Weekly | 2018 | Week 17

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

| CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	30-Apr	8:00	GER	Retail Sales, Mar'18, y/y	1,5%	N/A
	30-Apr	11:00	ITA	(Preliminary) Headline HICP, Apr'18	0,8%	N/A
	30-Apr	14:00	GER	(Preliminary) Headline HICP, Apr'18	1,4%	N/A
Wednesday	2-May	9:30	CZ	Manufacturing PMI, Apr'18	57,0	N/A
	2-May	10:00	EMU	(Final) Manufacturing PMI, Apr'18	56,0	N/A
	2-May	11:00	EMU	Unemployment, Mar'18	8,5%	N/A
	2-May	11:00	EMU	(1st est.) GDP 1Q18, q/q (SA)	0,4%	N/A
	2-May	11:00	ITA	(1st est.) GDP 1Q18, q/q (SA)	0,3%	N/A
	2-May	14:00	CZ	Budget Balance, Apr'18, CZK bn.	N/A	N/A
	2-May	20:00	USA	FOMC Rate-setting meeting, Fed Funds Lower Bound	1,75%	1,75%
Thursday	3-May	11:00	EMU	(Preliminary) Headline HICP, Apr'18	0,4	N/A
	3-May	13:00	CZ	CNB MP meeting, repo rate	0,75%	0,75%
Friday	4-May	10:00	EMU	(Final) Services PMI, Apr'18	55,0	N/A
	4-May	11:00	EMU	Retail Sales, Mar'18, y/y	2,0%	N/A

* LOCAL TIME IS CET
** (REUTERS/ BLOOMBERG) POLL

| MAY 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
SPP 792	3-May	4-May	2-Nov-18	CZK 0-5 bn.	N/A
CZGB 2015-2023**	9-May	11-May	25-Oct-23	CZK 5 bn. max	0,45%
CZGB 2017-2027**	9-May	11-May	10-Feb-27	CZK 5 bn. max	0,25%
CZGB 2006-2036**	9-May	11-May	4-Dec-36	CZK 2 bn. max	4,20%
SPP 793	10-May	11-May	9-Nov-18	CZK 0-5 bn.	N/A
SPP 794	17-May	18-May	16-Nov-18	CZK 0-5 bn.	N/A
CZGB 2018-2021**	23-May	25-May	23-Feb-21	CZK 5 bn. max	0,75%
CZGB 2015-2026**	23-May	25-May	26-Jun-26	CZK 5 bn. max	1,00%
CZGB 2018-2029**	23-May	25-May	23-Jul-29	CZK 5 bn. max	2,75%
SPP 795	24-May	25-May	23-Nov-18	CZK 0-5 bn.	N/A
SPP 796	31-May	1-Jun	30-Nov-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

"BABIS DOESN'T LIE ↗."

WEEK AHEAD

Eurozone 1Q18 GDP growth and April inflation are the biggest things this week to the West of us. And, of course, FOMC meeting. For **Eurozone 1Q18 growth**, a surprisingly low expectation of 0.4% q/q is what I see lit up on Bloomberg and/or Reuters terminals. In light of the fact that, according to first data ► released last week, France did actually slow substantially, and because, based on monthly data, Germany likely did too, I think it is a correct expectation. Not a good news for ECB, though, but there is only so much it can now do. **For inflation, April data will merely confirm the old story:** zero demand inflation pressures in the Eurozone. Which will lead few more analysts to postpone their hike expectations close to the end of next year. Or later. **FED** will hold a meeting but won't change Fed funds. FOMC will, however, prepare the market for the coming hike at the next meeting.

In the Czech Republic, CNB's meeting is No.1 event. CNB will release a new forecast which will have to correct the massively inaccurate February one ↗ – the inflation is nowhere near 2.4% February forecast said it'd be at in March…And CZK also doesn't seem to be on the verge of plunging below 25 to make 2Q18 average 24.9 as CNB forecast…CNB should admit the inflation is much less of a problem than it thought or wanted, and push the next hike well into 2019.

WEEK BEHIND

Czech confidence remained unchanged, and hence very high, in April ▶

April Eurozone leading indicators…▶

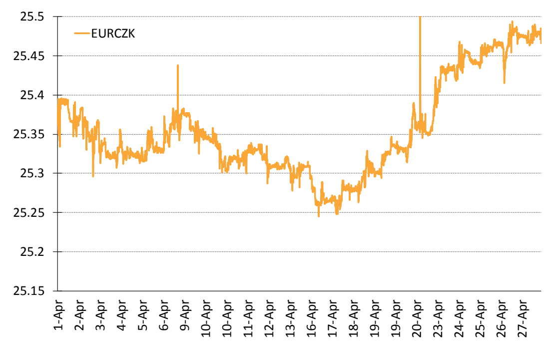
…and first 1Q18 GDP data confirm slowing growth momentum…▶

…and ECB acknowledges – but downplays – that. ▶

Eurozone inflation remained unchanged and low in April, preliminary data indicate ▶

| FX

EURCZK WEAKENED TOWARDS 25.50 IN THE RUN-UP TO CNB MEETING THIS WEEK



EURCZK continued to drift higher towards 25.50 in the run-up to this week's CNB meeting.

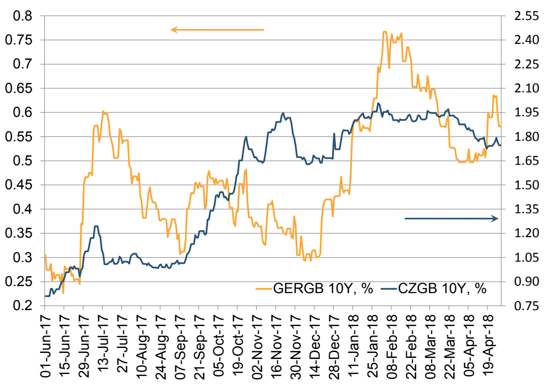
New forecast will be unveiled this week, one that will have to correct the unmitigated disaster that the February one was. And considering the data in Eurozone that came out over 1Q18 (and last week, see below) that correction certainly won't be in the more hawkish direction…
With the meeting close, there were comments by number of central bankers, incl. Nidetzky ↗, Mora ↗, Benda ↗ and de facto chief economist of CNB Holub ↗. The unifying theme among them was the unwavering conviction – a belief, really – that the Phillips curve will eventually prevail. In other words, belief that – while inflation may have been lower and CZK weaker than forecast – the wage growth will soon translate into high inflation. The truest believer ↗ amongst them is V.Benda, nonchalantly dismissing the heavy undershooting of February forecast as "within tolerance" and going on to assert that the risks are "pro-inflationary"…Hmm…Although he's not new Zamrazilova just yet (CNB Board member in 03/2008-02/2014, who famously wanted to tighten policy in 2010, 2011 and 2012) but he's well on track to be respectable replacement of her if he

keeps ignoring reality like he did last week.

| FI

German yields returned lower before ECB meeting.

GERMAN YIELDS FELL IN THE RUN-UP TO ECB MEETING

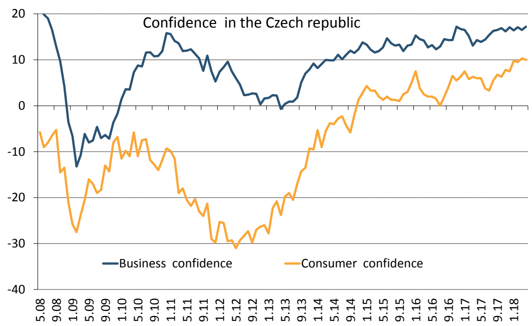


Although Draghi was trying to downplay the softness in 1Q18, German bond market sold off on net anyway last week, mostly before the ECB event risk could play out. For all the brave face Draghi was trying to put on, I don't think German bonds yields will return to where they were two weeks back (i.e. almost 65 bps. at 10Y) soon. The hard data on Eurozone growth in 1Q18 are now coming out and are weaker than in previous quarters, inflation remains low, the leading indicators continue to call for still weaker momentum ahead. In other words, there's a lot why one should think ultra-loose policy will stay with us longer than many analysts previously thought: recall there were some who were calling for ECB hike in 1H19…No longer.

| CZECH ECONOMY

Czech confidence changed imperceptibly in April…

CZECH CONFIDENCE UNCHANGED ON MARCH, VERY LIKELY HAS NOW PEAKED.



…meaning that a) confidence of households remained close (10 pts.) to the March all-time high (10.3 pts.) and b) business one was still far below pre-crisis levels.

As for the consumer confidence, the signs of weakening growth dynamics in Eurozone nonetheless, households don't feel it just yet – and, frankly, don't have reason to – just yet. Unemployment is still at record low here (and lowest in EU), salaries are rising fast and the morning notes of analysts proclaiming that the best in this business cycle is already behind us are hardly something that households register, let alone pay attention to. But it will come: and confidence will not improve from here.

For businesses, the confidence rose did rise

42 Financial Services

against March, but only marginally so, to a joint (with November 2016) post-crisis high of 17.2 pts. This is just 0.1 pts above March, so hardly anything worth commenting. Business confidence thus still remains substantially lower than what it was before the crisis of 2008-9. With leading indicators in Eurozone having again worsened in April, what we saw in April was thus likely the peak of Czech business confidence.

| EUROZONE ECONOMY

Leading indicators worsened again in April, reinforcing my view that this expansion is now on the downhill.

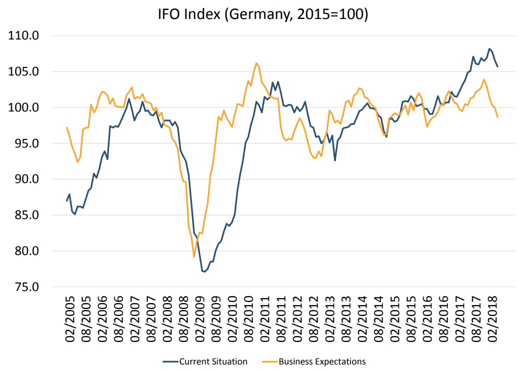
German IFO worsened further and did so in both the assessment of the current situation (where we are now back to summer 2017 levels) and, more importantly, in the expectations. Expectations are now lowest in two years, likely a reflection of trade war fears but also of general weakening of the global demand dynamics. German growth now looks set to be about 0.5-0.6% q/q in 1Q18 and 2Q18, and 0.4% q/q in 2H18.

Same story – of growth dynamics slackening – was told by April PMI.

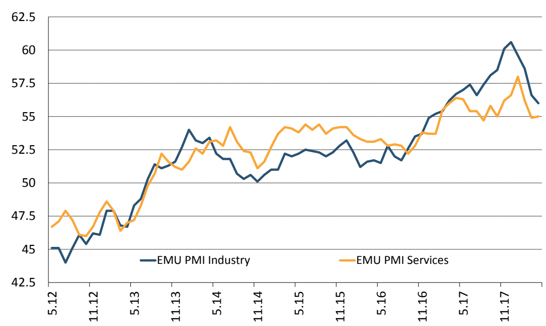
The **situation worsened primarily in manufacturing where index fell to a 17-month low of 56**, down from March 56.6 and thus 4.6 pts. below the high seen in December of last year. Major factor behind the April decline was the fall of orders (both domestic and export ones) to the weakest in 6 quarters. Hiring, on the other hand, continued unabated and backlogs continued to increase, but that is more a reflection of the past than the indication of the future. In the 2nd half of this year I expect that both of these sub-indices will have shown worsening as well. **In services, the index stabilized but at 55 pts it is as well full 3 pts below the December 2017 high.**

Put together, April PMI shows that, while remaining robust, growth slowed markedly since the end of last year. Current PMI is consistent with 0.5%

LEADING INDICATORS CONTINUE TO WORSEN IN APRIL, BOTH IN GERMANY…



…AND IN WIDER EUROZONE



quarterly expansion of the Eurozone economy in 2Q18. While certainly not weak, the fact that Eurozone labor market is still far from inflationary tight means that this is not what ECB would want to see: European central bank would need the growth dynamics to remain at end-of-2017 levels for at least two years for the economy to have at least a shot at producing some inflation.

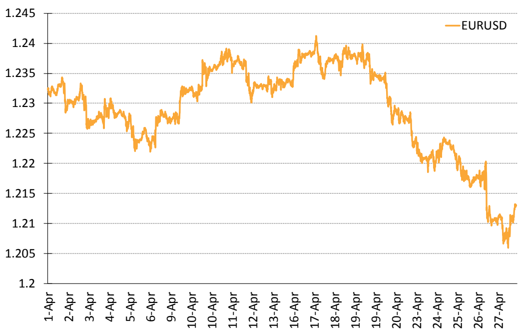
April PMI and IFO thus in my view again increased the chance that ECB won't end QE this year, and likely not even in 1H19.

ECB tried to downplay the 1Q18 weakness, but one could see that some of the confidence of previous meetings has been lost.

About current monetary policy, nothing was changed, about the future one, nothing was said or even hinted: Draghi precluded all the questions about it by saying that monetary policy wasn't discussed. What was discussed, he said, was the recent string of weaker-than-expected data.

In this respect Draghi acknowledged the "*moderation in growth*" and "*some loss of momentum*" across countries and "*almost all sectors"* but tried to play it cool by saying that slowdown was to be expected after period of very strong growth, that whatever the recent fall (and it was in places "*sharp*") the soft indicators are still high, that there may have been one-off factors (weather etc.) that weighed on growth or that some factors are actually endogenous (labor shortages) and indicative of strong economy…
He urged "*caution in reading these developments"* and said that his current view is one of caution "*tempered by an unchanged confidence*" that inflation will move to 2%, i.e. to ECB's inflation aim. Which, then again, was in a bit of a contrast with the (again- and by now oft-) repeated acknowledgement that "*there hadn't been any convincing upward (inflation) trend or signs that this upward trend is about to come".*
No matter what caused the slowdown in 1Q18 that elicited the above-mentioned rumination of Draghi

EURUSD FINALLY FELL LAST WEEK



about the causes, the important thing to me is that the slowdown seems to be real and that actual growth is set to be weaker this year than in 2017, with negative implications for inflation.
As regards monetary policy, it is more complicated. See, if inflation were the only thing ECB cares about, it'd have to continue with QE well into next year and wouldn't think about hike until late 2020. But politics, politics. There are hawks inside the ECB who want to see QE over as soon as possible, and ECB also probably doesn't want to be buying assets to deal with the 2010 recession when next one – statistically closer by the day – knocks on the door. Therefore, I think QE will stop at the end of 1Q19. This will be premature from inflation perspective point of view but it will be so.

Implications for EURUSD are clear: dollar should strengthen. And it did last week, with EURUSD falling to lowest since mid-January. About time.

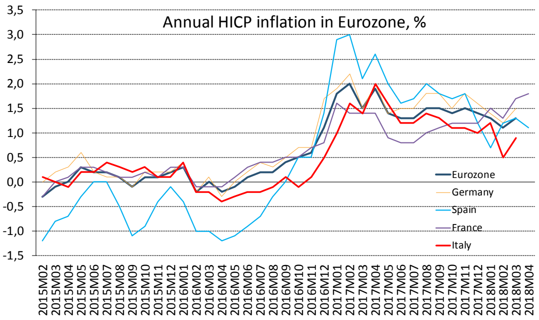
Flash 1Q18 GDP data give the first preliminary confirmation of the loss of the Euro area growth dynamics.

French 1Q18 GDP growth slowed notably compared with the last quarter of 2018 (0.7% q/q) when it recorded just 0.3% q/q. This was also below the expectations of analysts (not that they are anything to go by…). In structure, household demand grew the same slow 0.2% q/q as in 4Q17, fixed investments slowed to 0.6% q/q (as against 1.1% in 4Q17), exports weakened massively (-0.1% q/q vs. +2.5% q/q in 4Q17) with imports remaining unchanged. What this shows is that the slowdown may have had its origin abroad. If so, Germany surely slowed down too.

In Spain, according to the preliminary release of the Spanish statistical office, **economy grew 0.7% q/q,** just like in previous two quarters and in line with the market expectation. Structure is not yet available, but considering the same tempo as in 3Q17-4Q17, the structure won't be too dissimilar.
While only two big economies reported GDP data, weak German data from industry in 1Q18 and retail

suggest that growth there was weaker than in 4Q17 as well. And with Italy a permanent laggard, that, consequently, the entire Euro area growth shifted down in 1Q18.

EURO AREA INFLATION LIKELY REMAINED UNCHANGED (= VERY LOW) IN APRIL



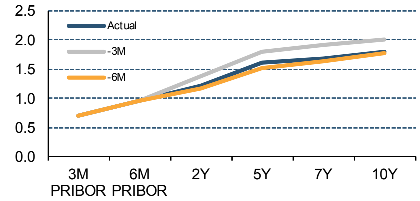
The Eurozone inflation in April probably didn't change, i.e. remained low.

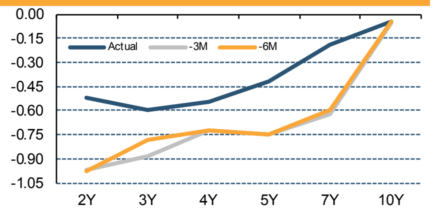
This seems to follow from the first estimates of inflation in Spain and France, released last Friday. Spanish preliminary headline HICP inflation fell in April to 1.1% (from March 1.3%) while French one, surprisingly, rose to 1.8%, the fastest since October 2012. But it wasn't because of the demand: French CPI (i.e., local, non-harmonized, measure of inflation) was 1.6%, same as in March, and French statistical office said this was due to two offsetting factors: "*a sharp acceleration in energy prices, and to a lesser extent, in food products prices"* which was *"offset by a slowdown in the prices of services.*"

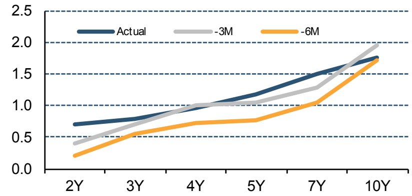
In other words, far from what ECB would want to hear.

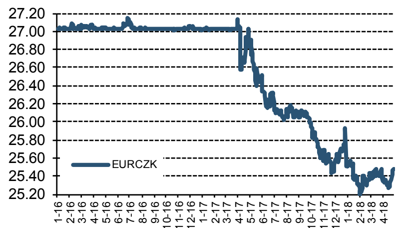
| Markets ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.709	0.969	1.225	1.603	1.688	1.793
	-1M	0.709	0.969	1.265	1.630	1.715	1.800
	-3M	0.709	0.969	1.380	1.805	1.905	2.010
	-6M	0.709	0.969	1.180	1.525	1.638	1.770
ASW spread*		**2Y**	**3Y**	**4Y**	**5Y**	**7Y**	**10Y**
bps.	Actual	-0.523	-0.596	-0.549	-0.419	-0.193	-0.047
	-1M	-0.516	-0.574	-0.491	-0.367	-0.114	0.110
	-3M	-0.971	-0.888	-0.720	-0.752	-0.621	-0.054
	-6M	-0.975	-0.782	-0.724	-0.752	-0.600	-0.049
CZGB**		**2Y**	**3Y**	**4Y**	**5Y**	**7Y**	**10Y**
%	Actual	0.702	0.782	0.956	1.184	1.495	1.746
	-1M	0.749	0.851	1.054	1.263	1.601	1.910
	-3M	0.409	0.701	1.003	1.053	1.284	1.956
	-6M	0.205	0.556	0.720	0.773	1.038	1.721
FX		**EURCZK**	**EURPLN**	**EURHUF**	**EURRON**	**EURTRY**	**EURUSD**
	Actual	25.471	4.207	312.78	4.663	4.908	1.213
	-1M	25.462	4.204	312.45	4.653	4.942	1.231
	-3M	25.318	4.132	309.34	4.662	4.664	1.243
	-6M	25.618	4.247	310.31	4.609	4.399	1.161









‡ 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

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