

May 14 | 2018

Weekly | 2018 | Week 19

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| CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Tuesday	15-May	8:00	GER	(Preliminary) GDP, 2Q18, q/q	0.4%	N/A
	15-May	9:00	CZ	(Preliminary) GDP, 2Q18, q/q	0.7%	0.6%
	15-May	11:00	EMU	Industrial production, Mar18, y/y	3.7%	N/A
	15-May	11:00	EMU	(Preliminary) GDP, 2Q18, q/q	0.4%	N/A
Wednesday	16-May	11:00	EMU	(Final) Headline / Core HICP, Apr18, y/y	0.7/1.2%	N/A
Friday	18-May	9:00	CZ	Industrial PPI, Apr18, y/y	0.0%	N/A
	18-May	9:00	CZ	Export / Import Price, Mar18, y/y	N/A	N/A
	18-May	10:00	EMU	Trade balance, Mar18, EUR bn.	21.1	N/A
	18-May	10:00	EMU	Current Account, Mar18, EUR bn.	N/A	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

“WHAT A DIFFERENCE A YEAR MAKE: I REMEMBER CLEARLY WHEN ARGENTINE SOLD 100 YEAR BOND THAT WAS 3.5X OVERSUBSCRIBED THIS TIME LAST YEAR... AND FT TRIED TO EXPLAIN THAT... ↗”

WEEK AHEAD

First estimate of 1Q18 GDP data from Germany and Czech Republic, and April import prices are the top releases this week.

1Q18 GDP data for Czech Republic and Germany will be released tomorrow. For Germany, monthly data from industry and retail indicate noticeable slowdown of growth in 1Q18 as against 0.6% quarterly expansion seen in 4Q17: the forecast is for 0.4% q/q, and I would add it is more likely to be less than that than more.

For Czech Republic, I expect slowdown in dynamics too, to 0.6% q/q (from 0.8% in the last quarter of last year). Neither Germany, nor Czech Republic will release structure of the growth this week so it will still be a guess game as to what the exact structure of growth was.

There will be a release of **April 2018 Czech import prices as well**. This is important to see whether the dampening effect of import prices on the domestic price level continues. Since part of that effect in last 12 months was due to stronger CZK, I expect March should not see further decline in import prices like what we saw throughout 2017 and early 2018. But since Eurozone inflationary pressures remain non-existent, I don't expect import prices to begin to rise either.

WEEK BEHIND

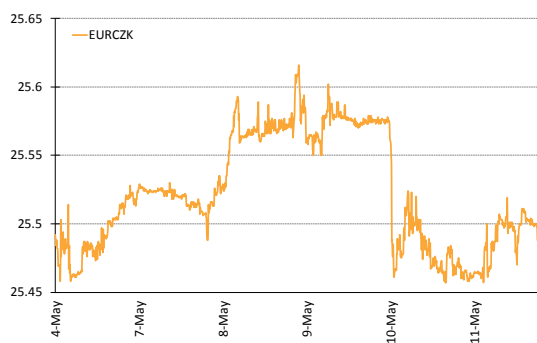
Czech demand inflation dynamics quickened further in April... ▶

Retail sales were slow in March, but what's truly strange are car sales ▶

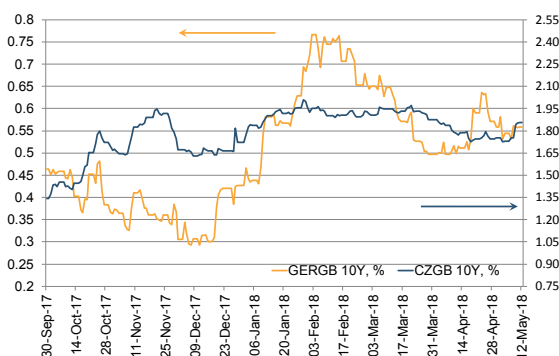
Czech industry rebounds, but manufacturing continues to lag ▶

German orders continue to fall, ill omen for our industry for 2Q18 ▶

EURCZK SPIKED TO 25.60 ON A LOW BANK-HOLIDAY LIQUIDITY



CZECH 10Y YIELDS RISE 10 BPS. ON HIGHER INFLATION



FX

Another banking-holiday, hence another low liquidity, hence another short-lived spike in EURCZK.

EURCZK spiked to 25.60 mid last week before returning to 25.50 shortly thereafter.

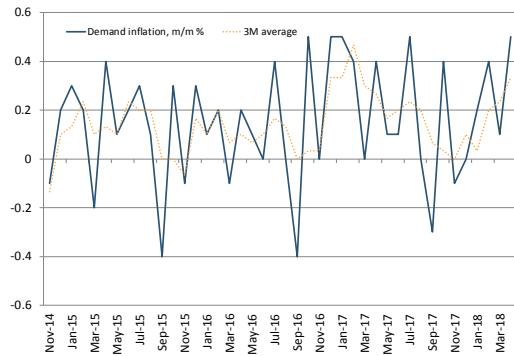
FI

Czech 10Y yields rose 10 bps on higher-than-expected inflation.

Other than that, nothing else happened.

CZECH ECONOMY

CZECH DEMAND INFLATION QUICKENS FURTHER AT THE BEGINNING OF 2Q18



Czech annual inflation rose more than expected in April, the reason being faster monthly growth of demand inflation and of oil prices.

Annual monetary policy relevant inflation rose to 1.8% from March 1.6% and thus is now only marginally below the CNB target of 2%.

The monthly increase was 0.3% m/m whereas price level stagnated in April of 2017. The April 2018 growth was the reflection of quicker oil prices (1.4% monthly gain as opposed to -0.3% m/m in April of 2017) and somewhat quicker demand inflation (0.5% vs 0.4%). In the latter case, though, most of that increase is due to seasonal increase of prices of clothing and footwear.

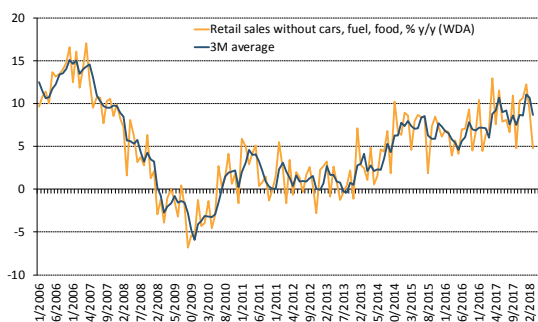
That by itself is certainly nothing dramatic, but the demand inflation (which y/y stayed at 1.8%, just like in March) did rise 1% over last three months, a clear and undisputed acceleration from the beginning of the year. Although this is to a good extent due to still rising house prices (i.e., due to imputed rents), coupled with the weaker than expected CZK it could bring about, were it to continue in the coming three months, the earlier hike than what recent forecast of CNB expects.

I still, however, think that there will be further slowdown in Eurozone growth momentum and that it will start filtering into Czech economy. Therefore, though the April demand inflation present a pro-inflationary risk to my view on Czech rates, I don't change it just yet.

Czech retail sales slowed in March, and although I wouldn't read much into this just yet, it is another thing to watch more carefully now.

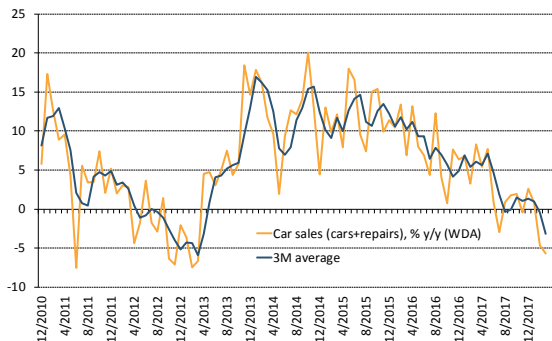
Czech core retail sales (i.e., no fuel, no cars, no food) fell to just 5% y/y (WDA). Although this is surprising, nothing else indicates this should be the beginning of the new trend. See, this happens now and then - last time it occurred last October when

CORE RETAIL SALES SLOWED DOWN IN MARCH, BUT I EXPECT THAT TO BE TRANSITORY



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CAR SALES REMAIN PERPLEXINGLY WEAK



growth rate also fell precipitously to 5%, only to return to double digit growth in the following month. It looks more like some kind of a problem with adjustment of the data – I cannot think of how, but the different timing of Easter could have had an impact. We'll see next month when retail sales for April are released whether this was one off or not, but considering continuing strong wage growth, confidence and labor market tightness, I am more than certain this won't be repeated.

What is more worrisome – and more perplexing – is the **persistent weakness in car sales**. These increased for the first time this year, but only imperceptibly so (+0.2% m/m), and the growth came after two declines in the previous months (3.4% m/m in February and 0.1% m/m in January) and after weak growth (2.3%) in 2017. I still cannot come up with the explanation for this: nothing else in the data points in that direction.

Industry recovered in March, but mostly outside of the manufacturing.

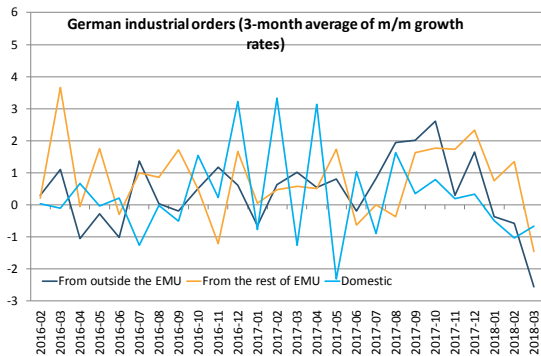
Having fallen in February (-1.3% m/m) and January (-0.2% m/m), the overall industrial production rebounded in March: 1.4% m/m (5.5% y/y) was, however, enough only to push quarterly growth in 1Q18 to 0.4% (as against 4Q17). That was substantially slower than 4.2% q/q growth seen in 4Q17. And what makes the March result less of a success is the fact that the growth was predominantly due to 8.5% monthly rise in the utilities, i.e. the production of electricity, heating.

In manufacturing, the general weakness persisted: after fall of 3.2% m/m in February (and growth of 2% in January), manufacturing rose just 0.5% m/m (5.1% y/y), meaning the manufacturing output in 1Q18 was actually lower than in 4Q17.

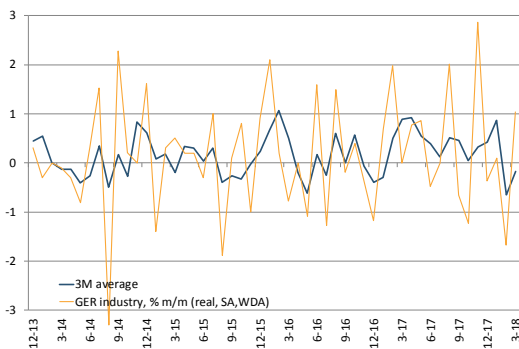
And although the PMI stabilized in Czech Republic, the momentum keeps slowing to the west of us. That and the weak 1Q18 make the repeat of 2017 performance (5.7% y/y) highly unlikely: I reckon Czech industry will grow at about 3.5-4% this year.

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ORDERS IN GERMAN INDUSTRY CONTINUE TO DECLINE



GERMAN INDUSTRY GREW 1% M/M IN MARCH, BUT THAT IS NOT ENOUGH IN LIGHT OF WEAK PERFORMANCE SINCE DECEMBER



EUROZONE ECONOMY

German industry continues to lose steam. Orders fell for the third time in a row in March.

After 3.5% decline in January, February saw -0.2% m/m and March -0.9% m/m. Foreign non-euro orders fell in all three months this year (domestic ones and foreign euro orders fell in two out of three months of 1Q18) so it appears the cold is coming from outside the Eurozone.

For ECB, the implication is that QE might have to stay a little longer.

For Czech Republic this release only reinforces the forecast made few lines above here regarding the industry and is another confirmation that the best is already behind us in this cycle in Eurozone, and hence in Czech Republic. CNB should take notice.

And the fact that German industry, after three weak months, finally rose meaningfully (1% m/m) in March doesn't change that.

See, one percent monthly gain does not compensate for February decline of 1.7% m/m, or for the weak growth in the previous two months (-0.4% and +0.1% growth rates in December 2017 and January 2018, respectively).

Therefore, considering the weak orders that are about to feed into actual production numbers, March reading, while on the surface optimistic, will, in retrospect, look like clear one-off. Next two months don't look so great.

Elsewhere in Eurozone, it was also good, but again: looking forward there aren't many reasons to be that optimistic.

French industry fell short of the expectations when it recorded a fall of 0.4% m/m instead of the growth of the same magnitude, **but Spain and Italy made up for that.** Spain rose 1.2% m/m, beating forecast (-0.1% m/m) by a huge margin, and so did Italy (1.2% vs. 0.5% m/m). The March Euro-area wide figure will thus not be all that weak when released tomorrow but considering the orders in

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Germany and general weakening of leading indicators, I don't see how we could see quicker growth of industry in 2Q18 and 3Q18 than in 1Q18.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	0.709	0.969	1.358	1.773	1.868	1.955	
	-1M	0.709	0.969	1.240	1.600	1.686	1.780	
	-3M	0.709	0.969	1.325	1.735	1.835	1.935	
	-6M	0.709	0.969	1.205	1.553	1.669	1.800	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.637	-0.672	-0.605	-0.485	-0.272	-0.098	
	-1M	-0.534	-0.645	-0.568	-0.421	-0.198	-0.009	
	-3M	-0.762	-0.798	-0.668	-0.662	-0.547	-0.032	
	-6M	-0.833	-0.735	-0.699	-0.690	-0.550	0.026	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	0.721	0.871	1.072	1.288	1.596	1.857	
	-1M	0.706	0.764	0.958	1.179	1.488	1.771	
	-3M	0.563	0.712	0.972	1.073	1.288	1.903	
	-6M	0.372	0.627	0.771	0.863	1.119	1.826	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.487	4.266	315.36	4.636	5.156	1.194	
	-1M	25.309	4.178	311.29	4.660	5.070	1.233	
	-3M	25.377	4.168	311.88	4.655	4.673	1.229	
	-6M	25.553	4.226	311.54	4.646	4.509	1.167	

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

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