Weekly | 2018 | Week 18

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	7-May	8:00	GER	Industrial orders, Mar'18, y/y WDA	5.0%	N/A
	7-May	9:00	CZ	Retail sales, Mar'18, y/y	1.5%	2.0%
	7-May	9:00	CZ	Industrial production, Mar'18, y/y	-0.2%	-0.7%
Tuesday	8-May	8:00	GER	Industrial production, Mar'18, y/y	3.0%	N/A
Wednesday	9-May	8:45	FRA	Industrial production, Mar'18, y/y	2.8%	N/A
	9-May	9:00	CZ	Trade Balance, Mar'18, CZK bn.	21.3	N/A
	9-May	9:00	SPA	Industrial production, Mar'18, y/y	3.6%	N/A
Thursday	10-May	9:00	CZ	CPI, Apr'18, y/y	1.8%	1.7%
	10-May	10:00	ITA	Industrial production, Mar'18, y/y	2.3%	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

"MUSK IS IN GUINNESS BOOK NOW. CATEGORY: MOST EXPENSIVE EARNINGS CALL ↗. ALSO, REMINDED ME HEAVILY OF SKILLING AT ENRON ↗"

WEEK AHEAD

A usual batch of Czech monthly data from the end of 1Q18 (industry, retail, foreign trade) and beginning of 2Q18 (inflation) is the only thing worth looking at this week.

Retail sales and industrial production will both show headline figures affected by fewer working days in March.
Adjusted for that, retail sales should retain solid dynamics, especially at the level of core retail sales (i.e., without food, fuel and cars). The big question mark remains over what happened with car sales in March – recall they fell almost 5% y/y in February, something I found very puzzling and inexplicable.
As for the industrial production, WDA m/m data should show rebound after weak January and February in both industry (-0.4 m/m and -1.2% m/m) and manufacturing (+1.7% and -3% m/m).

The inflation for April will show stability, the base effect from last year now having been fully reflected in numbers.

WEEK BEHIND

CNB refuses to admit in its May forecast that its inflation modelling may be a bit inaccurate… ▶

1Q18 GDP data confirm loss of momentum in Eurozone ▶

Eurozone retail sales ended 1Q18 on a very weak note… ▶

…and unemployment doesn't suggest it will change soon. ▶

Eurozone inflation also surprised negatively in April… ▶

…which, together with more hawkish FOMC, pushed EURUSD below 1.20 ▶

| FX

EURCZK spiked to 25.80 in the run-up to the CNB meeting, helped by banking-holiday-induced low liquidity.

Once CNB released its forecast, EURCZK returned back to 25.50 where it was at the beginning of last week.

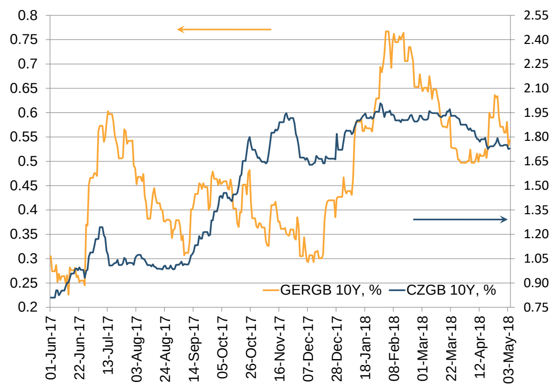
EURCZK SPIKED TO 25.80, RETURNED TO 25.50 AFTER CNB MEETING

| FI

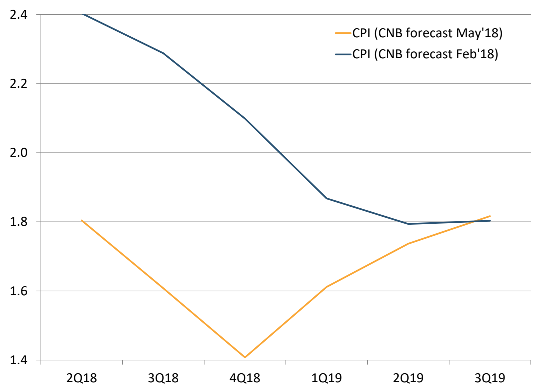
Nothing extraordinary in the bond markets.

To be honest, after the string of weak data in Eurozone, I would have expected more than just 4 bps. decline in the 2Y and 10Y German yields. I expect the yields to make up for that in the coming week(s), especially if someone from ECB speaks.

GERMAN YIELDS FELL ONLY 4 BPS… AFTER THE STRING OF WEAK DATA.



CNB REVISED ITS FORECAST, BUT ONLY AS A FAR AS 2018 INFLATION IS CONCERNED



| CZECH ECONOMY

CNB didn't change the setting of the monetary policy – and neither its outlook.

While the former wasn't surprising at all, the latter was. See, the heavy undershooting of the inflation vs. the expectations of the February forecast (March inflation was 0.6 pp below what that forecast said it'd be) was bound to cause the reticence on the CNB part.

But one could have reasonably expected also the outlook to change, if for nothing else then to account for the facts that a) Eurozone economy clearly lost momentum and b) that Czech inflation showed less of a sensitivity to labor market tightness than previously expected.

CNB would, however, have none of it. Although the new forecast is significantly lower than the previous one when it comes to this year's inflation (see picture), everything else stayed the same. In other words, CNB still expects inflation to rise to target in 2019 but not without the strengthening of the CZK (which is still forecast at 24.30 at the end of 2019 and 24.60 at the end of this year) and not without higher rates (3M PRIBOR at 1% in 4Q18 and over 2% in 4Q19). **Long story short: CNB didn't seem to learn anything. It is still implicitly saying it'll need 4 hikes and 5% strengthening of the currency over next 6 quarters to contain inflation.**

And the recent disconnectedness between labor market and inflation isn't the only reason CNB should think twice about making such bullish (or foolish?) forecasts of inflation. Last week's data from Eurozone – low April inflation, weak March retail sales (see below), no improvement in the labor market – point to a noticeable loss of dynamics in our biggest partner. That for sure will dampen inflationary pressures, almost non-existent to start with, there, and consequently, here.

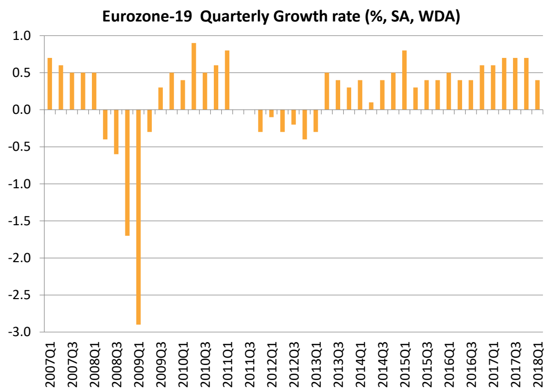
My view thus doesn't change: the inflation may have already hit the bottom in Czech Republic but it will rise to 2% only gradually and will not grow much above this year or next. But, importantly, this will be so – and here I differ from CNB – without stronger CZK and need for tighter policy.

The fact that Czech manufacturing worsened further in April (though marginally: PMI fell 0.1 pts to 57.2, lowest since September 2017), though with little direct link to consumer inflation, also suggests that economic momentum cooled off. The implication of that for inflation outlook are clear.

| EUROZONE ECONOMY

Hard data confirm Euro area economy indeed lost momentum in 1Q18.

1Q18 GDP CONFIRMS LOSS OF MOMENTUM IN EUROZONE

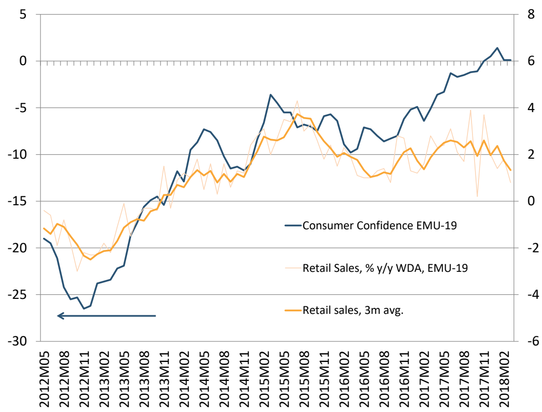


Eurozone GDP growth slowed notably in 1Q18 (0.4% q/q), confirming (in hard data) the loss of momentum indicated by leading indicators throughout the 1Q18. That the economy slowed was likely even before the first official GDP data came out for the entire Eurozone - as I mentioned last week, France slowed strongly, Spain and Italy didn't quicken and monthly data on industry and retail were weak.

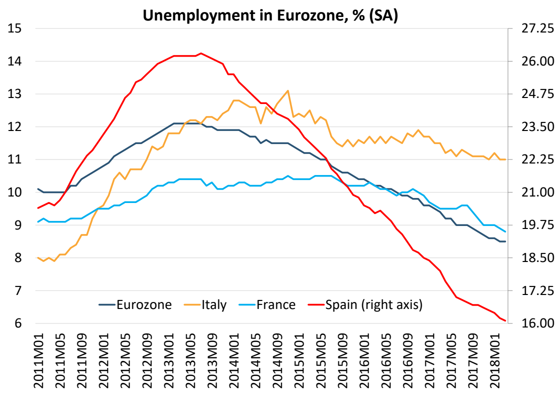
With 0.4% q/q for the whole of Eurozone (and 0.7% q/q in Spain and in 0.3% q/q in Italy) it thus looks very likely that Germany slowed as well (Germany didn't release the growth estimate yet; it will do so in mid-May). **The structure of Euro area 1Q18 GDP growth is not yet known** but France can give some indication. French growth was dragged down by household demand, falling exports (which likely will also be reflected in German data) and fixed investments.

Although 1Q18 GDP numbers are last quarter's news, it doesn't look like situation got better in 2Q18. **The April leading indicators indicate that the economy is now still growing at about 0.4-0.5% quarterly rate:** final April service PMI was even revised down to 54.7 (first estimate was 55) and while manufacturing was revised up to 56.2 (first estimate 56), it is still lowest since March 2017 (and the revision is less important than the revision of service PMI as manufacturing is far smaller part of the economy).

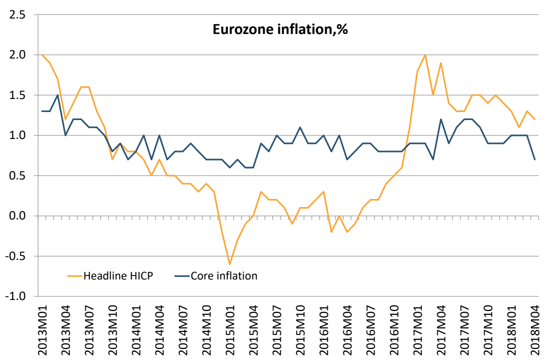
RETAIL SALES SURPRISED NEGATIVELY IN MARCH AND…



…EUROZONE UNEMPLOYMENT REMAINED UNCHANGED



EUROZONE APRIL CORE INFLATION SURPRISES NEGATIVELY



Although not that important with GDP data in, for completeness: retail sales in Eurozone were again disappointingly weak in March.

They increased just 0.1% m/m in March for a meagre annual growth of 0.8%. This was way less than expected (0.5% m/m) and certainly not what ECB would want to see. There was a 0.2% monthly gain in food sales, 0.5% m/m fall in non-food products and 0.4% gain in automotive fuels. Although I don't know how it could impact the sales, let us keep in mind that Easter was in March-April in 2018 whereas it was in middle of April of 2016. It thus may have or may not have had the impact: we'll see when April data are released. However, retail sales growth would've been weak in 1Q18 even if March sales were 0.5% m/m.

And Eurozone unemployment isn't falling fast enough to let me think this will change soon. In March, unemployment stayed the same as in February (8.5%) and rate of y/y improvement in the rate worsened to -0.9 pp. (from -1 pp in previous months). France (8.8%), Germany (3.4%) and Spain (16.1%) saw small improvement (0.1 pp) in the unemployment rate, Italy saw none (11%). **In other words, the labor market is still at least 2 years from the state where some demand pressures could be expected.**

Eurozone April inflation surprised negatively, especially in its core component. This is another reason to think that ECB will have hard time pulling the plug on QE in September.

Headline inflation declined to 1.2%, marginally below March 1.3%, but core inflation fell from 1% in March to 0.7% in April. Partially, this was the base effect (last year, core changed from 0.7 to 1.2% between March and April) so it will be reversed in May, but the monthly dynamics also undershot the expectations: in Italy, inflation rose 0.5% m/m instead of forecast 0.6%, in Spain it stagnated (instead of +0.1% m/m), in Germany it fell 0.1%

FOMC AND WEAK EURO AREA DATA PUSH EURUSD LOWER

m/m instead of stagnating. And the monthly data on retail sales, unemployment etc. mentioned above give little hope that inflation will start rising toward 2% soon.

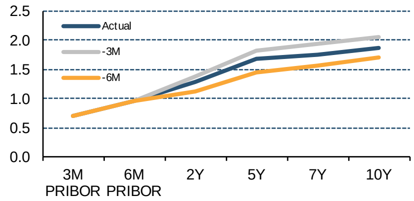
FOMC meeting didn't produce any change in the monetary policy but made it pretty clear it will come soon.

No wonder: core PCE inflation jumped to 1.9% y/y in March 2018 (as March 2017 decline of prices telecommunications services fell from the base) and the private sector wage growth was strongest since crisis (although that means just 2.9% y/y).
Inflation, moreover, is running at around 2.5% annualized rate, based on monthly growth rates, so unless there is a marked economic slowdown ahead (and nothing in the data suggests there is) there will be a space to tighten the policy.

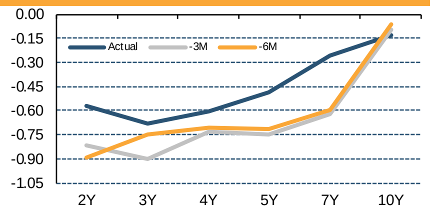
The statement reflected the increased confidence: Committee dropped the language that it is "*monitoring inflation developments closely*", indicating it is fairly certain inflation will stay at or around 2% from now on, and that it will thus permit the tightening. Although Fed didn't explicitly say it was going to hike faster than what its latest forecast calls for, the combination of the hawkish shift in the language and the weak data from Eurozone pushed EURUSD below 1.20.
This strengthening, however, shouldn't do anything to FED's outlook: it is too small to cause any monetary policy tightening in an economy as closed as US one. Therefore, 2 more hikes are almost a certainty this year, and risks are skewed towards more.

| Markets ‡

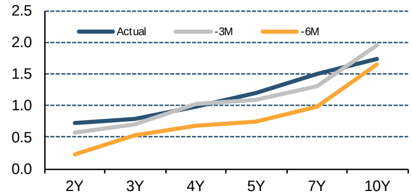
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.709	0.969	1.290	1.675	1.760	1.863
	-1M	0.709	0.969	1.275	1.635	1.720	1.810
	-3M	0.709	0.969	1.390	1.835	1.930	2.050
	-6M	0.709	0.969	1.130	1.460	1.577	1.710



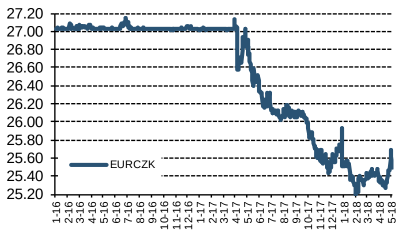
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.574	-0.678	-0.608	-0.483	-0.259	-0.134
	-1M	-0.542	-0.594	-0.541	-0.424	-0.178	0.033
	-3M	-0.820	-0.904	-0.731	-0.749	-0.623	-0.097
	-6M	-0.893	-0.749	-0.710	-0.717	-0.598	-0.063



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	0.716	0.777	0.972	1.192	1.501	1.729
	-1M	0.733	0.843	1.013	1.211	1.542	1.843
	-3M	0.570	0.696	1.019	1.086	1.307	1.953
	-6M	0.237	0.527	0.670	0.743	0.979	1.647



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.488	4.246	313.64	4.659	5.055	1.196
	-1M	25.326	4.201	311.27	4.664	4.912	1.228
	-3M	25.237	4.171	309.91	4.647	4.697	1.246
	-6M	25.682	4.245	310.80	4.594	4.514	1.161



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

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