

May 28 | 2018

Weekly | 2018 | Week 21

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Wednesday	30-May	8:00	GER	Retail sales, Apr'18, y/y	1.7%	N/A
	30-May	9:00	SPA	Retail sales, Apr'18, y/y	1.8%	N/A
	30-May	9:00	SPA	(Preliminary) HICP, May'18, y/y	1.7%	N/A
	30-May	11:00	EMU	(Final) Consumer Confidence, May'18	0.2	N/A
	30-May	14:00	GER	(Preliminary) HICP, May'18, y/y	1.8%	N/A
Thursday	31-May	8:45	FRA	(Preliminary) HICP, May'18, y/y	2.1%	N/A
	31-May	9:00	SPA	(Final) GDP, 1Q18, q/q	0.7%	N/A
	31-May	11:00	EMU	Unemployment rate, Apr'18	8.4%	N/A
	31-May	11:00	EMU	(Preliminary) Headline/ Core HICP, May'18, y/y	1.6% / 1%	N/A
	31-May	11:00	ITA	(Preliminary) HICP, May'18, y/y	0.9%	N/A
Friday	1-Jun	9:00	CZ	(Final) GDP, 1Q18, q/q	0.5%	0.4%
	1-Jun	9:30	CZ	(Final) manufacturing PMI, Apr'18	56.2	N/A
	1-Jun	10:00	ITA	(Final) GDP, 1Q18, q/q	0.3%	N/A
	1-Jun	14:00	CZ	Budget balance, May'18, CZK bn.	N/A	N/A

* LOCAL TIME IS CET

** (REUTERS/ BLOOMBERG) POLL

JUNE 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2018-2021**	6-Jun	8-Jun	23-Feb-21	CZK 4 bn. max	0.75%
CZGB 2014-2025**	6-Jun	8-Jun	17-Sep-25	CZK 4 bn. max	2.40%
CZGB 2018-2029**	6-Jun	8-Jun	23-Jul-29	CZK 4 bn. max	2.75%
SPP 797	7-Jun	8-Jun	7-Dec-18	CZK 0-5 bn.	N/A
CZGB 2007-2022**	13-Jun	15-Jun	12-Sep-22	CZK 4 bn. max	4.70%
CZGB 2017-2027**	13-Jun	15-Jun	10-Feb-27	CZK 4 bn. max	0.25%
CZGB 2015-2030**	13-Jun	15-Jun	15-May-30	CZK 4 bn. max	0.95%
SPP 798	14-Jun	15-Jun	14-Dec-18	CZK 0-5 bn.	N/A
CZGB 2018-2021**	20-Jun	22-Jun	23-Feb-21	CZK 4 bn. max	0.75%
CZGB 2013-2028**	20-Jun	22-Jun	25-Aug-28	CZK 4 bn. max	2.50%
CZGB 2017-2033**	20-Jun	22-Jun	13-Oct-33	CZK 4 bn. max	2.00%
SPP 799	21-Jun	22-Jun	21-Dec-18	CZK 0-5 bn.	N/A
SPP 800	28-Jun	29-Jun	28-Dec-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 BITCHING ABOUT MEDIA IS PRETTY STRANGE FOR A GUY WHOSE CAR COMPANY PRODUCES NO CARS, YET GETS MORE MEDIA ATTENTION THAN ANY OTHER CARMAKER ↗”

WEEK AHEAD

Lots of data this week.

In the Czech Republic, structure of the 1Q18 GDP growth is the most interesting release analytically, but it is to some extent yesterday's news – that the growth in the beginning of this year was slower than in any quarter of the last year has been clear for some time, so the only remaining question is what caused the slowdown. Based on data from Germany (see below) it looks like net exports were the culprit, in which case the inflationary implications of 1Q18 slowdown are relatively modest (it'd be different if household demand were to be shown to be behind this).

Looking forward, however, the more important release is that of May PMI. That said, it shouldn't be that much of a surprise: if German May PMI is any indication (see below) May saw another weakening in the growth prospects here as well.

In the Eurozone, final 1Q18 GDP data for Italy, Spain aren't that interesting, but preliminary May inflation certainly is. Recall that April saw the surprising dip` in core inflation (from 1% to 0.7%) which may or may not have been due to Easter (I'd say it was) so May should see core inflation returning to 1% again. Not great, especially considering the continuing loss of growth momentum in 2Q18, as evidenced in May PMI data.

WEEK BEHIND

Czech consumer and business confidence diverge further in May ▶

German 1Q18 growth dragged down by net exports & weak government demand ▶

Eurozone leading indicators at 1 ½ low in May, sending... ▶

...together, with warily dovish ECB minutes, EURUSD to near my 2018 target ▶

| FX

EURCZK continued to drift upward, hitting 25.85 at the end of last week.

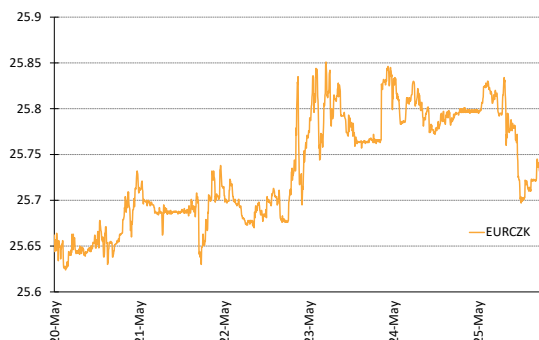
This was again mostly due to strengthening of the dollar. We're now, I would say, close to where some speculators might throw in the towel, accelerating the slide of the CZK. Because, as they see it, the promised strengthening of the CZK isn't happening anymore, and just the opposite is. There's certainly so much spec money in the EURCZK that such a dash for the door would shake the EURCZK massively.

| FI

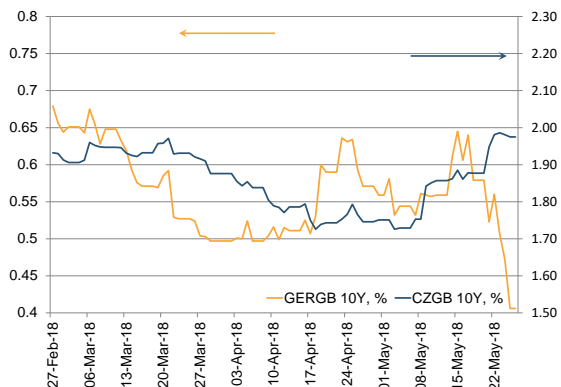
Last week I said that "if I had to guess, I'd say we'll see 10Y Bund close to 50 bps soon". Here we go.

Release of the ECB minutes from the April 25-26 meeting and weak PMI reading for May sent the 10Y to lowest in 5 weeks, close to 40 bps. Strange at the first glance that CZ bond yields didn't respond, but that is the reflection of the selloff in the EURCZK market.

EURCZK CONTINUES TO DRIFT UPWARD.

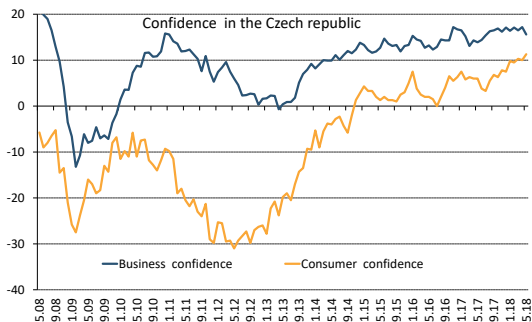


GERMAN YIELDS FELL ON WEAK PMI, DOVISH ECB MINUTES



CZECH ECONOMY

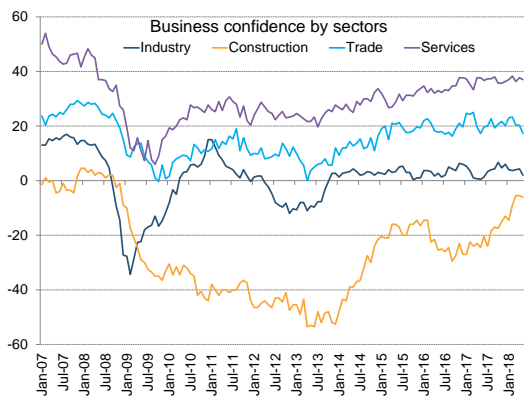
CONSUMER CONFIDENCE AT THE NEW HIGH WHILE...



Czech confidence indicators continue to diverge.

Consumer confidence rose to the new all-time high of 11.3 pts in May. Consumers are thus clearly unaffected by the increasingly weaker outlook in Eurozone or, for that matter, in the Czech business sector (more on that in the following paragraph). This is to an extent understandable: as long as the unemployment is extremely low and isn't changing and the rate of growth of nominal wages is high, there is no reason to become worried. Unless, of course, you happen to read PMI market reports...Which most of the consumers certainly don't. As is usual, consumer confidence tends to trail, not lead the economic situation, and it is not different now.

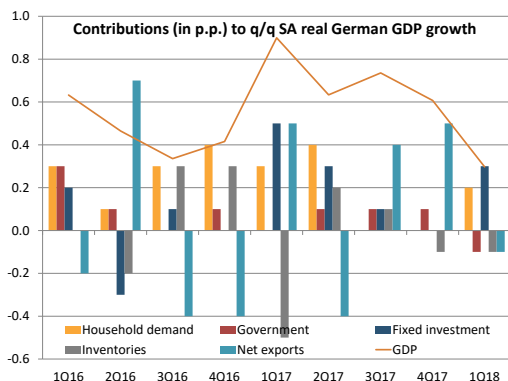
...CONFIDENCE IN BUSINESS SECTOR SLIDES TO LOWEST IN ALMOST A YEAR.



For businesses, it is different as they are better informed about the outlook. And it was primarily the outlook component of the business confidence that was behind the May decline of **the business confidence to lowest (15.6) since July 2017 (15.4)**. As for the structure, trade and industry worsened most, the latter reflecting the fact that industry outlook worsened in Germany as well (and that some of German weakness is probably already being felt in foreign orders by the Czech industry).

What this divergence tells us – or, better still, what it confirms – is that we will for sure see weaker growth this year than in 2018 and that the slowdown may be substantial (to around 2%). Another consequence of this divergence is the expectation of worsening of trade balance: uber-optimistic households equal strong import growth whereas less optimistic industry means slower growth of exports.

GERMAN GROWTH SLOWDOWN IN 1Q18 DUE TO NET EXPORTS, GOVERNMENT



EUROZONE ECONOMY

German growth weakened substantially in 1Q18 (to 0.3% q/q), helping to drag Eurozone growth down. Here's why.

Main reason for the slowdown as against the 0.6% q/q growth seen in 4Q17 was that the contribution of net exports turned negative (as both imports and exports fell) and that so did, after a long time, growth of government demand; household demand grew, somewhat surprising revelation considering the weak monthly retail sales data in 1Q18.

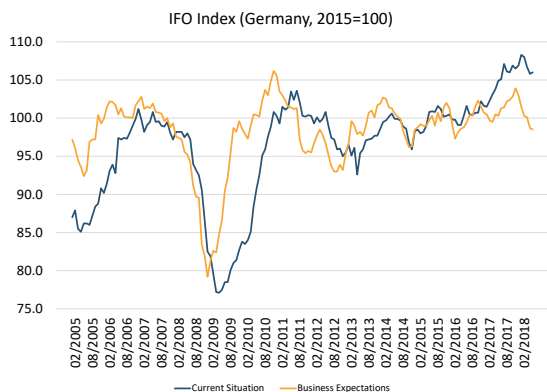
Looking forward, the net exports will probably not improve much. The fact that imports fell in 1Q18 was reflection of weak exports (export is fairly import-heavy) but I'd dare say that had it not been for the investments and household growth, the decline of imports would have been smaller. In the remainder of the year, with local labor market strong and some signs of wages finally picking up, the household- and investment-related imports will remain high. On the other hand, exports will remain weak as leading indicators suggest.

As for the government demand, 1Q18 decline looks like one-off, so I expect it to return to its usual 0.1 pp contribution to quarterly growth. **Altogether, thus, Germany should grow at the average of 0.4% q/q in the remainder of the year**, putting the 2018 GDP growth at somewhat below 2% y/y.

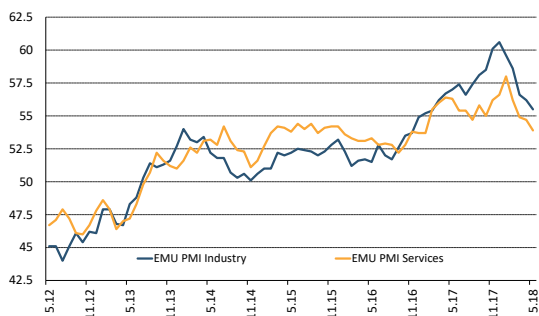
That it will be so and that Eurozone as a whole won't do much better either is seen in May'18 IFO and PMI indices.

German IFO index remained unchanged in May (102.2), with small increase (+0.2 pts.) in the assessment of the current situation offset by the same-size worsening of the expectations. The expectations component thus fell to 98.5 which is lowest since March 2016. If the expectations translate into worsening of the actual situation, then the German growth in the second half of the year might be even lower than 0.4% q/q.

IFO WEAKENED FURTHER AND...



...SO DID PMI, SO...



...NO SURPRISE EURUSD FELL FURTHER.



In Eurozone, the picture cannot be too different, Germany being the biggest member of the Euro-area economy. **The overall PMI index fell to 1 ½ year low (54.1), with both services (53.9, 16-month low) and manufacturing (54.5, 18-month low) contributing to the weakness.** That the cold is at least to some extent coming from the outside is seen in the fact that export growth subindex was weakest since August 2016. Country-wise, **Germany fell to 20-month low (53.1)**, a marked slowdown against April (54.6), let alone against the beginning of the year. In France, the overall index fell to 16-month low but manufacturing rose to three-month high. Which was really the only positive thing in the May PMI release.

Most important for the ECB was this sentence in the press release accompanying the data: *“average selling prices for goods and services rose at the slowest rate since last September, with companies often reporting difficulties in hiking prices amid weak final demand.”* There goes the convergence of inflation to 2% soon. And the 2018 end to QE.

No wonder, then, that EURUSD fell further. It is now close to my 2018 target of 1.15.

ECB minutes from the April meeting acknowledged the loss of momentum, if not yet the inflationary implications thereof.

ECB was trying to put the brave face on the weakening growth momentum, but couldn't hide the disappointment altogether. Hence the sentence that *“confidence in the eventual convergence of inflation to inflation aim remained unchanged”*, followed by the remark that *“it was widely cautioned that the uncertainty around the outlook had increased since the March monetary policy meeting”*. The former confident statement rested on what ECB called *“the encouraging signs of strengthening in nominal wage growth”* (though here I'd add that those signs are still few and far between), the former 'caution' statement was due to *“global factors, including the threat of increased protectionism”*. Finally, ECB remained wary of what might come in the weeks

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between April and June meetings: “*data releases ahead of the June meeting would need to be carefully scrutinized to better understand the recent moderation in growth*”. As it turned out, the data that came out during the May pointed in the direction of further weakness: inflation was lower (though likely one-off), PMI / IFO weakened further etc. Some comfort can be drawn from resilience of consumer confidence, but that isn’t much: in recent quarters, confidence hasn’t translated into actual retail sales growth.

All in all, somewhat dovish (though, admittedly, cautiously so) minutes again increased the probability that there will not be an end to QE this year. And that if there is one next year, it will come after protracted tapering period.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	0.709	0.969	1.360	1.743	1.840	1.910	
	-1M	0.709	0.969	1.230	1.615	1.703	1.808	
	-3M	0.709	0.969	1.295	1.675	1.780	1.908	
	-6M	0.709	0.969	1.330	1.660	1.761	1.890	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.497	-0.561	-0.456	-0.330	-0.153	0.065	
	-1M	-0.518	-0.611	-0.551	-0.417	-0.190	-0.043	
	-3M	-0.706	-0.706	-0.645	-0.633	-0.531	-0.002	
	-6M	-0.990	-0.835	-0.756	-0.699	-0.525	0.027	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	0.863	0.969	1.205	1.413	1.687	1.975	
	-1M	0.712	0.781	0.973	1.198	1.513	1.765	
	-3M	0.589	0.749	0.931	1.042	1.249	1.905	
	-6M	0.340	0.649	0.830	0.961	1.236	1.917	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.727	4.313	319.47	4.628	5.494	1.165	
	-1M	25.465	4.228	312.94	4.661	4.926	1.210	
	-3M	25.366	4.169	313.70	4.658	4.664	1.232	
	-6M	25.450	4.209	312.06	4.639	4.721	1.193	

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

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AVAILABLE AT THOMSON REUTERS EIKON MESSENGER

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