

December 03 | 2018

Weekly | 2018 | Week 48

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS*	42FS
Monday	3-Dec-18	9:30	CZ	(Final) manufacturing PMI, Nov18	52.0	N/A
	3-Dec-18	10:00	EMU	(Final) manufacturing PMI, Nov18	51.5	N/A
	3-Dec-18	14:00	EMU	Budget Balance, Nov18	N/A	N/A
Tuesday	4-Dec-18	9:00	CZ	Average real monthly wage, 3Q18, y/y	5.8%	5.5%
Wednesday	5-Dec-18	10:00	EMU	(Final) services PMI, Nov18	53.1	N/A
	5-Dec-18	11:00	EMU	Retail sales, Oct'18, y/y	2.0%	N/A
Thursday	6-Dec-18	8:00	GER	Industrial orders, Oct'18, y/y (WDA)	-3.1%	N/A
	6-Dec-18	9:00	CZ	Retail sales, Oct'18, y/y	2.7%	2.5%
	6-Dec-18	8:00	GER	Industrial production, Oct'18, y/y (WDA)	2.1%	N/A
Friday	7-Dec-18	9:00	CZ	Industrial production, Oct'18, y/y (WDA)	5.4%	3.4%
	7-Dec-18	9:00	CZ	Trade Balance, Oct'18, CZK bn.	9.00	7.4
	7-Dec-18	11:00	EMU	(Final) 3Q18 GDP, q/q	0.20%	N/A

* LOCAL TIME IS CET

** (REUTERS/ BLOOMBERG) POLL

DECEMBER 2018 AUCTIONS

NAME	DATE OF AUCTION	DATE OF ISSUE	MATURES ON	AMOUNT OFFERED*	COUPON
SPP 803***	20-Dec-18	21-Dec-18	4.1.19-21.6.19	CZK 5 bn. max	N/A
SPP 804***	27-Dec-18	28-Dec-18	4.1.19-21.6.19	CZK 5 bn. max	N/A

* 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.

*** DEPENDING ON HOW 2018 BUDGET TURNS OUT.

THOUGHT OF THE WEEK

“SO, IF BABIS STRANGLES HIS SON, HIS POLLS GO TO 40% ↗?”

WEEK AHEAD

Data-heavy week both here, and in Eurozone.

Local monthly data for October – industry, retail, trade balance – will offer the first hints as to how the economy was doing at the beginning of this year's last quarter. And November PMI will show what to expect from economy's major component, the industry, in the remainder of this year.

In Eurozone, German industrial data are among the most awaited, even more than the structure of 3Q18 GDP for the whole Eurozone. This is understandable: the latter can very accurately be deduced from structural data on big economies that were released previously, the former cannot (or can, from PMI, but only imperfectly). **Retail sales** will show that demand of households remained weak at the beginning of 4Q and thus that faster Eurozone inflation that ECB's been forecasting for a year or so is still nowhere in the offing.

WEEK BEHIND

Czech 3Q18 growth propped by government spending and, to a lesser extent, by household demand ▶

This will change as Czech consumer confidence plummeted in November ▶

Eurozone inflation remains non-existent... ▶

...and leading indicators continue to worsen ▶

| FX

EURCZK returned to 26,...

...higher-than-previously-expected GDP growth in 3Q18 nonetheless. The reluctance of CZK to strengthen may at least partially be due to the fact that Resolution fund fees on CZK deposits, forwards etc. are now close (assessed on the base of balance sheet of banks as of December 31)> After all, see how EURCZK rose in December 2017 all the way to 26. In other words, we will not see stronger CZK this month.

| FI

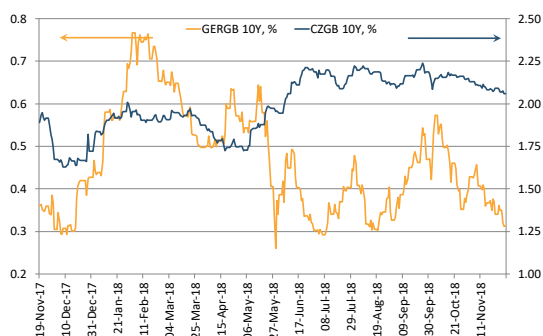
German yields continued to drift lower.

Weaker soft indicators, low preliminary November core inflation pushed German 10Y to almost 30 bps., level unseen since the end of August. Czech 10Y yields continued their slow-motion drift towards 2%.

EURCZK RETURNS TO 26

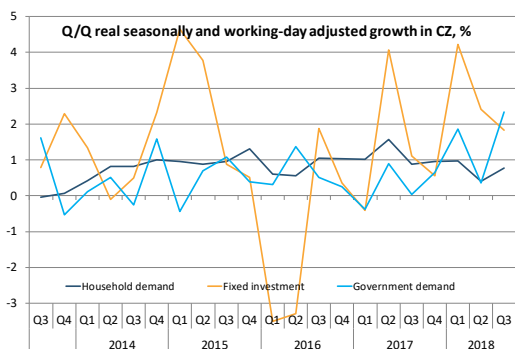


BUND YIELDS CONTINUE TO MOVE LOWER

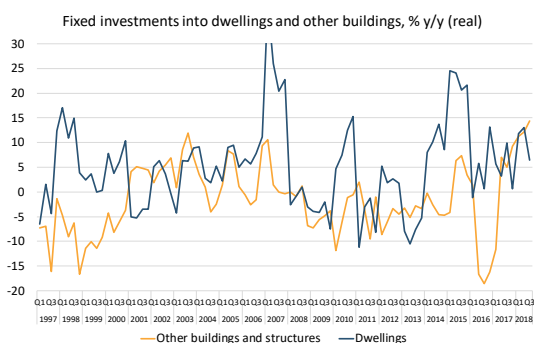


CZECH ECONOMY

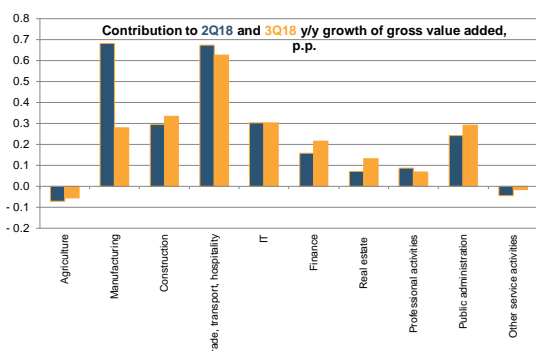
CZECH GROWTH IN 3Q18 PROPPED BY GOVERNMENT SPENDING, BOTH IN CONSUMPTION...



...AND IN FIXED INVESTMENTS, MAINLY INFRASTRUCTURE CONSTRUCTION.



MANUFACTURING A WEAKEST CONTRIBUTOR TO GROWTH SINCE END OF 2013



Czech economy seems, on the surface, to be ignoring the cold from the West. But that is mainly due to the generosity (=imprudence) of the government.

That is what the structural 3Q18 GDP data Czech statistical office released last week suggest.

On the surface, things are bright: whereas the first estimate couple of weeks back had the economy grow at the 0.4% quarterly rate, the 2nd estimate pushed the quarterly growth 0.2 pp up to 0.6% q/q. That looks like all couldn't be better. Except

a) part of the improvement of 3Q18 growth against the 1st estimate is due to downward changes in the previous quarters (y/y growth from 1st estimate, 2.3%, was only increased by 0.1 pp in the 2nd estimate), growth still lags b) the forecast of CNB and MinFin and c) growth seen in neighboring countries (page 3 here ↗).

Structure-wise, on the **supply side**, after many quarters the contribution of something else but the manufacturing was the largest driver of growth. Whereas in 2Q18 manufacturing added 0.7 pp to annual growth, it – probably squeaking under the WLTP tests that stopped production of some cars – added less than half of that (=0.3 pp) in 3Q18, making the manufacturing's contribution smallest since 4Q13 (and order-of-magnitude smaller than 3.5 pp contribution seen in 3Q17). Trade and transport (plus hospitality) was thus the largest contributor to value added in third quarter. The overall industry contributed 0.5 pp, chiefly due to relatively strong production of energy, and because of construction.

On the **demand side**, quarterly expansion was primarily due to strongest q/q growth (2.3%) of government demand since 1Q13, hardly something that we should be proud of or call sustainable. The y/y growth of government demand is 5.3% (!). **Household demand** grew further, at 0.8% q/q, strong but under 1% q/q rates that we regularly saw

between mid-2014 and end of 2017. **Fixed investments grew strongly further**, with q/q expansion of 1.8% coming after 4.2% and 2.4% quarterly increases in first two quarters of 2018. This was again primarily due to government spending on infrastructure construction, as can be seen in the annual growth of investments into structures *other than intended for dwelling* which rose to all-time high of 14.4% (real).

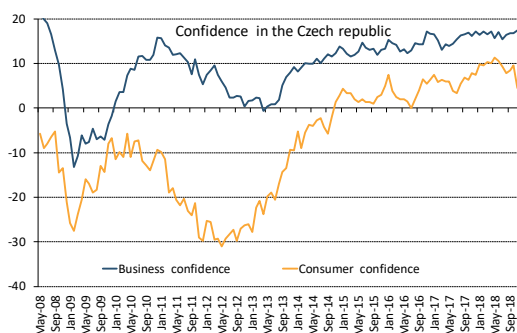
To sum, while headline growth number may suggest that all's fine, digging deeper in the structure and seeing the primacy of government spending in the 3Q18 growth reveals a growth that is weaker and more fragile than what headline might lead one to conclude.

And that is before household demand, that resilient pillar of growth in last years, slows ...

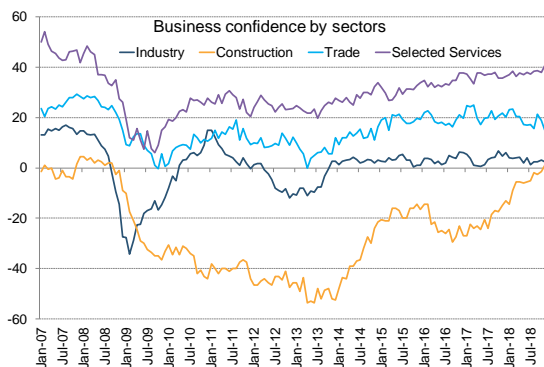
... as consumer confidence seems to suggest it soon will. In November, **confidence plummeted to 4.5 pts., lowest since July 2017**. This fall was due to the fact that the worries that the *general* economic situation will worsen in next year increased markedly among the consumers (even if, strangely but perhaps expectedly, intention to save remained almost unchanged as did worries about worsening of *individual* financial situation of the respondents).

In business, the confidence, on the other hand, improved to the best (17.4 pts.) since July 2008. This, however, is only due to construction while confidence in trade fell to lowest since March 2015. That construction is so optimistic is reflection of both real estate boom and of government infrastructure spending.

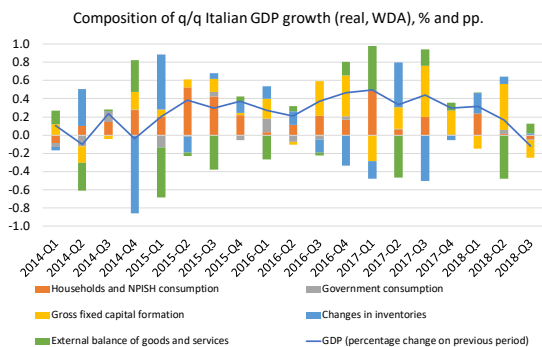
CONSUMER CONFIDENCE FALLS TO LOWEST SINCE SUMMER 2017,...



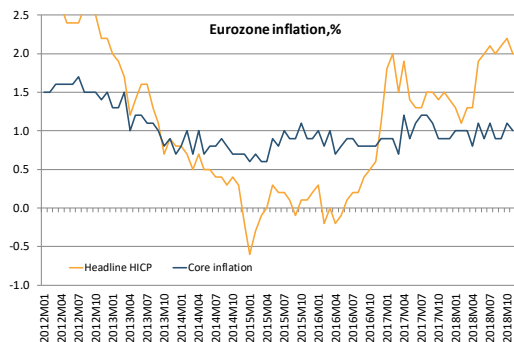
...WHILE BUSINESS CONFIDENCE IS HELD UP ONLY BY BOOMING CONSTRUCTION



ITALIAN Q/Q GROWTH NEGATIVE IN 3Q18



EUROZONE CORE INFLATION STILL WITHOUT TREND.



EUROZONE ECONOMY

Italian 3Q18 GDP was weakest since 2Q14, with 2nd estimate having lowered the quarterly growth further from 0% to -0.1%.

Italian is a remarkable slowdown: year ago, economy grew 0.4% q/q and as recently as 1Q18 it grew 0.3% q/q. Structure-wise, only net export was the positive contributor to q/q growth (0.1 pp), everything else was a drag on growth. For household demand, this was the first negative contribution (-0.05 pp) to quarterly growth since 1Q14 (-0.09 pp). No wonder Italians are pissed off.

The annual growth was just 0.7%, weakest of all big economies in the Eurozone. Little wonder, then, that Italian politics remains chaotic amid conflict between Rome and Brussels, and that...

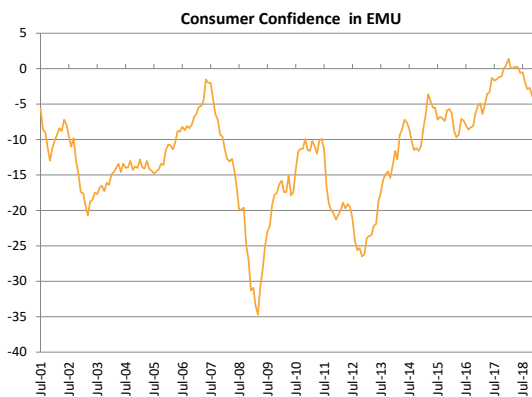
...Italian inflationary pressures are non-existent. As, however, are the Eurozone ones.

Italian November headline HICP inflation remained almost unchanged at 1.7% (vs. 1.6% in October). Although core HICP inflation wasn't released just yet, it probably only rose marginally as non-harmonized (=non-HICP) inflation that was released increased from 0.7% in October to 0.9% in November. It is thus safe to predict that Italian core HICP inflation likely remained lowest of 4 big Eurozone economies: the core HICP inflation was 0.5% in October, so rise of non-HICP inflation in November suggests there was small rise of HICP inflation as well (likely to 0.6%).

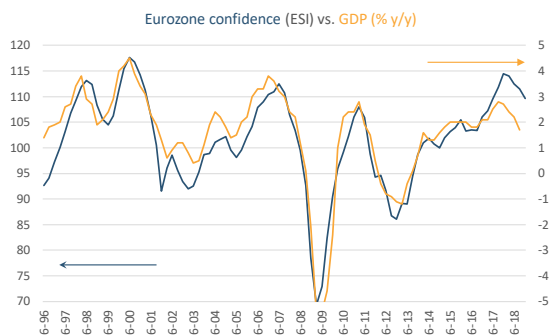
Eurozone core inflation decreased back to 1%, meaning it hasn't been outside the range of 0.8-1.1% since September 2017. Headline inflation fell to 2%, reflecting the slower growth of energy prices (9.1% y/y vs. 10.7% in October). Considering the decline of oil prices in November, energy prices will decelerate rapidly in December, taking the headline lower.

To sum: there is still no sign of inflation actually

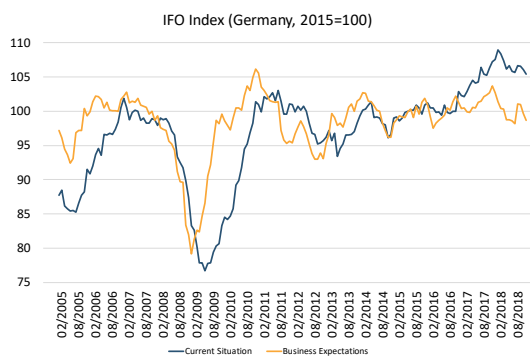
CONSUMER CONFIDENCE LOWEST SINCE APRIL 2017,...



...DRAGGING THE OVERALL SENTIMENT TO LOWEST IN 5 QUARTERS.



IFO CONTINUES TO WORSEN, THOUGH ONLY SLOWLY



converging sustainably to ECB target, as has been promised by the central bank repeatedly over (at least) last year. And with oil prices down and economic momentum weakened, it is hard to see how inflation will climb to 2% in a sustainable manner in the foreseeable future.

Eurozone leading indicators certainly don't suggest quicker growth is ahead.

The decline of consumer confidence to lowest (-3.9 pts) since March 2017 took the overall Economic Sentiment Indicator (ESI) to lowest (109.5) in 5 quarters. Although the consumer confidence hasn't shown any link to retail sales in last years and although ESI has overestimated the growth in last year and a half, their trendlines speak clearly: economy isn't returning to 2017 growth any time soon.

German IFO is also worsening, though only slightly so: the assessment of the current situation is weaker than at any time since September of 2017 and the business expectations are, after the precipitous decline in November (to 98.7) back at July level. Combined with PMI, it doesn't look like a quick comeback of German economy is in making.

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MARKETS ‡

MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y	
%	Actual	2.020	2.080	2.348	2.415	2.388	2.368	
	-1M	1.820	1.910	2.365	2.540	2.515	2.500	
	-3M	1.500	1.600	2.045	2.218	2.246	2.290	
	-6M	0.910	0.990	1.350	1.718	1.785	1.878	
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y	
bps.	Actual	-0.750	-0.789	-0.731	-0.622	-0.423	-0.307	
	-1M	-0.840	-0.810	-0.791	-0.683	-0.459	-0.352	
	-3M	-0.726	-0.814	-0.700	-0.527	-0.274	-0.174	
	-6M	-0.470	-0.558	-0.431	-0.331	-0.084	0.069	
CZGB**		2Y	3Y	4Y	5Y	7Y	10Y	
%	Actual	1.598	1.611	1.684	1.793	1.965	2.061	
	-1M	1.525	1.657	1.727	1.857	2.056	2.148	
	-3M	1.319	1.320	1.483	1.691	1.972	2.116	
	-6M	0.880	0.959	1.194	1.387	1.701	1.946	
FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD	
	Actual	25.964	4.292	323.61	4.654	5.902	1.132	
	-1M	25.844	4.327	322.82	4.663	6.298	1.141	
	-3M	25.763	4.304	326.60	4.635	7.602	1.160	
	-6M	25.796	4.304	320.02	4.664	5.428	1.166	

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

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