Weekly | 2018 | Week 37

MARTIN LOBOTKA, (+420) 777 027 165, MLobotka@42fs.com, Research@42fs.com

CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	17-Sep-18	9:00	CZ	PPI Industrial, Aug'18, y/y	3.1%	3.3%
	17-Sep-18	9:00	CZ	Export prices, Jul'18, y/y	N/A	N/A
	17-Sep-18	11:00	EMU	(Final) HICP, Aug'18, y/y	2.0%	N/A
Wednesday	19-Sep-18	10:00	EMU	Current account, Jul'18, EUR bn.	N/A	N/A
Thursday	20-Sep-18	16:00	EMU	(Flash) Consumer confidence, Sep'18	-2.0	N/A
Friday	21-Sep-18	8:45	FRA	(Final) GDP 2Q18, q/q (SA)	0.2%	N/A
	21-Sep-18	10:00	EMU	(Preliminary) Manufacturing/Services PMI, Sep'18	54.5/54.4	N/A

* LOCAL TIME IS CET
** (REUTERS/ BLOOMBERG) POLL

SEPTEMBER 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2007-2022**	5-Sep-18	7-Sep-18	12-Sep-22	CZK 3 bn. max	4.70%
CZGB 2018-2029**	5-Sep-18	7-Sep-18	23-Jul-29	CZK 5 bn. max	2.75%
SPP 800	13-Sep-18	14-Sep-18	14-Dec-18	CZK 0-5 bn.	N/A
SPP 801	20-Sep-18	21-Sep-18	21-Dec-18	CZK 0-5 bn.	N/A
CZGB 2018-2021**	19-Sep-18	21-Sep-18	23-Feb-21	CZK 3 bn. max	0.75%
CZGB 2014-2025**	19-Sep-18	21-Sep-18	17-Sep-25	CZK 3 bn. max	2.40%

* 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

"LEHMAN AFTER 10 YEARS: NOT EXACTLY A GREAT CALL ↗ ".

WEEK AHEAD

Second-tier inflation data to be released here.

Export/Import prices for July and PPI for August is what I mean by that. Import prices will be shown to have increased again, with CZK weakening at its peak back in the summer.

In Eurozone, most important releases are the soft data. Consumer confidence for September is forecast to have worsened a bit, while PMI for both services and manufacturing is expected to have stabilized at the end of 3Q18. In other words, no soft indicator will show that we should expect quickening of growth.

WEEK BEHIND

CZ: August inflation makes September hike almost certain ▶

EMU: industry in third decline in last four months ▶

ECB: pretending that everything goes according to plan ▶

| FX

CZK strengthened to strongest since mid-May, dipping below 25.50.

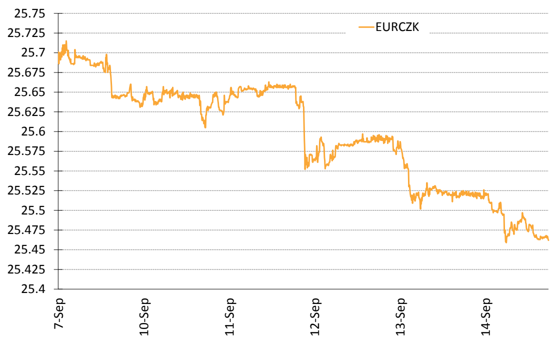
This was caused by Governor Rusnok interview with Reuters ↗ in which he indicated that two more hikes are possible this year, with the first one to be delivered next week. Market took this to mean that September hike is a done deal and another one after that, probably in October, is almost done as well. And with recent inflation developments (see below), they both are. Unless, that is, CZK strengthens further. Which it easily may.

| FI

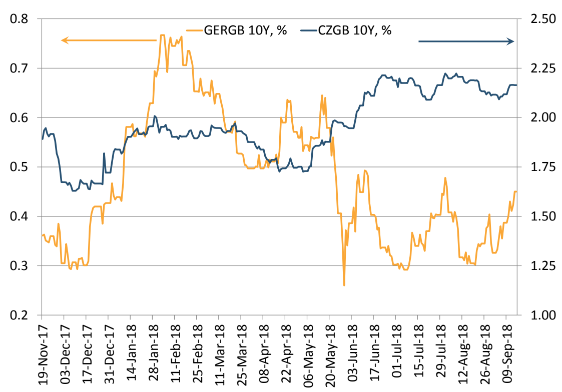
German yields were pushed up by optimistic ECB.

As described in more detail below, the optimistic ECB (i.e., the hawkish ECB) pushed German yields up as it became clear QE will end soon despite no improvement in core inflation and despite slower Eurozone economy.

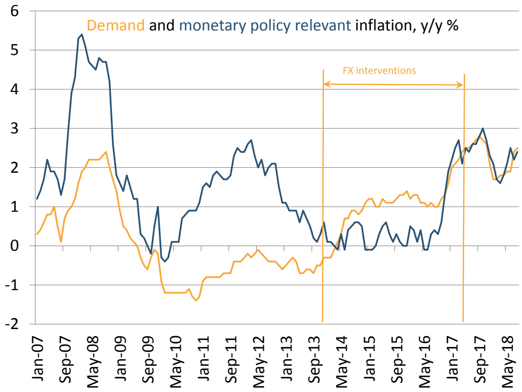
EURCZK FELL TO LOWEST SINCE MID-MAY ON HAWKISH CNB



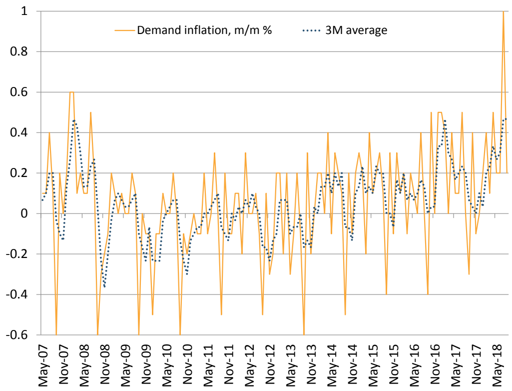
GERMAN YIELDS CLIMB HIGHER ON ECB



INFLATION RISES TO 2.5%



DYNAMICS OF THE DEMAND INFLATION REMAIN ELEVATED



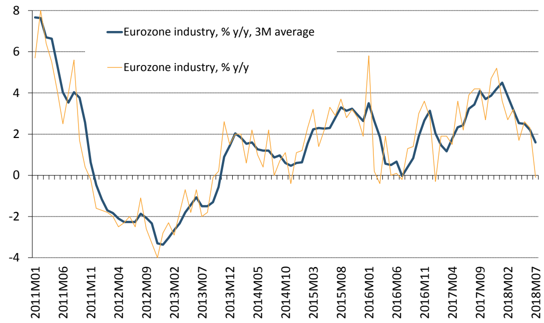
| CZECH ECONOMY

Czech inflation rose 0.1% m/m in August to the annual level of 2.5% y/y. With demand inflation at 2.5% as well, CNB will hike in two weeks.

Monthly growth of 0.1% m/m was the first August monthly rise since August 2007. The reason for this unusual development for this part of the year is to be found in the housing sector: prices of electricity rose 0.5% m/m (other distributors increased prices, copying CEZ which did it in early summer), heating / water rose 0.4%. And, let us not forget the ever-increasing real estate prices: rents went up 0.4% m/m. In other parts of the consumer basket, the development was far less dramatic: in four areas (transport, alcohol & tobacco, clothing and food) there were even notable declines. That services were behind the recent rise of inflation is seen in that the prices of goods fell 0.2% m/m in August whereas prices of services rose 0.5% m/m.

Annual inflation rose to 2.5%, valid for headline, MPRI and demand one as well. The demand inflation is now 0.6 pp higher than in May and its monthly dynamics remains elevated - so it is almost certain that CNB will hike at its September meeting. Considering CZK is still weaker than expected, to *not* hike would be a surprise.

EUROZONE INDUSTRY DECLINES Y/Y FOR THE FIRST TIME SINCE JANUARY 2017



| EUROZONE ECONOMY

Eurozone industry remained weak in July, recording 2nd consecutive fall of 0.8% m/m and, thus,

…the third monthly decline in last 4 months. Same is true of manufacturing component thereof – July decline was 0.7% m/m after June's -0.8% m/m.

July weakness was caused by fall in the production in Germany and Spain, both by 1.8% m/m. The only big country where production rose in July was France (+0.7% m/m, same as in June).

The annual growth thus dipped below zero (-0.1% y/y) for the first time since January 2017. And while some rebound to black numbers is expected for the following months, the fact that German industrial orders continue to decline (see Weekly 36 here ↗), it is hard to see return to 5% annual growth rates we saw at the end of 2017.

ECB continues to pretend all goes according to the plan (i.e., inflation's firmly on convergence path to its target) even if little seems to support it.

Last week's meeting obviously didn't bring any changes to the monetary policy stance, actual or expected. ECB repeated that it intended to end the QE at the end of this year ("*subject to incoming data confirming our medium-term inflation outlook",* just in case) and that it had not had any debate regarding the reinvestment policy (i.e., ECB promises to reinvest all, and that is for now).

New forecast didn't say anything new either: inflation is forecast to be 1.7% in 2018, 2019 and 2020, with core inflation strengthening in 2019-20 to make up for the base effect of oil prices (next year, 2018 increase of oil prices will fall out of the base).

At the press conference, ECB strove to make it look like nothing will stop core inflation from climbing up – with precious little hard data corroborating that optimism.

First, although ECB broadened the set of growth risks it perceives to not only include rise of protectionism, but also the EM volatility, it stuck to its mantra that **risks to growth are nonetheless "balanced"**. I don't see one single thing that could push growth up, though. It leaves me to wonder what the positive risks to the growth that offset the negative ones are. ECB was silent on that.

Second, ECB admitted that "*measures of underlying inflation remain generally muted"* but added that "*they have been increasing from earlier lows".* Well, core inflation has been around 1% for last five years, without any trend whatsoever. But what really made me go "what? where?" was the ECB's statement that wage growth is being pushed up. Just hit LNTWEMUY Index on Bloomberg to see how much nominal labor costs went up in recent years…(hint: much like core inflation, i.e. not at all).

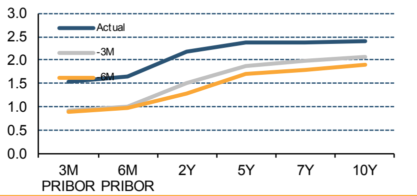
Third, asked whether the recent massive slowdown of industry is of any concern, Draghi said no: it was to be expected as it is a reflection of "*convergence of the economy to its steady state path*". Kid you not. No mention of foreign orders in Germany having dropped in almost all months this year due to weaker foreign demand…

Fourth, *"domestic part of growth remains resilient because of the consumption".* Gasp – retail sales are growing at about 1% y/y…

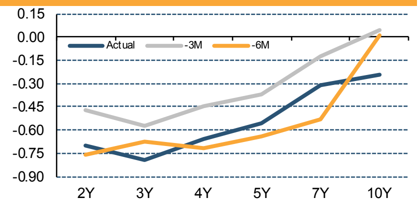
All in all, ECB pretends the glass is full when it is 2/3 empty…But since ECB wants to end QE, it can't do otherwise. While the end of QE is certain now, ECB having essentially pre-committed to do so, the rate hike next year is very unlikely in my eyes, considering wages, inflation, retail sales.

| Markets ‡

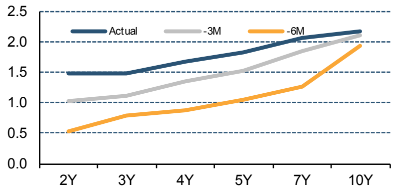
MM / IRS (%)	3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
Actual	1.540	1.650	2.170	2.373	2.380	2.408
-1M	1.460	1.550	1.935	2.135	2.178	2.210
-3M	0.920	1.010	1.495	1.880	1.970	2.065
-6M	0.900	0.990	1.280	1.695	1.790	1.910



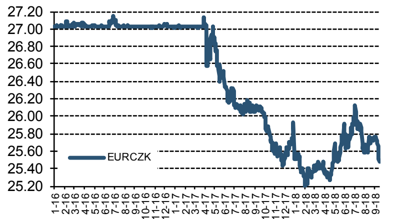
ASW spread* (bps.)	2Y	3Y	4Y	5Y	7Y	10Y
Actual	-0.700	-0.797	-0.661	-0.557	-0.315	-0.244
-1M	-0.655	-0.740	-0.636	-0.461	-0.222	-0.034
-3M	-0.471	-0.571	-0.446	-0.368	-0.123	0.045
-6M	-0.759	-0.673	-0.722	-0.644	-0.534	0.012



CZGB** (%)	2Y	3Y	4Y	5Y	7Y	10Y
Actual	1.470	1.482	1.675	1.816	2.065	2.164
-1M	1.280	1.290	1.457	1.674	1.956	2.176
-3M	1.024	1.114	1.354	1.512	1.847	2.110
-6M	0.521	0.792	0.868	1.051	1.256	1.922



FX	EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
Actual	25.477	4.306	324.85	4.640	7.175	1.163
-1M	25.768	4.322	324.44	4.666	6.748	1.135
-3M	25.729	4.286	322.52	4.664	5.495	1.161
-6M	25.396	4.213	311.24	4.668	4.797	1.231



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

| Contacts

Martin Lobotka, Analyst (+420) 777 027 165, MLobotka@42fs.com

Research Research@42fs.com

Available at Thomson Reuters Eikon Messenger

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