Weekly | 2017 | Week 44

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	30-Oct	8:00	GER	Retail sales, Sep'17, y/y (SA)	3.0%	N/A
	30-Oct	9:00	SPA	(1st est.) GDP, 3Q17, q/q (SA)	0.8%	N/A
	30-Oct	9:00	SPA	(Preliminary) HICP inflation, Oct'17	1.7%	N/A
	30-Oct	14:00	GER	(Preliminary) HICP inflation, Oct'17	1.7%	N/A
Tuesday	31-Oct	7:30	FRA	(1st est.) GDP, 3Q17, q/q (SA)	0.5%	N/A
	31-Oct	8:45	FRA	(Preliminary) HICP inflation, Oct'17	1.2%	N/A
	31-Oct	11:00	EMU	Unemployment, Oct'17	9.0%	N/A
	31-Oct	11:00	EMU	(1st est.) GDP, 3Q17, q/q (SA)	0.5%	N/A
	31-Oct	11:00	ITA	(Preliminary) HICP inflation, Oct'17	1.3%	N/A
Wednesday	1-Nov	9:30	CZ	Manufacturing PMI, Oct'17	57.0	N/A
Thursday	2-Nov	10:00	EMU	(Final) Manufacturing PMI, Oct'17	58.6	N/A
	2-Nov	13:00	CZ	CNB monetary-policy meeting, 2W repo rate	0.5%	0.50%
Friday	3-Nov	9:00	CZ	Trade balance, Sep'17, CZK bn.	18.5	15

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

NOVEMBER 2017 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
SPP 772	2-Nov-17	3-Nov-17	8-Dec-17	CZK 5bn. max	N/A
CZGB 2015-2023	8-Nov-17	10-Nov-17	25-Oct-23	CZK 4bn. max	0.45%
CZGB 2017-2027	8-Nov-17	10-Nov-17	10-Feb-27	CZK 4 bn. max	0.25%
CZGB 2017-2033	8-Nov-17	10-Nov-17	13-Oct-33	CZK 4 bn. max	2.00%
SPP 773	16-Nov-17	20-Nov-17	29-Dec-17	CZK 5bn. max	N/A
CZGB 2017-2020	22-Nov-17	24-Nov-17	10-Feb-20	CZK 4 bn. max	0.00%
CZGB 2015-2026	22-Nov-17	24-Nov-17	26-Jun-26	CZK 4 bn. max	1.00%
CZGB 2015-2030	22-Nov-17	24-Nov-17	15-May-30	CZK 4 bn. max	0.95%

* FOR T-BILLS, THIS IS MAXIMUM AMOUNT PER PRIMARY DEALER.

THOUGHT OF THE WEEK

"NOW THAT 90-YEAR OLD BUSH SR. IS ACCUSED OF SEXUAL HARASSMENT, IT IS ONLY A QUESTION OF TIME BEFORE MOTHER THERESA IS. "

WEEK AHEAD

CNB meeting is the most important thing locally this week, while flash (3Q17) GDP and preliminary (October) inflation data will be the most important things west of here.

CNB is expected to deliver another 25 bps. hike: this is pretty much certain given the fact that already at the September meeting there were 3 people in favor of the hike and those who weren't had said since then that this time they'd be for.

More importantly than the hike – which is already priced in – is how hawkish a message CNB delivers. The new forecast will be unveiled (which may even have the EURCZK forecast published again). The market, especially the bond one, saw pretty aggressive repricing recently so we may see some correction if what is priced in is not what CNB outlines. Personally, I don't think more hikes are necessary from inflation point of view, but, like FED, CNB will surely say strong growth of economy, wages will have to soon translate into inflation. Hence the new forecast will probably see three hikes for 2018.

In Eurozone, not much of a change expected for inflation, and the GDP growth will probably arrive slightly slower than in 2Q17, but not by too much. In other words, nothing to change the course set last week by ECB (see below).,

WEEK BEHIND

Czech elections' stalemate continues ▶

Draghi recalibrates QE & manages to send euro down at the same time ▶

Eurozone indicators still very optimistic (& optimism still not backed by hard data) ▶

| FX

EURCZK oscillated between 25.60 and 25.70 last week, with no response to ECB meeting.

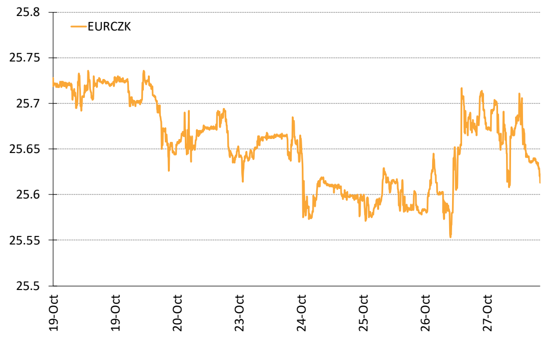
The pair is now apparently waiting for CNB meeting this Thursday which should produce a hike and more hawkish forecast of the interest rate trajectory.

| FI

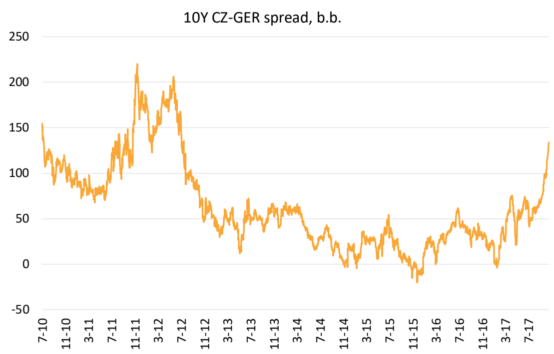
CZ-GB yield spread widened noticeably last week.

Whereas 10Y German yields fell below 40 bps on (market disappointment with) ECB, Czech yields continued to climb higher as markets continued to position themselves for the CNB's hawkish rotation of late. The spread at 10Y is now above 130 bps., highest since July 2012.

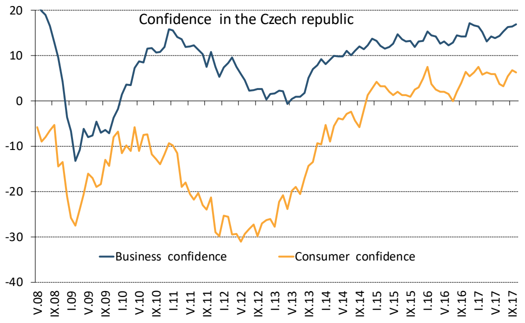
EURCZK TRADING IN A TIGHT RANGE.



CZ AND GER BONDS CONTINUE TO DIVERGE



CONFIDENCE REMAINS HIGH IN THE CZECH ECONOMY



| CZECH ECONOMY

Consumer confidence remains high across both business and consumer sectors.

In the business sector, the confidence is slowly crawling to the post-crisis high (of November 2016), the strengthening of the CZK nonetheless. In the consumer sector, confidence remains close to an all-time high. In other words, the atmosphere is one of pervasive optimism. And this bodes well for the growth and for CNB monetary policy normalization drive.

The week after the elections didn't bring us any closer to new government so ANO's Babis is now contemplating the minority government.

The game of nerves (= the waiting for detractors or split in one of the parties) began. Most of the parties that made it into Parliament don't want to have anything to do with Babis, either because of program incompatibility (Communists) or fear of being decimated / tainted by cooperation with ANO (Social Democrats, Christian Democrats, Civic Democrats, STAN or TOP09 or Pirates). On the other hand, the only party that would want to go to the government with Babis (extremist SPD) is (for now) unacceptable to ANO. Hence the ANO's idea of trying to form the minority government.

The way things look now is that we're unlikely to have proper government for some time – not that that is a bad thing economy-wise... Even if ANO' minority government were to somehow get past the confidence vote, the government resulting therefrom would be inherently unstable. What seems more likely is that at some point there will be a turncoat or two (wouldn't be for the first time in modern Czech history…) that will enable fragile government between Babis & SPD, with the former repeating ad nauseam that it was the obduracy of other – democratic – parties that forced him into such unsavory partnership.

| EUROZONE ECONOMY

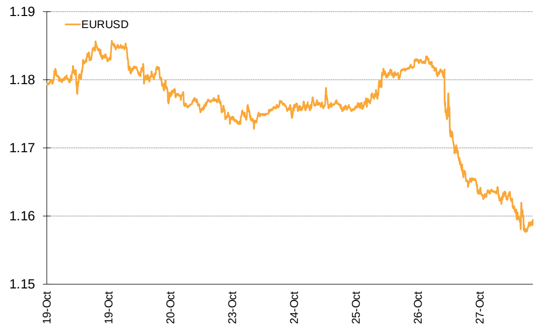
Draghi managed to pull the trick: do what's a cautious move in the hawkish direction and elicit the resoundingly dovish market response.

ECB announced the "downsizing" of the asset-purchase program so that instead of EUR 60 bn. in monthly purchases it will only do half that amount starting in January next year. The reduced purchases of EUR 30 bn. are scheduled to continue until September 2018, at which point the ECB will need to take the decision on how to proceed further with the program. Judging from the market response – slide of EURUSD from over 1.18 before the ECB meeting to below and the fall of German 10Y yields from over 50 bps. to well below 40 bps. – market expected something different. Hawkishly different.

The lack of announcement of proper "tapering", i.e. the keeping of the open-ended nature of the APP (=point at which monthly purchases fall to zero is not given and from press conference it can be inferred that Governing Council (GC) expects APP to run beyond that date), combined with the repeat of 2015 promise to "*reinvest the principal payments from maturing securities purchased under the APP for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary* ", the (renewed) promise to conduct main refinancing operations as full-allotment fixed-rate ones until 2019 and the (repeated) promise to keep rates "*at their present levels for an extended period of time, and well past the horizon of our net asset purchases*" proved clearly more dovish that what the market expected. There was also – and we should add it to the list of measures that guarantee that policy will stay loose for long – the warning that the October announcements are not a one-way street, i.e. that monthly volumes purchased under APP can be increased should need arise.

ECB also announced that beginning November 6,

EURUSD FALLS BELOW 1.16 IN RESPONSE TO ECB MEETING



2017, it will start publishing the expected 12-month-ahead maturity schedule of its asset holdings (which total EUR 2100 bn.), but that is more transparency communication thing than anything else.

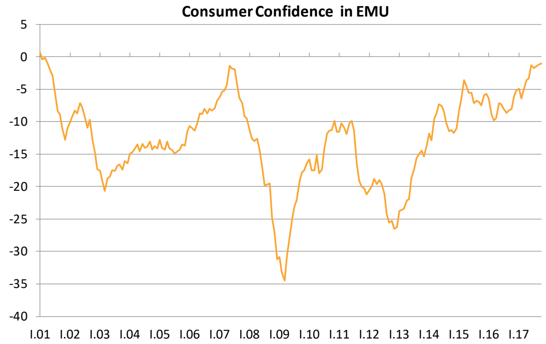
I personally don't think the meeting should've been such a surprise as markets' response indicated: ECB was always going to remove the policy accommodation very slowly, partially out of the recollection of the few premature moves in its recent past (2011 hikes, remember?) and certainly out of the fact that inflation is not moving towards the target (not that FED cares much about the same in US) despite all the growth and jobs having been created.

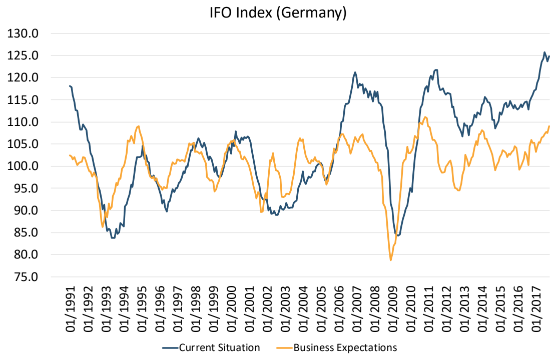
The press conference wasn't very interesting, though my ennui was interrupted when Constantio said "*we are now looking about the stocks, but nothing has been decided yet*". It turned out he was talking about stocks of non-performing loans, not about buying equities… 😉

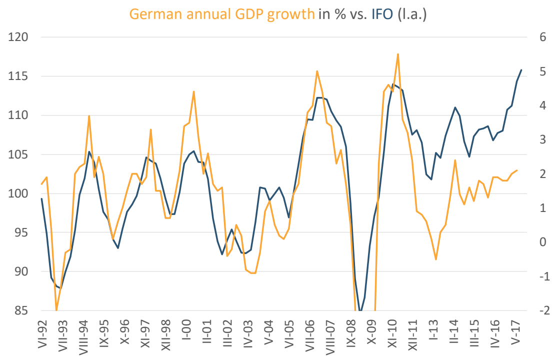
Elsewhere at the presser, Draghi just brushed away the concerns of few journalists that ECB will not have enough assets to buy ("we will buy more corporate debt") and admitted that "some members" would've preferred to put a firm end-date on purchases, though the dissent has been less sharp than at the time when APP was launched. That this Hawkish Opposition (which is rumored to count about 4 countries) is led by Jens Weidmann was clear and in any case confirmed the following day (Friday) when Bundesbank president said the decisions taken the day before by the GC were "*not necessary against the backdrop of the ongoing increasingly broad economic upswing*" and that he thought "*clear ending to the net sales of bonds to the ECB should've been indicated*". North-South split is apparently still in full force.

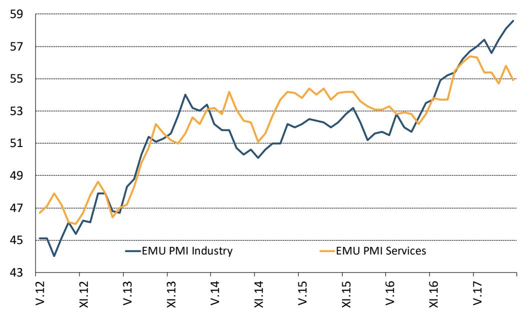
Put together, ECB follows the anticipated course: the ultimate end of QE is not at the horizon, the policy will stay very loose for very long and the hikes are excluded in 2018 and, I think, in 2019 as well.

LEADING AND SOFT INDICATORS CONTINUE TO CALL FOR QUICKER GROWTH AHEAD…







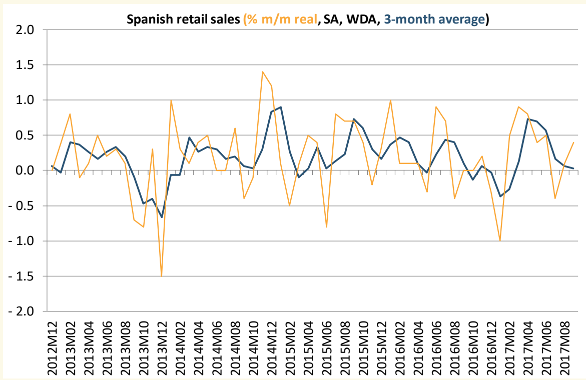


Leading indicators are probably part of why Weidmann is worried about extending the QE.

All of them, as released last week, continue to point in the direction of quicker growth. Consumer confidence climbed to a new 18-year high; IFO's current situation assessment hovers close to the all-time high and its expectations' component is highest since 2010 (the outbreak of the debt crisis). The level of IFO is consistent with German GDP growth of almost double the current rate, i.e. with 5%. Manufacturing PMI also rose in October and service one remains around 55, i.e. solidly in expansion territory.

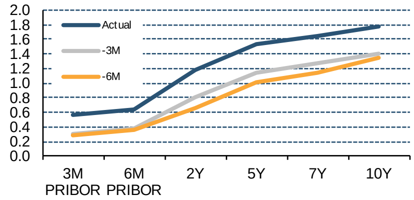
I wouldn't worry about the inflationary implications of the leading indicators, though. First, confidence and IFO have been pointing in the direction of much quicker growth of Eurozone and Germany for some time without such a quickening materializing. Second, hard data so far fail to reflect the strength of the leading indicators: last week's first release of September retail sales (for Spain) still shows no trend towards quicker growth of household consumption. Thirds, there is still a lot of slack in the overall Eurozone economy and, as US experience shows, even the fact that the labor market hit their natural limits isn't guarantee of higher inflation.

…BUT HARD DATA ARE STILL SAYING "NO".

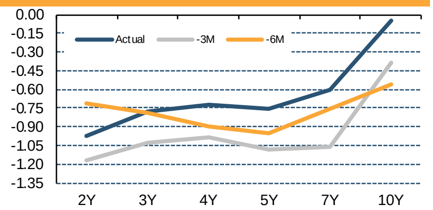


| Markets ‡

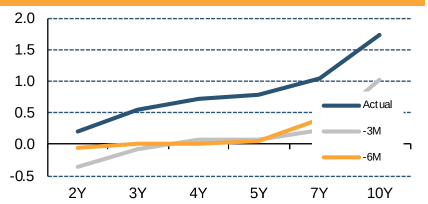
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.560	0.630	1.180	1.525	1.638	1.770
	-1M	0.470	0.530	1.020	1.380	1.473	1.620
	-3M	0.310	0.380	0.806	1.143	1.280	1.406
	-6M	0.290	0.360	0.660	1.005	1.150	1.355



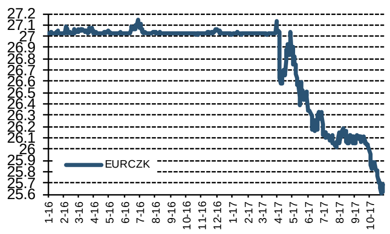
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.975	-0.782	-0.724	-0.752	-0.600	-0.049
	-1M	-1.288	-1.186	-1.165	-1.137	-1.021	-0.334
	-3M	-1.175	-1.033	-0.984	-1.080	-1.063	-0.382
	-6M	-0.710	-0.785	-0.893	-0.956	-0.758	-0.565



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	0.205	0.556	0.720	0.773	1.038	1.721
	-1M	-0.268	-0.005	0.129	0.243	0.452	1.286
	-3M	-0.369	-0.088	0.077	0.063	0.217	1.024
	-6M	-0.050	0.000	0.012	0.049	0.392	0.790



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.618	4.247	310.31	4.609	4.399	1.161
	-1M	26.029	4.313	310.95	4.602	4.199	1.179
	-3M	26.068	4.252	304.69	4.560	4.147	1.175
	-6M	26.838	4.227	312.84	4.539	3.871	1.090



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

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