

May 21 | 2018

Weekly | 2018 | Week 20

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| CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Wednesday	23-May	10:00	EMU	(Preliminary) Services / Manufacturing PMI, May'18	54.7/56	N/A
	23-May	16:00	EMU	Consumer Confidence, May'18	0.5	N/A
Thursday	24-May	8:00	GER	(Final) GDP, 2Q18, q/q	0.3%	N/A
	24-May	9:00	CZ	Consumer / Business Confidence, May'18	N/A	N/A
Friday	25-May	10:00	GER	IFO Business Climate, May'18	102.0	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

“ERDOGAN LECTURES ON MONETARY POLICY. KID YOU NOT?”

WEEK AHEAD

Structure of German GDP growth and soft indicators is what's on this week's agenda in Eurozone.

German GDP growth slowed down markedly in 1Q18 so it will be interesting to see where did the slow-down come from – it sure looks like foreign trade, but let us see.

The array of leading indicators – IFO in Germany, PMI and confidence in Eurozone, all from May – are important to see whether the slowdown in dynamics seen in 1Q18 is temporary or here to stay (I expect the latter).

For Czech Republic, it is only the consumer and business confidence. The resilience of the former is probably going to be confirmed again while we should see another weak reading of the latter.

WEEK BEHIND

Czech growth dynamics slowed further in 1Q18 ▶

Czech import prices confirm disinflation is over ▶

German growth slowed more than expected in 1Q18 ▶

Eurozone inflation confirmed very low in April ▶

FX

EURCZK continued to drift upward, hitting 25.65 at the end of last week.

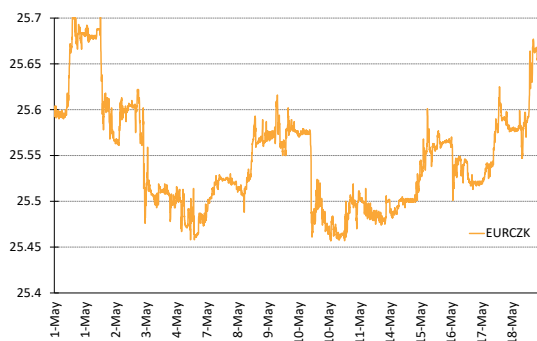
This was mostly due to strengthening of the dollar, and other regional currencies, especially zloty, suffered as well (and more). The difference here is that another 30-40 halers and I would expect the speculators who piled into CZK expecting it to go towards 24.50 this year to reassess the expectation.

FI

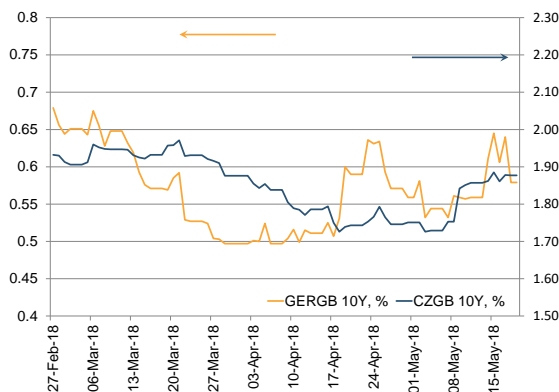
German yields fell amid rising uncertainty.

Lower growth dynamics, persistently low inflation, and the prospect of market-unsavory government in Italy combined to send German yields lower. 10Y fell back below 60 bps. and if I had to guess, I'd say we'll see it close to 50 bps soon.

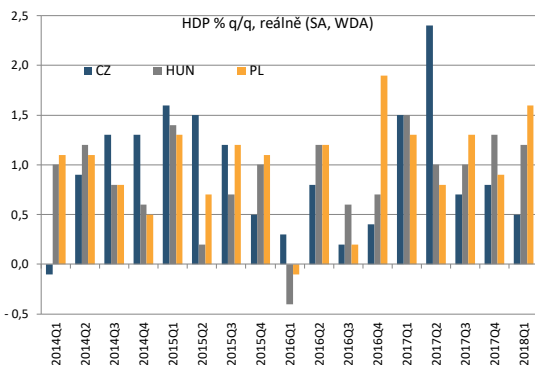
EURCZK STRENGTHENS TO 25.65 ON STRONGER USD



GERMAN 10Y FELL AMID HEIGHTENED UNCERTAINTY, WEAK GROWTH DATA.



CZECH GDP GROWTH CONTINUES TO SLOW & LAG THE REGION



CZECH ECONOMY

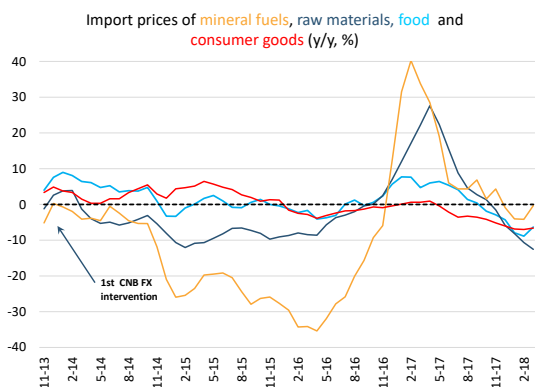
Preliminary 1Q18 GDP data confirmed further loss of momentum at the beginning of 2018.

The growth in 1Q18 was 0.5% q/q, less than in 2H17 (when the average growth rate was 0.7% q/q) and far, far less than in 1H17 (when it was 2% q/q). Moreover, the rate of growth was again slower than in Hungary and Poland where 1Q18 GDP growth was 1.2% q/q and 1.6% q/q, respectively. The structure wasn't released just yet, but CSO said the growth was due to domestic demand – which is in line with what German statistical office said of German growth in the first quarter, but doesn't really explain what was behind the slowdown of growth.

In light of our tight links with Germany and with German leading indicators (or industrial orders) suggesting 2Q18 won't be better in Germany than fairly weak 1Q18 (see below), I don't see why Czech growth should accelerate in coming quarters. The growth forecast of 3% now looks pretty optimistic: between 2% and 2.5% looks more reasonable now.

Import and producer prices confirm disinflation over.

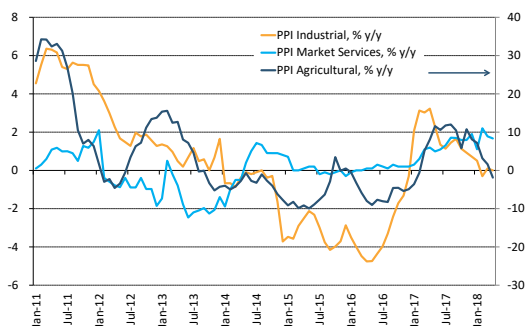
IMPORT PRICES STOPPED FALLING M/M, BUT ARE STILL MARKEDLY LOWER Y/Y



March import prices rose 0.4% m/m, confirming my view from 4 weeks back that import prices stopped falling in February, i.e. when CZK stopped strengthening. The biggest increase in March was in food import prices (+1.2% m/m), but all categories went up. In the y/y terms, import prices of all main categories are lower than in March 2017: raw materials (-12.6% y/y), food prices (-6.3% y/y), consumer manufactured goods (-6.6% y/y). The only import prices that aren't lower than year ago are that of mineral fuels: the growth of the oil prices at the end of 1Q18 meant the import prices of mineral fuels stagnated y/y.

In the coming months, the stagnating / weakening

PRODUCER PRICE GROWTH SLOWED IN APRIL ACROSS ALL CATEGORIES.

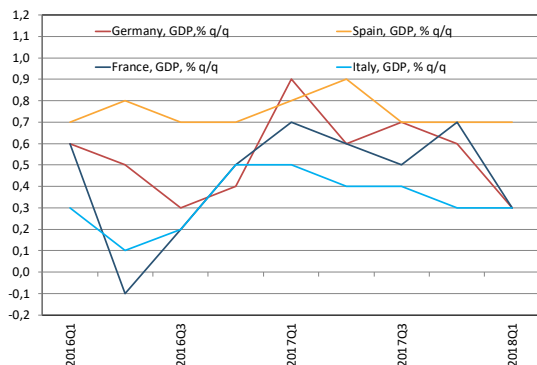


CZK means the import prices won't fall anymore and will start rising. But this will only be a slow rise as there is no inflation in Eurozone to speak of (and CZK only weakened marginally so far). The import prices of consumer goods will still be lower y/y at the end of this year.

In April, producer prices rose everywhere except for the agriculture where they fell 2.4% m/m. But since growth of market services (0.6% m/m) and growth of industrial producer prices (0.2% m/m) was lower this April than in April 2017, y/y growth slowed for all three indicators compared with March. The industrial producer prices stagnated (against +0.1% y/y in March), market services slowed to 1.7% (1.8% in March, 2.2% in February) and agricultural producers' prices fell y/y for the first time since February 2017.

Put together, the big consumer prices disinflation we saw in the previous months is over, but the price level growth will be moderate in the 2H18: unless CZK weakens substantially (which it is now long overdue but...), we won't see inflation rise much above 2% this year. Slowdown in growth dynamics here and in Eurozone, weak Eurozone inflation won't permit anything else.

GERMAN GROWTH SLOWS MARKEDLY IN 1Q18, HELPING...



| EUROZONE ECONOMY

German growth weakened substantially in 1Q18, helping to drag Eurozone growth down.

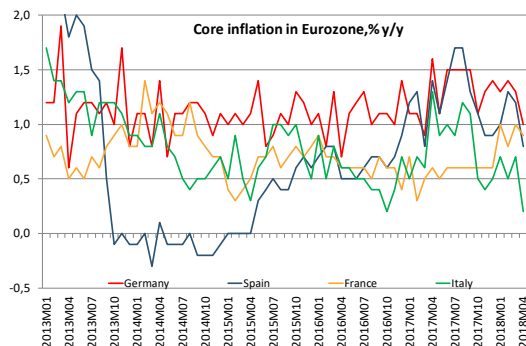
After 0.6% q/q recorded in the last quarter of 2017, German growth momentum weakened in 1Q18, with growth rate having halved. This brought the growth in Germany to the same tempo as in France or Italy, and helped to drag the overall 1Q18 Euro area growth to 0.4% q/q.

Although the structure of German growth wasn't released, German statistical office said German growth was due to domestic demand only - mainly investments, mainly in construction, while household demand rose only "slightly" against 4Q18 (which really does not meet a lot considering

... TOGETHER WITH THE PROSPECT OF NEW ITALIAN GOVERNMENT, TO SEND EURO TO 2018 LOW.



APRIL CORE INFLATION FALLS STRONGLY IN ALMOST ALL BIG ECONOMIES, HELPING...



that it stagnated in 4Q18 after outright fall in 3Q18). **In other words, even in Germany where unemployment is extremely low it will be hard to see higher inflation soon.** What that means for Euro area inflation should be clear. And so should be the implications for the ECB policy: either longer period of QE or, should politics prevail over monetary policy, the end of QE this year followed by longer period of unchanged (ultra-low) rates. Both have the same implications, though: cheaper EURUSD and low yields for long. **The dollar indeed strengthened last week, though it wasn't only because of downshift in growth...**

...but also because of the deal between the two renegade parties that did great in March 4 Italy elections.

See, Movimento 5 Stelle, an anti-establishment outfit, and Lega Nord (per l'Indipendenza della Padania), a far right party, came to an agreement last week to form the populist government, a deal that sent euro investors reeling and Italian 10Y bonds from 1.5% two weeks ago to well over 2% at one point last week. Although the parties in the final version of the policy paper announcing the deal dropped the references to "return to pre-Maastricht era" as well as calls for ECB to cancel the EUR 250 bn. in debt it holds, both of which were found in the previous drafts, the markets were spooked. Italy has been relatively calm for last few years, so this was bound to elicit the market response.

Although with Brexit a clear mess (no plan whatsoever 2 years after, Tories split, Irish border problem intractable) the chances that Italy will embark on the same path are small, the government will not exactly be the market friendly one. This will (continue to) weigh on euro.

Final April data confirmed inflation is non-existent in Eurozone, though probably not as low in general as numbers showed.

The headline inflation was confirmed at 1.2% in April and the core was at 0.7%, both lower than in

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March but more so for the latter (headline stood at 1.3% in March, core at 1% in March). Large decline in core inflation was seen in every big economy except for France, and overall it was due to decline in services (from 1.5%/y to 1% y/y). Because of this large decline (0.5 pp) that occurred around Easter, I am certain it will be reversed once May data come out: and yes, I admit I don't know how Easter could've influenced the service inflation, but I also don't see reason why service inflation would've suddenly fallen so much.

Anyway, even if core returns to March 1%, it still means it didn't go anywhere in last three years. Despite ECB's promises to the contrary.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	0.709	0.969	1.400	1.840	1.929	2.020	
	-1M	0.709	0.969	1.243	1.613	1.695	1.785	
	-3M	0.709	0.969	1.310	1.725	1.838	1.965	
	-6M	0.709	0.969	1.270	1.575	1.682	1.815	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.636	-0.707	-0.652	-0.528	-0.315	-0.143	
	-1M	-0.576	-0.668	-0.599	-0.451	-0.239	-0.046	
	-3M	-0.687	-0.752	-0.678	-0.662	-0.561	-0.050	
	-6M	-0.901	-0.749	-0.705	-0.677	-0.513	0.076	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	0.764	0.893	1.087	1.312	1.614	1.877	
	-1M	0.667	0.737	0.931	1.162	1.456	1.739	
	-3M	0.623	0.751	0.960	1.063	1.277	1.915	
	-6M	0.369	0.660	0.797	0.898	1.169	1.891	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.645	4.301	318.19	4.633	5.291	1.177	
	-1M	25.333	4.167	310.23	4.658	4.995	1.235	
	-3M	25.305	4.134	311.05	4.662	4.665	1.241	
	-6M	25.567	4.235	311.94	4.639	4.569	1.179	

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

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