Weekly | 2017 | Week 48

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Tuesday	28-Nov	9:00	SPA	Retail sales, Oct'17, y/y (SA)	2.2%	N/A
Wednesday	29-Nov	8:45	FRA	(2nd est.) GDP 3Q17, q/q (SA)	0.5%	N/A
	29-Nov	9:00	SPA	(Flash) HICP, Nov17, y/y	1.9%	N/A
	29-Nov	11:00	EMU	(Final) Business Climate Indicator, Nov17	114.6	N/A
	29-Nov	14:00	GER	(Flash) HICP, Nov17, y/y	1.7%	N/A
Thursday	30-Nov	8:45	FRA	(Flash) HICP, Nov17, y/y	1.2%	N/A
	30-Nov	9:00	SPA	(Final) GDP 3Q17, q/q (SA)	0.8%	N/A
	30-Nov	11:00	EMU	Unemployment rate, Nov17	8.9%	N/A
	30-Nov	11:00	ITA	(Flash) HICP, Nov17, y/y	1.2%	N/A
	30-Nov	11:00	EMU	(Flash) HICP (headline/core), Nov17, y/y	1.6%/1%	N/A
Friday	1-Dec	9:00	CZ	(2nd est.) GDP 3Q17, q/q (SA)	0.5%	0.4%
	1-Dec	9:30	CZ	Manufacturing PMI, Nov17	58.2	N/A
	1-Dec	10:00	ITA	(Final) GDP 3Q17, q/q (SA)	0.5%	N/A
	1-Dec	10:00	EMU	(Final) manufacturing PMI, Nov17	60.0	N/A
	1-Dec	14:00	CZ	Budget Balance, Nov17, CZK bn.	N/A	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 ARE SMARTPHONES BEHIND WEAK PRODUCTIVITY GROWTH OF LATE? ↗ "

WEEK AHEAD

Czech statistical office will release the structure of the 3Q17 GDP growth data.

That is the most important release this week – the growth of 0.5% q/q was rather surprising, coming after the unprecedented 2.5% q/q growth in 2Q17, so the question is what drove it. Considering that investments rose 6% q/q in 2Q17, it is almost certain that investments must have grown in 3Q17 as well.

The other important release is the **manufacturing PMI** – with Eurozone one ► hitting second highest in entire PMI history in November, Czech PMI probably also improved.

In Eurozone, November preliminary inflation is the most important release, though no big change is expected against October: core inflation is expected to have remained at 1% in November, i.e. still well levels where ECB could say "yes, now is the inflation self-sustaining". **Structure of Spanish GDP is another interesting release**, but only from analytical point of view – even if demand of households is shown to have been the primary driver of growth (it wasn't in Germany or France), it still wouldn't mean much from inflation outlook perspective: Spanish unemployment being double-digit isn't consistent with high inflation in Spain any time soon.

WEEK BEHIND

Confidence high in Czech Republic ▶

4Q17 shaping up to be strongest this year in Eurozone ▶

German 3Q17 growth driven by inventories, exports, not household demand ▶

ECB minutes a disappointingly bland reading ▶

FED looks set to hike in December despite low inflation ▶

| FX

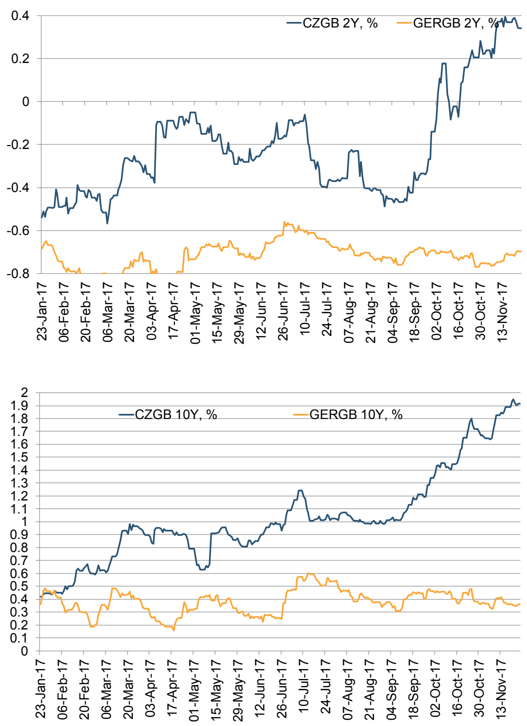
EURCZK strengthened below 25.50 and towards 25.40, although this appears to have been just a technical move, with no new data or central bankers' comments.

| FI

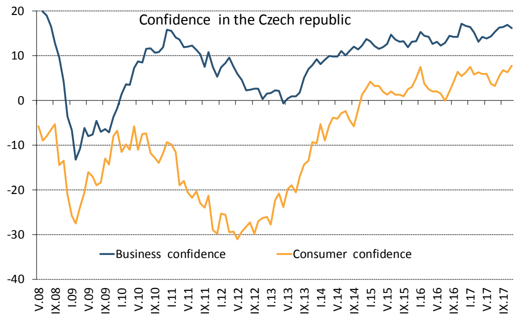
Bond markets were calm both here and in Germany.

EURCZK FALLS TOWARDS 25.40

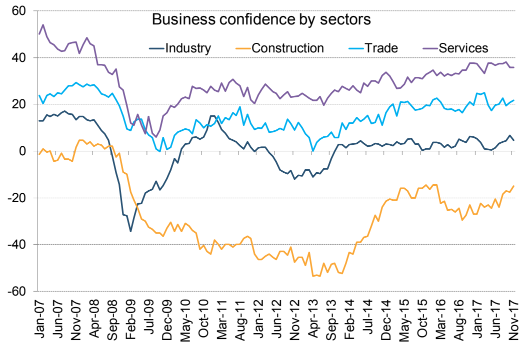
BOND MARKET TAKES A REST



CONFIDENCE REMAINS HIGH…



…THOUGH ONE IN INDUSTRY AND SERVICES COULD BE HIGHER, GIVEN CIRCUMSTANCES.



| CZECH ECONOMY

Czech confidence data didn't change much in November…

…confirming that the agents in the economy, both on the business side and on the consumer side, remain very optimistic. That said, one could argue that business confidence, esp. in services and in industry, should be higher. More so in light of recent consumer confidence and high manufacturing PMI releases.

| EUROZONE ECONOMY & FED

4Q17 is shaping up to be the best Eurozone quarter this year, November soft indicators suggest.

Eurozone consumer confidence index entered the positive territory – for the first time since very early in 2001! And if you plot it against the historical GDP growth, it predicts the rate of around 4% y/y (from 2.5% y/y in 3Q17). Even taking into account the fact that confidence has been over-predicting the growth for a year now, that next couple of quarters will be fastest since 2010 is very likely.

The same follows from other November indicators: PMI and German IFO.

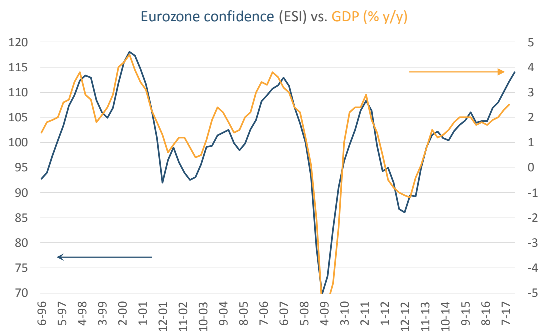
Eurozone composite PMI rose to highest (57.5) since April 2011, primarily because of the second highest reading (60) in manufacturing in PMI history (the highest having been in April 2000). All of the components rose, suggesting economy is growing strongly: the backlogs of orders rose to highest since summer 2006, the hiring to highest since Fall 2000 etc. What ECB will like to hear is that the output prices rose at the highest rate since June 2011 (though there is not that much of a correlation between HICP and output price index of PMI). German IFO also remained historically very high in November, and expectations' component thereof rose to highest since December 2010.

All in all, ECB should be pleased – but unless it really starts seeing demand inflation picking up (which won't happen sooner than unemployment rate falls another 2.5 pp), the tighter policy is off the table.

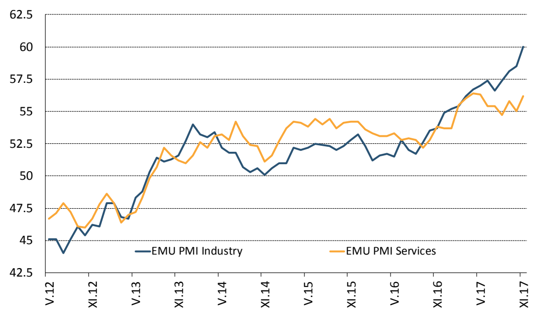
If PMI was music to ECB's ears, structure of 3Q17 German GDP growth was not.

The data released last week showed the 0.8% quarterly growth was driven by equal contribution (0.4 pp) of net exports and inventories whereas the contributions of the main components of the domestic demand – that of fixed investments and

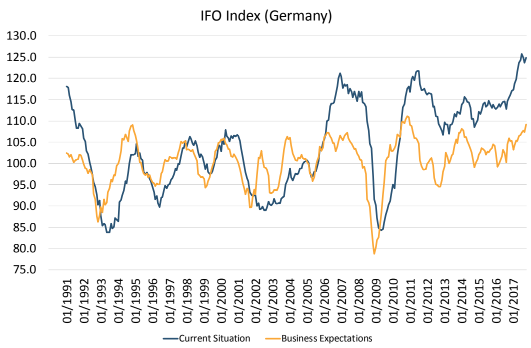
CONSUMER CONFIDENCE POINTS AT FASTER GROWTH AHEAD IN EUROZONE



THE SAME MESSAGE IS SENT BY PMI OR…



…GERMAN IFO



household demand – were small and offsetting each other.

What this shows is that even if you have unemployment rate that is second lowest in Europe (after us), the domestic demand and thus the demand inflation may not automatically and/or quickly follow: German core inflation has been without trend around 1% for long period of time, the very tight labor market nonetheless.

And, it also shows that – whatever the central banks' model-based obsession is – the exports (which contributed 0.8 pp to quarterly growth of GDP in 3Q17) don't really care much about currency strength.

Put together: I don't see any reasons to change my view that – all the quickening od growth nonetheless – ECB will not tighten for a long time. Not until late 2019.

For how important the last ECB meeting was, the account ↗ of it, released last week, was a disappointingly bland reading.

Not much new did we learn. Minutes just confirmed that ECB is more optimistic about future, that growth is strengthening, but that this has so far failed to translate into a meaningful quickening of the inflation rate. Therefore, the asset purchase program cannot yet be terminated ("*progress towards the inflation aim continues to require a substantial degree of monetary policy accommodation*") but doesn't need to continue at EUR 60 bn. monthly rate (*"extension of the net asset purchases at a monthly pace of €30 billion until the end of September 2018…reflects growing confidence in the gradual convergence of inflation towards the ECB's aim"*). Hence the decision to halve the purchase rate and extend the program until September 2018.

There apparently was some discussion ("few members argued…") about announcing the clear end date for APP but minutes are silent on how were the arguments of the proponents of this view (progress on inflation front having being sufficient, impact of such announcement not expected to surprise markets, economic expansion robust enough to cope with such announcement, deflation risks unlikely to emerge etc.) disposed of. So, clearly, the majority just outvoted the dissenters - as many times in last few years.

Minutes ↗ from the most recent FOMC meeting revealed that – although puzzled by the low inflation – most of the FOMC members want to press ahead with the third hike in December.

FED is facing the dilemma just like ECB or CNB, only in the more acute form – because the recovery there is the most advanced one.

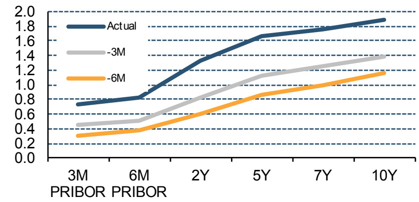
The labor market is at full strength or beyond it, the economy has been growing for a long time - but the (core PCE) inflation has been very low, trending towards 1% in recent months. And so while "*many participants judged that much of the recent softness in core inflation reflected temporary or idiosyncratic factors and that inflation would begin to rise once the influence of these factors began to wane*", many also said that "*there was some likelihood that inflation might remain below 2 percent for longer than they currently expected.*" Many also expressed concerns that the longer the inflation remains below the target, the bigger the chance of fall in the long-term inflation expectations, making reaching inflation target sustainably in the long run more difficult.

That said, the reservations and uneasiness about soggy inflation will not prevent most of them from hiking in December: only *„few participants thought that additional policy firming should be deferred until incoming information confirmed that inflation was clearly on a path toward the Committee's symmetric 2 percent objective.*" and only "*few participants cautioned that further hikes while inflation remained persistently below 2 percent could unduly depress inflation expectations or lead the public to question the Committee's commitment to its longer-run inflation objective.*"
Hence, come December, the FOMC will have delivered on its promise from last year: three hikes in 2017. Though if decision-making were to be dictated by inflation-growth outlook only (as it

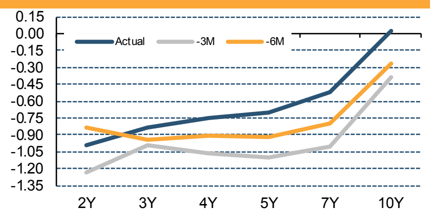
should), it would have delivered one, at most. Especially considering the symmetricity of the FOMC target (2.5% inflation being as good as 1.5%).

| Markets ‡

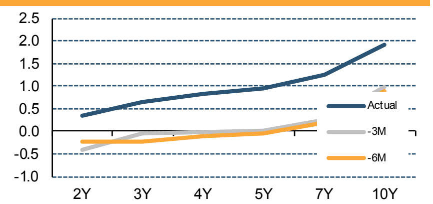
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.740	0.820	1.330	1.660	1.761	1.890
	-1M	0.540	0.610	1.190	1.540	1.653	1.785
	-3M	0.460	0.510	0.826	1.120	1.250	1.380
	-6M	0.300	0.380	0.603	0.870	0.995	1.153



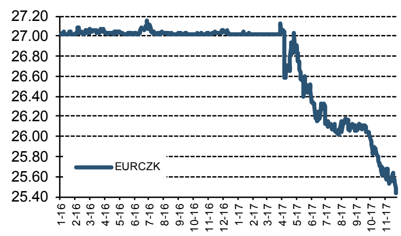
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.990	-0.835	-0.756	-0.699	-0.525	0.027
	-1M	-0.951	-0.734	-0.690	-0.708	-0.551	0.015
	-3M	-1.237	-0.992	-1.070	-1.096	-1.004	-0.391
	-6M	-0.842	-0.947	-0.905	-0.923	-0.802	-0.270



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	0.340	0.649	0.830	0.961	1.236	1.917
	-1M	0.239	0.616	0.768	0.832	1.102	1.800
	-3M	-0.411	-0.041	-0.022	0.024	0.246	0.989
	-6M	-0.239	-0.234	-0.107	-0.053	0.193	0.883



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.450	4.209	312.06	4.639	4.721	1.193
	-1M	25.604	4.239	310.08	4.599	4.452	1.181
	-3M	26.097	4.256	304.45	4.598	4.101	1.192
	-6M	26.445	4.176	307.35	4.552	4.003	1.121



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

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