Weekly | 2018 | Week 10

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

| CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**
Monday	11-Mar-19	8:00	GER	Industrial production, Jan'19, y/y (WDA)	-3.3%
	11-Mar-19	9:00	CZ	CPI, Feb'19, y/y	2.6%
Wednesday	13-Mar-19	11:00	EMU	Industrial production, Jan'19, y/y (WDA)	-2.1%
Thursday	14-Mar-19	9:00	CZ	Retail sales, Jan'19, y/y	0.9%
Friday	15-Mar-19	9:00	CZ	Industrial production, Jan'19, y/y (WDA)	1.6%
	15-Mar-19	11:00	EMU	(Final) HICP, Feb'19, y/y	1.5%

* 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

“HERE IS WHY YOU CAN'T WIN A TRADE WAR WITH CHINA: ONE, LIFE IN EM IS INHERENTLY VOLATILE. SECOND, NO BALLOT BOX PRESSURE. THREE, NO TICKERS AT CNBC FOR THE PRESIDENT TO LOOK AT ↗”.

WEEK AHEAD

Locally, CPI for February is the most important release. January 2019 saw another increase of demand inflation as well as of monetary-policy relevant inflation, but this was mostly due to housing, as has been the case for last year or so. So the only thing I am interested in in the February release is whether it was the same or whether, which is unlikely, some broader demand pressures that CNB continuously mentions finally showed up.

In Eurozone, only January industrial production and final inflation for February will be released. Considering that big countries excluding Germany already reported January results (France: +1.7% y/y, Spain + 2.4% y/y, Italy – 0.8% y/y) and that they were much better than expected, I find the market expectation of -2.1% too pessimistic. The actual figure will be much better than this.

WEEK BEHIND

Czech wages up 8% in 2018, driven by public sector ▶

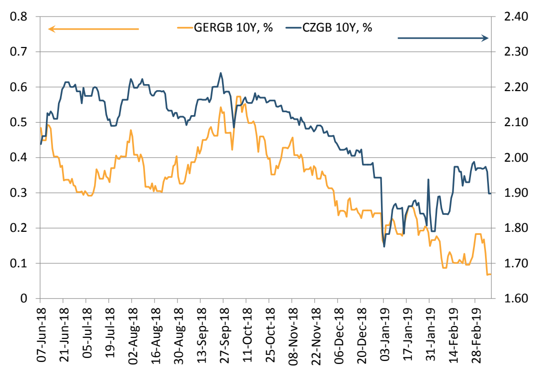
Eurozone 4Q18 GDP growth structure cautiously optimistic… ▶

…as was the service PMI. ▶

ECB in a panic mode ▶

CZK DIDN'T RESPOND TO ECB DOVISH MESSAGE,…

…BUT BONDS DID.



| FX

EURCZK spent another week in a tight range…

…of 25.60-25.65. No news to push the pair either way, just like the week before. ECB didn't help either way.

| FI

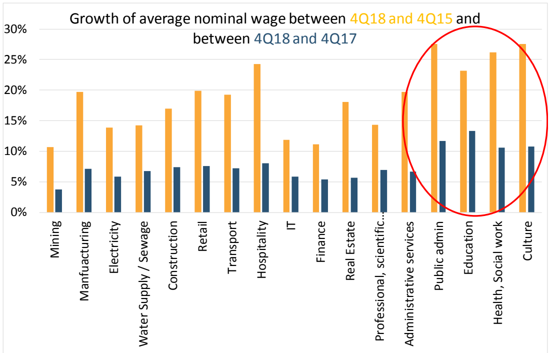
While CZK did not, bond yields did respond to ECB easing.

German 10Ys slid below 10 bps. while Czech 10Ys returned to 1.9%. With hikes in Eurozone not happening any time soon and with CNB unlikely to hike this year, there is a space for CZGBs to come further down yield-wise.

| CZECH ECONOMY

Czech wages continued to grow strongly at the end of the year, though the growth did slow down somewhat.

WAGE GROWTH IN LAST YEAR AND LAST THREE YEARS DRIVEN BY PUBLIC SECTOR

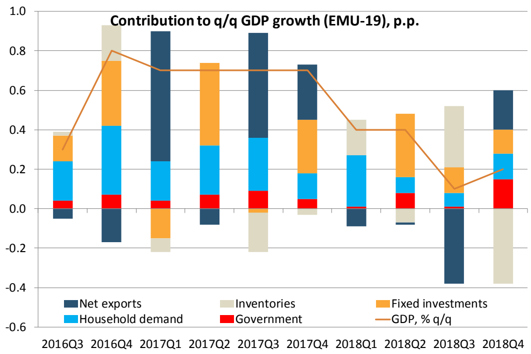


Nominal wage growth in the final quarter of last year was 6.9% y/y, below the 8%+ growth rates seen in the first three quarters of 2018. Considering the inflation, the real growth was 4.7%, weakest since 4Q17 (when it was the same, +4.7%). For the entire 2018, average wage grew 8.1% in nominal terms and 5.9% in real terms.

The structure of wage growth by NACE categories reveals that the growth in the last quarter, the last year and last three years was driven primarily by the public sector where wages increased by over a quarter over last three years and over 10% between 4Q18 and 4Q17. This is the reflection of massive increase of government spending in last years, one that is now catching up with the government (see discussion on page 4 in previous Weekly ↗).

This year, weakness in German manufacturing and increasing pessimism will dampen the wage growth, although the increases in public spending (another salary increase for public sector workers approved last year for 2019 budget) will still keep the average nominal wage growth in the economy at 5%. In 2020, this growth will slow further.

EUROZONE 4Q18 Q/Q STRUCTURE GIVES REASON FOR OPTIMISM



| EUROZONE ECONOMY

Eurozone GDP growth was confirmed at 0.2% q/q at the end of last year. Structure was cautiously optimistic.

This was slightly better than 0.1% q/q expansion in 4Q17, but still well below 0.5% growth rates of 2017. **Quarterly structural data were cautiously optimistic, though**.

First, net exports became a net contributor to growth for the first time since 4Q17 (though mainly because of smaller negative contribution, -0.2 pp. from imports).

Secondly, the contributions of major domestic demand components were all positive: household demand added 0.13 pp (3Q17: 0.07 pp), fixed investments added 0.12 pp (3Q17: 0.13 pp). The contribution to q/q GDP growth of government demand of 0.15 pp. was largest since 1Q16.

Finally, the decline in inventories will likely be reversed next quarter. The decline in 4Q18 may have been indicative of higher demand than forecast by companies (i.e., of actual demand exceeding the actual production). If so, inventories will need to be rebuilt.

Some more cautiously optimistic news came from final Eurozone service PMI.

Final February service PMI was a positive surprise since it rose 0.5 pts. against the flash estimate of 52.3 pts., and was thus 1.6 pts. higher than in January. It also more than offset the weakness in manufacturing, pushing the composite PMI to 51.9, 0.5 pts. up from preliminary estimate and 0.9 pts. up from January reading. These are still levels consistent with weak growth – but with growth that is at least decidedly positive.

German industrial orders declines seems to have stabilized

German industrial orders fell most m/m in 7 months…

…but this was mainly due to the upward revision of December's data. The monthly decline in January of 2.6% came after the December's previously-reported 1.6% decline was revised to a growth of 0.9%.
However, the revisions and updates and whatnot don't change the fact that a) orders fell 2% cumulatively in last three months and b) that orders are 3.7% lower than what they were a year ago.

As for the structure, the driver of the decline over last three months, as well as over last year, were orders from Eurozone which fell 9% over last three months and were, in February, 7% lower than in February 2018. Considering that Germany exports all over the place, this indicates that the weakening in Eurozone could not have been confined to just one country. Product-wise, most of the weakness came, surprisingly, from intermediate goods (-6.3% y/y). Capital goods' orders fell just 2.5% y/y.

ECB is in a panic mode.

Only few weeks after it discontinued its asset-purchase program, ECB sent a doubly dovish message at its meeting last week.

First, it had cut its growth and inflation forecasts for 2019 quite aggressively compared with the December forecast that underpinned its decision to stop QE. GDP outlook was revised from 1.9% in December forecast to 1.1% in March forecast, inflation from 1.8% to 1.2%. ECB had also cut inflation forecast for 2020 and 2021, from 1.7% to 1.5% in 2020 and from 1.8% to 1.6% in 2021. This of course had the effect on the monetary policy. ECB thus extended the no-hike guarantee "*at least through the end of 2019",* and of course *"in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.*" As early as in late January, ECB said rates will remain unchanged "*at least through* *summer 2019*". And ECB also dropped its confidence line, present in almost all statements last year, which said that ECB was confident, based on "*underlying strength of domestic demand*", that inflation would converge sustainably to ECB's aim. This is gone now. Like that confidence.

Second, it unveiled another (third, actually) set of liquidity-providing operations, TLTRO-III (Targeted Long-Term Refinancing Operation). This will again be a sequence of auctions of 2-year loans which ECB hopes will ensure that there is no credit squeeze for the private economy now that it is in the soft spot. That is why there is "T" in the name: some banks were recently reported to have started to invest more in government bonds, and ECB, via TLTROs, wants to make sure that whatever cheap credit banks will get from ECB they will extend to the private sector, not, as was the case with LTROs back in the day, to buy sovereign bonds.

Draghi also acknowledged that not only the uncertainty increased but that also the outlook definitely worsened – that is why ECB acted instead of waiting, as one journalist suggested during the press conference, for the uncertainty to play out. Or, in Draghi's poetic description, *"in a dark room you move with tiny steps. You don't run, but you do move."*
On possibility of recession, ECB is relatively upbeat: "*we assess the probabilities of a recession as being very low, as well as the probabilities of a de-anchoring of inflation expectations are indeed very low in our assessment".* This second part is a subtle reminder not to expect new QE unless situation deteriorates dramatically. Although Draghi kept that door ajar, responding to the question of whether ECB is "*ready to adjust all of your instruments available, whether that also include[s] the net asset purchase program?*" with the following answer:

"Well, you see optionality is everywhere. Now, the issue is whether we see contingencies that would justify the use of certain instruments instead of others. I don't want to speculate at this point in

EURUSD FALLS AS ECB EASES

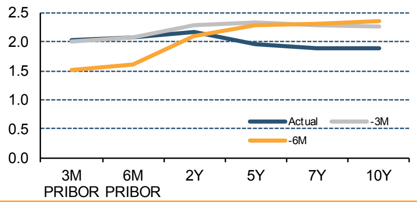
time. At this point in time, we've just taken all these decisions and we think they are the right decisions and the adequate decisions to be taken at this point in time."

As expected, EURUSD went down post-meeting, but not much: markets already priced in this retreat of ECB and FED's high bar for another hike offset whatever effect the de-facto easing of ECB would've had otherwise.

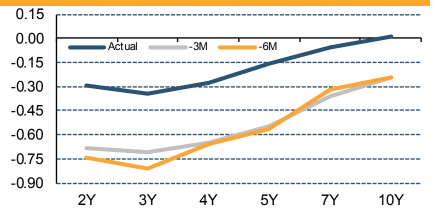
All in all, this meeting was just the confirmation of what I've long expected: that ECB won't hike before 2020. And it may well happen it will not hike even in 2020.

| Markets ‡

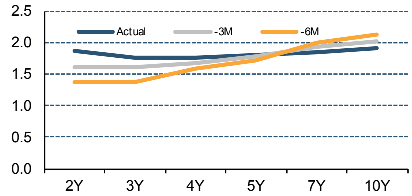
MM / IRS (%)	3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
Actual	2.030	2.070	2.155	1.955	1.893	1.888
-1M	1.990	2.050	2.028	1.740	1.678	1.708
-3M	2.010	2.070	2.290	2.323	2.293	2.265
-6M	1.510	1.610	2.103	2.285	2.313	2.360



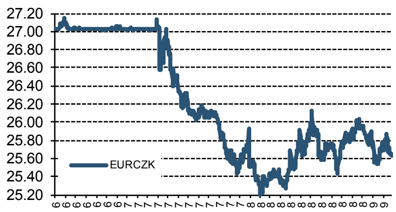
ASW spread* (bps.)	2Y	3Y	4Y	5Y	7Y	10Y
Actual	-0.298	-0.344	-0.274	-0.157	-0.056	0.011
-1M	-0.227	-0.215	-0.205	-0.142	0.045	0.133
-3M	-0.681	-0.711	-0.654	-0.549	-0.365	-0.243
-6M	-0.744	-0.808	-0.656	-0.566	-0.324	-0.242



CZGB** (%)	2Y	3Y	4Y	5Y	7Y	10Y
Actual	1.857	1.751	1.751	1.798	1.837	1.898
-1M	1.801	1.698	1.605	1.598	1.722	1.840
-3M	1.609	1.609	1.679	1.774	1.928	2.022
-6M	1.359	1.377	1.584	1.719	1.989	2.118



FX	EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
Actual	25.648	4.301	315.36	4.746	6.116	1.124
-1M	25.812	4.312	318.90	4.748	5.943	1.132
-3M	25.864	4.291	323.26	4.647	6.038	1.138
-6M	25.689	4.315	324.94	4.622	7.409	1.155



‡ 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.