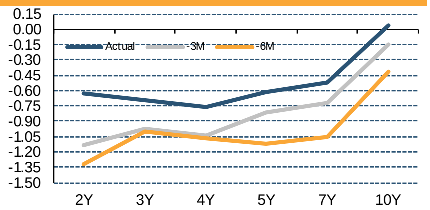
Italy remained a laggard. The growth was mere 0.3% q/q, below 0.4% q/q seen in 3Q17. As elsewhere, this was due to softer domestic demand as against 3Q17 – so it is not entirely of Italian origin. However, the fact that real wages don't grow amid unemployment that is over 11% certainly didn't (doesn't) help. Looking forward, though, **PMI indicates re-acceleration of growth to around 0.4-0.5% q/q.** That is obviously welcome, but at that rate it will be ages before meaningful dent is made in the army of unemployed… **And with**

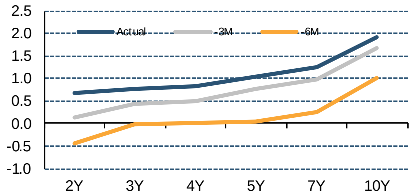
uncertainty apparently created by the Italian elections yesterday, the growth may suffer.

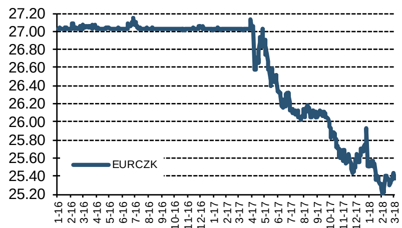
| MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.709	0.969	1.293	1.663	1.753	1.863
	-1M	0.709	0.969	1.390	1.835	1.930	2.050
	-3M	0.709	0.969	1.275	1.590	1.688	1.820
	-6M	0.709	0.969	0.875	1.158	1.305	1.430
ASW spread*		**2Y**	**3Y**	**4Y**	**5Y**	**7Y**	**10Y**
bps.	Actual	-0.632	-0.691	-0.764	-0.612	-0.518	0.044
	-1M	-0.820	-0.904	-0.731	-0.749	-0.623	-0.097
	-3M	-1.131	-0.973	-1.039	-0.816	-0.724	-0.147
	-6M	-1.327	-1.003	-1.074	-1.119	-1.057	-0.418
CZGB**		**2Y**	**3Y**	**4Y**	**5Y**	**7Y**	**10Y**
%	Actual	0.661	0.772	0.814	1.051	1.235	1.906
	-1M	0.570	0.696	1.019	1.086	1.307	1.953
	-3M	0.144	0.447	0.479	0.774	0.964	1.673
	-6M	-0.452	-0.023	0.006	0.039	0.248	1.012
FX		**EURCZK**	**EURPLN**	**EURHUF**	**EURRON**	**EURTRY**	**EURUSD**
	Actual	25.369	4.189	313.71	4.661	4.692	1.232
	-1M	25.237	4.171	309.91	4.647	4.697	1.246
	-3M	25.577	4.214	313.89	4.633	4.655	1.190
	-6M	26.056	4.253	305.70	4.595	4.068	1.186









‡ 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 ↗

| 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.

By accepting this report, a recipient hereof agrees to be bound by the foregoing limitations.