

April 02 | 2018

Weekly | 2018 | Week 13

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Tuesday	3-Apr	8:00	GER	Retail sales, Feb'18, y/y	2.4%	N/A
	3-Apr	9:00	CZ	(Final) GDP, 4Q18, q/q	0.5%	0.50%
	3-Apr	9:30	CZ	Manufacturing PMI, Mar'18	57.6	57.2
	3-Apr	10:00	EMU	(Final) Manufacturing PMI, Mar'18	56.6	N/A
	3-Apr	14:00	CZ	Budget balance, Mar'18, CZK bn.	N/A	N/A
Wednesday	4-Apr	11:00	EMU	(Preliminary) Core/Headline HICP, Mar'18	1.1%/1.4%	N/A
Thursday	5-Apr	8:00	GER	Industrial orders, Feb'18, y/y	6.3%	N/A
	5-Apr	11:00	EMU	(Final) Services PMI, Mar'18	55.0	N/A
	5-Apr	11:00	EMU	Retail Sales, Feb'18, y/y	2.3%	N/A
Friday	6-Apr	9:00	GER	Industrial production, Feb'18, y/y (WDA)	4.3%	N/A
	6-Apr	9:00	CZ	Industrial production, Feb'18, y/y	5.8%	5.5%
	6-Apr	9:00	CZ	Retail Sales, Feb'18, y/y	5.6%	N/A
	6-Apr	9:00	SPA	Industrial production, Feb'18, y/y (SA)	3.0%	N/A

* LOCAL TIME IS CET

** (REUTERS/ BLOOMBERG) POLL

APRIL 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
SPP 788	5-Apr	6-Apr	5-Oct-18	CZK 0-5 bn.	N/A
CZGB 2007-2022**	11-Apr	13-Apr	12-Sep-22	CZK 4 bn. max	4.70%
CZGB 2015-2026**	11-Apr	13-Apr	26-Jun-26	CZK 4 bn. max	1.00%
CZGB 2017-2033**	11-Apr	13-Apr	10-Feb-27	CZK 4 bn. max	0.25%
SPP 789	12-Apr	13-Apr	13-Jul-18	CZK 0-5 bn.	N/A
SPP 786	19-Apr	20-Apr	19-Oct-18	CZK 0-5 bn.	N/A
CZGB 2018-2021**	25-Apr	27-Apr	23-Feb-21	CZK 4 bn. max	0.75%
CZGB 2018-2029**	25-Apr	27-Apr	23-Jul-29	CZK 4 bn. max	2.75%
CZGB 2017-2033**	25-Apr	27-Apr	13-Oct-33	CZK 4 bn. max	2.00%
SPP 791	26-Apr	27-Apr	27-Jul-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

"MOVE FAST, BREAK PEOPLE 🚀🚀."

WEEK AHEAD

Monthly data on industry & retail sales in Czech Republic will not bring anything game-changing. Not even anything unusual.

The dynamics of the industrial production should begin to slacken now, as suggested by the slowdown of soft indicators here and in Germany in February. This slowdown, as preliminary data released two weeks ago made it clear, extended into March in Eurozone. This will not only be confirmed again this week as final Eurozone PMI data are released, but release of Czech March PMI will show that the loss of momentum in industry isn't Germany-only. Retail sales, on the other hand, likely grew strongly in February, at least in the core category (i.e., except cars, fuel, food): strong confidence, strong growth of wages and weaker inflation make anything else highly unlikely. Whether the car sales improved is a question, though – these have been illogically weak in last couple of quarters so it'd be about time to see improvement there.

In Eurozone, retail sales for February will be shown to have remained around 2% y/y, just like Spanish retail sales released last week (more on which below) suggested. Preliminary inflation data on the entire Eurozone will be of no surprise as all big economies reported their own individual data last week.

WEEK BEHIND

■ CNB meeting a slightly dovish affair, CNB sees anti-inflationary risks to February forecast ▶

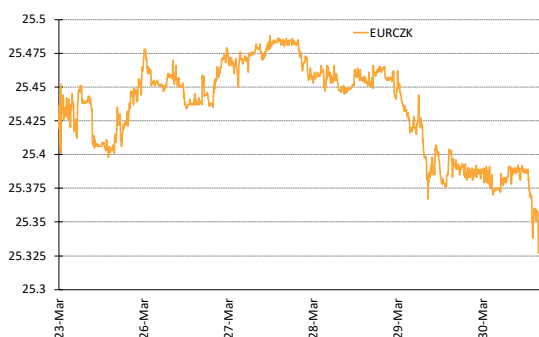
■ Import prices fell again in January, all components are markedly lower y/y ▶

■ Czech consumer confidence hits new record, business one stagnates ▶

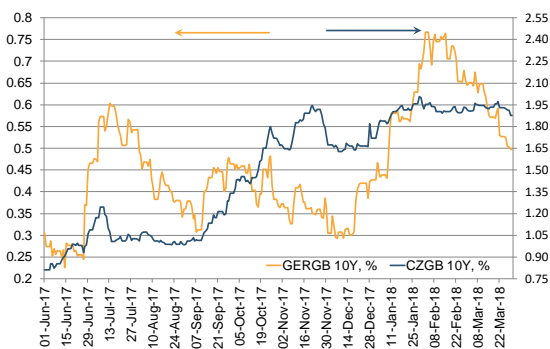
■ Data from large Euro area economies suggest inflation remained low in March ▶

■ Business confidence fell in retail, industry in EMU ▶

CZK STRENGTHENS AFTER CNB, EVEN THOUGH CNB SOUNDED DOVISH



GERMAN YIELDS CONTINUED TO TREND LOWER



FX

EURCZK fell to 25.325 at the end of last week...

...despite the dovish CNB meeting. This market really doesn't make sense to me: first, the fact that probability of EU referendum has been creeping upwards for last four months doesn't seem to matter one iota. Ok. Then CNB says next hike comes "at the end of the year at the earliest" and CZK strengthens...Go figure.

FI

German yields continued to drift lower.

Lower-than-expected March preliminary inflation seems to have been the cause this time around. 10Y German yield fell to below 50 bps. for the first time since early January. Czech yields also drifted lower, but only marginally.

April 02 | 2018

| CZECH ECONOMY

CNB left the interest rates unchanged last week and sent a slightly dovish message.

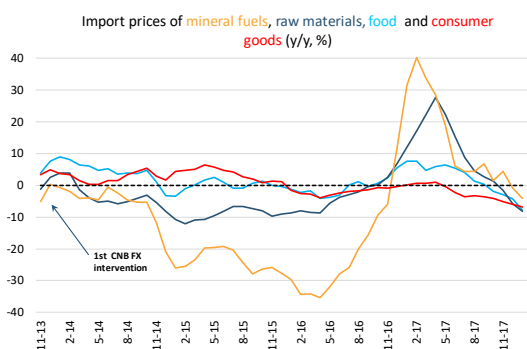
This was not surprising as it was in line with its February 01 forecast (which sees next hike only at the end of 2018) and because the inflation data that'd been released since February 01 were lower than forecast. CNB couldn't say anything but that *"domestic inflation fell further at the start of this year"* and that this brought the inflation *"markedly below the central bank's forecast"*.

On the other hand, CNB noted that the outlook for the economic activity in Eurozone improved as against the expectation embodied in the February forecast, and, and this is more important, that CZK didn't strengthen as much as forecast assumed; CNB further said CZK may, going forward, strengthen *"more gradually compared to the forecast"*.

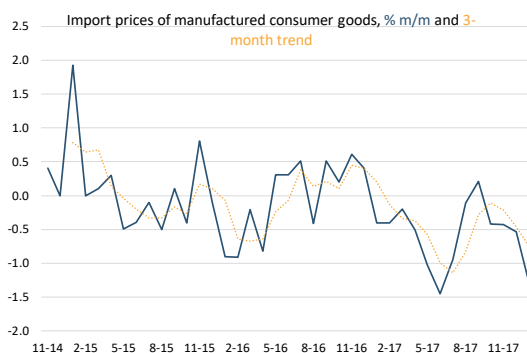
In sum, lower-than-forecast inflation and weaker-than-expected CZK made, in CNB assessment ↗, for the *"slightly anti-inflationary"* balance of risks to the February 01 forecast. **CNB thus reiterated the rather dovish message from February meeting** when it said that the next rise of the interest rates is forecast *"at the close of this year at the earliest"*. The qualifier "earliest" wasn't there before and clearly means that CNB is less sure it will be necessary to raise interest rates this year (though forecast nominally expects so).

For the remainder of this year, CNB still expects massive strengthening of the CZK which I strongly doubt will happen. The question is whether that will move CNB to hike this year. I think it will not since it will be shown that demand pressures here are far less persistent than CNB said. See, the pure demand-driven inflation in Czech Republic has always been low, even last year – although it looked like demand inflation was rising, it was only due to EET and real estate prices. This year, demand inflation will be shown to not be a problem: CZ is far too open to be able to easily generate demand inflation of threatening magnitude.

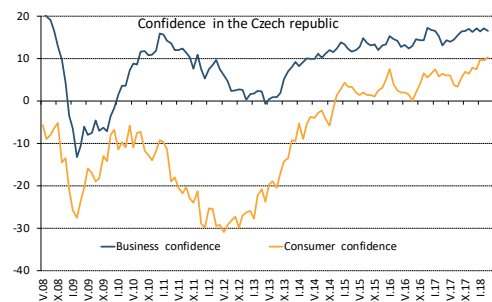
IMPORT PRICES CONTINUED TO DECELERATE.



MONTHLY DYNAMICS OF CONSUMER GOODS IMPORT PRICES REMAINS VERY WEAK



CONFIDENCE OF CONSUMERS HITS ALL-TIME HIGH IN MARCH, THAT OF BUSINESS CONTINUES TO STAGNATE...



Looking forward to 2019, CNB forecasts that next year will see substantial normalization of the policy, but this is based mainly on the assumption that ECB will normalize in 2019. Which, in light of non-existent demand pressures in Eurozone, is increasingly looking like overly optimistic assumption.

The openness of the economy means inflation could be imported, sure. Except just the opposite is true now.

Import prices continued to decelerate in January (-0.6% m/m, -5.8% y/y), with all components falling on a y/y basis: food & material import prices fell 8% y/y, price of mineral fuels by 4% y/y and of consumer manufactured goods by 7% y/y.

As regards monthly dynamics, it is not so uniform but also shows clear anti-inflationary pressures in demand part of the consumer inflation. See, import prices of consumer goods, of vehicles and machinery (as well as of food) fell in January (-1.3% m/m, -1.2% m/m, -1.6% m/m) and, to illustrate it is not one-off, all of these are lower than in September of last year (by 2.6%, 2.5% and 3.7%, respectively).

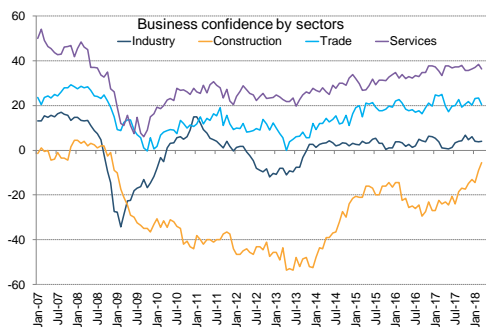
The only category that saw import prices rising were mineral fuels (2.3% m/m in January, 10% since September 2017) and tobacco & beverages (1% and 3.9%, respectively). Not even the category of "other raw materials" rose over last 5 months: whereas in January import prices of raw materials rose 1.7%, they fell 2.3% since September.

Enough numbers: what this means is that we're not importing any inflation, just the contrary. Here, stronger CZK and weak Eurozone inflationary pressures combine. And unless one or both change(s), we will not see import price inflation anytime soon.

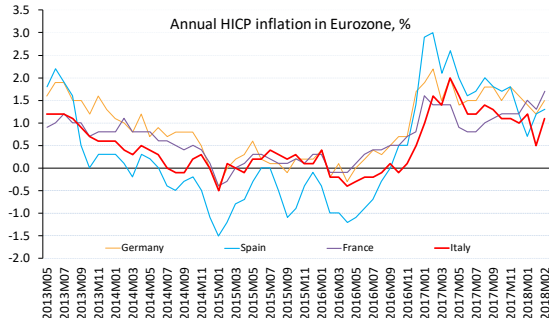
Confidence of consumers hit new all-time high while that of companies continued to stagnate.

In March, consumer confidence rose to 10.3,

...AND WOULD'VE FALLEN W/O CONSTRUCTION.



INFLATION QUICKENS IN ALL BIG EMU COUNTRIES, BUT LESS THAN EXPECTED.



SPANISH RETAIL SALES' GROWTH STILL WEAK



highest ever and thus the level at which we should continue to see double-digit growth of core retail sales. This is understandable: all-time low of unemployment, 7% growth of nominal wage, weak inflation all point in one direction.

What is puzzling, however, is that **confidence of businesses hasn't really changed in last half a year or so**: 16.5 pts. in March is the same it was in October of last year and the same it was at the beginning of 2017. Moreover, had it not been for the increase in confidence in construction, the overall business confidence would have decreased.

EUROZONE ECONOMY

Eurozone inflation apparently rebounded from February lows, but remained very low nonetheless.

The data on the Eurozone as a bloc will only be available this Wednesday, but big four economies already released the March estimates last week. All of these were a) higher than in February (which was unusually low), b) lower than expectations and, with the exception of France, c) below the level from January 2017. Furthermore, the core inflation appears to have remained at the February level, i.e. no demand pressures whatsoever.

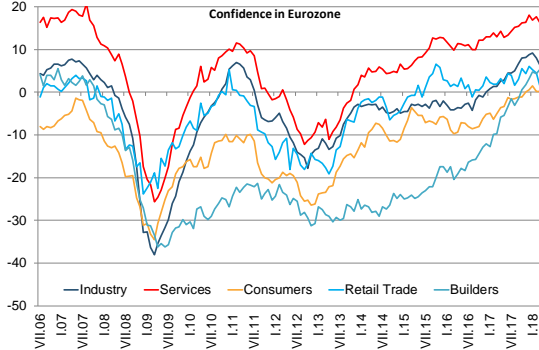
And since household demand in Eurozone doesn't seem to be quickening, core inflation is unlikely to do so either. First retail sales data for February – from Spain, as is usual – showed continuing weak growth of about 2% y/y, hardly something that is going to translate to faster core inflation soon. Retail sales data for the entire Eurozone will be released this Thursday, but they are unlikely to be much better than 2%, a conclusion that...

... the unchanged March consumer confidence also seems to support.

Consumer confidence remained high in March, but unchanged (0.1 pts.) from February. Yes, these are

April 02 | 2018

CONFIDENCE WORSENS IN RETAIL AND INDUSTRY, THAT OF CONSUMERS REMAIN HIGH



the levels consistent with faster growth of retail sales than witnessed hereto, but since we've seen these levels in past months and yet they've failed to translate into actual retail sales growth, I am skeptical February was different.

Perhaps more important takeaway from the confidence survey is that confidence worsened – as was the case in the Czech Republic – in business sector (apart from construction). The biggest decline was seen in industry (echoing the March PMI / IFO decline ▶), confidence in retail trade also fell to lowest since August of last year. Retailers thus confirm that household demand is not as strong as one could infer from the consumer confidence.

All in all, confidence data support the conclusion I drew from PMI / IFO earlier: that EMU economy lost momentum in early 2018 and that household demand is unlikely to quicken as much as to force ECB to hike in 2019.

April 02 | 2018

MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	0.709	0.969	1.270	1.630	1.715	1.800	
	-1M	0.709	0.969	1.300	1.700	1.795	1.920	
	-3M	0.709	0.969	1.315	1.620	1.713	1.845	
	-6M	0.709	0.969	1.010	1.360	1.480	1.619	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.537	-0.581	-0.527	-0.384	-0.144	0.076	
	-1M	-0.795	-0.702	-0.680	-0.646	-0.507	0.010	
	-3M	-0.283	-0.878	-0.770	-0.745	-0.648	-0.124	
	-6M	-1.149	-1.083	-1.064	-1.047	-0.957	-0.278	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	0.733	0.851	1.022	1.246	1.571	1.876	
	-1M	0.505	0.783	0.935	1.054	1.288	1.930	
	-3M	1.032	0.572	0.779	0.875	1.065	1.721	
	-6M	-0.139	0.080	0.210	0.313	0.523	1.341	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.333	4.211	312.56	4.657	4.875	1.232	
	-1M	25.410	4.176	313.87	4.657	4.633	1.219	
	-3M	25.507	4.178	310.79	4.667	4.547	1.201	
	-6M	25.992	4.313	311.63	4.595	4.211	1.181	

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

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April 02 | 2018

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