

March 26 | 2018

Weekly | 2018 | Week 12

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

CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	26-Mar	8:45	FRA	(Final) GDP, 4Q17, q/q	0.6%	N/A
	26-Mar	9:00	CZ	Consumer / Business Confidence, March'18	N/A	N/A
Tuesday	27-Mar	9:00	SPA	(Preliminary) HICP, Mar'18, y/y	1.6%	N/A
	27-Mar	11:00	EMU	Economic Confidence, Mar'18	113.3	N/A
Wednesday	28-Mar	10:00	SPA	Retail sales, Feb'18, y/y	2.0%	N/A
Thursday	29-Mar	13:00	CZ	CNB rate-setting meeting, 2-week repurchase rate	0.75%	0.75%
	29-Mar	14:00	GER	(Preliminary) HICP, Mar'18, y/y	1.6%	N/A
	29-Mar	9:00	CZ	Export/Import Prices, Jan'18	N/A	N/A
Friday	30-Mar	8:45	FRA	(Preliminary) HICP, Mar'18, y/y	1.5%	N/A
	30-Mar	11:00	ITA	(Preliminary) HICP, Mar'18, y/y	0.8%	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

“TIME FOR ZUCKERBERG TO DON A SUIT AND SET OUT ON ITS ROAD TO CANOSSA.”

WEEK AHEAD

The biggest local event is 2018's second CNB meeting while preliminary inflation for March is on Eurozone watcher's radars.

CNB will not do anything regarding the repo, but what interests me is what it will say about inflation and EURCZK. Inflation was lower in first two months of 2018 than what it expected (with actual February reading having been 0.4 pp lower than CNB February forecast) so that is an anti-inflationary risk to its forecast. On the other hand, EURCZK is at 25.40 but was expected to be lower by now (average in 2Q18, which begins shortly, is forecast at 24.90), being a pro-inflationary risk. I think CNB will now play it cool, saying these two risks offset, but as it becomes clearer – in 2Q18-3Q18 – that inflation remains low even without CZK getting stronger, the consequence of there being no demand pressures in CZ, CNB will have to come to terms with the new reality and adjust the expected repo rate trajectory downwards. But we are not there yet.

In Eurozone, preliminary inflation in all big economies is forecast to have increased in March, but that is only due to food / energy effect. Core inflation very likely remained unchanged, and thus low. And weakening of leading indicators ▶ doesn't bode well for its rise.

WEEK BEHIND

Part of CSSD apparently wants referendum on EU membership as well ▶

Leading indicators in Eurozone show notable loss of growth momentum in March ▶

FED hikes again, but remains moderate in outlook ▶

FX

EURCZK remained in a very tight range of 25.375-25.425 for most of the last week...

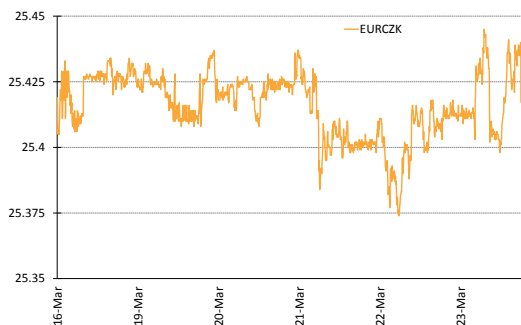
...the comments of Zimola ▶ that he'd welcome the referendum on the exit of CZ from EU nonetheless. The market complacency really surprises me: a lot of investors made a profit on EURCZK and now have government that can, even if only by mistake or miscalculation, bring about the EU exit referendum. Which, considering the population latently, and irrationally, against EU, could quickly get out of hand. And yet market sits still. Go figure.

FI

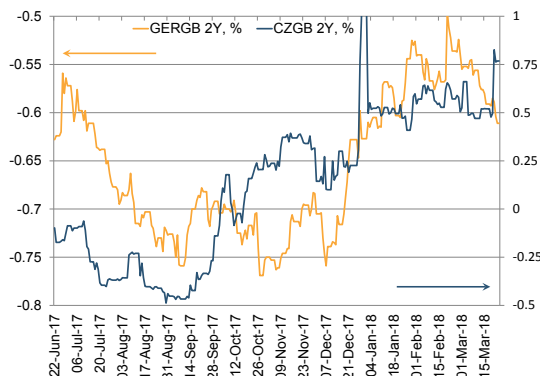
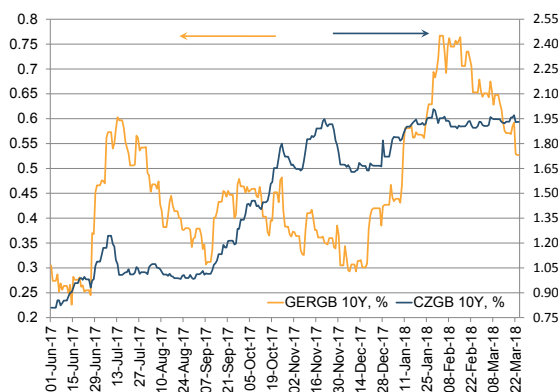
German yields continued to drift lower.

The cause was clear: the combination of weaker leading indicators, fears of trade war and somewhat less-than-hawkish FED after its meeting last week. Czech longer-dated bonds didn't move much.

EURCZK TRADED SIDeways.



GERMAN YIELDS CONTINUED TO TREND LOWER



CZECH ECONOMY

Nothing new except for 2nd in command at Social Democrats calling for referendum on EU membership...

Now, this in my view is the reflection of the utter despair of some Social Democrats, possibly combined with the inability to carry the defeat of one of them. Zimola, the deputy head of CSSD who ran for chairman in February and lost, said last Monday that he was against the exit but thought people should decide. In a week that showed how easily influenced people really are (Cambridge Analytica ↗), let alone how little they know about specific and complex issues, this is about as prudent as the decision of CSSD to join the government of Babis four years back.

By the way, from that and also the from how Zimola is pushing CSSD to again join the coalition with Babis, I can't resist the impression that Zimola is becoming new Zeman, i.e. a spurned Social Democrat on a vengeance mission ☺

I already wrote that but what really puzzles me is that CZK took this in a stride...With so much at stake, and storm potentially gathering – is it really a stretch that Babis, desperate for a coalition, makes the same mistake as Cameron and promises referendum, hoping it'll end up well?

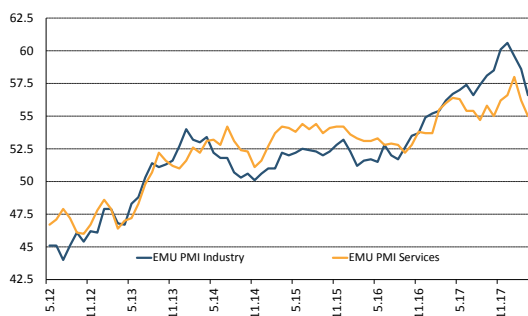
EUROZONE ECONOMY & FED

March decline in leading indicators across the Eurozone puts the idea of quickening economic growth to rest.

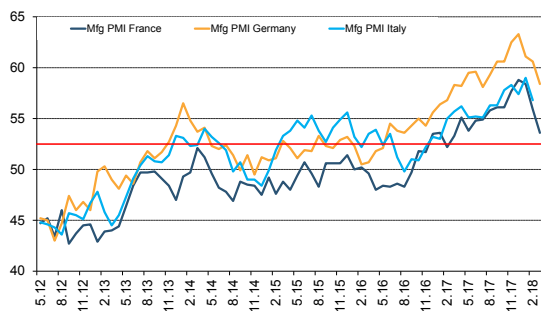
This was the second month in which leading indicators slowed sharply.

Eurozone PMI in manufacturing fell to 56.6 and is now full 4 pts. lower than in December, and also lowest since July 2017. Service PMI fell to 55 pts (3 pts. lower than in December) and thus is now at the level of October 2017. The overall (composite) PMI output index (being composite of output in

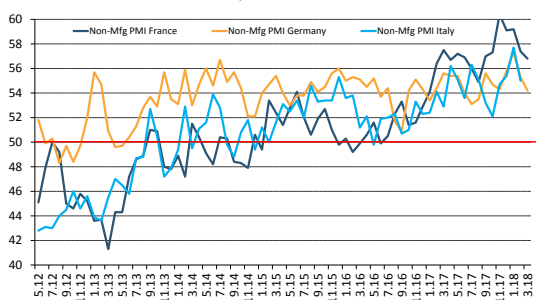
LEADING INDICATORS IN EUROZONE WEAKEN IN MARCH: PMI FALLS IN BOTH...



...INDUSTRY AND...

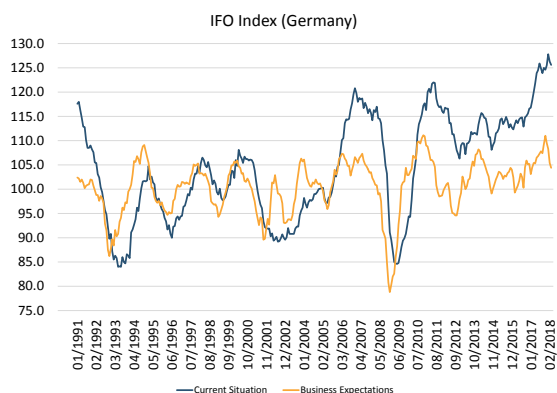


...SERVICES, AND SO DOES...



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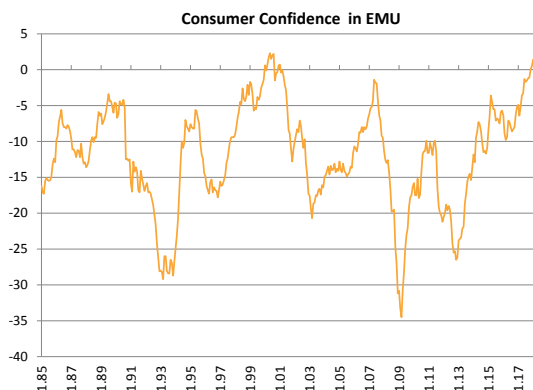
...GERMAN IFO.



manufacturing and total Service PMI index) is thus now lowest in 14 months, driven not only by slower actual output (14 months' low in industry, 5 months' low in services) but also by slowdown in orders (export orders are weakest since November 2016).

Same is true of IFO: business expectations fell to lowest (104.4) since January 2017 (103.1). Although the assessment of the current situation remained very high (125.6), it did retreat from January all-time high (127.8).

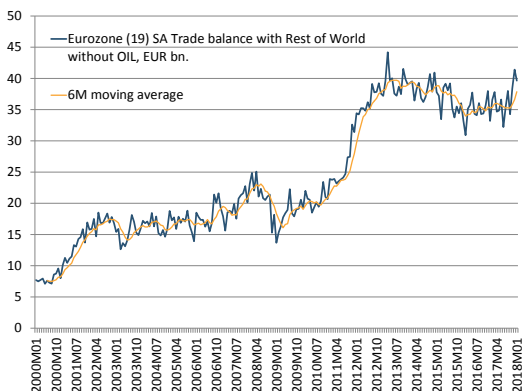
CONSUMER CONFIDENCE REMAINED THE SAME



March flash consumer confidence was thus the only soft / leading indicator that didn't worsen against February. Instead, it remained unchanged at February's 0.1. That said, even confidence is lower than what it was at the end of 2017, though is still very high by historical standard.

I don't have the definite answer as to what caused the March decline, but the decline of stock markets in February and Trump's tariff-rattling in March must have contributed. The important thing is different, though: **whereas in December the PMI was pointing at 1% q/q growth of GDP** (which I didn't believe for a second) and although the 1Q18 average is consistent with 0.7-0.8% q/q growth in this quarter, **the loss of momentum over 1Q18 is notable** and leads me, together with the tendency of PMI to overshoot the actual growth in last few quarters, to **expect 0.6 and 0.5% q/q in 1Q18 and 2Q18 respectively**. The inflationary implications of growth slowdown are clear: **ECB is more likely to prolong the QE than it was couple of months back**. The decision last week to add 7 German regional development agencies to the QE list of eligible assets ↗ may indicate ECB wants to (be able to) play in the markets a little longer...

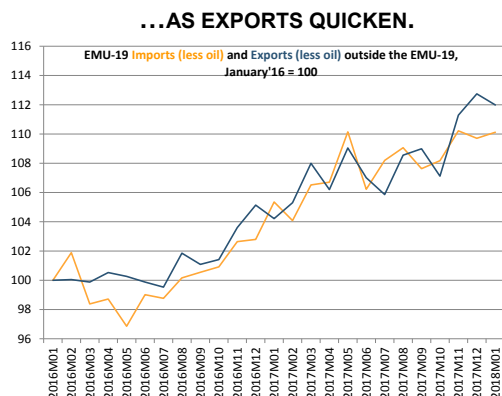
EU TRADE BALANCE WITHOUT OIL IMPROVES...



EU trade balance surplus remains large, courtesy of exports.

The surplus in January was EUR 20 bn., i.e. not too different from the average surplus seen over 2015-2017 (EUR 20.4 bn.). Without oil, and thanks exclusively to the growth of exports (strong euro

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nonetheless), the trade surplus was almost EUR 40 bn. in January, well above the average in last two years (35.9 bn.). This speaks for euro strength, though historically trade balance is a weak predictor of actual exchange rate.

FED hiked again, but wasn't as hawkish as markets expected.

The first meeting chaired by new Chairman Jerome H. Powell wasn't a surprise, at least not in its outcome: the hike of 25 bps. to 1.50%-1.75% was widely expected. What was a bit disappointing for the hawks out there was relatively measured statement: but could something else really have been expected from the debut of a lawyer by training at the helm of FED?

The FED's statement [↗](#) noted the "moderation" of growth rates of fixed investments and of household demand compared with 4Q17 while it also said the economic outlook "strengthened in recent months" and expressed view that rolling 12-month inflation will "move up to and stabilize around" 2% in "coming months". The market expectation that 2018 dot-plot will see additional three hikes (i.e., for total of four this year) wasn't met: FED did move up 2019 by 25 bps., but kept 2018 forecast unchanged, despite the fiscal stimulus of government.

Relative hawkishness of FED compared with that of ECB leaves me with clear expectation for EURUSD: down to 1.15. Last week, it remained around 1.235.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	0.709	0.969	1.290	1.700	1.790	1.898	
	-1M	0.709	0.969	1.290	1.675	1.785	1.910	
	-3M	0.709	0.969	1.310	1.620	1.711	1.840	
	-6M	0.709	0.969	0.960	1.295	1.408	1.534	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.522	-0.598	-0.528	-0.407	-0.168	0.034	
	-1M	-0.719	-0.715	-0.646	-0.632	-0.541	-0.015	
	-3M	-1.084	-0.827	-0.934	-0.833	-0.649	-0.174	
	-6M	-1.294	-1.168	-1.123	-1.083	-1.003	-0.320	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	0.768	0.872	1.085	1.293	1.622	1.931	
	-1M	0.571	0.746	0.923	1.043	1.244	1.895	
	-3M	0.226	0.623	0.615	0.787	1.062	1.666	
	-6M	-0.334	-0.055	0.095	0.212	0.405	1.214	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.427	4.228	312.89	4.663	4.915	1.235	
	-1M	25.364	4.173	313.14	4.653	4.659	1.230	
	-3M	25.754	4.192	311.74	4.639	4.521	1.186	
	-6M	26.048	4.266	309.93	4.598	4.179	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

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