

October 29 | 2018

## Weekly | 2018 | Week 43

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## CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Tuesday	30-Oct-18	9:00	SPA	Retail sales, Sep'18, y/y	N/A	N/A
	30-Oct-18	9:00	SPA	(Preliminary) HICP, Oct'18, y/y	2.3%	N/A
	30-Oct-18	8:30	FRA	(1st est.) GDP 3Q18, q/q (SA)	0.4%	N/A
	30-Oct-18	10:00	ITA	(1st est.) GDP 3Q18, q/q (SA)	0.2%	N/A
	30-Oct-18	11:00	EMU	(1st est.) GDP 3Q18, q/q (SA)	0.3%	N/A
	30-Oct-18	14:00	GER	(Preliminary) HICP, Oct'18, y/y	1.0%	N/A
Wednesday	31-Oct-18	8:00	GER	Retail sales, Sep'18, y/y	2.4%	N/A
	31-Oct-18	8:45	FRA	(Preliminary) HICP, Oct'18, y/y	2.6%	N/A
	31-Oct-18	9:00	SPA	(1st est.) GDP 3Q18, q/q (SA)	0.6%	N/A
	31-Oct-18	11:00	EMU	(Preliminary) HICP, Oct'18, y/y	2.2%	N/A
Thursday	1-Nov-18	9:30	CZ	(Final) Manufacturing PMI, Oct'18	52.60	52.40
	1-Nov-18	8:00	CZ	CNB rate-setting meeting, 2W repo rate	1.75%	1.75%
	1-Nov-18	14:00	CZ	Budget balance, 1Q-3Q18, CZK bn.	N/A	N/A
Friday	2-Nov-18	10:00	EMU	(Final) manufacturing PMI, Oct'18	52.10	N/A

\* LOCAL TIME IS CET

\*\* (REUTERS/ BLOOMBERG) POLL

## NOVEMBER 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
CZGB 2018-2029**	21-Nov-18	23-Nov-18	23-Jul-29	CZK 3 bn. max	2.75%
CZGB 2017-2033**	21-Nov-18	23-Nov-18	13-Oct-33	CZK 2 bn. max	2.00%

\* 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

“TWO+ YEARS AFTER AND NOT EVEN CABINET CAN AGREE ON BREXIT ➔”

## WEEK AHEAD

Probably the most interesting week of 4Q18, both here and in Eurozone.

In Czech Republic, CNB's meeting is No. 1 event. Although there are signs that the economy is slowing (higher savings rate, weaker retail sales, weaker industry) and risks abound (Brexit, Italy, market turmoil), CNB is clearly fixated on the weaker CZK. Hence, even if demand inflation isn't too high once you take away accommodation (accommodation contributed 0.9pp to 2.2% inflation in September, most of this being imputed rents due to housing price increase), I expect CNB to hike another 25 bps. this Thursday. The obsession with CZK “weakness” trumps all other considerations. There will be new forecast released so that makes hike more likely as well.

In Eurozone, first GDP data for 3Q18 will be released. That the economy grew less in 3Q18 than in 1H18 is almost given, so the only question is how much did it slow down from 1Q-2Q18 quarterly growth of 0.4%. My expectation is 0.3% (and then 0.2% q/q in 4Q18),.

Apart from 4Q18 GDP, there's also the preliminary October inflation – but this is unlikely to show anything extraordinary. In other words, core inflation very likely stayed close to 1% for the umpteenth month in a row.

WEEK BEHIND

**CZ: consumer confidence improves slightly in October** ▶

**EMU: ECB meeting a bonfire of largely unwarranted optimism** ▶

**EMU: leading indicators weak midway through 4Q** ▶

| FX

**EURCZK remained weak despite central bankers' indications that hike this Thursday is very likely.**

Board member Nidetzky said in Bloomberg [↗](#) interview that *“the developments in the real economy are creating room to continue with monetary-policy normalization”* mainly because he thinks that *„the pressure that’s preventing koruna gains will be more persistent, which creates room to tighten monetary conditions through the interest-rate channel.”* I.e., *“CZK is much weaker than I thought so we need to hike more than I thought”*.

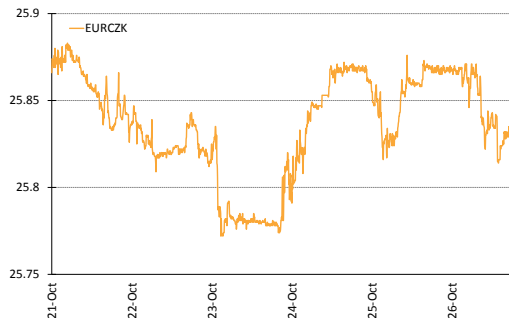
Mora, another Board member, said basically the same in [ihned.cz](#) interview [↗](#) : *“Current exchange rate developments, especially those of CZK vs. EUR, admit further rate increases”*. These two are thus clearly going to vote for 5<sup>th</sup> hike this year this Thursday. And apart from Dědek, it is likely that everyone else will too.

| FI

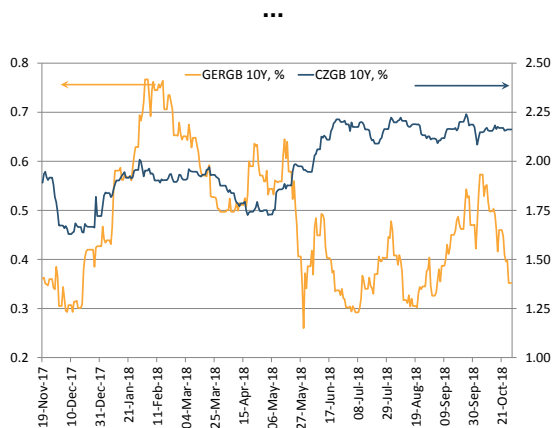
**German yields extended their decline from previous week...**

...falling to 7-week low of 35 bps. at 10Y. This was due to the combination of factors: persistent pessimism surrounding Italy, market turmoil after weaker results from Amazon / Google, and obviously weak PMIs in Eurozone that pushed rate hikes further out in the future.

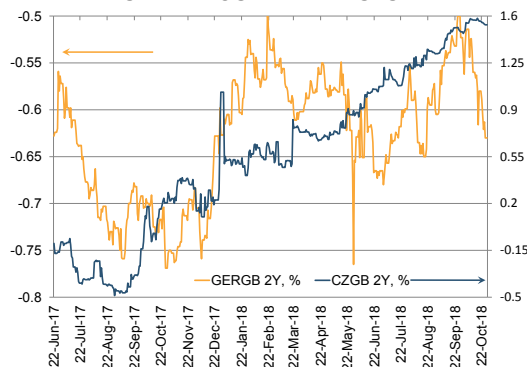
**EURCZK WITHOUT MOVES DESPITE CBANKERS' HINTS AT FORTHCOMING HIKE.**



**GERMAN 10Ys YIELDS EXTEND THEIR DECLINE**

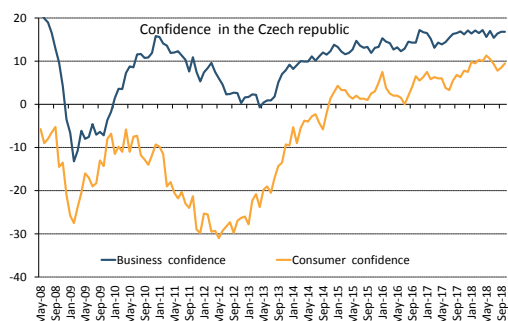


**...AS SHORT END PUSHES THE ECB HIKES FURTHER OUT IN THE FUTURE.**



CZECH ECONOMY

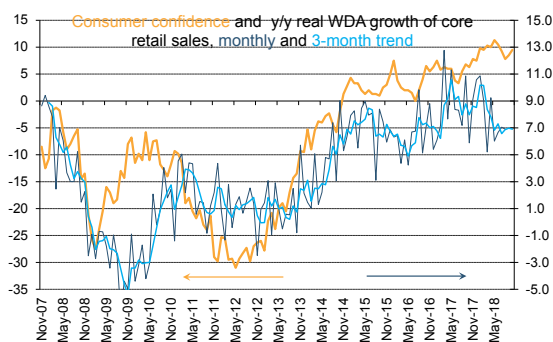
CONFIDENCE LITTLE CHANGED IN OCTOBER



Consumer confidence improved for the second month in a row, while business one stagnated.

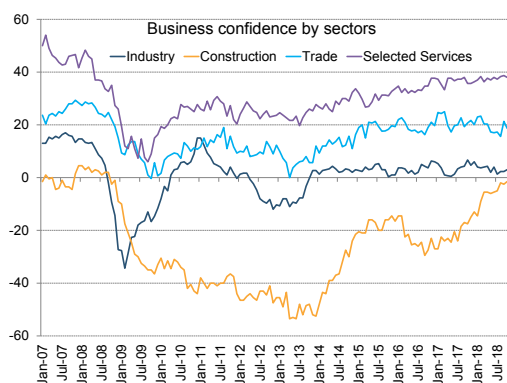
In October, consumer confidence rose to 9.5 pts. thus returning to July level. It is thus still very close to the all-time high seen in May (11.3 pts.). The improvement in October was driven by better expectations for the next twelve months when it comes to overall economic situation. Other components (expectations of price level, of unemployment, and the intention to save) were little changed compared with September. All in all, consumers are still very optimistic – though the slowdown in retail sales in 2018 indicates that something did change over 2017.

CONSUMER CONFIDENCE AND RETAIL SALES DIVERGE



Business confidence remained unchanged at 16.8 pts. in October, and is thus at the same level as in October 2017 (16.9). The only segment that's shown a clear upward trend over last year is construction, a reflection of the current boom in the real estate sector. The confidence in construction sector is now highest since November 2008. In other sectors, situation is less terrific: confidence in services, trade and industry has stagnated for number of months now.

BUSINESS CONFIDENCE STABLE AS ONLY CONSTRUCTION IMPROVES



## | EUROZONE ECONOMY

**ECB's meeting was a bonfire of (at least somewhat) ungrounded optimism.**

That ECB didn't change the policy was no surprise: it was never going to happen. What was much more interesting to see was whether the assessment of the risks surrounding the latest forecast changed, and whether that change might perhaps lead to the reassessment of the decision, taken in early summer, to discontinue QE at the end of the year.

**Neither happened. Draghi made it look like that what happened so far doesn't justify doing so.** His assessment of the risks surrounding the Eurozone growth outlook is that the risks are still "balanced". He did acknowledge that there was "weaker momentum" but added that there was no "downturn":

*"We're talking about a weaker momentum, not a downturn. (...). There is a weaker momentum. Yes, there are weaker survey data coming out and maybe some more expected in the future. But is this enough of a change to make us change the baseline scenario? The answer is no."*

Draghi also made it fairly clear that the bar to continue with all-Eurozone QE past December is high, adding that other tools to help if needed (OMT, TLTROs) will remain in the toolbox. Hence, QE's very likely to end in 2 months.

**To me, his optimism was unjustified and ungrounded.** Asked about Rome-Brussels wrangle about the budget, he said that he was "confident an agreement will be found". Asked about possibility of hard Brexit impacting Eurozone, he said he was "still confident that a good common-sense solution [would] be found where financial stability risks [would] be minimized". Well, confidence is good, but should be based on something better than hope.

And, at any rate, one should be prepared. Asked

what ECB would do if Italian government debt became ineligible as collateral for ECB operations, he said “*we don't know*” – but indicated that this is what OMT (“Outright monetary transactions”, ECB program announced back in August 2012) is for.

His optimism didn't stop with Brexit or Italy. On underlying demand pressures and the sustainable convergence of inflation to ECB's target, he said that “*after all this assessment*” (that negotiated wages are going up, that utilization rates are high, that labor market is getting tighter), Governing Council has “*no sense that (it) should doubt [its] confidence that inflation is gradually converging to [its] aim.*” Well, I would doubt it at least, considering that

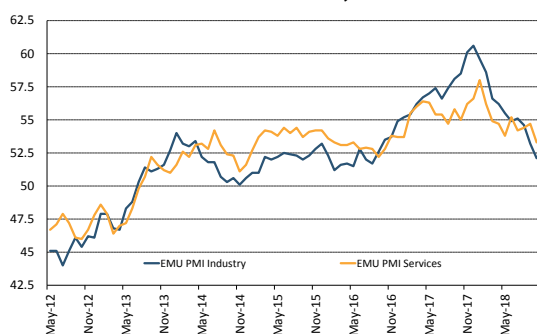
a) US, Germany have been struggling with nominal wage growth for years even with full employment, and that

b) ECB's inflation forecast have been imprecise, to put it mildly, in last 10 years.

Anyway, new forecast will be presented at the next meeting. But I stand behind what I wrote before: QE will end even if inflation doesn't pick up.

First hike? I think slowing economy will force ECB to stay put in 2019, but if economic growth so much as picks up slightly, ECB's going to tighten even if core inflation is at 1% this time next year. You know, the need to create maneuvering space for when next recession hits, wean the economy off the easy money while going is good etc. will all overpower pure inflation concerns.

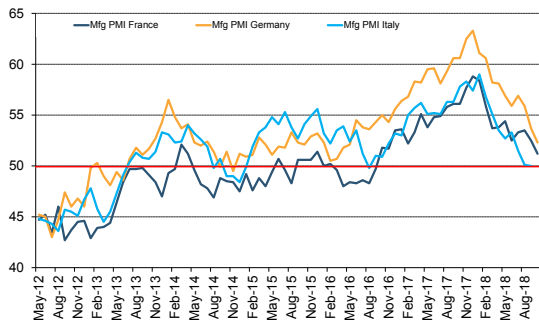
#### EUROZONE PMI SHOWS FURTHER LOSS OF MOMENTUM OF THE ECONOMY MIDWAY THROUGH 4Q18,...



#### Leading indicators generally worsened midway through 4Q18.

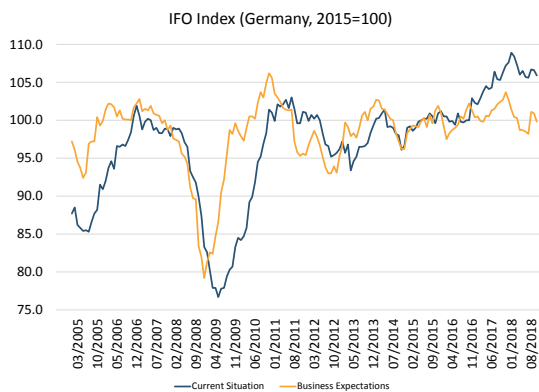
Eurozone manufacturing PMI fell further in October, hitting lowest (52.1) since August 2016. The actual production sub-index was lowest (51.2) in almost 4 years. And considering the first outright decline of new export orders since June 2013 and first decline of overall manufacturing orders since November 2014, it is unlikely things turn around soon in manufacturing.

...ESPECIALLY IN MANUFACTURING,...



The crucial question thus is: is the weakness in industry feeding into dominant service sector? It may be so – the overall PMI in a service sector fell to a 2-year low of 53.3 in October, with optimism for year ahead sinking to lowest since end of 2014 and new orders increasing just marginally (2<sup>nd</sup> slowest in almost 2 years). So, while the weakness in services sector is not as pronounced as in manufacturing one, signs are not good.

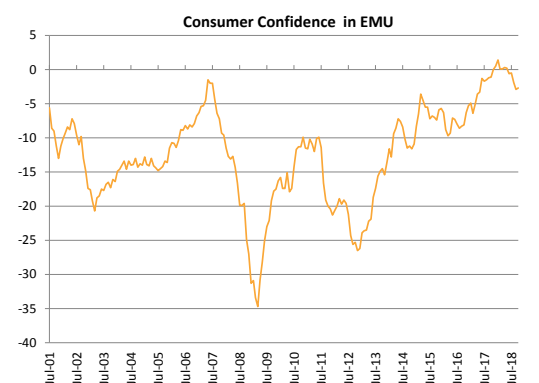
...AND YET GERMAN IFO REMAINS SURPRISINGLY HIGH



All in all, the GDP growth in 4Q18 looks set to be 0.2-0.3% q/q. And the PMIs are now close to levels where ECB historically has been in easing bias.

Elsewhere, **German IFO** index also worsened, but only marginally. IFO expectations dipped below 100 pts. again, assessment of the current situation declined to 105.9 pts. In both cases, these are historically high levels. What is thus strange and noteworthy is the divergence between German manufacturing PMI (52.3 in October, lowest since May 2016) and IFO.

OCTOBER CONSUMER CONFIDENCE UNCHANGED VS. SEPTEMBER



Finally, **Eurozone consumer confidence** was the only indicator that improved – if only marginally so (October: -2.7, September: -2.9 pts.). But the lack of link between confidence and retail sales makes me discount the implications of this release for inflation and for ECB quite heavily.

MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	1.790	1.880	2.325	2.507	2.499	2.500	
	-1M	1.700	1.770	2.225	2.400	2.419	2.435	
	-3M	1.200	1.290	1.875	2.120	2.122	2.140	
	-6M	0.900	0.990	1.225	1.603	1.688	1.793	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.790	-0.763	-0.744	-0.650	-0.425	-0.338	
	-1M	-0.743	-0.776	-0.613	-0.537	-0.329	-0.248	
	-3M	-0.649	-0.711	-0.610	-0.491	-0.172	0.024	
	-6M	-0.523	-0.596	-0.549	-0.419	-0.193	-0.047	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.535	1.657	1.735	1.857	2.074	2.162	
	-1M	1.482	1.534	1.753	1.863	2.090	2.187	
	-3M	1.226	1.287	1.468	1.629	1.950	2.164	
	-6M	0.702	0.782	0.956	1.184	1.495	1.746	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.816	4.311	324.19	4.661	6.378	1.140	
	-1M	25.765	4.281	323.41	4.654	7.034	1.160	
	-3M	25.635	4.286	322.45	4.624	5.656	1.166	
	-6M	25.471	4.207	312.78	4.663	4.908	1.213	

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

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