Weekly | 2018 | Week 14

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| CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Tuesday	10-Apr	9:00	CZ	CPI, Mar'18, y/y	1.7%	1.7%
	10-Apr	9:00	CZ	Unemployment, Mar'18	3.5%	3.6%
Wednesday	11-Apr	20:00	USA	FOMC Minutes (March 21, 2018 meeting) released	N/A	N/A
Thursday	12-Apr	8:45	FRA	(Final) Headline HICP, Mar'18	1.7%	N/A
	12-Apr	11:00	EMU	Industrial production, Feb'18, y/y (WDA)	3.5%	N/A
Friday	13-Apr	8:00	GER	(Final) Headline HICP, Mar'18	1.5%	N/A
	13-Apr	9:00	SPA	(Final) Headline HICP, Mar'18	1.3%	N/A
	13-Apr	10:00	CZ	Current Account, Feb'18, CZK bn.	32.0	N/A
	13-Apr	11:00	EMU	Trade balance, Feb'18, EUR bn.	20.2	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

"NO WAY AM I SHORTING TESLA, BUT I SURE AS HELL WOULD WANT TO SHORT PEOPLE WHO ARE LONG TESLA."

WEEK AHEAD

Czech inflation is the most important release this month. Since the base effects from 2017 are now fully reflected in the CPI, I don't expect inflation fell further in March. If it turns out to be the forecast 1.7%, the 1Q18 average will be 1.9%, 0.3 pp below the CNB's forecast, an anti-infllationary risk to its February forecast. This should also be the first indication that inflation isn't rising even if CZK doesn't strenghten as CNB forecast assumed it will. Apropos, CNB forecast saw CZK strengthening to 24.9 in 2Q18 *and* at the same time inflation would rise to 2.4% - - and I am willing to bet anyone this will NOT happen. Inflation will be way lower in 2Q18 and CZK way weaker.

In Eurozone, final HICP data for March aren't important as they seldom differ from the preliminary estimates, and when they do they only do so marginally. Eurozone-wide **industrial production for February** is important but the weakness in Germany reported last week (see below) almost gurantees it will not be anything extraordinary.

WEEK BEHIND

Although Czech 2H17 growth was revised up… ▶

…February industry… ▶

…or retail sales, while the latter still strong, make it unlikely that 2017 growth will be repeated this year ▶

Government, however, continues to behave like good times are here to stay forever ▶

Eurozone retail sales continue to grow weakly despite sky-high consumer confidence… ▶

…which helps to explain persistently low inflation ▶

German industrial data weak so far this year, suggesting GDP slowdown in 1Q18 ▶

| FX

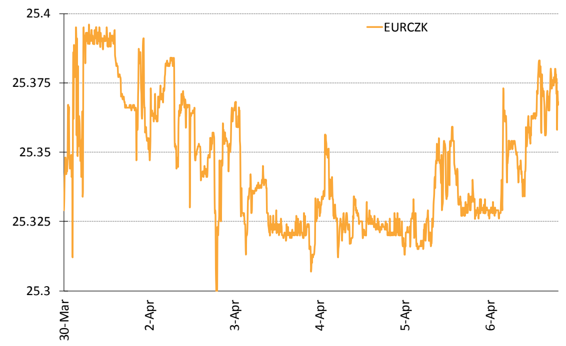
EURCZK remained in a tight range of 25.3-25.40 throughout last week.

| FI

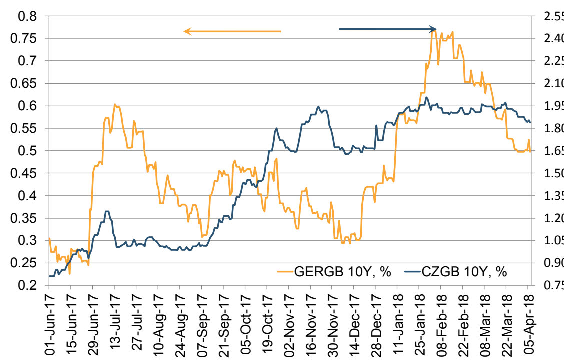
German / Czech yields' movements were tiny last week.

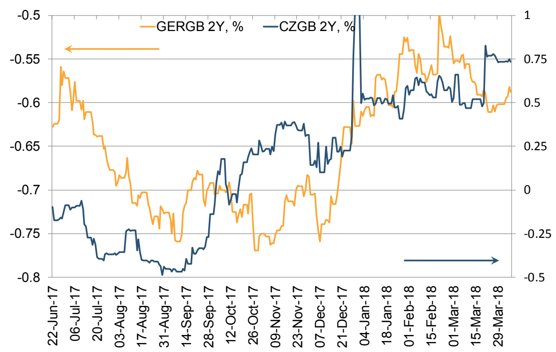
German 2Y rose few bps, Czech 10Ys fell few bps. – and that was pretty much it.

CZK HIBERNATED LAST WEEK…

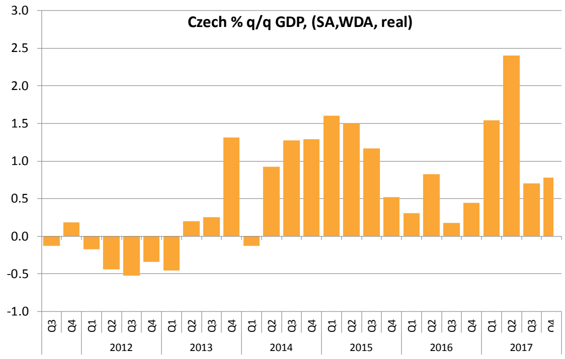


…AS DID THE BOND YIELDS.

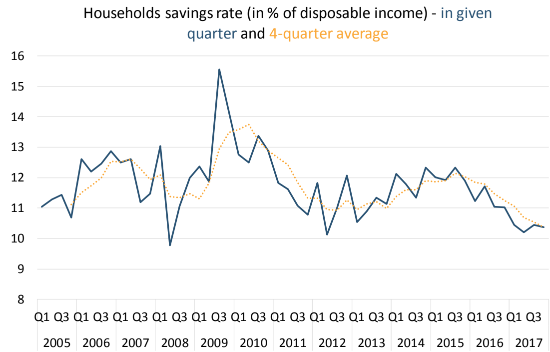




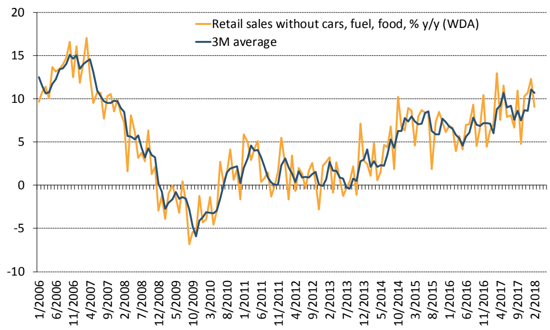
GDP GROWTH REVISED UP IN 3Q AND 4Q17



HOUSEHOLDS SAVINGS RATE LOW, BUT STABILIZED NOW



NON-FOOD, NON-CAR RETAIL SALES STILL GOING STRONG.



CAR SALES WEAKEST SINCE EARLY 2013

| CZECH ECONOMY

Although Czech growth in 2017 was revised up last week, monthly data from February were less optimistic.

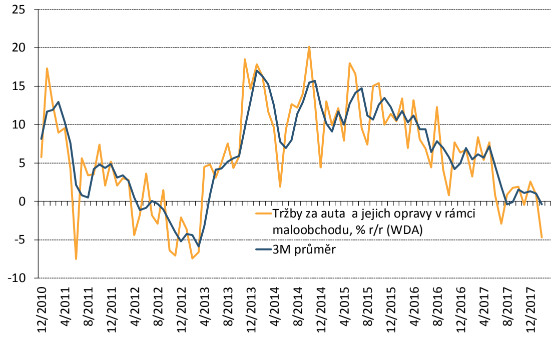
In the third, and last revision of the 4Q17 data, CSO (Czech Statistical Office) revised the quarterly growth in last two quarters of last year by 0.1 p.p. and 0.3 pp, respectively, to 0.7% and 0.8% q/q. The larger of the two revisions was due to (1.1 pp) upward revision to quarterly growth of government demand, and 0.5 pp quicker growth of fixed investments; the rate of growth of government demand in 4Q17 was thus fastest since beginning of 2013. As a consequence, **annual growth for the whole of 2017 was revised to 4.6%, and to 5.5% for the last quarter of that year**.

Other new information from the release was the 4Q17 savings rate of households. It remained low (10.4%) and thus pretty much identical to levels seen in previous three quarters of 2017. Recall, as picture to the left shows, that savings rate had fallen notably in 6 quarters between 3Q15 and 4Q16 – 2017 savings rate shows that source of household demand growth (=dissaving) was exhausted. Because another source of household demand growth of previous years – falling number of unemployed people – is also exhausted (unemployment rate is lowest in EU and at or below natural rate of unemployment), it comes as no surprise that the growth of household demand in 4Q17 was weakest in 2017 (+0.6% q/q). And it also explains why I think we'll see slower demand of households this year.

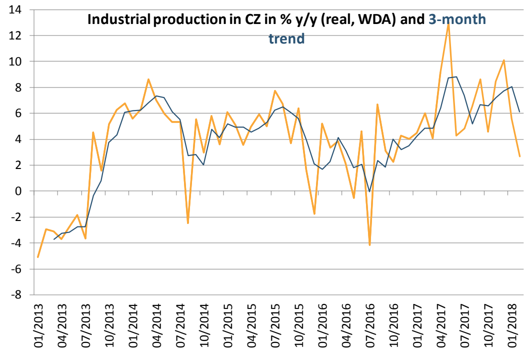
While 2017 growth data exceeded everyone's expectations…

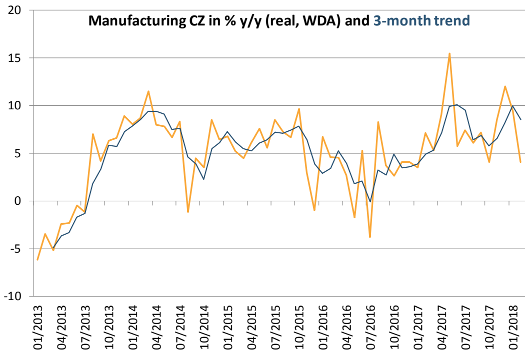
…data for February - industry and retail - show such a growth is unlikely to be repeated this year.

Although retail sales were generally still very good, the weakness in car sales deepened. The

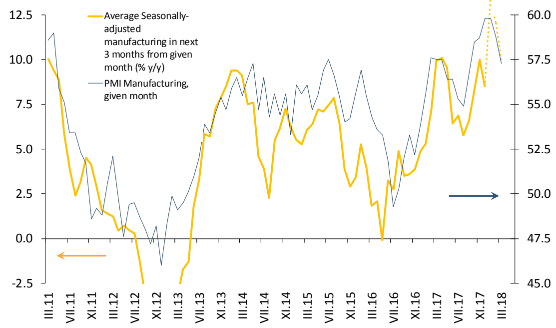


INDUSTRY DISAPPOINTS IN FEBRUARY





PMI, THOUGH HAVING FALLEN TO LOWEST LAST SEPTEMBER, STILL POINTS AT ≈ 8% Y/Y GROWTH IN MANUFACTURING IN 2Q18



core retail sales slowed to 9.1% y/y in February (from over 12% y/y in January), thus falling in line with their growth in 2017 (8.8%). Surprisingly, and negatively so, there was no rebound in car sales, just the contrary – car sales fell 4.7% y/y, the weakest result since March 2013. This really makes little sense in view of the strong macroeconomic fundaments. I read a hypothesis that this has something to do with re-exports of cars (a practice described, in Czech, here ↗) during weak CZK in interventions' era, but 1) I can't imagine how would weaker CZK incentivize this practice, and 2) the dynamics of car sales has been slowing since beginning of 2016, i.e. well (=16 months) *before* the end of interventions. So it is hardly something to do with end of interventions.

The weakness in car sales is even more perplexing considering that fuel sales grew 7.6% y/y in February.

While retail sales are still generally strong (though the total sales' growth of 2.3% y/y was weakest since October 2016, courtesy of car sales), **the February industry figures were disappointing. Industry fell 1.2% m/m to just 2.7% y/y** (weakest since October 2016). And it was despite the fact that energy production, a drag on growth in previous two months (-9.5% m/m and -7.1% m/m), rebounded (7.2% m/m) due to cold weather. This implies that manufacturing must have been weak – and it was, having fallen 3% m/m (to 4.1% y/y), hence effectively having erased all the gains it made over December and January. This, however, wasn't a complete surprise in view of weak German data (see below).

Looking forward to 2Q18, the dynamics of the manufacturing should be around 8% y/y: **that is what the PMI, which fell to 57.3 in March** (weakest since September 2017 as it is, but high generally nonetheless)**, suggests.**

Nothing new when it comes to budget: strong economy and EU money help mask the underlying frailty of the public finances.

The headline surplus of CZK 16.3 bn. for the first three months of 2018 looks great (it was CZK +4.3 bn. in 1Q17) but only until one realizes that there was CZK 17.8 bn. more of EU money we got this year than in 1Q17. Adjusting for EU money, the deficit would've been CZK 5.3 bn., marginally larger than CZK 4.6 bn. in 1Q17. But – one has to realize that the economy is, in nominal terms, approximately *7%* bigger in 1Q18 as against 1Q17…And yet we have deficit that is the same as this time last year.

That the economy is booming is reflected in growth of tax revenues: VAT is up 13.2% y/y at the central government level, the total tax revenues are up 9.1% (CZK 33 bn.). The growth this strong is at least to some extent due to EET: it is too fast to be explained just by the nominal growth of consumption.

While revenues' side is thus OK, expenditures' one is where the problem lies. The total expenditures are CZK 26.5 bn. (8.7%) larger than in 1Q17, with CZK 21 bn. of that due to higher current expenditures like interest on existing debt (+CZK 2bn: yeah, negative interest rates are a thing of past), pensions (+CZK 5.1 bn.), higher wages (non-teachers' salaries in school system rose 20% just since July 1, 2017…).

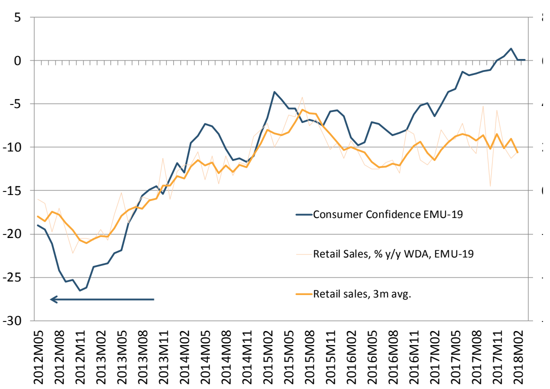
In short: whatever additional revenues government gets it manages to immediately squander away, with apparently no worry that the current good times won't last forever.

| EUROZONE ECONOMY

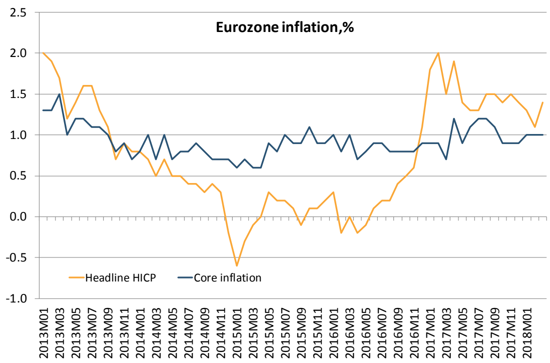
Eurozone retail sales continue to grow weakly, explaining why inflation remains well below ECB target.

February retail sales grew just 1.8% y/y, i.e. even below the average of 2015-2017 (2.2% y/y) and only slightly better than January's growth of 1.5% y/y. These are clearly not the growth rates that could translate into demand pressures and lift Eurozone inflation meaningfully and sustainably,

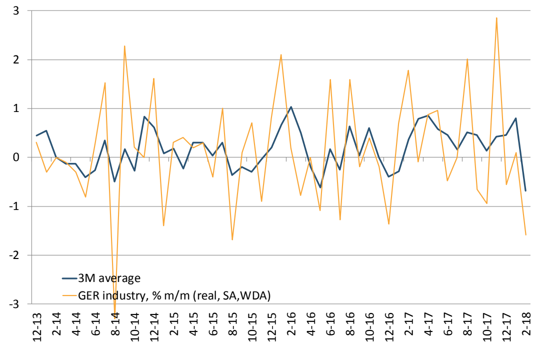
RETAIL SALES CONTINUE TO GROW WEAKLY DESPITE HIGH CONFIDENCE



INFLATION REMAINS LOW



GERMAN INDUSTRY AND MANUFACTURING DISAPPOINTS IN FEBRUARY…



the very high level of consumer confidence nonetheless.
Apropos, consumer confidence. As picture shows, massive improvement in confidence over 2017 hasn't translated at all into faster growth of sales.

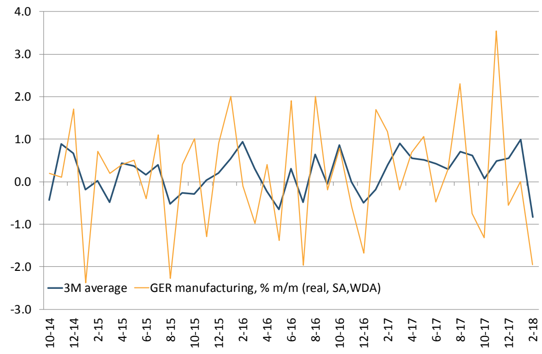
March Eurozone inflation, as data on individual economies released previously suggested, remained low.

March headline inflation rebounded 0.3 pp to 1.4%, mainly because the food prices, having decelerated to 1% y/y in February, returned to their usual annual growth of approximately 2%. Although ECB targets headline inflation, what matters most is how sustainable the underlying inflation really is – and this is measured by core inflation.

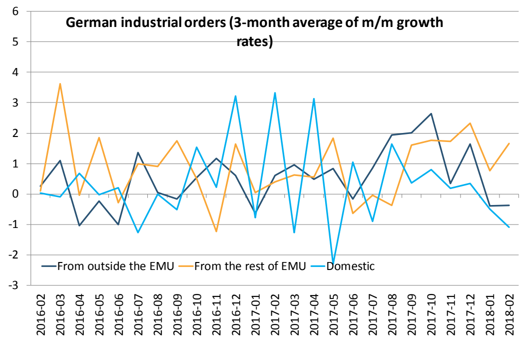
Core inflation, however, remained unchanged at 1%, i.e. extending the 5-year period during which it didn't go anywhere and during which it merely oscillated between 0.6% and 1.2%. **For ECB, this means that it is no closer to the attainment of the inflation goal than it was when it'd launched the asset purchases in earnest three years ago.** From that it follows that scrapping the program in September as it is now planned shouldn't happen. That said, political reality might prevail in the end, though: pressure from Netherlands or Germany, long-term opponents of the quantitative easing, might force ECB to stop the program soon after September even if inflation target hasn't been met and, what's more, isn't guaranteed to be met.

German industrial data were weak in February, and orders, together with slowdown in leading indicators, don't suggest quick rebound.

German industry fell at the fastest monthly rate (1.6%) since summer 2015, and the drop was not concentrated in one sector either, with longer-term goods being affected most: capital goods fell 3.1% m/m, consumer durables fell 4.2% m/m.
The **manufacturing sector thus contracted 2% m/m** which made for every weak last three months:



… AND ORDERS DATA DON'T SHOW TIT SHOULD TURN AROUND FOR BETTER SOON



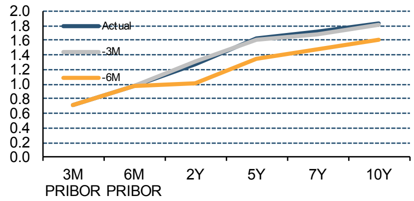
manufacturing stagnated in January and fell 0.6% in December of 2017. This fits into the picture painted by leading indicators.

And 1Q18 orders data don't foretell the quick rebound. February orders rose 0.3% m/m (3.7% y/y), but this came after 3.5% decline in January, so hardly a positive news. The weakness in 1Q18 has been driven primarily by orders from outside the Eurozone and from domestic economy – orders from inside the Eurozone remained strong.

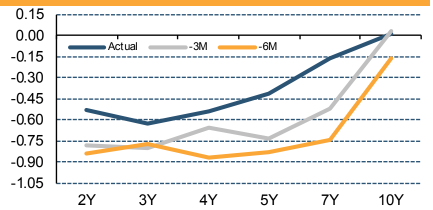
All in all, German industrial data in 1Q18 seem to support my view that not only will there be no quickening of q/q growth of GDP as against 2H17, but that there might likely be a small slowdown.

| Markets ‡

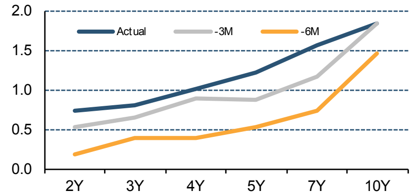
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.709	0.969	1.268	1.635	1.721	1.825
	-1M	0.709	0.969	1.295	1.690	1.787	1.895
	-3M	0.709	0.969	1.310	1.610	1.689	1.805
	-6M	0.709	0.969	1.020	1.350	1.479	1.615



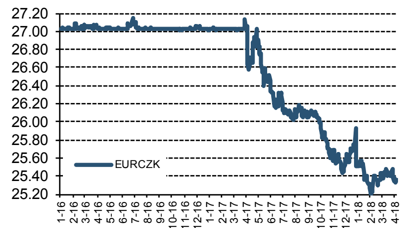
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.534	-0.634	-0.542	-0.415	-0.169	0.013
	-1M	-0.806	-0.697	-0.747	-0.621	-0.502	0.065
	-3M	-0.787	-0.802	-0.661	-0.732	-0.523	0.033
	-6M	-0.842	-0.776	-0.869	-0.832	-0.749	-0.160



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	0.734	0.798	1.008	1.220	1.552	1.838
	-1M	0.489	0.779	0.859	1.069	1.285	1.960
	-3M	0.523	0.652	0.888	0.878	1.166	1.838
	-6M	0.178	0.385	0.394	0.518	0.730	1.455



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.364	4.199	312.09	4.662	4.970	1.228
	-1M	25.389	4.188	312.83	4.661	4.708	1.240
	-3M	25.540	4.153	308.44	4.631	4.495	1.203
	-6M	25.888	4.311	312.20	4.577	4.241	1.173



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

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