Weekly | 2017 | Week 50

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CALENDAR

DAY	DATE	TIME (CET)*	MARKET	RELEASE	CONSENSUS**	42FS
Monday	11-Dec	9:00	CZ	CPI, Nov17, y/y	2.7%	2.6%
	11-Dec	10:00	ITA	Retail sales, Oct'17, m/m (m/m)	0.0%	N/A
Wednesday	13-Dec	8:00	GER	(Final) HICP, Nov17, y/y	1.8%	N/A
	13-Dec	11:00	EMU	Industrial production, Oct'17, y/y (WDA)	3.2%	N/A
	13-Dec	20:00	USA	FOMC Rate Decision, Upper/Lower bound of Fed funds target rate	1.5%/1.25%	1.5%/1.25%
Thursday	14-Dec	8:45	FRA	(Final) HICP, Nov17, y/y	1.3%	N/A
	14-Dec	9:00	GER	(Final) HICP, Nov17, y/y	1.7%	N/A
	14-Dec	10:00	CZ	Current account, Oct'17, CZK bn.	3.1	4.0
	14-Dec	13:45	EMU	ECB rate-setting meeting,	no change	no change
Friday	15-Dec	11:00	EMU	Trade Balance, Oct'17, EUR bn.	24.3	N/A

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

DECEMBER 2017 AUCTIONS

NOTHING SCHEDULED UNTIL THE END OF MONTH.

* FOR T-BILLS, THIS IS MAXIMUM AMOUNT PER PRIMARY DEALER.
** DEPENDING ON MARKET CONDITIONS.

THOUGHT OF THE WEEK

"WHENEVER I SEE A REPORT TITLED "X RISKS / TRADES FOR 2018", I KNOW 70% ARE THERE JUST BECAUSE SOMEONE CHOSE "X" ARBITRARILY AND EX ANTE."

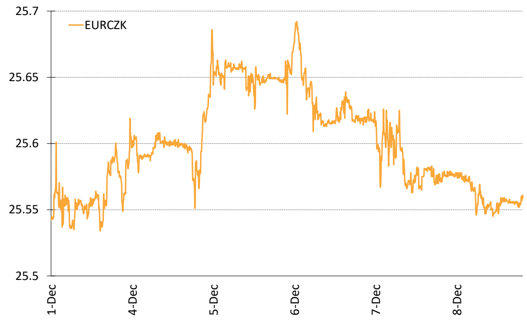
WEEK AHEAD

Week of central banks.

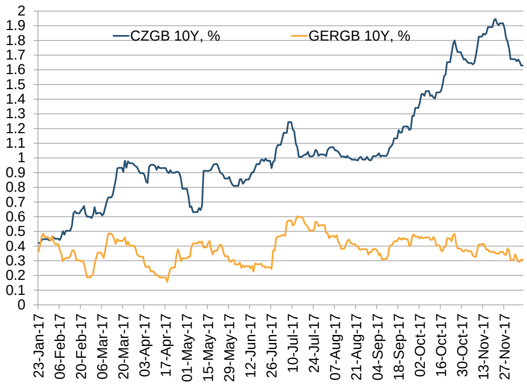
The last meetings of 2017 of both the ECB and the FED year are scheduled for this week. While ECB is expected to stay put, having lowered the tempo of assets purchases at the previous meeting, FED will very likely deliver the third hike this year.
Although US (core PCE) inflation is significantly below the midpoint of the FED's target range (2%) which, coupled with the symmetricity of the target range, leaves FED with huge maneuvering space even if inflation were to pick up strongly and unexpectedly (and so FED could easily – should – wait for decisive proof of inflation picking up), FED insists on a hike now, arguing the tight labor market will eventually translate into inflation Even though it's been saying this for three years now,…Anyway, it's not what I think they *should* do but what I think they *will* do – and they will most likely hike.

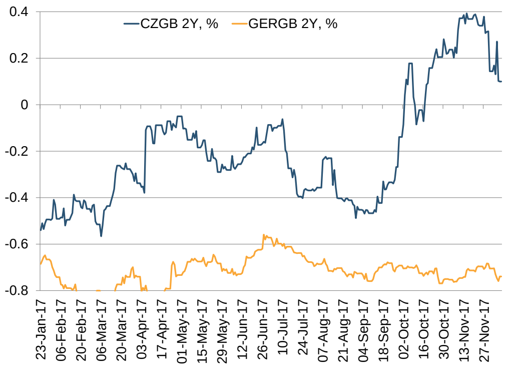
In the Czech Republic, November inflation is the most important release. Last year in November food prices rose 1.3% m/m, adding 0.4 pp to monthly inflation and 0.6 pp to y/y inflation (as against average contribution to annual inflation of -0.1 pp in January-October 2016): this means there should be fairly notable base effect in November (and then in the following three months).

EURCZK WEAKENS ON CBANKERS' COMMENTS



YIELDS FALL AS IR EXPECTATIONS ARE REVISED





WEEK BEHIND

Czech retail sales began 4Q17 on weaker footing… ▶

…but wage growth, inflation outlook paint an optimistic picture for the coming months. ▶

CZ industrial production in October in line with 1Q-3Q17 average ▶

Eurozone 3Q17 growth confirmed driven by domestic demand ▶

First EMU 4Q17 hard data suggest soft indicators are wrong again in painting much faster GDP growth for 4Q ▶

| FX

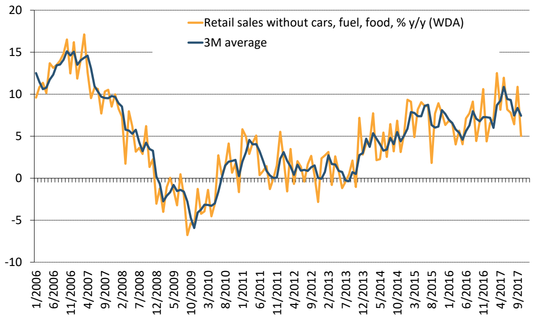
EURCZK attacked 25.70 before retreating back to 25.60 as the market digested the central bankers' comments in the run up to the last monetary-policy meeting of this year.
There was Vojtech Benda saying he'll "*probably*" vote for the hike at the December meeting and there was Governor Rusnok saying he sees "*equal probability*" of him voting for no change and a hike, adding, on the dovish side, that he expects the tightening tempo to average 25 bps per 6 months in this cycle. This is more than what is in the CNB's forecast, but less than what market expects.
With Mojmit Hampl having previously said the same as Benda, it only takes one more Board member for the hike to be delivered in December. Not that I think it is necessary, but it ain't about what I think is necessary…

| FI

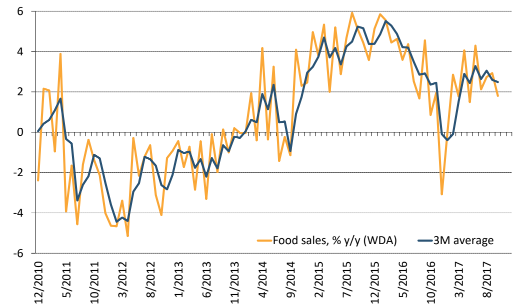
Czech yields continued to slide, though only slowly.

Since there wasn't much move in the Bunds, I infer this is the bond market response to relatively dovish outlook of governor Rusnok for 2018 hikes.

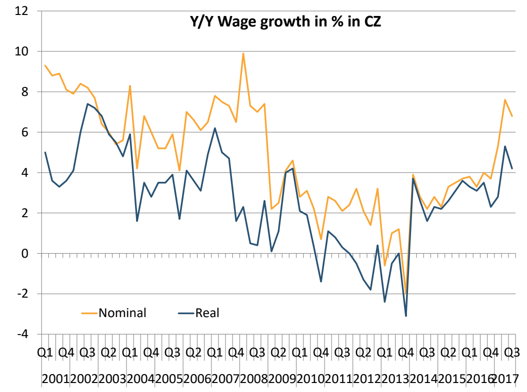
RETAIL SALES BEGAN 4Q17 ON WEAKER NOTE, MAINLY DUE TO THE WEAKER CORE SALES…



…AND FOOD SALES.



REAL WAGE GROWTH SLOWS MORE THAN NOMINAL ONE AS INFLATION EATS INTO WAGES.



| CZECH ECONOMY

Retail sales began the 4Q17 on a weak footing, but it is more likely than not that a] this is just technical one-off and b] sales will quicken in the coming 6 months.

Total real retail sales (adjusted for the different number of working days) rose just 3.5% y/y in October, below the 1Q-3Q17 average of 5.2%. This was due to somewhat slower (than in September) growth of food sales (1.8%) and, primarily, the weakest growth of non-food non-car sales (5% y/y), since December 2016.

Not that the current three month average core (=non-food, non-car) retail sales growth of 7.4% y/y is anything but weak, but the dynamics of the annual growth of core sales has been continuously weakening since having peaked in May. This is very likely a reflection of inflation eating into the nominal wages and the fact that the unemployment rate hit its lower bound (and cannot improve further).

It is seen in 3Q17 **nominal and real wage growth**, released last week. Nominal growth remained strong at 6.8% y/y (against 7.6% in 2Q17) while the real wage growth slowed down to 4.2% in 3Q17 from 5.3% in 2Q17.

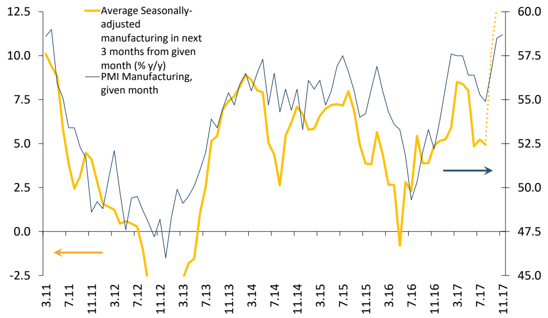
On the bright side, this, however also means that as the inflation slows down in next 6 months, the real wage growth will strengthen. This is more likely to be the case given that nominal wage growth will remain strong (the Czech unemployment rate being lowest in the entire Eurozone now).

Put together: there are no reasons whatsoever to worry about household demand.

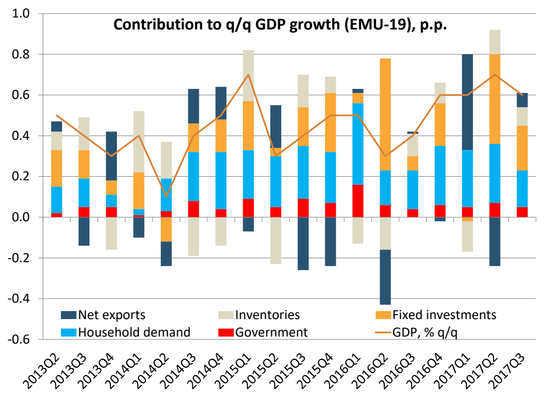
In October, industry production rose in line with expectation at double-digit unadjusted rate (10.5% y/y).

Adjusting for the different number of working dates, the growth was 5.3% y/y (4.8% in manufacturing

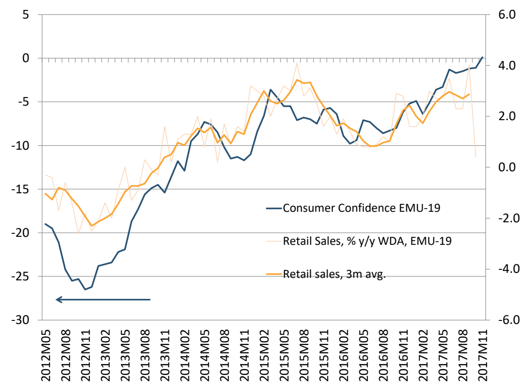
PMI HIGHEST SINCE APRIL 2011, HINTING AT DOUBLE-DIGIT MANUFACTURING GROWTH IN NEXT THREE MONTHS.



EUROZONE 3Q17 GROWTH DRIVEN AGAIN BY DOMESTIC DEMAND, BUT…



…RETAIL SALES MASSIVELY DISAPPOINT IN OCTOBER



alone), in line with the average over 1Q-3Q17 of 5.9%, and so far also in line with PMI. The next three months should, however, see (SA) growth rates of manufacturing at around 10% if historical relationship between PMI and manufacturing were to hold.

Honestly, I don't think we'll see that, but some quickening of the growth should materialize.

| EUROZONE ECONOMY & FED

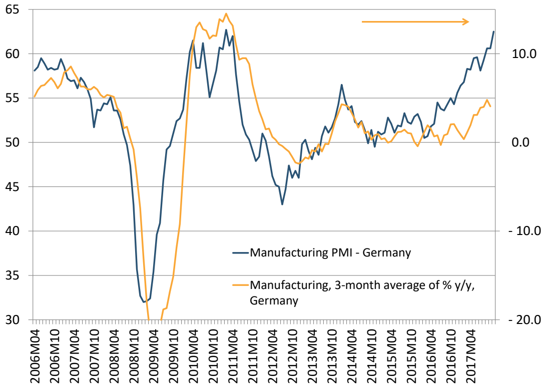
Final 3Q17 Eurozone growth data confirmed domestic demand was a primary growth driver. First hard data suggest 4Q17 won't be as fast as soft indicators suggest.

The former wasn't that surprising: Italy, France and Spain all had growth driven by domestic demand. Only Germany was an exception, with 3Q17 growth being primarily due to net exports and inventories.

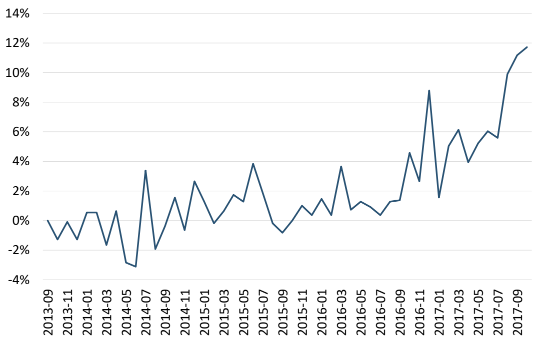
Looking forward, this is unlikely to change, although the first hard data seem to confirm my view that it'd be fatuous to expect as big a quickening of the growth as the recent leading / soft indicators suggest (see page 4 here ↗). I am talking about the retail sales here. **October Eurozone retail sales disappointed massively,** with 1.1% monthly decline against September bringing the y/y growth rate to just 0.4%. Spain must have played a role there, with Catalonian referendum having led to weakest Spanish sales since summer 2014 (see page 5 here ↗), but it cannot explain the weakness in the Eurozone alone. Consumer may have been waiting for the Black Friday sales and weather was warmer than usual across swathes of Eurozone in October, but on the other hand unemployment rate fell to 8.8% … Be it as it may, **the rise of consumer confidence in November to highest in 17 years and the general lack of reasons why sales should weaken leaves me with the forecast of rebound in November sales** (and revision of October data).

There wasn't any closing the gap between German industrial production and PMI

GERMAN MANUFACTURING CONTINUES TO LAG PMI…



…BUT ORDERS RAISE HOPE THE GAP WILL CLOSE PARTIALLY SOON.



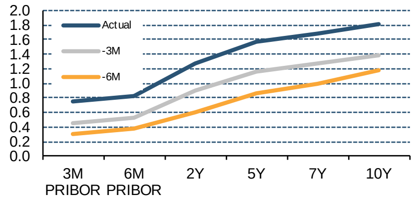
in October. Orders, however, suggest there will be some, soon.

German industrial production fell in October in what was the biggest decline this year (1.4% m/m), with manufacturing component down 2% and with all categories (expect for consumer non-durables) contributing to the weakness. This brought the annual growth to just 2.7% and 2.5%, respectively, a far cry from what both IFO and PMI suggest: PMI calls for growth of about 8-10% y/y of manufacturing!

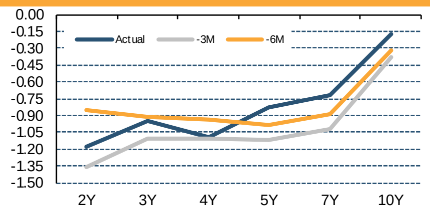
Orders suggest the October weakness will not be repeated while, on the other hand, also not indicating the growth will quicken as much as PMI suggest. October German industrial orders rose 0.5% after upwardly revised September (1.2% m/m), bringing the annual growth to 6.8%. This should keep the industry / manufacturing growing well in the coming months, enabling us to ignore dismal October industry results. But one must admit these are not growth rates that'd translate into 8-10% growth of manufacturing.

| Markets ‡

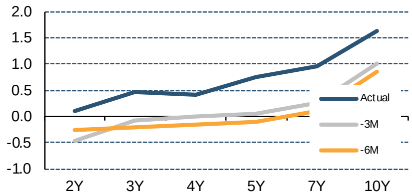
MM / IRS		3M PRIBOR	6M PRIBOR	2Y	5Y	7Y	10Y
%	Actual	0.750	0.830	1.275	1.575	1.675	1.810
	-1M	0.720	0.790	1.210	1.555	1.670	1.800
	-3M	0.460	0.520	0.895	1.163	1.265	1.393
	-6M	0.300	0.370	0.600	0.865	0.995	1.173



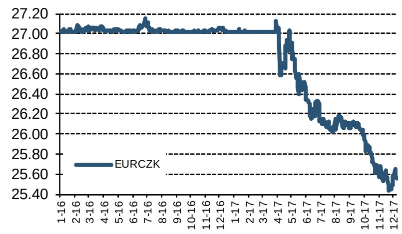
ASW spread*		2Y	3Y	4Y	5Y	7Y	10Y
bps.	Actual	-1.175	-0.949	-1.097	-0.828	-0.715	-0.181
	-1M	-0.888	-0.803	-0.769	-0.762	-0.590	-0.043
	-3M	-1.362	-1.109	-1.103	-1.116	-1.019	-0.379
	-6M	-0.856	-0.911	-0.939	-0.983	-0.895	-0.320



CZGB**		2Y	3Y	4Y	5Y	7Y	10Y
%	Actual	0.100	0.463	0.408	0.747	0.960	1.629
	-1M	0.322	0.562	0.704	0.793	1.080	1.757
	-3M	-0.467	-0.094	-0.003	0.047	0.246	1.014
	-6M	-0.256	-0.216	-0.159	-0.118	0.100	0.853



FX		EURCZK	EURPLN	EURHUF	EURRON	EURTRY	EURUSD
	Actual	25.560	4.197	313.92	4.633	4.516	1.177
	-1M	25.534	4.231	311.89	4.640	4.507	1.164
	-3M	26.117	4.244	306.51	4.602	4.108	1.204
	-6M	26.175	4.185	307.61	4.562	3.961	1.120



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

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