

Weekly | 2018 | Week 26

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	2-Jul	9:30	CZ	Manufacturing PMI, Jun'18	55.8	N/A
	2-Jul	10:00	EMU	(Final) Manufacturing PMI, Jun'18	55.0	N/A
	2-Jul	11:00	EMU	Unemployment, May'18,	8.5%	N/A
	2-Jul	14:00	CZ	Budget balance, Jun'18, CZK bn.	N/A	N/A
Tuesday	3-Jul	11:00	EMU	Retail sales, May'18, y/y	1.6%	N/A
Wednesday	4-Jul	9:00	CZ	Retail sales, May'18, y/y	3.5%	3.0%
	4-Jul	10:00	EMU	(Final) Services PMI, Jun'18	55.0	N/A
Thursday	5-Jul	8:00	GER	Industrial orders, May'18, y/y (WDA)	1.7%	N/A
	5-Jul	9:00	SPA	Industrial production, May'18, y/y WDA	1.7%	N/A
Friday	6-Jul	9:00	GER	Industrial production, May'18, y/y WDA	1.5%	N/A

* LOCAL TIME IS CET

** (REUTERS/ BLOOMBERG) POLL

JULY 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2015-2026**	11-Jul	13-Jul	26-Jun-26	CZK 4 bn. max	1.00%
CZGB 2014-2027**	11-Jul	13-Jul	19-Nov-27	CZK 4 bn. max	VAR
CZGB 2011-2023**	25-Jul	27-Jul	18-Apr-23	CZK 4 bn. max	VAR
CZGB 2018-2029**	25-Jul	27-Jul	23-Jul-29	CZK 4 bn. max	2.75%

* 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

“HARLEY-DAVIDSON WORKERS BACKING UP TRUMP DESPITE THREAT OF WORK SHIFT ↗ , AIRBUS GUY BACKING BREXIT ↗ DESPITE THREAT OF LOSS OF JOBS: I MEAN, IF THIS IS NOT THE PERFECT EXAMPLE OF FALSE CONSCIOUSNESS ↗, THEN WHAT IS? WHERE IS GRAMSCI WHEN YOU NEED HIM MOST?”

WEEK AHEAD

End-of-1H18 manufacturing PMI and May retail sales will be released this week. With German PMI having worsened in June again ↗, one shouldn't expect anything else than slight worsening here as well – the market consensus is for worsening from 56.5 to 55.8. **For retail sales**, on the other hand, one shouldn't expect anything other than strong (WDA) growth rate: unemployment is at all-time low, wages are growing at the rate just below double-digit one etc.

In **Eurozone**, on the contrary, May retail sales release will be nothing to celebrate: the expectation is for anemic growth of just 1.6%. As for the **May German industrial orders or production, not much should be expected either** – orders fell in first four months of the year and PMI worsened between April and May, so I don't expect orders picked up much in May or that production grew strongly in May, certainly not so much as to, in case of orders, make up for the fall over January-April.

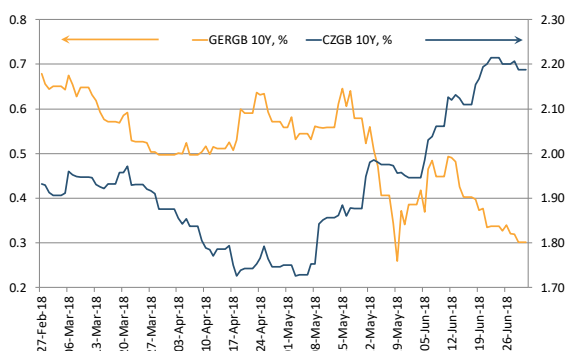
WEEK BEHIND

- **CNB: hike to 1% due to weak CZK** ▶
- **CZ: no change in consumer or business confidence** ▶
- **CZ: 1Q18 savings rate at the all-time low** ▶
- **EUROZONE: German IFO lowest in little over a year** ▶
- **EZ INFLATION: core inflation in June just like in January** ▶

EURCZK BREAKS 26 FOR A FEW HOURS



BOND YIELDS UNEVENTFUL LAST WEEK



FX

EURCZK weakened above 26 for few hours on Thursday before reverting below.

The intra-day low was 26.08 around noon on Thursday, despite the fact that CNB hiked its repo by 25 bps. the day before. This was first time EURCZK was above 26 since late September of 2017. This, however, wasn't exclusively Czech move, though – EURPLN rose to 4.36, EURHUF to 329. Clearly, the region is seeing flight of capital towards USD as global uncertainty rises (trade war).

FI

Yields remained unchanged last week.

German 10Y remained at around 30 bps., Czech 10Ys slightly below 2.20%. The spread remains at 6- year high.

CZECH ECONOMY

CNB hiked the 2W repo rate to 1%, as I expected, for the reasons I expected.

Although the May 2018 forecast called for the next tightening for the end of this year, it also expected EURCZK to be much lower now than what it is: the said forecast expected EURCZK to average 25.20 in 2Q18 and 24.80 in 3Q18. Considering that EURCZK is now at almost 26, this presented clear pro-inflationary risk to the forecast. And, I would add, *the* most important one. There were two other reasons for the hike that CNB mentioned (higher than expected domestic inflation, bigger inflationary pressures from abroad) but these were significantly less important. The former referred to the fact that the actual monetary policy relevant inflation (MPRI) for 2Q18 will certainly be larger than 1.8% expected by May forecast, considering that April's MPRI was 1.8% and May's one was 2.1%. The latter reflected the rise of oil prices and the strengthening of dollar against euro, meaning the CZK price of oil rose.

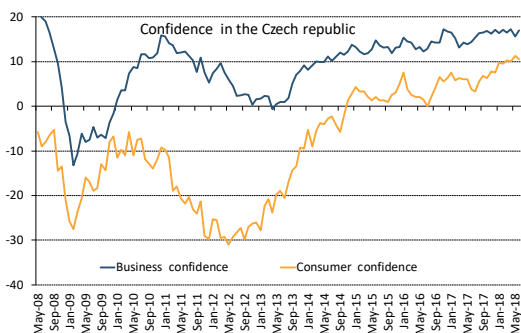
Looking forward, all depends on EURCZK. Unless CZK strengthens then even if local inflation doesn't quicken (and I think it won't, unless the historical relationship between our inflation and Eurozone one miraculously breaks down) CNB will be tempted to hike again this year. And since I think EURCZK might soon be at 27, this is likely.

No change in consumer or business sentiment at the end of 1st half.

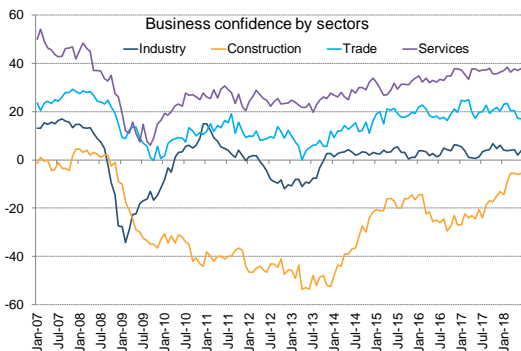
Consumer confidence retreated 0.8 pts. to 10.5, second highest reading ever. This may have been due to the escalation of the trade war between US and others, or to something else ☺ It is hard to say, here.

For businesses, the only notable development was another (fourth consecutive) fall of confidence in trade: the level to which it fell in June (17 pts.) was the lowest since September 2016. This most likely

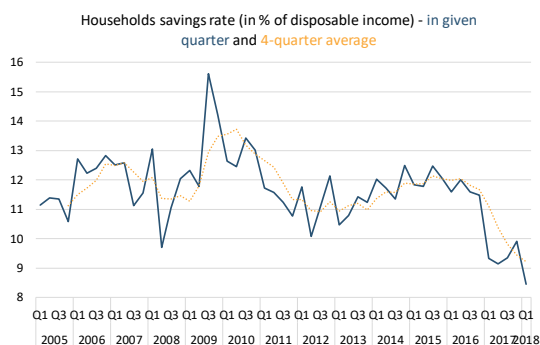
CONSUMER AND BUSINESS CONFIDENCE UNCHANGED IN JUNE



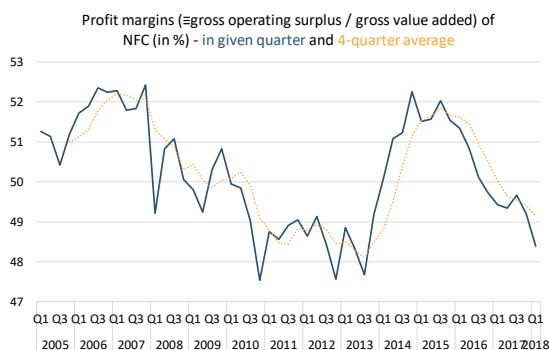
4TH CONSECUTIVE FALL IN CONFIDENCE IN TRADE LIKELY A REFLECTION OF TRADE TENSIONS



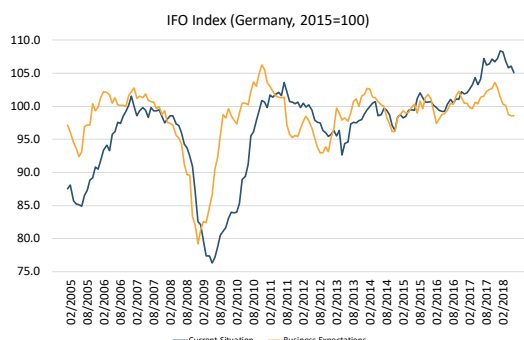
HOUSEHOLDS' SAVINGS RATE FELL TO NEW LOW IN 1Q18



PROFITABILITY OF NFCs WORSENEO FURTHER IN 1Q18



GERMAN IFO WORSENS TO LOWEST IN LITTLE OVER A YEAR



is the reflection of trade tensions between US and – pretty much – the rest of the world.

Final GDP data lowered the 1Q18 growth to 4.2% y/y.

The quarterly expansion rate remained unchanged at 0.5% q/q, meaning that what changed were growth rates in 2017 (though overall growth remained unchanged at 4.5% in 2017).

There were some changes in the structure of 1Q18 growth rate – the household demand growth increased 0.2 p.p. as against the previous estimate (to 4.1% y/y) whereas the gross fixed capital formation was lowered by 2.3 p.p. (to 9.9%) as were both exports (-0.3 p.p. to 3.8% y/y) and imports (-0.8 p.p. to 5.7%).

What was most important in 1Q18 final GDP data release was **the savings rate** and the profitability of non-financial corporations in 1Q18: the former **fell to a new low of 8.4%** while the latter continued to worsen, with it now being lowest in 5 years. The former is clearly the reflection of overall optimism (and isn't entirely different from the route that government took in that 'to save for worse times' is almost an anathema), the latter the reflection of rising wages.

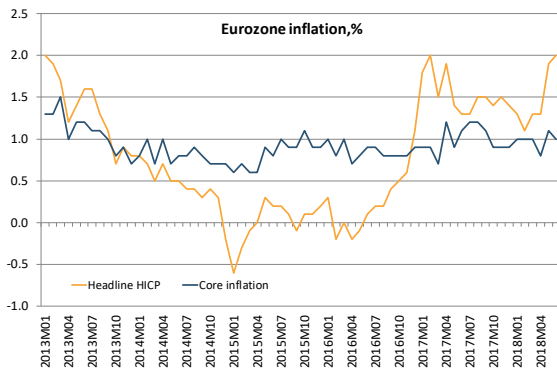
EUROZONE ECONOMY & FED

German IFO fell further in June, reaching lowest (101.8) since May 2017.

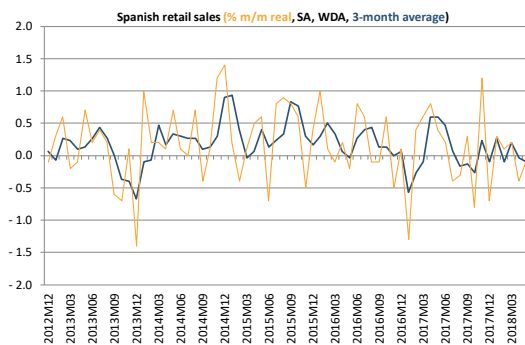
This was *not* due to the fall of expectations which have been dragging the overall business climate index down in last months: the expectations sub-index remained essentially unchanged (98.6 pts.) as against May (98.7). But the assessment of current situation fell to lowest (105.1 pts.) since June 2017, though it does remain at historically high level: the current situation index hasn't been above 105 except for last year. IFO is thus another evidence that situation in Germany isn't improving after the slowdown seen this year.

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EUROZONE CORE INFLATION FINISHES 1ST HALF OF THE YEAR JUST WHERE IT STARTED IT : AT 1%.



...AND SPANISH RETAIL DOESN'T INDICATE CORE INFLATION WILL LIFT ANYTIME SOON.



Eurozone core inflation remained at 1% in June, finishing the 1st half of the year at exactly the same level where it started it.

Meaning that the June 2018 core inflation was 0.1 pp *below* the level of June 2017. And 0.1 pp above the level of June 2016. In other words, the inflationary pressures haven't really changed in last two years.

Yes, the headline inflation rose further to 2% in June (from 1.9% in May and 1.3% in June 2016), but that is merely the reflection of rising fuel prices (and, to some small extent, higher food prices). See, in June 2017 fuel prices grew at 2.2% y/y but at 8% in June 2018 (vs. 6.1% y/y in May). Food prices grew just 1.4% y/y in June 2017 but 2.8% in June 2018. Altogether, it is clear that whatever increase we did have in headline inflation was due to non-demand factors.

ECB targets headline so it can pretend the inflation target has been hit, but the truth is that it didn't happen on a sustainable basis.

And it also doesn't look like Eurozone inflation will become sustainable at 2% soon. For that, the household demand would have to quicken, but the first retail data from June – from Spain – don't show anything like that. The m/m growth in May was negative (-0.1% m/m) and that is also the average growth over March-May period. Which is hardly anything that would threaten to unleash the inflation anytime soon.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	1.160	1.240	1.630	1.910	1.971	2.030	
	-1M	0.910	0.990	1.350	1.718	1.785	1.878	
	-3M	0.900	0.990	1.270	1.630	1.715	1.800	
	-6M	0.760	0.850	1.313	1.619	1.713	1.844	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.555	-0.610	-0.425	-0.329	-0.063	0.158	
	-1M	-0.470	-0.558	-0.431	-0.331	-0.084	0.069	
	-3M	-0.537	-0.581	-0.527	-0.384	-0.144	0.076	
	-6M	-0.281	-0.875	-0.768	-0.744	-0.648	-0.123	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.075	1.151	1.424	1.581	1.908	2.188	
	-1M	0.880	0.959	1.194	1.387	1.701	1.946	
	-3M	0.733	0.851	1.022	1.246	1.571	1.876	
	-6M	1.032	0.572	0.779	0.875	1.065	1.721	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.989	4.372	329.26	4.664	5.368	1.168	
	-1M	25.796	4.304	320.02	4.664	5.428	1.166	
	-3M	25.347	4.213	312.48	4.654	4.877	1.232	
	-6M	25.534	4.178	310.35	4.680	4.555	1.201	

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

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