Weekly | 2017 | Week 47

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Calendar

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Wednesday	22-Nov	16:00	EMU	(Flash) Consumer confidence, Nov'17	-0.9	N/A
Thursday	23-Nov	8:00	GER	(2nd est.) GDP 3Q17, q/q (SA)	0.8%	N/A
	23-Nov	10:00	EMU	(Flash) Manufacturing/Services PMI, Nov'17	58.2/55.2	N/A
	23-Nov	13:30	EMU	ECB account of the MP meeting	N/A	N/A
Friday	24-Nov	9:00	CZ	Business/Consumer confidence, Nov'17	N/A	N/A
	24-Nov	10:00	GER	Ifo Business Climate, Nov'17	116.5	N/A

* 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

" So everyone gets to carry passports except for bankers… ↗ "

WEEK AHEAD

A week of leading indicators and ECB minutes.

In Eurozone, we'll see the mid-quarter report on how optimistic the consumers and companies are – there will be reports from Germany (IFO) and from all of Eurozone (confidence, PMI) and there's no reason to expect any significant deviation from previous months. Market expectation for PMI is almost the same as what the actual number in October was.

A bit less **interesting data release is the 2nd estimate of German GDP growth in 3Q17**. The growth surprised on the upside (0.8% q/q) and we'll see what exactly the reason was, but it is hardly going to be something to move markets. We already have indications from German statistical office that fixed investments and net exports were positive drivers. The only remaining thing is how did the households do - the performance of household demand is what matters for ECB and the monetary policy, rather than investments in machinery and equipment.

Most important event is the release of ECB account of the most important meeting this year. ECB decided on the October 26 meeting to recalibrate the QE, so we'll want to see how much of an opposition there was to such a step and how close we are to actually seeing the monthly purchases eventually fall to zero.

WEEK BEHIND

Import/ producer prices suggest consumer inflation peaked in Czech Republic ▶

Czech economy now growing 14 quarters in a row ▶

German, Italian growth quickened in 3Q17 ▶

Eurozone industry continues to grow at 5% annualized growth rate ▶

10Y bond risk premium climbs above 150 bps. ▶

| FX

EURCZK continued to trade a bit above 25.50, the surprisingly strong 3Q17 GDP release nonetheless.

EURCZK RANGE-BOUND IN 25.50-25.60 RANGE

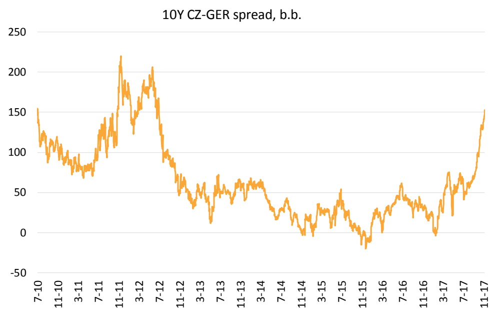
| FI

10Y CZ-GER bond spread climbed above 150 bps. for the first time since July 2012.

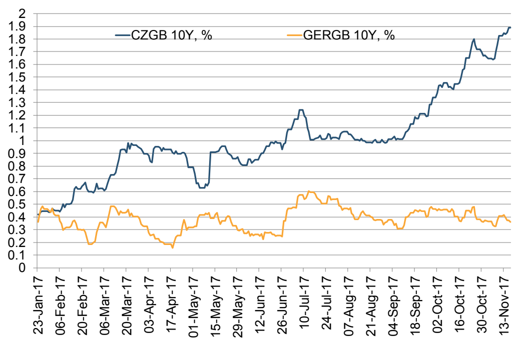
This is the consequence of Czech 10Y yields continuing to climb towards 2% amid market ongoing repricing in expectation of CNB hikes. This was reinforced last week by hawkish statement of CNB Governor who said ↗ last week that he imagined normalization of the policy in two years, where normalization means having real rate of 1%-With inflation target of 2%, he said this means repo rate at 3%. In the same vein, Mojmir Hampl – who at the beginning of the year called for *later* exit from the interventions … - said ↗ he can imagine voting for another 25 bps. hike in December...

I personally think this is way overdone: as explained previously, no way will CNB hike as much to make policy as divergent from that of ECB as is now priced in the market and as Rusnok dreams. I believe yields will be 50-75 bps. lower in 1Q18 than now, as market realizes its expectations were wrong.

10Y SPREAD HITS HIGHEST SINCE JULY 2012…



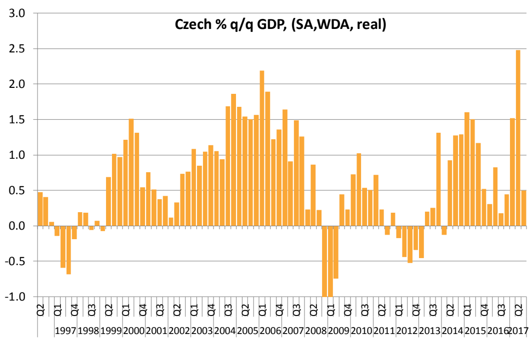
…AS 10Y CZGBS CLIMB TOWARDS 2%.



| CZECH ECONOMY

Czech economy grew further in 3rd quarter, posting the 14th consecutive growth (0.5% q/q, 5% y/y). And this despite high base from 2Q17.

Czech economy posts 14th consecutive growth quarter

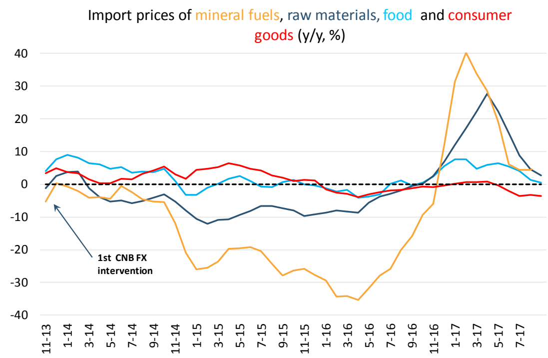


This being the preliminary release, there weren't many details, i.e. no structural data (these will be released on December 1). Statistical office merely said that the growth was due to all components of the aggregate demand, especially the domestic demand of both households and firms. The latter is surprising considering that the growth of fixed investments in 2Q17 was fastest in 20 years – another quarter of growth on top of that is certainly unexpected. Maybe it is (also) the consequence of the fact that labor is hard to find.

The strong growth has implications for monetary policy: although the link between growth and inflation has historically been weak in Czech Republic (and is much weaker globally now than, say, 10 years back), part of CNB will – if it will want to – find justification in the growth data for a hike. **I personally think that the disinflation that will start in November will not let CNB as a whole to tighten the policy, but some will surely call for it.** See recent comments of Rusnok and Hampl.

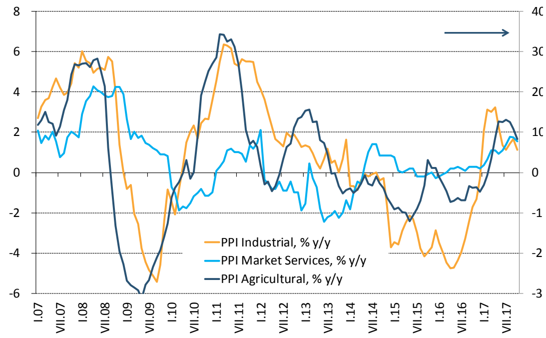
Import prices and producer prices seem to suggest Czech inflation has peaked.

Import prices rose for the first time since February, but only because of 3% monthly gain of import prices of mineral fuels.



September was the first month since February when (overall) import prices didn't fall. Having fallen almost 6 percent cumulatively over March-August, they increased 0.3% m/m in September, primarily because of 3.1% monthly growth of import prices of mineral fuels (i.e., because of oil price). The manufactured consumer goods, the subcomponent of the overall import price index, also stopped falling in September after having done nothing else this year – having fallen by 5% over January through August, they increased in September. However, the fact that 1) this increase was a marginal one (0.2% m/m) and 2) that CZK strengthened, make it likely

PRODUCER PRICES SLOWED IN ALL SECTORS IN SEPTEMBER



that October was another month in which import prices of (at least) consumer goods fell.

Producer prices also indicate the peak of inflation is likely over. All of the components slowed – industrial PPI to 1.1%, agricultural PPI to 8.3% y/y (slowest since March) and market services to 1.6%. Next couple of months might see industrial PPI quicken a bit on oil prices, but agricultural PPI should reflect slowing dynamics of world food prices.

Altogether, the import prices and the producer prices confirm my view that inflation has peaked, and that we are in for a solid disinflation over November-March. The inflation will fall down below 2% and the CNB should think twice whether another hike is necessary.

| EUROZONE ECONOMY

Growth in Italy and Germany quickened in 3Q17.

First estimates released by the respective statistical offices showed that **Germany expanded by 0.8% q/q** in 3Q17 (i.e., almost the 1Q17's rate of 0.9% q/q), faster than the 2Q17 growth of 0.6% q/q and also above expectations of the same growth. The annual growth rate climbed to 2.8% from the 2.3% in 2Q17. This is closer to what IFO suggest the German growth should be, but still well below: IFO is at levels that have historically been associated with almost 5% y/y growth.

Structure wasn't released yet, but German statistical office said investments (especially in machinery and equipment) and net exports were the reason behind the increase. This is another indication that the same may have driven the 3Q17 growth in the Czech Republic as well.

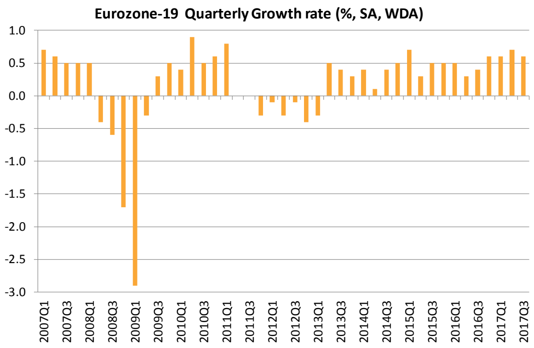
In Italy, the growth also quickened to 0.5% q/q (1.8% y/y), bringing the current growth string to 13 quarters in a row. No structural data were released and no indication was given.

With Italy and Germany out now, the Eurozone 2nd estimate, released last week as well, reaffirmed 0.6% q/q growth in 3Q17. Again, no structure at this point, though French and German data indicate that fixed investments were important in 3Q17, and that net exports may have been too.

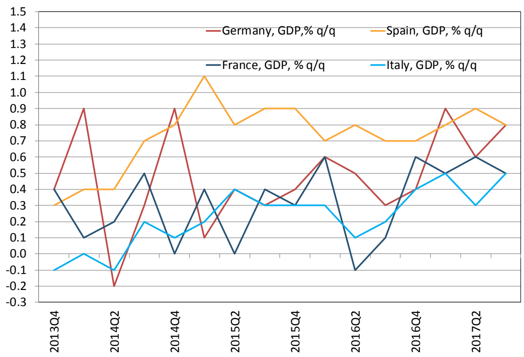
After all, it would be consistent with Eurozone industry dynamics in 3Q17.

The growth of industrial production remained very good at its end, with annualized growth close to 5% in last three months ending in September. Not only that, but the annualized dynamics has been close to 5% in three months ending in August, July or June, so no one-off. This is a reflection of strong growth of fixed investments and probably also of strong external demand.

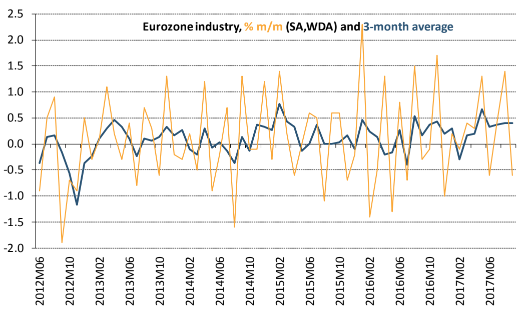
EUROZONE GROWTH A BIT WEAKER IN 3Q17 AGAINST 2Q17



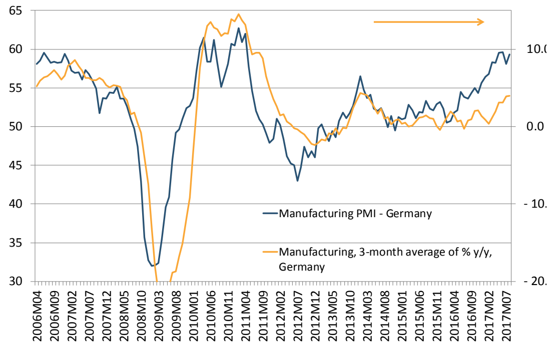
BIG ECONOMIES CONTINUE TO PERFORM WELL



EUROZONE INDUSTRY AT 5% ANNUALIZED GROWTH RATE SINCE JUNE…



..AND THAT WHILE GERMAN INDUSTRY LAGS PMI.

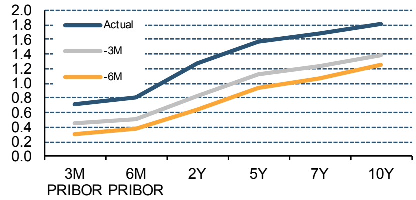


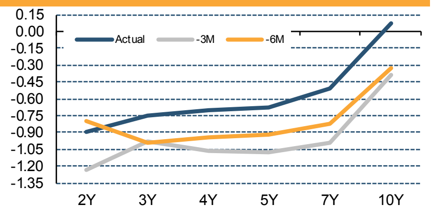
Looking at the individual countries, growth of industry in Italy and France is more or less in line with PMI whereas German industry lags the PMI which points at around 7-8% annual growth rate (and the divergence persisted for some time now).

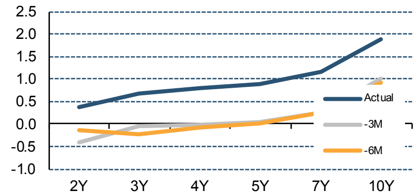
Looking forward – and although I don't see German industry quickening as much as the gap between PMI and growth suggest it should – high overall PMI, solid growth of world economy, strong growth of domestic demand (and the base effect that will soon set in) make it almost certain that **we will soon see growth rates for the entire Eurozone around 4.5-5% in 1Q18.**

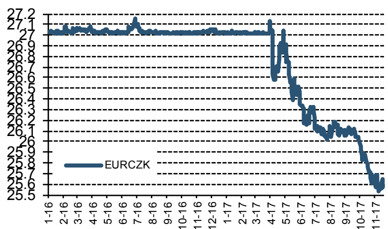
| MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	**Actual**	0.720	0.810	1.270	1.575	1.682	1.815
	-1M	0.510	0.570	1.075	1.395	1.499	1.625
	-3M	0.460	0.500	0.829	1.125	1.240	1.385
	-6M	0.300	0.370	0.645	0.945	1.075	1.245
ASW spread*		**2Y**	**3Y**	**4Y**	**5Y**	**7Y**	**10Y**
bps.	**Actual**	-0.901	-0.749	-0.705	-0.677	-0.513	0.076
	-1M	-1.059	-0.809	-0.852	-0.857	-0.733	-0.129
	-3M	-1.230	-0.984	-1.063	-1.083	-0.990	-0.387
	-6M	-0.798	-0.999	-0.945	-0.925	-0.828	-0.326
CZGB**		**2Y**	**3Y**	**4Y**	**5Y**	**7Y**	**10Y**
%	**Actual**	0.369	0.660	0.797	0.898	1.169	1.891
	-1M	0.016	0.414	0.469	0.538	0.766	1.496
	-3M	-0.401	-0.041	-0.020	0.042	0.250	0.998
	-6M	-0.153	-0.229	-0.080	0.020	0.247	0.919
FX		**EURCZK**	**EURPLN**	**EURHUF**	**EURRON**	**EURTRY**	**EURUSD**
	Actual	25.595	4.237	311.86	4.642	4.574	1.179
	-1M	25.758	4.236	308.02	4.584	4.315	1.177
	-3M	26.069	4.273	304.00	4.584	4.137	1.172
	-6M	26.497	4.191	308.98	4.569	3.987	1.116









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

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