Weekly | 2018 | Week 11

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

| CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	19-Mar	10:00	ITA	Industrial production, Jan'18, y/y	4.5%	N/A
	19-Mar	11:00	EMU	Trade balance, Jan'18, EUR bn.	22.3	N/A
Tuesday	20-Mar	16:00	EMU	(Preliminary) Consumer confidence, March	0,0	N/A
Thursday	22-Mar	10:00	EMU	(Preliminary) Manufacturing PMI, Mar'18	58.1	N/A
	22-Mar	10:00	GER	IFO Business Climate, Mar'18	114.6	N/A
	22-Mar	10:00	EMU	(Preliminary) Services PMI, Mar'18	56.2	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

" STREET IS POWERFUL."

WEEK AHEAD

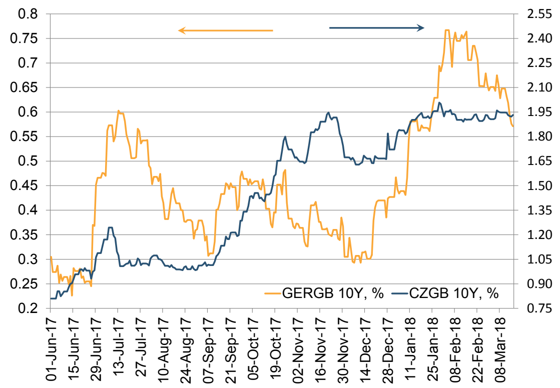
Week of soft indicators.

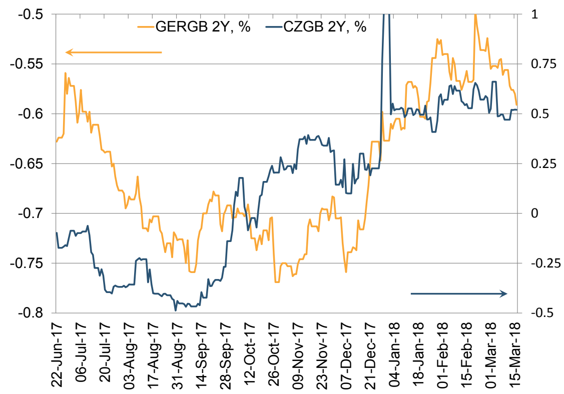
In Eurozone, three key indicators will be released: Euro area-wide PMI, in both services and in manufacturing, and consumer confidence, and then German-only IFO.

All of these should confirm what indicators in February suggested: that economy will continue to grow at 'merely' the recent rate (i.e., at ≈ 0.6% q/q) and not even flirt with ≈1% quarterly GDP growth rate these indicators hinted at at the end of 2017 and beginning of 2018. In other words, while I wouldn't expect them to fall much further, I certainly don't expect them to have increased back to December 2017 / January 2018 levels.

EURCZK STRENGTHENS MARGINALLY.

GERMAN YIELDS FALL ON DOVISH ECB POLICYMAKERS





WEEK BEHIND

Czech (and Eurozone ▶) industry fell at the beginning of 2017, but only due to non-manufacturing ▶

Prices of industrial / agricultural producers eased further in February ▶

Household remain on the spending spree, but still ignore cars ▶

Eurozone inflation stable and low in February, reinforcing dovish stance of ECB ▶

| FX

EURCZK strengthened marginally to hit 25.40 at one point last week.

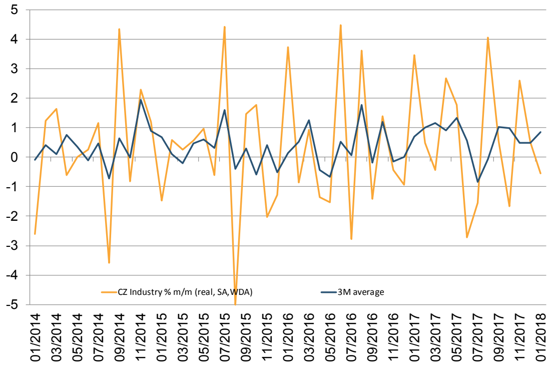
The trading in last few weeks thus has been very calm, with most, if not all, just being technical / flow trading.

| FI

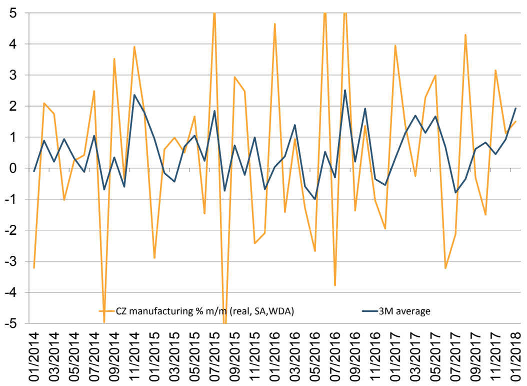
German yields fell to lowest since January while Czech ones remained unchanged.

This was clearly due to the dovish statements from ECB policymakers. Benoit Coeure repeated rates would remain at very low levels for long while Jan Smets from Belgium voiced his concern that inflation may take longer to rise than previously forecast and that ECB should not accept sub-target inflation growth. On top of that, the final HICP for February came in lower (1.1%) than the first estimate (1.2%), reinforcing the view that bond-buying might stay with us well beyond September.

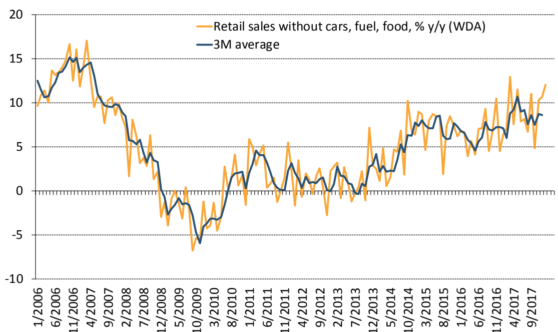
INDUSTRIAL PRODUCTION FELL ON FALL OF UTILITIES / ENERGY.



MANUFACTURING, ON THE OTHER HAND, FINISHED THE BEST THREE MONTHS IN OVER A YEAR.



CORE RETAIL SALES CONTINUE TO GROW AT DOUBLE-DIGIT ANNUAL RATE WHILE…



| CZECH ECONOMY

Czech industrial production fell marginally at the beginning of the year, but…

… there is nothing to worry about here. First, the decline was only due to non-manufacturing component of the industry and, second, the overall dynamics remained strong, both in overall industry and particularly in manufacturing.

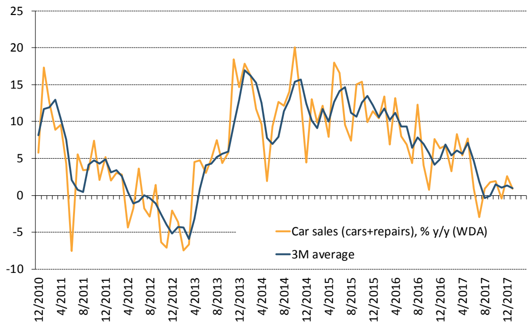
The decline of 0.6% m/m in January was driven by strong decrease of production in (volatile) energy & utilities component (= electricity, gas, steam, air-conditioning). This segment saw almost 10% monthly decline in January (after 7% monthly decline in December).
The manufacturing, on the other hand, added another 1.5% m/m in January for the strongest three-month growth since October 2016 (November 2017: +3.2% m/m, December 2017: +1.1% m/m).
That the annual growth of manufacturing remained close to 10% (9.4% y/y, to be precise) whereas the entire industry slowed to 5.5% y/y then shouldn't come as a surprise. And it should continue for at least few months: although PMI retreated somewhat, it is still at levels consistent with 10% annual growth of manufacturing.

Households still on the spending spree– but somehow continue to ignore cars.

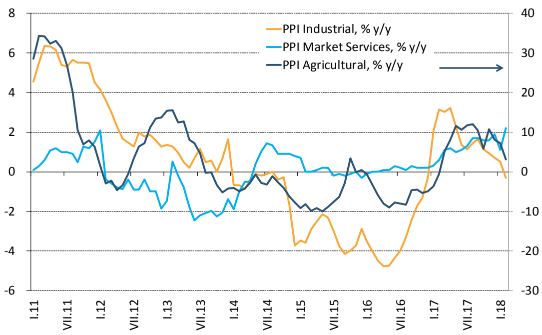
Core retail sales (=no cars, no fuel, no food) rose 12% y/y in January (yes, that is real and adjusting for working days differences) which means that only March 2017 saw stronger growth in last 10 years. Not that it comes as surprise: strong growth of nominal wages continues (4Q17 at real 5.3% y/y & no signals of slowdown in 1Q18), as does ultra-low unemployment and sky-high consumer confidence.

Outside the core sales, situation is a bit more mixed. On the one hand, food sales continue to grow at 3.5% y/y, pretty much just like throughout the entire last year, while fuel sales even quickened

…CAR SALES CONTINUE TO DEFY THE STRONG MACRO FUNDAMENTS.



PRODUCER PRICES IN FIRST FALL IN OVER A YEAR, PRICES OF MARKET SERVICES IN STRONGEST GROWTH IN 5 YEARS.



the growth to 7.8% y/y. On the other hand – and it remains at odds with the overall macro picture - car sales grew just 1% y/y in January, perplexingly slow tempo even if one takes into account the growth in previous years. It doesn't make sense to me…But since this is so incongruent with the overall situation, I don't read much into it.

February producer prices confirmed the ongoing food-driven disinflation, though there appeared a pocket from which inflation could come.

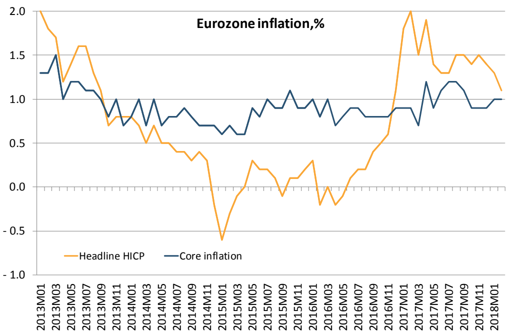
Prices of agricultural producers fell 2.2% m/m, strongest monthly decline since November 2016. This brought their annual growth to 3.2% (from 7.2% in January) and thus to slowest growth since February of last year. Qualitatively the same is true of **industrial producers** whose **prices** – owing to the monthly decline of 0.4% (in turn mainly due to oil products and coke) – recorded **the first annual contraction since December 2016** (-0.3% y/y).

In other words, both the fuel and food prices, which – apart from EET and imputed rents – were behind last year's inflation hump, are very unlikely to add anything to this year's inflation. On the contrary, they are likely to become a further drag on annual consumer inflation in coming months.

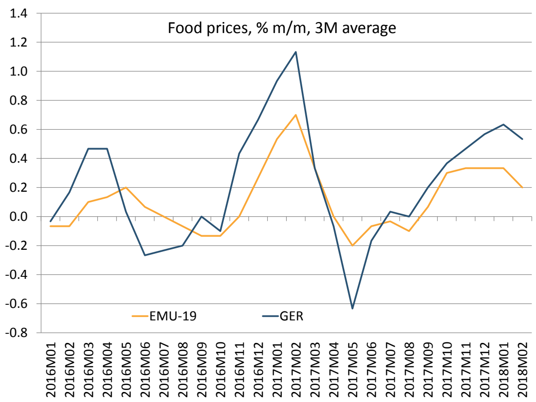
It was different with prices of market services. These, on the other hand, erased the January (seasonal & advertising-driven) slowdown and re-accelerated on the back of higher charges for advertising (7.1% m/m), employment services (9.3%) and postal services (5.3% m/m). In other words, strong demand and tight labor market do appear to have some effect on B2B pricing.

While market services may eventually show up in consumer inflation (or not, if these costs are not passed onto consumers but absorbed into margins), they are the only pro-inflationary factor that I see - and moderate one at best. See, food and fuel prices decelerate, Eurozone remains non-

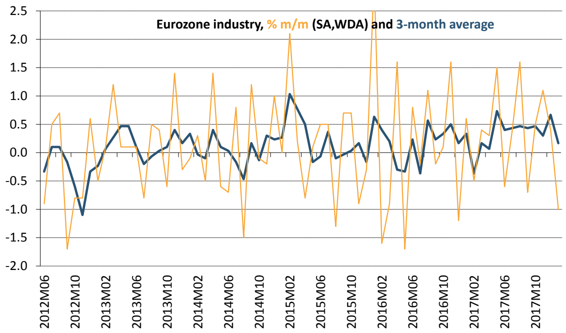
EUROZONE CORE INFLATION UNCHANGED, HEADLINE FELL FURTHER AS…



…FOOD BASE EFFECT SET IN.



EUROZONE INDUSTRY FELL SHARPLY IN FEBRUARY…



inflationary, CZK is strong. It will be hard for Czech inflation to repeat 2017 levels anytime soon.

| EUROZONE ECONOMY

Final February inflation confirmed stable and low inflation in Eurozone.

In February, core inflation remained at 1%, just like in January and almost exactly at the average level over 2013-2017 which was 0.9%. In other words, little changed over last four years in terms of actual inflation.

Headline inflation – which is what ECB targets - fell to 1.1%, the level last time seen at the end of 2016. This was mainly the reflection of slower growth of food prices: the unprocessed food became a drag on annual inflation rate to the tune of 0.1 pp while it added +0.4 pp back in February of 2017. No wonder: this time in 2017, the food prices growth was much faster.

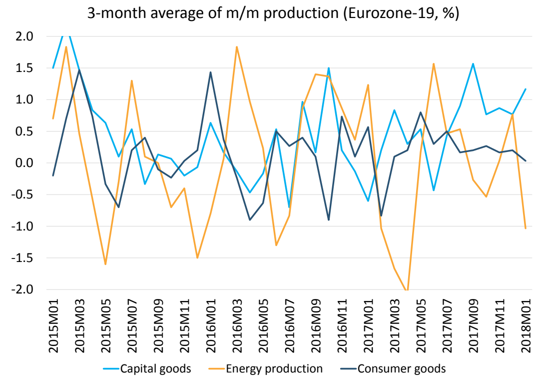
To make the long story short: there is no reason for ECB to change its strongly dovish stance from the meeting two weeks ago ↗.

Manufacturing stagnated in February, but overall dynamics remained between 1% and 1.5% quarterly rate.

The overall industrial production fell 1%, dragging the average monthly growth in last three months to 0.2% m/m, but this is no sign of lost dynamics. First, this was due to fall of production in energy / utilities sector, just like in CZ, and second, as mentioned, manufacturing dynamics remained respectable.

Although the m/m change in February in manufacturing was zero, the growth in last three months was respectable 1.2%. With PMI still very high by historical standard (though it did retreat recently), solid growth should continue even if there are some headwinds from strong euro. As is now clear, the gap between PMI and actual production

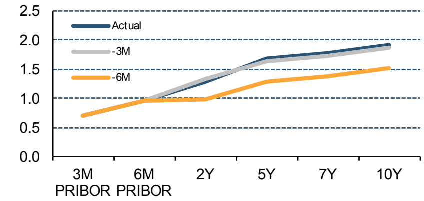
…BUT PRIMARILY DUE TO ENERGY / UTILITIES



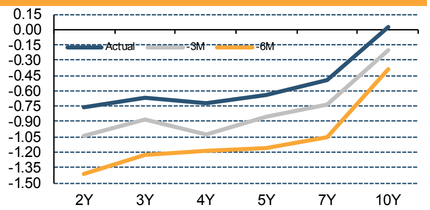
will close from the PMI side: no quickening of growth is to be expected.

| Markets ‡

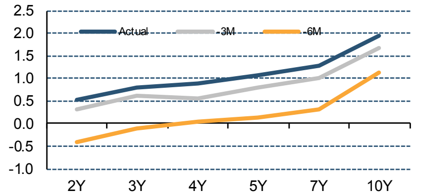
MM / IRS (%)	3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
Actual	0.709	0.969	1.280	1.695	1.780	1.910
-1M	0.709	0.969	1.275	1.695	1.795	1.915
-3M	0.709	0.969	1.340	1.645	1.740	1.870
-6M	0.709	0.969	0.985	1.280	1.383	1.523



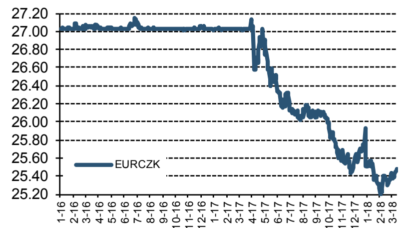
ASW spread* (bps.)	2Y	3Y	4Y	5Y	7Y	10Y
Actual	-0.760	-0.666	-0.719	-0.638	-0.502	0.022
-1M	-0.747	-0.733	-0.669	-0.634	-0.551	-0.011
-3M	-1.040	-0.883	-1.032	-0.859	-0.732	-0.205
-6M	-1.408	-1.229	-1.185	-1.155	-1.057	-0.390



CZGB** (%)	2Y	3Y	4Y	5Y	7Y	10Y
Actual	0.520	0.799	0.871	1.057	1.278	1.932
-1M	0.528	0.722	0.926	1.061	1.244	1.904
-3M	0.300	0.601	0.547	0.786	1.008	1.665
-6M	-0.423	-0.102	0.030	0.125	0.326	1.133



FX	EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
Actual	25.418	4.219	310.93	4.670	4.821	1.229
-1M	25.355	4.157	311.28	4.661	4.648	1.241
-3M	25.686	4.207	314.13	4.622	4.540	1.175
-6M	26.090	4.276	309.30	4.602	4.107	1.195



‡ 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.