Weekly | 2018 | Week 49

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Calendar

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	10-Dec-18	9:00	CZ	CPI, Nov18, y/y	2.0%	1.9%
	10-Dec-18	10:00	ITA	Industrial production, Oct'18, y/y (WDA)	1.0%	N/A
Wednesday	12-Dec-18	11:00	EMU	Industrial production, Oct'18, y/y (WDA)	0.8%	N/A
Thursday	13-Dec-18	8:00	GER	(Final) HICP, Nov18, y/y	2.2%	N/A
	13-Dec-18	8:45	FRA	(Final) HICP, Nov18, y/y	2.2%	N/A
	13-Dec-18	13:45	EMU	ECB rate-setting meeting	no change	no change
Friday	14-Dec-18	9:00	SPA	(Final) HICP, Nov18, y/y	1.7%	N/A
	14-Dec-18	9:30	EMU	(Preliminary) Services PMI,Dec '18	52.80	N/A
	14-Dec-18	10:00	EMU	(Preliminary) Manufacturing PMI,Dec '18	51.80	N/A
	14-Dec-18	11:00	ITA	(Final) HICP, Nov18, y/y	1.7%	N/A
	14-Dec-18	10:00	CZ	Current Account, Oct'18, CZK bn.	11.0	10.0

* 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

"The number of resignations from May's cabinet in last 6 month is higher than number of resignations in Italy in last decade…Just sayin'…"

WEEK AHEAD

ECB meeting and vote in the Commons on Brexit withdrawal agreement are the most important events this week.

Although it is unreasonable to expect that ECB would backtrack on its summer decision to discontinue the QE at the end of this month, to expect that ECB will soften its confidence that inflation is "converging sustainably" to the target is, on the contrary, – and in light of recent weak inflation, growth data -entirely reasonable.

On Friday, preliminary PMI data from Eurozone manufacturing and service sector will be released. I don't expect any meaningful improvement on November data.

On Tuesday, British Parliament votes on Withdrawal agreement ↗. Expect negative result and FX volatility.

WEEK BEHIND

Czech households still keep wallets open, but will this last?

Industry begins 4Q18 on a weak note

Czech government continues to spend as if recessions were outlawed

Eurozone 3Q18 GDP growth dragged down by net exports, weak household demand

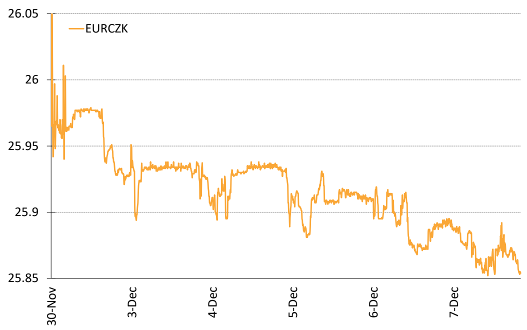
…and the latter doesn't seem to be much of a booster in 4Q18 either

| FX

EURCZK fell about 0.1 CZK to 25.85.

I don't know what caused this, but I don't think it was due to data releases: EURCZK almost never responds to Czech data and, moreover, the strengthening of CZK vs. EUR was gradual and uniform throughout last week, not sudden as would be the case if exchange rate responded to a release.

EURCZK DECLINES TO 25.85



| FI

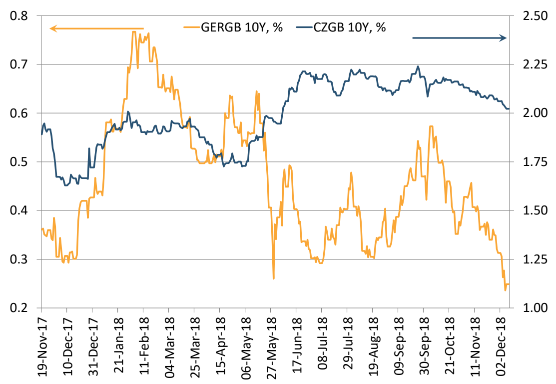
German yields fell to a 6-month low…

…clearly a consequence of flight to quality among the investors spooked by renewed equity sell-off (the fall of oil prices also didn't help, portending as it does the downward pressure on the Eurozone inflation in the coming months).

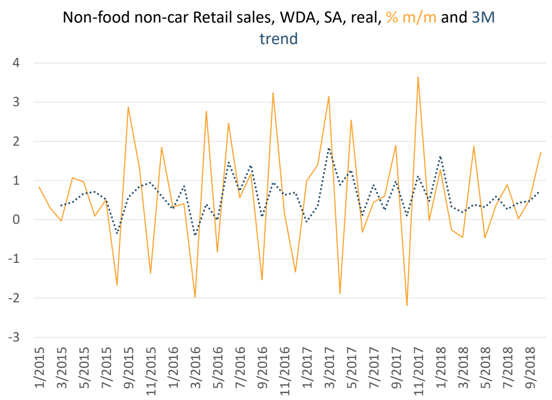
French yields also fell while Italian ones rose: another demonstration of which government assets market views as safe and which as risky ones.

Czech yields slipped to within basis points of 2%.

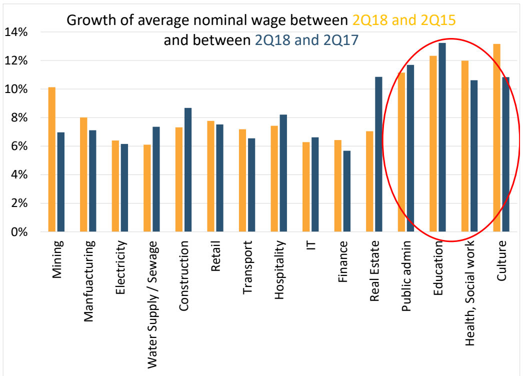
BUND YIELDS CONTINUE TO MOVE LOWER



THE MONTHLY DYNAMICS OF RETAIL IMPROVED IN LAST TWO MONTHS.



WAGES CONTINUE TO GROW STRONGLY, MAINLY IN THE PUBLIC SECTOR



| CZECH ECONOMY

Czech households continue to spend as wage growth continues and inflation remains in check.

Core retail sales (no cars, no food, no fuel) grew 1.7% m/m in October, fastest monthly gain since April (1.9%), translating into annual growth of 9.4%, fastest annual rate since January 2018 (10.4%). Since monthly rates tend to be volatile, I tend to look at three-month averages: and here, the quickening of growth is evident, with 3-month average of 0.75% m/m meaning annualized rate of 9%!

I, however, don't think we will really see 9% growth anytime in next year.

First, the **economy peaked**, as is seen in slower growth here but, more importantly, in Germany. And it is the German growth that always leads ours.

Second, **consumer confidence** is now decreasing and although households continue to report, in the confidence surveys, that the increased concern for the economy nonetheless their intention to save does not change, I think it is only a matter of time before it will (change) – and before savings rate increases back to long-term average of 12% (from current below-average value of 10%). The weaker growth and higher uncertainty will cause this - and higher interest rates on deposits will add to the motivation to save (the falling rates on consumer loans on despite CNB tightening certainly will not).

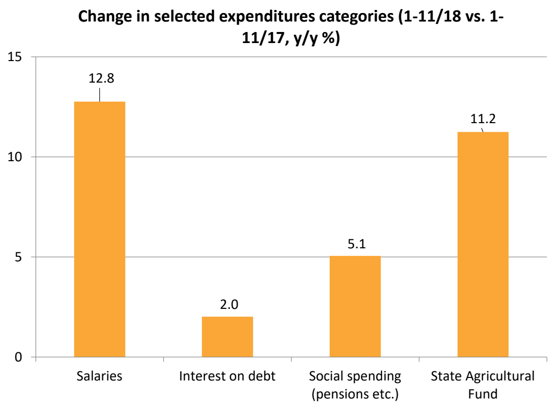
Finally, **wages**. It was reported last week that nominal wage growth in 3Q18 was 8.5% y/y, i.e. the growth rate just like in first half of the year. However, this headline growth masks the ongoing divergence between the private and the public sector.

In the private sector, the growth was about 7% y/y – industry wages, for example, grew 7.1% y/y, wages in retail +7.5% y/y, in transportation +6.6% y/y. In all of these cases, moreover, the growth slowed against the end of last year of the year.

In public sector, double-digit growth remains the norm: public administration saw the wages grow 11.7% y/y, education 13.2% y/y, healthcare 10.6 y/y. In all of these cases, and different to what's happening in private sector, growth is quicker than at the end 2017 (education + 9.2% in 4Q17, public administration +10.5%, healthcare +9.9%).

So, while it appears that the private sector wage growth has hit its limits, there appear to be no limits in public sector…Considering the weakening economic momentum in Eurozone, which inevitably will show up in our economy, it is almost certain the wage growth in the private sector will be slower in 2019 than it is now, and this, given the size of the private sector, will drag the overall wage growth lower. Public sector, who knows – this government is about as fiscally responsible as a 5-year in the toyshop…

GOVERNMENT CONTINUES TO SQUANDER ALL THE EXTRA MONEY ON CURRENT EXPENDITURES.



Proof? See the budget.

Budget ended up in a deficit of CZK 17.7 bn. in first eleven months of this year (adjusted for the effect of EU money on both sides of the budget).

MinFin is quick to point out that transfer of money in 2017 from privatization accounts (outside the budget) *to* the budget (and no such transfer in 2018), and different timing of contributions *from* budget to perennially money-losing state-run export-insurance company EGAP (April 2018 vs. December 2017) makes y/y comparison tricky – and that had it not been for these changes, the budget would be better this year than in 2017 (where deficit was 13 bn. for the first eleven months).

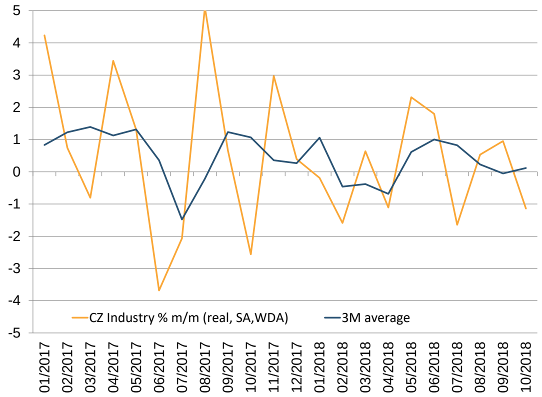
But this is beside the point. The problem is that government is not running CZK 40 bn. surplus in times like this. See, tax revenues are up CZK 78 bn. y/y in 01-11/2018, so to ask for a CZK 40 bn. surplus now instead of deficit government is running would still allow for some additional CZK 40 bn. in spending. But no, government decided that all almost CZK 80 bn. in additional taxes will be spent, and then some. What on? Well, current expenditures: wages are CZK 12.4 bn. higher y/y, social spending is CZK 24.5 bn. higher (pensions + CZK 18 bn. out of that), transfers to lower-level administrative units to cover higher salaries there are CZK 19.1 bn. higher, etc.

Current expenditures thus rose CZK 83 bn. in the first 11 months of this year. Capital expenditures, with massive help from EU (CZK +29 bn. in EU revenues), rose only 40% of what the current expenditures rose, i.e. by CZK 34.7 bn. At least we know where the government's priorities are…

To sum: government continues to squander all the money it gets from fast growth (and then some more it borrows) on current (and to a good extent mandatory) expenditures. Rainy day fund? No way. Recession in the offing? Naaah….

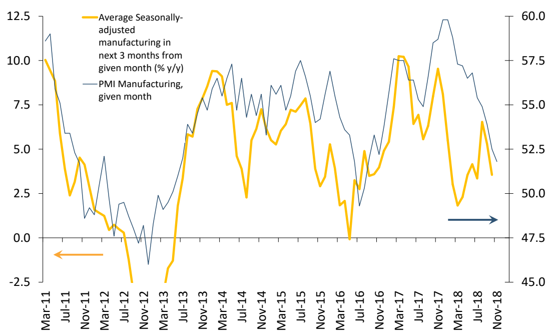
Industry begins 4Q18 on a weak note, and it will not improve soon.

INDUSTRY BEGAN 4Q18 ON A WEAK NOTE,…



Industrial production rose just 3.3% y/y in October, in line with the October PMI (which was 52.5, the lowest since December 2016).
The monthly contraction of 1.1% means that the production barely increased in August-October. The October decline was mainly due to production of energy and utilities, but manufacturing didn't grow either. It declined by 0.5% m/m in October which, although less than the 1.1% decline of the overall industry, still means that the beginning of 4Q18 was weak.
And that one cannot expect that after 3Q18 (during which manufacturing declined slightly) 4Q18 will be much better. I know, there are still two months to go in 4Q18 so judging the quarter by its first month may seem premature, but **manufacturing PMI** having fallen in November to **51.8, the weakest since August 2016**, certainly strengthens that expectation.

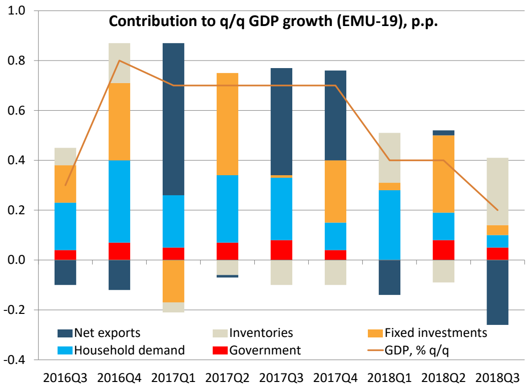
…AND NOVEMBER PMI DOESN'T GIVE HOPE THIS WILL CHANGE SOON



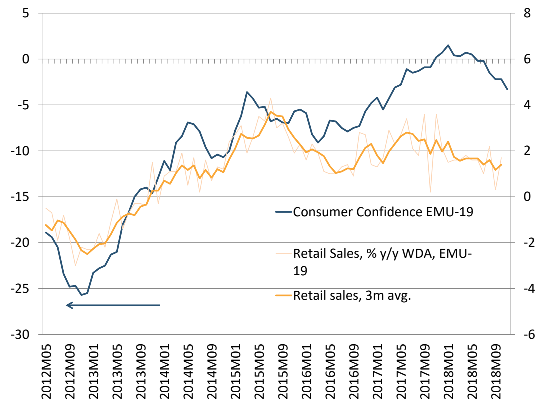
| EUROZONE ECONOMY

Household demand, net exports the main reasons for weak 3Q18 GDP growth in Eurozone.

EUROZONE 3Q18 GDP GROWTH WEAKNESS DUE TO NET EXPORTS, HOUSEHOLD DEMAND,…



…AND THE LATTER WON'T HELP GROWTH IN 4Q18 MUCH EITHER.



This wasn't a surprise, though – after all, we already had the data for all the big economies before the Eurostat released the all-Eurozone data. Hence, just briefly.

The annual GDP growth was confirmed at 1.6% y/y, weakest since 4Q14, and far below the rate of growth seen in 3Q17 (2.8%). Structure-wise, contribution of household demand (0.55 pp) was weakest since 3Q14, that of exports (1.14 pp) weakest since 1Q16. The quarterly growth of 0.2% was weakest since 2Q14, again due to weak household demand growth and negative contribution (-0.26 pp, largest since 4Q15) of net exports.

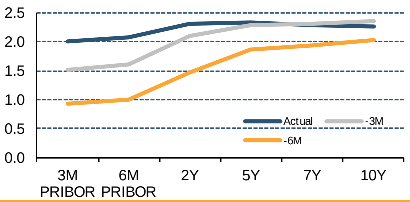
And household demand won't be much of a booster for 4Q18 GDP as well.

At least, judging from the retail sales data. Retail sales grew just 1.7% y/y in October, the average growth in last three months having been just 1.4%. The monthly growth was 0.3%, and almost none in last three months.

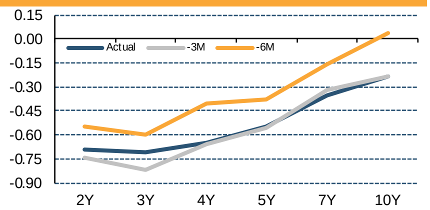
With growth in both services and industry not rebounding (see November PMI), with labor market's rate of improvement slowing and with household confidence declining, one thus should expect at most what was seen in 3Q18 from household demand in 4Q18. And quite possibly less.

| Markets ‡

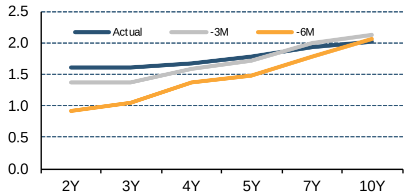
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	2.010	2.070	2.300	2.320	2.284	2.260
	-1M	1.990	2.050	2.440	2.585	2.576	2.568
	-3M	1.510	1.610	2.100	2.280	2.313	2.355
	-6M	0.920	1.000	1.463	1.855	1.933	2.023



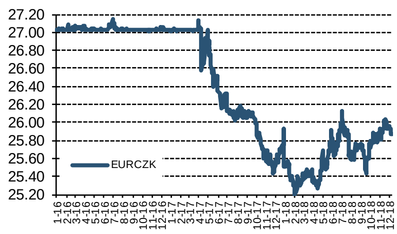
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-0.691	-0.710	-0.647	-0.546	-0.356	-0.238
	-1M	-0.945	-0.885	-0.849	-0.753	-0.555	-0.459
	-3M	-0.741	-0.816	-0.659	-0.561	-0.324	-0.237
	-6M	-0.549	-0.604	-0.401	-0.377	-0.155	0.039



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	1.609	1.609	1.679	1.774	1.928	2.022
	-1M	1.495	1.635	1.711	1.832	2.021	2.109
	-3M	1.359	1.377	1.584	1.719	1.989	2.118
	-6M	0.914	1.035	1.359	1.478	1.778	2.061



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.864	4.291	323.26	4.647	6.038	1.138
	-1M	25.931	4.288	321.49	4.658	6.188	1.134
	-3M	25.689	4.315	324.94	4.622	7.409	1.155
	-6M	25.752	4.278	319.75	4.659	5.270	1.177



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

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